Quarterly Bulletin

September 2009

South African Reserve Bank

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Quarterly Economic Review

Introduction

Mindful of the severe downward momentum in global growth arising from the financial and broader economic crisis, authorities in most parts of the world adopted very expansionary monetary and fiscal policies during the past year. While economic activity and international trade suffered severely, especially in the final quarter of 2008 and first half of 2009, signs of bottoming out and, in some instances, tentative recovery emerged in recent months. The economy of the United States (US) continued to contract in the second quarter of 2009, but other large industrialised economies such as France and Germany experienced a return to modest positive rates of economic growth. Simultaneously, leading economies in developing Asia such as China registered firm rates of economic growth. Rising international share prices and prices of a number of key commodities also suggested that expectations were becoming more positive.

At the same time, global inflationary pressures remained subdued. Despite recent increases in the prices of crude oil and other commodities, the level of such prices was, on balance, substantially below the level twelve months earlier. With global inflation not a strong concern, policy interest rates remained low.

In South Africa the economy recorded another negative real growth rate in the second quarter of 2009 – the third successive quarterly contraction. However, the pace of contraction in the first quarter of 2009 had been worse than in the second quarter, suggesting a moderation over time of the recessionary forces in the economy. Stimulatory monetary and fiscal policies were pursued by the South African authorities over the past nine months in an attempt to support domestic demand, and were reinforced by similar policies elsewhere in the world, which indirectly started to stabilise demand for South African exports. Nevertheless, as in the first quarter of 2009 the three main sectors – primary, secondary and tertiary – each recorded a contraction in real value added in the second quarter.

The largest negative contribution to growth came from the manufacturing sector, with widespread contractions in the various subsectors, the most prominent declines being in the manufacturing of chemicals, and wood and paper products. Agricultural production also declined in the second quarter when a smaller maize crop was harvested than in the previous season, while livestock production edged lower. By contrast, real value added in mining recovered somewhat in the second quarter of 2009, led by production of platinum group metals and diamonds.

Real household consumption expenditure weakened further in the second quarter of 2009 alongside declining real disposable income and high levels of household debt. The decline was most severely felt in the purchases of durable goods. Growth in real final consumption expenditure by government slowed in the second quarter as spending on defence declined and real spending on compensation of employees decelerated. Fixed capital formation increased at a slower pace in the second quarter from a high base set in the first quarter, with public corporations in particular recording very high levels of capital spending.

Alongside a subdued level of sales, the level of real inventories receded further in the second quarter of 2009, at a substantially faster pace than in the first quarter.

Whereas in the final quarter of 2008 and first quarter of 2009 both the volume of imports and that of exports fell markedly, the strong contraction in imports continued in the second quarter of 2009, but the volume of exports registered only a marginal decrease. Owing mainly to these volume changes, the trade balance reversed into a surplus. In addition, a moderate narrowing of the shortfall on the country's services, income and current transfer account with the rest of the world was registered. As a result, the deficit on the current account of the balance of payments narrowed significantly to 3,2 per cent of gross domestic product. This deficit was financed through a combination of direct and portfolio investment inflows. Foreign direct investment in South African telecommunications enterprises rose further, while non-resident interest in South African shares and debt securities picked up alongside an improvement in sentiment towards emerging-market assets in general.

In the market for foreign exchange sentiment towards the rand improved on account of smaller trade deficits and renewed non-resident interest in investment in South Africa. Accordingly, the effective exchange rate of the rand appreciated significantly, particularly in the second quarter of 2009, and subsequently fluctuated around firmer levels.

The firmer external value of the rand contributed to an improved outlook for inflation. Furthermore, despite an upward trend in many international commodity prices since early 2009, almost all commodity prices remained well below their peak levels in mid-2008. Accordingly, producer price inflation not only slowed but in recent months the level of producer prices actually declined. This also started to work through to consumer price inflation, with the targeted rate of inflation decelerating to 6,7 per cent in July 2009. However, wage settlements and unit labour cost increases remained high in the first half of 2009.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (the Bank) first reduced the repurchase rate in December 2008 and subsequently lowered it further in several steps; the most recent being a reduction of 50 basis points announced in August 2009. This brought the cumulative reduction over the past nine months to 5 percentage points and the level of the repurchase rate to 7 per cent per annum. Other interest rates in the money market remained well aligned with this policy rate.

In the capital market bond yields continued to reflect market participants' inflation expectations, which had recently improved, as well as expectations of a considerable increase in issues of bonds by the government and public corporations in the near future, as the infrastructure programme gains further momentum while tax revenue is constrained by subdued levels of economic activity.

In the first eight months of 2009 expectations of an improvement in the global economy, although fragile, were reflected in rising share prices in markets around the world. This also extended to South Africa, where share prices recovered some of the earlier losses suffered in 2008. By contrast, subdued conditions and negative wealth effects characterised the real-estate market, with nominal house prices declining in recent months.

Growth in the broadly defined M3 money supply and in banks' loans and advances to the private sector decelerated further in the first half of 2009, with quarter-to-quarter growth in both these aggregates becoming negative in the second quarter of the year. This reflected the impact of weak activity levels and generally tight economic conditions, accompanied by low levels of business and consumer confidence.

In the period April to June 2009 the borrowing requirement of the public sector increased notably compared with the situation a year earlier, led by the borrowing needs of national government and public corporations. The national government budget deficit widened considerably not only on account of tax revenue shortfalls in the wake of the recession but also due to deliberate efforts to step up service delivery, infrastructure spending and transfers to the needy. The deficit continued to be easily financed, primarily through the issuing of Treasury bills and bonds in the domestic market, but also through tapping foreign sources of finance through the issue of foreign currency-denominated South African government bonds in international markets.

Domestic economic developments

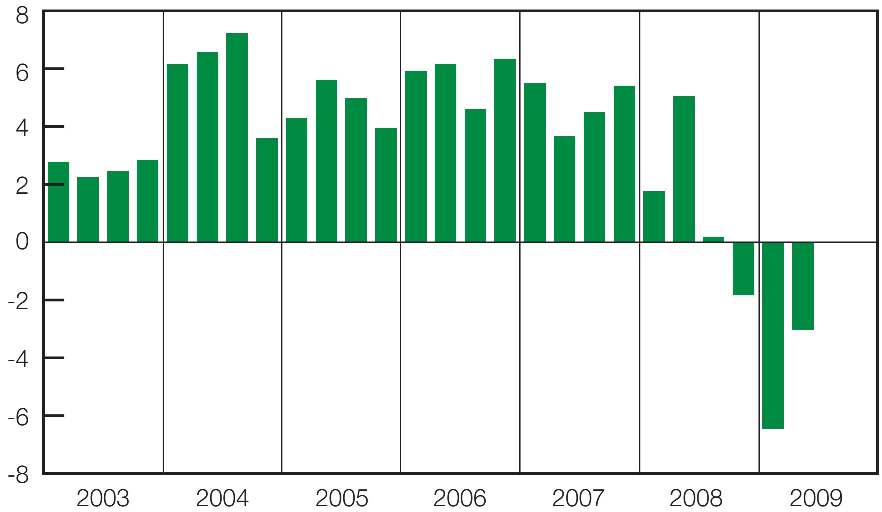
Domestic output[1]

Real output growth in the South African economy remained weak in the second quarter of 2009. Having declined at annualised rates of 1,8 per cent and 6,4 per cent in the preceding two quarters, real *gross domestic production* contracted at a rate of 3 per cent in the second quarter of 2009. Production volumes continued to decline in all three major sectors of the economy.

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

Real gross domestic product

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Real value added by the *primary sector* contracted at an annualised rate of 3,6 per cent in the second quarter of 2009, following a decline of 23,0 per cent in the preceding quarter. An increase in the real value added by the mining sector was more than offset by a contraction in real output by the agricultural sector in the second quarter.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sectors	2008					2009	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	-12,4	18,3	3,3	6,0	0,9	-23,0	-3,6
Agriculture	25,0	16,7	31,6	16,7	18,8	-2,9	-17,1
Mining	-25,8	19,2	-8,8	0,5	-6,5	-32,8	5,5
Secondary sector	1,2	11,8	-4,6	-15,0	2,9	-14,7	-5,7
Manufacturing	-0,6	14,3	-9,4	-21,8	1,2	-22,1	-10,9
Tertiary sector	3,7	1,6	1,7	2,4	3,5	-0,8	-1,2
Non-agricultural sector	*1,1*	*5,0*	*-0,5*	*-2,2*	*2,8*	*-6,3*	*-1,9*
Total	1,7	5,0	0,2	-1,8	3,1	-6,4	-3,0

Agricultural production, which increased at a rate of 18,8 per cent in 2008, contracted at an annualised rate of 17,1 per cent in the second quarter of 2009, following a decline of 2,9 per cent in the first quarter. Lower output volumes of most summer crops were largely to blame for this further decline. The commercial maize crop for 2009 is estimated at 11,6 million tons, compared with 12,7 million tons harvested in the previous season. In addition, the real value added by livestock edged lower over the period.

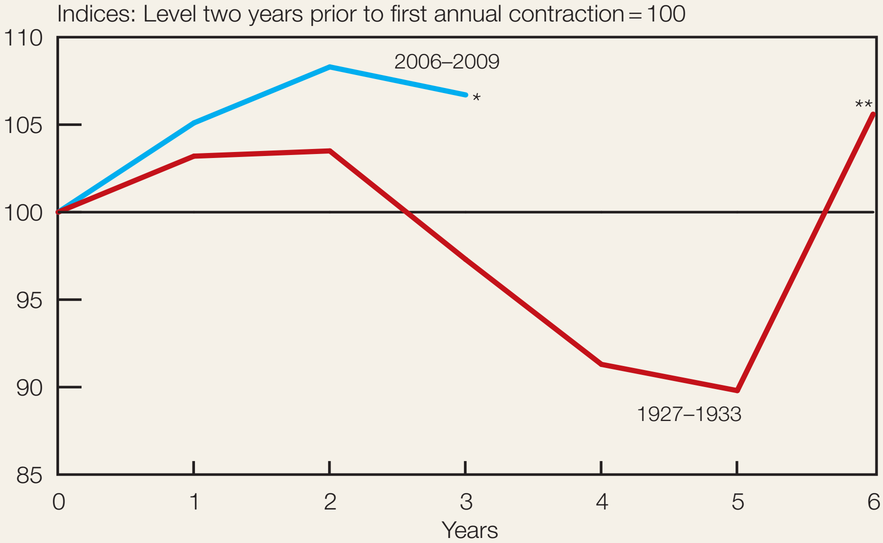
Comparison with the Great Depression

Economic conditions in South Africa are currently harsh, with real gross domestic product having contracted for three consecutive quarters. The present subdued levels of economic activity are in stark contrast to the strong growth experienced in recent years, particularly from 2004 to 2007.

Nevertheless, the current contraction in South Africa's real gross domestic product is of a considerably smaller magnitude than the decline of approximately 6 per cent in 1930 – the first of three years of contraction during the Great Depression. In the accompanying graph the level of real gross domestic product in the years immediately before and during the Great Depression is compared with the run-up to the current contraction and the expected contraction itself. A negative growth rate of 1,5 per cent was used for 2009 as a whole, as estimated by the International Monetary Fund in its latest *World Economic Outlook* publication. Momentum was lost at a much stronger pace during the Great Depression, compared to that in the current contraction. During the Great Depression, which was also a global economic crisis, economic policy-makers had little systematic knowledge of how to deal with depression conditions. By contrast, current policy-makers are better equipped and have already implemented large-scale fiscal and monetary stimulation on an internationally co-ordinated basis. This increases the probability that the global recession will be of limited magnitude and duration.

South Africa: Real gross domestic product

Indices: Level two years prior to first annual contraction = 100



* International Monetary Fund estimate, July 2009
** South African Reserve Bank estimate based on Stadler, J J. 1962. "The gross domestic product of South Africa, 1911–1959". Unpublished D Com thesis, University of Pretoria

In the *mining sector* the real value added increased at an annualised rate of 5,5 per cent in the second quarter of 2009, after having declined at a rate of 32,8 per cent in the preceding quarter. Increased output, mainly by the platinum group metals, which benefited from firmer international commodity prices, restored positive momentum in the sector. Growth in the real output of diamonds, manganese and iron ore also improved moderately during the second quarter of 2009.

Following a revised decline at an annualised rate of 14,7 per cent in the first quarter of 2009, the real value added by the *secondary sector* receded at a more moderate rate of 5,7 per cent in the second quarter. A smaller contraction in real production of the manufacturing sector was the main contributing factor to the slower pace of decline. Growth in real value added by the construction sector remained firm over the period, while the rate of contraction in electricity, gas and water production slowed.

On a quarter-to-quarter basis, *manufacturing production* declined at an annualised rate of 10,9 per cent in the second quarter of 2009, compared with a contraction of 22,1 per cent recorded in the first quarter. Although the decline in manufacturing output was broad-based and consistent with subdued demand growth, pronounced declines were recorded by the subsectors responsible for the manufacturing of chemicals; wood and paper products; electrical machinery; and textiles and clothing. The weaker-than-expected demand growth, and low business confidence culminated in excess production capacity. The utilisation of capacity in the manufacturing sector accordingly worsened from 78,2 per cent in the first quarter of 2009 to 77,9 per cent in the second quarter.

The continued weakening of overall economic activity in the second quarter of 2009 caused a further decline in electricity demand. Consequently, the real value added by the sector that supplies *electricity, gas and water* contracted further, although its pace of decline slowed from an annualised rate of 7,9 per cent in the first quarter of 2009 to 1,4 per cent in the second quarter, alongside higher mining production and several very cold winter spells over this period.

Real output by the *construction sector* increased at an annualised rate of 12,2 per cent in the second quarter of 2009 compared with a growth rate of 14,7 per cent registered in the first quarter. The demand for residential and non-residential buildings remained subdued, while activity in the civil construction sector increased, although at a slower pace, due to ongoing infrastructure development projects.

The real value added by the *tertiary sector* declined at an annualised rate of 1,2 per cent in the second quarter of 2009, following a decline of 0,8 per cent recorded in the first quarter. The contraction in the second quarter of 2009 was mainly due to receding activity in the financial intermediation, insurance, real-estate and business services sector, as well as a further decline in the real value added by the commerce sector over this period.

Real output of the *commerce sector* declined further at an annualised rate of 4,5 per cent in the second quarter of 2009, compared with a decline of 2,5 per cent recorded in the first quarter. Subdued activity in the commerce sector persisted due to a further decrease in the real value added by the wholesale, retail and motor trade subsectors, in line with the sustained weak household-sector demand. The real value added by the motor trade subsector remained under pressure as the demand for new motor vehicles declined further. Activity in the market for used vehicles, and motor vehicle parts and accessories, however, contracted at a slower pace than in the first quarter of 2009.

Real value added by the *finance, insurance, real-estate and business services sector* contracted in the first and second quarters of 2009. A decline in the real value added by the banking, insurance and business services sector was partly offset by increased trading activity in the domestic securities markets.

The real value added by the *transport, storage and communication sector* contracted by 1,8 per cent in the first quarter and 1,1 per cent in the second quarter of 2009. This was the net result of stagnant growth in the communication subsector and slower growth in the land transport subsector. Activity in the latter subsector was harmed by receding freight volumes, consistent with further declining import and export volumes over the period.

Real production by *general government* increased at a rate of 2,4 per cent in the second quarter of 2009, slightly lower than the growth rate of 2,7 per cent recorded in the first quarter, partly due to a slower increase in employment by general government.

Real gross domestic expenditure

Aggregate *real gross domestic expenditure* declined at an annualised rate of 14,5 per cent in the second quarter of 2009, following positive annualised growth of 2,2 per cent recorded in the first quarter. The decline in real gross domestic expenditure was a consequence of a contraction in real final consumption expenditure by households, alongside a deceleration in both final consumption expenditure by general government and real gross fixed capital formation. Accordingly, real final domestic demand, which increased at an annualised rate of 0,5 per cent in the first quarter of 2009, contracted at a rate of 3,5 per cent in the second quarter. The level of real inventories contracted at a markedly faster pace in the second quarter of 2009 than in the preceding quarter.

Real gross domestic expenditure

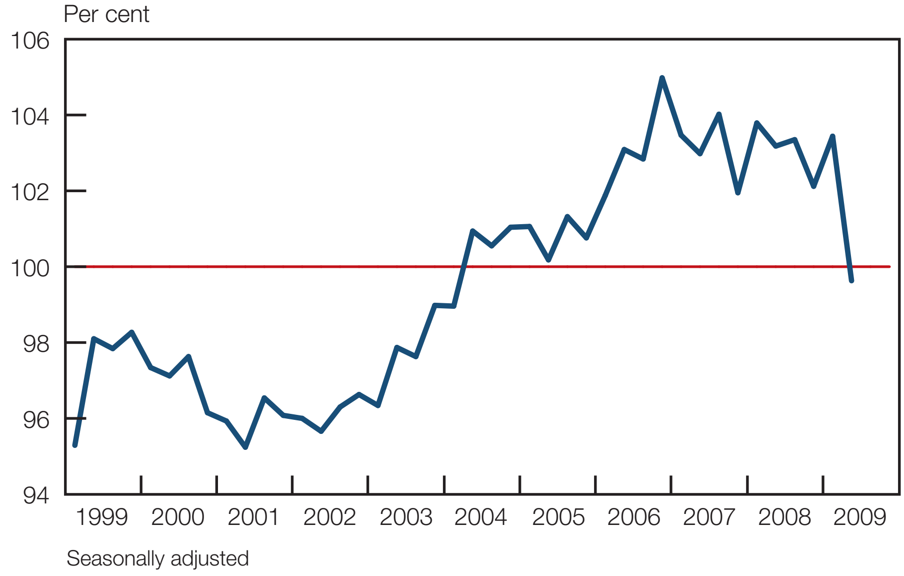
Percentage change at seasonally adjusted annualised rates

Components	2008					2009	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure:							
Households	3,0	1,3	-0,9	-2,7	2,3	-4,8	-5,8
General government	12,3	-2,1	10,2	3,6	5,0	5,8	0,2
Gross fixed capital formation	10,4	5,2	7,3	3,0	10,2	12,7	0,1
Domestic final demand	**6,0**	**1,4**	**2,6**	**-0,4**	**4,3**	**0,5**	**-3,5**
Change in inventories (R billions)*	11,1	-4,7	-11,2	-21,1	-6,5	-16,6	-52,9
Gross domestic expenditure	**12,5**	**-1,7**	**0,7**	**-3,9**	**3,1**	**2,2**	**-14,5**

* At constant 2000 prices

Regardless of the three consecutive contractions in the gross domestic product since the fourth quarter of 2008, the ratio of gross domestic expenditure to gross domestic product trended below 100 in the second quarter of 2009; the first time since the beginning of 2004. The stickiness of gross domestic expenditure till the current quarter reflected the efficiency of the tight monetary policy stance of 2008. The deterioration of expenditure behaviour, on the other hand, could be a reflection of the lagged effect of the recent monetary policy relaxation, accompanied by low confidence levels of consumers and business enterprises, the lower wealth effect and the discomfort towards future income generating possibilities.

Gross domestic expenditure as a percentage of gross domestic product



The rate of decline in *real final consumption expenditure by households* accelerated from 4,8 per cent in the first quarter of 2009 to 5,8 per cent in the second quarter. Although declines were registered by all spending components, it was much more pronounced in household expenditure on durable goods.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Components	2008					2009	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Durable goods	-5,2	-8,3	-7,6	-20,1	-5,2	-15,2	-18,8
Semi-durable goods	11,3	3,3	0,1	2,6	6,8	-7,9	-9,7
Non-durable goods	0,8	0,6	-3,2	-2,3	1,3	-12,2	-3,4
Services	4,0	3,9	2,6	-0,1	3,7	6,5	-2,7
Total	**3,0**	**1,3**	**-0,9**	**-2,7**	**2,3**	**-4,8**	**-5,8**

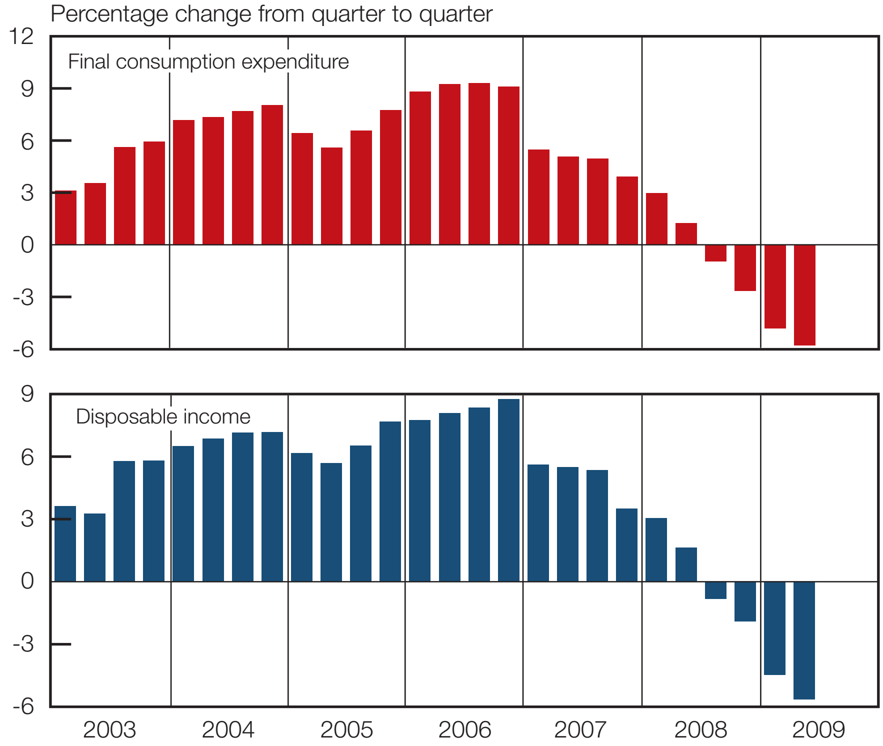
Real expenditure on *durable goods* declined further at an annualised rate of 18,8 per cent in the second quarter of 2009, compared with the rate of decline of 15,2 per cent recorded in the first quarter. Lower spending on durable goods was particularly evident in the categories for personal transport equipment, medical equipment, and furniture and household appliances. Vehicle sales continued to be constrained by low consumer confidence, and the fact that households were more averse to debt and lenders more averse to risk. Alongside a decline in outlays on residential buildings, expenditure on furniture and household appliances contracted further.

Households' real spending on *semi-durable goods* contracted at an annualised rate of 9,7 per cent in the second quarter of 2009, faster than the rate of 7,9 per cent recorded in the first quarter, with the most pronounced decline in the real outlays on motorcar tyres, parts and accessories.

Following a decline of 12,2 per cent in the first quarter of 2009, real household spending on *non-durable goods* declined at a more sedate pace of 3,4 per cent in the second quarter of 2009. Decreased expenditure on non-durable goods was noticeable in all the subcategories of non-durable goods, with the exception of petroleum products. On a year-on-year basis the price of fuel declined by more than 20 per cent in the second quarter of 2009, giving impetus to households' increased expenditure on fuel. Growth in real final consumption expenditure by households on *services* moved from an annualised growth rate of 6,5 per cent in the first quarter of 2009 to a contraction of 2,7 per cent in the second quarter.

Similar to the decline in household expenditure, *real household disposable income* contracted for the fourth consecutive quarter. Following negative growth of 4,5 per cent in the first quarter of 2009, real household disposable income declined at an annualised rate of 5,7 per cent in the second quarter. Fewer hours worked and layoffs in specific industries could have contributed to the decline in real household disposable income. The ratio of household debt to disposable income inched marginally lower from 76,8 per cent registered in the first quarter to 76,3 per cent in the second quarter of 2009. Likewise, on account of the general decline in interest rates, the ratio of debt-service cost to disposable income receded from 10,9 per cent in first quarter of 2009 to 9,5 per cent in the second quarter of 2009.

Real final consumption expenditure and disposable income of households



Seasonally adjusted annualised rates

Having increased at an annualised rate of 5,8 per cent in the first quarter of 2009, growth in real final consumption expenditure by *general government* decelerated to a rate of 0,2 per cent in the second quarter. The slower growth in real government expenditure reflected lower spending on the defence procurement programme and lower real spending on compensation of employees. Relative to gross domestic product, consumption expenditure by general government remained broadly unchanged from the first quarter of 2009 to the second quarter.

Real gross fixed capital formation increased at a significantly slower pace in the second quarter of 2009. Following an upwardly revised annualised rate of increase of 12,7 per cent in the first quarter of 2009, growth in real gross fixed capital formation slowed to a mere 0,1 per cent in the second quarter. The deceleration in capital spending primarily reflected substantially slower growth in real capital outlays by public corporations. Capital outlays by private business enterprises – the largest subcomponent of gross fixed capital formation – declined at a pace broadly similar to that recorded in the first quarter of 2009, whereas investment activity by general government continued to increase. However, the ratio of gross fixed capital formation to gross domestic product was maintained at about 24,8 per cent in both the first and second quarters of 2009.

Real gross fixed capital formation

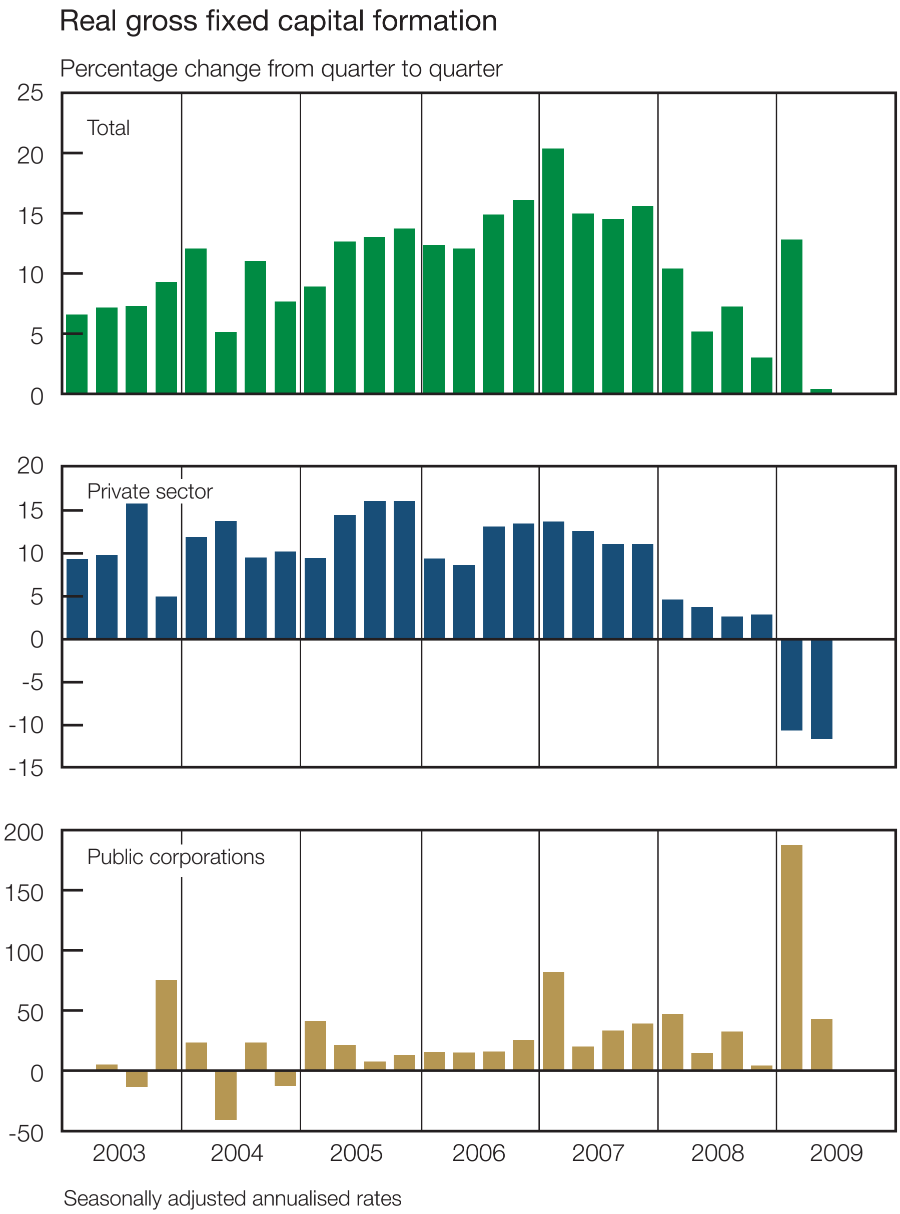
Percentage change at seasonally adjusted annualised rates

Components	2008					2009	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Private business enterprises	4,6	3,8	2,6	2,9	6,5	-10,6	-11,6
Public corporations	46,8	14,5	32,4	4,1	30,5	187,5	42,7
General government	7,9	2,6	5,3	2,3	9,7	0,6	2,4
Total	10,4	5,2	7,3	3,0	10,2	12,7	0,1

Following a decline of 10,6 per cent in the first quarter of 2009, real fixed capital outlays by *private business enterprises* contracted further at 11,6 per cent in the second quarter of 2009. Real capital investment by most subsectors of the private sector lost momentum over the period, reflecting low business and consumer confidence levels, as well as the more conservative lending practices applied by financial institutions in financing the acquisition of capital equipment.

Although mining companies, in general, carried on with existing capital expenditure projects, a variety of expansion projects was postponed due to the ongoing decline in international trade volumes and weak demand. As reflected by the further increase in excess production capacity among business enterprises in the manufacturing sector, capital spending by the manufacturing sector moderated further in the second quarter of 2009.

Despite the slower pace of increase in real fixed capital expenditure by *public corporations* in the second quarter of 2009, investment activity remained robust. Real gross fixed investment by public corporations increased at an annualised rate of 42,7 per cent in the second quarter of 2009. The electricity utility contributed to the continued growth in real capital investment in the second quarter of 2009. The demothballing of three coal-fired power stations and the refurbishment of other older power stations augmented capital spending by the electricity subsector. Furthermore, the addition of diesel locomotives to expand the existing fleet of locomotives contributed to the increased investment in the transport subsector.



Gross fixed capital formation by *general government* increased in the second quarter of 2009. Following an increase at an annualised rate of 0,6 per cent in the first quarter of 2009, growth in real government capital expenditure accelerated to a rate of 2,4 per cent in the second quarter. Increased capital spending by provincial and local government in the second quarter largely reflected the rehabilitation of water and sanitation infrastructure.

Real inventories declined by R52,9 billion in the second quarter of 2009 compared with a decline of R16,6 billion in the first quarter. However, the contribution of the change in real inventories to growth in real domestic expenditure diminished from 1,3 percentage points in the first quarter of 2009 to a negative contribution of 10 percentage points in the second quarter. Inventory de-accumulation in the second quarter of 2009 was mainly evident in the manufacturing sector and in agricultural stocks-in-trade.

The reduction of manufacturing inventories in the second quarter of 2009 was more pronounced in the manufacturing of motor vehicles, as companies scaled down production in line with the weaker demand for new vehicles. Agricultural stocks-in-trade tapered off in the second quarter of 2009 due to a run-down of particularly maize stockpiles over the period.

Factor income

Growth over four quarters in *total nominal factor income* edged lower from 7,1 per cent in the first quarter of 2009 to 4,7 per cent in the second quarter. This reflected slower growth in both the gross operating surplus of business enterprises and compensation of employees.

The year-on-year growth in the *gross operating surplus* of business enterprises decelerated from 5,7 per cent in the first quarter to 1,9 per cent in the second quarter of 2009, as business conditions tightened further. This slowdown in growth was mainly due to negative rates posted by the mining and manufacturing sectors, which more than offset better performances by the electricity, gas and water, and construction sectors. Consequently, the share of gross operating surplus in total factor income receded from 52,1 per cent in the first quarter of 2009 to 51 per cent in the second quarter.

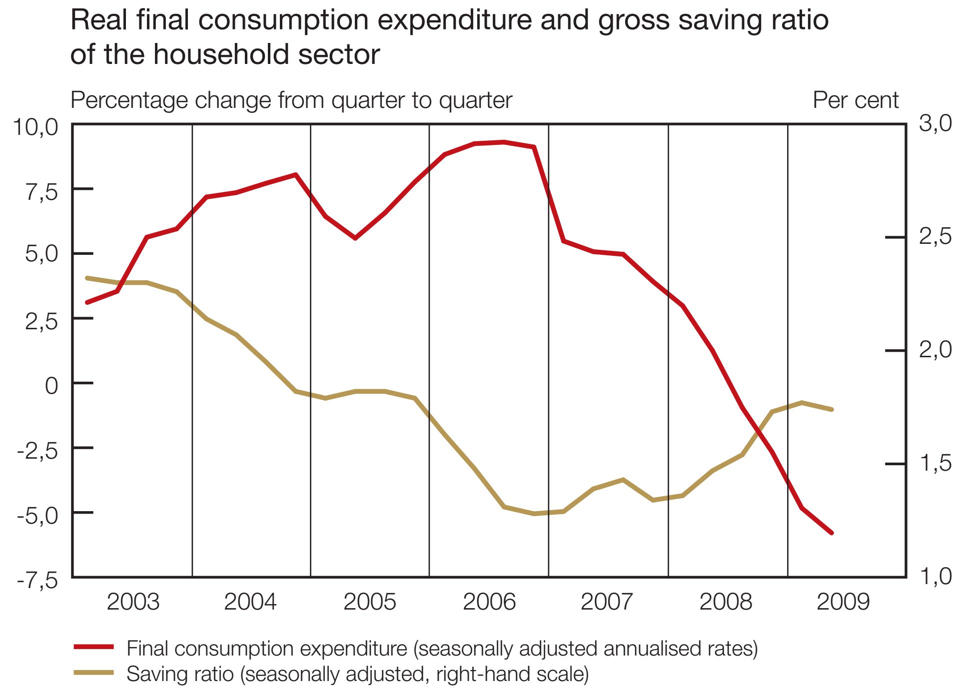
Measured over one year, an increase of 8 per cent was recorded in *total compensation of employees* in the second quarter of 2009, less than the rate of increase of 8,6 per cent recorded in the first quarter. Total salaries and wages moderated throughout the economy in the second quarter, as the turnover of business enterprises came under pressure, necessitating a reduction in overhead costs and staff retrenchments. However, the ratio of compensation of employees to total factor income increased from 47,9 per cent in the first quarter of 2009 to 49 per cent in the second quarter.

Gross saving

The *national saving ratio* or gross saving as a percentage of gross domestic product rose from its most recent low of 15,0 per cent in the third quarter of 2008 to 16,5 per cent in the second quarter of 2009. The improvement in the saving performance can be attributed to stronger growth in the gross saving of the private sector relative to gross domestic product. A lack of business and consumer confidence, a reduction in household wealth due to the collapse in asset prices and subdued economic conditions partly explained the lower spending on consumer and capital goods. The improved saving ratio lessened South Africa's dependency on foreign capital from 38 per cent of gross capital formation in the first quarter of 2008 to 16,1 per cent in the second quarter of 2009; this was the first time since the first quarter of 2004 that the dependency on international savings to finance gross capital formation had reached this low level.

Gross saving by the *corporate sector* as a percentage of gross domestic product rose from 11,9 per cent in the 2008 calendar year to 13,3 per cent in the first quarter of 2009 and to 14,1 per cent in the second quarter. Although the growth in gross operating surplus of business enterprises slowed further in the second quarter of 2009, much lower dividend, interest and tax payments underpinned the savings level of the corporate sector.

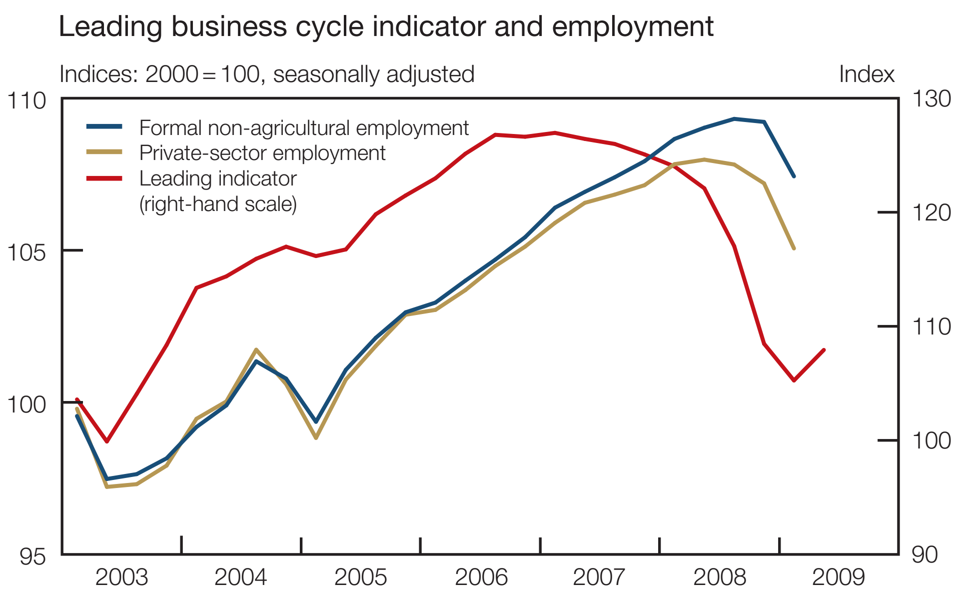
The gross saving rate of the *household sector* edged lower from 1,8 per cent in the first quarter of 2009 to 1,7 per cent in the second quarter. The saving ratio, however, improved from the fourth quarter of 2007 when a saving ratio of 1,3 per cent was recorded. This improvement occurred concurrent with a slowdown in the pace of growth of consumption expenditure by households.



The gross saving ratio of the *general government* moderated slightly from 1,9 per cent in the first quarter of 2009 to 0,7 per cent in the second quarter. Lower income, especially from taxes, and persistent increases in concomitant current expenditure adversely affected the level of saving by general government. In times of weak economic activity, the saving ratio of general government normally declines as fiscal policy becomes anti-cyclical and the burden of social grants to aid the less fortunate increases.

Employment

According to the March 2009 *Quarterly Employment Statistics* (QES) survey conducted by Statistics South Africa, the expansion phase in the employment cycle that commenced in 2003 peaked in the third quarter of 2008. Consistent with the second consecutive quarterly decline in the country's gross domestic product, the level of enterprise-surveyed employment in the formal non-agricultural sectors of the economy



contracted sharply in the first quarter of 2009 – total employment declined from a seasonally adjusted 8,47 million jobs in the final quarter of 2008 to 8,34 million in the first quarter of 2009.

Seasonally adjusted and annualised, employment levels contracted at a rate of 0,3 per cent in the final quarter of 2008 and 6,4 per cent in the first quarter of 2009. Private-sector employment numbers contracted for the third successive quarter, from an annualised rate of decrease of 0,6 per cent in the third quarter of 2008 to 7,8 per cent in the first quarter of 2009. Public-sector employment growth, which had bolstered formal non-agricultural employment in the past, also became negative in the first quarter of 2009 as employment levels contracted at an annualised rate of 1,6 per cent. Year-on-year growth in the annual average level of public-sector employment amounted to 4,5 per cent in 2008; the highest rate of increase since 1996. Employment losses recorded in the six months to March 2009 almost reversed the employment gains made in the year to September 2008.

Measured over four quarters, total formal non-agricultural employment decreased by 1,1 per cent in the first quarter of 2009; private-sector employment declined by 2,6 per cent, countered by an increase in public-sector employment at a rate of 4,2 per cent.

As shown in the accompanying table, eight of the nine industries in the private sector recorded job losses in the first quarter of 2009. In fact, the pace at which jobs were lost accelerated in all sectors except for the gold-mining sector. The bulk of employment opportunities were lost in the finance, insurance, real-estate and business services sector; manufacturing sector; trade, catering and accommodation services sector; and in the non-gold mining sector, totalling roughly 122 000 jobs.

Change in enterprise-surveyed formal non-agricultural employment: March 2009

Sector	Over one quarter*	Over four quarters	
		Number	Percentage
Mining	-15,1	-10 300	-2,0
Gold mining	-7,1	-3 000	-1,8
Non-gold mining	-18,6	-7 200	-2,1
Manufacturing	-8,6	-66 500	-5,1
Electricity supply	-0,4	1 400	2,5
Construction	-13,7	-20 000	-4,2
Trade, catering and accommodation	-5,3	-59 200	-3,4
Transport, storage and communication	-11,4	-7 400	-2,9
Financial intermediation and insurance	-7,3	-12 100	-0,6
Community, social and personal services	1,1	3 100	0,8
Total private sector	**-7,7**	**-170 900**	**-2,6**
National, provincial and local government	0,95	59 500	3,8
Public-sector enterprises	-13,4	15 700	6,7
Total public sector	**-1,6**	**75 200**	**4,2**
Grand total	**-6,4**	**-95 700**	**-1,1**

* Quarter-to-quarter seasonally adjusted annualised rates

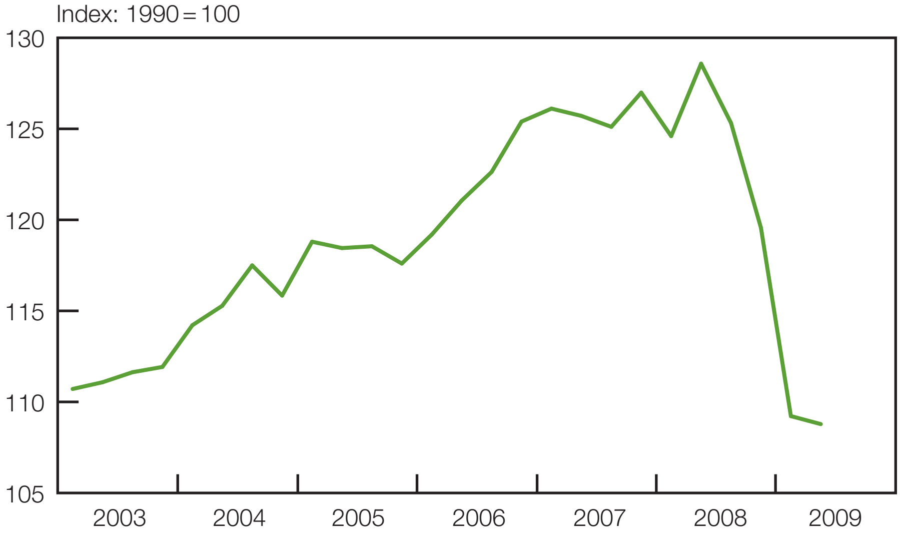
In the manufacturing sector, job shedding took place unabatedly from the second quarter of 2007. The pace of decline, however, had picked up considerably since the middle of 2008, consistent with the steep decline in output by the manufacturing sector. The physical volume of manufacturing production decreased, weighed down by the continued fall in the production of durable goods, more specifically in the categories for transport equipment, and iron and steel products, partly reflecting the contraction in passenger vehicle sales as households' financial conditions weakened further. Moreover, the slowdown in economic activity also affected commercial vehicle sales.

The Bureau for Economic Research (BER) *Manufacturing Survey*, conducted in the second quarter of 2009, indicated that the manufacturing sector was still suffering from declining sales and new order volumes during the period. However, manufacturing conditions are expected to recover somewhat in the remainder of 2009 as economic conditions improve.

Mining activity contracted in line with commodity price levels which, in the latter part of 2008 and in the first half of 2009, continued to fluctuate at levels far below their mid-2008 peaks as the persistent global recession continued to curtail the demand for commodities. Total employment losses in the mining sector amounted to 28 100 in the fourth quarter of 2008 and first quarter of 2009 combined. Employment in the gold-mining sector expanded at an annualised rate of 8,0 per cent in the third quarter of 2008, only to decrease at a rate of 7,1 per cent in the first quarter of 2009. At the same time, job losses were registered in the non-gold mining sector at an annualised rate of 18,6 per cent in the first quarter of 2009.

With real output contracting steeply among the major users of electricity, namely the mining and manufacturing sectors, electricity production also dropped, contributing to a slight decline in employment in the electricity supply sector in the first quarter of 2009 at a quarter-to-quarter annualised rate of 0,4 per cent. However, in the year to the first quarter of 2009, employment still rose at a moderate rate of 2,5 per cent. In the first half of 2009, industrial production contracted by 13,9 per cent.

Industrial production



Seasonally adjusted

Employment in the construction sector decreased at an annualised rate of 13,7 per cent in the first quarter of 2009, following an increase of 3,6 per cent in the preceding quarter. The BER *Construction and Building Survey* for the second quarter of 2009 showed only a marginal improvement in business confidence in the building industry, despite the easing in the monetary policy stance since December 2008. In addition to significantly lower activity reported in the residential building sector, non-residential building activity also tapered off. Moreover, confidence in infrastructure-related activity, measured by the

First National Bank (FNB) civil confidence index, declined from the first quarter of 2009 to the second quarter, as private-sector fixed investment in the mining, manufacturing and property development sectors deteriorated.

Since the second quarter of 2008, the trade, catering and accommodation services sector shed a cumulative 59 200 jobs as household consumption expenditure contracted in an environment involving a tight monetary stance, high consumer price inflation, subdued consumer confidence and negative wealth effects. Similarly, with the economic slowdown intensifying, employment in the finance, insurance, real-estate and business services sector contracted further in the first quarter of 2009 at an annualised rate of 7,3 per cent.

Respondents surveyed in the BER *Retail Survey* in the second quarter of 2009 reported lower sales volumes and orders across all subsectors of the retail sector compared with the same period in 2008. At the same time, shrinking sales volumes in the vehicle trade and wholesale trade sectors affected overall profitability, thereby contributing to retrenchments.

Having shown virtually no employment gains in the private transport, storage and communication sector in the final quarter of 2008, approximately 7 800 jobs were lost in the subsequent quarter, mainly reflecting the lower demand for the transport and storage of goods because of the subdued activity in the trade, construction and mining sectors.

Public-sector employment registered an annualised decrease of 1,4 per cent in the first quarter of 2009 – the first in a four-year period. All tiers of government recorded job losses with the exception of provincial governments, which created some 7 500 job opportunities. In his State of the Nation Address, the President announced government's intention to create half-a-million jobs through the *Expanded Public Works Programme* over a period of six months to improve service delivery.

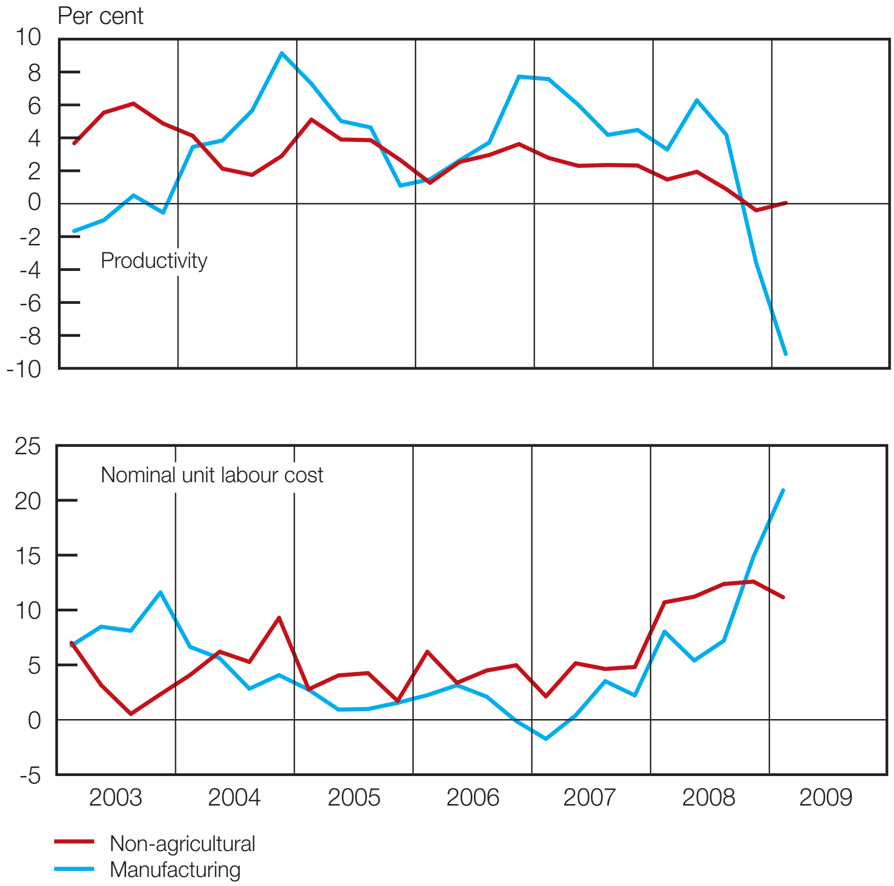
With the domestic economy in recession and retrenchments becoming widespread, the Department of Labour announced an increase in the payout value for laid-off Unemployment Insurance Fund (UIF) contributors, and an extension in the UIF payout period from eight months to a year. Notwithstanding recessionary conditions, the tendency for strike action intensified as workers in both the public and private sectors demanded above-inflation wage increases. Other labour supply-related concerns, such as the recognition of specialised skills and an occupation-specific dispensation in the public sector, also came to the fore. According to Andrew Levy Employment Publications, the number of working days lost due to strikes and other work stoppages almost doubled from 265 000 in the first half of 2008 to 526 000 in the first half of 2009.

Labour cost and productivity

The year-on-year rate of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy has exceeded 10 per cent since the first quarter of 2008. This rate of increase, however, decelerated from a peak value of 13,4 per cent in the third quarter of 2008 to 11,2 per cent in the first quarter of 2009. In the private sector average nominal remuneration per worker moderated to 10,5 per cent in the year to the first quarter of 2009, while it moderated to 11,7 per cent in the public sector.

In the private sector all the sectors registered remuneration growth rates in excess of the upper limit of the inflation target range – ranging from 8,6 per cent in the financial services sector to a high of 23,3 per cent in the electricity supply sector. The gold-mining, manufacturing and construction sectors in particular recorded strong increases. In the public sector the dispersion of growth in nominal remuneration per worker was more diverse, recording a year-on-year rate of only 1,1 per cent in the public sector's transport and storage subsector, and extending to a rate of 17,4 per cent at the local government level. According to Andrew Levy Employment Publications, the average level of wage settlements in the first half of 2009 amounted to 9,7 per cent compared with 8,3 per cent in the first half of 2008. Average annual headline consumer price inflation equalled 8,1 per cent over the first half of 2009 – yielding a real wage increase of 1,6 per cent.

Productivity and nominal unit labour cost in the formal non-agricultural and manufacturing sectors



Following a slight contraction in economy-wide labour productivity in the year to the fourth quarter of 2008, labour productivity growth returned to a positive year-on-year rate of 0,1 per cent in the first quarter of 2009, as the pace of decline in employment creation was slightly in excess of the contraction in domestic output. However, labour productivity in the manufacturing sector deteriorated further, with the rate of decrease accelerating from 3,6 per cent in the fourth quarter of 2008 to 9,2 per cent in the first quarter of 2009 as staff retrenchments did not match the rapid decline in manufacturing output. Voluntary leave and reduced overtime counted among the arrangements that contributed to this outcome.

The steep decrease in manufacturing labour productivity resulted in nominal unit labour cost in the manufacturing sector accelerating apace from 14,8 per cent in the year to the final quarter of 2008 to 20,9 per cent in the year to the first quarter of 2009. By contrast, year-on-year nominal unit labour cost increases in the formal non-agricultural sector of the economy moderated somewhat from 12,6 per cent in the fourth quarter of 2008 to 11,2 per cent in the first quarter of 2009.

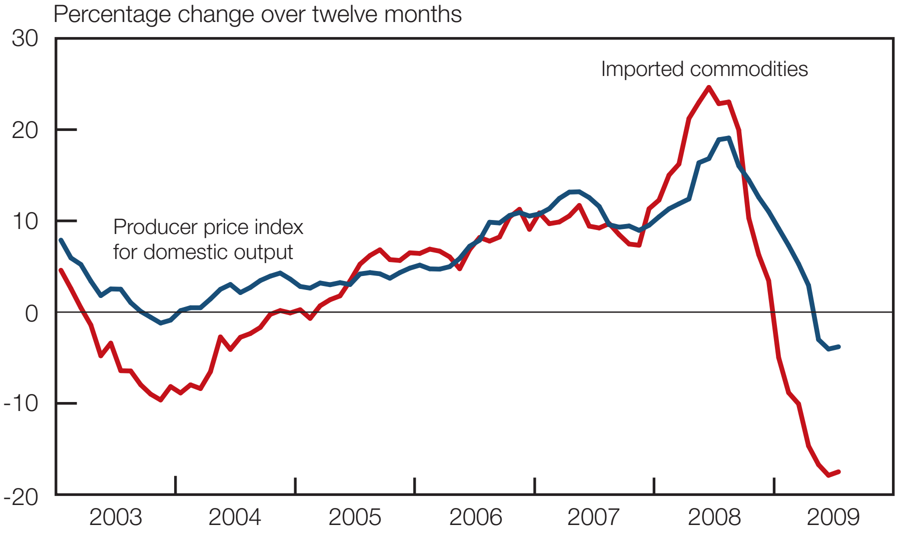
Prices

In the first seven months of 2009 producer price inflation decelerated sharply, while consumer price inflation moderated, but remained sticky above the inflation target range. Producer prices decreased at a year-on-year rate of 3,8 per cent in July and headline consumer prices increased at a year-on-year rate of 6,7 per cent in July 2009. The differential between year-on-year consumer and producer price inflation consequently widened to 10,5 percentage points in July 2009.

Year-on-year changes in producer prices of imported commodities have been negative since the beginning of 2009, amounting to a rate of decrease of 17,5 per cent in July 2009. The prices of imported mining commodities decreased significantly at a twelve-month rate of 45,4 per cent in July 2009. The prices of imported agricultural commodities have been in deflation for the past eleven months to July 2009, amounting to 18,9 per cent in the year to March 2009, before the rate of deflation slowed to 8,1 per cent in July. Prices of products of petroleum and coal decreased at a rate of 18,5 per cent in the year to July 2009, as the appreciation in the exchange rate of the rand countered the US dollar crude oil price increases in the first seven months of 2009. Prices of imported manufactured goods remained broadly subdued, as inflation remained suppressed in South Africa's trading partners. For instance, the prices of basic metals, chemicals and chemical products, and furniture followed a declining trend similar to that of petroleum and coal products.

Producer prices

Percentage change over twelve months



Year-on-year producer price changes for domestic output moved from an increase of 9,2 per cent in January 2009 to a decrease of 3,8 per cent in July 2009. A sharp decrease in the prices of mining commodities and, more recently, in the prices of manufactured products led the reversal. Producer price inflation of electricity, however, remained at elevated levels.

Disinflation in overall producer prices in the eleven months to July 2009 was prompted by decreases in the prices of particularly mining products, which reached a negative year-on-year rate of 15,2 per cent in July 2009. Producer price inflation in the manufacturing category turned around to deflation at a year-on-year rate of 4,1 per cent over the same period. In the manufacturing category the prices of products of petroleum and coal, and basic metal products decreased by 32,6 per cent and 15,5 per cent, respectively, in the twelve months to July 2009. Prices in the electricity, gas, steam and water category increased at a year-on-year rate of 23,9 per cent in July, largely driven by substantial increases in electricity prices, amounting to 27,4 per cent in that month. Twelve-month producer price inflation for agricultural products amounted to a negative year-on-year rate of 1,7 per cent in July 2009, driven largely by considerable decreases in the prices of grain products, and fruit and nuts.

Overall food inflation at the producer level continued to decelerate in the first seven months of 2009, led by declines in the producer prices of food at the agricultural level and moderating manufactured food price inflation. Overall producer food prices increased at a year-on-year rate of 12,5 per cent in January 2009, decelerating at 2,0 per cent in July. At the agricultural level, food price inflation fluctuated from a twelve-month rate of 13,2 per cent in January 2009, bolstered by short-lived increases in the prices of fruit and nuts, to deflation of 8,1 per cent in March 2009; the rate of deflation amounted to 6,7 per cent in July. Manufactured producer food price inflation more than halved between January 2009 and July, amounting to a year-on-year rate of 0,8 per cent in the latter month.

Food prices

Percentage change over twelve months

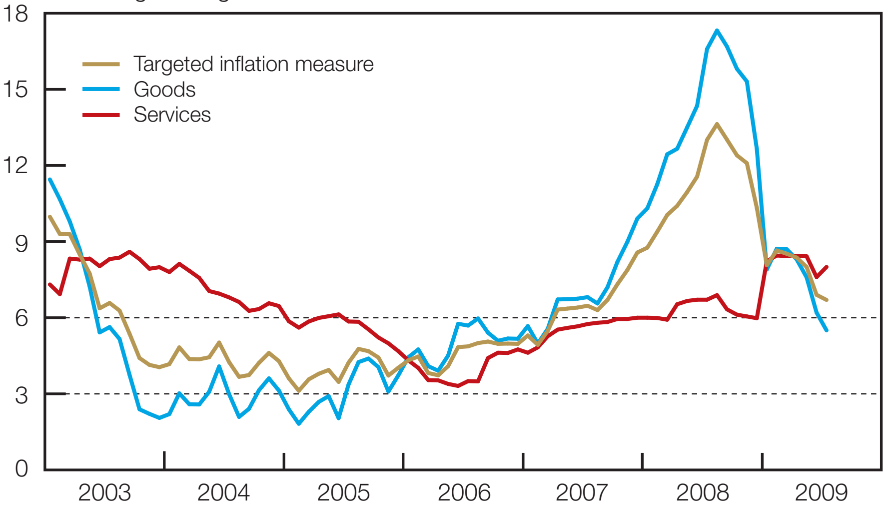
		Domestic producer prices of food			Headline consumer food prices		
		Agricultural food	Manufactured food	Total	Unprocessed food	Processed food	Total
2008	Jan	25,6	18,7	21,4	13,9	13,4	13,4
	Feb	18,6	20,3	20,0	14,5	14,2	14,1
	Mar	18,0	20,4	20,2	14,7	16,5	15,3
	Apr	6,0	19,5	14,5	13,6	17,8	15,7
	May	0,7	19,1	11,8	12,9	20,5	17,0
	Jun	2,0	19,4	12,6	13,9	21,9	17,6
	Jul	1,8	20,8	13,4	13,6	22,9	17,8
	Aug	-2,6	20,5	11,6	14,5	23,3	18,8
	Sep	-4,5	19,6	10,3	12,7	22,6	17,6
	Oct	-10,4	15,6	5,4	11,7	22,0	16,7
	Nov	-6,4	13,4	5,8	11,9	21,3	16,6
	Dec	-5,7	12,8	5,7	12,9	20,3	17,1
	Year	**3,6**	**18,3**	**12,7**	**13,4**	**19,7**	**16,5**
2009	Jan	13,2	12,0	12,5	13,0	19,6	16,1
	Feb	4,4	10,9	8,3	13,6	18,4	15,8
	Mar	-8,1	9,4	2,2	14,0	15,7	14,9
	Apr	-2,0	8,4	4,5	13,7	13,7	13,7
	May	-1,5	6,2	3,4	13,2	10,9	12,1
	Jun	-6,5	3,7	0,0	10,9	8,7	9,8
	Jul	-6,7	0,8	-2,0	8,2	7,0	7,6

At the consumer level, food prices remained elevated, with the subcategories for unprocessed and processed foods both lagging their counterpart categories at the producer level considerably. In fact, the differential between unprocessed consumer food price inflation and agricultural producer food price inflation widened considerably in the first half of 2009. A stepwise narrowing was, however, evident in the categories for processed consumer food prices and manufactured producer food prices. Year-on-year, consumer food price inflation amounted to 7,6 per cent in July 2009, while unprocessed food prices increased by 8,2 per cent and processed food prices increased by 7,0 per cent.

As already mentioned, headline consumer price inflation has exceeded the upper limit of the inflation target range for 28 consecutive months and amounted to 6,7 per cent in the year to July 2009. Year-on-year consumer goods price inflation decelerated moderately from 8,7 per cent in March 2009 to 5,5 per cent in July. Consumer price inflation for durable goods accelerated from a year-on-year rate of 1,7 per cent in January 2009 to 3,3 per cent in July. For semi-durable consumer goods inflation moved broadly sideways, amounting to a twelve-month rate of 5,1 per cent in July 2009. Non-durable goods price inflation exceeded total goods price inflation as it accelerated moderately to 6,5 per cent in the year to July.

Consumer prices

Percentage change over twelve months



* CPIX up to December 2008; CPI for all urban areas from January 2009

Headline CPI service price inflation remained sticky and recorded a year-on-year rate of 8,0 per cent in July 2009. Double-digit rates of increase were evident in the categories for health, education, restaurants and hotels, health insurance, financial services and funeral services.

An assessment of price movements across the classification of individual consumption by purpose (COICOP) categories presented in the accompanying table suggests that in the year to July 2009, nine of the twelve categories with a combined weight of 73,9 per cent increased at rates above the upper limit of the inflation target range, with half of these recording double-digit rates of increase. Only the clothing and footwear category increased at a twelve-month rate of 5,2 per cent in July, which was within the target range, while prices in the communication category increased at a rate below the lower limit of the inflation target range. Prices in the transport category declined in the twelve-months to July 2009.

Headline CPI inflation in COICOP categories

Twelve-month percentage changes

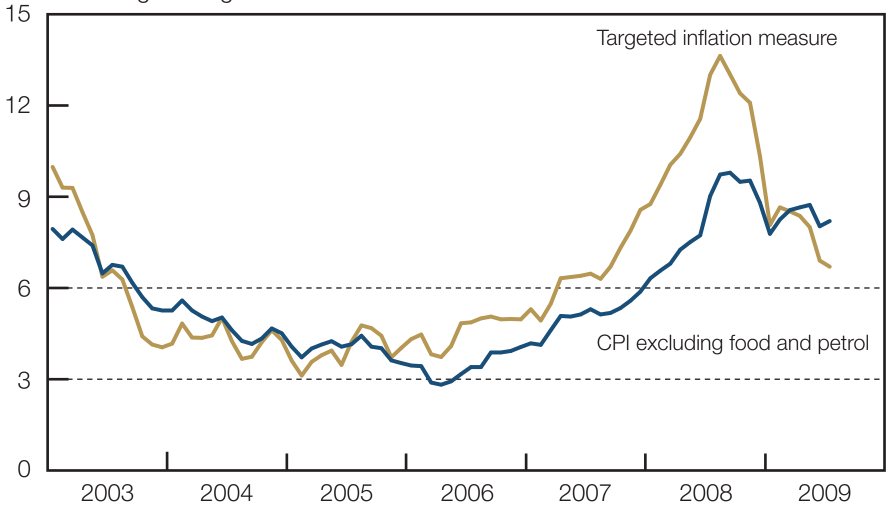
	Weights	July 2009
Recreation and culture	4,19	13,7
Miscellaneous goods and services	13,56	12,8
Alcoholic beverages and tobacco	5,58	11,5
Health	1,47	10,9
Education	2,19	10,5
Restaurants and hotels	2,78	10,4
Food and non-alcoholic beverages	15,68	8,3
Housing and utilities	22,56	8,2
Household contents, maintenance and equipment	5,86	6,7
Clothing and footwear	*4,11*	*5,2*
Communication	3,22	0,6
Transport	18,80	-3,4
Total headline CPI	100,00	6,7

Italics denote values inside the inflation target range of between 3 and 6 per cent in July 2009

Excluding the volatile food, non-alcoholic beverages and petrol categories from the inflation target measure, consumer price inflation also remained above the inflation target range, amounting to a year-on-year rate of 8,2 per cent in July. Despite overall administered prices having remained broadly unchanged over the twelve months to July 2009, significant price increases occurred in some components, particularly in electricity tariffs and in the cost of education services. Omitting the impact of petrol prices (which declined strongly over the period), administered price inflation amounted to 11,1 per cent in the year to July 2009.

Measures of underlying inflation

Percentage change over twelve months



* CPIX up to December 2008; CPI for all urban areas from January 2009

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2009

	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2009	6,9	9,4	9,7	8,7
2010	5,7	8,6	10,1	8,1
2011	5,6	8,3	9,9	7,9

Source: Bureau for Economic Research at Stellenbosch University

The BER *Inflation Expectations Survey*, conducted in the second quarter of 2009, showed moderating inflation expectations in the three years to 2011. Inflation was expected to decelerate from 8,7 per cent in 2009 to 8,1 per cent in 2010 and to 7,9 per cent in 2011. Among the three surveyed groups, financial analysts expected headline consumer price inflation to move into the target range in 2010 and to remain within the range throughout 2011. By contrast, business and trade union representatives expected inflation to remain above the upper limit of the inflation target throughout the forecast period.

Foreign trade and payments

International economic developments

Preliminary indications suggest that the supportive policy measures implemented in many parts of the world are fuelling a still fragile global economic recovery from the deep and fairly synchronised recession. In this regard, multilateral institutions also played an important part in assisting countries in coping with the adverse effects of the global financial crisis. The Group of Twenty (G-20) Finance Ministers and Central Bank Governors made recommendations to restore global growth and confidence, and eventually to unwind emerging measures introduced in response to the crisis. In addition, the International Monetary Fund (IMF) has recently announced an initiative to inject US$250 billion into the global economic system by supplementing countries' foreign-exchange reserves.

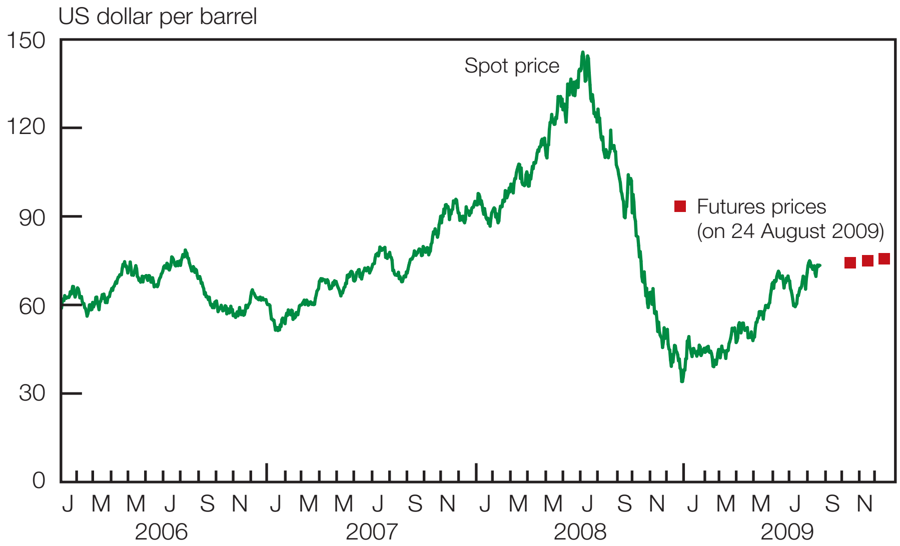
The recent improvement in economic conditions is still very tentative and remains uneven across regions and countries. Real output in most advanced economies declined further in the second quarter of 2009, although at a slower pace. Real output in the US declined by 1,0 per cent in the second quarter of 2009, following a contraction of 6,4 per cent in the preceding quarter. The decline in real gross domestic product in the second quarter primarily reflected negative contributions from fixed investment, private consumption expenditure, inventory investment and exports. Preliminary estimates suggest that the pace of contraction in the euro area also slowed from almost 10 per cent in the first quarter of 2009 to 0,4 per cent in the second quarter, with Germany and France recording modest positive growth rates in the second quarter. Economic activity in Japan, however, rebounded in the second quarter of 2009 as a result of positive contributions from exports, private consumption expenditure and public investment.

Economic growth in emerging-market economies as a group recovered in the second quarter of 2009, following sharp contractions in many individual countries. More specifically, economic growth improved notably in China, South Korea and Taiwan.

The IMF updated its growth projections in early July 2009 and is now expecting global economic activity to contract by 1,4 per cent in 2009, before expanding by 2,5 per cent in 2010. Real production in advanced economies is projected to decline sharply in 2009, while economic growth in emerging-market and developing economies is expected to decelerate markedly. The IMF downgraded the outlook for Africa in 2009 as the continent was more negatively affected than initially expected by the decline in global trade volumes.

Oil prices continued to increase during the second quarter of 2009, reaching levels for Brent crude of around US$70 per barrel in early June 2009. Oil prices have been underpinned by a more optimistic global economic outlook, rising equity prices, a weaker US dollar and encouraging economic developments in China. In recent months the Organization of the Petroleum Exporting Countries (OPEC) has had difficulty in ensuring that member countries adhere to output target cuts. Oil prices declined briefly in early July 2009 amid concerns about the pace of a global economic recovery and the demand for energy, but have since rebounded to above US$72 per barrel in the final week of August 2009. Brent crude oil futures contracts for delivery in the fourth quarter of 2009 traded, on average, around US$75 per barrel towards the end of August 2009.

Brent crude oil prices



Source: Bloomberg

Headline inflation continued to ease in advanced and emerging-market economies in the first seven months of 2009, affected by subdued global economic conditions and lower crude oil and other commodity prices since mid-2008. In the US headline consumer price inflation slowed further to a twelve-month rate of decrease of 2,1 per cent in July 2009. Japan also continued to experience deflation in recent months. Consumer price inflation in the euro area has trended downwards since mid-2008 and prices decreased at a year-on-year rate of 0,7 per cent in July 2009. Consumer price inflation in most of the major emerging-market economies also decelerated from the middle of 2008. Several emerging Asian economies, including China, have also experienced deflationary pressures in recent months.

Most central banks have eased official policy rates since the onset of the global financial crisis, and have implemented unconventional monetary policy measures in response to the deteriorating economic conditions and dissipating inflationary pressures. Since April 2009, official interest rates have been reduced by central banks in Australia, Brazil, Canada, Chile, the Czech Republic, Denmark, the euro area, Hungary, India, Indonesia, Mexico, New Zealand, Poland, Russia, Sweden, Thailand and Turkey. The Bank of Israel, however, increased the official interest rate by 25 basis points to 0,75 per cent in August 2009.

Current account

The contraction in real gross domestic production and the almost simultaneous steep decline in the volume of merchandise imports in the first half of 2009 led to a turnaround in the deficit on the trade account in the second quarter of 2009 despite the relatively subdued external demand for domestically produced goods. South Africa's trade balance, which had registered deficits since the third quarter of 2005, consequently switched from a deficit of R53,4 billion in the first quarter of 2009 to a surplus of R26,6 billion in the second quarter.

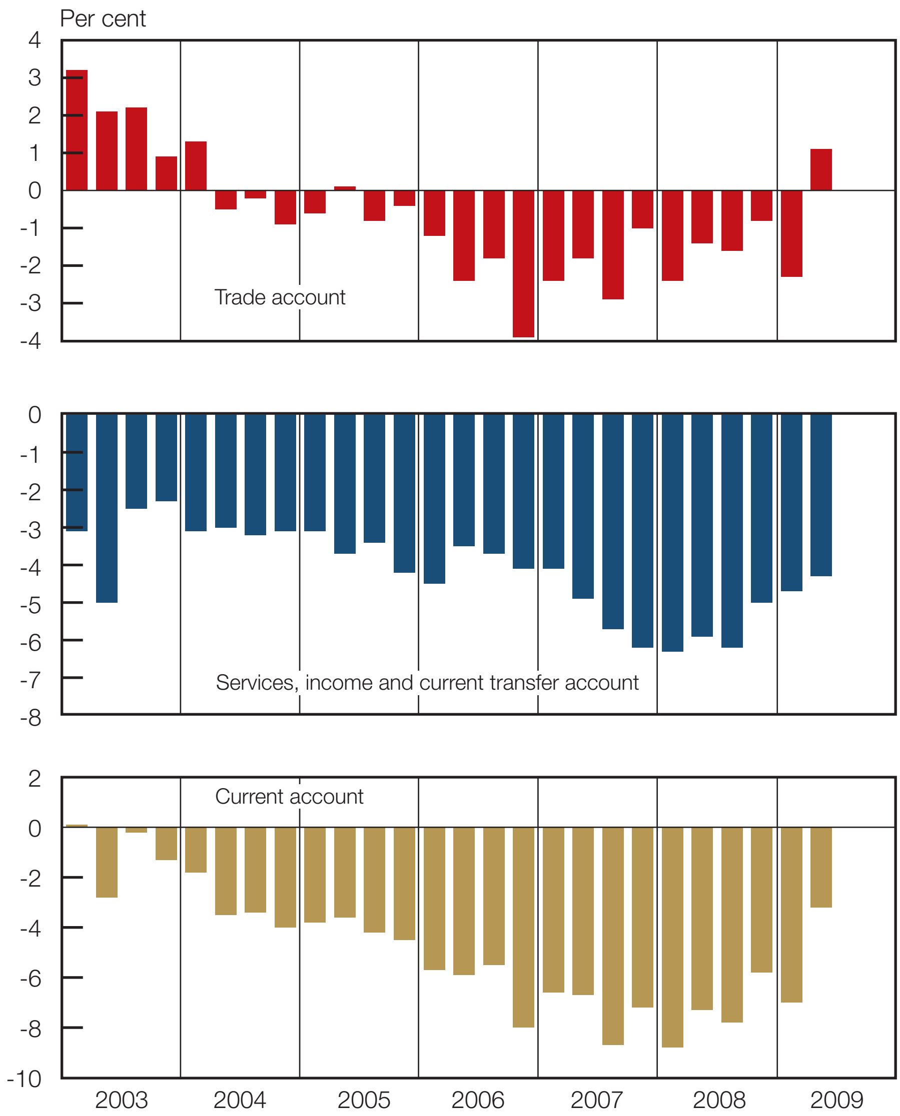
The contraction in domestic economic activity since the middle of 2008 has also had a profound positive impact on the shortfall on the country's services, income and current transfer account with the rest of the world. Owing to a combination of continued lower net income and other service-related payments to non-residents, the deficit on this account narrowed considerably. As a result, the negative imbalance on the current account of the balance of payments improved from 7,0 per cent of gross domestic product in the first quarter of 2009 to 3,2 per cent in the second quarter.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

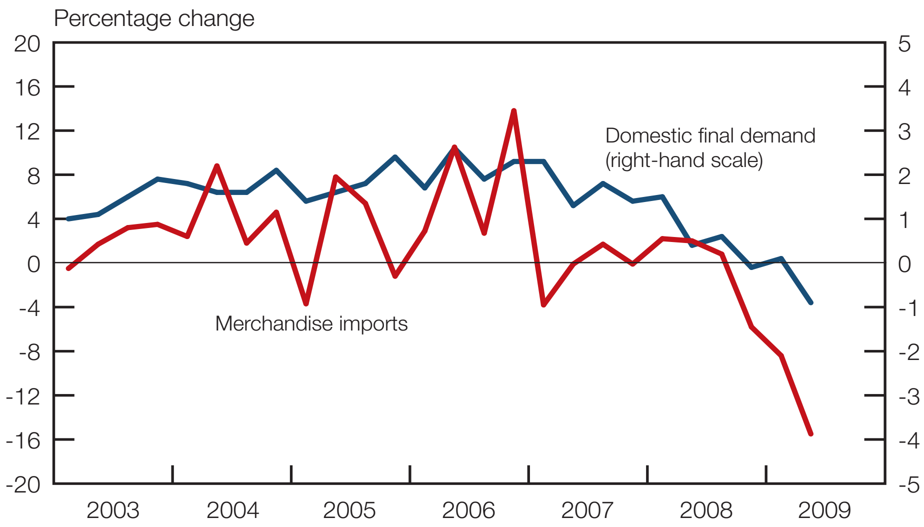
	2008					2009	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports................	568,4	680,1	706,3	668,2	655,8	538,4	484,2
Net gold exports	46,1	47,5	49,4	51,2	48,5	51,0	47,5
Merchandise imports................	-668,1	-759,9	-792,4	-739,0	-739,9	-642,8	-505,1
Trade balance	**-53,6**	**-32,3**	**-36,7**	**-19,6**	**-35,6**	**-53,4**	**26,6**
Net service, income and current transfer payments	-138,8	-133,9	-143,9	-117,7	-133,6	-110,3	-99,7
Balance on current account	-192,4	-166,2	-180,6	-137,3	-169,2	-163,7	-73,1
As a percentage of gross domestic product	*-8,8*	*-7,3*	*-7,8*	*-5,8*	*-7,4*	*-7,0*	*-3,2*

Current account as a ratio of gross domestic product



Subdued domestic demand conditions alongside weak business and consumer confidence levels gave rise to the third consecutive quarterly decline in the volume of merchandise imports in the second quarter of 2009. The contraction in the physical quantity of *merchandise imports* gained further momentum as various private-sector capital expenditure projects were postponed in view of the fall in global demand. Consistent with the slowdown in gross fixed capital formation, the imports of especially machinery and electrical equipment, and of vehicles and transport equipment receded strongly in the second quarter. In addition, the imports of intermediate and consumer goods also tapered off. Overall, the volume of imported goods shrank for the third consecutive quarter, declining by 15,5 per cent in the second quarter of 2009. Relative to gross domestic expenditure, the volume of merchandise imports decreased from 24,4 per cent in the first quarter of 2009 to 21,4 per cent in the second quarter – significantly lower than the most recent peak of 28,1 per cent recorded in the third quarter of 2008. Over the same period, the strengthening of the exchange value of the rand more than offset the moderate increase in the international price of crude oil and other import commodities, leading to a decline of 7 per cent in the rand price of merchandise imports. The value of imported goods accordingly dropped by 21,4 per cent from R643 billion in the first quarter of 2009 to R505 billion in the second quarter.

Volume of merchandise imports and domestic final demand



The combined effect of a decline in the volume and rand price of *merchandise exports* hampered export proceeds in the second quarter of 2009. The value of merchandise exports fell by 19,4 per cent in the first quarter of 2009 and by a further 10,1 per cent in the subsequent quarter. Although all main export categories registered declines, the value of manufactured exports declined markedly.

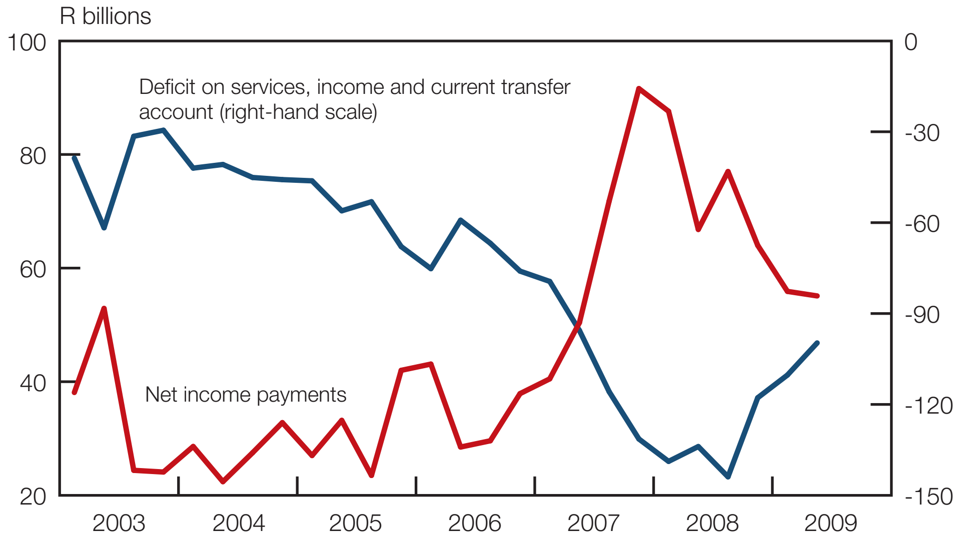
Following a decline of no less than 21 per cent in the first quarter of 2009, the volume of merchandise exports contracted further by a marginal 2,8 per cent in the second quarter. An increase in the demand for domestically produced mining products from especially Asia, partly negating lower export orders for domestically manufactured products from Europe and the US, boosted the performance of merchandise exports in an environment of contracting international trade volumes. The partial resurgence in the demand for mining products underpinned international commodity prices, which continued to trend higher in the second quarter of 2009. However, the increase in the dollar price of commodities was more than neutralised by the appreciation in the external value of the rand during the quarter. Consequently, the unit price of merchandise exports fell by 7,5 per cent in rand terms over the period.

On the London market the fixing price of gold rose slightly from US$908 per fine ounce in the first quarter of 2009 to US$915 per fine ounce in the second quarter. The precious metal maintained its status as a hedge against inflation by international investors wishing to preserve wealth. Mainly suppressed by the strengthening of the exchange value of the rand, the realised rand price of net gold exports declined by 12,7 per cent in the second quarter of 2009, after having increased noticeably in the preceding two quarters. The decline in the rand price of gold occurred alongside an increase of 6,7 per cent in the physical quantity of gold exports. As a result, the value of net gold exports receded by 6,9 per cent from R51 billion in the first quarter of 2009 to R47,5 billion in the second quarter.

The deficit on the services, income and current transfer account, which had narrowed consistently from the fourth quarter of 2008, amounted to R99,7 billion or 4,3 per cent of gross domestic product in the second quarter of 2009 – comparable with the average long-term ratio of 4,4 per cent. A decrease in net income payments, and a further contraction in transport and freight-related service payments to non-residents predominantly supported the continued moderation in the deficit.

Net income payments to the rest of the world, which had been contracting because of lower gross dividend payments to foreign shareholders since the fourth quarter of 2008, decreased further in the second quarter of 2009. Gross dividend payments in the first half of 2009 were, in fact, 26,5 per cent lower when compared with the corresponding period in 2008, effectively returning to dividend levels last recorded in early 2007. The harsh domestic economic conditions and the impact on the distribution of income continued to affect income accruing to foreign investors. Lower dividend payments were augmented by a decline in gross interest payments on outstanding external interest-bearing liabilities in an environment of relatively low international interest rates.

Deficit on the services, income and current transfer account, and net income payments



Payments related to transport and freight services rendered by non-residents also declined substantially in the second quarter of 2009 as merchandise trade volumes continued to trend downwards. In addition, payments for “other services” contracted over the period as these services form an integral part of the cost structures of local producers. However, payments for technical services remained elevated as the demand for this type of service remained brisk due to ongoing infrastructural initiatives in the domestic economy.

In the second quarter of 2009, South Africa's terms of trade improved for the third consecutive quarter. The strengthening in the country's terms of trade mainly resulted from import prices, which declined at a faster rate than export prices.

Financial account

The surplus on the financial account of the balance of payments narrowed somewhat in the second quarter of 2009. Including unrecorded transactions, this surplus declined from R35,3 billion in the first quarter of 2009 to R26,7 billion in the second quarter. A change in investors' sentiment towards risk-taking in emerging-market economies resulted in significantly higher identified net inflows of direct and portfolio investment capital in the second quarter. For the second consecutive quarter, non-resident investors were net purchasers of South African equity and debt securities. Other investment capital flows were more subdued: apart from the reduction in global cross-border trade and loan finance to emerging-market economies due to the ongoing turmoil in world financial markets, this also partly reflected the reduction in the country's external financing needs following the substantial narrowing in the deficit on the current account. The balance on the financial account, including unrecorded transactions, as a percentage of gross domestic product, decreased from 6,1 per cent in the first quarter of 2009 to 4,6 per cent in the second quarter.

Net financial transactions not related to reserves

R billions

	2008				2009	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	6,2	22,4	3,3	74,4	11,7	23,9
Portfolio investment	17,2	-7,6	-57,3	-68,1	10,1	29,0
Other investment	2,5	22,2	2,0	53,8	-9,3	-26,0
Change in assets						
Direct investment	-2,8	-11,6	50,7	29,2	4,4	-3,7
Portfolio investment	-6,5	-4,3	-51,1	-63,4	-0,9	-0,3
Other investment	7,9	5,4	52,9	77,9	-1,5	16,4
Total financial transactions*	**46,0**	**60,6**	**39,1**	**195,1**	**35,3**	**26,7**

* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded a substantial capital inflow of R23,9 billion in the second quarter of 2009, compared with an inflow of R11,7 billion in the first quarter. The more-than-doubling of direct investment inflows in the second quarter of 2009 primarily reflected the acquisition of an additional portion of the shareholding in a South African telecommunications company by a non-resident investor.

As foreign investors' sentiment towards emerging-market assets improved, *foreign portfolio investors* increased their holdings of South African equity and debt securities by R29,0 billion in the second quarter of 2009; an inflow of R10,1 billion had been registered in the first quarter. The inflow of portfolio investment capital through the JSE Limited (JSE) and the Bond Exchange of South Africa (BESA) in the second quarter of 2009 was supplemented by the issuance of a US$1,5 billion international bond by the government, with part of the proceeds utilised to redeem a maturing bond issue over the same period.

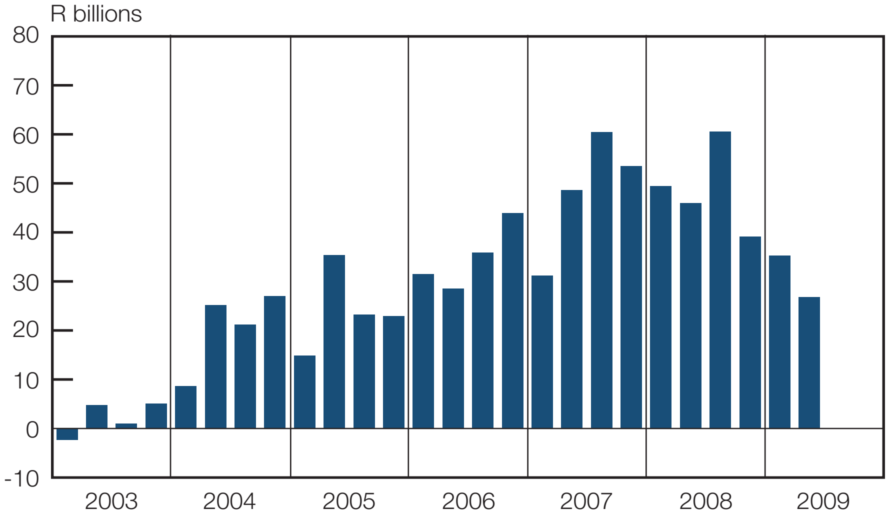
Other foreign investment in South Africa recorded an outflow of R26,0 billion in the second quarter of 2009, following an outflow of R9,3 billion in the preceding quarter. As had been the case in the first quarter of 2009, the outflow of capital mainly reflected a decline in non-resident rand-denominated deposits with, as well as short-term loan financing to, South African banks.

South African-owned assets abroad

Direct investment abroad by South African companies changed from an inflow of R4,4 billion in the first quarter of 2009 to an outflow of R3,7 billion in the second quarter as resident companies continued to acquire offshore entities and fund their foreign subsidiaries.

As part of their asset diversification strategies, South African institutional and individual investors continued to broaden their holdings of foreign portfolio assets. *Portfolio investment* abroad increased by R0,3 billion in the second quarter of 2009.

Balance on financial account



Including unrecorded transactions

Other outward investment from South Africa changed to an inflow of R16,4 billion in the second quarter of 2009, from an outflow of R1,5 billion in the first quarter. The inward movement of capital in the second quarter primarily reflected a decline in rand-denominated deposits of resident banks abroad, as well as a reduction in loans and advances extended to foreign banks by the domestic banking sector.

Foreign debt

South Africa's total outstanding foreign debt decreased further from US$71,8 billion at the end of the fourth quarter of 2008 to US$67,4 billion at the end of the first quarter of 2009. This decline resulted from a decrease in both rand- and foreign currency-denominated debt.

Foreign debt of South Africa

US$ billions at end of period

	2008				2009
	1st qr	2nd qr	3rd qr	4rd qr	1st qr
Foreign currency-denominated debt	**44,7**	**43,0**	**42,5**	**42,0**	**39,4**
Bearer bonds	16,0	15,0	14,1	14,0	13,3
Public sector	5,9	5,6	5,4	5,3	5,3
Monetary sector	12,5	12,0	11,9	12,1	10,5
Non-monetary private sector	10,3	10,4	11,1	10,6	10,3
Rand-denominated debt	**29,3**	**33,1**	**35,0**	**29,8**	**28,0**
Bonds	6,0	7,9	9,4	8,0	6,6
Other	23,3	25,2	25,6	21,8	21,4
Total foreign debt	**74,0**	**76,1**	**77,5**	**71,8**	**67,4**
As a percentage of gross domestic product	*25,5*	*25,8*	*26,0*	*25,9*	*25,8*

The decline in the country's foreign currency-denominated debt in the first quarter of 2009 was mainly due to a decline in foreign liabilities of the private banking sector – private non-banking sector liabilities decreased only marginally over the period. During the first quarter of 2009, the depreciation of the euro against the US dollar resulted in a decrease in South Africa's euro-denominated international bonds expressed in US dollar terms. The decline in the country's rand-denominated debt in the first quarter of 2009 mainly reflected non-resident investors' net sales of domestic rand-denominated bonds during the period.

Measured in rand, South Africa's total outstanding foreign debt decreased from R668 billion in the fourth quarter of 2008 to R649 billion in the first quarter of 2009.

International reserves and liquidity

Net capital inflows on the financial account of the balance of payments in excess of the deficit on the current account resulted in an increase due to balance-of-payments transactions of R7,1 billion in South Africa's net international reserves in the second quarter of 2009. In the first quarter of 2009 the increase had amounted to R1,8 billion.

Measured in US dollar, the value of the gross gold and other foreign reserves of the South African Reserve Bank (the Bank) – the international reserves before accounting for reserve-related loans – increased from US$34,1 billion at the end of March 2009 to US$35,8 billion at the end of June, but declined marginally to US$35,7 billion at the end of July. The Bank's short-term credit facilities utilised remained roughly unchanged at US$650 million from the end of March to the end of July 2009. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) advanced from 19,2 weeks at the end of March 2009 to 20,1 weeks at the end of June.

The Bank's international liquidity position increased from US$33,5 billion at the end of March 2009 to US$34,6 billion at the end of June and further to US$34,7 billion at the end of July.

Exchange rates

After strengthening marginally by 0,8 per cent during the first quarter of 2009, the nominal effective exchange rate of the rand increased by 17,5 per cent from the end of

March 2009 to the end of June. Although the weighted average exchange rate of the rand strengthened throughout the second quarter of 2009, a particularly sharp increase of 12,8 per cent was recorded during April. The domestic currency benefited mainly from substantial capital inflows into the country, following the improvement in investors' sentiment towards emerging-market assets, an increase in commodity prices, and expectations of an improvement in the country's deficit on current account after the release of better-than-expected foreign trade data.

The weighted average exchange rate of the rand declined by 0,6 per cent from the end of June 2009 to the end of July, partly in response to the recent downgrading of the IMF's forecast for global economic growth and a concomitant decline in international commodity prices.

Nominal effective exchange rate of the rand and international commodity prices

The real effective exchange rate of the rand increased by 17,6 per cent during the first half of 2009, following a decline of 16,5 per cent during 2008. As in the past, the volatility in the real effective exchange rate of the rand adversely affected the competitiveness of South African exporters.

Exchange rates of the rand

Percentage change

	30 Sep 2008 to 31 Dec 2008	31 Dec 2008 to 31 Mar 2009	31 Mar 2009 to 30 Jun 2009	30 Jun 2009 to 25 Aug 2009
Weighted average*	-7,8	0,8	17,5	-1,3
Euro	-8,9	2,5	16,7	-1,8
US dollar	-10,6	-3,4	23,8	-0,5
Chinese yuan	-10,9	-3,2	23,7	-0,5
British pound	11,6	-2,1	6,2	1,1
Japanese yen	-23,1	5,2	20,3	-1,7

* Against a basket of 15 currencies

The average net daily turnover in the domestic market for foreign exchange amounted to US$12,5 billion in the first quarter of 2009 and increased to US$15,0 billion in the second quarter. The increase in the average net daily turnover in the domestic market for foreign exchange was partly due to the increased participation of non-resident parties in the markets for debt and equity securities. The share of transactions in which non-residents participated consequently increased from 72,1 per cent in the first quarter of 2009 to 75,1 per cent in the second quarter.

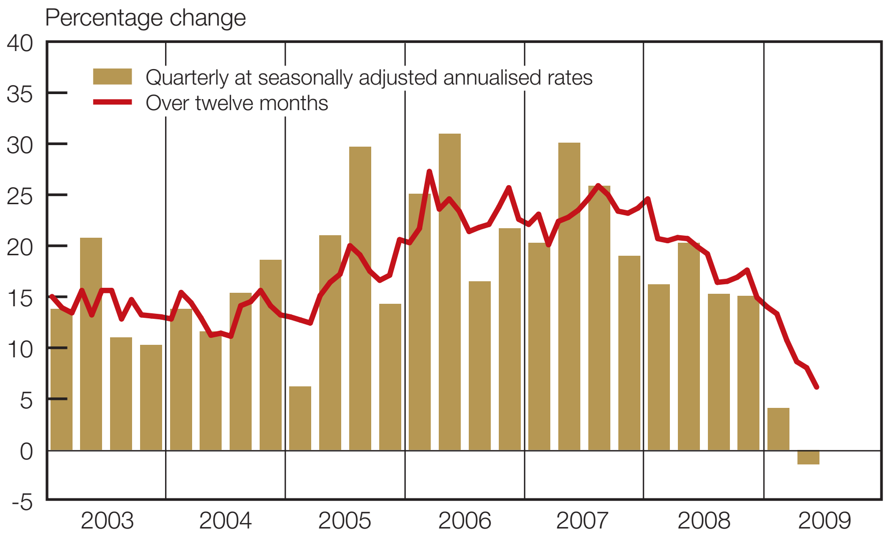
Monetary developments, interest rates and financial markets

Money supply

In the second quarter of 2009 the recessionary conditions in the domestic economy were mirrored by the behaviour of the monetary and credit aggregates, which in turn fed back to the real economy. The broadly defined money supply (M3) decelerated further in the second quarter of 2009 from a twelve-month growth rate of 8,5 per cent in April 2009 to 6,0 per cent in June. On a quarter-to-quarter[2] basis, growth in M3 decelerated from 4,1 per cent in the first quarter of 2009 to a negative growth rate of 1,4 per cent in the second quarter.

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

Growth in M3



To a large extent, the deceleration in M3 growth was a reflection of the ongoing slowdown in economic activity, lower inflation, and the fragility of both corporate- and household-sector incomes and balance sheets.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2008		2009	
	3rd qr	4th qr	1st qr	2nd qr
Notes and coin	4,5	16,3	13,7	-1,0
Cheque and transmission deposits	-1,7	12,8	-4,2	1,4
Call and overnight deposits	19,7	-3,7	-23,3	26,0
Other short- and medium-term deposits*	12,0	16,3	42,1	-11,6
Long-term deposits**	53,6	43,8	-24,9	-13,1
M3	15,3	15,1	4,1	-1,4

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

The maturity structure of monetary aggregates revealed a strong preference for call and overnight deposits in the second quarter of 2009, while term deposits contracted sharply. Notes and coin in circulation, which incorporates a strong transactions motive for holding money, registered negative growth in the second quarter of 2009 – the first negative quarterly growth rate since the second quarter of 1998.

The corporate sector contributed R4,6 billion to the overall increase of R8,3 billion in M3 deposits in the second quarter of 2009, while the household sector contributed R3,7 billion. Growth over twelve months in M3 deposit holdings of the corporate sector decelerated considerably from 9,4 per cent in March 2009 to 4,8 per cent in June. Similarly, growth over twelve months in M3 deposit holdings of the household sector stood at 9,2 per cent in June 2009, compared with 13,8 per cent recorded in March.

In a statistical sense, the increase in M3 during the second quarter of 2009 was largely explained by an increase in net foreign assets. Banks' claims on the private sector, which has played a prominent role as the main contributor to the overall quarterly increases in M3 since the second quarter of 2004, contracted by R21,5 billion during the second quarter of 2009. Net claims on the government sector declined moderately during the period.

Statistical counterparts of change in M3

R billions

	2008		2009	
	3rd qr	4th qr	1st qr	2nd qr
Net foreign assets	5,5	-14,5	7,6	20,6
Net claims on the government sector	13,4	17,3	5,6	-5,0
Claims on the private sector	32,1	38,3	27,1	-21,5
Net other assets and liabilities	-9,8	6,6	-27,1	14,2
Total change in M3	41,2	47,6	13,1	8,3

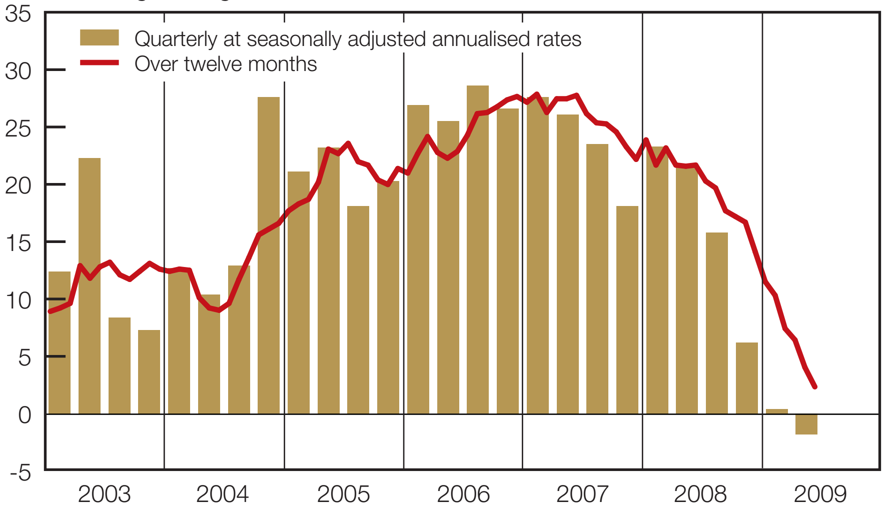
The income velocity of circulation of M3 reached a new record low of 1,20 in the second quarter of 2009, as M3 growth surpassed growth in nominal gross domestic product.

Credit extension

During the second quarter of 2009, growth in banks' total loans and advances extended to the private sector approached levels previously observed in the 1960s, as the slowdown in economic activity and prevailing stricter lending conditions continued to restrain both the household and corporate sectors' demand for credit.

Growth over twelve months in banks' total loans and advances extended to the private sector decelerated considerably from 7,3 per cent in March 2009 to 3,9 per cent in May and further to 2,2 per cent in June. On a quarterly and seasonally adjusted and annualised basis, growth in total loans and advances fell from 0,1 per cent in the first quarter of 2009 to a negative growth rate of 1,8 per cent in the second quarter – the first such growth rate to be recorded since the first quarter of 1966.

Total loans and advances to the private sector



Mortgage advances, which account for approximately 53 per cent of total loans and advances, decelerated further and reached a twelve-month growth rate of 8,2 per cent in June 2009, consistent with the lacklustre real-estate market and the private banks' stricter mortgage lending requirements.

Quarterly changes in banks' total loans and advances by type

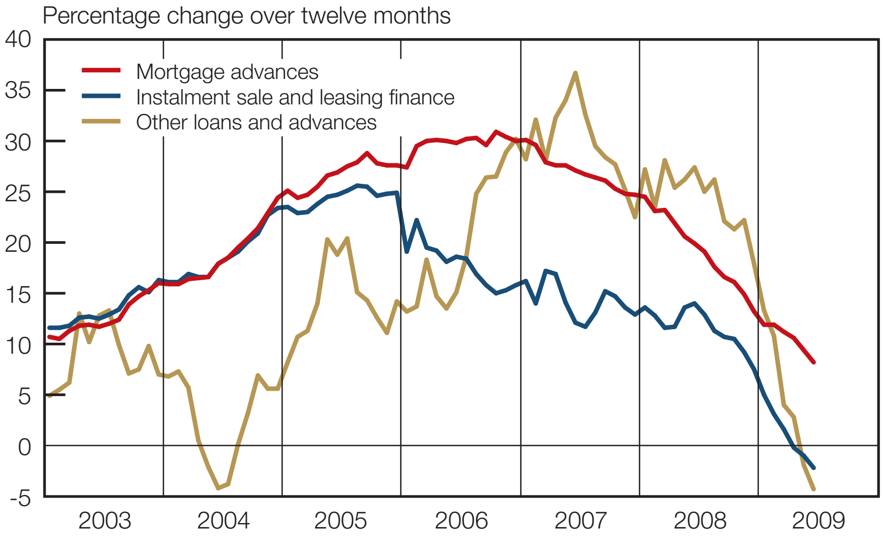
R billions

	2008	2009	
	4th qr	1st qr	2nd qr
Mortgage advances	25,2	14,3	2,2
Instalment sale credit and leasing finance	0,2	-3,7	-5,2
Other loans and advances	-10,9	-0,7	-18,7
Overdrafts	-12,6	2,2	-1,5
Credit card advances	-0,6	-0,2	-0,7
General advances	2,3	-2,7	-16,4
Total loans and advances	**14,5**	**9,9**	**-21,7**
Of which: To household sector	15,0	11,7	-1,6
To corporate sector	-0,5	-1,8	-20,1

Twelve-month growth in *instalment sale and leasing finance*, which accounts for about 13 per cent of total loans and advances, registered a third consecutive negative growth rate in June 2009, mainly due to waning demand for motor vehicles and other durable goods.

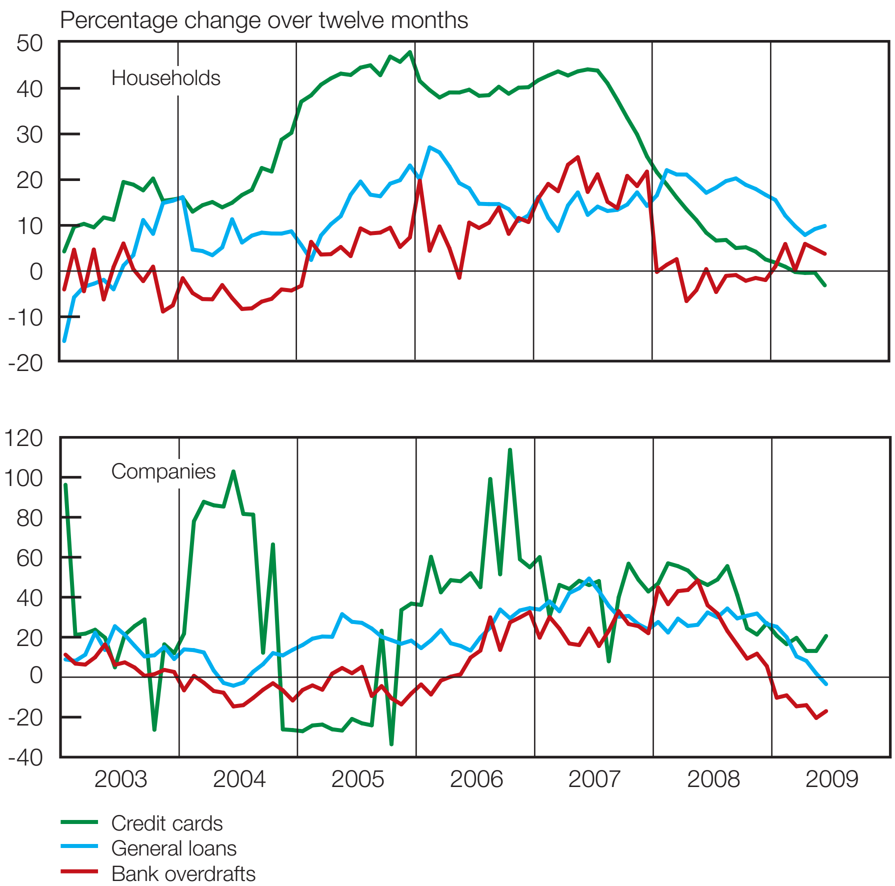
Other loans and advances, which consist of general loans, credit cards and bank overdrafts, decelerated from 4,0 per cent in March 2009 to negative growth rates of 1,9 per cent in May and 4,3 per cent in June. By contrast, the pace of decline in overdraft advances to the household sector eased somewhat from negative rates recorded since April 2008 to twelve-month growth rates of around 5 per cent in the second quarter of 2009, as households resorted to short-term unsecured credit following the reduction in domestic interest rates.

Loans and advances to the private sector by type of credit



The corporate sector accounted for the largest part – 93 per cent – of the overall decline in total loans and advances extended to the private sector during the second quarter of 2009. Growth over twelve months in credit extended to the corporate sector decelerated from 8,6 per cent in March 2009 to a mere 2,3 per cent in May and further recorded a negative growth rate of 0,4 per cent in June. Similarly, twelve-month growth in total loans and advances extended to the household sector decelerated from 6,2 per cent in March 2009 to 5,3 per cent in May and further to 4,6 per cent in June.

Other loans and advances to households and companies

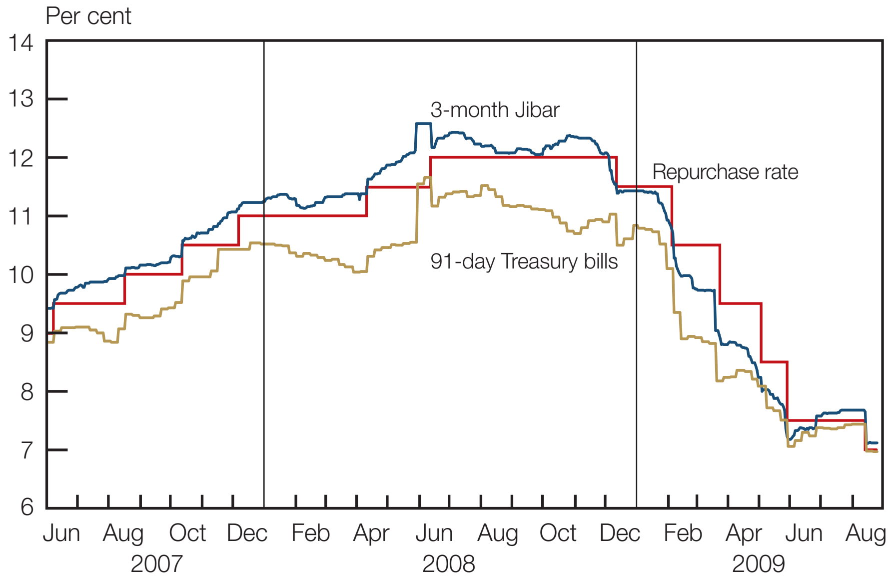


Interest rates and yields

The MPC of the Bank left the repurchase rate unchanged at 7,5 per cent at its June 2009 meeting, following five consecutive reductions totalling 450 basis points starting with the December 2008 meeting. Although key factors, such as the widening output gap and weaker domestic demand, pointed to an improved inflation outlook, some risks posed by a variety of cost-push and exogenous factors were perceived to be too high to justify further relaxation of monetary policy. At its August meeting, however, the MPC noted evidence of further widening of the output gap and reduced inflationary pressures, and lowered the repurchase rate to 7,0 per cent. The MPC statements discussing developments underlying the June and August 2009 decisions are reproduced on pages 55–60 of this *Bulletin*.

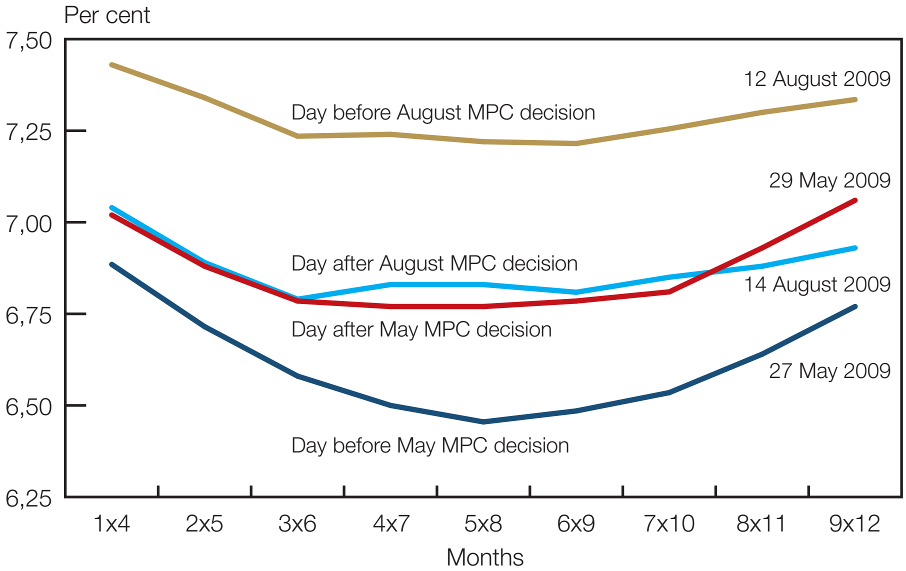
Following a marked decline in the first five months of 2009, other money-market interest rates temporarily edged higher from the end of May 2009 before receding again in the wake of the reduction in the repurchase rate announced in August. For instance, after reaching a three-year low of 7,18 per cent at the end of May 2009, the three-month Johannesburg Interbank Agreed Rate (Jibar) gradually increased by 50 basis points to 7,68 per cent at the end of July, but declined to 7,12 per cent on 24 August 2009. Against the backdrop of some repricing reflecting an increase in the issuance of government debt instruments, the rate on 91-day Treasury bill rate also trended higher and reached 7,44 per cent at the end of July receding to 6,97 per cent on 24 August.

Money-market rates



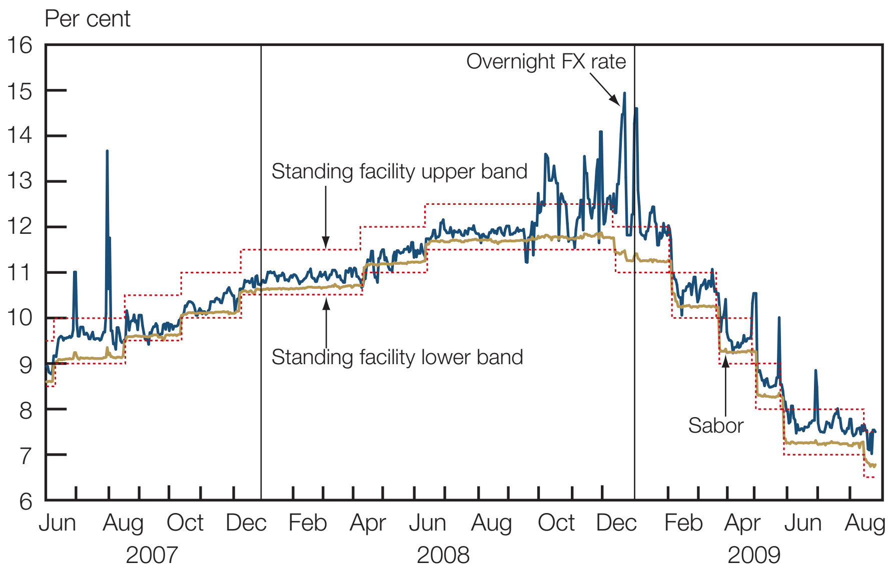
The forward rate agreement (FRA) yield curve shifted lower during the first five months of 2009 but temporarily moved higher from the end of May 2009, as market expectations regarding further relaxation of monetary policy subsided. For instance, the 3x6-month FRA rate increased from 6,61 per cent on 27 May 2009 to 7,24 per cent at the end of July. As indicated by the FRA yield curve interest expectations were altered significantly following the MPC meeting and repurchase rate reduction in August.

Forward rate agreement yield curves



The South African Benchmark Overnight Rate on Deposits (Sabor) remained well within the standing facility limits during the second quarter of 2009. The implied rate on the one-day rand funding in the foreign-exchange swap market (overnight FX rate) continued to decline, although displaying occasional short-lived sharp increases towards month-ends.

Benchmark overnight rates



Both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private-sector banks remained aligned with the movements in the repurchase rate and amounted to 11,0 per cent from late May to mid-August before receding to 10,5 per cent following the August 2009 decision of the MPC.

The *standard interest rate* on loans granted by government from the State Revenue Fund, as defined by the Public Finance Management Act, declined from 11,5 per cent to 10,5 per cent on 1 July 2009. Concurrently, the *official rate of interest* applicable to fringe benefit taxation, as defined in the Income Tax Act, declined from 9,5 per cent to 8,5 per cent.

Interest rates on the RSA *government fixed-rate retail bonds* are priced off the government bond yield curve on a monthly basis. The following table depicts how rates on fixed-rate bonds have changed since January 2009:

Interest rates on RSA fixed-rate retail bonds in 2009

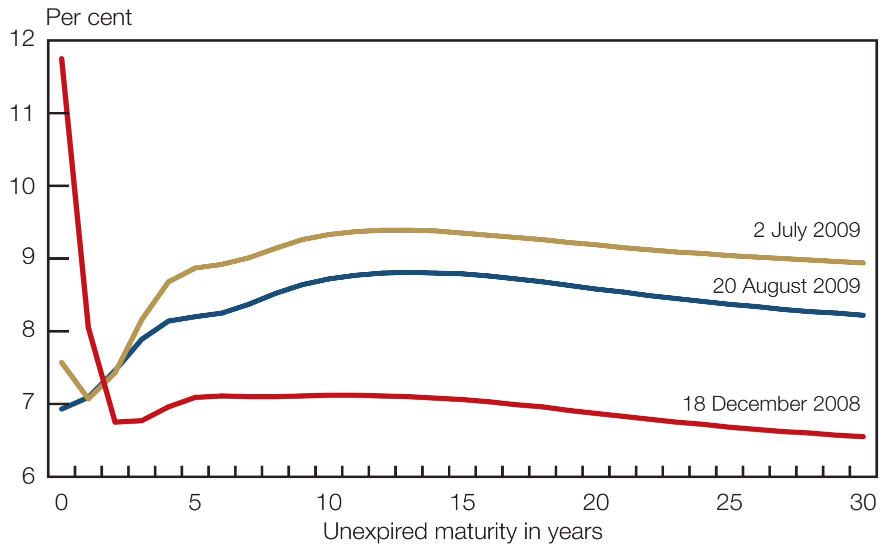
Per cent

	2-year bond	3-year bond	5-year bond
Effective from:			
1 Jan	9,75	10,00	10,50
1 Mar	9,50	9,75	10,25
1 Jun	9,00	9,25	9,75
1 Jul	9,25	9,50	9,75

The *daily average yield on the R157 government bond* (maturing in 2014/15/16) fluctuated higher from a low of 7,04 per cent on 18 December 2008 to 8,78 per cent on 3 July 2009. This was in response to, among other things, the release of worse-than-expected inflation data, higher international oil prices, and the higher level of issuance and expected further increase in the supply of government bonds. Subsequently, the bond yield declined to 8,14 per cent on 20 August following the release of lower inflation data and the appreciation in the exchange value of the rand. The daily closing yield on the US government's dollar-denominated 10-year bond followed a similar trend, increasing from 2,06 per cent on 30 December 2008 to 3,95 per cent on 10 June 2009, before fluctuating lower to 3,45 per cent on 20 August. Consequently, the spread between the South African R157 bond yield and the US 10-year bond yield narrowed marginally from 496 basis points on 18 December 2008 to 469 basis points on 20 August 2009.

From December 2008, bond yields at the extreme short end of the *yield curve* decreased in line with the lowering of the repurchase rate. Increases were, however, evident in the medium to long end of the curve to 2 July 2009, before moving downwards. Consequently, the yield gap, measured as the difference between yields at the extreme long and short ends of the curve, changed notably from a negative 520 basis points on 18 December 2008 to a positive 129 basis points on 20 August 2009.

Yield curves



The release of worse-than-expected inflation data and rising international oil prices contributed to the widening of the gap between nominal yields on conventional bonds and real yields on inflation-linked government bonds in 2009. This proxy for expected inflation, namely the *break-even inflation rate* in the four-year maturity range, increased from 3,88 per cent on 10 February 2009 to 6,58 per cent on 6 July as nominal yields increased and real yields declined. Subsequently, the break-even inflation rate declined to 5,94 per cent on 20 August as nominal yields decreased on lower inflation expectations.

The *currency risk premium*[3] on South African government bonds widened from 14 basis points in February 2009 to 264 basis points in July, as the yield on domestic rand-denominated bonds generally increased, while the corresponding yield on dollar-denominated bonds decreased.

The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[4] spread narrowed from 718 basis points in November 2008 to 389 basis points in July 2009, on improved investor confidence in emerging-market assets. The *sovereign risk premium* on South African government US dollar-denominated bonds in the five-year maturity range trading in international markets also narrowed from an average of 720 basis points in November 2008 to 279 basis points in July 2009.

3 Measured as the differential between South African government bond yields on rand-denominated debt in the 6-year maturity range issued in the domestic market and South African dollar-denominated debt in the 8-year maturity range issued in the US market.

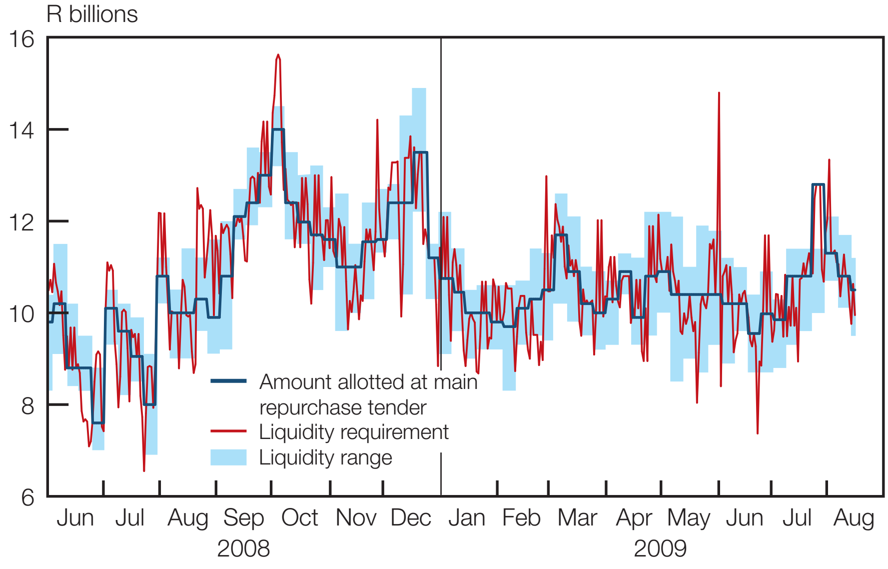
4 EMBI+ measures total returns on US dollar-denominated debt instruments of emerging markets.

Money market

The average daily liquidity requirement of the private-sector banks varied within the broad range of between R7,4 billion and R14,8 billion during the second quarter of 2009. The liquidity provided by the Bank at the weekly main refinancing auctions fluctuated between R9,6 billion and R10,9 billion over the same period.

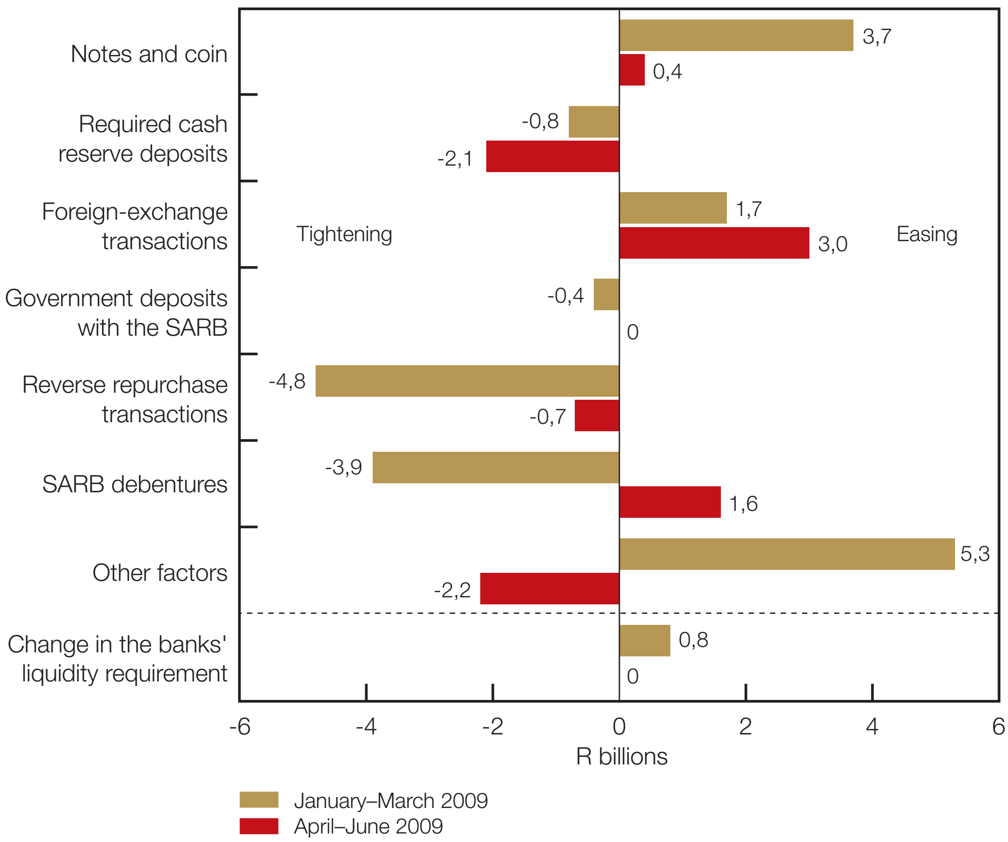
In addition to the use of standing facilities and supplementary repurchase transactions, daily liquidity variations were occasionally accommodated through banks' utilisation of their cash reserve accounts. The statistical counterparts influencing market liquidity over the period under review are depicted in the accompanying graph.

Liquidity requirement, range and amount allotted



During the second quarter of 2009, notes and coin in circulation, and banks' cash reserve deposits with the SARB drained liquidity to the net value of R1,7 billion. This tightening in liquidity conditions was mainly offset by the net redemption of South African Reserve Bank (SARB) debentures and reverse repurchase transactions to the value of R0,9 billion, which injected liquidity into the money market. The purchases of foreign exchange by the Bank injected a further R3,0 billion.

Factors influencing money-market liquidity



Special Treasury bills with a maturity of six days, amounting to R2,0 billion, were issued during June 2009 and further assisted the Bank in smoothing liquidity flows in the market. Between April and July 2009, coupon payments amounting to R8,9 billion on various government bonds, including the R186, were effected from the tax and loan account.

Bond market

On 22 June 2009, BESA became a wholly owned subsidiary of the JSE, in terms of which the JSE acquired the entire issued share capital of BESA.

Activity in the South African primary bond market was dominated by *public-sector* issuance during the first seven months of 2009. Net issues of R52,4 billion were made by the public sector during the aforesaid period, reflecting the increased funding needs of central government and state-owned enterprises. These two entities accounted for 54 per cent and 42 per cent of total public-sector net issues, while local government accounted for the remaining 4 per cent over the same period.

According to the current National Treasury auction calendar, central government and state-owned enterprises are expected to issue bonds to the value of R113,3 billion in the 2009/10 fiscal year. Meanwhile, the Minister of Finance indicated that government faces a larger deficit than initially projected, resulting in additional domestic borrowing. This could further add to the weekly supply of government bonds, which increased from an average of R1,1 billion in April 2009 to R1,5 billion in July.

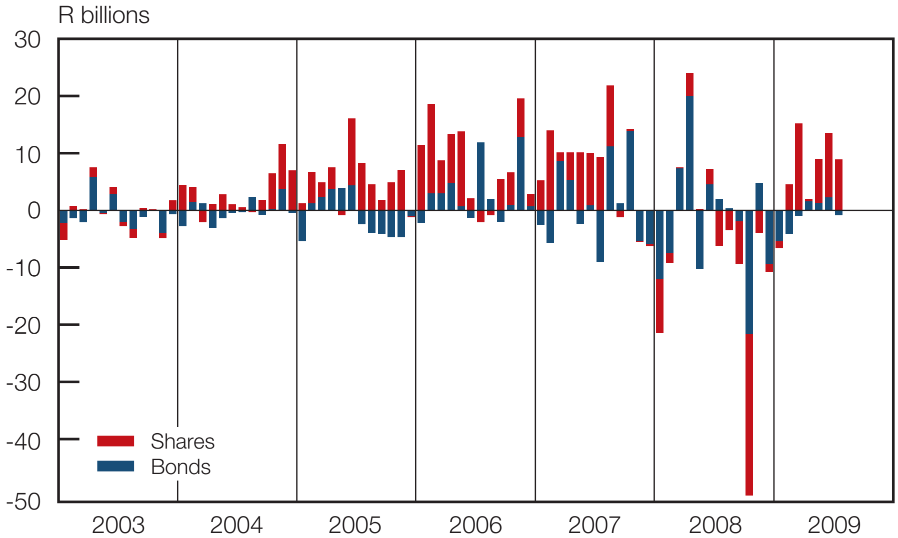
Net issues of bonds by the *private sector* amounting to R10,8 billion in the first seven months of 2009, contributed to an outstanding nominal value of private-sector loan stock listed on the JSE of R225,8 billion at the end of July. Very low issues by the private corporate sector in the bond market reflected unfavourable financial market conditions and the high cost of raising funds. The banking sector, however, recorded record-high net issues in July 2009 as market conditions improved. Net redemptions of commercial paper of R14,3 billion in the first seven months of 2009 brought the outstanding nominal value of *commercial paper* listed on the JSE to R47,6 billion at the end of July.

The slowdown in economic activity and lower liquidity in global financial markets depressed supply and demand for rand-denominated bonds in the *European* and *Japanese Uridashi bond markets* during 2009. Net redemptions of rand-denominated bonds issued in the European market to the value of R8,7 billion was recorded in the first seven months of 2009, compared with net issues of R8,9 billion in the same period of 2008. Over the same period, interest in rand-denominated debt issued in the Uridashi market faded, as net issuance of R5,0 billion was 69 per cent lower than the net issuance in the corresponding period of 2008.

Turnover in the domestic secondary bond market abated during the first seven months of 2009 alongside weaker bond prices and declining participation by non-residents. The value of bonds traded on the JSE waned from R4,3 trillion in the first quarter of 2009 to R3,4 trillion in the second quarter. Thus far in 2009, total turnover of R8,9 trillion was 26 per cent lower than the value traded in the corresponding period of 2008. The average value traded per day amounted to R60,9 billion in the first seven months of 2009, compared with R82,3 billion in the same period of 2008.

Despite higher bond yields, *non-residents* showed little interest in the domestic bond market and net sales of domestic debt securities amounted to R10,4 billion in the first quarter of 2009. Non-residents then returned to the domestic bond market and gradually increased their holdings to reflect net purchases of R5,0 billion in the second

Net purchases of shares and bonds by non-residents



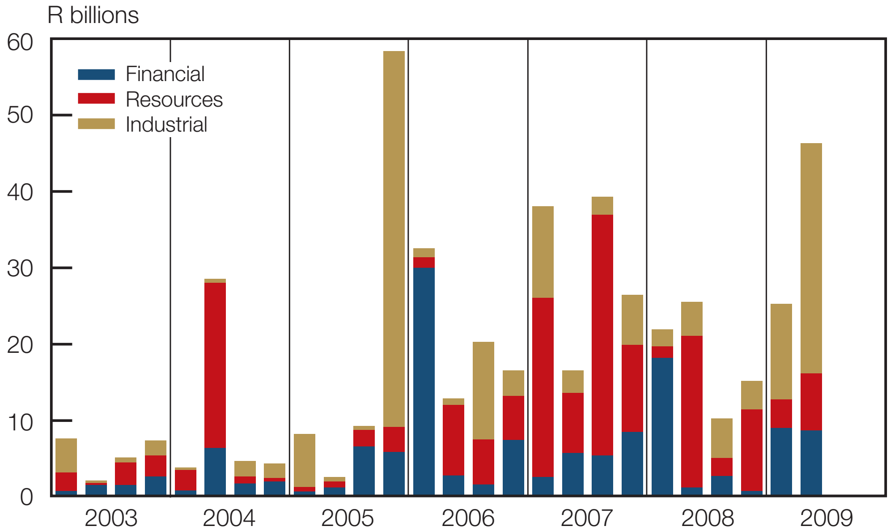
Transactions on the JSE Limited

quarter. Non-residents' cumulative net sales of South African debt securities amounted to R6,3 billion in the first seven months of 2009, compared with net purchases of R3,9 billion in the corresponding period of 2008. Non-resident participation in the domestic bond market declined from 18 per cent in 2007 to 13 per cent in 2008 and further to an average of 12 per cent in the first seven months of 2009.

Share market

The total value of *equity capital raised in the domestic and international primary share markets* by companies listed on the JSE of a marked R46,5 billion in the second quarter of 2009 and R76,7 billion in the first seven months of 2009 was boosted by the recent monthly high of R37,6 billion in May 2009. The equity raised thus far in 2009 was 40 per cent more than the R54,8 billion raised in the corresponding period of 2008 and somewhat more than the amount raised in the full year 2008. Of the total capital raised thus far in 2009, the industrial, financial and resources sectors accounted for 56 per cent, 25 per cent and 17 per cent, respectively. Capital was mainly raised through acquisition of assets and the waiver of pre-emptive rights to the amounts of R44,7 billion and R19,0 billion over the same period.

Capital raised in the primary share market



Listing activity in the first seven months of 2009 remained subdued as only 4 new listings were recorded compared with 15 new listings in the corresponding period of 2008, while delistings amounted to 15 and 13 over the same periods. Of these listings, 1 new listing and 2 delistings on Alt^{X} brought this exchange's total to 76 which, together with the 326 companies on the main board and 13 companies on the development and venture capital boards, added to a total of 415 listings on the JSE at the end of July 2009.

Despite the slight increase of 3 per cent in the total value of shares traded on the JSE in the second quarter of 2009 – along with somewhat higher share prices – volatility and uncertainty was reflected by turnover of R1,5 trillion in the first seven months of 2009, which was 20 per cent less than the R1,9 trillion recorded in the corresponding period of 2008. Turnover on Alt^{X} amounted to R1,3 billion in the first seven months of 2009 – a decrease of 63 per cent when compared with the value traded in the same period of 2008. The average daily total turnover amounted to R10,1 billion in the first seven months of 2009; lower than the R12,8 billion recorded in the corresponding period of 2008, but similar to the R10,6 billion average in the same period of 2007.

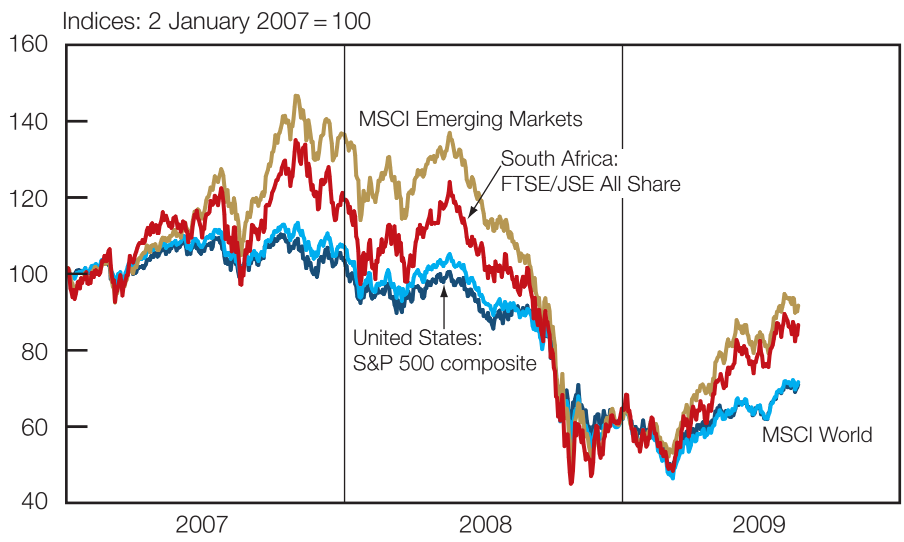
As share prices picked up, the total *market capitalisation* of the JSE recovered some of its earlier losses as it increased by 31 per cent from R4,0 trillion in February 2009 to R5,2 trillion in July. Accounting for only 0,2 per cent of total market capitalisation at the end of July 2009, the combined market capitalisation of all companies listed on Alt^X decreased by 35 per cent from a high point of R20,0 billion in November 2008 to R13,1 billion in July 2009. Total market liquidity – measured by annualised turnover as a percentage of total market capitalisation – declined from 94 per cent in October 2008 to 54 per cent in July 2009.

A general easing in global risk aversion and partial recovery in global equity markets led to renewed *non-resident* interest in, and exposure to, the domestic secondary share market in 2009. This was evident as non-residents reverted from record-high net sales of domestic shares to the value of R50,5 billion in the last half of 2008 to net purchases of R46,8 billion in the first seven months of 2009.

The recent rebound in global equity markets was in the wake of better-than-expected economic results, pointing to a possible bottoming out of the global recession. In conjunction with this somewhat improved economic outlook, investors displayed a willingness to acquire riskier assets. The decline from 42 per cent on 3 March 2009 to 25 per cent on 20 August in domestic expected volatility, measured by the South African Volatility Index, supported this more optimistic outlook. This view was also evident as the *FTSE/JSE All-Share Price Index* (Alsi) fluctuated higher, rising by 36 per cent from its recent low on 3 March 2009 to 20 August. The Alsi was supported by all three major sectors in the share market, with share prices in the financial sector increasing by 41 per cent from 3 March 2009 to 20 August, outperforming the other sectors as it gained ground based on factors such as the lower interest rates and appreciation in the exchange value of the rand. Industrial sector share prices increased by 36 per cent and the prices of resources shares gained 33 per cent as commodity prices increased over the same period.

The Alsi, measured in US dollar terms, and the Morgan Stanley Capital International (MSCI) Emerging Markets index outperformed both the Standard & Poor's (S&P) 500 composite index and the MSCI World Index from 3 March 2009 to 20 August, alongside expectations of relatively higher economic growth in emerging markets. In US dollar terms, the Alsi

Share prices



increased by 77 per cent from 3 March 2009 to 20 August and the MSCI Emerging Markets Index rose by 76 per cent, while the MSCI World and the S&P 500 composite indices recorded increases of 51 per cent and 45 per cent, respectively.

With lower earnings and dividends declared in the past twelve months, the historical dividend yield on all classes of shares decreased from 4,5 per cent in February 2009 to 3,2 per cent in July, with the *earnings yield* decreasing from 11,8 per cent to 8,5 per cent over the same period. Conversely, the *price-earnings ratio* of all classes of shares increased from 8,4 in February 2009 to 11,8 in July.

Market for exchange-traded derivatives

In the first seven months of 2009, turnover in the *financial derivatives* market was subdued when compared with the corresponding period of 2008. Lower trading volumes followed investors' uncertainty regarding the underlying equity market and a reduction in risk appetite, despite recent somewhat improved global risk aversion. Although single-stock futures accounted for only 8 per cent of the total turnover in the first seven months of 2009, they continued to be the most preferred trading instrument, accounting for 68 per cent of the total number of contracts traded. The equity index products accounted for 22 per cent of total number of contracts traded, but 92 per cent of total value traded over the same period.

Trading activity in *commodity futures and options* declined in the seven months to July 2009 when compared with the corresponding period in 2008, as the ongoing global economic crisis dampened overall demand for agricultural commodities. The downward trend in commodity trades was also in tandem with volatile prices of domestic agricultural products, movements in international grain prices and the exchange value of the rand.

Trading activity on *Yield-X* recorded robust growth in the seven months to July 2009. Currency futures and options contracts dominated trade as participants hedged against currency risk, accounting for 93 per cent of the total number of contracts traded. US dollar/rand contracts remained the most preferred trading instrument representing 81 per cent of total currency contracts traded over the period January to July 2009. Turnover in currency futures and options traded accounted for 41 per cent of total turnover, while turnover in interest rate futures and options contracts traded accounted for 37 per cent in the seven months to July 2009.

The number of *warrants* traded increased in the first seven months of 2009 compared with the corresponding period of 2008, as market participants continued to hedge against risks in the equity market. However, turnover declined together with persistent price volatility in the underlying share market. Turnover in all derivatives traded on the JSE for the first seven months of 2009 is indicated in the table below.

Derivatives turnover on the JSE, January to July 2009

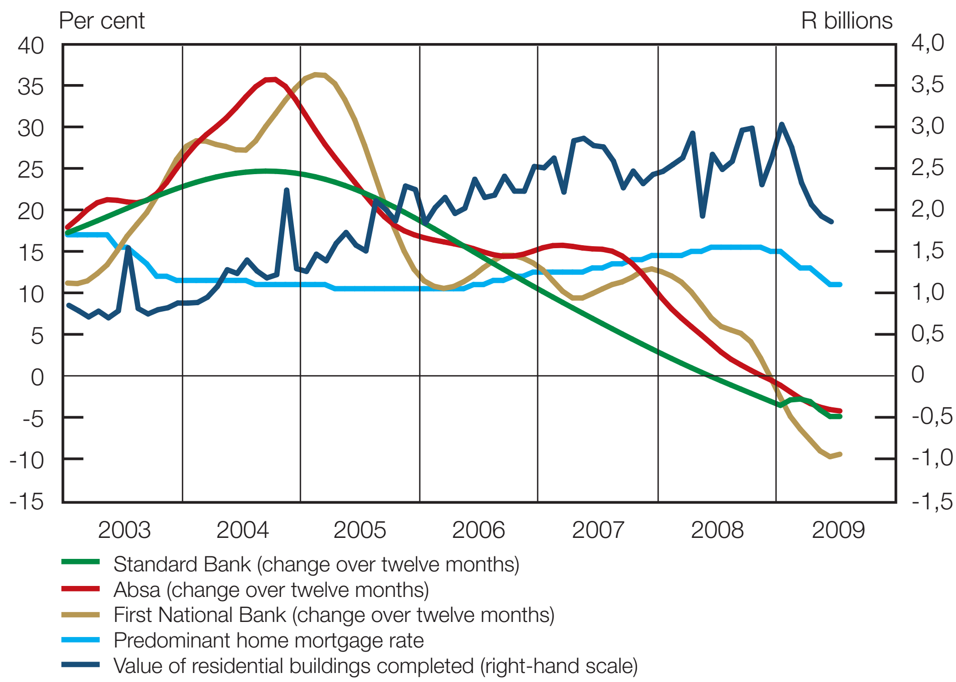
	Value R billions	Change over one year Per cent
Financial futures and options on futures	1 645	-50
Warrants	2	-12
Agricultural commodity futures and options	138	-40
Interest rate derivatives	86	69

Real-estate market

The house price deflation continued in 2009, with no signs yet of improvement in property demand, confirming the existence of long delays before the effect of interest rates becomes visible in real activity. Persistent stress selling and its resultant oversupply of property in the market have also been noted as contributing factors to the downward momentum in house prices in addition to the banks' tightened lending criteria. The year-on-year rate of change in the average house price in the middle segment of the market, as measured by Absa, declined from 15,7 per cent in March 2007 to a negative 4,2 per cent in July 2009. Similarly, the year-on-year rate of change in the average house price, as measured by FNB, declined from a recent high of 12,9 per cent in December 2007 to a negative 9,5 per cent in July 2009, while the year-on-year rate of change in the Standard Bank median house price declined from 3,2 per cent to a negative 4,9 per cent over the same period.

Alongside the decline in house prices, activity in the construction of new houses slowed significantly in 2009 due to poor demand as the adverse economic conditions depressed employment prospects and expected household income. The value of residential buildings completed recorded, on average, a year-on-year decline of 7 per cent in the first half of 2009, compared with growth of 2 per cent in 2008 and 19 per cent in 2007.

House prices, mortgage rate and residential buildings completed



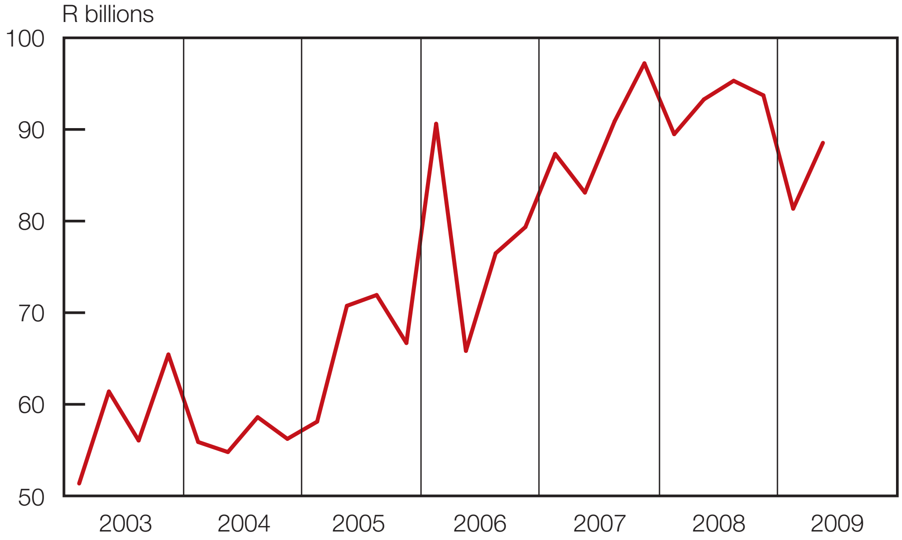
Non-bank financial intermediaries

Net inflows[5] into non-bank financial intermediaries[6] declined from R95,3 billion in the third quarter of 2008 to R81,4 billion in the first quarter of 2009, hampered by pressure in employment growth and real disposable income of households. Subsequently, the net inflows increased to R88,5 billion in the second quarter as inflows into unit trusts improved. On a gross basis, premiums and contributions paid to insurance companies and pension funds, which accounted for the bulk of the inflows, recorded a decline of

5 Total premiums and contributions received plus net sales of units minus administrative expenses.

6 Defined as unit trusts, private pension and provident funds, official pension and provident funds and insurers.

Net inflow of funds into non-bank financial institutions



20 per cent from R88,4 billion in the third quarter of 2008 to R70,5 billion in the second quarter of 2009. By contrast, inflows into unit trusts accelerated by 75 per cent over the same period.

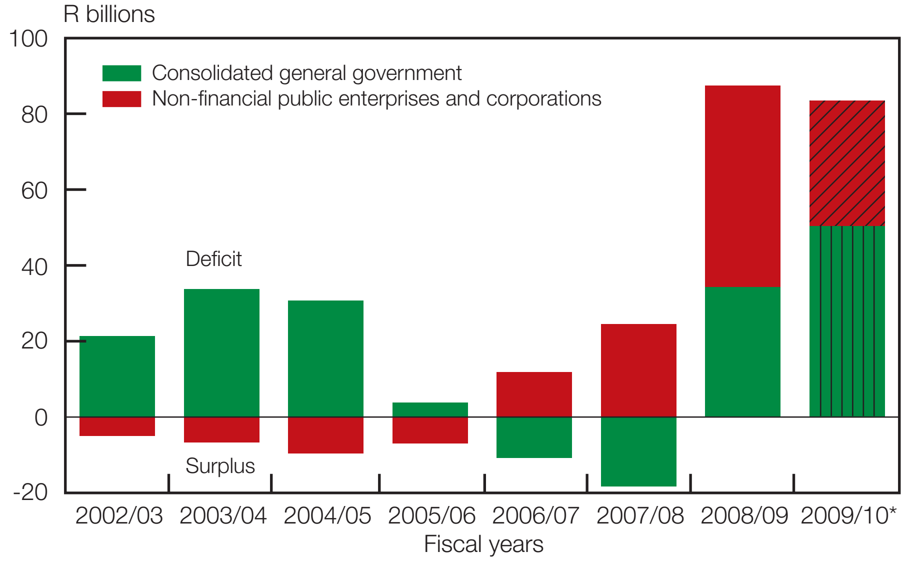
Public finance

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

Non-financial public-sector borrowing requirement[7]

Accelerated infrastructure spending by consolidated general government, and non-financial public enterprises and corporations significantly widened the non-financial public-sector borrowing requirement in the first quarter of fiscal 2009/10. The non-financial public-sector cash deficit also reflected government's commitment to supporting sustainable economic growth and social development through infrastructure development, social assistance transfers to households and spending on social services. Relative to gross domestic product, the non-financial public-sector borrowing requirement amounted to 14,4 per cent in April–June 2009, compared with a deficit of 0,6 per cent recorded in the same period a year earlier.

Non-financial public-sector borrowing requirement



* April–June 2009

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

Non-financial public-sector borrowing requirement

R billions

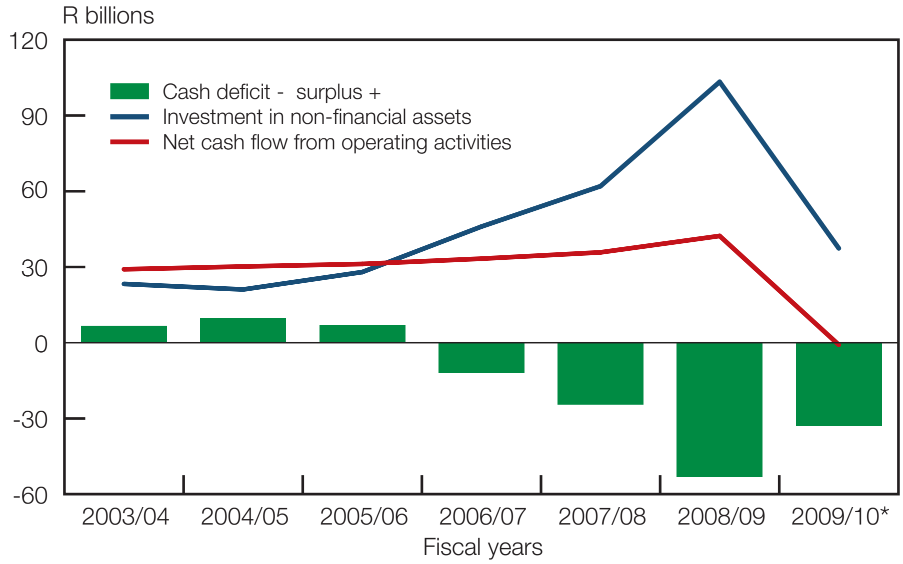
Level of government	Apr–Jun 2008*	Apr–Jun 2009*
National government	2,2	54,0
Extra-budgetary institutions	-2,7	-1,3
Social security funds	-1,5	-1,7
Provincial governments	-2,2	-2,1
Local governments	3,5	1,6
Non-financial public enterprises and corporations	4,2	33,0
Total**	3,5	83,5
As a percentage of gross domestic product	*0,6*	*14,4*

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

Net cash flow from operating activities, together with net investment in non-financial assets of the *non-financial public enterprises and corporations*, resulted in a cash deficit of R33,0 billion in the first quarter of fiscal 2009/10. This can be compared with a cash deficit of R4,2 billion recorded in the corresponding period a year earlier. The cash deficit widened on account of higher net investment in non-financial assets by major non-financial public enterprises and corporations as they are expected to shoulder a sizeable share of the broader public-sector capital investment programme. In addition, Eskom received the second tranche, amounting to R7,5 billion, of a subordinated loan from the National Treasury. During April–June 2009, capital spending more than doubled year on year as investment in power generation, transmission, distribution, transport hubs, freight rail and pipelines gathered momentum. These investments, as key drivers of economic and social development, are expected to enhance the long-term growth potential of the economy.

National government finances have deteriorated alongside continued sluggish economic conditions, with cash receipts arising from tax collections and other revenue declining by 6,7 per cent in the first quarter of fiscal 2009/10 compared with receipts in the same period a year earlier. Cash payments for operating activities increased by 29,1 per cent year on year during the period under review. Net cash flow from operating activities, together with net purchases of non-financial assets, registered a cash deficit of R54,0 billion during April–June 2009. This was substantially higher than the cash deficit recorded in the corresponding period a year earlier due to higher expenditure.

Finances of non-financial public enterprises and corporations



* April–June 2009

An analysis of the *Provincial Revenue Fund Statements* indicated a R2,1 billion cash surplus in the April–June quarter of 2009 – almost similar to the cash surplus recorded in the same period a year earlier. Grants – equitable share transfers and conditional grants – from national government remained provincial governments' main source of cash receipts. This revenue category was 20,6 per cent more than in April–June 2008 and totalled R72,4 billion in the first quarter of fiscal 2009/10. During the period under review, cash payments for operating activities rose by 20,1 per cent year on year to total R65,9 billion. Over this period net investment in non-financial assets amounted to R6,5 billion, or 32,2 per cent more than in the same period a year earlier.

Provincial governments increased their bank deposits from R6,5 billion to R6,6 billion between March and June 2009. Their overall indebtedness to banks decreased from R1,7 billion to R1,1 billion between these respective dates.

Extra-budgetary institutions recorded a cash surplus of R1,3 billion in April–June 2009, less than half the cash surplus recorded in the same period a year earlier. Preliminary data indicated a moderate improvement in the financial position of *social security funds*, which recorded a cash surplus of R1,7 billion in the first quarter of fiscal 2009/10, compared with a cash surplus of R1,5 billion recorded in the same period a year earlier.

In the first quarter of fiscal 2009/10 *local governments* recorded a cash deficit of R1,6 billion, marginally lower than the April–June 2008 cash deficit. This can be attributed to substantial growth in grants received from national and provincial governments despite the increasing infrastructure-related spending. Net investment in non-financial assets trended higher and showed a 21,9 per cent year-on-year growth rate. The *2009 Budget Review* indicated that local government capital spending would average R54,1 billion per annum over the medium-term projection period to 2011/12.

Budget comparable analysis of national government finance

In contrast to the economic slowdown and relatively weak revenue collections, national government expenditure in April–June 2009 rose by 32,5 per cent year on year and totalled R180,0 billion. This increase was substantially higher than the April–June 2008 growth rate due to extraordinary growth in transfers and subsidies. It was also higher than the average year-on-year rate of increase recorded in the same period during the five years prior to fiscal 2009/10. The *2009 Budget Review* projected a 16,2 per cent increase in national government expenditure for the 2009/10 fiscal year as a whole.

Spending by national government relative to gross domestic product amounted to 31,1 per cent in April–June 2009, higher than 24,0 per cent recorded in the corresponding quarter of fiscal 2008/09.

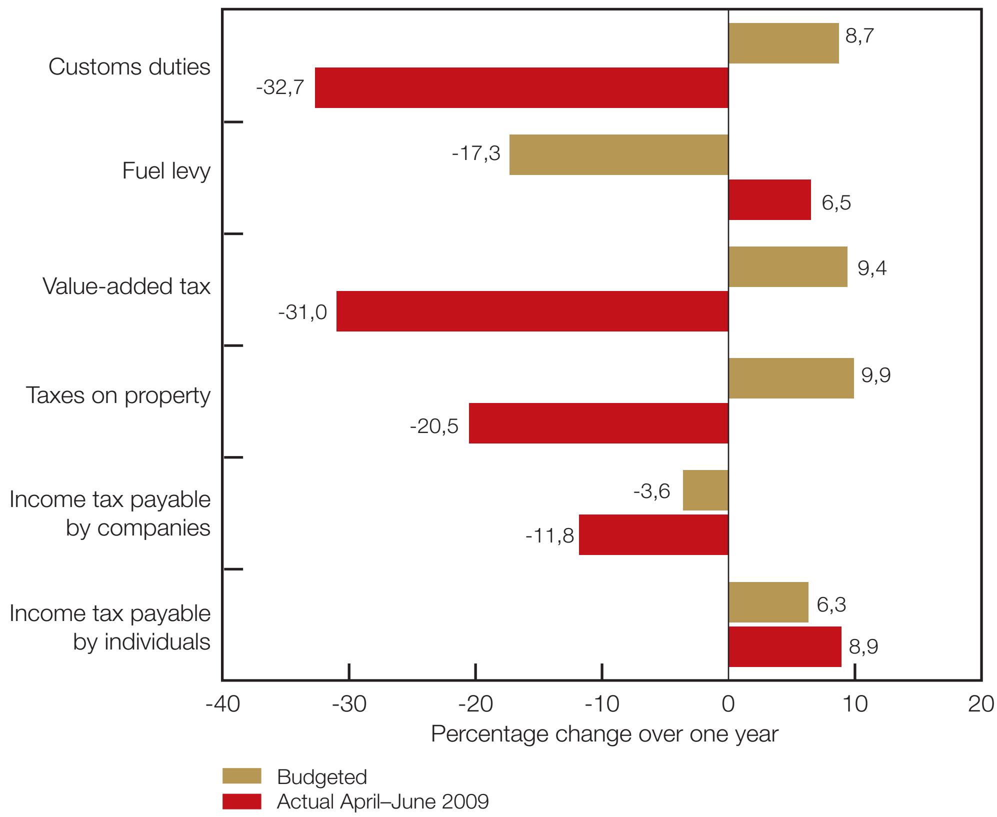
During April–June 2009 transfers and subsidies rose strongly and totalled R79,1 billion. Transfers from the National Treasury included R4,2 billion for the provincial conditional grant paid on the Gautrain loan, and a grant of R1,7 billion to provinces and municipalities for integrated housing and human settlement development. Furthermore, as mentioned earlier, the National Treasury transferred R7,5 billion to Eskom as part of a subordinated loan. Payments for capital assets amounted to R1,4 billion in the April–June quarter of 2009, or 35,2 per cent more compared with the corresponding period of the previous fiscal year. Projections in the *2009 Budget Review* indicated that this spending category would equal R8,5 billion in fiscal 2009/10. Interest cost of national government for April–June 2009 was 17,4 per cent more than in the corresponding period a year earlier.

After taking into account cash-flow adjustments,[8] national government cash-flow expenditure in the first quarter of fiscal 2009/10 equalled R177,4 billion – 28,0 per cent more than in the corresponding quarter of fiscal 2008/09.

8 Transactions arising from timing differences between the recording of transactions and bank clearances, and late departmental requests for funds.

The slowdown in domestic economic activity, together with subdued international trading conditions, was evident in national government tax revenue collections during the first quarter of fiscal 2009/10. In the light of these developments, national government revenue decreased by 10,0 per cent and amounted to R122,3 billion in April–June 2009. The *2009 Budget Review* projected that national government revenue would increase by 5,7 per cent in fiscal 2009/10.

National government revenue



Owing to the current economic slowdown, most major tax categories recorded decreases during the first quarter of fiscal 2009/10. The decrease in taxes on income, profits and capital gains also reflected the eroded company profits, hence the lower corporate income tax payments. The sluggish behaviour of taxes on property primarily signalled the continued slowdown in real-estate market activity and the associated lower collections of transfer duties. Value-added tax – the major subcategory of taxes on goods and services – declined substantially, reflecting continued moderation in domestic demand. Taxes on international trade and transactions also contracted, due to falling imports; consequently lower customs duties were collected in the first quarter of fiscal 2009/10.

National government revenue in fiscal 2009/10

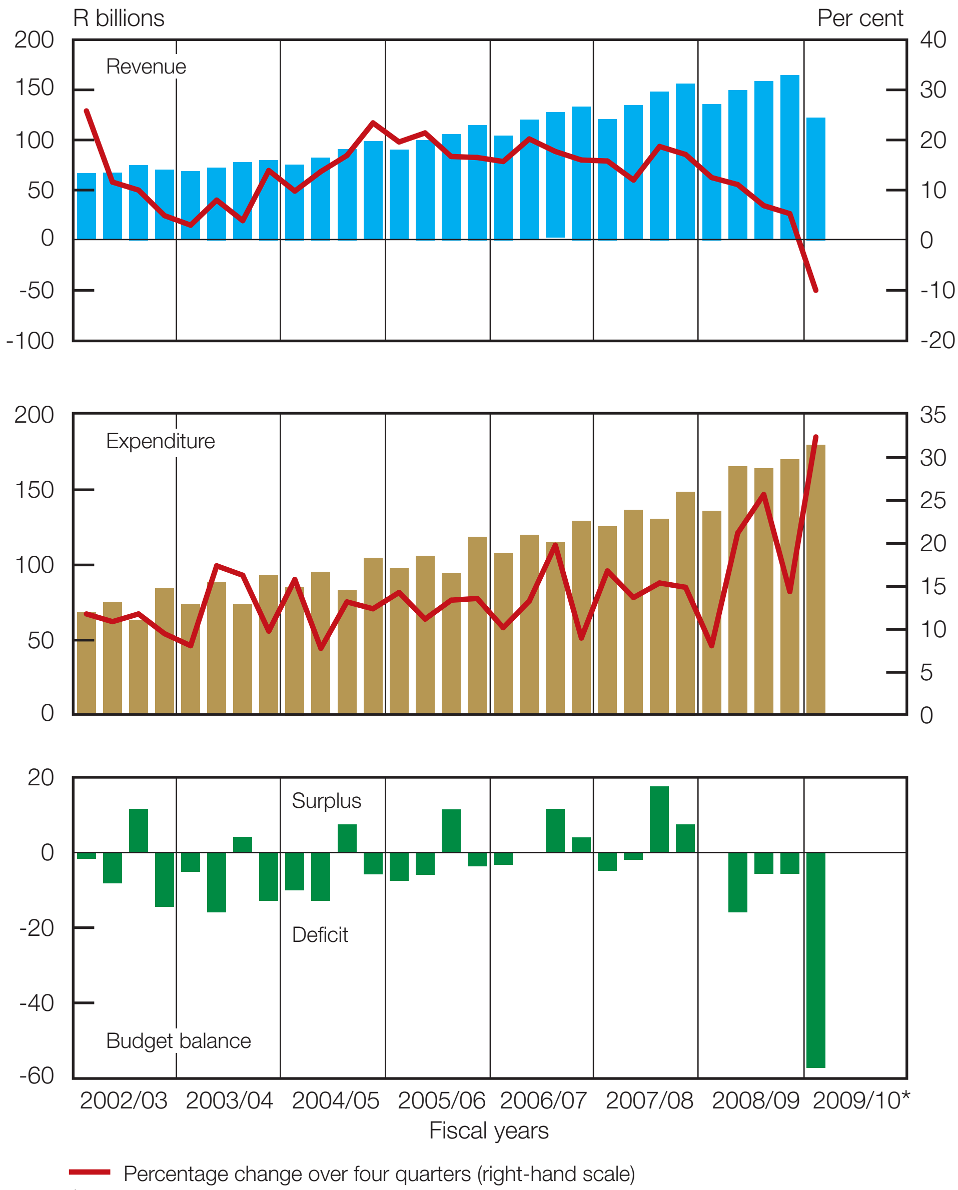
Revenue source	Originally budgeted		Actual Apr–Jun 2009	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	389,0	1,4	84,2	-1,6
Payroll taxes	7,8	5,8	1,9	8,1
Taxes on property	10,4	9,9	2,1	-20,5
Taxes on goods and services	226,5	12,7	35,1	-22,8
Taxes on international trade and transactions	25,3	9,5	3,8	-33,3
Other revenue	11,9	-8,3	2,4	9,8
Less: SACU** payments	27,9	-3,5	7,0	-3,5
Total revenue	643,0	5,7	122,3	-10,0

* April–June 2008 to April–June 2009
** Southern African Customs Union

National government revenue as a ratio of gross domestic product declined from 24,0 per cent in the April to June quarter of 2008 to 21,1 per cent in the same quarter of fiscal 2009/10.

After taking into account cash-flow adjustments, national government cash-flow revenue in the first quarter of fiscal 2009/10 amounted to R120,4 billion, representing a year-on-year rate of decrease of 11,6 per cent.

National government finances



* April–June 2009

The net result of national government revenue and expenditure in the first quarter of fiscal 2009/10 was a cash-book deficit before borrowing and debt repayment of R57,7 billion – against an almost balanced budget recorded in April–June 2008. This outcome seems consistent with the projected substantial increase in the deficit for fiscal 2009/10. As a ratio of gross domestic product, the deficit amounted to 10,0 per cent in the first quarter of the current fiscal year, compared with a ratio very close to zero recorded in the same period a year earlier.

In April–June 2009, the cash-flow deficit before borrowing and debt repayment amounted to R57,0 billion, significantly higher than the cash-flow deficit of R2,3 billion recorded in the corresponding period of fiscal year 2008/09. Extraordinary receipts included R3,9 billion in proceeds from the sale of Telkom shares in Vodacom. After taking into account these receipts and the cost on revaluation of foreign debt at redemption, the net borrowing requirement of national government for the period under review amounted to R53,2 billion – more than 12 times the net borrowing requirement recorded in April–June 2008.

The net borrowing requirement was financed through debt instruments issued in the domestic and foreign capital markets, as indicated in the accompanying table. As envisaged in the 2009 Budget, the bulk of the net borrowing requirement was financed domestically, with net issues of long-term government bonds amounting to R19,3 billion in April–June 2009. Although the *2009 Budget Review* projected that net issues of domestic Treasury bills would amount to R15,4 billion in fiscal 2009/10, the outcome for the first quarter already exceeded the budgeted amount by R10,8 billion. Included in the issues to date, an amount of R17,8 billion has a maturity of 91 days and less.

National government financing in fiscal 2009/10

R billions

Item or instrument	Originally budgeted	Actual Apr–Jun 2009	Actual Apr–Jun 2008
Deficit	95,6	57,0*	2,3*
Plus: Extraordinary payments	0,9	0,0	0,0
Cost on revaluation of foreign debt at redemption	2,3	0,3	1,9
Less: Extraordinary receipts	4,0	4,1	0,0
Net borrowing requirement	**94,8**	**53,2**	**4,3**
Treasury bills	15,4	26,2	9,9
Domestic government bonds	63,7	19,2	5,6
Foreign bonds and loans	6,1	6,3	-2,8
Change in available cash balances**	9,6	1,5	-8,4
Total net financing	**94,8**	**53,2**	**4,3**

* Cash-flow deficit
** Increase - decrease +

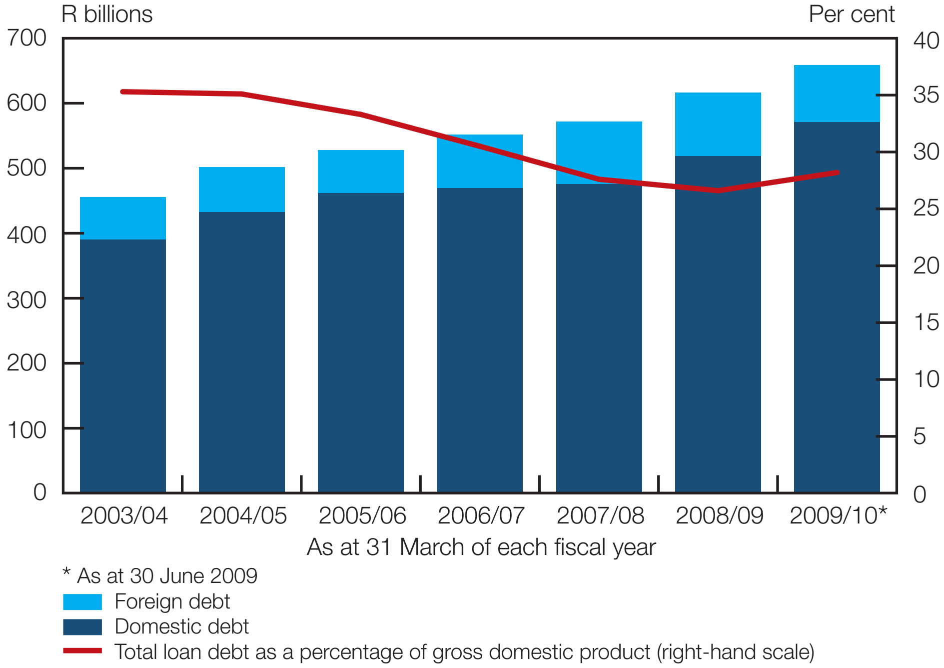
Domestic long-term funding was obtained at an average rate of 8,6 per cent per annum, while domestic short-term instruments were sold at an average of 7,7 per cent. The average maturity of domestic marketable bonds of national government decreased from 123 months at the end of March 2009 to 121 months at the end of June.

To reduce pressure on the domestic capital market and ensure an appropriately balanced debt portfolio, national government raised a total of R12,3 billion in May 2009 through the foreign issuance of a US$1,5 billion ten-year bond with a coupon rate of 6,875 per cent. Government recorded net issues of foreign bonds and loans during April–June 2009. The average maturity of foreign marketable bonds of national government increased from 77 months at the end of March 2009 to 98 months at the end of June.

National government funding activities decreased government's available cash balances by R1,5 billion during April–June 2009, bringing these balances to R99,9 billion at the end of June. Deposits with the Bank increased by R0,4 billion and totalled R70,5 billion as at 30 June 2009. At the same time, deposits with private-sector banks decreased by R1,9 billion and brought the balance to R29,4 billion at the end of June 2009.

Relative to total national government loan debt, domestic debt increased from 84,2 per cent at the end of March 2009 to 86,7 per cent at the end of June 2009. Following switch transactions undertaken by government, short-term domestic bonds have decreased in magnitude as the maturity profile now comprises more long-term bonds.

Total loan debt of national government



Foreign debt decreased from 15,8 per cent of total loan debt to 13,3 per cent between March and June 2009 as revaluation effects on account of appreciation of the rand reduced the value in rand of government's foreign debt. In terms of currencies, the major share of national government's foreign debt is denominated in US dollar, followed by the euro.

Total national government loan debt increased from R616 billion at the end of March 2009 to R658 billion at the end of June. Accordingly, total national government loan debt relative to gross domestic product rose from 26,6 per cent to 28,2 per cent between these dates.

Statement of the Monetary Policy Committee

25 June 2009

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

The domestic economy continues to show signs of stress in the wake of the global economic downturn. Output growth remains negative, while trends in household consumption expenditure have continued to deteriorate. There are, however, signs that the downturn, both globally and domestically, may be nearing the lower turning point, but the recovery is expected to be slow and protracted.

The inflation rate has continued its downward trend, which has been constrained by relatively sticky services price inflation. While the widening output gap and weak domestic demand pose a downside risk to the inflation outlook, these risks are increasingly being offset by various cost-push and exogenous factors that are impacting on the economy, as well as by deteriorating inflation expectations.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas declined from 8,4 per cent in April 2009 to 8,0 per cent in May. Food price inflation declined from 13,6 per cent in April to 12,1 per cent in May, but remains the main contributor to the inflation outcome, having contributed 1,9 percentage points. Housing and utilities inflation contributed 1,8 percentage points, mainly as a result of the 29,6 per cent increase in electricity prices and the 15,1 per cent increase in the cost of maintenance and repairs. Services price inflation has remained unchanged at 8,4 per cent since March 2009, while goods price inflation declined from 8,7 per cent to 7,6 per cent over the same period.

Producer prices declined at a year-on-year rate of 3 per cent in May 2009. Nonetheless, agricultural product prices increased at a year-on-year rate of 1,5 per cent, while manufactured food product prices increased by 6,2 per cent.

The outlook for inflation

The most recent CPI inflation forecast by the staff of the South African Reserve Bank (the Bank) shows that CPI inflation is still expected to continue its moderate downward trend, to enter the target range during the second quarter of 2010, and to remain within the target range for the rest of the forecast period ending 2011. A more favourable exchange rate assumption has been offset by higher-than-expected petrol price increases and inflation outcomes.

CPI inflation expectations, as measured by the Bureau for Economic Research (BER) at Stellenbosch University deteriorated during the second quarter of 2009. Average inflation expectations for 2009 increased from 8,3 per cent in the first quarter to 8,7 per cent in the second quarter, mainly as a result of upward revisions by financial analysts. While a downward trend for the subsequent two years remains, only the financial analysts predict inflation to be within the inflation target range in the coming two years. Overall, CPI inflation is expected to average 8,1 per cent and 7,9 per cent in 2010 and 2011 respectively.

Inflation expectations, as measured by the yield differential between conventional and inflation-linked bonds, also showed a moderate increase over the past weeks. However, the break-even rate has generally remained within the inflation target range over the short- to medium-term maturities.

The growth prospects for the economy remain a downside risk to the inflation outlook. The output gap, which is the difference between actual and potential output growth, has widened over the past few quarters. Following the 6,4 per cent contraction of gross domestic product (GDP) in the first quarter of 2009, the most recent high frequency data and indicators suggest that the negative trend in GDP growth is likely to have continued during the second quarter of 2009. Mining production declined at a year-on-year rate of 10,6 per cent in April, but increased by 7,2 per cent on a month-on-month basis. Total manufacturing production declined by 3,3 per cent in April 2009, compared with the previous month, and by 21,6 per cent on a year-on-year basis.

The composite leading indicator as compiled by the staff of the Bank increased slightly in April. The indicator suggests that the lower turning point in the cycle could be reached later in the year. The Kagiso Securities/Bureau for Economic Research Purchasing Managers' Index remains at low levels, but recorded a slight increase in May, also indicating an expectation that the economy may be approaching its lower turning point. This is consistent with the Rand Merchant Bank/Bureau for Economic Research Business Confidence Indicator, which declined further in the second quarter, but the rate of decline has slowed.

The domestic growth prospects will be determined, to an important degree, by international developments. The global downturn has resulted in a significant decline in South Africa's exports in the first quarter of 2009, leading to a wider deficit on the current account of the balance of payments compared with the previous quarter. The outlook for the global economy remains uncertain, but there is a general sense of cautious optimism that the lower turning point of the cycle might have been reached. The general view appears to be that the global economy will remain under pressure for most of this year before beginning a slow recovery. Global inflation remains well contained.

Growth in domestic expenditure has remained subdued, with real domestic final demand contracting by 1,5 per cent in the first quarter of 2009. Real final consumption expenditure by households declined at a quarter-on-quarter annualised rate of 4,9 per cent. Contractions in consumption were experienced in all broad categories of goods, but there was a rebound in the growth of expenditure on services. Growth in real gross fixed capital formation moderated to 2,6 per cent during the same period. The main contributor to the 2,2 per cent increase in gross domestic expenditure was final consumption expenditure by general government, which increased by 5,9 per cent.

Household consumption expenditure appears to have remained under pressure in the second quarter of 2009. In April, real retail trade sales declined by 1,1 per cent compared with the previous month, and by 6,7 per cent on a year-on-year basis. Real wholesale trade sales increased by 0,7 per cent on a month-on-month basis, but declined by 15,1 per cent on a year-on-year basis. While new vehicle sales in May increased marginally compared with the previous month, the year-on-year decline measured 32,9 per cent.

Household consumption expenditure is expected to remain constrained by tighter credit criteria of banks and negative wealth effects. The various house price indicators all show that house prices have continued to decline. The All-Share Index on the JSE Limited has recovered somewhat from its lows in March, but is still substantially below the levels recorded during the first half of 2008.

Growth in expenditure may also be affected negatively by the adverse trends in employment growth. According to the Quarterly Employment Survey of Statistics South Africa, 179 000 jobs were lost in the formal non-agricultural sector during the first quarter of 2009.

The exchange rate of the rand has fluctuated against the US dollar between a range of about R7,85 and R8,25 since the previous meeting of the MPC. As global risk aversion has declined, a number of emerging-market economy currencies have appreciated and since the beginning of the year, the rand has appreciated by approximately 15 per cent on a trade-weighted basis.

As noted above, food price inflation remains the main contributor to the inflation outcome, but the downward trend has continued, although at a slow pace. The spot price of yellow maize has declined by about 40 per cent since June 2008, and is now at levels last seen in the final quarter of 2006.

The main upside risk to the inflation outlook comes from cost-push pressures, particularly from electricity price increases and other administered prices, as well as nominal wage increases, which have generally been in excess of inflation. In the first quarter of 2009 the increase in unit labour cost over four quarters amounted to 11,2 per cent.

The international oil price has re-emerged as a potential upside risk to the inflation outlook. The price of North Sea Brent crude oil reached levels in excess of US$70 per barrel in the past week, before declining to current levels of around US$67 per barrel. As a result of the higher international product prices, a further petrol price increase is likely in July.

Monetary policy stance

The MPC has decided to keep the repurchase rate unchanged at 7,5 per cent per annum. This decision is based on the economic and inflation analysis provided above. The committee is fully cognisant of the fact that there has been significant monetary accommodation since December 2008. The MPC remains fully committed to its mandate of achieving and maintaining price stability.

Statement of the Monetary Policy Committee

13 August 2009

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

There are encouraging signs that the global slowdown may have reached its lower turning point, although the speed and extent of the recovery are still subject to a high degree of uncertainty. The South African economy appears to be lagging behind these international developments and it is likely that the domestic economy contracted in the second quarter of this year. The domestic economy remains constrained by weak global and domestic demand.

Targeted inflation declined materially in June, but is still outside the inflation target range. Expectations are that it will take some time before inflation returns to within the target range on a sustainable basis. Cost-push pressures appear to be the main source of upside risk to the inflation outlook.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas declined from 8,0 per cent in May 2009 to 6,9 per cent in June. The main contributors to the inflation outcome were food and non-alcoholic beverages, housing and utilities, and miscellaneous goods and services. Each of these categories contributed 1,6 percentage points to CPI inflation. Petrol prices declined at a year-on-year rate of 25 per cent, despite the 17 cents per litre increase in the petrol price in June. Administered price inflation, excluding petrol prices, measured 9,1 per cent in June, with electricity prices increasing by 28,6 per cent.

Producer prices declined at a year-on-year rate of 4,1 per cent in June, compared with a decline of 3,0 per cent in May. Prices of mining and chemical products were the main contributors to this trend, but there was also further moderation in food price inflation. Prices of agricultural products declined at a year-on-year rate of 1,7 per cent, while prices of manufactured food products increased at a rate of 3,7 per cent, compared with a rate of 6,2 per cent in the previous month.

The outlook for inflation

The most recent CPI inflation forecast by the staff of the South African Reserve Bank remained more or less unchanged compared with the previous forecast. However, CPI inflation is still expected to continue its moderate downward trend, to enter the target range during the second quarter of 2010 and to remain within the target range for the rest of the forecast period ending in 2011.

These projections are broadly in line with the Reuters consensus survey of private-sector analysts. The most recent survey for July indicates that analysts expect inflation to decline to within the inflation target range during the second quarter of 2010, and to average 5,8 per cent and 5,6 per cent in 2010 and 2011 respectively. Expectations derived from the yield differential between conventional government bonds and inflation-linked bonds have remained within the inflation target range over the short- to medium-term maturities.

The outlook for the international economy appears to have improved. The cautious optimism that the bottom of the cycle may have been reached continues to prevail, although some analysts still doubt the strength and sustainability of this recovery. The recovery is also not expected to be uniform across countries or regions. According to the July 2009 *World Economic Outlook* of the IMF, global output is expected to contract by 1,4 per cent in 2009 before recovering to 2,5 per cent in 2010. The developed economies are expected to grow by 0,6 per cent, while growth in emerging economies is expected to average 4,7 per cent in 2010. At this stage, global inflation appears to be under control despite the significant monetary accommodation in a number of advanced economies.

Domestic economic conditions remain subdued amid indications that the economy contracted further in the second quarter of 2009, although at a slower rate of contraction than in the previous quarter. Manufacturing production declined at a year-on-year rate of 17,1 per cent in June, and by 3 per cent in the three months to June 2009 compared with the previous three months. The utilisation of production capacity in manufacturing in May 2009 was 78 per cent; down from 84,4 per cent a year ago. The Kagiso/Bureau for Economic Research Purchasing Managers' Index (PMI) declined in July, indicating that the difficult conditions in the manufacturing sector are likely to persist. However, according to the PMI, expectations of business conditions six months ahead continued to improve. Similarly, the Bank's composite leading business cycle indicator increased for a second consecutive month in May 2009, indicating the possibility of a recovery later in the year.

Household consumption expenditure growth continued to contract during the past few months. New vehicle sales declined again in July, with total vehicle sales declining by 4,5 per cent in July compared with the previous month. Total vehicle exports declined by 12 per cent on a month-on-month basis, and by 60,3 per cent on a year-on-year basis. Real retail trade sales contracted at a seasonally adjusted rate of 3,6 per cent in the second quarter of 2009 compared with the first quarter. On a year-on-year basis, retail sales declined by 6,7 per cent in June. The First National Bank/Bureau for Economic Research Consumer Confidence Index increased moderately in the second quarter of 2009, although it is still at low levels.

The weak state of domestic demand is reflected in the rate of credit extension to the private sector. Year-on-year growth in total loans and advances of banks to the private sector declined from 6,3 per cent in April 2009 to 2,2 per cent in June. On a quarter-on-quarter basis, negative growth of 1,8 per cent was measured in the second quarter of 2009. Year-on-year growth in mortgage advances moderated to 8,2 per cent in June, while instalment sales credit and leasing finance, as well as other loans and advances, experienced negative year-on-year growth. These declines are due, in part, to stricter lending criteria being applied by banks.

The impact of negative wealth effects on domestic consumption expenditure may have dissipated somewhat with the partial recovery of equity prices in the local and global markets. Since the beginning of the year, the All-Share Index on the JSE Limited has increased by about 14 per cent. However, the index is still significantly below the levels reached in 2008. The various house price indices all show that house prices continued to decline in July, but the pace of decline appears to be moderating.

The exchange rate of the rand has remained relatively volatile, but within a range that has prevailed since May 2009 with the decline in global risk aversion. The exchange rate of the rand has fluctuated between approximately R7,68 to the US dollar and R8,32 to the US dollar since the previous meeting of the MPC. Since the beginning of the year, the nominal effective exchange rate of the rand has appreciated by about 13 per cent.

As noted above, food price developments continue to be a major factor in the overall inflation outcomes. After months of relative stickiness, food price inflation at the consumer price level appears to be responding to the favourable trends at the producer price level. In June 2009 food price inflation declined to 9,8 per cent compared with a rate of 16,1 per cent in January 2009.

The main upside risks to the inflation outlook emanate from cost-push pressures. The international oil price has continued its stronger upward trend, as the outlook for the global economy improves. The price of North Sea Brent crude oil has remained above US$70 per barrel for most of the period since the previous meeting. Although domestic petrol prices were reduced by 21 cents per litre in July, the current under-recovery indicates that a further petrol price increase is likely in August.

Other adverse cost pressures include administered price increases, particularly electricity prices, and wage increases that have generally been in excess of inflation. According to Andrew Levy Employment publications, wage settlements in the first six months of 2009 averaged 9,7 per cent. In the first quarter of 2009 the increase in unit labour cost over four quarters amounted to 11,2 per cent.

Monetary policy stance

The MPC is of the view that, notwithstanding upside cost pressures, the adverse economic conditions appear to tilt the balance of risks to the inflation outlook towards the downside over the medium term. The MPC has, therefore, decided to reduce the repurchase rate by 50 basis points to 7 per cent per annum with effect from 14 August 2009.

Business cycles in South Africa during the period 1999 to 2007

by J C Venter[1]

Introduction

The South African Reserve Bank (the Bank) has identified reference turning points in the cyclical movement of the economy since 1946. These upper (peaks) and lower (troughs) turning points in the business cycle were discussed in various articles and notes published in earlier issues of the Bank's *Quarterly Bulletin*. The most recently identified trough in the business cycle occurred in August 1999.[2]

The previous two longest upward phases of the business cycle – both lasting 44 months – occurred from September 1961 to April 1965 and from January 1978 to August 1981. The current upward phase, which started in September 1999, surpassed this record in May 2003. Although there were two periods – in 2001 and again in 2003 – when the growth rate of aggregate economic activity briefly moderated, neither of these periods qualified as downward phases of the business cycle.[3]

The purpose of this article is to discuss the determination of a reference peak in the business cycle, following the trough in August 1999. The first section briefly describes the methodology employed by the Bank in determining a reference turning point in the business cycle. This is followed by the statistical results obtained if this methodology is applied to recent data. A brief overview of macroeconomic events and developments between 1999 and 2007 is then presented, followed by a graphic comparison of movements in selected economic indicators during this upward phase and the two previous longest upward phases of the business cycle. Finally, the date of the upper reference turning point is identified.

Methods used to determine reference turning points in the business cycle

It is important to note that the Bank determines reference turning points in the business cycle in terms of the growth cycle definition of business cycles. Growth cycles represent the fluctuations around the long-term growth trend of aggregate economic activity; so-called trend-adjusted cycles. Therefore, the Bank's business cycle chronology, published regularly in the *Quarterly Bulletin*, represents reference turning-point dates that distinguish between upward phases when the pace of growth in aggregate economic activity exceeded its long-term growth trend, and downward phases when aggregate economic activity either contracted or increased at a slower rate than its long-term growth trend.

The Bank uses a combination of methods to determine whether a reference turning point in the business cycle has occurred. The three *composite business cycle indicators* – leading, coincident and lagging – are continuously analysed. A composite business cycle indicator is compiled by integrating various economic indicators into a single index. The composite leading business cycle indicator currently comprises 12 economic indicators, which have historically preceded turning points in the business cycle. Similarly, 5 economic indicators, which have historically coincided with turning points in the business cycle, form the composite *coincident* business cycle indicator. The composite *lagging* business cycle indicator is calculated by using 7 economic indicators, which have historically followed turning points in the business cycle.

1 The author wishes to thank N Maphalala, A Bosch, N Mahlo and N Phadime for valuable assistance in applying the statistical methods employed during this analysis.

2 Venter, J C and Pretorius, W S. 2001. "A note on the business cycle in South Africa during the period 1997 to 1999". *Quarterly Bulletin*. September. Pretoria: South African Reserve Bank.

3 Venter, J C. 2005. "Reference turning points in the South African business cycle: Recent developments". *Quarterly Bulletin*. September. Pretoria: South African Reserve Bank.

Once the composite indicators point to the likelihood that a turning point in the business cycle has occurred, two comprehensive diffusion indices are calculated. Similar to the calculation of the composite business cycle indicators, the *current diffusion index* is compiled from the actual month-to-month symmetrical percentage changes in each of 186 seasonally adjusted time series. These time series represent economic processes, such as production, sales, employment and investment, in the various sectors of the economy. The deviation of the current diffusion index from its long-term trend provides a proxy for the cyclical movement in aggregate economic activity.

The same 186 time series are used to calculate the *historical diffusion index*, which can be defined as a measure of dispersion of the changes in a number of time series. This index depicts the number of time series that are increasing (relative to each one's long-term trend) as a percentage of the total number of series considered. Therefore, an index value exceeding 50 indicates that the majority of time series considered is increasing in that particular month, implying that the economy is in an upward phase of the business cycle. Following the same logic, an index value below 50 indicates that the economy is in a downward phase of the business cycle. In the construction of both the current and historical diffusion indices, the sectoral contributions are weighted according to each sector's contribution to gross value added.

Despite the invaluable information the composite and diffusion indices provide, a reference turning point in the business cycle is never determined as the result of a purely statistical exercise, since these methods seldom all point to exactly the same turning point date. Consequently, various other macroeconomic indicators, together with significant economic events and developments occurring near a possible turning point, must be considered in order to identify the reference turning point date finally.

Statistical results

When the statistical methods as described are applied, the results confirm that a definite upward phase of the business cycle commenced subsequent to the most recent trough in August 1999. The results also indicate two brief periods of weaker expansion – during 2001 and again during 2003 – followed by four years of exceptional economic growth. Furthermore, the analysis provides evidence that a reference peak in the business cycle has already occurred.

The composite business cycle indicators

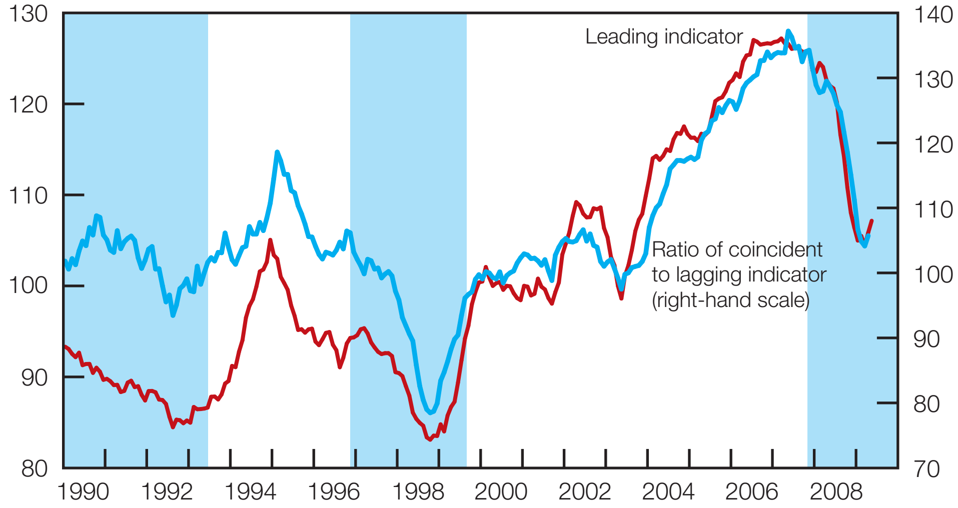
The composite leading business cycle indicator reached a lower turning point in October 1998, ten months before the most recent business cycle trough. The leading indicator then increased significantly before reaching a peak in February 2000, whereafter it followed a moderate downward trend up to September 2001. After another steep increase, the indicator again reached a peak in April 2002, decreasing abruptly until May 2003. Hereafter, the indicator rose markedly up to July 2006 and then moderated somewhat before reaching its most recent peak in March 2007. The leading indicator has since decreased significantly. Based on its historical relationship with the business cycle, the leading indicator pointed to a possible peak in the business cycle towards the end of 2007 or early in 2008.

The ratio of the composite coincident business cycle indicator relative to the composite lagging business cycle indicator serves as an additional leading indicator of the business cycle.[4] As depicted in Graph 1, the movements in this ratio were quite similar to those in the composite leading business cycle indicator, with the ratio peaking in May 2007; two months after the peak in the leading indicator.

4 Venter, J C. 2004. "Note on the revision and significance of the composite lagging business cycle indicator". *Quarterly Bulletin*. December. Pretoria: South African Reserve Bank.

Graph 1 Composite leading business cycle indicators

Indices: 2000 = 100

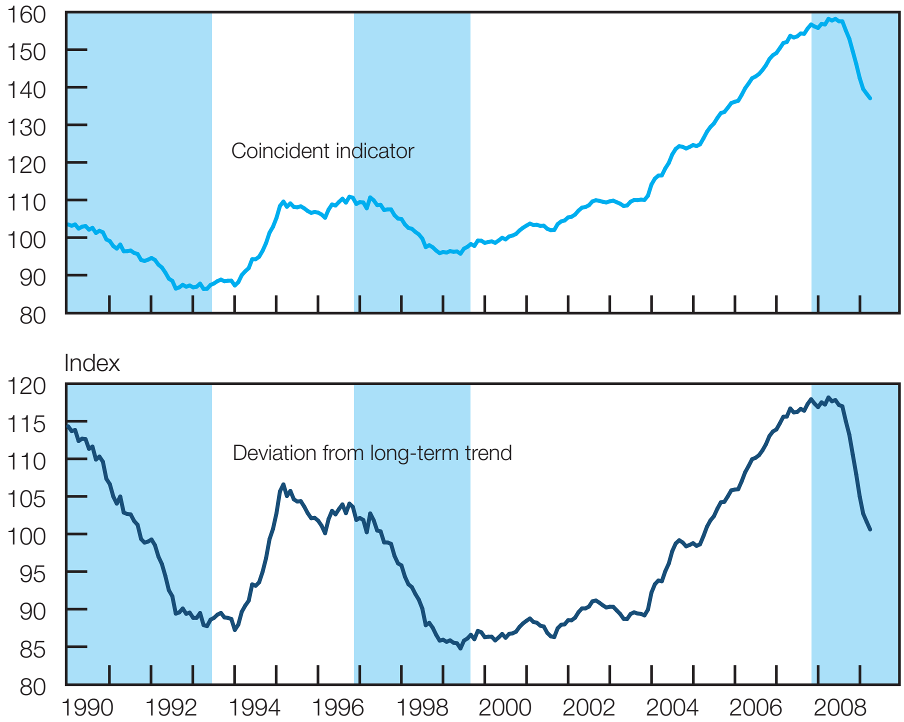


Downward phases of the business cycle

The composite coincident business cycle indicator – expressed as the deviation from its long-term trend – reached a lower turning point in June 1999, followed by a protracted upward movement. Initially, this upward trend was fairly moderate, with a number of brief interruptions – notably in 2001 and 2003. Since the beginning of 2004, the rising medium-term trend in the coincident indicator had become much more pronounced, as the economy expanded at a brisk pace. The indicator moderated somewhat during 2007 and reached its most recent peak in April 2008. The composite coincident business cycle indicator and the deviation from its long-term trend are shown in Graph 2.

Graph 2 Composite coincident business cycle indicator

Index: 2000 = 100

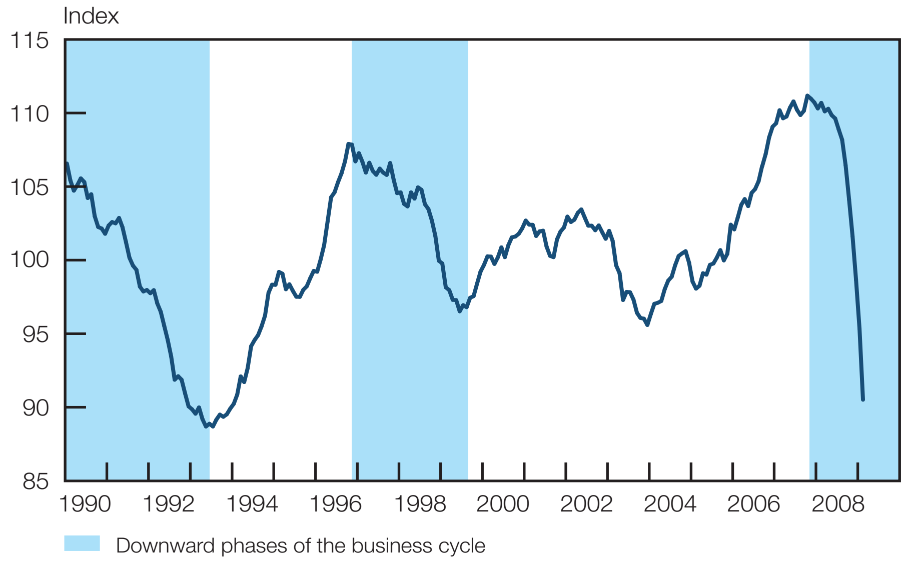


Downward phases of the business cycle

The current diffusion index

The deviation of the current diffusion index from its long-term trend reached a lower turning point in June 1999. Graph 3 shows that the indicator then increased steadily during the remainder of 1999 and 2000, before falling back somewhat in 2001. Following another brief period of increase, the trend-adjusted current diffusion index displayed a rather pronounced drop from the second half of 2002 to the end of 2003. The decline in the deviation-from-trend indicator was exaggerated somewhat by the steep rise in the index from 2004 onwards. This steep rise resulted in a probable overestimation of the trend rate of growth during 2003, thereby over-accentuating the downward movement in the current diffusion index's deviation from its long-term trend during that period. After increasing significantly for a period of almost four years, the indicator reached a peak in October 2007, followed by a striking decline.

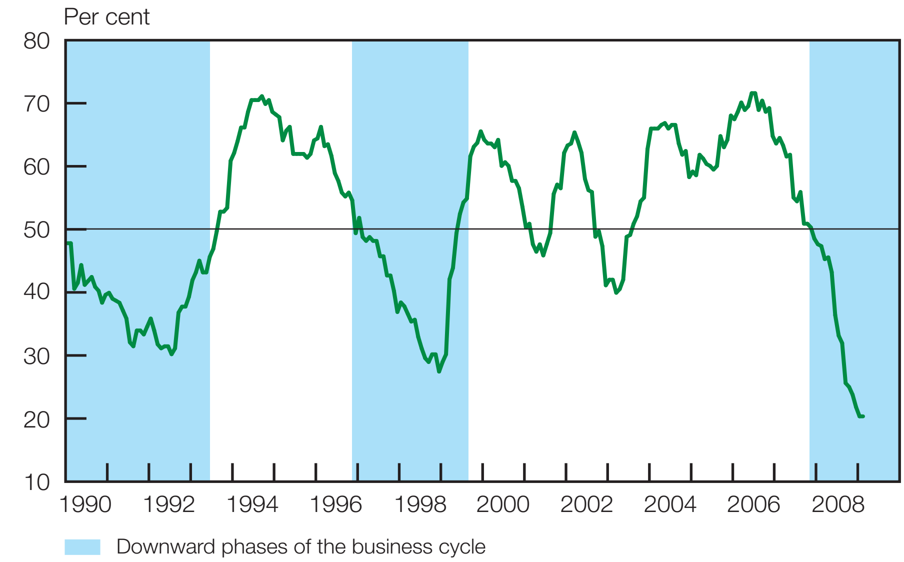
Graph 3 Current diffusion index (deviation from long-term trend)



The historical diffusion index

The historical diffusion index (depicted in Graph 4) rose above 50 per cent in June 1999, indicating that an upward phase in the business cycle had commenced. The number of

Graph 4 Historical diffusion index



economic time series that were decreasing (relative to their respective long-term trends) briefly outnumbered those increasing in 2001, and again between 2002 and 2003. The historical diffusion index then remained above the 50 per cent mark until November 2007, whereafter it declined notably to around 20 per cent – suggesting that a peak in the business cycle had been reached.

Macroeconomic events and developments

During most of 1999 the downward phase of the business cycle, which was exacerbated by the Asian financial crisis, continued, but then started to give way to a recovery in general economic activity, with the South African economy entering an upward phase of the business cycle in September 1999.

This record-length upward phase of the business cycle may readily be divided into two distinct periods. The earlier part of the recovery – from 1999 to 2003 – was characterised by a fairly moderate expansion in aggregate economic activity, occasionally interrupted by brief retardations in the growth rate of general economic activity that threatened to end the upward phase prematurely. The latter part of the upward phase represented a period of exceptional economic expansion, characterised by unprecedented growth in certain sectors of the economy, alongside extraordinary increases in the prices of commodities and most asset classes.

Demand for South African exports was spurred on by brisk economic activity in most of South Africa's major trading-partner countries during 1999 and 2000, with local manufacturing production subsequently responding favourably from the second half of 1999. The export-led recovery in domestic output growth was aided further by a pick-up in international commodity prices over the period. Initially, the cyclical recovery was also supported by sturdy growth in agricultural output.

World economic activity decelerated noticeably during 2001, mainly as a consequence of developments in the United States (US), where a mild recession occurred. This resulted in a sharp global contraction in investment spending, particularly in computing and electronics equipment. The bursting of this so-called dot-com bubble initially affected exports from Asia and then spread to commodity-producing economies, such as South Africa. Although the weaker international demand conditions caused domestic output growth to decelerate somewhat during 2001, export volumes held up fairly well, supported by improved price competitiveness of domestic producers brought about by a sustained depreciation in the exchange rate of the rand since the start of 2000. With the slowdown in global economic growth fairly short-lived, domestic output growth once again accelerated from the fourth quarter of 2001 and throughout 2002.

Consumption expenditure by households had expanded at a fairly rapid pace since the second half of 1999. A marked reduction in lending rates in the aftermath of the Asian financial crisis significantly reduced the debt-financing cost of households, boosting expenditure on durable and semi-durable goods in particular. In the face of the slowdown in global economic growth in 2001, domestic final demand showed remarkable resilience. Consumption expenditure by government and households increased at a lively pace, which continued throughout 2002, the latter underpinned by further reductions in lending rates during 2001.

The slowdown in world output growth in 2001 caused international crude oil prices to decline meaningfully during that year. As a result, consumer price inflation briefly declined to slightly less than 6 per cent during the third quarter of 2001. However, consumer price inflation picked up notably throughout 2002, due to an increase in international crude oil prices, rising food prices and, in particular, imported goods prices following the marked depreciation in the exchange rate of the rand in the second half of 2001. These observed inflationary pressures prompted a cumulative increase of 400 basis points in the Bank's repurchase rate in 2002.

Even though the recovery in general economic activity began in the third quarter of 1999, the South African economy failed to create significant formal-sector employment opportunities until the fourth quarter of 2001. This resulted partly from continued pressure on domestic producers to become more competitive in the global market and a shift in the domestic economy to become more capital-intensive. However, the decline in formal-sector employment may have been exacerbated by the under-measurement of employment numbers in certain services sectors, where employment opportunities were, in fact, created.

Early in the recovery, the national government continued to consolidate the fiscal position and to manage public finances prudently. As a result, government expenditure initially grew at a very moderate pace, before accelerating from 2002 onwards. During the first four fiscal years of the upward phase of the business cycle, continued improvements in the efficiency of tax collection and a broadening of the tax base resulted in consistently higher-than-budgeted revenue collections by government. This enabled government to embark gradually on a more expansionary fiscal policy stance later on in the upward phase, targeted at improved social service delivery, expanded public works programmes and the extension of the social safety net in the form of various grants.

Lacklustre international economic growth, particularly in the euro area, led to diminishing demand for South African exports during 2002 and the first half of 2003. The decline in domestic export volumes was aggravated by the considerable appreciation in the exchange rate of the rand from January 2002 onwards, resulting in pressure on the international price competitiveness of South African exporters. These developments contributed towards a slowdown in the growth rate of gross domestic product, with output in the manufacturing sector actually contracting in 2003.

Contrary to the supply side of the economy, the significant appreciation in the exchange value of the rand kept aggregate demand fairly buoyant throughout 2003. Notable declines in the prices of imported goods resulted in a considerable deceleration in overall consumer price inflation, enabling lending rates to be lowered by a cumulative 550 basis points in 2003. This underpinned demand, with all the components of gross domestic expenditure recording healthy growth rates during the year.

From about the second half of 2003, the global economy gathered momentum and continued to grow briskly until 2007. This period was characterised by a number of factors, which included the continued and rapid rise in international commodity prices, notably crude oil prices; and rapid economic growth in most emerging-market economies, particularly in China, India and other Asian countries. This was accompanied by widening current-account imbalances in a number of countries. Furthermore, consumer price inflation moderated worldwide, resulting in a fairly accommodative monetary policy stance globally. In addition, marked increases were recorded in the international prices of most assets, especially those of shares, bonds and residential property.

Against the backdrop of these developments, the South African economy shifted gear early in 2004 and set off on an elevated growth path. During the four years up to 2007, gross domestic product increased at an annual average rate in excess of 5 per cent. The services sector performed exceptionally well throughout this period, reflecting the strength of domestic expenditure. Strong demand for residential and non-residential buildings, as well as a number of infrastructure development projects, led to the construction sector registering double-digit growth rates throughout this four-year period. Manufacturing output expanded due to robust global and domestic demand. Despite an extraordinary rise in international commodity prices during the latter part of the upswing – driven by strong demand from China, India and other Asian countries – the overall volume of mining production remained disappointingly subdued.

Growth in real gross domestic expenditure continued to outpace that in real gross domestic production. All the components of domestic final demand increased at a brisk pace between 2004 and 2007. The real disposable income of households increased rapidly over this period, augmented by continued tax relief, employment gains, subdued consumer price inflation and further interest rate reductions. Household consumption expenditure increased apace, particularly spending on imported goods, as the sustained appreciation in the exchange rate of the rand resulted in cheaper imported goods. Between 2004 and 2006, new vehicle sales expanded vigorously. Growth in real fixed capital formation generally outpaced the other components of final expenditure. This robust growth was widely dispersed, with both the public and private sectors increasing their capital expenditure over a range of sectors due to necessary infrastructure development and the expansion of production capacity.

Since 2002, growth in the volume of imports has consistently outpaced growth in the volume of exports, resulting in a continuous deterioration of the deficit on the current account of the balance of payments. This was exacerbated by the appreciation in the exchange rate of the rand, South Africa's high propensity to import consumer goods, and increased imports of capital goods related to the boom in fixed capital formation.

The strong growth in expenditure was accompanied by rapidly rising debt levels, as households' debt relative to their disposable income reached a new record high in each successive quarter from the middle of 2005 onwards. Debt was mainly incurred in order to purchase durable consumer goods and real estate. The steep upward trend in the prices of residential property and other financial assets created strong wealth effects. Since the second half of 2004, credit extension has increased markedly, spearheaded by vigorous growth in mortgage advances. Despite the robust credit growth, households' debt-service cost relative to their disposable income remained fairly well contained, on account of lower interest rates.

The sharp depreciation in the exchange rate of the rand from May 2006, and sustained high and rising international crude oil prices, together with sharply rising international food prices, caused consumer price inflation to accelerate from about the middle of that year. As a result, interest rates were gradually raised from the middle of 2006 up to about the middle of 2008. Growth in household consumption expenditure slowed in each successive quarter from the fourth quarter of 2006. Real retail trade sales reached a plateau in 2006, while new vehicle sales contracted sharply during 2007 and 2008 as demand from heavily indebted consumers ceased abruptly.

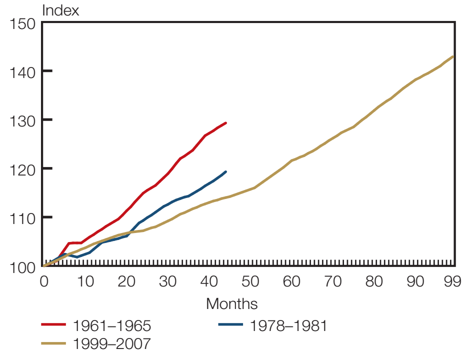
During the third quarter of 2007 widespread concerns developed around the risky sub-prime segment of the mortgage market in the US. This led to a loss of confidence and a severe reduction of liquidity in global credit markets, causing the re-pricing of risk globally. Despite these developments, growth in real gross domestic product remained fairly buoyant throughout 2007, but started to decelerate from the first quarter of 2008 as global and domestic demand waned. However, the poor output growth registered in the first quarter of 2008 was exaggerated by electricity-supply disruptions impacting heavily on the mining and manufacturing sectors in particular. Growth in virtually all the sectors of the economy receded sharply throughout 2008 and into 2009, indicating that the upward phase of the business cycle had come to an end.

Upward phase comparison

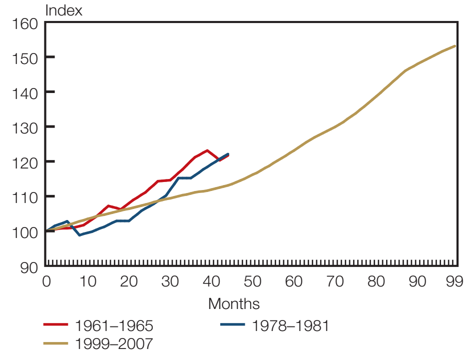
Graph 5 shows the movements of selected economic indicators during the most recent upward phase of the business cycle, as well as during the previous two longest upward phases on record, subject to data availability. For each indicator, the data were indexed to set the trough-month equal to one hundred.

Graph 5 Upward phase comparison of selected economic indicators

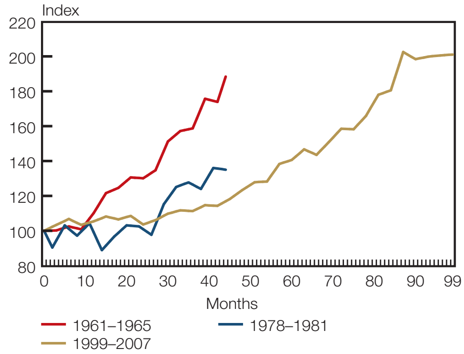
Real gross value added excluding agriculture



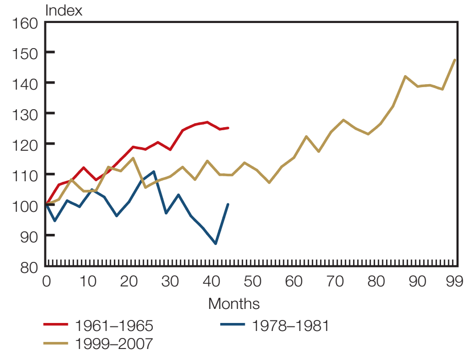
Real final consumption expenditure by households



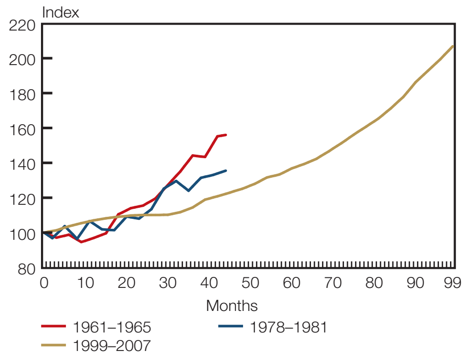
Volume of imports of goods and services



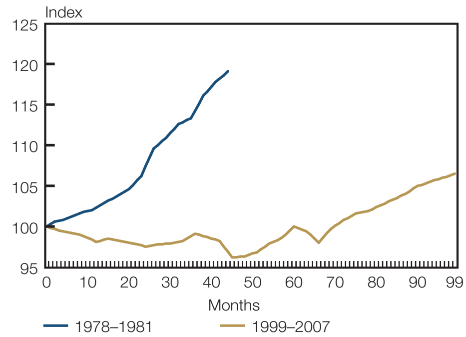
Volume of exports of goods and services



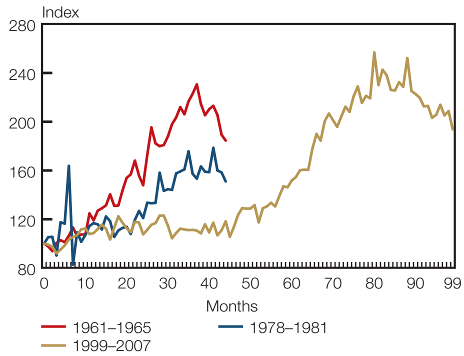
Real gross fixed capital formation



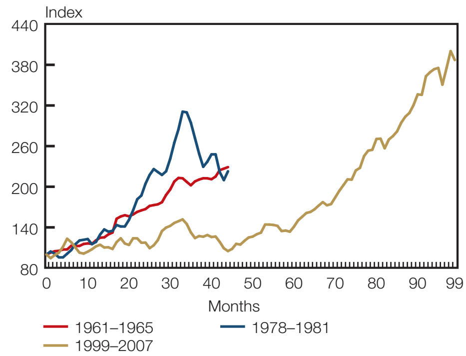
Total formal non-agricultural employment



New vehicle sales



Prices of all classes of shares



Conclusion

With household debt at record-high levels, accelerating consumer price inflation and a concomitant rise in lending rates, consumer demand petered out during 2007. Similarly, rising global inflation and high debt levels in most developed countries resulted in a slowdown in global demand. Developments in global credit markets further tainted the outlook for world output growth.

The statistical results show that the composite leading business cycle indicator reached an upper turning point in March 2007, whereafter it has followed a sustained downward trend. The composite coincident business cycle indicator lost momentum throughout 2007 and the deviation from its long-term trend peaked in April 2008. The deviation of the current diffusion index from its long-term trend reached a peak in October 2007. The historical diffusion index indicated an upper turning point in the business cycle one month later in November 2007.

After all the available information had been duly considered, the final reference date for the upper turning point in the South African business cycle was established as November 2007, with the most recent upward phase of the business cycle lasting a record 99 months.