Quarterly Bulletin

December 2008

South African Reserve Bank

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No 250

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ISSN 0038-2620

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Introduction

The global economic landscape deteriorated further in the third quarter of 2008 as concerns over counterparty risk were amplified by further widespread losses, liquidity and solvency problems in the financial sector, and the failure of a large investment bank in the United States of America (US). Uncertainty prevailed regarding the extent to which governments, confronted by a crisis that was clearly of systemic proportions, would act to support financial institutions.

Numerous actions were taken by the authorities in an attempt to stabilise matters. These ranged from the injection of liquidity into money markets and the expansion of the range of assets acceptable in central banks' refinancing operations to the issuing of financial guarantees, the takeover of troubled assets, and the recapitalisation and in some instances the nationalisation of institutions. Many central banks also lowered their policy interest rates, in some instances on a co-ordinated basis. The monetary policy and financial market measures were complemented by fiscal easing in an effort to revive economic activity. International co-operation and co-ordination in economic and financial policy were bolstered through various forums, including in the G-20 countries.

Nevertheless, confidence among participants in the financial markets remained low and in many instances credit facilities were cut back or only made available on less favourable terms than before. As risk premiums rose, this trend was accompanied by a reduction in the issuance of bonds, while securitisation in many instances came to a standstill. Simultaneously, equity prices declined considerably, while exchange rates also adjusted significantly with various emerging-market currencies experiencing downward pressure as some international investors liquidated their emerging-market exposures, favouring the familiarity of the mature economies.

Global growth projections continued to be adjusted downwards, with the most recent estimates pointing towards outright contractions in real gross domestic product in the US, euro area and some other developed economies. With global demand deteriorating rapidly, the prices of commodities fell sharply. For instance, the international price of crude oil declined from a peak of more than US$146 per barrel in mid-2008 to levels around US$50 per barrel at the end of November, while international prices of food commodities receded by approximately 30 per cent over the same period. This contributed to significantly lower projected inflation rates. However, it seemed clear that Africa and other developing areas and countries would not be able to escape a slowing of economic growth in the wake of weaker global demand and declining prices of export commodities.

In South Africa the economy weakened considerably in the third quarter of 2008, recording the lowest quarterly growth rate in ten years. A substantial contraction in real value added was registered by the mining sector, which was directly affected by weaker international demand, falling commodity prices and interruptions due to maintenance, safety procedures and strikes. In a similar vein the real output originating in the manufacturing sector declined significantly in the third quarter. However, the harvesting of a bumper maize crop was reflected in a brisk positive growth rate recorded by the agricultural sector.

Real gross domestic expenditure registered a reversal from negative growth in the second quarter of 2008 to a modest positive growth rate in the third quarter as fixed capital formation and government consumption expenditure strengthened. Real fixed capital formation by public corporations displayed very strong growth in the third quarter, led by outlays to expand electricity-generation capacity and to upgrade the country's airports. By contrast, growth in capital expenditure by the private sector was generally sluggish, although the providers of telephone services increased their investment over the period. In the third quarter of 2008 real final consumption expenditure by government picked up notably, mainly on account of the acquisition of military aircraft.

The tight domestic economic environment in the third quarter of 2008 was reflected in stagnant real disposable income of the household sector and a contraction – the first since the fourth quarter of 1998 – in the sector's real final consumption expenditure. Purchases of consumer durables declined considerably, while expenditure on non-durable goods such as food and fuel also receded, consistent with the high real prices of these items. Greater caution among consumers was reflected in a slight further reduction in the ratio of household debt to disposable income in the third quarter of 2008, after it had peaked in the first quarter and started edging lower in the second quarter of the year.

Alongside subdued sales, the level of real inventories receded further in the third quarter of 2008, albeit at a somewhat slower pace than in the second quarter.

Whereas improved electricity supply to domestic industries contributed to a strong recovery in the volume of exports in the second quarter of 2008, export volumes advanced only marginally in the third quarter as global demand lost momentum and international prices of commodities fell considerably. Import volumes also rose at a subdued pace in the third quarter, mirroring the generally sluggish growth in domestic demand. The terms of trade declined further in the third quarter, contributing to a widening of the trade deficit. This was exacerbated by a moderate further widening of the shortfall on the country's service, income and current transfer account. As a result, the deficit on the current account of the balance of payments rebounded in the third quarter to 7,9 per cent of gross domestic product. This deficit was financed through a combination of direct and other investment inflows, while portfolio investment switched to a net outflow in the third quarter of 2008.

Prompted by the deterioration of global financial risk and the further reduction in international commodity prices, the effective exchange rate of the rand depreciated significantly during September 2008 and subsequently fluctuated around lower levels. Broadly similar behaviour was displayed by the currencies of a number of other commodity-producing countries with comparatively large current-account deficits.

The depreciation of the external value of the rand presented a new risk to the inflation outlook, although the considerable reduction in international oil and other commodity prices, and the subdued global and domestic demand and increased surplus production capacity, assisted in containing inflation pressures. Accordingly, the twelve-month rate of CPIX inflation peaked in August 2008, and decelerated in the subsequent two months as the prices of fuel and food – previously strong drivers of inflation – started to run out of steam. Most recently tentative indications of moderation in underlying measures of inflation were observed, while producer price inflation also started to decelerate. A further reduction in measured inflation is expected on account of the change-over to a new consumer price index "basket", with the first data on the new basis due to be released in February 2009. However, wage settlement rates rose steadily in the first three quarters of 2008 and increases in unit labour cost remained high. Surveyed inflation expectations also remained high.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (the Bank) raised the repurchase rate in June 2008 and subsequently kept it unchanged at 12 per cent at its meetings in August and October. Other money-market interest rates remained well aligned with this policy rate. The main short-term interbank interest rates in South Africa did not rise significantly relative to the repurchase rate, as counterparty risks continued to be seen as normal.

In the capital market, bond yields declined in July and August 2008, partly in response to the expected favourable impact on inflation outcomes of a reweighted and rebased consumer price index basket to be introduced in January 2009. Yields rebounded in September alongside the substantial depreciation in the exchange rate of the rand, but receded again in the final months of the year as the depreciation was stemmed and inflation prospects brightened with the further reduction in international oil and food prices.

In the second half of 2008 weakening economic prospects were reflected in share prices falling considerably in share markets around the world. South African shares were no exception, with the downward movement in equity prices exacerbated by the dramatic reduction in international commodity prices, given the importance of resources shares in the local market. From their high point in May 2008 to a recent low in November, overall South African equity prices fell by more than 40 per cent. Activity in the real-estate market was also subdued, with stagnant nominal and falling real house prices.

Growth in the broadly defined M3 money supply and in the banks' loans and advances to the private sector decelerated further in the four months to October 2008, reflecting the impact of slower economic growth, generally tight economic conditions, low consumer and business confidence, and negative wealth effects arising from movements in asset prices.

In the period from April to September 2008 the public-sector borrowing requirement increased notably compared with the situation a year earlier, led by the borrowing needs of public corporations and national government. The budget deficit continued to be easily financed. Looking ahead, the October 2008 *Medium Term Budget Policy Statement* (MTBPS) projected lower tax revenue over the next three fiscal years than was previously budgeted for, mainly for cyclical reasons. With government expenditure in 2009/10 and 2010/11 also projected to be higher and capital outlays by the public corporations set to increase further, provision was made for larger budget deficits and public-sector borrowing requirements.

In the MTBPS it was announced that, with the change-over to a new consumer price index basket from January 2009, the target variable for inflation-targeting purposes would no longer be CPIX (the consumer price index for metropolitan and other urban areas, excluding mortgage interest cost) but would be changed to the overall consumer price index for all urban areas. This followed the revised methodology for incorporating housing costs in the consumer price index that Statistics South Africa (Stats SA) decided on, following an investigation of international best practice. From January 2009 the headline measure of inflation will no longer include mortgage interest cost, but will include owners' equivalent rent – the rental value of dwellings that owner-occupiers would have received had they let out their dwellings to other parties. Unlike with mortgage interest cost, this component does not immediately mirror movements in the repurchase rate; accordingly, its inclusion in the targeted inflation measure does not present perverse short-term incentives to monetary policy-makers.

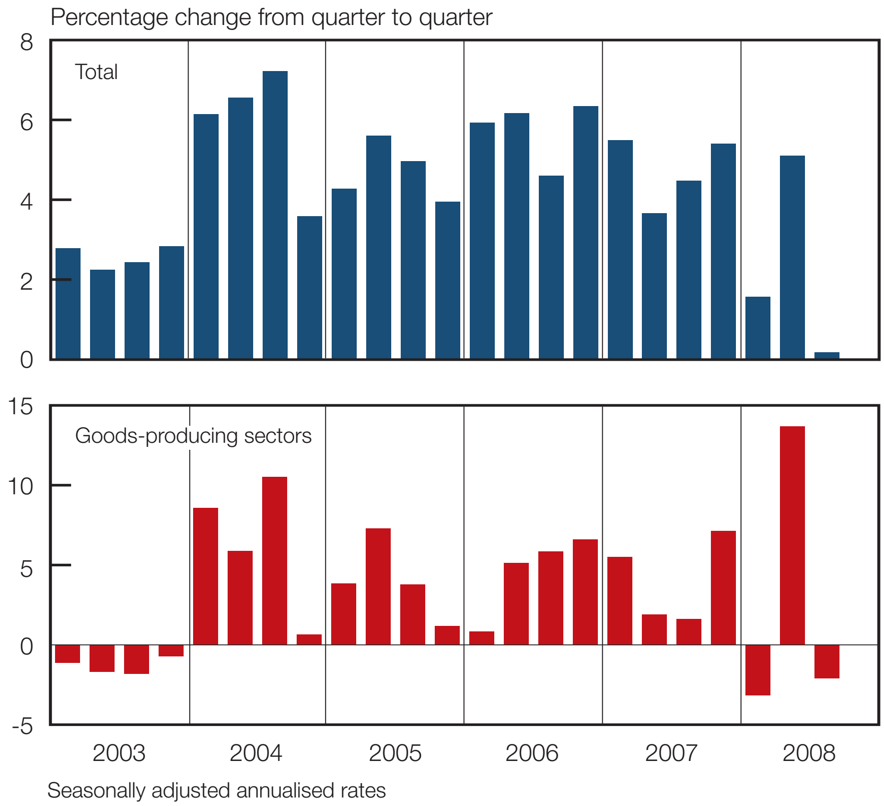
1 The quarter-to-quarter growth rates referred to in this section are based on seasonally adjusted data.

Domestic economic developments[1]

Domestic output

Real economic growth in South Africa slowed noticeably in the third quarter of 2008, consistent with slower global economic growth. After a rebound in the second quarter of 2008, growth in *real gross domestic production* decelerated from a revised annualised rate of 5,1 per cent in the second quarter of 2008 to a mere 0,2 per cent in the third quarter. The sluggish growth in real output in the third quarter was visible in all the major goods-producing sectors of the economy. The level of the real gross domestic product in the first three quarters of 2008 was 3,7 per cent higher than in the corresponding period in 2007, falling short of the average growth rate of 5,2 per cent per annum recorded from 2004 to 2007.

Real gross domestic product



Mainly as a result of a decline in mining production in the third quarter of 2008, the real value added by the *primary sector,* which expanded at an annualised rate of 19,2 per cent in the second quarter of 2008, declined at a rate of 0,5 per cent in the third quarter.

Similar to the second quarter of 2008, the *agricultural sector* made a positive contribution to overall growth in the third quarter. Although the quarter-to-quarter output growth in real value added by the agricultural sector lost some momentum in the third quarter, the sector's real production was still 13,8 per cent higher, compared with the same quarter of 2007. Output in the agricultural sector benefited from increased production of field crops where a bumper maize crop was harvested, bolstered by favourable weather conditions.

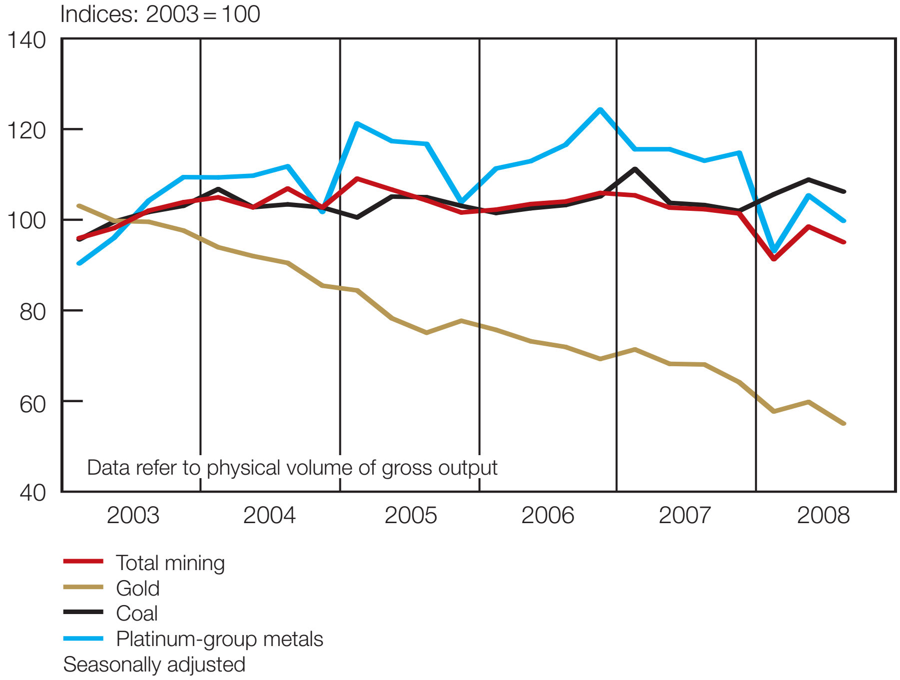
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sectors	2007					2008		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	0,4	-2,5	1,7	1,2	0,8	-14,5	19,2	-0,5
Agriculture................	9,5	11,4	7,1	15,5	2,9	16,2	19,4	16,1
Mining	-2,8	-7,5	-0,4	-4,4	0,0	-25,8	19,2	-8,0
Secondary sector	7,4	3,6	1,6	9,4	6,1	1,2	11,8	-2,6
Manufacturing	5,8	1,4	-1,4	9,0	4,5	-0,6	14,3	-6,9
Tertiary sector	5,6	4,9	6,1	4,7	5,4	3,7	1,6	1,5
Non-agricultural sector ..	*5,5*	*3,7*	*4,5*	*5,3*	*5,2*	*1,1*	*5,0*	*-0,1*
Total	**5,5**	**3,7**	**4,5**	**5,4**	**5,1**	**1,6**	**5,1**	**0,2**

Having increased at a rate of 19,2 per cent in the second quarter of 2008 as electricity supply improved, real value added by the *mining sector* contracted at an annualised rate of 8,0 per cent in the third quarter. The decline in mining output was evident in most of the major subsectors. In particular, the production of platinum-group metals, gold, diamonds and coal contracted over this period. Lower mining production reflected the statistical effect of the high base established in the second quarter, exacerbated by weaker international demand and falling commodity prices. Platinum output was also adversely affected by extensive maintenance programmes usually conducted in February, safety-related shutdowns and one-day strikes.

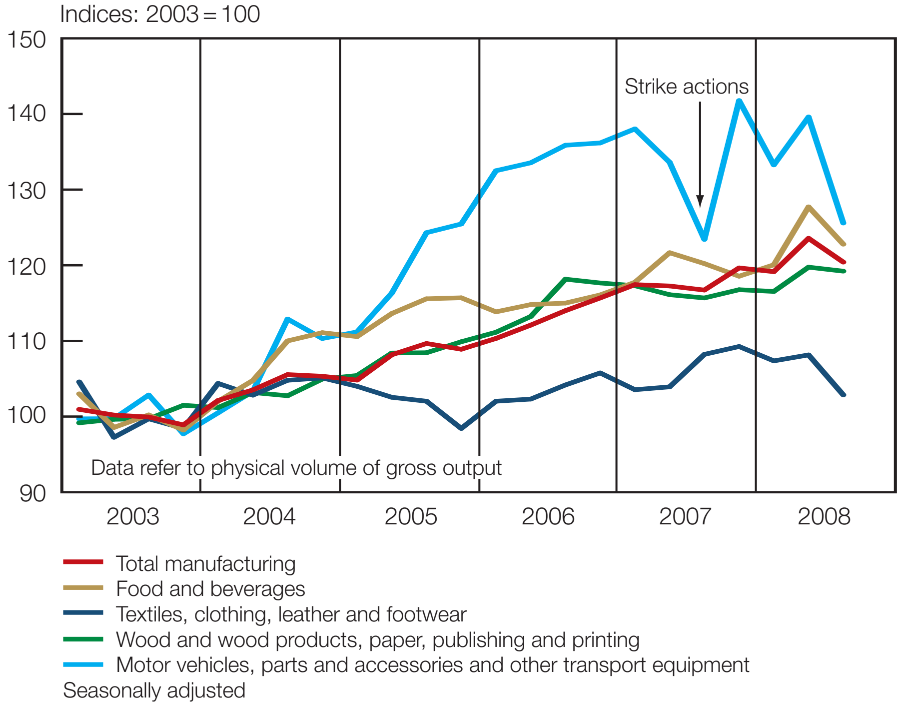
Production of selected mining commodities



Real value added by the *secondary sector* switched from an annualised rate of growth of 11,8 per cent in the second quarter of 2008 to a decline of 2,6 per cent in the third quarter. The contraction could mainly be attributed to a decline in manufacturing output, while growth in real value added by the construction sector maintained its momentum.

Real output of the *manufacturing sector* turned around from an annualised growth rate of 14,3 per cent in the second quarter to a decline of 6,9 per cent in the third quarter of 2008. This decline could largely be ascribed to slowing domestic demand, falling commodity prices and decelerating global economic growth. Notably slower growth was observed in especially the manufacturing subsectors for motor vehicles, parts and accessories; textiles, clothing, leather and footwear; and food and beverages. The domestic demand for these products was probably affected by the sluggish growth in real income, higher interest rates and already high debt levels, which inhibited the take-up of more credit. In addition, the supply of repossessed vehicles increased, which may have dampened the demand for new vehicles. The rate of capacity utilisation in the manufacturing sector remained broadly unchanged from the second quarter of 2008 and amounted to 85,3 per cent in the third quarter.

Production by selected manufacturing subsectors



Real output originating in the *sector supplying electricity, gas and water* increased at an annualised rate of 3,0 per cent in the third quarter of 2008 following a decline of 2,1 per cent in the second quarter. The increase in real value added mainly involved the electricity-generation subsector. Electricity exports to neighbouring countries increased somewhat over the period, while the continuation of fairly mild winter temperatures contributed to a moderation in the demand for electricity for heating purposes.

Growth in real value added by the *construction sector* continued at a brisk pace and recorded an annualised rate of 15,0 per cent in the third quarter of 2008, faster than the rate of 9,1 per cent registered in the second quarter. Growth in the construction sector reflected robust activity in the subsector for construction works, which continued to benefit from the upgrading of existing infrastructure and large projects such as the Gautrain, power stations, roads, sports stadiums and related infrastructural developments.

Quarter-to-quarter growth in real value added by the *tertiary sector* decelerated marginally in the third quarter of 2008. Following annualised growth of 1,6 per cent in the second quarter of 2008, real output growth in the tertiary sector moderated to 1,5 per cent in the third quarter. Increased activity in the government sector offset a contraction in the trade sector and slower growth in the finance, insurance, real-estate and business services sector over the period.

The real output of the *trade sector* contracted further at an annualised rate of 6,9 per cent in the third quarter of 2008. This decline mainly reflected a contraction in real value added by the retail, wholesale and motor trade subsectors, consistent with the muted household consumption expenditure in the third quarter. Falling local demand resulted as growth in real disposable income slowed and curbed consumer spending, amplified by higher interest rates.

Growth in real value added by the *transport, storage and communication sector* was maintained at an annualised rate of approximately 4,5 per cent in both the second and third quarters of 2008. Slower growth in the transport subsector was roughly offset by increased activity recorded in the communication sector over the period.

The real value added by the *finance, insurance, real-estate and business services sector* increased at an annualised rate of about 3,3 per cent in both the second and third quarters of 2008. Although real output in the banking sector moderated somewhat over the period, this slowdown was partly offset by higher trading volumes in equities, bonds and other financial market instruments as investors repositioned themselves in a volatile market.

The real value added by *general government* increased at an annualised rate of 3,9 per cent in the third quarter of 2008, higher than the rate of 2,5 per cent attained in the second quarter. This was largely due to increased employment in the sector.

Domestic expenditure

Aggregate *real gross domestic expenditure* turned around from an annualised rate of contraction of 3,5 per cent in the second quarter of 2008 to an increase of 1,0 per cent in the third quarter. The sustained robust growth in gross fixed capital formation and a notable increase in government consumption expenditure mainly accounted for the higher growth in expenditure over this period. Final consumption expenditure by households contracted alongside a further decline in inventories in the third quarter of 2008.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Components	2007					2008		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure:								
Households	5,5	5,1	5,0	3,9	6,6	3,3	0,9	-0,8
General government	13,9	-3,9	8,5	1,0	4,8	12,4	-2,0	9,6
Gross fixed capital formation	20,4	15,0	14,5	15,6	16,3	12,5	6,0	10,0
Domestic final demand	**9,6**	**5,2**	**7,4**	**5,6**	**8,0**	**6,7**	**1,4**	**3,1**
Change in inventories (R billions)*	14,4	9,7	5,1	-12,5	4,2	11,5	-5,0	-4,3
Gross domestic expenditure	**4,7**	**4,1**	**5,6**	**-1,6**	**6,0**	**15,1**	**-3,5**	**1,0**

* At constant 2000 prices

Having lost considerable momentum over the preceding seven quarters, *real final consumption expenditure by households* declined at an annualised rate of 0,8 per cent in the third quarter of 2008. This was the first contraction since the fourth quarter of 1998. Growth in real expenditure by households amounted to 3,1 per cent in the first nine months of 2008, compared with the corresponding period in 2007, substantially lower than the rate of 6,6 per cent registered for 2007 as a whole. Consequently, the ratio of household spending to gross domestic product receded from 61,4 per cent in 2007 to 60,4 per cent in the third quarter of 2008. Consumer confidence remained low in the third quarter, influenced by the financial strain experienced by households during that period.

The contraction in consumer spending in the third quarter of 2008 was particularly evident in expenditure on durable and non-durable goods. Real outlays on semi-durable goods rose at a much slower pace in the third quarter, while expenditure on services increased at the same pace as in the second quarter.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Components	2007					2008		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods	9,4	-12,6	7,6	-0,7	4,7	-8,5	-8,8	-9,9
Semi-durable goods	10,4	23,2	5,9	6,0	15,8	10,8	3,3	0,1
Non-durable goods	4,5	5,1	6,1	2,5	5,5	0,7	0,6	-2,6
Services	3,3	4,0	2,8	5,8	4,6	6,3	3,1	3,1
Total	**5,5**	**5,1**	**5,0**	**3,9**	**6,6**	**3,3**	**0,9**	**-0,8**

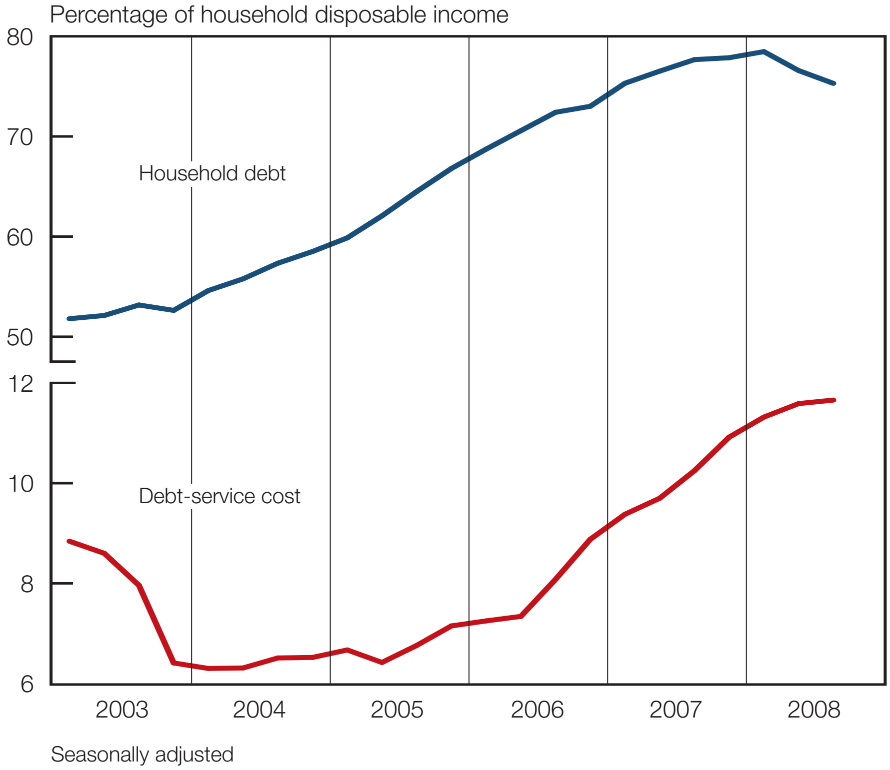
Real expenditure on durable goods declined at annualised rates of 8,8 per cent in the second quarter of 2008 and 9,9 per cent in the third quarter. Expenditure on personal transport equipment remained under pressure, indicative of relatively high financing costs and household debt levels. The purchasing power of households was furthermore eroded by high fuel and food prices. Consumers reduced their spending on most of the subcategories of durable goods barring an increase in spending on recreation and entertainment goods.

Growth in household expenditure on *semi-durable goods* decelerated to an annualised rate of 0,1 per cent in the third quarter of 2008 from 3,3 per cent in the preceding quarter. Real outlays on household textiles, furnishings and glassware; and on motorcar tyres, parts and accessories contracted, while spending on clothing and footwear continued growing apace. For the first nine months of 2008, real outlays on semi-durable goods rose at a year-on-year rate of 7,7 per cent, substantially lower than the 15,8 per cent recorded for 2007 as a whole.

Real expenditure on non-durable goods remained subdued and declined at an annualised rate of 2,6 per cent in the third quarter of 2008. The latest decline was mainly due to a contraction in the demand for food, beverages and tobacco; and petroleum and fuel products. Persistent increases in the real prices of these products were a key reason for the decline in spending. Growth in consumers' real outlays on services was maintained at a rate of 3,1 per cent in the second and third quarters of 2008.

The *real disposable income* of the household sector moved essentially sideways in the third quarter of 2008. Simultaneously, growth in credit extension to households moderated further. Although still high, the ratio of household debt to disposable income of households showed some signs of moderation, edging lower to a level of 75,3 per cent in the third quarter of 2008. Slower growth in household indebtedness was more than fully offset by higher interest rates, resulting in a further slight increase in debt-service cost relative to disposable income of households over the period.

Household debt and debt-service ratios



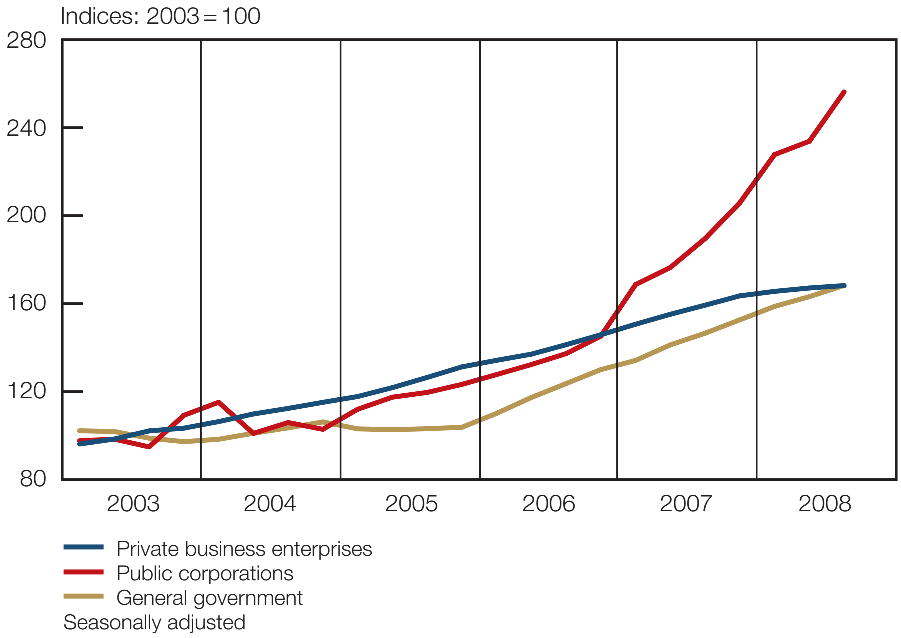
Real final consumption expenditure by general government rose at an annualised rate of 9,6 per cent in the third quarter of 2008, following a decline of 2,0 per cent in the second quarter. Government spending was bolstered in the third quarter of 2008 by the purchase of aircraft as part of the defence procurement programme. Growth in real compensation of employees by government also edged higher in the third quarter of 2008 compared with the preceding quarter. Excluding the cost of the aircraft, real final consumption expenditure by general government increased at an annualised rate of 5,1 per cent in the third quarter.

Real gross fixed capital formation expanded further in the third quarter of 2008. Annualised growth in gross fixed capital formation accelerated from 6,0 per cent in the second quarter of 2008 to 10,0 per cent in the third quarter. The increased pace of capital spending in the third quarter of 2008 was mainly due to further investment by public corporations and general government.

Real capital outlays by the *private sector* continued to grow in the third quarter of 2008, albeit at a slower pace than in the previous quarter. Growth in real capital formation in the financial services sector, including investment in private residential buildings, decreased.

This decrease could be attributed to the declining demand for, and affordability of, residential buildings. This lower level of spending was, however, neutralised by increased capital formation in the transport and communication sector with brisk investment by the telephone industry over the period. Capital investment in the mining and commerce sectors reflected the continuation of long-term projects rather than the starting of new ones, while modernisation of production facilities continued in manufacturing.

Real gross fixed capital formation



Growth in real fixed capital investment by *public corporations* expanded at an annualised rate of 44,3 per cent in the third quarter of 2008. Increased investment by the electricity sector reflected high capital outlays on generation capacity, including the coal-fired Kusile and Medupi power stations. Accelerated capital expenditure in the transport and communication sector could be linked to the upgrading of the country's airports, partly in preparation for the 2010 FIFA World Cup.

Real fixed capital formation by *general government* increased in the third quarter of 2008. Government remains committed to expanding and improving the public service and investing in the infrastructure required for future growth, as stated in the *Medium Term Budget Policy Statement* (MTBPS).

The level of real inventories decreased further in the third quarter of 2008, albeit at a somewhat slower pace than in the second quarter. Decreases in inventories were evident in most sectors, although there was a build-up of inventories in the manufacturing sector. The relatively high interest cost of carrying inventories along with subdued sales may have contributed to the negative inventory investment in the third quarter of 2008.

Factor income

With profit growth slowing and threats of labour layoffs in some sectors of the economy, the growth over four quarters in total *nominal factor income* decelerated from 19,0 per cent in the second quarter to 17,3 per cent in the third quarter of 2008. This decrease could be attributed to slower growth in both compensation of employees and gross operating surpluses – although the rate of growth of the latter remained relatively high.

Measured over four quarters, the rate of growth in *compensation of employees* decelerated slightly from 12,5 per cent in the second quarter of 2008 to 12,1 per cent in the third quarter. Although activity in the construction sector was still brisk in the third quarter, the subdued demand for residential properties left its mark on employment in the sector. Consistent with the decrease in production in the mining and trade sectors, prospects for employment in these sectors also deteriorated during the third quarter of 2008. However, firm increases in average salary and wage levels rendered support to the rate of growth in overall compensation of employees.

The rate of increase in nominal *operating surpluses*, measured over four quarters, decelerated from 25,1 per cent in the second quarter of 2008 to a still healthy increase at a rate of 22,2 per cent in the third quarter. The slower growth in gross operating surpluses of business enterprises in this period was evident in the manufacturing, trade, transport and financial, real-estate and business services sectors, and reflected the rising costs of inputs as well as a moderation in sales as export volumes and prices came under pressure. Despite the slower growth in gross operating surpluses of business enterprises in the third quarter of 2008, the momentum was still higher than the year-on-year rate of 17,4 per cent recorded in 2007 as a whole.

Gross saving

Gross saving as a percentage of gross domestic product improved from 14,0 per cent in the first quarter of 2008 to 15,6 per cent in the third quarter. This increased the national saving ratio for the first nine months of 2008 to 15,0 per cent compared with 14,6 per cent recorded in 2007. Nevertheless, South Africa's dependence on foreign capital to finance gross capital formation remained substantial due to the continued strong drive in fixed capital expenditure; in the first nine months of 2008 capital formation constituted 23,0 per cent of gross domestic product.

Gross saving by the *corporate sector* as a percentage of gross domestic product increased from 9,3 per cent in the first quarter of 2008 to 11,7 per cent in the second quarter and 12,1 per cent in the third quarter. The average saving ratio for the first nine months of 2008 improved to 11,0 per cent from the historic low of 9,9 per cent recorded in 2007. The improved saving performance in the third quarter was due to strong growth in the gross operating surplus of business enterprises and slower growth in dividends being declared. On a year-on-year basis the gross operating surplus of business enterprises increased by 24,9 per cent in the first nine months of 2008, compared with 23,6 per cent recorded in 2007. Growth in dividends declared slowed in the first nine months of 2008 after strong growth was recorded in 2007.

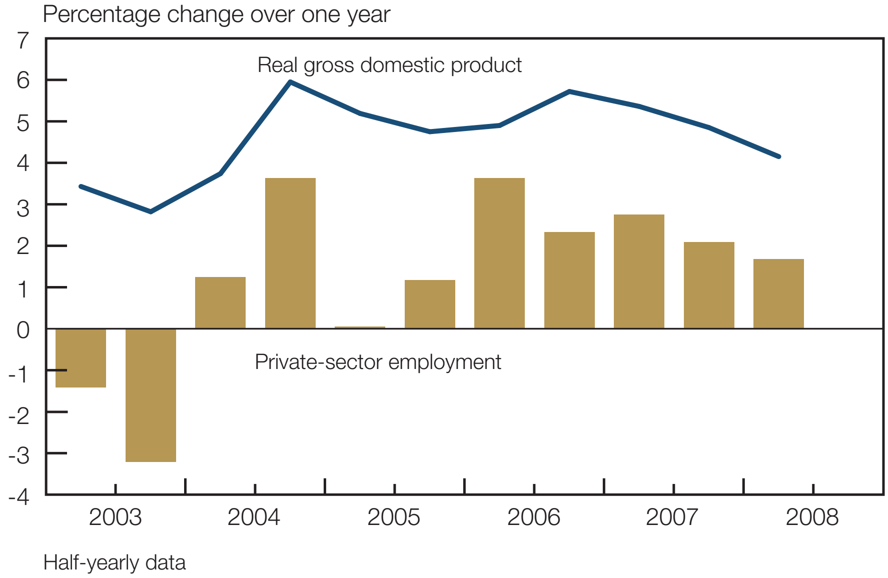
The gross saving by the *household sector* as a percentage of gross domestic product increased slightly from 1,2 per cent in the first quarter of 2008 to 1,6 per cent in the third quarter. This improvement reflected a slight contraction in real final consumption expenditure by households – the first contraction to be recorded in the current decade – while the real disposable income of households still increased, albeit at a much slower pace than before.

Gross saving by *general government* as a ratio of gross domestic product weakened to 1,9 per cent in the third quarter of 2008 from 3,5 per cent in the first quarter. The saving performance by general government in the third quarter of 2008 was somewhat dampened by a moderation in tax revenue and expenditure on arms procurement.

Employment

In recent quarters slowing growth in real gross domestic production led to a deceleration in formal non-agricultural employment growth. Formal non-agricultural employment, however, still increased by roughly 110 000 jobs in the six-month period to June 2008, raising the number of employed to 8,5 million. Reflecting the objective of improving the efficiency of public service delivery, employment growth in the public sector accelerated from the first quarter of 2008 to the second quarter, while private-sector employment growth decelerated considerably over the same period.

Growth in real gross domestic product and private-sector employment



According to the *Quarterly Employment Statistics* (QES) survey by Statistics South Africa (Stats SA), formal non-agricultural employment growth decelerated from a seasonally adjusted and annualised rate of 3,9 per cent in the first quarter of 2008 to 1,5 per cent in the second quarter. Over the same period, private-sector employment growth decelerated abruptly from 4,0 per cent to a mere 0,5 per cent. By contrast, public-sector employment growth accelerated meaningfully from 3,3 per cent in the first quarter of 2008 to 5,0 per cent in the second quarter, expanding the employment complement by around 22 000 jobs.

Within the *private sector*, quarter-to-quarter employment changes ranged from an annualised rate of decline of 5,2 per cent in the construction sector to a rate of increase as high as 13,4 per cent in the electricity-generation sector. In an effort to expand existing production capacity to meet the electricity demand of a growing domestic economy, the electricity-generation sector raised its staff complement from 47 600 in the final quarter of 2004 to 59 300 in the second quarter of 2008. Despite the adverse impact of insufficient electricity supply on the mining sector, about 8 500 employment opportunities were created in the mining sector in the first half of 2008. In the second quarter of 2008 employment growth in the gold-mining sector rebounded strongly to an annualised rate of 4,1 per cent, after falling back markedly in the first quarter. This increase was bolstered, in part, by the soaring dollar price of gold, which reached a peak in March 2008. Employment growth in the non-gold mining sector outperformed that of the gold-mining sector in the second quarter of 2008. Despite high commodity prices during this period, non-gold mining employment growth at an annualised rate of 5,5 per cent in the second quarter of 2008 was less than in the preceding quarter.

Change in enterprise-surveyed formal non-agricultural employment: June 2008

Sector	Over one quarter*		Over four quarters
	Number	Percentage	Percentage
Mining	6 300	5,0	3,9
Gold mining	1 700	4,1	-1,7
Non-gold mining	4 600	5,5	6,8
Manufacturing	5 200	1,6	-0,5
Electricity supply	1 800	13,4	9,5
Construction	-6 300	-5,2	-0,6
Trade, catering and accommodation	-15 200	-3,4	-0,1
Transport, storage and communication	-1 200	-1,9	2,2
Financial intermediation and insurance	14 600	3,1	3,9
Community, social and personal services	3 500	3,6	-0,4
Total private sector	**8 700**	**0,5**	**1,4**
National, provincial and local government	18 700	4,9	4,7
Public-sector enterprises	3 300	5,7	2,2
Total public sector	**22 000**	**5,0**	**4,4**
Grand total	**30 700**	**1,5**	**2,0**

* Quarter-to-quarter seasonally adjusted and annualised rates

Notwithstanding the deceleration in domestic and global demand for manufactured goods, employment in the manufacturing sector rose at a seasonally adjusted and annualised rate of 1,6 per cent in the second quarter of 2008, having previously declined by 0,2 per cent in the first quarter. However, for most of the first eleven months in 2008, the employment sub-index of the Investec Purchasing Managers Index (PMI) remained below the critical level of 50, suggesting possible job pruning in the sector in future.

Employment growth in the construction sector faltered during 2008, but nevertheless registered a slight increase over the preceding year as a result of continued large-scale infrastructural developments and ongoing activity in the non-residential sector. In the second quarter of 2008, employment numbers in the construction sector decreased at an annualised rate of 5,2 per cent, in part reflecting a deterioration in economic conditions and slowing demand in the residential building sector partly due to increased financial distress in the household sector. The tight economic conditions faced by households also had a bearing on employment growth in the trade, catering and accommodation services sector, where employment numbers decreased at an annualised rate of 3,4 per cent in the second quarter of 2008.

Quarterly employment gains were recorded in all tiers of the *public sector* in the second quarter of 2008, except in its transport, storage and communication services component. This resulted in public-sector employment growth accelerating to a seasonally adjusted and annualised rate of 5,0 per cent in the second quarter of 2008. The bulk of the additional 22 000 jobs created in the second quarter of 2008 were in public enterprises and at national government level, where employment numbers increased at annualised rates of 11,4 per cent and 8,8 per cent, respectively.

The volume of job advertisement space in the print media, which serves as an indicator of prospective employment opportunities, decreased by as much as 9,8 per cent in the year to the third quarter of 2008, corroborating the slowdown in formal non-agricultural employment growth.

The Rand Merchant Bank/Bureau for Economic Research (RMB/BER) Business Confidence Index fell back substantially during 2008, not auguring well for employment growth in coming months.

In 2005 Stats SA embarked on a major review of the *Labour Force Survey* in terms of survey methodology, the survey questionnaire, the frequency of data collection and data releases, and the survey data capture and processing systems. This project culminated in the release of the *Quarterly Labour Force Survey* (QLFS) at the end of August 2008. The QLFS is a household-based sample survey that collects data on the labour market activities of individuals aged 15 years or older residing in South Africa. According to the QLFS, the country's unemployment rate improved from 23,5 per cent in the first quarter of 2008 to 23,1 per cent in the second quarter, but worsened slightly to 23,2 per cent in the third quarter.

Economically active and employed persons

Actual numbers (millions) in September

	2004	2005	2006	2007	2008
Total employed persons	11,6	12,3	12,8	13,2	13,7
Economically active population.................	15,8	16,8	17,2	17,2	17,8
Unemployment rate (per cent)	26,2	26,7	25,5	23,0	23,2

Sources: Statistics South Africa: *Labour Force Survey*, September 2007 and *Quarterly Labour Force Survey*, August 2008 and October 2008

According to the QLFS, overall employment in the South African economy declined by 0,5 per cent or 74 000 job opportunities in the third quarter of 2008. This decline was largely on account of a fall in informal-sector employment from 2,3 million to 2,2 million over this period. Formal-sector employment gains of 24 000 were therefore more than offset by the contraction in informal-sector employment.

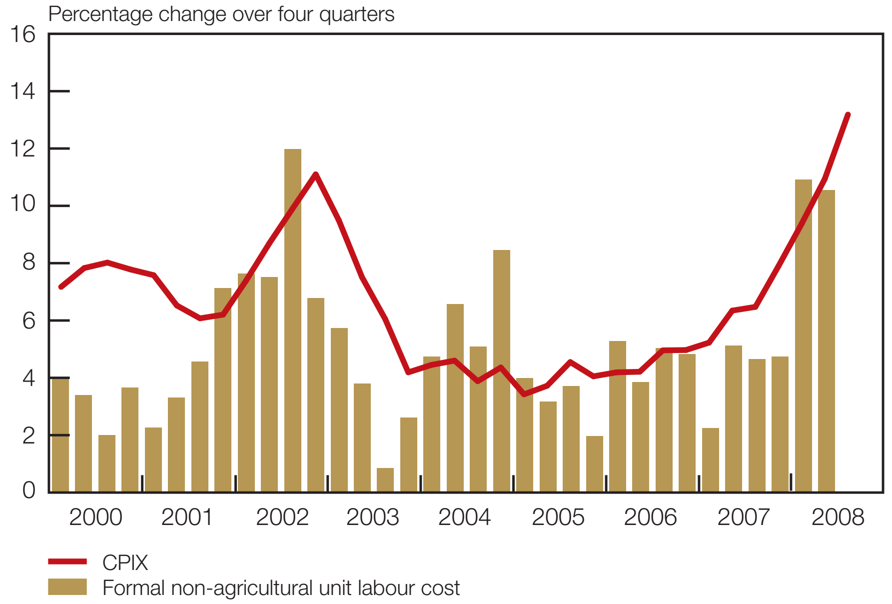
Labour cost and productivity

Measured over a four-quarter period, the rate of increase in *nominal remuneration per worker* in the formal non-agricultural sector accelerated markedly from 7,1 per cent in the third quarter of 2007 to 12,7 per cent in the second quarter of 2008, as consumer price inflation quickened. The rate of increase in nominal remuneration per worker was pushed higher by public-sector wage growth of as much as 15,8 per cent in the year to the second quarter of 2008. Although remaining at a double-digit level, private-sector nominal wage growth decelerated somewhat to 11,3 per cent over the period.

The marked acceleration in nominal remuneration per worker in the *public sector* in the year to the second quarter of 2008 resulted primarily from steep increases in nominal wage growth in the transport, storage and communication sector at a year-on-year rate of 26,2 per cent, as well as at provincial level at a rate of 19,2 per cent. In the *private sector*, wage increases in the second quarter of 2008 were especially pronounced in the non-gold mining sector, the construction sector as well as the trade, catering and accommodation sector at rates well advanced within double-digit territory.

According to Andrew Levy Employment Publications (a private-sector labour consultancy), the average rate of wage settlements amounted to 9,6 per cent in the first nine months of 2008, compared with 7,2 per cent in the same period in 2007 and 7,3 per cent for 2007 as a whole. Wage settlement rates ranged from 6,5 per cent in the food manufacturing sector to 13,4 per cent in the building and construction sector.

Nominal unit labour cost and CPIX



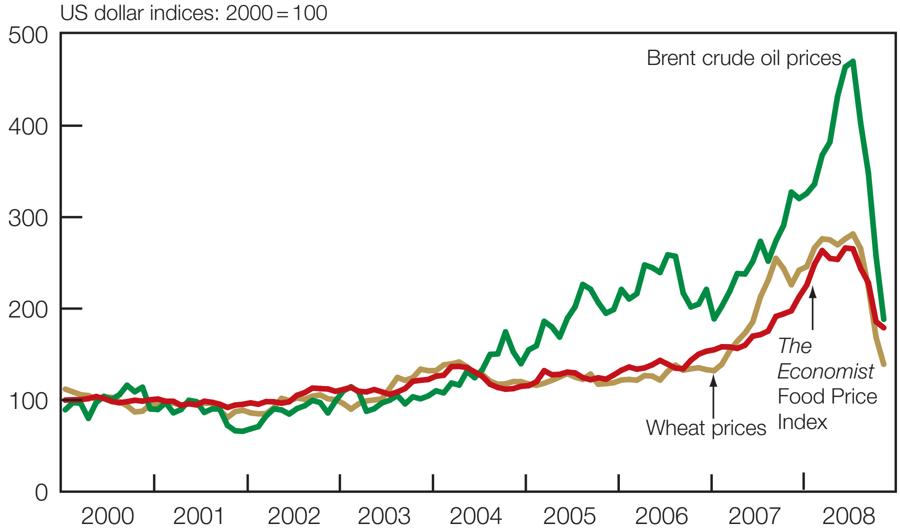
Following the improvement in non-agricultural output growth recorded in the second quarter of 2008, economy-wide productivity growth picked up from a year-on-year rate of 1,4 per cent in the first quarter of 2008 to 1,9 per cent in the second quarter. This improvement in labour productivity growth in the second quarter of 2008 contributed to a slightly lower increase in *nominal unit labour cost* at a year-on-year rate of 10,5 per cent in that quarter. Albeit at a somewhat lower level, the rate of increase in nominal unit labour cost in the manufacturing sector accelerated to 7,8 per cent over the same period. At these rates, nominal unit labour cost increases were well in excess of the inflation target range, fuelling inflationary pressures in the domestic economy.

Prices

Most recently, inflationary pressures in the world economy have begun to wane as the fallout from the financial market turmoil aggravated the slowdown in world economic growth and commodity prices fell back significantly. Nevertheless, almost all inflation-targeting countries, including South Africa, continued experiencing inflation rates in excess of their respective inflation targets, with the initial momentum generally provided by rising prices of energy and food.

Selected commodity prices

US dollar indices: 2000 = 100



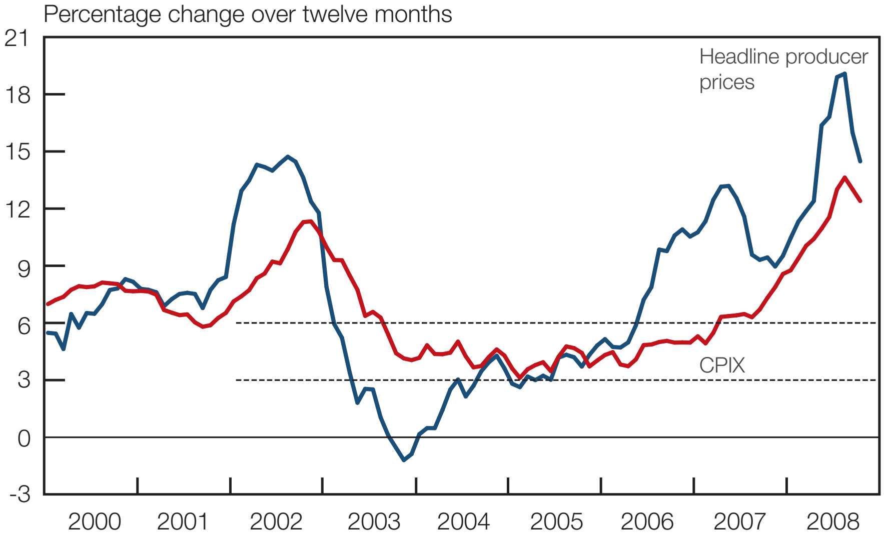
Sources: *The Economist* magazine, SAFEX and own calculations

In the domestic economy, recent increases in nominal salary and wage growth spurred on increases in nominal unit labour cost in excess of the inflation target range. Combined with the significant depreciation in the exchange value of the rand in October and November 2008, these forces have compounded future inflationary pressures in the economy. Simultaneously, however, these inflationary pressures were moderated by the reduction in commodity prices and the slowdown in the global economy.

Domestic producer and consumer price inflation has recently scaled new heights not seen since the introduction of the inflation-targeting monetary policy framework. Year-on-year CPIX inflation peaked at 13,6 per cent in August 2008 – more than double the upper limit of the inflation target range of 3 to 6 per cent – before decelerating somewhat to 12,4 per cent in October. Headline producer price inflation amounted to a year-on-year rate of 19,1 per cent in August 2008 – the highest rate of increase in almost 22 years – before decelerating to 14,5 per cent in October.

Consumer and producer prices

Percentage change over twelve months

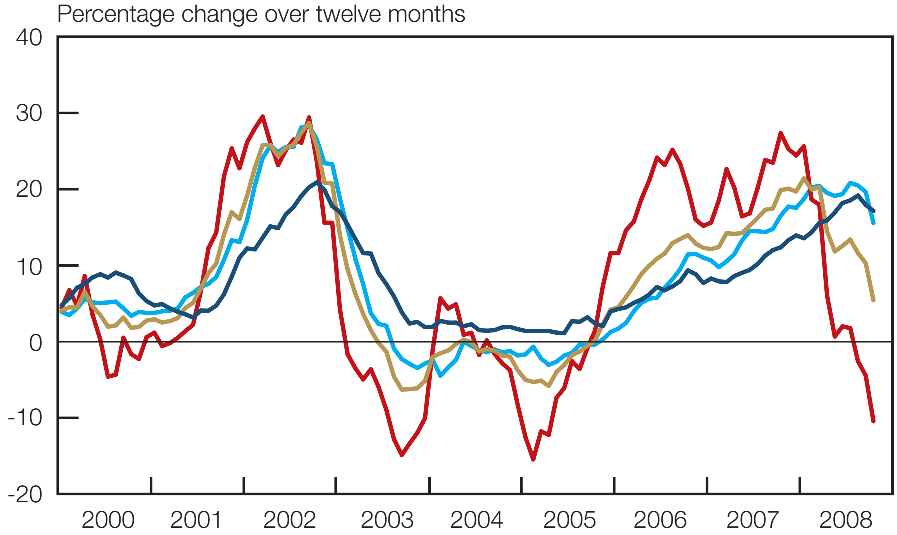


Producer price inflation of *imported commodities* amounted to a year-on-year rate of 23,0 per cent in August 2008, decelerating significantly to 10,3 per cent in October. While the prices of imported mining commodities rose by as much as 89,1 per cent in the year to June 2008; this rate of increase decelerated to 27,4 per cent in the year to October 2008 as crude oil and other commodity prices fell sharply. Imported manufactured food price inflation also decelerated somewhat to a year-on-year rate of 21,3 per cent in October 2008. Far lower year-on-year inflation was, however, recorded by the producer prices of imported agricultural commodities, radio, television and communication equipment and apparatus, as well as furniture.

Overall food price inflation at the producer level accelerated markedly to a twelve-month rate of 21,4 per cent in January 2008, as both agricultural and manufactured food prices rose briskly. However, in recent months a fall in agricultural commodity prices enabled food price inflation at the agricultural level to decelerate substantially, with such prices recording a year-on-year rate of decline of 10,4 per cent in October 2008. By contrast, inflation in producer food prices at the manufactured level accelerated considerably over the past year and amounted to a twelve-month rate of 20,8 per cent in August 2008, before decelerating to 15,6 per cent in October. Generally following producer prices, food price inflation at the retail (or consumer) level accelerated markedly to a peak of 19,2 per cent in August 2008 before decelerating to 17,2 per cent in October.

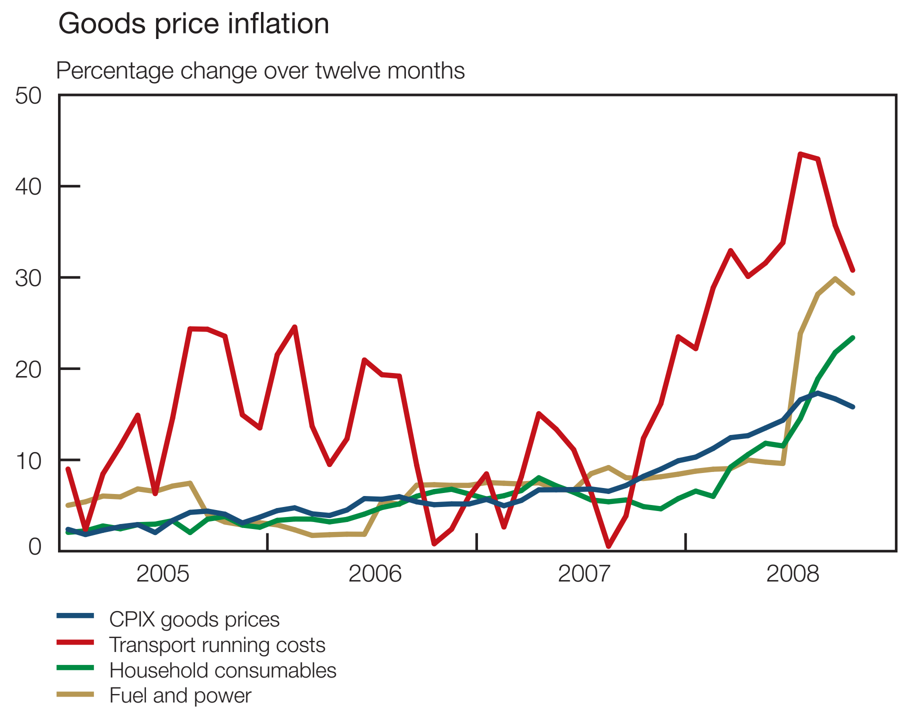
Food prices

Percentage change over twelve months



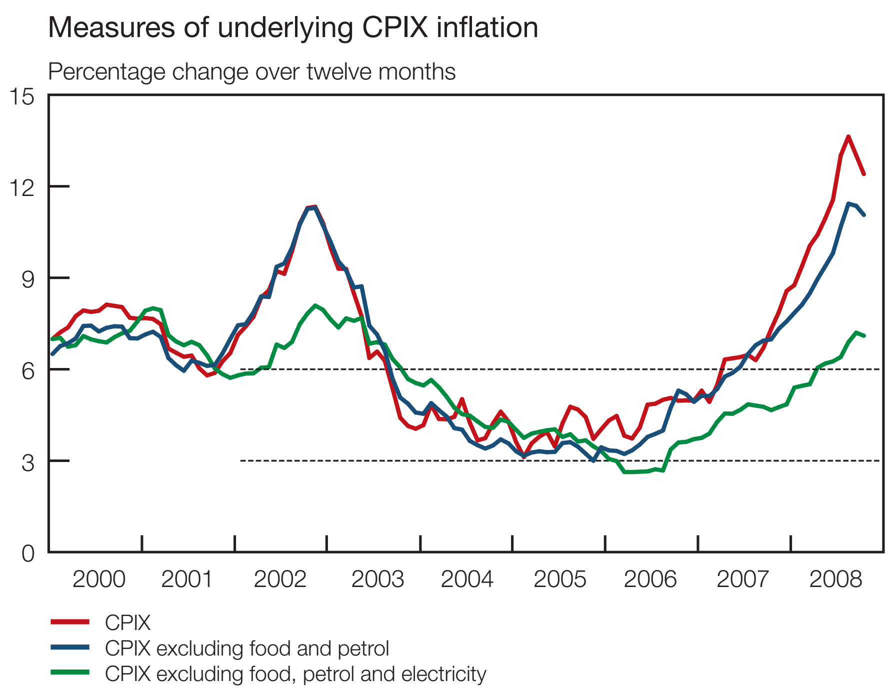
Agricultural PPI food
Manufacturing PPI food
Overall PPI food
CPIX food

Year-on-year *CPIX goods price inflation* accelerated significantly from 6,6 per cent in August 2007 to 17,3 per cent in August 2008 as food and petrol price increases added to the inflation momentum. The inland price of 93 octane unleaded petrol rose sharply from R7,33 per litre in January 2008 to a peak of R10,50 per litre in July before decreasing to R7,18 per litre in December. Recently, consumer price inflation has been impacted by electricity tariffs which rose by no less than 30,6 per cent over the year to October 2008. Within the consumer goods basket, accelerating price increases in other components – such as clothing and footwear, and household consumables – have also added impetus to CPIX goods price inflation in recent months.



CPIX services price inflation also breached the upper limit of the inflation target range of 6 per cent in April 2008, amounting to a year-on-year rate of 6,9 per cent in August before decelerating somewhat to 6,1 per cent in October. In October 2008 a year-on-year increases in excess of the inflation target range were evident in the prices of homeowners' cost, domestic workers' wages, dry-cleaning services and education costs.

Inflation in the prices of administered goods and services accelerated sharply to 22,1 per cent in the year to August 2008. Subsequently, this rate of increase decelerated to 18,2 per cent in October. The marked acceleration in administered goods and services price inflation resulted mainly from the already mentioned sharp increases in the prices of electricity and petrol, as well as a double-digit increase in telephone rental and installation costs.



Inflationary pressures in the economy have become more pervasive and persistent. When excluding the prime drivers of inflation, namely food, petrol and more recently, electricity, CPIX inflation would nevertheless have accelerated to 7,2 per cent in the year to September 2008, before decelerating slightly to 7,1 per cent in the year to October.

According to the inflation expectations survey conducted on behalf of the Bank by the BER at the University of Stellenbosch, expected CPIX inflation for 2008 has increased from 9,0 per cent in the survey conducted in the second quarter of 2008 to 10,2 per cent in the survey conducted in the third quarter. CPIX inflation is expected to decelerate to an average of 8,1 per cent in 2009 and to 7,4 per cent in 2010. Financial analysts and business representatives expect CPIX inflation to decline over the whole forecast period. By contrast, trade union representatives expect CPIX inflation initially to decelerate in 2009, but then to accelerate once again in 2010. Only financial analysts foresee CPIX inflation to be within the inflation target range of 3 to 6 per cent by 2010.

CPIX inflation expectations

Per cent, as surveyed by the BER in the third quarter of 2008

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2008	11,3	9,7	9,6	10,2
2009	7,3	8,8	8,2	8,1
2010	5,9	7,8	8,5	7,4

Source: BER, University of Stellenbosch

In the October 2008 MTBPS, the Minister of Finance announced that the new headline consumer price index (CPI) for all urban areas would become the new inflation target measure, replacing the CPIX for metropolitan and other urban areas excluding mortgage interest cost. This change was made possible by the exclusion of mortgage interest cost from the new headline CPI, being replaced with owners' equivalent rent, which is not perversely related to interest rate changes. The new CPI for all urban areas will be used as both the headline measure and the inflation target measure, following its release on 25 February 2009.

Foreign trade and payments

International economic developments

The global financial market turmoil intensified in recent months as liquidity in interbank money markets came under considerable pressure despite measures by major central banks to inject liquidity into the system. Confidence in the banking system deteriorated from mid-September 2008 when a major investment bank in the United States (US) filed for bankruptcy, and serious solvency concerns were raised regarding several other banks and financial institutions. In an effort to restore confidence, governments around the world acted with increasing vigour to recapitalise banks and other financial institutions in distress. Ongoing financial turmoil, however, increased the downside risks to growth and contributed to reduced inflationary pressures in many countries. Major central banks, including the Bank of Canada, the Bank of England, the European Central Bank, the US Federal Reserve, Sweden's Riksbank and the Swiss National Bank, accordingly announced a co-ordinated reduction in policy rates in early October 2008.

The International Monetary Fund (IMF) expressed concern in its October 2008 *World Economic Outlook* that many advanced countries may be moving closer to a recession. Global growth projections by the IMF were consequently revised downwards, only to be revised downwards again in November 2008 to 3,7 per cent in 2008 and 2,2 per cent in 2009, the slowest rate of increase since 2001. The slowdown in growth experienced by many countries could mitigate inflationary pressures through widening output gaps and declining commodity prices.

Real output in the US contracted in the third quarter of 2008, mainly due to negative contributions from personal consumption expenditure and residential fixed investment. Economic activity in Japan also contracted in the third quarter of 2008. The contraction in output was the result of negative contributions from imports and private investment. Preliminary data suggest that real output in the euro area also contracted during the third quarter of 2008.

Real growth patterns in the second quarter of 2008 were mixed with respect to different emerging-market regions, but nevertheless remained generally strong and supportive of global growth. Real output growth in many emerging-market countries for which data are available deteriorated further in the third quarter of 2008. The latest IMF and World Bank projections for China indicate that growth is likely to be around 9,5 per cent in 2008 and 8 per cent in 2009. The IMF estimates that economic growth in Africa will moderate further from 5,2 per cent in 2008 to 4,7 per cent in 2009. While high commodity prices benefited many commodity-producing countries, the financial market turmoil with its resultant curtailment in capital inflows to emerging markets will probably dampen growth in 2008.

International commodity prices, especially oil prices, retreated from mid-2008 as the global economy slowed. Inflationary trends in advanced economies exhibited a similar pattern, peaking in July 2008, before starting to moderate. In the US, following a 17-year record high in July 2008, annual headline consumer price inflation displayed a remarkable moderation in subsequent months. Similarly, in the euro area annual headline consumer price inflation peaked at a record high of 4 per cent in July 2008, before slowing in the following months. After returning to positive territory, the annual rate of change in Japan's core consumer price index (consumer prices excluding fresh food) reached its highest level in almost eleven years in July 2008, before edging lower in both September and October.

Annual headline consumer price inflation in October 2008 continued to decelerate in emerging-market countries such as Argentina, China, Hong Kong, Hungary, Malaysia, the Philippines, Poland, South Korea, Taiwan and Thailand. By contrast, Brazil and India registered a further acceleration in inflation. Annual consumer price inflation accelerated in most of the Southern African Development Community member countries in the third quarter of 2008. While many countries in this region are currently experiencing double-digit inflation rates, the IMF projects that, excluding Zimbabwe, inflation will decelerate by about 3 percentage points to around 9 per cent in 2009.

Since August 2008, monetary policy has been tightened in Brazil, Chile, Indonesia, Mexico, Russia and Thailand. By contrast, Australia, Canada, China, the Czech Republic, the euro area, Hong Kong, India, Japan, Malaysia, New Zealand, Poland, Switzerland, Taiwan, Turkey, the United Kingdom and the US have lowered policy rates. The US Federal Open Market Committee reduced the federal funds target rate by a further 50 basis points to 1,0 per cent in October 2008, effecting a cumulative 425 basis-point reduction since September 2007.

Current account[2]

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

The widening of the deficit on the current account of South Africa's balance of payments from 7,3 per cent of gross domestic product in the second quarter of 2008 to 7,9 per cent in the third quarter reflected in part the impact of the further slowdown in global economic activity and the substantial decline in international commodity prices. The decline in global demand in the third quarter of 2008 affected both the volume and prices of merchandise exports adversely. Over the same period, the rate of increase in the value of merchandise imports also slowed alongside the moderation in domestic economic activity and more stringent international credit conditions. As a result, the country's trade deficit with the rest of the world widened substantially to R44,3 billion in the third quarter of 2008.

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

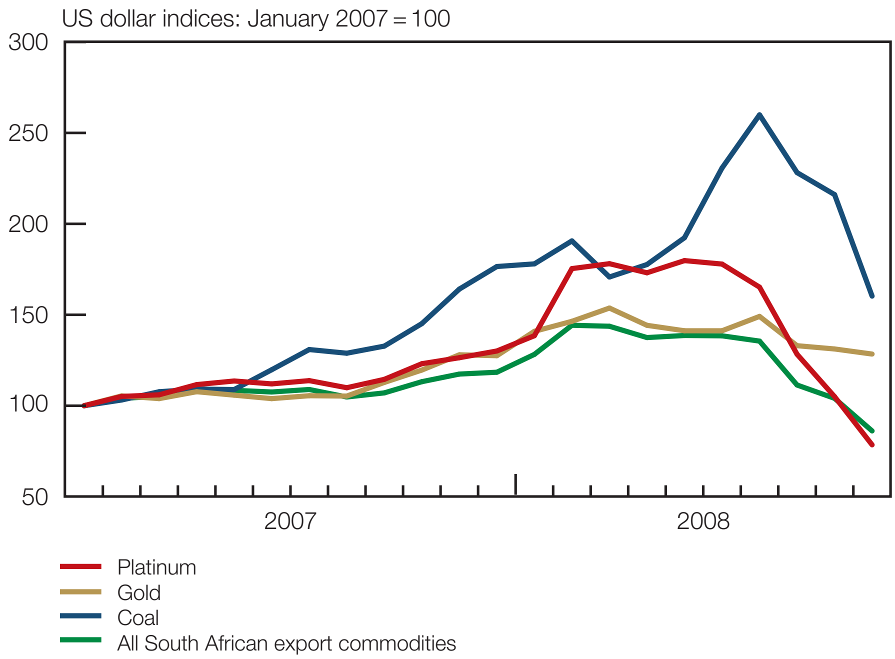
	2007			2008		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	487,4	533,0	493,9	565,7	680,5	705,8
Net gold exports	41,0	45,1	39,9	46,1	47,5	49,4
Merchandise imports	-587,7	-599,2	-574,3	-676,4	-762,3	-799,5
Trade balance	**-59,3**	**-21,1**	**-40,5**	**-64,6**	**-34,3**	**-44,3**
Net service, income and current transfer payments	-115,8	-131,5	-105,6	-137,8	-132,1	-141,4
Balance on current account	**-175,1**	**-152,6**	**-146,1**	**-202,4**	**-166,4**	**-185,7**
As a percentage of gross domestic product	*-8,7*	*-7,2*	*-7,3*	*-9,2*	*-7,3*	*-7,9*

The large trade deficit was further exacerbated by higher net income payments accruing to non-resident investors on their investment in domestic securities as well as by increased net payments for services. Thus, the shortfall on the service, income and current transfer account with the rest of the world widened to R141,4 billion in the third quarter.

After increasing by approximately 20 per cent in the second quarter of 2008, the value of *merchandise exports* advanced by only 3,7 per cent in the third quarter. The slower rate of increase in export earnings could be attributed to more subdued growth in both the volume and the rand price of merchandise exports. The much-anticipated deceleration in global demand and decline in international commodity prices encouraged local producers to curtail their output in the third quarter of 2008, after disposing of a large part of their accumulated inventories in the previous quarters. Consequently, the volume of exported goods advanced only marginally by 1,7 per cent in the third quarter of 2008. Sluggish growth in export volumes was recorded in the subcategory for motor vehicles and transport equipment, while the volume of exported machinery; electrical equipment; pearls; and precious and semi-precious stones receded over the period.

The rand price of merchandise exports advanced by 2 per cent in the third quarter of 2008 following an increase of 7 per cent in the preceding quarter. The continued gyrations in the exchange value of the US dollar alongside weaker global demand for commodities weighed down on the prices of South Africa's commodity exports. During the third quarter the overall commodity export price index in US dollar accordingly fell by 15,3 per cent as the prices of particularly gold and platinum declined notably. The price of platinum fell significantly by approximately 25 per cent from US$2 027 per fine ounce in the second quarter of 2008 to US$1 522 per fine ounce in the third quarter and even further to US$899 per fine ounce in October. Simultaneously, on the London market, the fixing price of gold declined from US$897 per fine ounce to US$869 per fine ounce and further to US$810 per fine ounce. The decline in the fixing price of gold partly reflected a deterioration of the safe-haven attraction of gold alongside falling international prices of crude oil.

Prices of selected commodities



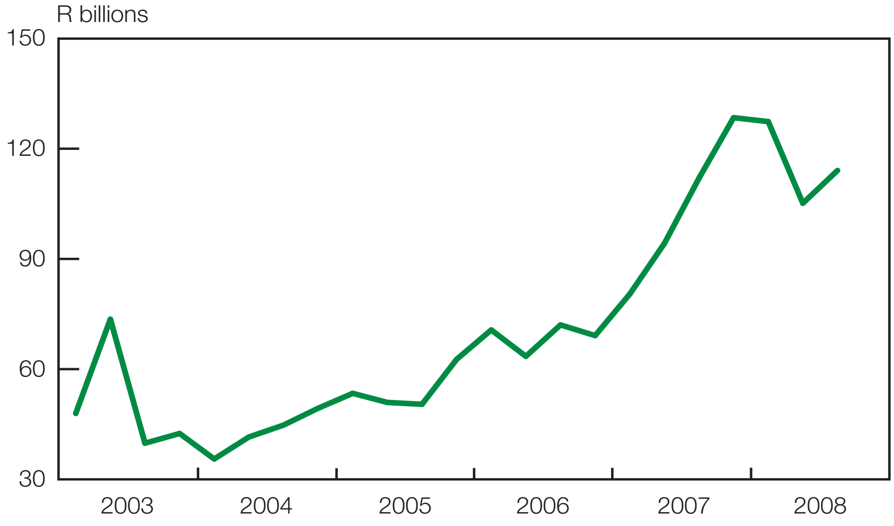
The value of the country's net gold exports advanced by 4 per cent in the third quarter of 2008. An increase of 8,5 per cent in the physical quantity of net gold exports was partly countered by a decline of 4,2 per cent in the average realised rand price of gold over the period.

The volume of *merchandise imports* rose at a moderate pace of around 1,3 per cent in the third quarter of 2008, mirroring the generally sluggish growth in domestic demand. The volume of imported crude oil increased marginally over this period. Notwithstanding the importation of two military aircraft by the national government, the overall volume of imported manufactured products declined by 2,2 per cent from the second to the third quarter of 2008, particularly held back by the subcategory for machinery and electrical equipment. Consequently, the country's import penetration ratio moved sideways over the period.

The price of Brent crude oil declined by more than 60 per cent from an all-time high of around US$144 per barrel in early July 2008 to levels of around US$50 per barrel by the middle of November. Fears of a global recession that would dent world oil demand and the strengthening US dollar formed the basis for the downward trend. Despite the decline in the international price of crude oil and movement in the exchange value of the rand against the US dollar from the second quarter of 2008 to the third quarter, the higher domestic prices of South Africa's main trading-partner countries caused the rand price of merchandise imports to increase by 3,5 per cent in the third quarter of 2008, following an increase of 11,5 per cent in the second quarter. The increases in both the volume and unit price of merchandise imports lifted the value of merchandise imports by 4,9 per cent from R762,3 billion in the second quarter of 2008 to R799,5 billion in the third quarter.

The negative imbalance on the service, income and current transfer account with the rest of the world widened by about 7 per cent from the second to the third quarter of 2008, mainly due to higher gross dividend payments stemming from recent increases in the profitability of domestic companies, together with the raising by non-residents of direct investment holdings in selected companies. As a result, gross dividend payments to non-resident investors increased by 23 per cent over the period. The current uncertainty in international financial markets may have contributed to lower spending by international tourists in South Africa, while expenditure by domestic residents travelling abroad also declined. Lower tourism expenditure by residents abroad was consistent with virtually stagnant real disposable income levels. Both travel-related spending abroad and spending by non-residents in South Africa displayed clear signs of a general economic slowdown from the second to the third quarter of 2008. By contrast, payments for technical and other production-related services, continued to increase over the period.

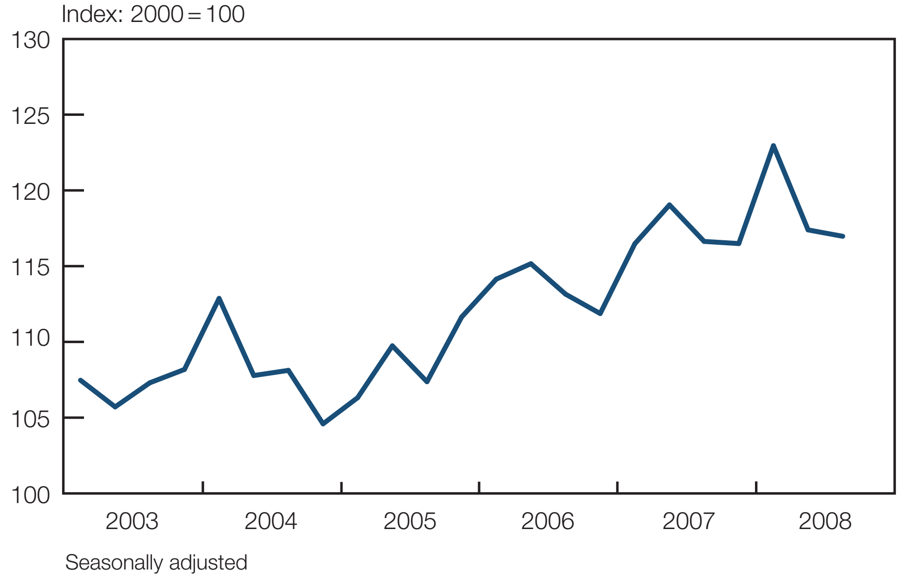
Gross dividend and interest payments to non-residents



Seasonally adjusted and annualised

A more rapid decrease in the dollar price of South Africa's international export commodities relative to the decline in the international price of crude oil caused the country's terms of trade to deteriorate further in the third quarter of 2008.

Terms of trade including gold



Financial account

Despite intensified global financial market turmoil in the developed economies, South Africa continued to attract significant capital inflows. Including unrecorded transactions, the surplus on the financial account of the balance of payments amounted to R60,6 billion or 10,2 per cent of gross domestic product in the third quarter of 2008. While capital inflows were recorded in all subcategories of the financial account during the second quarter of 2008, identified inflows in the third quarter mainly emanated from the net direct and other investment categories. This brought the net cumulative inflow of capital in the first three quarters of 2008 to R156,2 billion compared with an amount of R140,3 billion recorded in the same period of 2007.

Net financial transactions not related to reserves
R billions

	2007			2008		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	13,0	13,0	40,2	42,5	6,2	20,8
Portfolio investment	33,7	2,9	107,4	-19,1	27,3	-9,1
Other investment	30,2	5,2	58,3	26,9	1,6	15,6
Change in assets						
Direct investment	-1,1	-5,6	-20,9	-7,1	-4,9	-3,8
Portfolio investment	-4,2	-9,0	-24,0	-1,5	-4,8	-3,9
Other investment	-15,0	30,1	2,1	13,7	13,2	5,0
Total financial transactions*	**60,5**	**53,5**	**193,8**	**49,5**	**46,1**	**60,6**

* Including unrecorded transactions

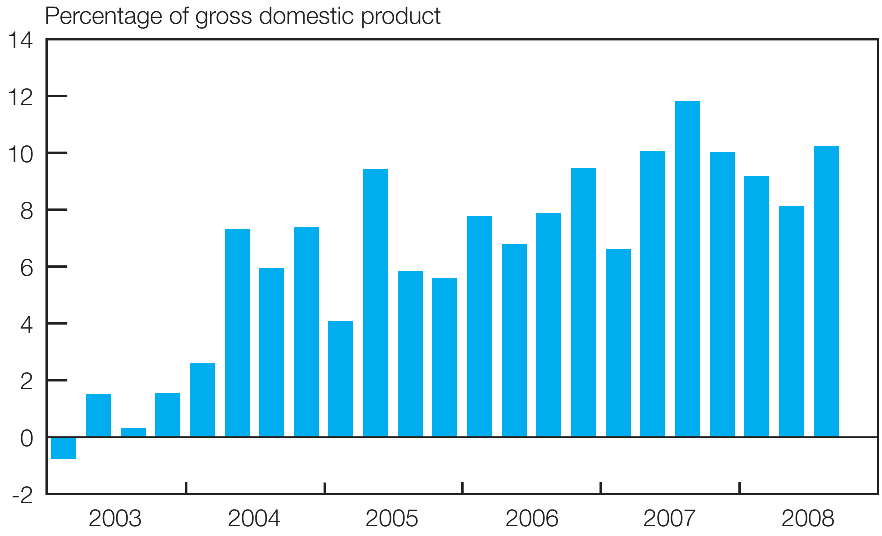
Foreign-owned assets in South Africa

Foreign direct investment into South Africa increased from an inflow of R6,2 billion in the second quarter of 2008 to an inflow of R20,8 billion in the third quarter. The inflow of capital in the third quarter was mainly attributable to an increase in long-term loan and short-term trade finance extended to domestic subsidiaries by non-resident holding companies and to the acquisition of the remaining shares in a South African motor vehicle manufacturing company by its foreign parent company.

Reflecting the worsening conditions in the global capital markets, *net portfolio investment* outflows from South Africa were recorded during the third quarter of 2008. Foreign investors seemed to prefer limiting their exposure to emerging-market assets and transferring funds to the familiarity of their home markets. Consequently, non-resident investors, on a net basis, reduced their holdings of domestic equity securities, while increasing their holdings of South African debt securities during the third quarter of 2008. On a net basis, the outflow of portfolio capital amounted to R9,1 billion in the third quarter of 2008. The net cumulative outflow of portfolio capital during the first three quarters of 2008 came to R0,9 billion, compared with a net inflow of R104,5 billion recorded during the same period of 2007.

Other investment flows into South Africa recorded an inflow of R15,6 billion in the third quarter of 2008, compared with an inflow of R1,6 billion in the second quarter. This inflow of capital could mainly be ascribed to short-term foreign loans drawn upon by South African banks, as well as an increase in non-resident investors' foreign-currency-denominated deposits with these banks. These outflows were, however, partly countered by a reduction in non-resident rand deposits with South African banks.

Balance on financial account*



* Including unrecorded transactions

South African-owned assets abroad

Outward direct investment recorded an outflow of R3,8 billion in the third quarter of 2008 compared with an outflow of R4,9 billion in the second quarter. South African companies continued to diversify their businesses through the acquisition of companies abroad, albeit at a somewhat slower pace than that recorded in previous quarters.

Portfolio investment by South African entities abroad recorded a further outflow of R3,9 billion in the third quarter of 2008 following an outflow of R4,8 billion registered in the previous quarter. South African individual investors, and to a lesser extent institutional investors, continued to diversify their investment abroad within the limits set by the relevant prudential regulations.

Other outward investment from South Africa recorded an inflow of R5,0 billion in the third quarter of 2008, compared with an inflow of R13,2 billion in the second quarter. This inflow can mainly be attributed to a decline in South African banks' foreign-currency-denominated deposits abroad, as well as a decline in loan financing extended by South African banks to foreign entities. The reduction in foreign assets of the domestic banking sector probably resulted from banks surrendering foreign currency to local importers and foreign investors who disposed of some of their domestic assets.

Foreign debt

South Africa's total foreign debt increased by US$2,1 billion to US$76,1 billion from the end of the first quarter of 2008 to the end of the second quarter, due to an increase in rand-denominated foreign debt. The outstanding foreign-currency-denominated debt declined over the period.

The decrease in foreign-currency-denominated foreign debt primarily reflected the redemption of euro-denominated bonds in international capital markets by the National Treasury and private-sector entities. In addition, the Bank continued to redeem part of the foreign credit facilities it had drawn on earlier. At the same time, non-resident investors increased their holdings of domestically issued rand-denominated bonds, while the South African banking and private-sector entities also increased their rand-denominated borrowings from non-residents.

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

	2007			2008	
	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Foreign-currency-denominated debt	**39,6**	**42,8**	**43,6**	**44,7**	**43,0**
Bearer bonds	13,9	14,8	15,2	16,0	15,0
Public sector	5,5	5,6	5,6	5,9	5,6
Monetary sector	11,2	13,2	12,7	12,5	12,0
Non-monetary private sector	9,0	9,2	10,1	10,3	10,4
Rand-denominated debt	**26,6**	**29,2**	**31,7**	**29,3**	**33,1**
Bonds	7,1	6,8	7,9	6,0	7,9
Other	19,5	22,4	23,8	23,3	25,2
Total foreign debt	**66,2**	**72,0**	**75,3**	**74,0**	**76,1**
As a percentage of gross domestic product	*25,4*	*26,8*	*26,6*	*25,5*	*25,8*

As a result of the appreciation of the exchange rate of the rand against the US dollar and the euro, South Africa's foreign debt decreased marginally from R601 billion at the end of March 2008 to R600 billion at the end of June.

The country's total external debt as a ratio of gross domestic product declined to around 25,8 per cent at the end of June 2008, after having risen to 26,6 per cent from the end of 2006 to the end of 2007. This ratio compares favourably with that of heavily indebted economies.

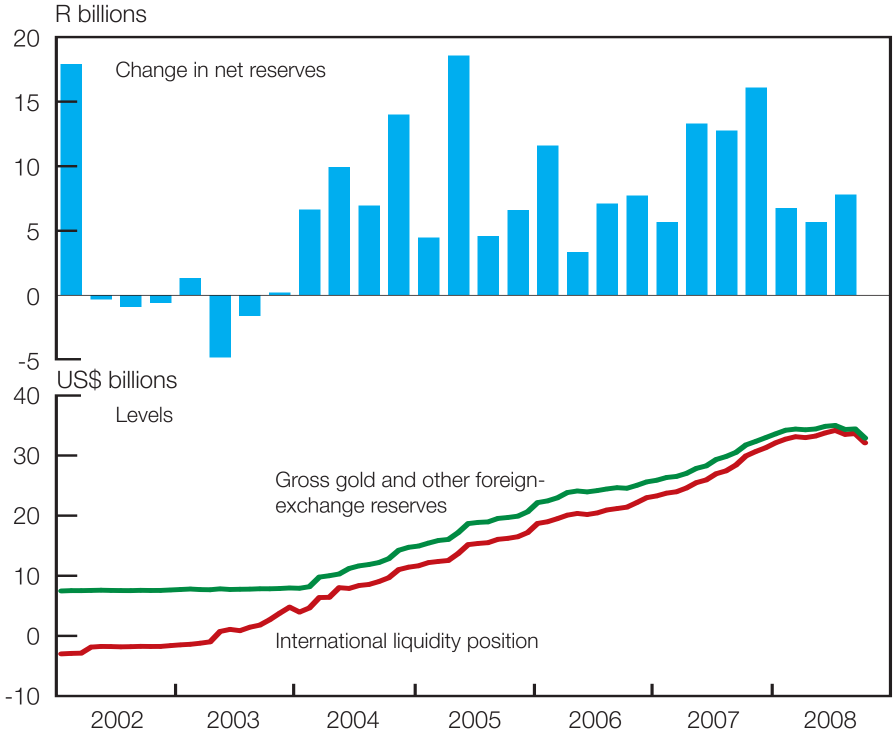
International reserves and liquidity

Net capital inflows on the financial account of the balance of payments continued to finance the deficit on the current account of the balance of payments. The country's overall balance of payments consequently recorded a surplus of R7,8 billion in the third quarter of 2008, compared with a surplus of R5,7 billion in the second quarter.

Measured in US dollars, the value of the gross gold and other foreign reserves of the Bank decreased from US$34,9 billion at the end of June 2008 to US$34,4 billion at the end of September and declined further to US$32,9 billion at the end of October. Valuation changes rather than flows underpinned these declines. The Bank's short-term credit facilities utilised declined from US$1,1 billion at the end of June 2008 to US$0,8 billion at the end of September and subsequently remained unchanged.

The international liquidity position decreased marginally from US$33,8 billion at the end of June 2008 to US$33,6 billion at the end of September and further to US$32,1 billion at the end of October.

Foreign reserves



Exchange rates

The nominal effective exchange rate of the rand increased, on balance, by 0,9 per cent in the third quarter of 2008. The weighted average exchange rate of the rand increased by 7,7 per cent from the end of June 2008 to end of July, but subsequently declined by 6,2 per cent from the end of August to the end of September.

Exchange rates of the rand
Percentage change

	31 Dec 2007 to 31 Mar 2008	31 Mar 2008 to 30 Jun 2008	30 Jun 2008 to 30 Sep 2008	30 Sep 2008 to 28 Nov 2008
Weighted average*	**-20,3**	**3,2**	**0,9**	**-10,2**
Euro	-22,2	3,0	4,4	-6,9
US dollar	-16,4	3,1	-5,2	-16,1
Chinese yuan	-19,8	0,8	-5,4	-16,2
British pound	-15,9	2,6	4,7	-1,8
Japanese yen	-25,9	9,1	-5,6	-23,7

* Against a basket of 15 currencies

The decline in the exchange rate of the rand during the latter half of the third quarter can in part be ascribed to spill-over effects of the global financial turmoil with investors rechannelling funds to familiar, mature markets, as well as the further deterioration in international commodity prices. From the end of September 2008 to the end of November, the weighted average exchange rate of the rand declined by a further 10,2 per cent alongside further strengthening of the US dollar.

The movement in the exchange value of the South African rand was not particularly unique as most commodity-producing emerging-market countries with large current-account deficits experienced significant declines in their currencies. In general, the current global financial market turmoil resulted in a significant appreciation of the US dollar, following increased investment in US assets by risk-averse investors.

Nominal effective exchange rate of the rand and platinum price

The real effective exchange rate of the rand declined by 5,3 per cent from December 2007 to September 2008 and increased by 3,1 per cent over the twelve months to September 2008.

The average net daily turnover in the domestic market for foreign exchange, which decreased to US$17,1 billion in the second quarter of 2008, increased to a record quarterly average of US$18,1 billion in the third quarter. The increase in activity on the domestic market for foreign exchange during the third quarter of 2008 coincided with increased volatility in the exchange rate of the rand. The value of transactions in which non-residents participated increased from US$12,9 billion per day to US$14,3 billion per day over the same period.

Monetary developments, interest rates and financial markets

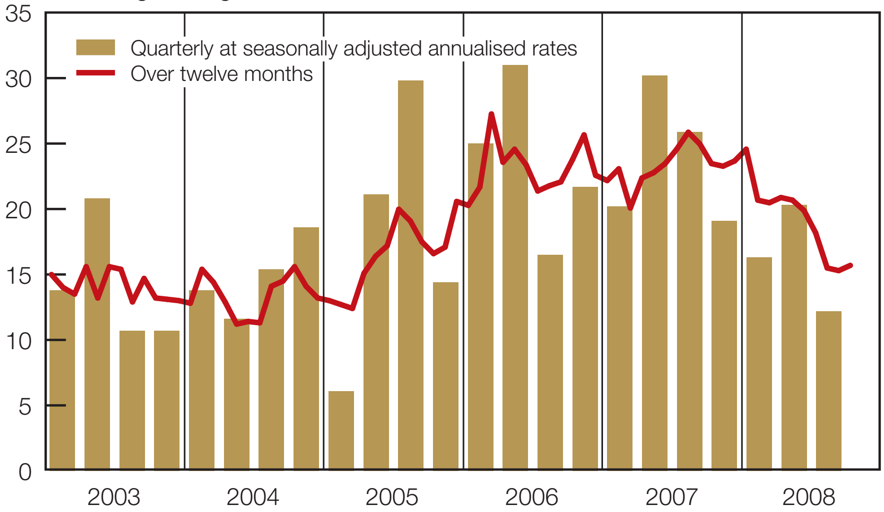
Money supply

After a two-year period of relatively high growth in the broadly defined money supply (M3), some moderation set in towards the end of 2007 and became more pronounced during the course of 2008. Growth over twelve months in M3 decelerated from 24,5 per cent in January 2008 to 15,2 per cent in September, before picking up slightly to 15,6 per cent in October. The broad aggregate's quarterly growth rate[3] decelerated from 20,3 per cent in the second quarter of 2008 to 12,2 per cent in the third quarter.

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

Growth in M3

Percentage change



The deceleration in M3 growth in recent months partly reflected the prevailing tighter credit conditions, diminishing wealth effects as asset prices receded, and slower underlying growth in income and expenditure. The slowdown in money supply growth in recent months was exaggerated by base effects due to high growth recorded a year earlier.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

Component	2007	2008		
	4th qr	1st qr	2nd qr	3rd qr
Notes and coin	4,9	7,3	13,3	4,5
Cheque and transmission deposits	12,4	9,0	6,7	-1,4
Call and overnight deposits	13,6	56,1	-33,5	2,9
Other short- and medium-term deposits*	16,7	-9,8	72,1	11,9
Long-term deposits**	50,4	60,9	8,5	53,6
M3	19,1	16,3	20,3	12,2

* Unexpired maturities of more than one day and up to six months, and savings deposits
** Unexpired maturities of more than six months

Long-term deposits, in conjunction with other short- and medium-term deposits, continued to underpin most of the increase in M3 during the third quarter of 2008. The persistent strong demand for these savings vehicles could probably be attributed to high interest returns, which encouraged depositors to lengthen the maturity of their deposits and supported the safe-haven status of holding monetary deposits. This is especially evident in the slight pick-up in October 2008 when turmoil in financial markets triggered a flight to lower-risk monetary assets. Notes and coin in circulation inched higher, and cheque and transmission deposits contracted in the third quarter of 2008, following sluggish growth recorded over the previous two quarters. The low transactions demand for money could be indicative of slower economic activity, the need to minimise the opportunity cost associated with holding non-remunerated money balances and the entrenchment of electronic payments for consumer transactions.

In the third quarter of 2008 the household sector was solely responsible for the growth in M3. With its deposits rising by R23,0 billion, this sector fully accounted for the overall increase of R23,0 billion in M3 deposits in the third quarter of 2008. Simultaneously, the deposits of the corporate sector remained broadly unchanged as the high cost of credit, slowdown in domestic economic activity, lower commodity prices and unfavourable developments in the financial markets impacted negatively on companies' earnings growth and cash flow.

After reaching a record low of 1,27 in the second quarter of 2008, the income velocity of circulation of M3 increased marginally to 1,28 in the third quarter of 2008, as M3 growth was surpassed by that of nominal gross domestic product.

Banks' claims on the private sector constituted the dominant statistical counterpart to the robust growth in M3 from the third quarter of 2004, reflecting sustained growth in total loans and advances. This domination continued so far in 2008. Net claims on the government sector increased somewhat in each of the first three quarters of 2008, their third-quarter increase partly on account of coupon interest payments on various government bonds.

Statistical counterparts of change in M3

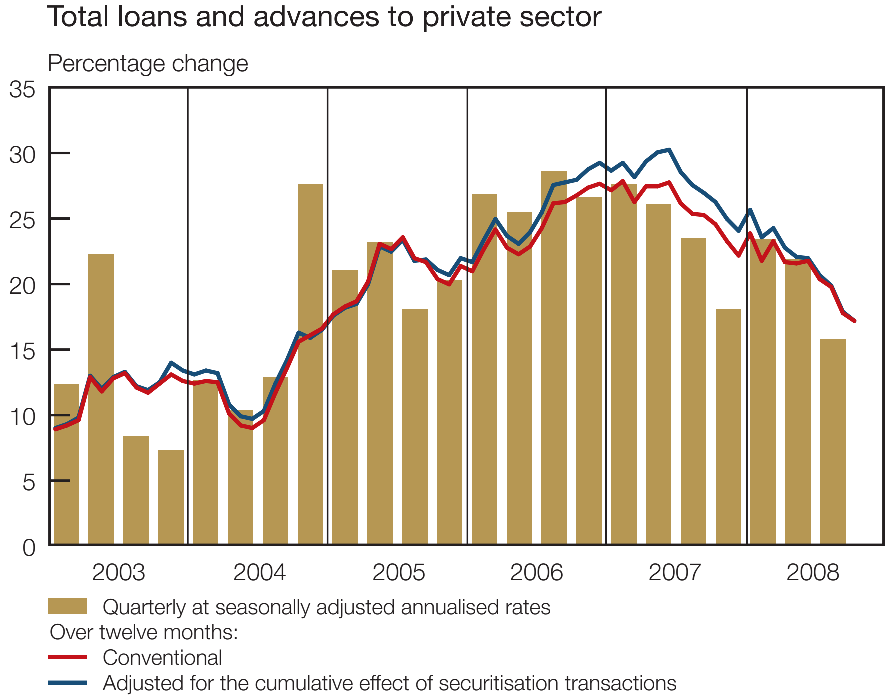
R billions

	2007	2008		
	4th qr	1st qr	2nd qr	3rd qr
Net foreign assets	2,0	13,0	-7,1	2,5
Net claims on the government sector	-17,9	35,7	14,6	9,7
Claims on the private sector	74,2	102,2	61,2	34,2
Net other assets and liabilities	5,0	-75,2	13,5	-23,4
Total change in M3	**63,3**	**75,7**	**82,2**	**23,0**

Credit extension

The progressive tightening in the monetary policy stance, which began in the middle of 2006, gradually impacted on credit demand by the household and corporate sectors. From mid-2007 this impact became evident in a substantial slowdown in growth in banks' total loans and advances[4] extended to the private sector, receding as low as 15,8 per cent in the third quarter of 2008. Simultaneously, the twelve-month growth rate of the aggregate receded below 20 per cent in August 2008 and reached 17,1 per cent in October, its lowest level since January 2005.

4 Total loans and advances to the domestic private sector consists 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'.



The twelve-month growth in total loans and advances, adjusted for securitisation transactions, decelerated from a record high of 30,2 per cent in June 2007 to 17,1 per cent in October 2008. Strong growth in the securitisation of banks' assets in 2007 was followed by marginal growth in the first ten months of 2008. Financial market turbulence and investors' heightened risk aversion following losses on sub-prime-related securitised assets had a pronounced dampening effect on issuing activity in the international asset securitisation market, which also spilt over to South Africa.

Quarterly changes in banks' total loans and advances by type

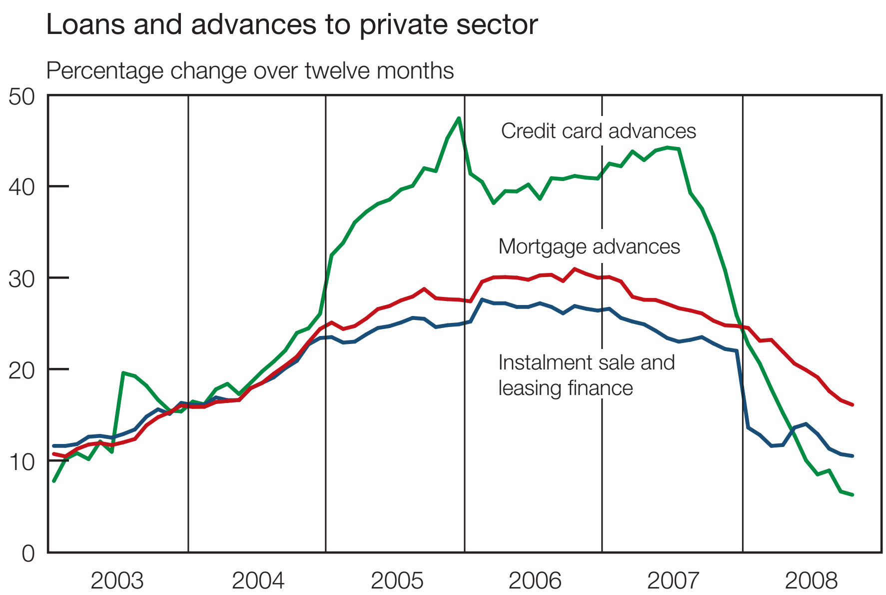
R billions

	2008	
	2nd qr	3rd qr
Mortgage advances	26,8	32,9
Instalment sale credit and leasing finance	4,1	3,3
Other loans and advances	34,5	1,9
Overdrafts	1,2	-9,2
Credit card advances	0,8	0,5
General advances	32,5	10,6
Total loans and advances	65,4	38,1
Of which: To household sector	13,4	19,4
To corporate sector	52,0	18,6

With the exception of mortgage advances, growth in all the categories of loans and advances slowed in the third quarter of 2008. Moving beyond the quarterly time horizon, however, growth over twelve months in *mortgage advances* also slowed from 24,5 per cent in January 2008 to 16,1 per cent in October, consistent with the deteriorating conditions in the property market.

Simultaneously, year-on-year growth in *instalment sale and leasing finance* – primarily directed at financing expenditure on motor vehicles and other durable goods –

decelerated from 13,6 per cent in January 2008 to 10,5 per cent in October. This was consistent with the subdued sales of durable goods in the economy. Substitution within this category continued with sustained growth in instalment sale finance due to aggressive marketing of such finance in lieu of leasing finance, following the implementation of the National Credit Act. Growth over twelve months in instalment sale finance remained around 23 per cent in the third quarter of 2008, while leasing finance continued recording negative growth rates as it had done since November 2007.



Other loans and advances, consisting of general loans, credit card advances and overdrafts, remained relatively robust. Twelve-month growth in these loans and advances fluctuated around 26 per cent in the first eight months of 2008, before declining to 21,3 per cent in October. However, twelve-month growth in credit card advances decelerated sharply from 44,0 per cent in July 2007 to only 6,2 per cent in October 2008 as households continued to limit their use of this form of credit.

At an aggregate level, the extension of total loans and advances to the household sector narrowly surpassed that to the corporate sector in the third quarter of 2008. Of the overall R38,1 billion in credit extended, R18,7 billion was taken up by the corporate sector, while R19,4 billion was utilised by the household sector. Volatility in the financial markets probably contributed to companies' continued reliance on bank credit. However, both the corporate sector and households displayed a diminishing appetite for bank-intermediated credit.

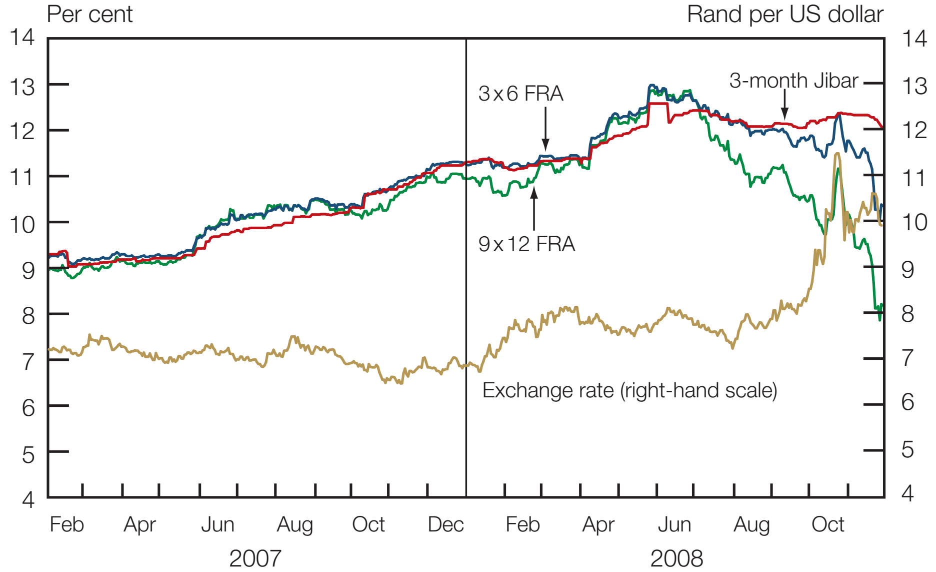
Interest rates and yields

Following an unchanged monetary policy stance at its August 2008 meeting, the MPC also maintained the repurchase rate at 12,0 per cent at its October meeting. In the statement concluding the October 2008 meeting, the favourable impact on the inflation outlook arising from a significantly lower oil price was noted, but the exchange rate of the rand was cited as a significant risk factor to the inflation outlook on account of the adverse conditions that prevailed in the international financial markets. The MPC statement discussing developments underlying the October 2008 decision is reproduced elsewhere in this *Bulletin*.

Other money-market interest rates generally adjusted downward from July 2008, as market participants started to expect an unchanged rather than more restrictive monetary policy stance for the remaining months of 2008 and factored in prospects of monetary policy easing during the second half of 2009. The three-month Johannesburg Interbank Agreed Rate (Jibar), for instance, declined by a cumulative 37 basis points from 12,42 per cent at the beginning of July 2008 to 12,05 per cent at the end of September. However, from October the Jibar moved higher, reaching 12,38 per cent on 27 October when sentiment turned bleak as renewed turmoil in the global financial markets imparted risk and uncertainty into the markets. The Jibar moved lower to 12,08 per cent on 26 November due to favourable developments in domestic inflation.

Despite the depreciation in the exchange value of the rand from August 2008, rates on forward rate agreements (FRAs) generally continued to display a downward trend, as expectations of a weaker global economy were starting to weigh down on the international price of oil. Increasingly, market participants brought forward their expectations of monetary policy easing to the first half of 2009 and factored in more prominent downward movements in interest rates than earlier expectations. Despite the weakening of the exchange value of the rand from the middle of October, FRAs broadly continued to suggest expectations of future easing in monetary policy.

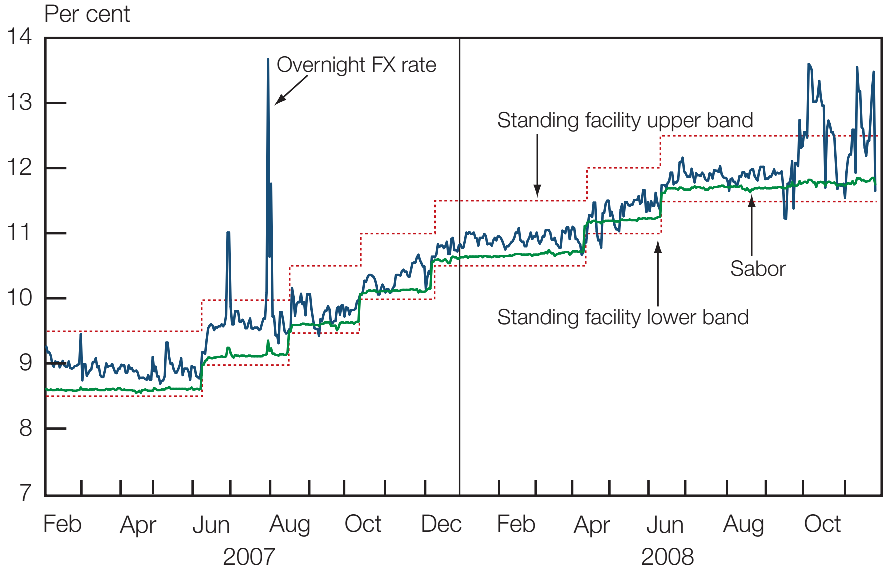
Forward rate agreements and exchange rate



The South African Benchmark Overnight Rate on Deposits (Sabor) continued to move in tandem with the repurchase rate and accordingly fluctuated in a narrow range around 11,70 per cent from mid-June 2008 to early December, staying well within the upper and lower standing facility limits.

From July to September 2008 the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) generally fluctuated above the Sabor rate, occasionally drifting to below the Sabor. During October the overnight FX rate increased considerably by 129 basis points in the midst of heightened global risk aversion, as some non-resident investors reduced their participation in this market segment.

Benchmark overnight rates



Both the prime overdraft rate and the predominant rate on mortgage loans of the private-sector banks have remained unaltered at 15,50 per cent since June 2008.

Interest rates on the *South African government fixed-rate and inflation-linked retail bonds* are priced off the government bond yield curves on a monthly and semi-annual basis respectively. The accompanying table depicts how rates on fixed-rate and inflation-linked bonds have changed from June 2008.

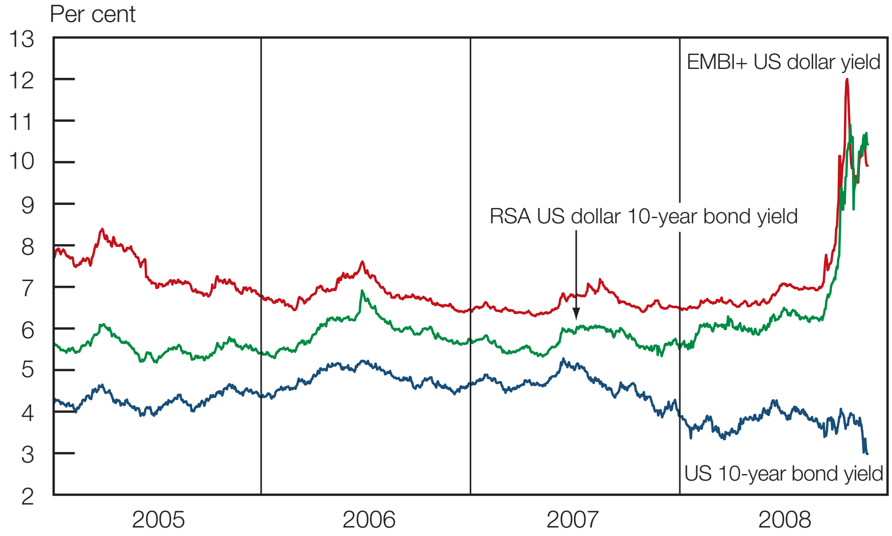
Interest rates on South African government retail bonds

Per cent

Effective from	2-year bond	3-year bond	5-year bond
Fixed rate:			
1 Jun 2008	10,00	10,25	10,75
1 Jul 2008	10,50	10,75	11,25
1 Sep 2008	10,25	10,50	11,00
1 Dec 2008	10,00	10,25	10,75
	3-year bond	5-year bond	10-year bond
Inflation linked:			
1 Jun 2008	3,00	2,75	2,50
1 Dec 2008	2,50	2,75	3,00

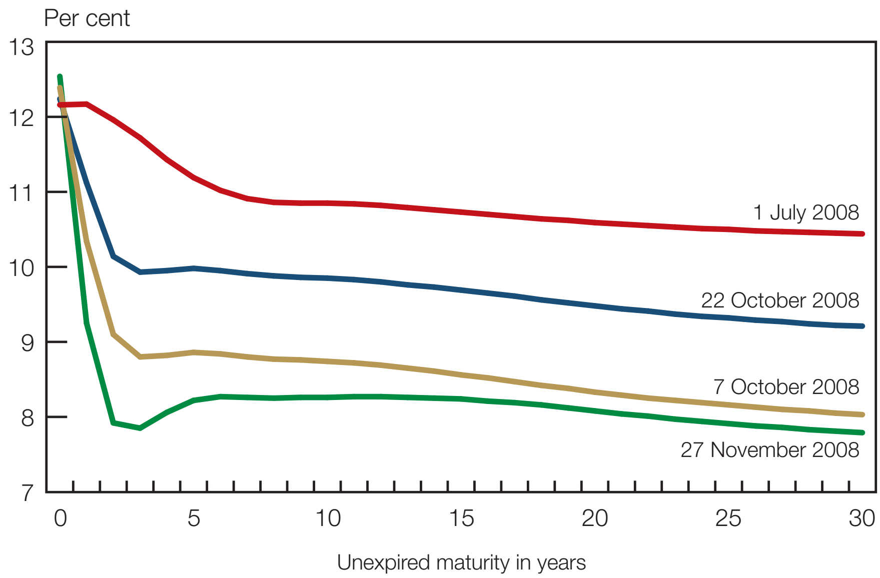
During the second half of 2008, South African bond yields responded to, among other things, movements in the exchange rate of the rand, continued declines in the international price of oil, the release of better-than-expected inflation figures in October and the view that bonds are a safe haven in times of financial market turmoil. From a recent high of 10,82 per cent on 1 July 2008, the *daily average yield on the R157 government bond* (maturing in 2015) edged lower to reach 8,17 per cent on 27 November. During the same period, the daily closing yield on the US ten-year bond fluctuated markedly and, on balance, recorded a decrease from 4,00 per cent to 2,98 per cent. Consequently, the spread between the South African R157 bond yield and the US ten-year bond yield narrowed from 681 basis points to 519 basis points.

US dollar-denominated bond yields



From July 2008, the level of the *yield curve* kept a steady downward trend across almost all maturities, reflecting a moderation in inflation expectations. The downward movement in the yield curve at the long end of the maturity spectrum was more than at the short end, which remained broadly anchored to the repurchase rate. However, from 8 October the level of the *yield curve* moved higher to 22 October as bond yields increased alongside the depreciating exchange value of the rand. Subsequently, the level of the yield curve moved downward to 27 November. The *yield gap* widened from a negative 172 basis points on 1 July 2008 to a negative 475 basis points on 27 November.

Yield curves



The downward trend of the *break-even inflation rate* in the five-year maturity range has reflected an improvement in inflation expectations since July 2008. From a recent high of 9,03 per cent on 1 July 2008, the break-even inflation rate declined to 5,22 per cent on 27 November. This was aided by a downward trend in nominal yields on conventional government bonds and slight movements in real yields on inflation-linked government bonds.

5 Measured as the differential between South African government bond yields on rand-denominated debt in the seven-year maturity range issued in the domestic market and South African dollar-denominated debt in the nine-year maturity range issued in the US market.

6 EMBI+ measures total returns on US dollar-denominated debt instruments of emerging markets.

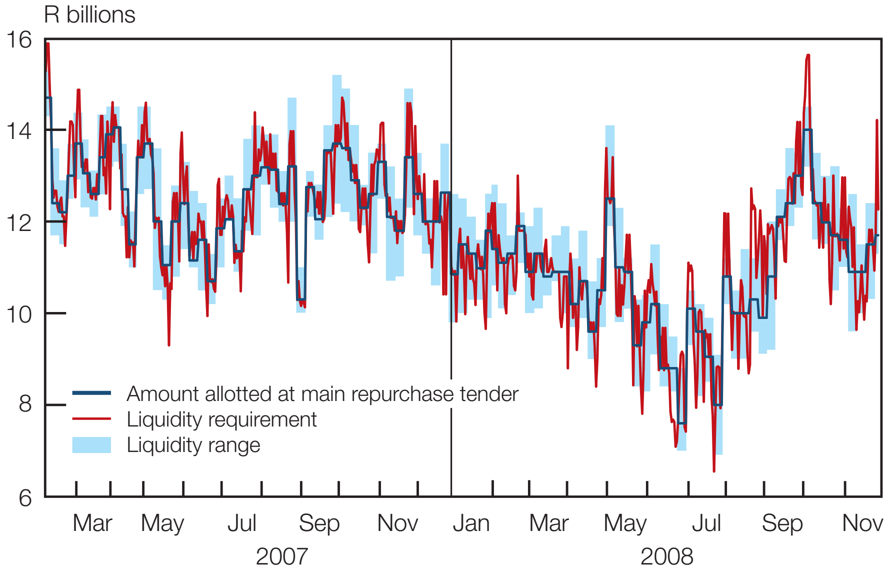
The currency risk premium[5] on South African government bonds narrowed significantly from 421 basis points in June 2008 to a negative 90 basis points in October. This was on account of an overall decline in the yield on domestic rand-denominated bonds, while the corresponding yield on dollar-denominated bonds recorded an overall increase during this period.

Continued global market risk aversion contributed to the widening of the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[6] spread from 243 basis points in May 2008 to 629 basis points in October – levels previously recorded in early 2003. Over the same period, the *sovereign risk premium* on South African government US dollar-denominated bonds in the six-year maturity range trading in international markets also widened significantly from 196 basis points to 588 basis points.

Money market

The daily liquidity requirement of the private-sector banks increased to levels of around R15 billion at the end of October 2008, from a low of R6,6 billion in July. The liquidity provided by the Bank at the weekly main refinancing tender fluctuated between R9,1 billion and R13,0 billion over the same period.

Liquidity requirement, ranges and amount allotted



Private banks made use of their cash reserve accounts with the Bank to square off their end-of-day liquidity positions. Occasionally, standing facilities and supplementary reverse repurchase transactions were also employed to accommodate daily liquidity fluctuations.

The Bank's purchases of foreign exchange injected liquidity amounting to R7,5 billion into the money market during the third quarter of 2008, compared with a substantial injection of R14,3 billion during the second quarter.

The issuance of reverse repurchase agreements and SARB debentures to the cumulative amount of R7,7 billion between July and September 2008, and an increase in both the required cash reserve balances held with the Bank, and in notes and coin in circulation served to counter the additional money-market liquidity infused by the Bank's foreign-exchange transactions.

Statistical counterparts of money-market liquidity flows

R billions (easing + tightening –)

	Jul–Sep 2008	Oct 2008
Notes and coin in circulation	-1,6	-2,6
Required cash reserve deposits	-2,7	1,0
Money-market effect of SARB foreign-exchange transactions	7,5	1,6
Government deposits with SARB	-0,9	-0,5
Use of liquidity management instruments	-7,7	-0,3
Reverse repurchase transactions	-2,5	0,4
SARB debentures	-5,2	-0,7
Other items net	0,0	2,3
Banks' liquidity requirement (decrease + increase –)	**-5,4**	**1,4**

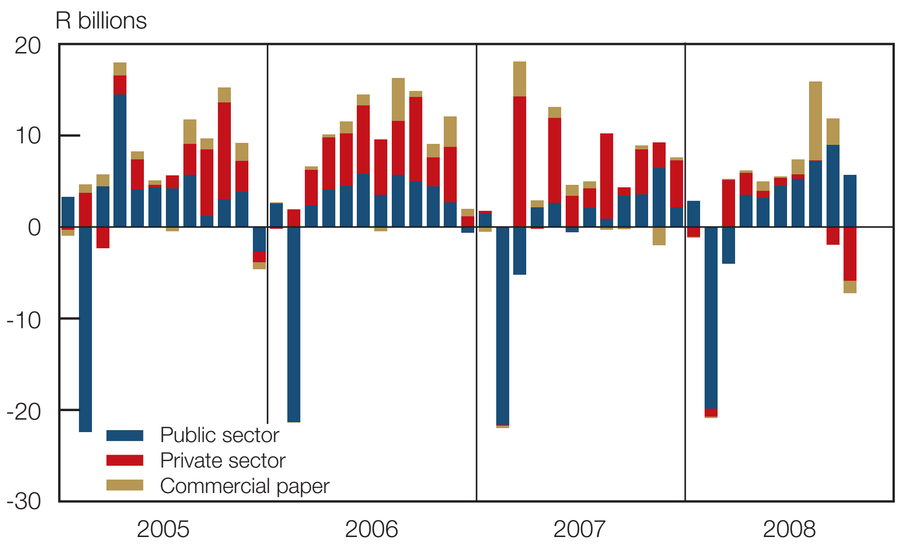
In addition to the final repayment of a syndicated term loan in June 2008, the Bank reduced its bilateral foreign borrowings by a relatively modest amount of US$100 million between July and September 2008.

Coupon interest payments on various government bonds to the value of R5,0 billion were effected from the government tax and loan account in September 2008, of which R0,1 billion accrued to the Bank on account of its own bond portfolio.

Bond market

Net redemptions of fixed-interest securities by *public-sector borrowers* of R2,7 billion in 2007 switched to net issues of R6,7 billion in the first ten months of 2008, as public-sector borrowers' demand for funds in the domestic primary bond market started to pick up from the second half of 2008. *Private-sector funding* activity in the domestic bond market in the first ten months of 2008 was subdued, probably due to the uncertainty in financial markets and unfavourable inflation and growth prospects. The outstanding nominal value of private-sector loan stock listed on the Bond Exchange of South Africa Limited (BESA) increased by only R0,03 billion in the first ten months of 2008, compared with R44,2 billion in the corresponding period of 2007.

Net issues in domestic primary bond market



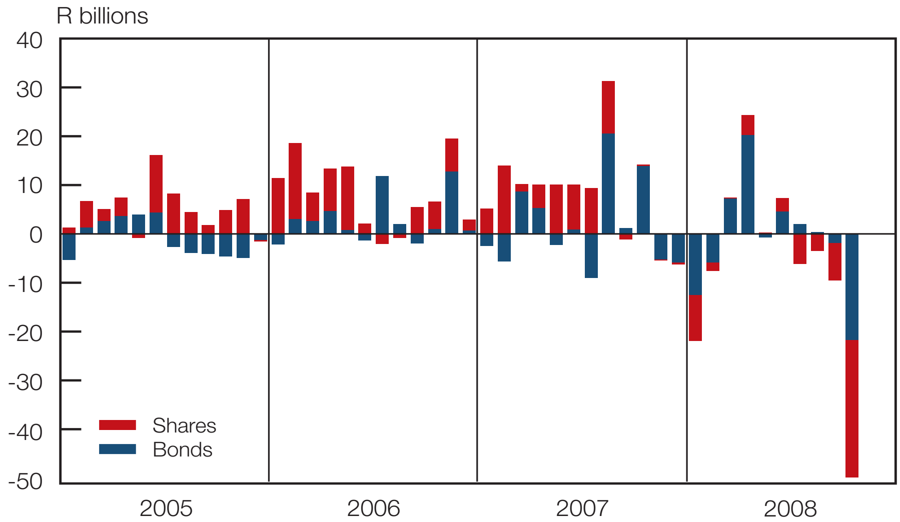
Issuance of commercial paper by both the private and public sectors rebounded in the second half of 2008, contributing to an increase of R13,1 billion in the first ten months of 2008, with the public sector accounting for R3,3 billion. The total outstanding nominal value of all debt listed on BESA increased by R32,5 billion during the same period, bringing the total outstanding nominal amount to R809,7 billion at the end of October.

Issuance of rand-denominated bonds in the *Japanese Uridashi bond market* increased steadily in 2008, as demand for these bonds increased. Net issues of R20,8 billion were recorded in the first ten months of 2008. Issuance of rand-denominated bonds in the *European bond market* amounted to R8,8 billion in the first ten months of 2008, compared with the R12,5 billion recorded in the corresponding period of 2007, reflecting higher redemptions in 2008.

Heightened volatility in yields and concerns about exchange rate volatility spurred trading activity in the *secondary bond market* where turnover reached R2,0 trillion in October 2008 from a record monthly high of R2,1 trillion in September. This contributed towards turnover of R18,3 trillion in the first ten months of 2008, which was 32 per cent more than the value traded in the corresponding period of 2007. On a quarterly basis, the value of turnover reached a record high of R6,2 trillion in the third quarter of 2008, from R5,2 trillion in the preceding quarter.

Non-residents' net purchases of bonds amounting to R24,0 billion in the second quarter of 2008 were followed by net purchases of R0,5 billion in the third quarter. Non-residents' net sales of domestic debt securities to the value of R1,9 billion in September 2008 and R21,7 billion in October, occurred amid heightened uncertainty in global financial markets. In the first ten months of 2008, non-residents' cumulative net sales of bonds amounted to R8,2 billion compared with net purchases of R31,1 billion recorded in the corresponding period of 2007. Non-residents' participation on BESA, measured as the sum of their purchases and sales as a percentage of total purchases and sales, declined from an average of 19 per cent in 2007 to 15 per cent in the first ten months of 2008.

Net purchases of shares and bonds by non-residents



Transactions on JSE and BESA

Share market

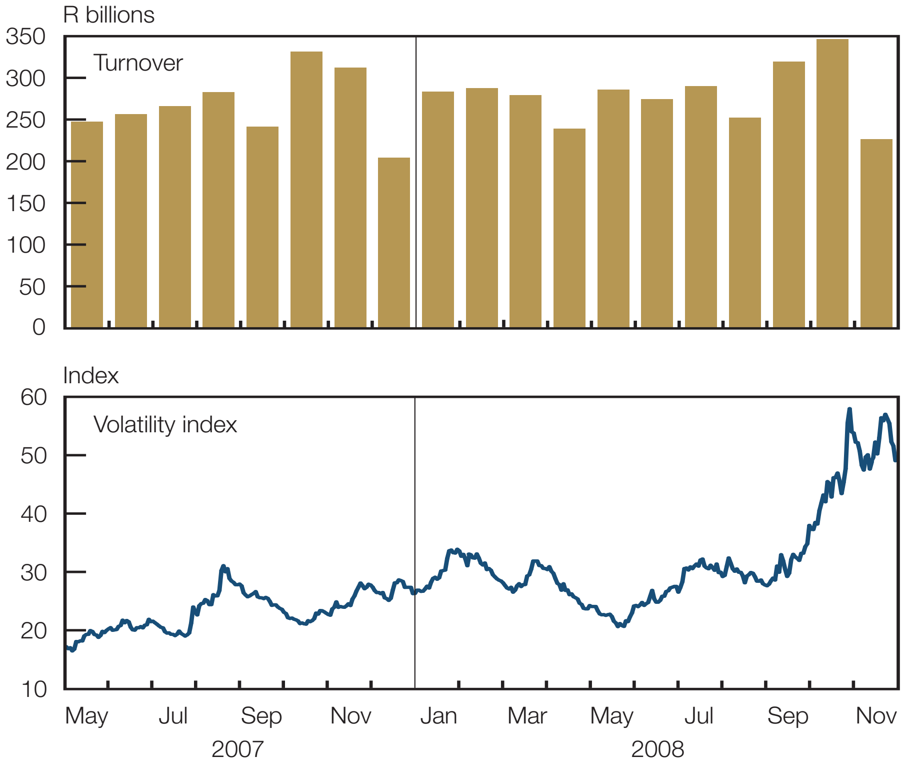
Funding sought in the domestic and international *primary share markets* by companies listed on the JSE Limited (JSE) waned in 2008, although upticks were registered in

March and June. A relatively subdued growth outlook and volatile global equity markets depressed local share prices and probably explain the reduced amount of R63,2 billion raised as equity capital in the first ten months of 2008 – 38 per cent below the R101,3 billion raised in the corresponding period of 2007. Companies with primary listings on the JSE accounted for 87 per cent of the capital-raising activity thus far in 2008, with nearly equal contributions by the resources and financial sectors.

New listings on the JSE by either an introduction or a private placing were fairly sparse in the ten months to October 2008. Of the 23 new listings thus far in 2008, 5 occurred on Alt^X and of the total of 17 delistings, Alt^X recorded only 1. The number of companies listed on the JSE amounted to 428 at the end of October 2008 – comprising 336 companies on the main board, 78 companies on Alt^X, and 14 companies on the development and venture capital boards.

Trading activity in the *secondary share market* was buoyant in 2008 and soared further in recent months alongside volatile share prices. The South African Volatility Index increased from 19 per cent at the beginning of May 2008 to 60 per cent at the end of October. The daily average turnover increased markedly from R11,5 billion in August 2008 to R14,2 billion in October from a record high of R14,6 billion in September. The value of shares traded on the JSE amounted to R2,9 trillion in the first ten months of 2008, which was 16 per cent more than the turnover in the corresponding period of 2007. Only a fraction of total turnover was recorded on Alt^X: it amounted to R4,7 billion in the first ten months of 2008, which was some 0,2 per cent higher than the value traded in the corresponding period of 2007.

Share market turnover and South African Volatility Index



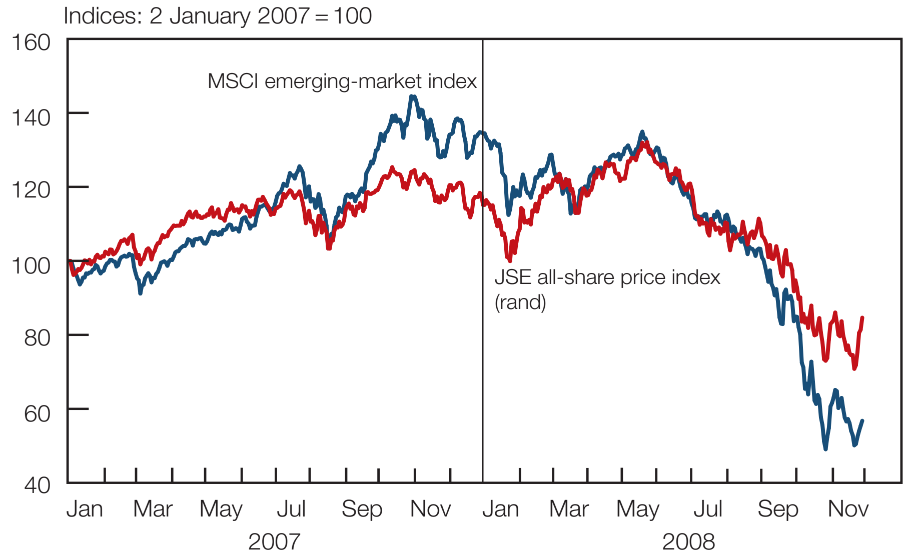
The total *market capitalisation* of the JSE declined from a record high of R6,3 trillion in May 2008 to R4,4 trillion in October due to lower share prices. However, according to the World Federation of Exchanges, the JSE maintained its ranking as the 19th largest stock exchange in the world in terms of market capitalisation for the past two-and-a-half years.

Half of this market capitalisation was contributed by the ten largest companies as at the end of October 2008. The market capitalisation of all companies listed on Alt^{X} also declined from R28,3 billion in April 2008 to R19,2 billion in October. Total market liquidity, measured by annualised turnover as a percentage of market capitalisation, increased considerably from 48 per cent in April 2008 to 94 per cent in October.

Non-resident investors' net selling of shares on the JSE intensified amid volatility in global equity markets. Net purchases of shares amounting to R7,0 billion in the second quarter of 2008 were followed by net sales of R17,1 billion in the third quarter. The change in sentiment towards the domestic share market was further demonstrated by the monthly record-high net sales of R28,2 billion in October 2008, resulting in cumulative net sales of R49,2 billion in the first ten months of 2008, compared with net purchases of R63,9 billion recorded in the corresponding period of 2007. Non-residents' participation in the domestic share market, measured as their purchases and sales as a percentage of total purchases and sales on the JSE, declined from an average of 21 per cent in 2007 to 19 per cent in the first ten months of 2008.

During the second half of 2008, developments in the domestic equity market mirrored those of international markets. The FTSE/JSE all-share price index (Alsi) decreased sharply by 46 per cent from an all-time high on 22 May 2008 to its recent low on 20 November, before recovering by 20 per cent to 27 November. Although lower commodity prices and less favourable domestic economic prospects had a negative effect on the Alsi, some level of resilience was exhibited as it declined by less than the overall emerging-market equities index as calculated by Morgan Stanley over the period from 22 May 2008 to 27 November. Domestically, the decline was evident in all three main sectors with resources shares recording the largest decline of 49 per cent from 22 May to 27 November. Industrial and financial share prices on balance recorded respective declines of 24 and 15 per cent over the same period.

Share prices



Measured in US dollar terms, the Alsi decreased by 51 per cent from a recent high on 19 May 2008 to 27 November. The Standard & Poor's 500 composite index fell by 38 per cent over the same period, reflecting global equity markets weakness due to a combination of factors, such as losses suffered by major US government sponsored enterprises, the insolvency of key financial institutions, and uncertainty regarding the success of numerous rescue packages aimed at injecting liquidity and supporting confidence in these markets.

The historical *dividend yield* on all classes of shares increased from 2,3 per cent in May 2008 to 4,4 per cent in October. Similarly, the *earnings yield* increased from 6,1 per cent to 10,6 per cent over the same period. Conversely, the *price-earnings ratio* of all classes of shares declined from 16,3 in May 2008 to 9,4 in October. The recent levels of the price-earnings ratio were less than the average of 15,8 in 2007 and its long-term average of 13,9, measured from 1990 to date, and partly reflected investors' negative expectations regarding the growth in future earnings of companies.

Market for exchange-traded derivatives

In November 2008, the JSE in collaboration with a bank introduced international derivatives (IDX), which provide South African investors with an opportunity to trade and gain exposure to international shares that are not listed on the JSE. These single-stock futures and their associated dividend futures are listed on the JSE's Equity Derivatives Market (Safex).

During the first ten months of 2008, turnover in *financial derivatives* on the JSE was bolstered by substantial movements in the underlying local share market. The number of contracts traded in the domestic financial derivatives market registered an increase of 65 per cent in the first ten months of 2008 when compared with the same period of 2007. Trading of risk through single-stock futures continued to dominate trading activity, with market exposure accounting for 87 per cent of the total number of contracts traded. The JSE hosts a significant derivatives market, globally ranked tenth largest in terms of volume traded and first in terms of the number of single-stock futures contracts traded.

Trading activity in *agricultural commodity futures and options* recorded steady increases during the first ten months of 2008. Again, significant changes in agricultural commodity prices contributed to the strong interest in this market. From the high levels recorded at the end of June 2008, prices of agricultural commodities receded, prompted by a good maize crop, lower international grain prices and substantially lower crude oil prices, which signify lower increases in agricultural input costs.

Derivatives turnover on the JSE, January to October 2008

	Value	Change over one year
	R billions	Per cent
Financial futures and options on futures	4 359	16
Warrants	3	24
Agricultural commodity futures and options	314	38
Interest rate derivatives	98	159

Trading activity on *Yield-X* escalated further in 2008, with the total number of contracts traded reaching an all-time high of 1,6 million in October 2008, contributing to the total of 4,9 million contracts traded in the first ten months of 2008. Currency futures and options on such futures – the latter issued for the first time in September 2008 – accounted for 92 per cent of total contracts traded alongside the volatility in world currency markets. Dollar/rand contracts remained the most traded and represented 86 per cent of the total number of currency contracts traded thus far in 2008. By value, interest rate futures and options accounted for 39 per cent, while currency futures and options accounted for 42 per cent of total trading in the ten months to October 2008.

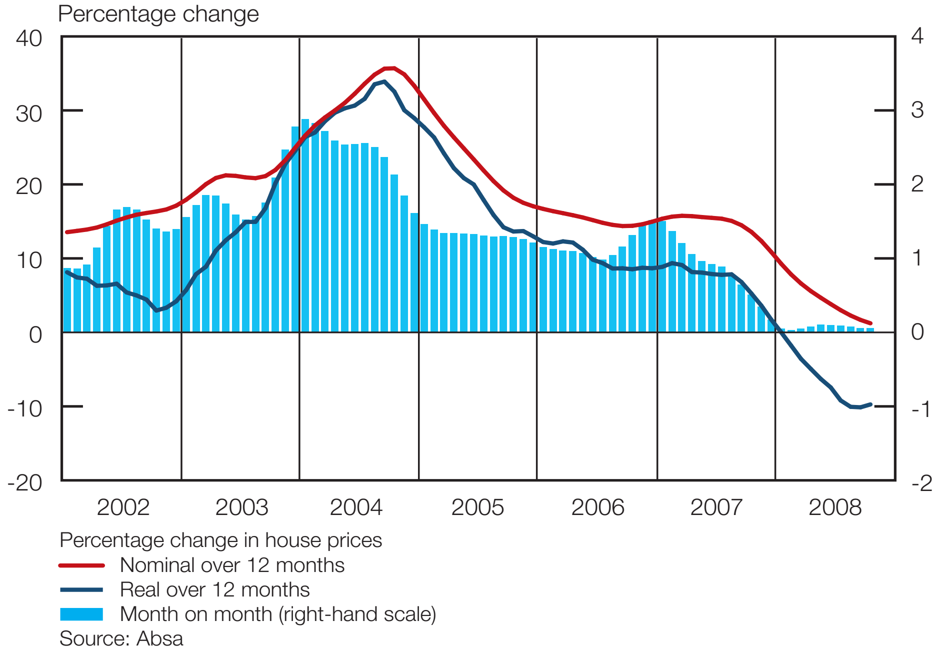
Trade in *warrants* increased in the first ten months of 2008, following a lacklustre performance in 2007. Turnover in all derivatives traded on the JSE for the first ten months of 2008 is indicated in the table on the previous page.

Real-estate market

A significant reduction in the affordability of housing resulted from the higher cost of mortgage finance, generalised increase in the cost of living and subdued growth in disposable income. Against this backdrop, the year-on-year rate of change in the average price of residential property in the middle segment of the market, as measured by Absa, decelerated from 15,8 per cent in March 2007 to a 15-year low of 1,2 per cent in October 2008. Similarly, the month-on-month rate of change in house prices declined from 1,5 per cent in December 2006 to 0,1 per cent in October 2008.

In real terms, the average house price on a twelve-month basis declined from February 2008 and recorded a negative rate of 9,7 per cent in October, as consumer prices rose faster than nominal house prices.

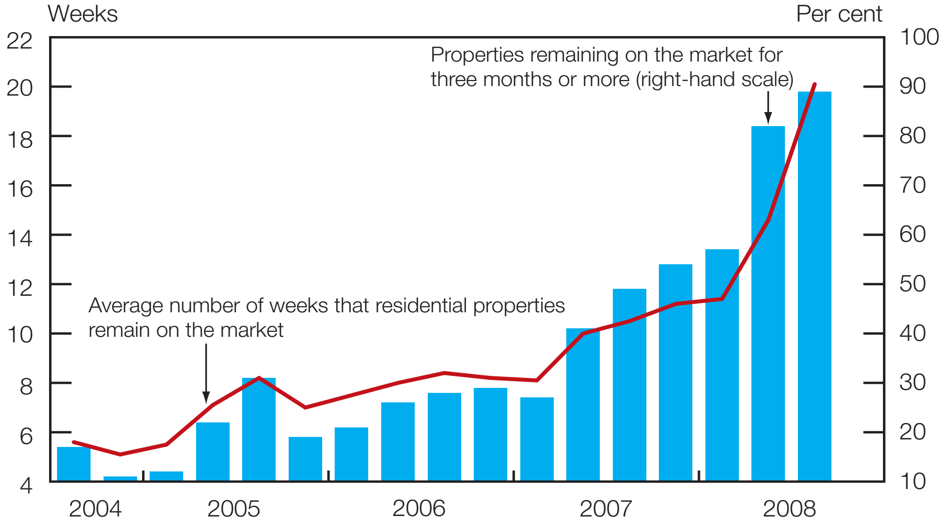
House prices



Source: Absa

The slowdown in the residential real-estate market is further confirmed by the First National Bank (FNB) Residential Property Barometer, which measures residential property market activity, perceptions and expectations of South African real-estate professionals. According to this barometer, the average length of time a residential property remains on the market increased from eight weeks in the first quarter of 2007 to more than twenty weeks in the third quarter of 2008. Almost 90 per cent of properties offered to be sold remained on the market for three months or longer in the third quarter of 2008, compared with 27 per cent in the first quarter of 2007.

Properties on the market



Source: First National Bank

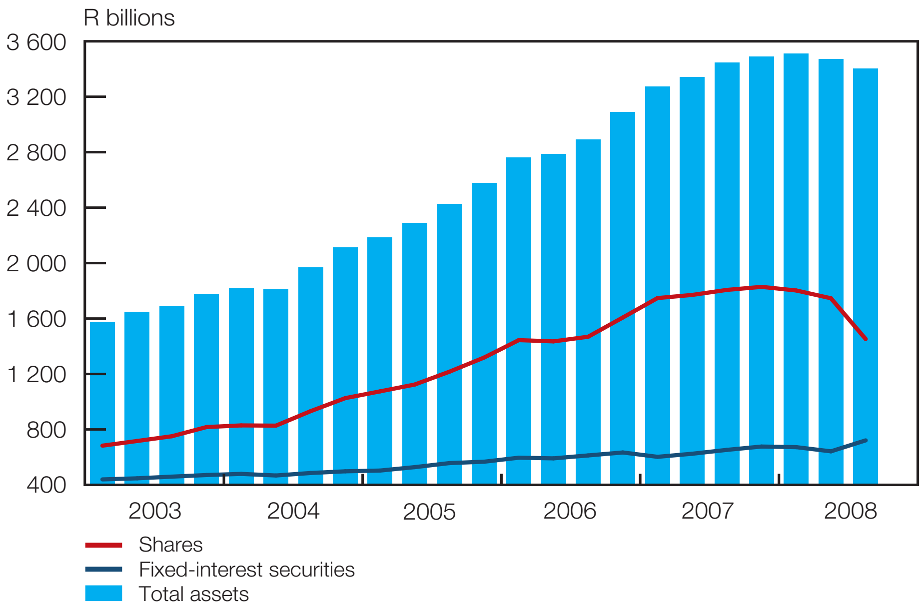
During the period January 2008 to October transfer duty collected on real-estate transactions was 25 per cent lower than in the corresponding period in 2007.

Non-bank financial intermediaries

The balance sheets of non-bank financial intermediaries[7] contracted during the second and third quarters of 2008 amid declines in asset prices. These institutions' total assets declined by 3 per cent from the end of the first quarter of 2008 to R3,4 trillion at the end of the third quarter as portfolio holdings were revalued. As a ratio of total assets, shares accounted for 43 per cent in the third quarter and bonds 21 per cent – compared with 52 per cent and 19 per cent respectively in the first quarter. However, the decline in the value of shares and bonds was probably countered somewhat by the revaluation effect of offshore asset holdings due to movements in the exchange value of the rand and switches to cash or cash-equivalent instruments.

7 Consisting of unit trusts, insurers, official and private pension and provident funds.

Assets of selected non-bank financial intermediaries



Public finance

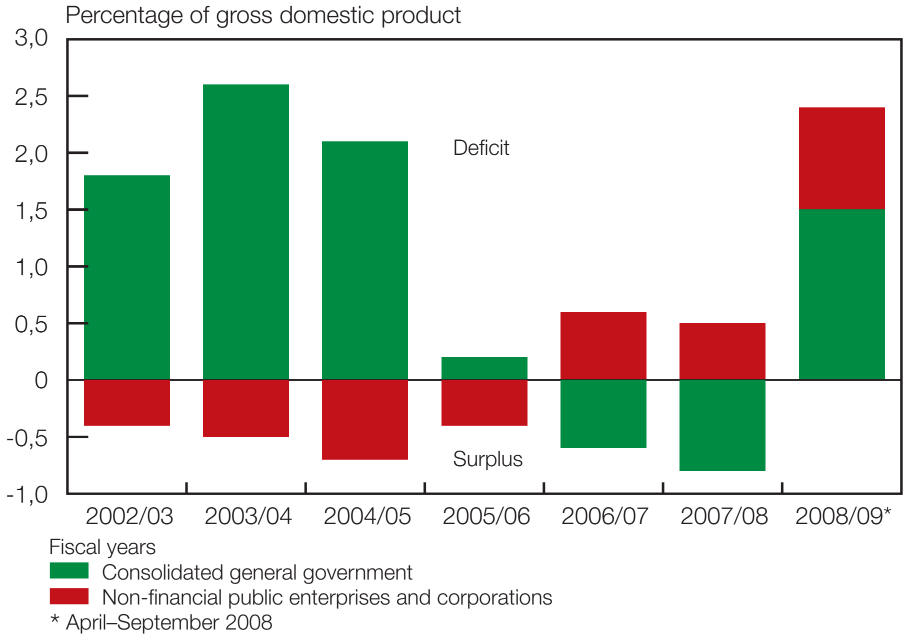
Non-financial public-sector borrowing requirement[8]

Consistent with the drive to improve infrastructure, continued robust spending in the first two quarters of fiscal 2008/09 raised the non-financial public-sector borrowing requirement.

The activities of the *non-financial public sector* resulted in a cash deficit of R28,5 billion in the first half of fiscal 2008/09, compared with a cash deficit of R0,6 billion recorded in the same period a year earlier. As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to 2,5 per cent, compared with a deficit ratio of 0,1 per cent recorded in the same period a year earlier. The widening was in line with the estimated turnaround from a revised surplus of 0,1 per cent in fiscal 2007/08 to an average borrowing requirement of 1,3 per cent over the medium term as stated in the *Budget Review 2008.*

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

Non-financial public-sector borrowing requirement



Financial activities of the various levels of the non-financial public sector are summarised in the accompanying table.

Non-financial public-sector borrowing requirement

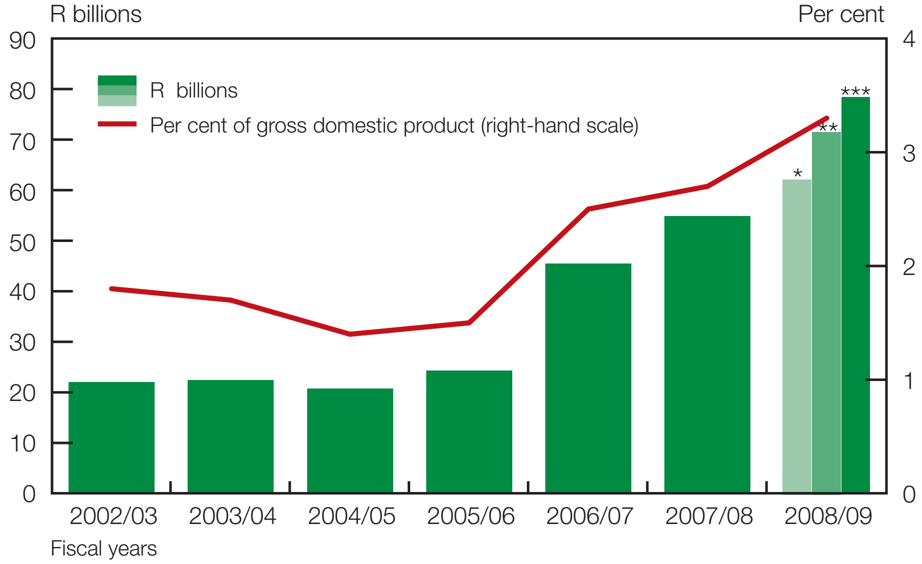
R billions

Level of government	Apr–Sep 2007*	Apr–Sep 2008*
National government	7,2	15,7
Extra-budgetary institutions	-2,7	-6,2
Social security funds	-4,1	-4,4
Provincial governments	-11,1	3,8
Local governments	7,5	8,8
Non-financial public enterprises and corporations	3,8	10,8
Total**	**0,6****	**28,5****

* Deficit + surplus –
** Individual amounts may not add up to the totals due to rounding

The cash deficit of the *non-financial public enterprises and corporations* increased substantially and reached R10,8 billion in the first two quarters of fiscal 2008/09, higher than the cash deficit recorded in the same period a year earlier. Over the same period, net investment in non-financial assets by major non-financial public enterprises trended higher and amounted to R30,8 billion. Capital investment accordingly displayed a year-on-year increase of 35,6 per cent compared with the corresponding period of the previous fiscal year.

Net investment in non-financial assets by public-sector enterprises



* April–September 2008 annualised
** *Budget Review 2008*
*** *Medium Term Budget Policy Statement 2008*

In the first two quarters of fiscal 2008/09, cash receipts from operating activities by *national government* reached R301 billion, which reflected a year-on-year growth rate of 11,8 per cent when compared with the same period a year earlier. Cash payments for operating activities increased by 14,2 per cent to a total of R313 billion during the period under review. 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 R15,7 billion in the first two quarters of the current fiscal year, compared with a cash deficit of R7,2 billion in the same period a year earlier.

An analysis of *Provincial Revenue Fund Statements* indicated that *provincial governments* recorded a cash deficit of R6,0 billion in the July–September quarter of 2008. This brought the cash *deficit* for the first half of fiscal 2008/09 to R3,8 billion, a turnaround from the cash *surplus* of R11,1 billion recorded in the corresponding period a year earlier. Grants received from national government, which include equitable share transfers and conditional grants earmarked for specific purposes, continued to be the main source of provincial receipts. Revenue in this category amounted to R120,8 billion in the first two quarters of fiscal 2008/09 – 16,4 per cent more than in the same period a year earlier.

Cash payments for operating activities by provincial governments totalled R114,9 billion in the first half of fiscal 2008/09, representing an increase of 29,9 per cent compared with the same period of the previous fiscal year. Spending on social services – education, health and social welfare – comprised over half of total provincial spending, with education being the largest spending category, followed by health. Net investment in non-financial assets in April–September 2008 amounted to R13,7 billion or 63,0 per cent more than in the same period a year earlier. This significant increase can mainly be attributed to the Gautrain Rapid Rail Link project.

While provincial governments' deposits with the private-sector banks decreased from R8,4 billion at the end of March 2008 to R6,9 billion at the end of September, their overall indebtedness to banks remained broadly unchanged around R0,4 billion between these respective dates. Their deposits with the Corporation for Public Deposits decreased significantly from R2,4 billion in March 2008 to R0,5 billion in September.

The estimated cash deficit of *local governments* amounted to R8,8 billion in April–September 2008, higher than the cash deficit of R7,5 billion recorded in the corresponding period of the previous fiscal year. Net investment in non-financial assets in April–September 2008 reached R19,5 billion – 29,6 per cent higher than a year earlier. This can be ascribed to an increase in infrastructure spending by municipalities, largely related to preparations for the 2010 FIFA World Cup.

Extra-budgetary institutions recorded an estimated cash surplus of R6,2 billion in the first two quarters of fiscal 2008/09 – higher than the cash surplus of R2,7 billion recorded in the corresponding period of fiscal 2007/08. Preliminary data show that *social security funds* recorded a cash surplus of R4,4 billion, compared with a cash surplus of R4,1 billion a year earlier.

Budget comparable analysis of national government finance

Spending by national government in the first six months of fiscal 2008/09 totalled R301 billion, representing a year-on-year rate of increase of 14,9 per cent. This rate of increase was slightly lower compared with the 15,2 per cent recorded in the first half of the previous fiscal year, stemming from slower growth in transfers by the Economic Services and Infrastructure Development cluster. The cash-flow[9] expenditure broadly followed the same trend. In real terms, growth in expenditure increased by 2,4 per cent in the period under review, significantly lower than the 8,2 per cent real growth recorded in April–September 2007, mainly on account of higher inflation. Expenditure incurred represented just under half of the originally budgeted expenditure for the full fiscal year. The *Budget Review 2008* projected that main budget outlays would increase by 12,8 per cent to R611 billion for the fiscal year 2008/09 as a whole.

9 Adjusted for transactions recorded in the government accounting system but not yet cleared in the banking system, and late departmental requests for funds.

National government expenditure as a ratio of gross domestic product amounted to 26,0 per cent in April–September 2008, slightly lower than the ratio of 26,3 per cent recorded in the corresponding period of the previous fiscal year.

During April–September 2008, interest paid on national government debt amounted to R27,6 billion, representing an increase of 3,6 per cent when compared with April–September 2007. To date, interest payments were R2,1 billion above the half-yearly projection, resulting mainly from switches on domestic government bonds and to a small extent early redemptions on foreign bonds and loans. As a ratio of gross domestic product, interest on government debt equalled 2,4 per cent, slightly lower than the value of 2,7 per cent recorded a year earlier. For fiscal year 2008/09, the *Budget Review 2008* projected that total interest payable on debt would amount to R51,2 billion, or decrease by 3,2 per cent when compared with the previous fiscal year.

Growth in spending included transfers and subsidies, particularly by the Economic Services and Infrastructure Development cluster. This cluster includes the Departments of Provincial and Local Government as well as Transport, which made transfer payments to supplement the infrastructure budgets of provinces and municipalities. In addition, these departments also paid subsidies to public and private corporations towards the 2010 FIFA World Cup infrastructure.

Starting from a low base, spending on capital assets grew at a year-on-year rate of 56,5 per cent and amounted to R3,4 billion in the first six months of fiscal 2008/09, almost equal to the rate of increase evidenced in the same period a year earlier. The bulk of the capital spending was by the Justice and Protection Services cluster, mainly Correctional Services and Safety and Security. Spending was aimed at construction and upgrading of correctional facilities, and acquisition of equipment needed to improve visible policing and detective services. Furthermore, capital outlays were also undertaken by the Department of Land Affairs on land reform programmes and projects. The original budget projected that payments for capital assets would amount to R7,5 billion in fiscal 2008/09 as a whole.

National government revenue continued to grow at a steady pace in the first half of fiscal 2008/09 and amounted to R285 billion, representing a year-on-year rate of increase of 11,7 per cent. Growth in revenue was in line with the originally budgeted projection, mainly driven by taxes on income, profits and capital gains as personal and corporate income taxes displayed a fair degree of resilience despite the economic slowdown. This rate of increase was lower than the average growth rate of 13,9 per cent recorded in the same period of the five fiscal years prior to 2008/09. The *Budget Review 2008* projected that national government revenue would grow by 11,7 per cent to amount to R625 billion for fiscal 2008/09 as a whole.

National government revenue in fiscal 2008/09

Revenue source	Originally budgeted		Actual Apr–Sep 2008	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains	369,8	11,4	178,6	17,8
Payroll taxes	7,5	18,9	3,5	9,7
Taxes on property	14,2	19,6	5,0	-15,6
Domestic taxes on goods and services	218,4	12,2	94,1	7,0
Taxes on international trade and transactions	31,5	16,2	11,9	-5,2
Other revenue	12,9	3,0	6,8	-8,1
Less: SACU** payments	28,9	17,0	14,5	9,7
Total revenue	**625,4**	**11,7**	**285,4**	**11,7**

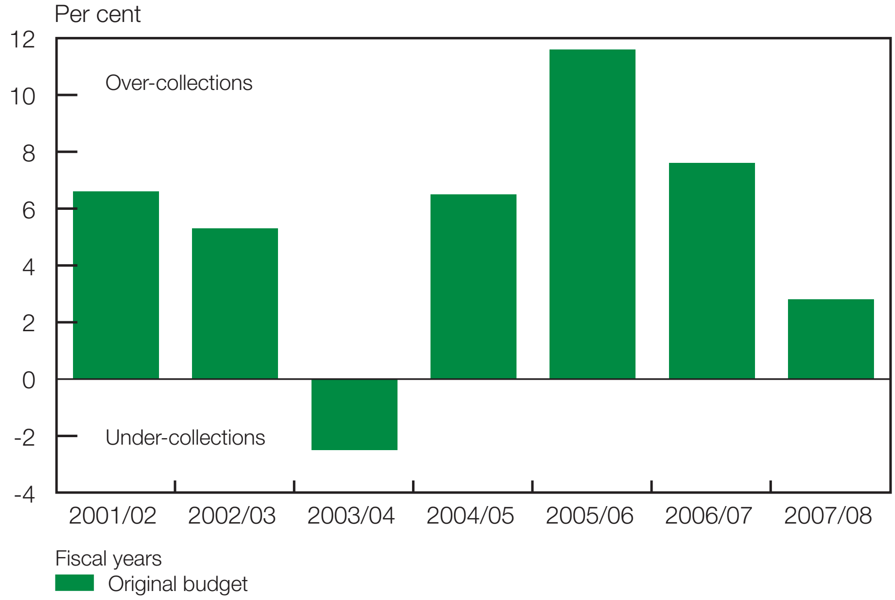
* April–September 2007 to April–September 2008
** Southern African Customs Union

As a ratio of gross domestic product, national government revenue amounted to 24,6 per cent in the period under review, lower than the ratio of 25,7 per cent in the corresponding period of the previous fiscal year.

National government cash-flow revenue amounted to R286 billion, representing a year-on-year rate of increase of 12,7 per cent in the first six months of fiscal 2008/09.

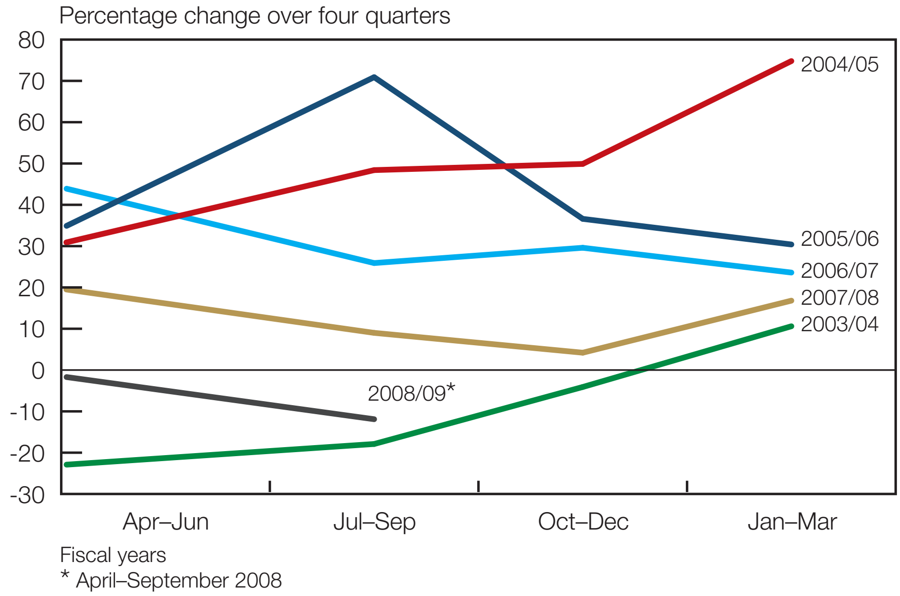
The major revenue category – that is, taxes on income, profits and capital gains – recorded a higher-than-estimated growth rate during April–September 2008. This increase was mainly on account of brisk growth in corporate income tax proceeds alongside the continued improvement in tax-collection efficiency. However, some other categories of taxes recorded sharp declines.

Deviations from budgeted national government tax revenue



During the period under review taxes on property registered a negative growth rate, indicating a contraction in activity in the real-estate market, a turnaround from the originally budgeted projection. Domestic taxes on goods and services rose moderately and followed the growth pattern of value-added tax (VAT), the major component of this tax category. This slowdown was indicative of the slower growth in final consumption expenditure by households, partly due to weaker growth in retail sales. Furthermore, the

Customs duties collected by national government



slow growth rate in VAT was also due to the reduction in customs and excise VAT collections, highlighting the lull in merchandise imports. Collections from taxes on international trade and transactions contracted during April–September 2008, in tandem with the slowdown in domestic demand for imports.

Growth in national government expenditure exceeded growth in revenue collections from April to September 2008, resulting in a cash-book deficit before borrowing and debt repayment of R15,9 billion – some R9,2 billion higher than the deficit recorded in April–September 2007. A surplus of R14,3 billion was originally budgeted for fiscal 2008/09 as a whole. The national government deficit as a ratio of gross domestic product amounted to 1,4 per cent, higher compared with the ratio recorded in the same period a year earlier.

The net result of national government cash-flow revenue and cash-flow expenditure in April–September 2008 was a cash-flow deficit before borrowing and debt repayment of R14,4 billion – significantly exceeding the cash-flow deficit recorded in the corresponding period of the previous fiscal year.

Extraordinary receipts amounted to R1,8 billion and included special restructuring proceeds from the South African Special Risks Insurance Association (SASRIA). After taking into account extraordinary transactions and cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R15,7 billion in April–September 2008, almost triple the net borrowing requirement recorded a year earlier.

As indicated in the accompanying table, the net borrowing requirement in the first six months of fiscal 2008/09 was financed through issuance of short- and long-term debt instruments in the domestic capital market. During this period, short-term instruments were sold at an average rate of 11,2 per cent, whereas long-term funding was obtained at an average yield of 9,5 per cent per annum.

National government financing in fiscal 2008/09

R billions

Item or instrument	Originally budgeted	Actual Apr–Sep 2008	Actual Apr–Sep 2007
Deficit	-14,3	14,4*	5,2*
Plus: Extraordinary payments	0,3	1,0	1,0
Cost on revaluation of foreign debt at redemption	1,8	2,1	1,0
Less: Extraordinary receipts	0,3	1,8	1,6
Net borrowing requirement**	**-12,7**	**15,7**	**5,7**
Treasury bills	5,8	8,5	5,9
Domestic government bonds	5,9	13,6	13,1
Foreign bonds and loans	-1,7	-1,8	-3,2
Change in available cash balances***	-22,7	-4,6	-10,1
Total net financing	**-12,7**	**15,7**	**5,7**

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

The National Treasury announced switch auctions during the July–September quarter of fiscal 2008/09, where primary market participants were allowed to switch the short-dated R153 bond to longer-term R186, R207 and R208 bonds.

Owing to issues and redemptions of domestic marketable bonds, the average outstanding maturity on these bonds increased from 104 months to 110 months between March and September 2008.

Funding activities of national government increased government's cash balances by R4,6 billion during the first six months of 2008/09, bringing the level of these balances to R99,1 billion at the end of September 2008. National government's deposits with the Bank increased by R1,9 billion and amounted to R65,9 billion at the end of September 2008. As one of the Bank's major liabilities, these deposits are partly used to finance the Bank's acquisition of foreign assets. At the same time, deposits with commercial banks increased by R2,7 billion, bringing the balance to R33,2 billion at the end of September 2008.

Total loan debt of national government increased from R572 billion at the end of March 2008 to R592 billion at the end of September. As a ratio of gross domestic product, national government total loan debt decreased from 27,6 per cent to 26,5 per cent between these two dates.

Foreign debt as a component of total loan debt decreased from R96,2 billion to R88,5 billion over this period. The decrease in foreign debt could mainly be attributed to early redemptions of foreign bonds and loans. In managing external vulnerability, the share of foreign debt in total loan debt declined further from 16,8 per cent to 14,9 per cent between March and September 2008 – both falling well within the range of values which the South African authorities view as appropriate. In fact, South Africa's debt ratios compare favourably with other emerging markets and several Organisation for Economic Co-operation and Development member countries.

However, as a result of further issues the average outstanding maturity of foreign marketable bonds of national government increased slightly from 81 months at the end of March 2008 to 82 months at the end of September.

The *Medium Term Budget Policy Statement 2008*

The Minister of Finance tabled the *2008* MTBPS before Parliament on 21 October, against a backdrop of severe global turmoil. It provided for a modest national government budget deficit over the medium term, contrary to the surpluses which were previously projected. Given signs of global recession, the cyclical benefits which South Africa enjoyed were projected to abate following subdued markets and lower commodity prices, thereby reducing tax revenues. Nevertheless, the prudent macroeconomic and fiscal policies that had been followed over the past decade ensured that the economy was well cushioned to weather the storm.

In the light of imminent changes in the methodology used to compile the consumer price index, the introduction of a new inflation target measure was announced in the 2008 MTBPS. Replacing the overall CPIX[10], the new headline consumer price index (CPI for all urban areas) would be the officially targeted measure of inflation from 2009. The target band for headline CPI would remain unchanged at 3–6 per cent. As shown in the table on page 51, the projected inflation rates for 2008, 2009 and 2010 were raised in the MTBPS when compared with the February *2008 Budget Review*. The surge in oil and food prices caused the projected value of 2008 in particular to be increased considerably. At the same time, projected growth in real gross domestic product was reduced by a significant margin, recognising the deteriorating global and domestic economic environment.

10 The overall consumer price index for metropolitan and other urban areas, excluding interest cost on mortgage loans for metropolitan and other urban areas.

Macroeconomic projections, 2008–2011

Per cent annual data

Variable	Revised estimate			Forecast			
	2008		2009		2010		2011
	Feb*	Oct**	Feb*	Oct**	Feb*	Oct**	Oct**
Real growth rate	4,0	3,7	4,2	3,0	4,6	4,0	4,3
Targeted inflation rate	7,1	11,6	4,9	6,2***	4,7	5,3***	4,7***

* *Budget Review 2008*
** *Medium Term Budget Policy Statement*, October 2008
*** Headline CPI inflation

Whereas the February *2008 Budget Review* projected a strong trajectory for government revenue on account of improved tax administration, strength of the economic base and cyclical economic factors, the October 2008 MTBPS showed revenue growth moderating and tax revenue as a percentage of gross domestic product edging lower in tandem with slower economic activity owing to global and domestic headwinds. With economic growth receding and commodity prices falling back from exceptionally high levels, the cyclical component of revenue was expected to decline.

The 2008 MTBPS provided for additional national government spending of R55,2 billion over the original February 2008 Budget, earmarked for national departments, provinces and local governments. These amounts would counter the effects of higher inflation, especially on salaries, social grants, fuel and capital projects. Moreover, it was geared towards strengthening the ability of provinces and municipalities to deliver services of a better quality; to invest in and maintain key infrastructure; and to support labour-intensive delivery of services. A particularly large increase in government expenditure in 2009/10 was provided for, as reflected in the accompanying table.

Fiscal projections

Per cent

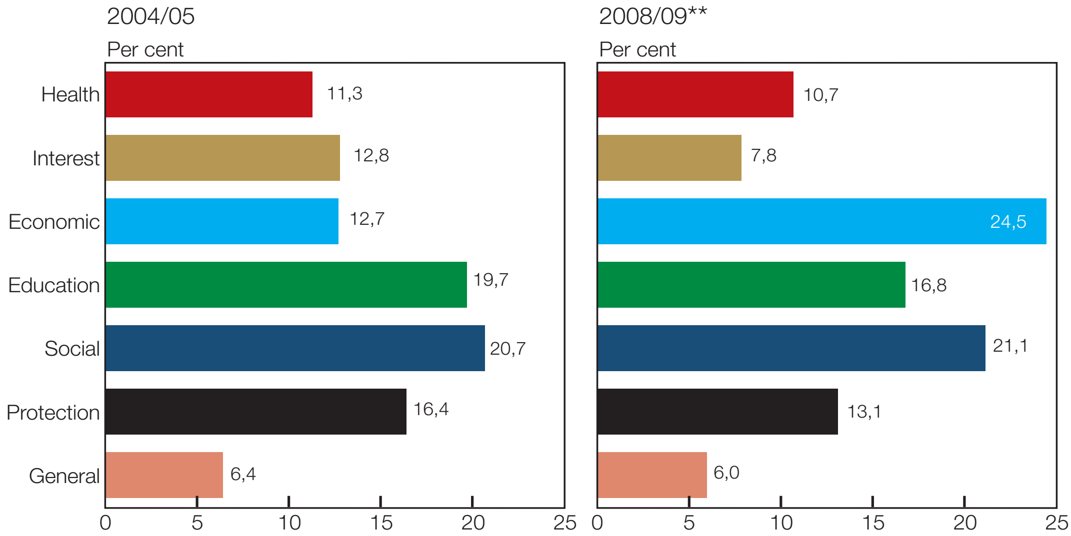
Components	Ratio of gross domestic product						
	2008/09		2009/10		2010/11		2011/12
	Feb*	Oct**	Feb*	Oct**	Feb*	Oct**	Oct**
Consolidated national government							
Revenue	28,4	27,6	28,7	27,4	28,6	27,3	27,4
Expenditure	27,6	27,5	28,1	29,0	27,9	28,4	27,4
Balance***	0,8	0,1	0,6	-1,6	0,7	-1,1	0,0
General government borrowing requirement	-0,5	0,1	-0,4	1,8	-0,5	1,3	0,2
Public-sector borrowing requirement	1,2	1,3	1,4	3,0	1,4	3,2	2,6

* *Budget Review 2008*
** *Medium Term Budget Policy Statement*, October 2008
*** Deficit – surplus +

A consolidated national government *surplus* of 0,6 per cent of gross domestic product was originally envisaged for fiscal 2009/10. Given the change in the global and domestic economic environment, by the time of the MTBPS a *deficit* of 1,6 per cent of gross domestic product was projected for fiscal 2009/10. Nonetheless, it was expected that government would continue to contribute positively to national saving throughout the medium-term period, as growth in capital spending would keep abreast of recurrent expenditure. Although the slowdown in cyclical revenue would put pressure on government saving, it would be offset by continued adjustment in the composition of spending, with infrastructure outlays growing more rapidly as a share of total expenditure.

Increased capital budget allocations reflected government's priorities, with additional funds flowing to public transport, education, health, social development, justice and protection services, as well as housing. In addition, a number of new prisons were being constructed through public-private partnerships.

Functional classification of budgeted government* expenditure



* Consolidated national and provincial government and social security funds
** *Medium Term Budget Policy Statement,* October 2008

As indicated in the MTBPS, total public-sector infrastructure expenditure from 2009/10 to 2011/12 was projected to amount to R693 billion – R124 billion higher than the estimate in the *2008 Budget Review*, largely ascribed to Eskom's revised capital expenditure plan. Public enterprises would shoulder the lion's share of the capital investment programme. Growth in investment by public enterprises over the past four years averaged 15,9 per cent per annum in real terms. Indications are that it would accelerate and is expected to average about 20 per cent a year over the medium term.

The public-sector borrowing requirement as a ratio of gross domestic product was projected to increase slightly further from the originally budgeted ratio of 1,2 per cent to 1,3 per cent in fiscal 2008/09. Furthermore, the MTBPS provided for substantially larger borrowing requirements in 2009/10 and 2010/11, whereafter it was projected to decrease to 2,6 per cent in fiscal 2011/12. Accelerated capital investment programmes, combined with a more challenging economic environment, resulted in the public sector moving from a surplus in 2007/08 to borrowing requirements over the medium term. Short-term increases in the main budget borrowing requirement are associated with a R60 billion loan to support Eskom's capital investment programme.

Statement of the Monetary Policy Committee

9 October 2008

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

Introduction

Since the previous meeting of the MPC the turmoil on global financial markets has intensified. This development has impacted negatively on the outlook for the international economy. As the banking crisis has deepened, global markets have been characterised by declining equity prices, exchange rate volatility and widening spreads on emerging-market debt. The prices of many commodities, including oil, have also declined, although gold is a notable exception by virtue of its safe-haven status.

Governments and central banks have undertaken various actions, both individually and in concert. The South African banking and financial system remains stable. However, domestic financial markets have experienced the impact of these developments. The domestic equity market has suffered losses in line with international markets, and the exchange rate of the rand has been negatively affected by increased global risk aversion, resulting in higher volatility and a significant depreciation. The South African Reserve Bank (the Bank) is monitoring developments closely.

The inflation outlook remains uncertain, as the risk profile has changed somewhat. The outlook has improved on account of the lower oil prices, but the exchange rate has emerged as a significant risk factor.

Recent developments in inflation

CPIX inflation increased from 13,0 per cent in July 2008 to 13,6 per cent in August. Food and petrol price increases were again the main contributors to this rising trend. Food prices increased at a year-on-year rate of 19,2 per cent in August, driven to a significant extent by grain product prices which increased by 36,5 per cent. Petrol prices increased at a year-on-year rate of 45,9 per cent in August, despite the 30 cent per litre reduction in the petrol price in that month. If food and petrol were excluded, CPIX inflation would have measured 8,1 per cent in August, compared with 7,4 per cent and 6,3 per cent in the prior two months. The significant upward trend in this measure was mainly due to electricity price increases of 23,9 per cent and 28,2 per cent in July and August respectively, but it also reflects continued generalised inflation pressures.

Producer price inflation also remained strong. Producer prices increased at a year-on-year rate of 19,1 per cent in August. The rate of increase in agricultural food prices declined to 2,3 per cent, but manufactured food price inflation remained elevated at over 20 per cent.

The outlook for inflation

The most recent central forecast of the Bank shows a moderate improvement in the inflation outlook since the previous MPC meeting, although the peak is slightly higher. As was the case at the previous meeting, some assumptions were made to try to account for the rebasing and reweighting of the CPI basket that will be introduced by Statistics South Africa in January 2009. Inflation is expected to peak at an average rate of 13,3 per cent in the third quarter of this year, and to average 6,9 per cent in 2009, after a significant decline in the first quarter of that year. Consumer price inflation is still expected to return to within the inflation target range only in the second quarter of 2010, and to reach a level of 5,5 per cent in the final quarter of that year.

According to the most recent inflation expectations survey conducted on behalf of the Bank by the Bureau for Economic Research (BER) at Stellenbosch University, CPIX inflation is expected to average 10,2 per cent in 2008 and 8,1 per cent and 7,4 per cent in 2009 and 2010 respectively. The increases in respect of 2009 and 2010 were significantly smaller than the increases observed in the previous survey. However, only the financial analysts expect inflation to return to within the target range by 2010. This is similar to the Reuters consensus survey conducted in August which indicates that inflation is expected to average 7,5 per cent in 2009 and 5,9 per cent in 2010.

Inflation expectations as measured by the yield differential between conventional government bonds and inflation-linked bonds indicated some improvement in expectations over the longer term. The break-even inflation expectation declined from just over 9 per cent in July 2008 to around 6,3 per cent at the end of September. The yield curve has remained inverted but has moved down since the previous meeting.

The continued upward trend in wage settlements also indicates that inflation expectations are not well anchored. According to the Quarterly Economic Survey of Statistics South Africa, year-on-year growth in unit labour cost measured 10,5 per cent in the second quarter of 2008, compared with 10,7 per cent in the previous quarter. The most recent Wage Settlement Survey of Andrew Levy Employment Publications shows that the average wage settlement rate increased to 9,6 per cent in the nine months to September 2008 compared with 8,3 per cent in the six months to June 2008.

The turmoil in international financial markets has resulted in some changes in the balance of risks as perceived by the MPC. The most significant of these changes relate to oil price and exchange rate developments.

The recent depreciation in the rand exchange rate poses a significant upside risk to the inflation outlook. Following the initial rejection by the US Congress of the Troubled Asset Relief Program (TARP), there was significant volatility in foreign-exchange markets as the dollar strengthened against a number of major currencies, particularly against those in emerging-market economies. The domestic foreign-exchange market was also affected, and the rand is currently trading at around R9,12 against the US dollar, compared with R8,00 at the previous MPC meeting. On a trade-weighted basis, the rand has depreciated by around 20 per cent since the beginning of the year and by almost 9 per cent since the previous meeting. The impact of the exchange rate on the inflation outlook will depend, to a significant degree, on the extent to which these new levels are sustained.

In most other instances the risks to the outlook have declined or remained unchanged. International oil prices have declined considerably over the past few weeks. Having peaked at around US$145 per barrel in July 2008, the price of North Sea Brent crude oil (Brent) has declined to current levels of around US$83 per barrel. At the time of the previous MPC meeting Brent was trading at US$112 per barrel. In line with these oil market developments, the price of 95 octane petrol in Gauteng has declined by a total of R1,29 per litre since August. The impact of the lower international oil prices on domestic petrol prices will be offset to some extent by the recent depreciation of the rand against the dollar.

As noted, food price inflation remains elevated, although agricultural price inflation at producer price level has declined further. International rice prices appear to have peaked and both maize and wheat prices are currently below the peaks reached earlier in 2008 in the global and domestic markets. Favourable base effects are also expected to contribute to a declining trend in food price inflation. However, food prices are expected to remain elevated in the short term, as evidenced by high increases in processed food prices at the producer level.

Household consumption expenditure has remained subdued in line with declining growth in disposable income and the less accommodative monetary policy stance. Growth in household consumption expenditure declined to 1,2 per cent in the second quarter of 2008 as expenditure on durable goods contracted by almost 15 per cent. This is reflected in the further decline in motor vehicle sales in September at a year-on-year rate of almost 20 per cent. Retail and wholesale trade sales growth have continued their negative trends. The latest FNB/BER Consumer Confidence Index shows an improvement relative to the second quarter, but remains at levels last seen in 2004.

Credit extension to the private sector exhibited further moderation. Growth over twelve months in total loans and advances to the private sector declined from 21,3 per cent in June 2008 to 19,7 per cent in August. Growth in mortgage advances moderated to 17,6 per cent in August 2008 while instalment sale credit and leasing finance grew by 11,3 per cent. The slower growth in credit extension to households is reflected in the ratio of debt to disposable income which declined in the second quarter of 2008 to 76,7 per cent.

Asset prices have been significantly affected by the recent global market turmoil and the softer trend in commodity prices. The associated negative wealth effects could contribute to a further moderation in consumption expenditure growth. The all-share index on the JSE Limited has declined by about 27 per cent since the beginning of the year, and by about 25 per cent since the previous MPC meeting. The housing market is also subdued with the Absa and Standard Bank House Price indices continuing to record negative real house price growth.

Domestic economic growth appears to be moderating, despite the rebound in the second quarter of 2008 when GDP growth of 4,9 per cent was recorded. This improvement was mainly the result of base effects following the 2,1 per cent growth rate recorded in the first quarter of 2008. Short-term indicators suggest that growth in the third quarter is likely to be subdued and that growth will remain below its estimated potential rate. The composite leading indicator of the Bank declined further in July and the RMB/BER Business Confidence Index also declined further in the third quarter of this year. The manufacturing sector remains under pressure as seen in the weaker trend in the volume of manufacturing production, as well as in the Investec/BER Purchasing Managers Index. Growth in real gross fixed capital formation remained relatively robust, despite declining from 16,9 per cent in the first quarter to 9,1 per cent in the second quarter. Investment expenditure is expected to underpin a positive growth rate.

Developments in the international markets have already had a negative impact on growth in a number of regions and global growth forecasts are being revised down further, particularly in the OECD countries. The slowing world economy is also likely to have an adverse effect on domestic growth prospects. The continuing crisis has led to a generally more accommodative monetary policy stance in a number of countries, and some governments and central banks are taking unprecedented steps to help stabilise the situation. At this stage it is unclear how the crisis will unfold, but heightened risk and uncertainty are likely to persist for some time.

Monetary policy stance

The MPC considered recent developments in the South African economy and the risks to the inflation outlook against the backdrop of conditions prevailing in the international financial markets. The MPC is of the view that an unchanged monetary policy stance is appropriate at this stage. Accordingly, the repurchase rate remains at 12 per cent per annum. The MPC remains committed to, and focused on, the achievement of the Bank’s mandate.

Note on the treatment of debt securities in the balance of payments

by M Kock, H Coetzer and L Motsumi[1]

1 The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank. The authors wish to thank S Walters, P Swart and Z Nhleko for comments and input.

Introduction

The South African Reserve Bank (the Bank) is the official compiler of South Africa's balance of payments. The purpose of this note is to clarify how debt security information is sourced, compiled and treated methodologically in the financial account of the balance of payments. Particular attention is given to the information obtained from the Bond Exchange of South Africa Limited (BESA),[2] and the note specifically addresses the treatment of the different types of non-resident bond transactions.

2 BESA is the formal licensed exchange for bonds in South Africa.

Sourcing and compilation

The Research Department of the Bank obtains detailed daily information on non-resident bond transactions on BESA directly from Strate. Strate is the authorised Central Securities Depository for electronic settlement of all financial instruments in South Africa and it effects and records the change of ownership of bonds.

All transactions in South African rand-denominated bonds to which a non-resident is a counterparty are included in the electronic download from Strate. In addition to normal trade-related information per individual transaction, the Bank also sources information regarding transaction types, the domestic counterparty's economic sector, and the non-resident counterparty's country of residence. The non-resident bond transaction data are aggregated in such a way that they include all matched deals. Matched deals are all valid deals (i.e., all the deal particulars entered by the seller match those entered by the buyer). If the details do not match, the deal is rejected by both BESA and Strate.

Table 1 Non-residents' net South African bond transactions in 2007

As aggregated by BESA	As aggregated by the Bank[(a)]						
	Transaction types						
Total	Total matched[(b)]	Outright[(c)]					Repos
		Total	Spot and standard	Options exercised	Free-of-value	Structured deals	
	(1 + 2 + 3 + 4 + 5)	(1 + 2 + 3 + 4)	(1)	(2)	(3)	(4)	(5)
16 032	20 046	19 758	6 117	1 930	7 236	4 475	288

Net purchases + net sales –
(a) As calculated by the South African Reserve Bank
(b) Matched trades include all transaction types
(c) Outright trades exclude repurchase agreements

Sources: BESA and Strate

The Bank applies the matched trade convention as best practice for the compilation of macroeconomic statistics. All matched trades are included and such trades can only be excluded if modified through a related equal and opposite trade or a reversal through an unrelated trade by the same counterparties. BESA applies different principles in determining the relevance of transactions included in its aggregated totals based on its requirements. Certain transactions – so-called excluded trades – are not incorporated in the BESA totals. These conventions account for the differences between the numbers compiled by the Bank and those disseminated by BESA, as shown in Table 1.

The balance of payments reflects all transactions between residents and non-residents. In the case of bonds, the bulk of these transactions are conducted through BESA with a change of ownership recorded by Strate. The data feed from Strate for the various transaction types therefore constitutes a central building block in the compilation of balance-of-payments statistics.

The data in Table 2, in the next section, are based on calculations by the Bank in adherence to the guidelines of the *Balance of Payments Manual* of the International Monetary Fund (IMF). The guidelines require that transactions in financial assets be recorded when economic ownership changes and for securities the transaction date (the time of the change in ownership of the securities) may precede the settlement date (the time of delivery of the securities).

Bond transaction types and the methodological treatment thereof in the balance of payments

In this section each transaction type distinguished in Table 1 is discussed briefly.

A *spot trade* is a straightforward transaction. It becomes a matched trade when both BESA and Strate verify that the transaction details, according to both the buyer and the seller, are the same. A matched spot trade settles on t+3.[3] A *standard trade* is also a matched trade, but settlement is not t+3. In standard trades the counterparties agree on a specific settlement date.

3 t+3 means that settlement takes place three working days after the deal has been matched.

Normally, spot and standard trades do not involve any further connected transactions. Therefore, such transactions between non-residents and South African residents are recorded as a change in "portfolio investment liabilities" in the financial account of the balance of payments.

A *free-of-value (FOV) transaction* is a central securities depository transfer of ownership, with no record of settlement of payment attached to the transaction. A bond transaction is classified as an FOV transaction type when the counterparties instruct Strate only to record a change of ownership with no instruction to settle in terms of value. As a consequence, there is no record of whether settlement occurred by means of cash or asset swap, or whether payment was made at all. FOV transactions are mostly conducted between related parties due to inherent counterparty risk.

FOV transactions are recorded as "portfolio investment liabilities" in the financial account of the balance of payments. Large FOV transactions are individually investigated to identify the appropriate contra-entries in the balance of payments. Otherwise, the contra-entry for FOV transactions between non-residents and residents is shown as an "asset" in the "other investment category" of the financial account to ensure that the double-entry system, on which the compilation of the balance of payments is based, is adhered to. In this case an increase in "portfolio investment liabilities" (an inflow of capital where a non-resident purchased a bond from a resident in an FOV trade) would be countered by an increase in "other investment assets" (an outflow of capital) as it is assumed that funds did not flow into South Africa. Conversely, if an FOV bond sale to a resident by a non-resident is recorded, resulting in a decrease in "portfolio investment liabilities" (an outflow of capital), it is countered by a decrease in "other investment assets" (an inflow of capital) as funds did not flow out of South Africa. In this way the double-entry system is maintained; otherwise the contra-entry would probably have fallen by default under "unrecorded transactions" in the balance of payments.

Table 2 Treatment of debt securities in the balance of payments in 2007

Financial account of the balance of payments	R millions	
Portfolio investment		
Liabilities		
Spot and standard trades[a]	6 117	
Free-of-value trades[a]	7 236	
Structured deals[a]	4 475	
Options exercised[a]	1 930	
Subtotal: outright trades[a]		19 758
Redemption of rand-denominated domestic bonds[b]	-2 707	
International bond issues, redemptions and amortisation[b]:		
Government	-6 883	
Parastatals	277	
Private sector	23 238	
Banks	10 671	
NCDs of South African banks[b]	916	
Subtotal: other debt securities[b]		25 512
Subtotal: Portfolio investment liabilities – debt securities		45 270
Portfolio investment liabilities – shares[b]		62 104
Total: Portfolio investment liabilities as recorded in the BoP[e] *(=5644)*[c]		107 374
Other investment		
Liabilities		
Repurchase transactions[a]	-276	
Other[b]	58 535	
Subtotal: other investment liabilities as recorded in the BoP[e] *(=5650)*[c]		58 259
Assets		
Repurchase transactions[a]	564	
Free-of-value trades[a], [d]	8 253	
Other[b]	-6 696	
Subtotal: other investment assets as recorded in the BoP[e] *(=5666)*[c]		2 121
Total: Net other investment as recorded in BoP[e] *(=5685)*[c]		60 380

(a) Data sourced from BESA and Strate as calculated by the South African Reserve Bank
(b) Data from other sources as calculated by the South African Reserve Bank
(c) Series as published in the statistical table on page S–78 of the December 2008 *Quarterly Bulletin*
(d) The contra-entry for free-of-value transactions as recorded under portfolio investment liabilities. This excludes free-of-value transactions with South African banks as counterparties, as it is included under other assets
(e) BoP refers to balance of payments

A bond transaction is classified as a *structured deal* (SD) where such a transaction is structured on the back of a transaction in another asset. This could typically be asset-backed swaps, such as swapping bonds for equities or vice versa. Payment is effected through the exchange of assets of similar value. With structured deals, which typically involve the exchange of assets of similar value, the bond component of the transaction usually trades at a yield away from the normal market yield. Structured deals are recorded under “portfolio investment liabilities” in the financial account of the balance of payments.

Options-related bond transactions are classified as *options exercised* (OX) and are usually priced outside the daily price or yield ranges at a yield away from the market with full settlement.[4] Options on underlying bonds are traded in the over-the-counter (OTC) market and when such options are exercised it results in a transaction in the underlying bond. Options exercised are recorded under “portfolio investment liabilities” in the financial account of the balance of payments.

4 Full settlement is change of ownership against payment (cash or other assets), that is, simultaneous delivery-versus-payment.

A *repurchase agreement* (repo) is an arrangement involving the sale of securities at a specified price with a commitment to repurchase the same or similar securities at a fixed price on a specified future date (usually very short term, for example overnight or one day) or on a date subject to the discretion of the purchaser. A repurchase transaction therefore consists of two separate linked transactions, with one being a buy and the other a sell. Legal ownership of the securities involved is transferred with these buy-/sell-back transactions in each of the linked transactions which constitute the repurchase agreement. The economic nature of a repo is similar to that of a collateralised loan[5] in the sense that the purchaser of the securities is providing funds to the seller for the period specified in the agreement and is receiving a return from the fixed price when the repurchase agreement is reversed.

5 A collateralised loan is backed by the securities traded in the repurchase transaction.

In the balance of payments, a repo transaction is treated as a loan. It is recorded as a newly created financial asset or liability in the form of a collateralised loan extended to a non-resident or received from a non-resident, rather than as an asset or liability constituting the underlying securities used as collateral. As a result, it does not form part of “portfolio investment liabilities” like the other transaction types. It is excluded from the outright trades and is recorded as “other investment assets or liabilities” in the “other investment category” of the financial account of the balance of payments as a loan.

All outright non-resident transactions in rand-denominated bonds, as listed in the top part of Table 2, are recorded in the “portfolio investment liability” category in the financial account of the balance of payments. Further sources are utilised to compile a balance-of-payments statement as far as debt securities are concerned with regard to the redemption of rand-denominated domestic bonds held by non-residents; the issuance, redemption and amortisation of bonds issued by South African residents denominated in rand and other currencies in the international financial markets; and non-resident transactions in negotiable certificates of deposit (NCDs) issued by the South African banking sector.

The contra-entry for FOV trades in the bottom part of Table 2 is recorded in the “other investment” category as part of “other investment assets”. Repurchase transactions in the bottom part of Table 2 are recorded in the “other investment” category as part of either “other investment assets” or “other investment liabilities”.

Conclusion

This note illustrates that the non-resident bond transaction statistics of the Bank, as published in the financial account of the balance of payments, incorporate all the non-resident transactions conducted through BESA and recorded by Strate. Perceived differences between data sets from various sources can be reconciled. The compilation process is robust and facilitates detailed analysis.

Note on the revision of South Africa's nominal and real effective exchange rate indices

by L Motsumi, M Oldfield, A Mokoetla, P Swart and B C de Beer

Introduction

The effective exchange rate indices calculated by the South African Reserve Bank (the Bank) were revised comprehensively in 1999, with a minor amendment in 2003. Subsequently, the country's international trade patterns have changed significantly, prompted by forces such as shifts in global and domestic demand, the continued expansion and diversification of the domestic economy, the conclusion of new trade agreements and further adjustments to import duties. These developments in South Africa's international trade patterns necessitated a reassessment of the nominal effective exchange rate and real effective exchange rate. This note briefly discusses the revisions introduced on account of the reassessment.

Methodology

The initial calculation of a competitiveness indicator for South Africa in 1999 was based on the guidelines contained in the Information Notice System (INS) of the International Monetary Fund (IMF). The methodology used to calculate the Bank's measure of external price competitiveness is described in a note by S S Walters and B C de Beer titled "An indicator of South Africa's external competitiveness", which was published in the September 1999 *Quarterly Bulletin*. This methodology was retained for the current revision exercise.

The nominal effective exchange rate reflects movements in the external value of the rand against a basket of currencies of the country's main trading partners. The real effective exchange rate is the nominal effective exchange rate adjusted for the inflation differential between South Africa and its major trading-partner countries. In calculating these two indices, each currency in the basket should be assigned an appropriate weight. As before, the weighting scheme chosen continues to reflect trade in manufactured goods. Accordingly, the real effective exchange rate of the rand may be regarded as a barometer of external competitiveness in manufacturing. The weights assigned to the selected trading partners reflect the price competition between South African exports and locally produced goods in foreign markets, between imports from the rest of the world and locally produced goods in South Africa, and between South African exports and exports of other countries in third-currency markets. Relevant formulae are shown in Annexure A.

In compiling the Bank's effective exchange rate indices, trading-partner countries or areas were selected on the basis of their relative importance in South Africa's bilateral trade. Foreign trade patterns for the period 1994–1996 formed the basis of the previously calculated indicators. For the new indicators, data for the period 2003–2005 on trade between South Africa and its trading partners, and between each pair of trading partners were extracted from the database of the United Nations. As in the previous calculation, the data covered trade in manufactured goods – specifically goods included in Standard International Trade Classification (SITC) categories 5 to 8, but excluding SITC category 68.[1]

The number of trading-partner countries or areas selected and incorporated into the calculation was revised from 13 to 15, focusing on those countries or areas that each represented more than 1 per cent of South Africa's total bilateral trade in manufactured goods. Overall, South Africa's trade with these 15 countries or areas covered almost 86 per cent of its total imports and 77 per cent of its total exports of manufactured goods. Allowing

1 SITC-5 – Chemicals and related products
SITC-6 – Manufactured goods classified chiefly by material
SITC-7 – Machinery and transport equipment
SITC-8 – Miscellaneous manufactured articles
SITC-68 – Non-ferrous metals

for not only bilateral import and bilateral export, but also for third-market competition, the revised weights are shown in Table1.

Table 1 Revised weights based on international trade in manufactured goods

Country/area	Bilateral import weight	Bilateral export weight	Third-market weight	Total weight
Euro area	43,04	25,58	25,70	34,82
United States	13,29	19,12	14,20	14,88
China	12,70	2,85	21,64	12,49
United Kingdom	10,23	13,98	8,52	10,71
Japan	7,19	15,77	11,00	10,12
Switzerland	1,83	4,42	3,47	2,83
Australia	1,64	4,54	0,43	2,04
India	2,06	2,18	1,73	2,01
Sweden	2,27	0,63	2,70	1,99
Republic of Korea	0,24	2,55	5,23	1,96
China, Hong Kong SAR	1,39	1,87	1,30	1,48
Singapore	1,23	0,93	2,22	1,40
Brazil	1,79	0,92	0,91	1,37
Israel	0,84	1,89	0,95	1,11
Zambia	0,27	2,77	0,002	0,80
Total	100,00	100,00	100,00	100,00

Table 2 A comparison between previous and revised weights

Country/area	Previous weight Per cent	Revised weight Per cent
Euro area	36,38	34,82
United States	15,47	14,88
China	3,14	12,49
United Kingdom	15,37	10,71
Japan	10,43	10,12
Switzerland	5,54	2,83
Australia	1,68	2,04
Sweden	1,81	1,99
India	–	2,01
Republic of Korea	2,64	1,96
China, Hong Kong SAR	2,70	1,48
Singapore	1,66	1,40
Brazil	–	1,37
Israel	1,22	1,11
Zambia	–	0,80
Canada	1,96	–
Total	100,00	100,00

As shown in Table 2, the importance of China in South Africa's external trade in manufactured goods increased substantially from 1994–1996 to 2003–2005. The outcome of the revision confirmed that the euro area and the United States of America remained South Africa's largest trading partners in manufactured goods, while the United Kingdom lost its third position to China to become the fourth largest partner. As a result, Japan moved to the fifth position. New partner countries whose trade with South Africa had increased over time were added, namely Brazil, India and Zambia. Conversely, Canada's share of trade with South Africa receded over time, leading to the exclusion of the Canadian dollar from the new basket.

Figure 1 illustrates that the difference between the old and the new nominal effective exchange rate index is small, reflecting that, with few exceptions, global trade patterns change only gradually.

Figure 1 Nominal effective exchange rate of the rand

In calculating a real effective exchange rate index for South Africa, the Bank opted to use producer price indices for manufactured goods, since these indices are aligned with the calculation of a competitiveness indicator for the manufacturing sector and are readily available for the set of trading-partner countries identified by the Bank. Overall, producer prices rather than prices of manufactured goods would be less relevant and susceptible to greater volatility, due to the inclusion of commodity prices in overall producer prices.

Figure 2 compares the previously used and new real effective exchange rates with each other. Differences between the two barometers of competitiveness are fairly small, although larger than those for the nominal effective exchange rate.

Figure 2 Real effective exchange rate of the rand

Conclusion

The newly calculated indices of the nominal and real effective exchange rates of the rand incorporate currency weights based on patterns of international trade in manufactured goods for the period 2003–2005, and display movements that are similar to the previously published indices. The revised set of weights will be applied in the calculation of the nominal and real effective exchange rates as from 1 January 2005. As the revised series will be statistically linked to the previously calculated effective exchange rate time series from that date, data prior to 1 January 2005 will not be affected by the revision exercise.

The implementation of the revised series will improve the assessment of South Africa's competitiveness in global markets, as well as the analysis of movements of, and trends in, the exchange value of the rand against a basket of currencies. While no single indicator provides an incontestable measure of competitiveness, the real effective exchange rate index gives an indication of cost and price competitiveness in international trade in manufactured goods.

Annexure A: Formulae

The following formulae were used in calculating appropriate exchange rate weights: X_i^k (M) represents country i's exports of manufactured goods to market k. s_j^k (M) represents country j's share of all manufactured exports to market k and w_i^k(M) is the share of country i's exports of manufactured goods shipped to market k. Therefore,

$$s_j^k(M) = \frac{X_j^k(M)}{\Sigma_{1 \neq k} X_i^k(M)}$$

$$w_i^k(M) = \frac{X_i^k(M)}{\Sigma_{n \neq i} X_i^n(M)}$$

β_i^m(M) and β_i^x(M) represent the share of imports and exports in country i's international trade in manufactured goods.

$$\beta_i^m(M) = \frac{\Sigma_{1 \neq i} X_1^i(M)}{\Sigma_{1 \neq i} X_1^i(M) + \Sigma_{n \neq i} X_i^n(M)}$$

$$\beta_i^x(M) = \frac{\Sigma_{n \neq i} X_i^n(M)}{\Sigma_{1 \neq i} X_1^i(M) + \Sigma_{n \neq i} X_i^n(M)}$$

W_{ij}(M) represents the sum of two components: the import component β_i^m(M) MW_{ij}(M), which reflects competition in the home market (country i), and the export component β_i^x(M) XW_{ij}(M), which reflects competition in all foreign markets.

$$W_{ij}(M) = \beta_i^m(M)\ MW_{ij}(M) + \beta_i^x(M)\ XW_{ij}(M) \text{ where}$$

$$MW_{ij}(M) = s_j^i(M) \text{ and}$$

$$XW_{ij}(M) = \tfrac{1}{2} BXW_{ij}(M) + \tfrac{1}{2} TXW_{ij}(M)$$

$$= \tfrac{1}{2}\ w_i^j(M) + \tfrac{1}{2} \frac{\Sigma_{k \neq ij}\ w_j^k(M)\ \ s_j^k(M)}{\Sigma_{k \neq i}\ w_j^k(M)\ (1-s_i^k(M))}$$

The import weight, MW_{ij}(M) is the share of country i's imports of manufactured goods coming from country j. The bilateral export weight, BXW_{ij}(M), is the share of country i's exports of manufactures going to country j. The third-market export weight, TXW_{ij}(M), is equal to the weighted average over all third-country markets of country j's import share divided by a weighted average of the combined import share of all country i's competitors, where the weights are the shares of country i's exports to the various markets. The bilateral and third-market export weights are arbitrarily given equal importance in the computation of the overall export weight, XW_{ij}(M).