Quarterly Bulletin

March 2010

South African Reserve Bank

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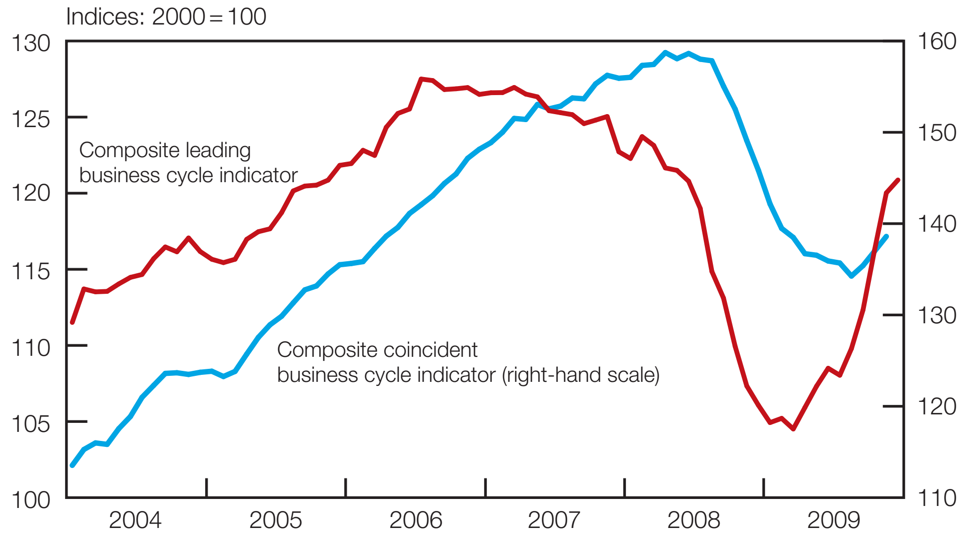
Introduction

In early 2010 it became increasingly clear that the recovery in global economic activity was gaining momentum, benefiting from the large-scale monetary and fiscal stimulus that continued in most parts of the world. Although the recovery was uneven and some uncertainties remained, forecasts of economic growth in 2010 and beyond turned increasingly optimistic. Doubts regarding the creditworthiness of institutions such as Dubai World and fiscal sustainability in Greece and some other highly indebted countries nevertheless clouded expectations. Further constraining factors included the steps taken by the authorities in China to moderate the growth in credit extension, an increase in the discount rate of the Federal Reserve in the United States (US) and, more generally, the realisation that authorities would in due course have to withdraw the extraordinary stimulus measures underpinning the recovery.

With the recovery starting from a low base, the world economy continued to experience substantial surplus capacity. This contributed to international inflationary pressures remaining muted, despite the relatively high prices of a number of commodities. Central banks in a handful of countries took steps to gradually reduce the degree of monetary stimulus by raising policy interest rates, but these remained the exceptions as in most instances rates were maintained at low levels.

In South Africa the sharp economic contraction in the early part of 2009 resulted in the real gross domestic product for the year as a whole contracting by 1,8 per cent. This was accompanied by a sharp decline in employment in the private sector and a rising unemployment rate. Nevertheless, the composite leading business cycle indicator had already begun to pick up from April 2009, with the coincident indicator trending firmly higher in recent months. Economic growth recovered from negative quarter-to-quarter rates in the first half of 2009 to a small positive rate in the third quarter that strengthened considerably further in the final quarter of the year.

Leading and coincident business cycle indicators



The growth in the fourth quarter of 2009 was fairly widespread across the various sectors of the economy. While agricultural production edged lower, mining output recovered, resulting in positive growth in the primary sector following earlier contractions. Manufacturing production gained further momentum from a low base, led by subsectors such as the motor vehicle industry, and contributed to an increase in output in the secondary sector. Production in the tertiary sector also rose during the quarter concerned, driven by improved trading conditions in the securities and derivatives markets, and increases in transport and communication activity.

Real domestic expenditure and final demand registered improvements in the final quarter of 2009. Following five successive quarters of contraction, real final consumption by households rose in the fourth quarter of 2009 alongside an increase in real disposable income. Expenditure on durable goods, especially new motor vehicles, rose notably during the period.

Final consumption expenditure by general government increased in the final quarter, although not as briskly as in the third quarter when military items were acquired. Real fixed capital expenditure edged lower in the fourth quarter as only the public corporations continued stepping up purchases of capital goods, with both government and the private sector reducing their capital expenditure. Inventory reductions continued in the fourth quarter, but at a slower tempo than previously.

Both import and export volumes rose in the fourth quarter of 2009, consistent with the recovery in domestic expenditure and world trade. At the same time South Africa's terms of trade improved, contributing to a modest increase in the trade surplus and a narrowing of the deficit on the current account to marginally below 3 per cent of gross domestic product. As before the deficit was financed with ease, most prominently through inward portfolio investment flows, allowing for a moderate further accumulation of international reserves by the Bank. The effective exchange value of the rand rose somewhat further in the final quarter of 2009, and declined slightly in the first two months of 2010.

In the course of 2009 inflation moderated as production volumes remained substantially below capacity. The monetary conditions of 2008 and the strengthening of the exchange value of the rand also worked through to the price and wage formation processes, while commodity prices remained fairly contained, especially in rand terms. Despite substantial increases in electricity prices, consumer price inflation decelerated to marginally below 6 per cent towards the end of 2009 before rising to slightly above the target range in December 2009 and January 2010, largely due to base effects. Wage settlements also moderated somewhat in the course of 2009.

Orderly conditions prevailed in the money market, with short-term interest rates remaining aligned with the Bank's repurchase rate that was held unchanged at 7 per cent per annum from August 2009. Reflecting the weak levels of economic activity and confidence, the banking sector's balance sheet stagnated with the banks' loans and advances to the domestic private sector actually declining slightly in nominal terms over twelve-month periods towards the end of 2009 and in early 2010. At the same time the broadly defined M3 money supply also displayed very little growth.

In the capital market the public sector increasingly issued debt securities as the infrastructure programme continued while tax revenue declined for cyclical reasons. These issues, and planned further issues in the coming years, rendered support to capital market interest rates. Share prices trended upwards during the past year, from a very low base set in early 2009. House prices also began to recover in the course of 2009.

The February 2010 Budget provided for continued fiscal stimulation that would gradually be withdrawn over the ensuing three years. The fiscal space created by prudent policies in good times make it possible to run fairly large budget deficits for a limited period, thereby bolstering the economy at a time when it is needed.

On 16 February 2010 government clarified and made explicit the mandate of the South African Reserve Bank through an open letter written to the Governor of the Bank by the Minister of Finance. The letter noted the constitutional objective of the Bank, which is to protect the value of the currency in the interest of balanced and sustainable growth. It was confirmed that the Bank should continue to pursue a target of 3 to 6 per cent for headline consumer price inflation, and should do so within a flexible inflation-targeting framework. This involves a focus on a medium-term time horizon in getting back to the target band if the economy experiences an inflation shock, thereby avoiding unnecessary instability in output and interest rates. Policy responses should have due regard for the factors that might impact on the attainment of balanced and sustainable growth, such as the source of the inflation shock, the magnitude of the gap between actual and potential economic growth, credit extension and asset bubbles, employment, and the stability and competitiveness of the exchange rate. Furthermore, the letter reaffirmed the Bank's role in overseeing and maintaining financial stability.

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

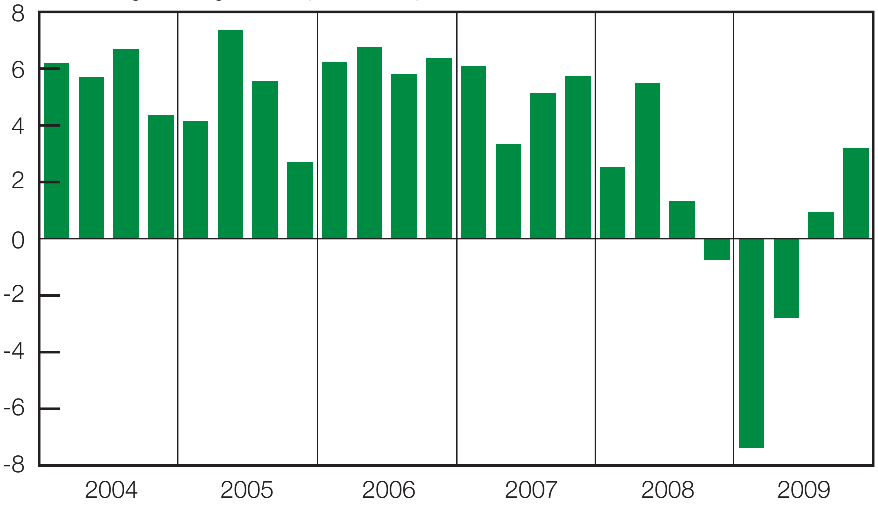
Domestic economic developments[1]

Domestic output

The South African economy continued to gather momentum in the fourth quarter of 2009. Subsequent to an increase of 0,9 per cent in the third quarter of 2009, growth in *real gross domestic product* accelerated to an annualised rate of 3,2 per cent in the fourth quarter of 2009. The enhanced performance in the final quarter resulted from stronger growth in the real value added by the secondary and tertiary sectors as well as a recovery in the real value added by the primary sector.

Real gross domestic product

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Notwithstanding the acceleration in quarter-to-quarter growth in the fourth quarter, real gross domestic product in South Africa still shrank by 1,8 per cent in 2009 as a whole; this was the first contraction in real gross domestic product on an annual basis to be recorded since 1992.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

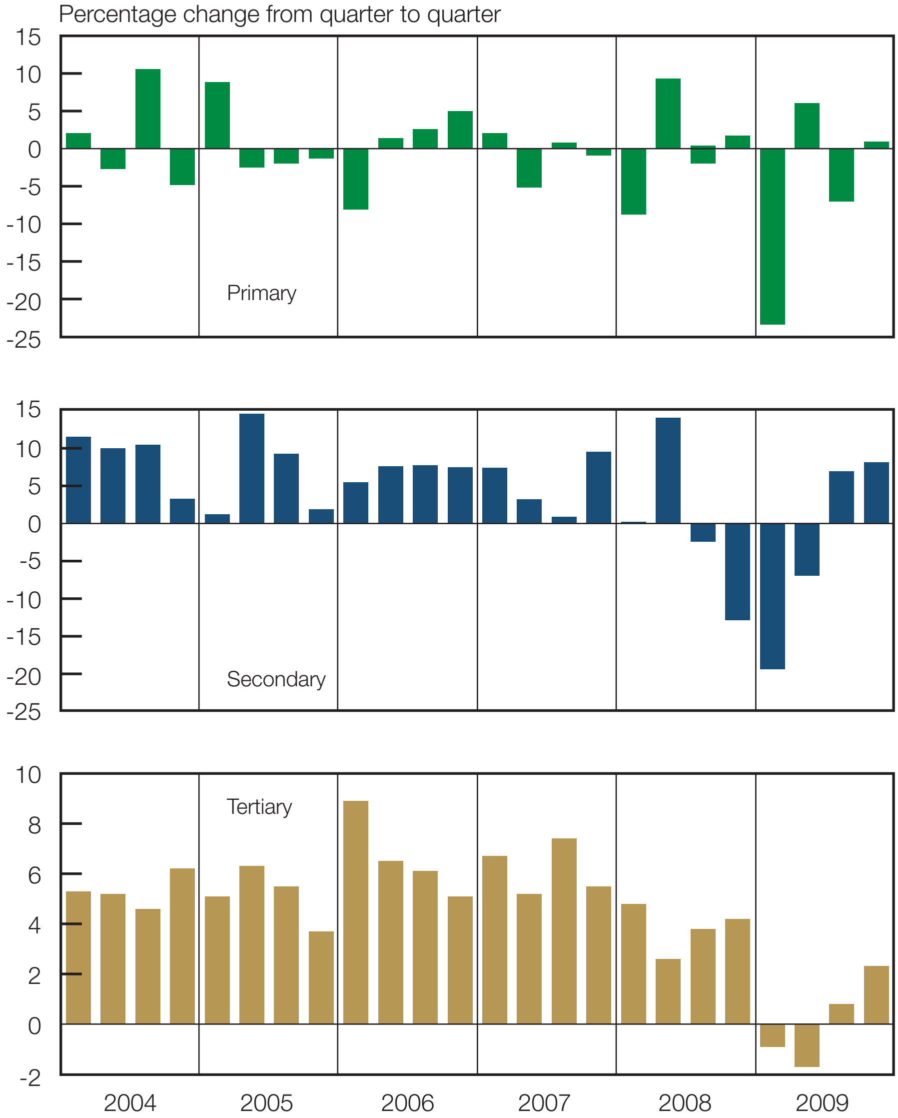
Sectors	2008					2009				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sector	-8,7	9,3	-2,3	1,7	-1,2	-23,8	5,1	-7,6	0,9	-6,0
Agriculture	12,8	6,2	17,8	5,6	10,9	-5,6	-15,8	-11,8	-7,6	-3,2
Mining	-15,8	10,5	-9,5	0,1	-5,4	-30,7	15,8	-5,8	4,6	-7,2
Secondary sector	0,2	14,0	-2,5	-12,9	3,4	-19,4	-6,9	7,0	8,1	-7,2
Manufacturing	-0,1	17,4	-5,2	-17,4	2,7	-25,5	-11,1	7,6	10,1	-10,7
Tertiary sector	4,8	2,6	3,8	4,2	4,7	-0,9	-1,7	0,8	2,3	1,1
Non-agricultural sector	*2,2*	*5,8*	*1,3*	*-0,5*	*3,7*	*-7,6*	*-2,0*	*1,8*	*3,8*	*-1,5*
Total	**2,5**	**5,5**	**1,3**	**-0,7**	**3,7**	**-7,4**	**-2,8**	**0,9**	**3,2**	**-1,8**

Following a decline of 7,6 per cent in the third quarter of 2009, real value added by the *primary sector* increased at an annualised rate of 0,9 per cent in the fourth quarter. The marginal growth resulted from a quarter-to-quarter increase in mining production and a slower rate of contraction in the real value added by the agricultural sector over the period.

The real value added by the *agricultural sector* contracted in all four quarters of 2009. The decline in the fourth quarter primarily stemmed from lower field crop production, especially wheat production, which was adversely influenced by poor weather conditions. In addition, wheat production was also influenced by a smaller area planted compared with the previous production season. Livestock and horticultural production, however, held up fairly well during the fourth quarter. In addition to a lower field crop in the fourth quarter of 2009, real output in the agricultural sector for 2009 as a whole was also affected by the lower production of maize, with the crop harvested decreasing from 12,7 million tons in the 2007/08 production year to 12,0 million tons in the 2008/09 production year. Having increased at a rate of 10,9 per cent in 2008, the real value added by the agricultural sector consequently declined by 3,2 per cent in 2009.

Real gross domestic product by sector

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Having been fairly erratic in the first three quarters of 2009, mining production increased at an annualised rate of 4,6 per cent in the fourth quarter of 2009, underpinned by higher output growth in the platinum group metals, diamonds, manganese and iron ore mining industries. This improvement partially resulted from a strong recovery in international commodity prices, driven to some extent by demand from Asia and restocking in certain advanced economies. By contrast, coal production was adversely affected by unplanned maintenance work and weather interruptions during the fourth quarter. For 2009 as a whole, however, the real value added by the mining sector decreased by 7,2 per cent, representing the largest contraction in mining output since 1974. Key factors affecting production volumes over and above subdued global demand in 2009 included safety-related issues, the strengthening of the exchange value of the rand, the further depletion of high-grade ore bodies and a sustained increase in operational costs, more specifically the cost of labour and electricity. One of the consequences was that South Africa, once the largest gold producer in the world, fell behind China and Australia in gold production during 2009.

The real value added by the *secondary sector* increased further from an annualised rate of 7,0 per cent in the third quarter of 2009 to 8,1 per cent in the fourth quarter. This firm performance was mainly due to a further acceleration in growth in manufacturing output, which more than neutralised slower growth in the real value added by the construction and the electricity, gas and water sectors.

Real value added by the *manufacturing sector* increased further, its annualised growth rate rising from 7,6 per cent in the third quarter of 2009 to 10,1 per cent in the fourth quarter. Although positive growth was recorded by all major subsectors, the surge in production in the fourth quarter was mainly evident in the export-orientated manufacturing sectors producing basic iron and steel products; motor vehicles, parts and accessories; as well as petroleum, chemical and rubber products. Increased activity in the manufacturing sector could partly be related to inventory restocking and a moderate pick-up in global demand. Activity in the sectors supplying the domestic market, however, remained fairly subdued as consumer demand remained relatively weak due to consumers being constrained by high debt levels and ongoing job losses. Consistent with the enhanced performance of the manufacturing sector, capacity utilisation advanced from 77,3 per cent in the third quarter of 2009 to 78,8 per cent in the fourth quarter, still meaningfully lower than the utilisation rates recorded during 2008.

Following an increase of 2,7 per cent in 2008, the real value added by the manufacturing sector contracted by 10,7 per cent in 2009. The record contraction in 2009 largely reflected significantly weaker global and domestic demand conditions, rising input costs as well as the negative impact of the strengthening of the exchange value of the rand.

Growth in the real value added by the sector *supplying electricity, gas and water* slowed from an annualised rate of 4,2 per cent in the third quarter of 2009 to 0,9 per cent in the fourth quarter. Consistent with the increased demand from the electricity-intensive manufacturing and mining sectors, electricity imports had to be increased to augment the domestic supply of electricity. For 2009 as a whole, the real value added by the sector supplying electricity, gas and water contracted by 0,5 per cent compared with an increase of 1,0 per cent recorded in 2008.

The real output of the *construction sector* continued to increase in the fourth quarter of 2009, albeit at a slower pace than in the third quarter. Activity in the civil construction sector, in particular, eased visibly amid the completion of certain infrastructure development projects related to the FIFA World Cup Tournament to be hosted in mid-2010. In addition, the demand for residential and non-residential buildings remained sluggish in the fourth quarter of 2009.

Growth in the real value added by the *tertiary sector* accelerated from an annualised rate of 0,8 per cent in the third quarter of 2009 to 2,3 per cent in the fourth quarter. This could be attributed to increased activity in all the subsectors of the tertiary sector. For 2009 as a whole, the real value added by the tertiary sector increased by 1,1 per cent; a much slower pace than the increase of 4,7 per cent recorded in 2008.

With the exception of the agricultural sector, the *trade sector* was the only sector that recorded a contraction in real value added in the fourth quarter of 2009. Subsequent to a contraction of 1,1 per cent in the third quarter of 2009, the annualised pace of decline slowed to 0,7 per cent in the fourth quarter, reflecting the seventh consecutive quarterly contraction in real value added by the commerce sector. This could mainly be attributed to a decrease in real value added by the wholesale and retail sector which more than neutralised an increase in the real value added by the motor trade sector. Over and above a surge in motor vehicle exports in the fourth quarter of 2009, increases in the real value added by the motor trade subsector were also supported by a subtle increase in the demand from rental companies restocking and upgrading their fleets in anticipation of the 2010 FIFA World Cup Tournament.

For the year 2009 as a whole, the real value added by the trade sector declined by 2,9 per cent, following an increase of 1,1 per cent recorded in 2008. The decline in 2009 was the largest contraction on record since 1986 when the real value added by the trade sector contracted at a rate of 3,6 per cent. Slower growth in 2009 resulted from declines in trade volumes in the aftermath of the global financial crisis and the subsequent collapse in global demand, and a reduction in disposable income which dampened domestic demand. Total vehicle sales accordingly declined by 25,9 per cent in 2009.

The real value added by the *transport, storage and communication sector* edged higher from an annualised rate of 1,2 per cent in the third quarter of 2009 to 1,9 per cent in the fourth quarter. This was largely the result of lively growth in the transport sector, particularly land transport, which was bolstered by increased volumes of merchandise imports and exports during the period. Overall, the real value added by the transport, storage and communication sector rose by 0,5 per cent in 2009, compared with an increase of 3,9 per cent recorded in 2008.

The real value added by the *finance, insurance, real-estate and business services sector* rose at an annualised rate of 1,1 per cent in the fourth quarter of 2009, following a decline of 1,5 per cent in the previous quarter. This reversal in growth reflected buoyant trading conditions in the securities and derivatives markets, which were only partly counteracted by a decrease in the real value added by commercial banks. Overall growth in the real value added by this sector slowed from 7,9 per cent in 2008 to 1,3 per cent in 2009, mainly attributable to slower growth in deposits with, and credit extension by, commercial banks and a decline in the volume of transactions in the securities and derivatives markets over this period.

Real output by *general government* accelerated from an annualised rate of 4,9 per cent in the third quarter of 2009 to 7,0 per cent in the fourth quarter as government continued to expand its staff complement. On a calendar year basis, the real value added by general government maintained growth at a rate of 4,2 per cent in both 2008 and 2009.

Real gross domestic expenditure

Real gross domestic expenditure increased at an annualised rate of 5,0 per cent in the fourth quarter of 2009, following a decline of 1,6 per cent recorded in the third quarter. The positive growth in real gross domestic expenditure in the fourth quarter was brought about by an increase in real final consumption expenditure by households alongside a slower pace of decline in real inventories. Spending by general government moderated over the same period while real gross fixed capital formation contracted at a slower pace than in the preceding quarter.

Having contracted at rates ranging between 1,5 per cent and 5,8 per cent for five consecutive quarters since the third quarter of 2008, real *final consumption expenditure by households* reversed course and increased at an annualised rate of 1,4 per cent in the fourth quarter of 2009. The higher consumer spending in the final quarter resulted primarily from rising spending on durable goods. On an annual basis, however, real final consumption expenditure by households contracted by 3,1 per cent in 2009 compared with an increase of 2,4 per cent in 2008; this was the first annual contraction in real spending since 1992.

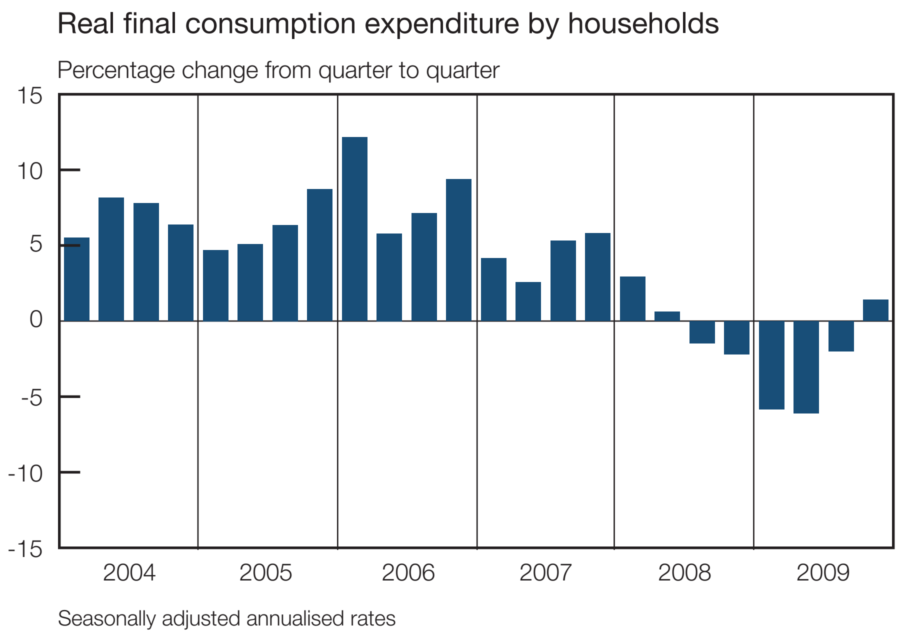
Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Components	2008					2009				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure:										
Households..............	2,9	0,6	-1,5	-2,2	2,4	-5,8	-5,2	-1,9	1,4	-3,1
General government..	11,6	-2,3	10,1	3,5	4,9	6,7	0,9	8,1	2,3	4,7
Gross fixed capital formation	17,5	7,9	12,4	2,8	11,7	5,2	-2,5	-6,5	-0,9	2,3
Domestic final demand	**7,2**	**1,4**	**3,3**	**-0,2**	**4,6**	**-1,3**	**-3,5**	**-1,0**	**1,1**	**-0,6**
Change in inventories (R billions)*....................	9,9	-6,5	-7,6	-26,4	-7,7	-6,8	-48,5	-56,9	-38,4	-37,6
Gross domestic expenditure..................	**14,7**	**-2,5**	**0,7**	**-2,7**	**3,3**	**3,3**	**-10,8**	**-1,6**	**5,0**	**-1,8**

* At constant 2005 prices

Growth in real outlays on *durable goods* accelerated from 0,7 per cent in the third quarter of 2009 to 15,2 per cent in the fourth quarter. The strong increase in mostly discretionary spending was mainly confined to the purchases of new motor cars and durable recreational and entertainment goods such as television sets, personal computers and mobile telephones. Relatively favourable interest rates alongside attractive promotions by various vehicle franchises boosted sales in personal transport equipment, while the moderation in prices of recreational durable goods prompted consumers to acquire these products. Real outlays on durable goods were probably also encouraged by the extension of the replacement cycle during the recessionary phase in the domestic economy. However, for 2009 as a whole, real expenditure on durable goods contracted by 11,3 per cent following a contraction of 7,1 per cent in 2008.



Expenditure on *semi-durable goods* contracted by 4,8 per cent and 7,2 per cent respectively in the second and third quarter of 2009 before contracting at an annualised rate of 0,6 per cent in the fourth quarter. Increased outlays on clothing and footwear; and household textiles, furnishings and glassware partly neutralised the contraction in spending on the remaining goods categorised under semi-durable goods. Real expenditure on semi-durable goods declined by 1,5 per cent in the year 2009 following an increase of 4,2 per cent in 2008.

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	3rd qr	4th qr	Year
Durable goods	2,0	-20,0	-13,2	-18,9	-7,1	-8,4	-17,6	0,7	15,2	-11,3
Semi-durable goods	7,3	3,9	0,0	-0,9	4,2	1,3	-4,8	-7,2	-0,6	-1,5
Non-durable goods	2,6	0,7	-2,2	-3,2	1,5	-9,9	-1,7	-5,4	-0,7	-4,4
Services	2,3	5,4	1,6	2,3	5,1	-3,4	-5,4	2,0	1,1	-0,6
Total	**2,9**	**0,6**	**-1,5**	**-2,2**	**2,4**	**-5,8**	**-5,2**	**-1,9**	**1,4**	**-3,1**

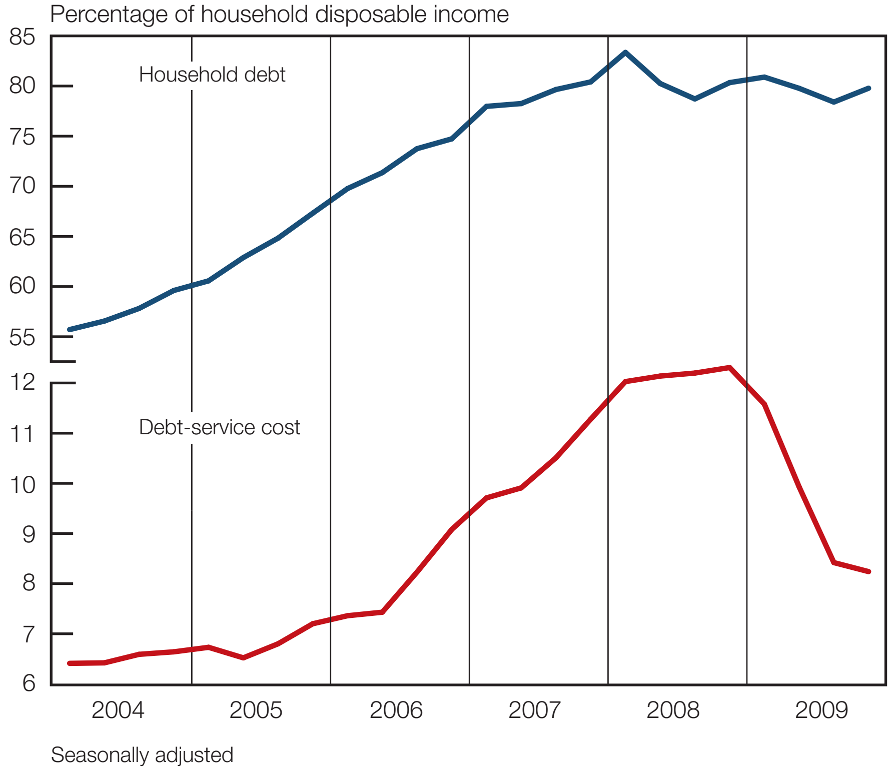
Real expenditure on *non-durable goods* contracted at an annualised rate of 5,4 per cent in the third quarter of 2009 before moderating to a decline of 0,7 per cent in the fourth quarter. This was the net result of increased spending on household consumer goods, which was partly neutralised by lower spending on food, beverages and tobacco and a moderation in spending on medical and pharmaceutical goods. For 2009 as a whole, real spending on non-durable goods declined at a rate of 4,4 per cent compared with an increase of 1,5 per cent in 2008, showing the extent to which consumers were pressured throughout 2009 to rein in and change their consumption habits in favour of cheaper and more affordable products.

Real consumer expenditure on *services* increased at an annualised rate of 1,1 per cent in the fourth quarter of 2009, moderately slower than the increase of 2,0 per cent recorded in the third quarter. Likewise, for the calendar year 2009, real outlays on services declined marginally by 0,6 per cent. This was the first annual decline since 1985 and only the second decline recorded since 1946, thereby reflecting some degree of prolonged pressure on the consumer.

The overall improvement in real final consumption expenditure by households was underpinned by a turnaround in real *household disposable income* in the fourth quarter of 2009. After five consecutive quarters of negative growth, real disposable income of households increased at an annualised rate of 2,7 per cent in the fourth quarter. This was brought about by stronger year-on-year growth in compensation of employees in the fourth quarter and a further moderation in consumer price inflation over the period. However, real disposable income by households declined by 2,8 per cent in 2009, compared with an increase of 2,4 per cent in 2008. This was the first annual decline in real disposable income since 1991, when a contraction of a mere 0,5 per cent was registered.

Household-sector debt relative to disposable income edged higher from 78,4 per cent in the third quarter of 2009 to 79,8 per cent in the fourth quarter. At the same time the ratio of debt-service cost to disposable income inched marginally lower from 8,4 per cent in the third quarter of 2009 to 8,2 per cent in the fourth quarter.

Household debt and debt-service ratios



Despite the absence of armaments acquired as part of the defence procurement programme, real final consumption expenditure by *general government* advanced at an annualised rate of 2,3 per cent in the fourth quarter of 2009. In the third quarter of 2009 government consumption expenditure increased at an annualised rate of 8,1 per cent.

The increase in government consumption expenditure in the final quarter of 2009 mainly reflected high employment levels emanating from labour-intensive programmes launched at provincial government level. Total real final consumption expenditure by general government increased by 4,7 per cent in 2009, virtually unchanged from the rate of change attained in 2008. However, as a percentage of gross domestic product, spending by general government increased from 19,1 per cent in 2008 to 20,8 per cent in 2009, probably reflecting the rising staff complement in the total public sector.

The rate of decline in *real gross fixed capital formation* moderated from 6,5 per cent in the third quarter of 2009 to 0,9 per cent in the fourth quarter. During the fourth quarter, fixed capital formation by the general government declined, while investment by the private sector contracted at a slower pace. Capital spending by public corporations increased at a slower pace. With quarterly annualised growth rates ranging between 5,2 per cent and a negative rate of 6,5 per cent in 2009, growth in total real gross fixed capital formation slowed from 11,7 per cent in 2008 to 2,3 per cent in 2009. However, as a ratio of the country's gross domestic product, gross fixed capital formation remained broadly unchanged at around 22,5 per cent in both 2008 and 2009.

Real gross fixed capital formation

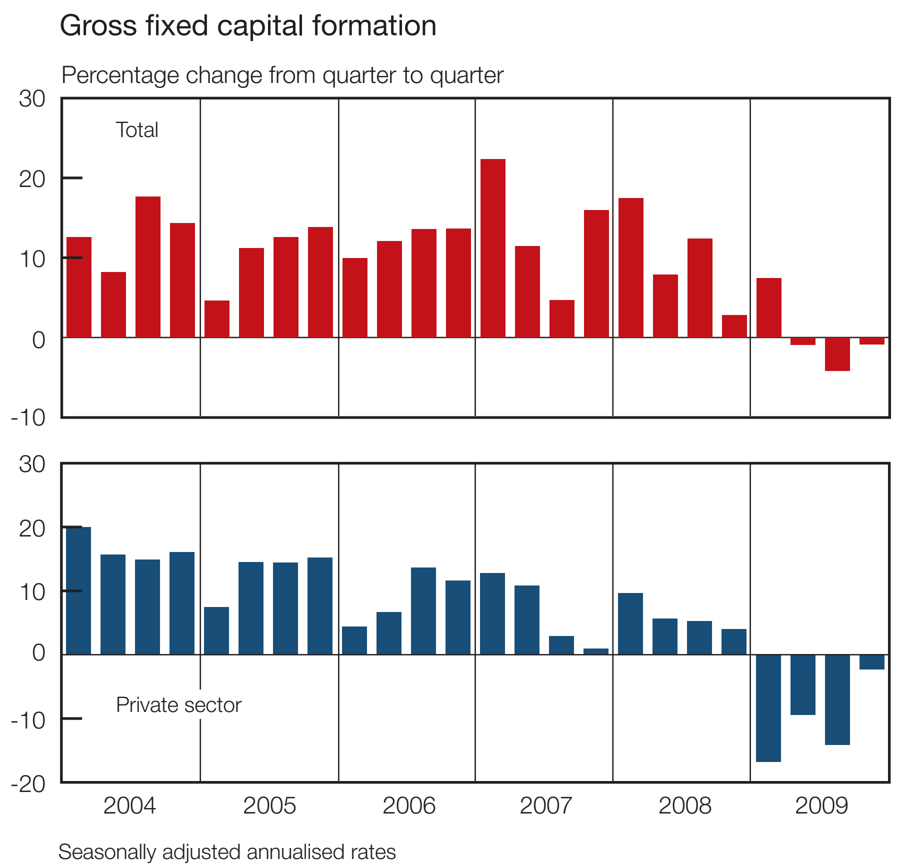
Percentage change at seasonally adjusted annualised rates

Components	2008					2009				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private business enterprises	9,7	5,6	5,3	4,0	5,6	-18,1	-9,5	-14,5	-2,3	-7,0
Public corporations	58,1	17,3	46,1	-2,1	41,0	147,9	21,7	17,0	8,7	40,7
General government	16,3	7,9	10,0	3,4	13,4	-3,2	-6,2	-6,9	-10,0	-1,2
Total	17,5	7,9	12,4	2,8	11,7	5,2	-2,5	-6,5	-0,9	2,3

Real fixed capital outlays by *private business enterprises,* which contracted markedly in the first three quarters of 2009, declined at a much slower pace in the fourth quarter of 2009. The pace of contraction slowed from an annualised rate of 14,5 per cent in the third quarter of 2009 to 2,3 per cent in the fourth quarter as real capital expenditure remained sluggish in most subsectors. Subdued grain prices affected real capital expenditure by the agricultural sector, while capital outlays in the mining sector were probably delayed on account of repressed demand and sales volumes in 2009.

Capital spending by the manufacturing sector declined further in the fourth quarter of 2009 as excess production capacity remained substantial. At the same time, capital investment in the transport, storage and communication sector was underpinned by increased demand from rental car agencies replacing their fleets in preparation for the 2010 FIFA World Cup Tournament and the importation of corporate aircraft during the last three months of 2009.

Growth in gross fixed capital formation by *public corporations* decelerated from 17,0 per cent in the third quarter of 2009 to 8,7 per cent in the fourth quarter. This substantial deceleration in capital spending primarily reflected slower growth in real outlays by most public corporations with the exception of the electricity subsector where real capital investment continued to grow in the fourth quarter of 2009. In addition, the transport subsector increased capital expenditure on a fleet of new buses to augment capacity for transporting passengers during the football tournament.



Gross fixed capital formation by *general government* declined further, registering annualised rates of contraction of 6,9 per cent in the third quarter of 2009 and 10,0 per cent in the fourth quarter. Owing to provincial governments spending less funds on capital projects than budgeted for, fixed investment spending by general government declined by 1,2 per cent in 2009, in contrast with the increase of 13,4 per cent recorded in 2008.

The level of *real inventories* continued to decline in the fourth quarter of 2009, although at a significantly slower pace. The smaller decline in the fourth quarter added 4,1 percentage points to growth in real gross domestic expenditure. By contrast, the reduction in inventory levels in the third quarter of 2009 subtracted 1,8 percentage points from growth in gross domestic expenditure. The further run-down in aggregate inventory levels in the fourth quarter of 2009 was mainly evident in the mining sector, especially in the gold mining sector, the manufacturing sector as well as in agricultural stocks-in-trade, particularly maize stockpiles. By contrast, an increase in commercial inventories was recorded and could be attributed to re-stocking in the motor trade sector as motor-traders expect demand from fleet owners to pick up in the wake of the 2010 FIFA World Cup Tournament. The level of industrial and commercial inventories relative to non-agricultural gross domestic product subsequently declined from its most recent high of 17,9 per cent in the third quarter of 2008 to 12,9 per cent in the fourth quarter of 2009.

Factor income

The growth over four quarters in *total nominal factor income* accelerated from 3,6 per cent in the third quarter of 2009 to 5,3 per cent in the fourth quarter. The increase in total nominal factor income resulted from increases in both the gross operating surpluses of business enterprises and compensation of employees. However, for 2009 as a whole, the year-on-year growth in factor income amounted to 5,7 per cent, substantially lower than the rate of 14,9 per cent recorded in 2008.

The *compensation of employees,* measured over four quarters, inched higher from a rate of 7,8 per cent in the third quarter of 2009 to 7,9 per cent in the fourth quarter. The increase was mainly evident in the general government sector where compensation paid by provincial governments increased substantially, mainly due to the expansion of the staff complement. Compensation of employees in most of the other sectors of the economy grew at a slower pace in the fourth quarter. Consistent with lower average wage settlement rates in 2009, aggregate remuneration of employees slowed from 13,6 per cent in 2008 to 8,3 per cent in 2009.

Growth in *total gross operating surpluses*, measured over four quarters, accelerated to 2,5 per cent in the fourth quarter of 2009, reverting from a contraction at a rate of 0,3 per cent in the third quarter. This was mainly caused by the increase in international commodity prices and the improvement of global consumption and investment demand on corporate earnings.

On an annual basis, the growth in total gross operating surpluses decelerated from 16,2 per cent in 2008 to 3,1 per cent in 2009; this was the lowest rate of growth recorded since 1982. Consequently, the share of the operating surplus in total factor income decreased from 50,6 per cent in 2008 to 49,4 per cent in 2009.

Saving

Gross saving relative to gross domestic product increased steadily throughout 2009, rising from 14,9 per cent in the first quarter of 2009 to 16,2 per cent in the fourth quarter. This improved saving performance could be attributed to increased saving by all three institutional sectors: corporate, household and general government. As a result, South Africa’s saving ratio rose from 14,9 per cent in 2008 to 15,3 per cent in 2009, thereby lowering the country’s dependency on foreign capital to finance gross capital formation from 32,2 per cent in 2008 to 20,6 per cent in 2009.

Gross saving of the *corporate sector* primarily reflects retained earnings, which depends on the profitability of firms. Although growth in total gross operating surpluses slowed substantially from 17,3 per cent in 2008 to only 2 per cent in calendar year 2009, the corporate saving ratio improved throughout 2009, rising from 11,1 per cent in 2008 to 13,1 per cent in 2009. Retained income was boosted by substantially lower dividend payments in 2009 and by a concerted effort to lower costs. The substantially lower inventory stock holdings also lowered the companies’ operating costs.

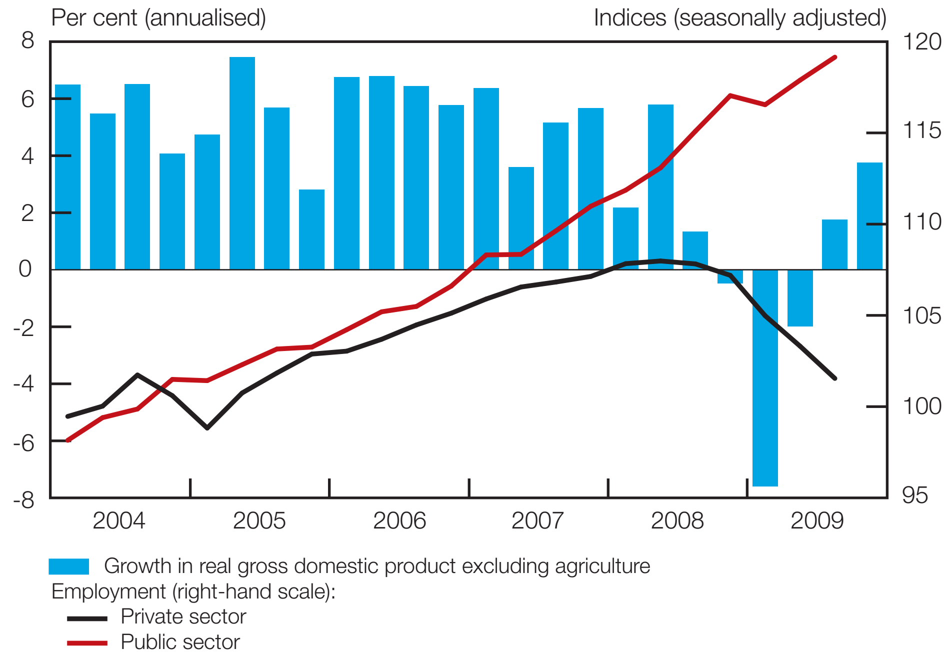
The saving ratio of *general government* declined from 1,6 per cent in the first quarter of 2009 to 0,5 per cent in both the third and the fourth quarters. In all four quarters government revenue fell short of government expenditure as fiscal policy remained in a stimulatory mode to support subdued domestic economic activity. Although no major military equipment was acquired in the fourth quarter of 2009, the saving ratio remained low due to declining revenue from taxes on income and wealth. The saving ratio declined from 2,6 per cent in 2008 to 0,7 per cent in 2009.

The gross saving ratio of the *household sector* increased moderately from a low of 1,4 per cent in the first quarter of 2009 to 1,5 per cent in the third and 1,7 per cent in the fourth quarter of 2009. The saving ratio increased from 1,2 per cent in 2008 to 1,5 per cent in 2009. This annual improvement could be attributed to lower expenditure by households on final goods and services, a decline in household indebtedness relative to disposable income, lower debt-service cost and households' reluctance to take on new credit.

Employment

Recent data confirmed that the employment-creating capacity of the formal non-agricultural sector of the South African economy remained weak in the third quarter of 2009, despite the uptick in economic activity during the period. Following a fairly prolonged phase of employment gains between the second quarter of 2005 and the third quarter of 2008, employment levels in the formal non-agricultural sector of the economy decreased unabatedly for four consecutive quarters up to the third quarter of 2009. Of the roughly 322 000 job opportunities lost in the year to the third quarter of 2009, about 315 000 jobs were shed in the first nine months of 2009. The level of enterprise-surveyed employment in the formal non-agricultural sector of the economy consequently shrank from a seasonally adjusted 8,5 million at the end of December 2008 to 8,2 million at the end of September 2009.

Output growth and employment



Consistent with the slowdown in domestic economic activity from the middle of 2008, employment levels in the private sector already began to shrink in the third quarter of that year. Public-sector employment growth, however, remained robust throughout the period, with the exception of a temporary setback in the first quarter of 2009 when employment levels receded at an annualised rate of 1,7 per cent.

There are signs that the informal sector is absorbing an increasing number of new entrants into the workforce. According to the latest *Quarterly Labour Force Survey* (*QLFS*), a household-based survey conducted by Statistics South Africa (Stats SA) to complement enterprise-based surveys with information on broader labour market indicators such as unemployment and employment in the informal sector, the subsistence agriculture sector and the domestic services sector, an estimated 89 000 jobs were created in the fourth quarter of 2009. As a result, South Africa's official unemployment rate decreased slightly from 24,5 per cent in the third quarter of 2009 to 24,3 per cent in the fourth quarter.

According to the *Quarterly Employment Statistics* (*QES*) survey conducted by Stats SA, formal non-agricultural employment decreased at a seasonally adjusted and annualised rate of 4,2 per cent during the third quarter of 2009, that is, at a somewhat faster pace than the rate of decrease recorded in the second quarter of 2009. In the year to the third quarter of 2009, overall employment levels decreased by 3,8 per cent; private-sector employment receded by 5,8 per cent whereas employment gains in the public sector advanced at a rate of 3,5 per cent over the period.

Quarterly changes in enterprise-surveyed formal non-agricultural employment in 2009

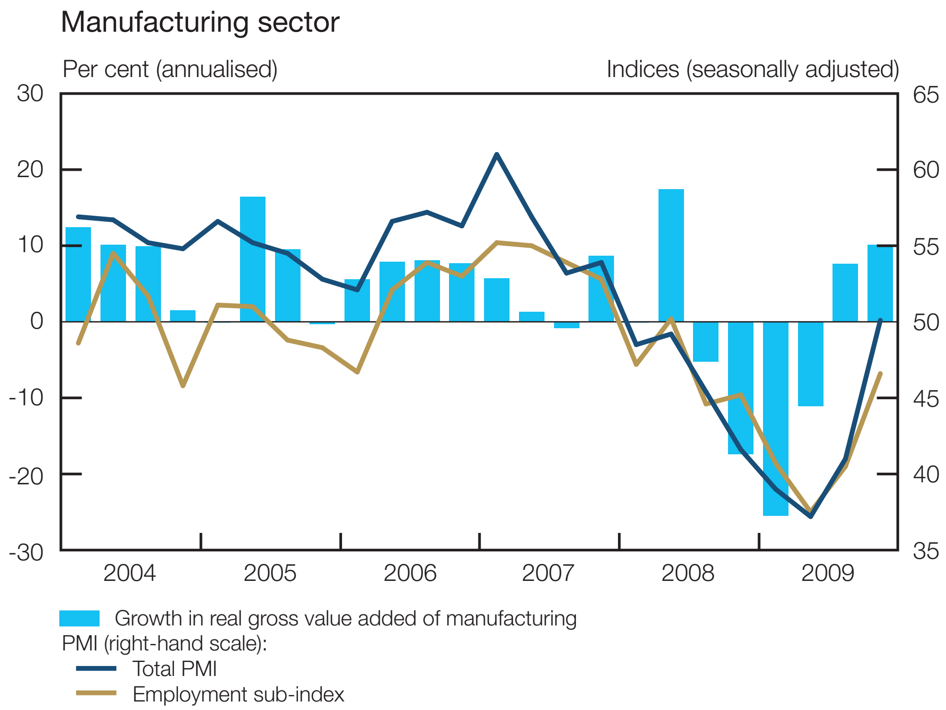
Change over one quarter in seasonally adjusted numbers*

Sector	1st qr	2nd qr	3rd qr
Mining	-20 900	-8 100	-5 000
Gold mining	-3 300	-2 000	200
Non-gold mining	-17 600	-6 100	-5 200
Manufacturing	-34 800	-18 700	-22 000
Electricity supply	-50	-70	-500
Construction	-13 900	-17 300	-10 700
Trade, catering and accommodation	-23 000	-11 600	-34 000
Transport, storage and communication	-2 100	-6 100	1 900
Financial intermediation and insurance	-43 000	-36 700	-41 200
Community, social and personal services	1 100	-4 000	2 300
Total private sector	-136 700	-102 600	-109 300
National, provincial and local government	3 800	26 700	27 500
Public-sector enterprises	-26 600	-10 500	-14 800
Total public sector	-8 000	21 500	20 200
Grand total	-144 700	-81 1000	-89 100

* Components may not add up to the totals due to rounding off of figures

The private sector shed almost 350 000 job opportunities in the first three quarters of 2009 with job losses recorded in all subsectors. Extensive job losses were registered in the finance, insurance, real-estate and business services sector; in the trade, catering and accommodation services sector; and in the manufacturing sector, collectively amounting to 266 000 jobs. The loss of job opportunities in the construction and the non-gold mining sectors came to a further 71 000 over the same period.

The contraction in global economic activity and the concomitant decline in international trade volumes adversely affected the performance of the manufacturing sector in South Africa. In addition to the relatively subdued domestic demand, following weak consumer spending, certain South African producers also experienced difficulty in competing internationally given the relative strength of the exchange value of the rand. On a quarter-to-quarter and seasonally adjusted basis, employment levels in the manufacturing sector accordingly receded by 7,0 per cent in the third quarter of 2009, following decreases of 10,5 per cent and 5,9 per cent in the first and second quarter of 2009 respectively. In the third quarter of 2009 considerable job losses occurred, especially in the subsector for motor vehicles, parts and accessories.



Similar to the trend in the global Purchasing Managers Index (PMI), the domestic PMI, compiled by the Bureau for Economic Research (BER) at Stellenbosch University for Kagiso Securities, fluctuated below the neutral index level of 50 for seven consecutive quarters up to the third quarter of 2009, before rebounding to 50,1 index points in the fourth quarter. The improvement in the PMI in the final quarter of 2009 reflected more positive expectations for the manufacturing sector among purchasing managers, which could possibly translate into employment gains in the near future. These expectations were corroborated by the BER *Manufacturing* survey for the fourth quarter of 2009, which revealed an improvement in confidence levels in the manufacturing sector following a slower pace of decline in domestic and export sales during the period.

The physical volume of total mining production decreased substantially in the first half of 2009, but contracted at a much slower pace in the third and fourth quarters. Over and above relatively weak global demand, lower production levels also reflected increased industrial action throughout the year, forced shutdowns of various plants due to safety-related issues and a steady increase in operational costs. Measured from quarter to quarter, employment in the mining sector decreased at a seasonally adjusted and annualised rate of 4,0 per cent in the third quarter of 2009 compared with decreases of 15,1 per cent in the first quarter of 2009 and 6,3 per cent in the second. The rate of decrease in jobs moderated markedly in both the gold and non-gold mining sector in the third quarter of 2009.

Employment levels in the construction sector decreased in the third quarter of 2009 at an annualised rate of 9,4 per cent, somewhat slower than in the preceding two quarters. Government's extensive infrastructural investment programme, coupled with private-sector investment, probably helped to sustain activity in civil construction amid the economic slowdown. The BER *Building and Construction* survey for the fourth quarter of 2009 confirmed that activity in the residential sector may have bottomed out, while activity in the non-residential building sector remained sluggish, trending moderately downwards. Retrenchments in the civil construction subsector probably slowed over the period.

As consumer demand remained subdued due to eroded household wealth, job losses and curtailed real income levels, domestic trade receded throughout 2009. When 2009 is compared with 2008, real retail trade sales decreased by 4,5 per cent and new passenger vehicles sales by 25,9 per cent. Employment in the trade, catering and accommodation services sector subsequently decreased at a seasonally adjusted and annualised rate of 7,8 per cent in third quarter of 2009, resulting in no fewer than 68 800 job losses in the first three quarters of 2009. At the same time, employment levels in the finance, insurance, real-estate and business services sectors decreased by 120 900, reflecting the weak domestic economic conditions, stagnant demand for credit and subdued activity in the real-estate market.

In the third quarter of 2009 growth in employment in the private transport, storage and communication sector; and the community, social and personal services sector rebounded at annualised rates of 3,1 per cent and 2,3 per cent respectively.

As mentioned earlier, employment levels in the public sector remained firm and rose by 4,0 per cent in the first nine months of 2009, compared with the same period in 2008, following an increase of 4,5 per cent in 2008. Public-sector employment increased at an annualised rate of 4,4 per cent in the third quarter of 2009, with national government departments, provinces and local government all adding to the civil service payroll. Employment levels in public enterprises; and in the public transport, storage and communication sectors contracted throughout 2009, registering rates of decrease of 16,7 per cent and 4,2 per cent respectively in the third quarter of 2009.

Despite the economy having been in a recession in the first half of 2009 with the risk of retrenchment fairly high, industrial strike action was pervasive in both the public and private sectors of the economy, with workers demanding higher real wages. During 2009 about 2,9 million workdays were lost as a result of strike action compared with 991 000 workdays lost in 2008.

In an effort by government to address youth unemployment, initiatives are in progress to improve information services to help young people access jobs and training opportunities. These reforms will be supported through a subsidy to employers that will lower the cost of employing young people without work experience. Under consideration is a cash reimbursement to employers for a two-year period, operating through the South African Revenue Service's (SARS) payroll tax system, and subject to minimum labour standards, with a view to raising employment of young school leavers by a further 500 000 by 2013.

Labour cost and productivity

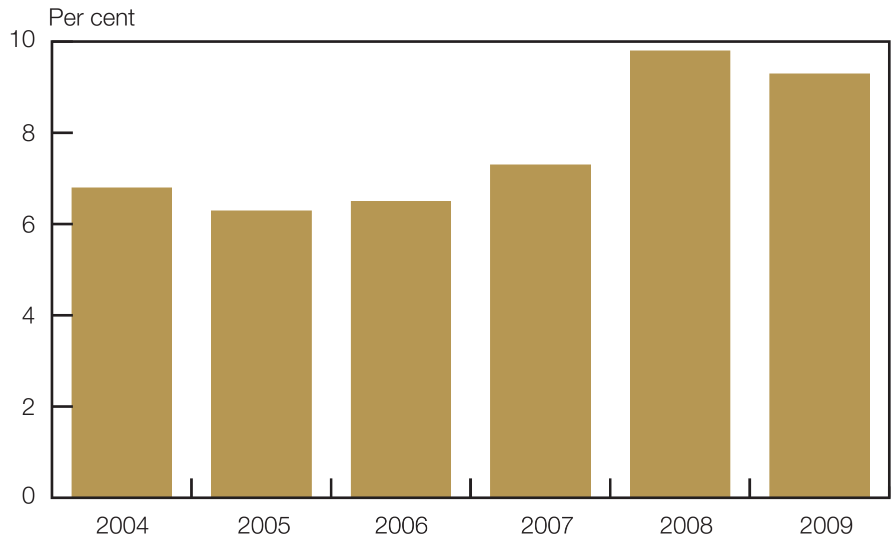
The year-on-year rate of increase in average nominal remuneration per worker in the formal non-agricultural sector of the economy peaked at a six-year high of 13,4 per cent in the second and third quarters of 2008, before moderating steadily to 12,1 per cent in the fourth quarter and further to 7,6 per cent in the third quarter of 2009.

Over the year to the third quarter of 2009, increases in average remuneration per worker in the private sector slowed to 7,7 per cent, compared with increases of 5,2 per cent recorded in the public sector. According to *Andrew Levy Employment Publications*, the average wage settlement rate in collective bargaining agreements amounted to 9,3 per cent in 2009 compared with a rate of 9,8 per cent in 2008.

Year-on-year increases in average remuneration per worker in the private sector exceeded the upper limit of the inflation target range of 6 per cent in all subsectors, except for the construction and the trade, catering and accommodation services sectors. In fact, double-digit rates of increase were registered in the electricity, mining and non-government transport, storage and communication sectors. Although the average remuneration per worker in the public sector as a whole increased at a year-on-year rate of 5,2 per cent in the third quarter of 2009, remuneration increases in the public transport, storage and communication sector as well as at local government level advanced at high rates of 11,6 per cent and 14,3 per cent respectively during the period.

Consistent with the increase in production volumes and a further decline in employment levels in the third quarter of 2009, the year-on-year rate of increase in labour productivity improved from 0,3 per cent in the second quarter of 2009 to 1,7 per cent in the third quarter. The year-on-year rate of *decrease* in labour productivity in the manufacturing sector moderated from 12,3 per cent to 6,4 per cent over the period as further staff reductions brought about a closer alignment of staff numbers with real output.

Wage settlement rates



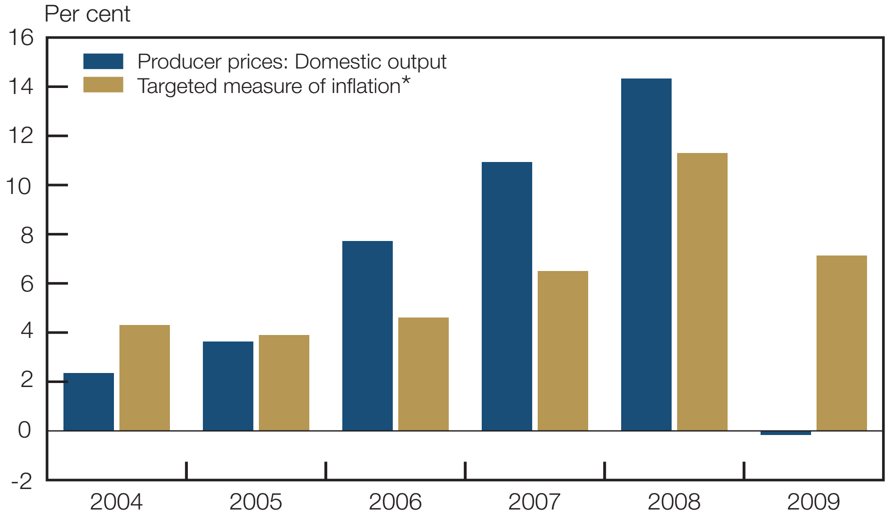
Source: Andrew Levy Employment Publications

Following the deceleration in the rate of increase in nominal remuneration per worker and the acceleration in economy-wide labour productivity increases in the year to the third quarter of 2009, nominal unit labour cost increases in the formal non-agricultural sector of the economy moderated from 8,4 per cent in the second quarter of 2009 to 5,7 per cent in the third quarter. Measured over a period of four quarters, the rate of increase in the cost of labour per unit of manufacturing output moderated from 24,8 per cent in the second quarter of 2009 to 15,5 per cent in the third quarter.

Prices

Inflationary pressures in the domestic economy continued to wane in the final quarter of 2009, underpinned by fairly subdued domestic demand and a continuous moderation in global inflation, alongside the appreciation in the external value of the rand. Both domestic producer and consumer price inflation decelerated markedly throughout 2009. Producer price inflation for domestic output moderated meaningfully from a 20-year all-time high annual average of 14,3 per cent in 2008 to zero in 2009, while consumer price inflation slowed from an annual average of 11,3 per cent in 2008 to 7,1 per cent in 2008.

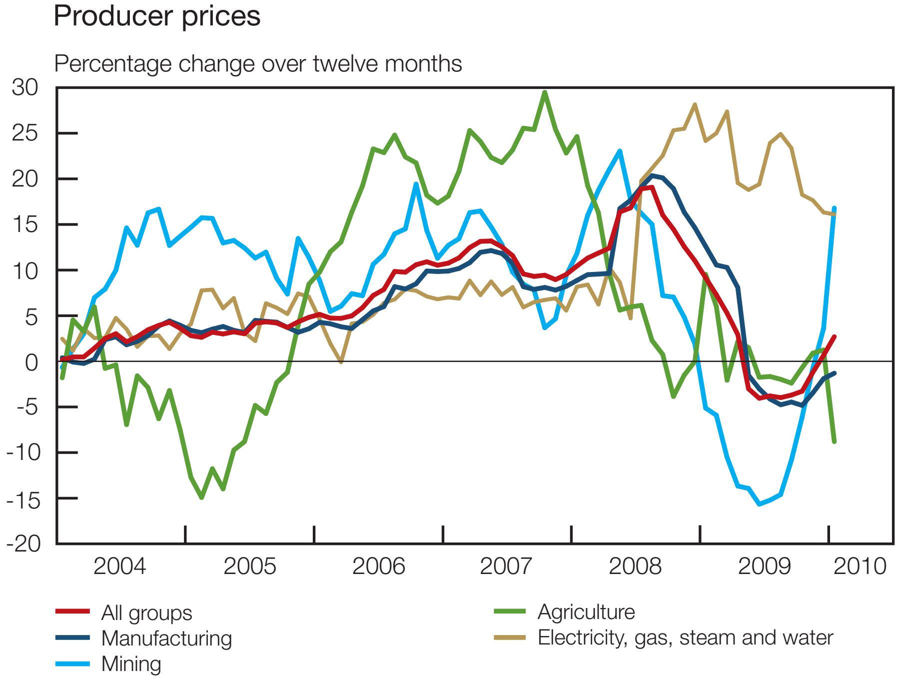
Producer and consumer price inflation



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

Producer price changes in the domestic economy are a culmination of price developments emanating from the cost of domestic and imported production factors. Owing largely to the strengthening of the external value of the rand alongside well-contained global prices, *producer prices for imported commodities* decreased considerably in 2009. In the year to June 2009 the prices of imported goods actually decreased at a rate of 17,9 per cent before this rate of decrease moderated in the subsequent six months to 3,5 per cent in December. In the year to January 2010 it rebounded to 2,6 per cent. The prices of imported mining commodities, including crude oil, were primarily responsible for the movements in the overall prices of imported commodities. The twelve-month rate of decrease in the producer price index for imported mining commodities reached an extreme of 47,4 per cent in June 2009, thereafter slowing to 9,8 per cent in December before surging to 14,3 per cent in January 2010. Year-on-year prices changes of imported agricultural commodities also remained negative throughout 2009, save for December, and amounted to 8,6 per cent in January 2010. Subdued global inflation and rand strength resulted in price declines of imported manufactured goods in the final three months of 2009, with a year-on-year rate of 0,9 per cent registered in December and 1,2 per cent in January 2010.

Producer prices for domestic output fell sharply during 2009. Positive year-on-year producer price inflation of 9,2 per cent was recorded in January 2009. Subsequently, the rate of increase moderated in the months to April, followed by year-on-year price declines in the following months to November 2009. In the year to December 2009, however, producer prices again increased and registered a rate of 0,7 per cent, primarily as a result of an increase of 3,6 per cent in the prices of mining products. Producer prices for domestic output accelerated to a twelve-month rate of 2,7 per cent in January 2010.



The producer price index for manufactured products decreased continuously in the eight months to December 2009, with the year-on-year decrease amounting to 1,9 per cent in December and 1,3 per cent in January 2010. Within the manufacturing category, products of petroleum and coal, and basic metal prices largely accounted for the rate of decline in the manufacturing producer price index. In fact, the prices of petroleum products decreased meaningfully during 2009; the rate of decrease amounted to as much as 35,1 per cent in the year to June, moderating to no change in the year to December. However, it jumped to a year-on-year increase of 12,6 per cent in January. The majority of the individual manufactured goods prices increased at single-digit rates in the year to December 2009. In the four months to January 2010, the producer prices of rubber, plastic, chemicals and chemical products and food recorded rates of decrease.

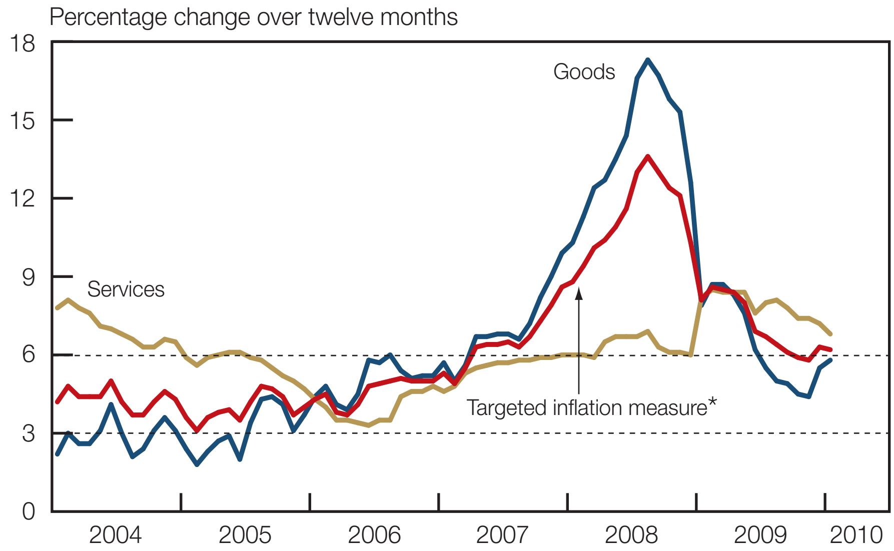
The producer price index for the electricity, gas and water category remained elevated when compared with the other broad categories, increasing at a year-on-year rate of 16,3 per cent in December 2009 and 16,1 per cent in January 2010 compared with an increase of 27,4 per cent in March 2009. These high rates of increase were mainly a result of the electricity tariff increases implemented by Eskom, the national power utility.

Changes in agricultural food prices were fairly volatile during the past two years, decreasing substantially in the first half of 2009 as international agricultural commodity prices (such as grain products and oil seeds) receded. In the year to January 2010 the rate of decrease in producer prices of agricultural food amounted to 18,7 per cent. Producer price inflation of manufactured food products decelerated consistently from double-digit rates in the final months of 2008 to a low positive value in August 2009. Subsequently, these prices decreased between September 2009 and January 2010, when calculated over a twelve-month period.

Following agricultural food price declines, consumer food prices registered a decline of 1,6 per cent in the year to January 2010, compared with a rate of increase of 16,0 per cent in December 2008. Between September 2009 and January 2010 producer prices of manufactured food registered negative rates of change, amounting to a twelve-month rate of 1,8 per cent in January. In the second half of 2009 the differential between manufactured food price inflation and prices of processed foods narrowed somewhat, however, the impact of the pass-through from manufactured food prices to processed food prices is yet to be fully realised. The twelve-month rate of increase in processed food prices amounted to 2,3 per cent in January 2010 compared with 19,6 per cent in January 2009. Similarly, the spread in the rate of change in the price index of unprocessed foods and food at the agricultural level narrowed from a high of 22,1 percentage points in March 2009 to 5,1 percentage points in December, but abruptly jumped to 19,6 percentage points in the next month. In coming months it can be expected that the price of food at the consumer level will trace that at producer level, although probably in a dampened way.

Having remained above the inflation target range for 30 consecutive months, *headline consumer price inflation* moderated to within the inflation target range in both October and November 2009, and amounted to 5,8 per cent and 5,9 per cent respectively. However, in the twelve months to December 2009 it accelerated again to 6,3 per cent, and to 6,2 per cent in January 2010, largely due to base effects.

Consumer prices



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

Lower rates of increase in *consumer goods prices* were primarily responsible for the deceleration in headline consumer price inflation. In fact, in the second half of 2009 year-on-year consumer goods price increases remained within the 3 to 6 per cent inflation target range, amounting to 4,4 per cent in November and 5,5 per cent in December. In the year to January 2010 it amounted to 5,8 per cent. As result of weak consumer demand, durable and semi-durable goods price inflation moderated substantially. However, price increases of non-durable goods initially remained at double-digit rates, briefly falling to within the inflation target range in October and November 2009, then accelerated to 8,6 per cent in January 2010. Within the consumer goods basket, housing and utilities (due to electricity tariff increases), health, education, tobacco and recreation and culture fanned the rate of increase in consumer goods prices. This was countered by price deflation in the transport and communication category.

Consumer prices

Quarter-to-quarter percentage changes at annual rates

		Headline CPI	CPI services	CPI goods
2009:	1st qr	6,2	10,7	2,5
	2nd qr	8,6	8,7	8,5
	3rd qr	6,0	7,1	5,1
	4th qr	3,3	3,0	3,4

Services price inflation, after remaining at a year-on-year rate of 8,4 per cent during the period from March to May 2009, decelerated to 6,8 per cent in January 2010. Consumer services price inflation was buoyed by price increases in the recreation and culture, education, insurance as well as restaurants and hotels categories.

Based on the classification of individual consumption by purpose (COICOP) categories, annual average rates of inflation in eight of the twelve categories were in excess of the upper limit of the inflation target range in 2009. In fact, of the eight categories, five categories registered inflation increases above 10 per cent. Two of these categories registered rates of increase below the inflation target range with only two categories being inside the range. The most noticeable acceleration in price inflation occurred in the recreation and culture category, which picked up from 1,3 per cent in 2008 to 11,6 per cent in 2009. Price changes in the transport category switched from an annual average rate of increases of 9,2 per cent in 2008 to a rate of decrease of 0,4 per cent in 2009, following petrol price declines.

Headline CPI inflation in COICOP categories

Annual average percentage changes

	Weights	2008	2009
Food and non-alcoholic beverages	15,68	15,3	9,7
Alcoholic beverages and tobacco	5,58	7,7	11,1
Clothing and footwear	4,11	12,6	4,9
Housing and utilities	22,56	12,2	7,9
Household content, maintenance and equipment	5,86	6,4	6,0
Health	1,47	5,5	10,8
Transport	18,80	9,2	-0,4
Communication	3,22	0,7	0,7
Recreation and culture	4,19	1,3	11,6
Education	2,19	6,6	9,9
Restaurants and hotels	2,78	n/a	11,0
Miscellaneous goods and services	13,56	6,1	11,6
Total headline CPI	**100,00**	**9,9**	**7,1**

Underlying inflationary pressures are still prevalent in the economy as indicated by the disaggregated analysis of the COICOP categories within headline CPI. Furthermore, when the impact of food, non-alcoholic beverages and petrol is omitted from the calculation of headline CPI, underlying year-on-year inflation amounted to 6,7 per cent in December 2009, exceeding the upper limit of the inflation target range for the 24th consecutive month.

Year-on-year CPI administered price changes moved from deflation at a rate of 1,2 per cent in June 2009 to inflation at a rate of 14,5 per cent in January 2010. This acceleration in administered price inflation was mainly driven by year-on-year price increases in the housing and utilities components (due to electricity tariff increases amounting to 26,8 per cent), petrol at a rate of 31,7 per cent and education services costs at a rate of 10,5 per cent in January 2010. When the effect of petrol prices is excluded from the calculation of administered prices, the year-on-year rate of increase amounted to 10,8 per cent in January 2010.

The BER *Inflation Expectations Survey*, conducted in the fourth quarter of 2009, showed expectations of moderating inflation in the three years to 2011. Inflation was expected to decelerate from 8,1 per cent in 2009 to 7,5 per cent in 2010, before accelerating marginally to 7,7 per cent in 2011. Among the three groups surveyed, financial analysts expected headline CPI to move into the target range in 2010 and to remain within the range during 2011, while business executives and trade unions expected inflation to remain above the upper limit of the inflation target range in 2009, 2010 and 2011.

Foreign trade and payments

International economic developments

Preliminary indications suggest that global economic growth accelerated to a seasonally adjusted and annualised rate of around 5 per cent in the final quarter of 2009. The global recovery continued to be supported by extraordinary monetary and fiscal policy stimulus packages, and also benefited from a rebound in manufacturing production reflecting an upturn in the inventory cycle.

The stronger-than-expected global economic recovery recently caused international organisations and private forecasters to revise their growth projections upwards for 2010. The International Monetary Fund (IMF), for instance, now expects global output to rebound by 3,9 per cent in 2010, following a contraction of 0,8 per cent in 2009. The recovery in advanced economies is expected to remain sluggish, with real output expanding by only 2,1 per cent in 2010. Growth in emerging-market and developing economies is, however, expected to accelerate to a rate of 6,0 per cent in 2010. After slowing to 1,9 per cent in 2009, the IMF expects output growth in Africa to rebound to 4,3 per cent in 2010. The global economy nevertheless still remains fragile and labour market conditions relatively weak. Debt concerns in Greece and the risk of contagion spreading to other countries with large public-sector deficits such as Portugal, Spain, Italy and Ireland could easily derail the economic recovery in the euro area.

The recovery in the United States (US) gained momentum in the fourth quarter of 2009 and the pace of job losses slowed significantly. This increase in economic activity in the fourth quarter primarily reflected positive contributions from private inventory investment, exports and personal consumption expenditure. Real output in Japan accelerated in the fourth quarter of 2009, underpinned by robust increases in external demand and private consumption expenditure. Private investment returned to positive growth rates following six quarters in negative territory, while government consumption and capital spending also moved back to positive growth. The economic recovery in the euro area, however, lost momentum and activity increased only modestly in the fourth quarter of 2009. This moderation was mainly due to the unexpected stagnation in the German economy and the contraction in real gross domestic product of some other member countries such as Greece, Spain and Italy.

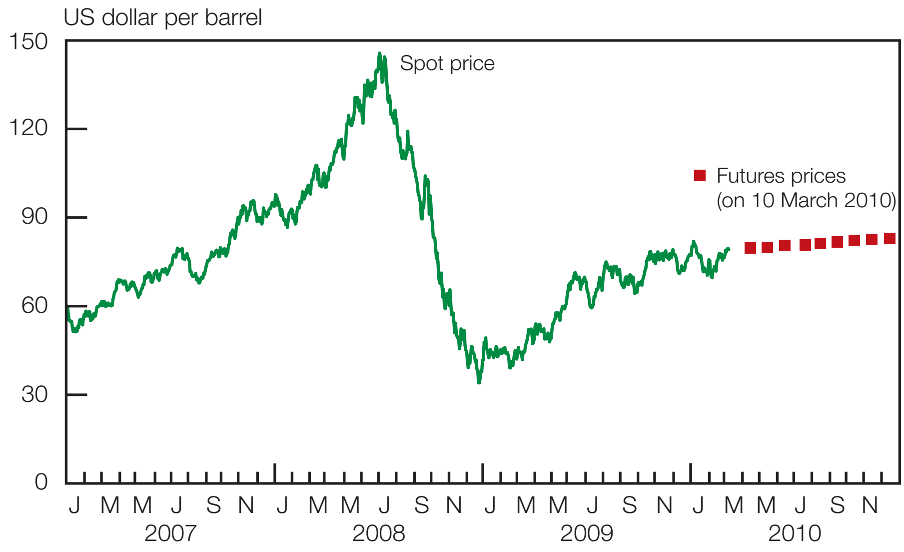
The recovery in economic activity in advanced economies collectively made a more substantial contribution to global growth in the fourth quarter of 2009 compared with preceding quarters. This upturn in advanced economies, especially in the US, is bound to have a positive spillover effect on South Africa given these economies' importance as an export destination.

Real output growth in emerging-market economies as a group seemed to have moderated somewhat in the fourth quarter of 2009, but remains robust in many countries. Emerging-market economies in Asia recovered swiftly after economic activity contracted in the fourth quarter of 2008, registering double-digit growth rates in the second and third quarters of 2009. Economic growth in the region, however, decelerated somewhat in the final quarter of 2009 due to the weaker performances of countries such as India, Singapore and South Korea. China recorded double-digit growth rates for the third successive quarter with real output advancing by 10,0 per cent in the fourth quarter of 2009. Prospects for growth in China continued to improve, buoyed by the pick-up in demand from developed economies as well as closer trade relations with the Association of Southeast Asian Nations (ASEAN) economies following the recent signing of a free-trade agreement. China is currently South Africa's largest export destination and positive growth prospects should have a favourable impact on South Africa's exports.

Following contractions in real output during the fourth quarter of 2008 and the first quarter of 2009, economic activity in emerging-market economies in the European and Latin American regions rebounded, and reached average growth rates exceeding 5 per cent in the third and fourth quarters of 2009. Economic growth in Russia and Turkey also rebounded strongly from the second quarter of 2009, joining a growing number of countries emerging from the protracted recession. Venezuela's economy, however, remained in a recession in the fourth quarter of 2009, as structural problems such as electrical power and water shortages were reinforced by an ongoing diplomatic dispute with Colombia, which negatively affected trade relations between the two countries.

Brent crude oil prices picked up during 2009 and reached a 15-month high of almost US$82 per barrel in early January 2010. Oil prices gained as a result of stronger economic growth in emerging-market economies, more in particular Asia, cold weather conditions in the northern hemisphere and increased stability in global financial markets. Crude oil inventories remained elevated during the fourth quarter of 2009 with expectations of further increases in the first half of 2010. World oil demand is projected to have increased modestly in the fourth quarter of 2009, compared with levels a year ago due to improved demand from China, India and the US. The Organization of the Petroleum Exporting Countries (OPEC) agreed to keep oil production quotas unchanged at its last meeting in December 2009, following the record production curtailment in the previous year. The group's compliance with output targets has since declined as crude oil prices revived and consumption rebounded. Brent crude oil futures contracts for delivery in the second quarter of 2010 traded around US$80 per barrel in early March 2010.

Brent crude oil prices



Source: Bloomberg

Current higher oil prices feeding into inflation seemed set to affect the still fragile economic recovery in most economies adversely. Following several months of deflation, consumer prices in the US and the euro area picked up from November 2009. Annual inflation increased mainly as a result of energy price base effects, improved consumer demand conditions and macroeconomic intervention measures. The deflationary trend in Japan started to dissipate in the second half of 2009. The IMF expects that headline inflation in advanced economies will rise from an average of around zero per cent in 2009 to 1,3 per cent in 2010, partly due to higher energy prices.

Inflation moderated steadily following the onset of the global recession and remains muted in most emerging-market economies. This moderating trend may, however, change as improved domestic demand conditions begin to reflect on prices, particularly in the emerging European and Asian regions. Food prices continue to remain low in most emerging-market economies despite the recent upturn in commodity prices. Consumer prices are expected to remain relatively subdued in most countries as a result of low food prices, surplus capacity as countries emerge from the recession, government measures such as subsidies and price controls in some economies.

Some central banks have already started to exit from accommodating monetary policy stances, while others are expected to keep policy rates at low levels in the short term. The key challenge currently facing central banks is to identify the turning point for growth and the emergence of upside risks to price stability. A number of central banks maintained their low level of policy rates during the fourth quarter of 2009 and in early 2010 due to subdued inflation expectations and concerns about the sustainability of economic growth. Countries experiencing relatively buoyant economic conditions, including Australia, Israel, Malaysia, Norway and China, have tightened monetary conditions. By contrast, central banks in the Czech Republic, Denmark, Hungary, Russia and Turkey have lowered interest rates further in a bid to support their economies.

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

Current account[2]

As could be expected from an economy reviving from a recession and lagging the moderate upturn in global economic activity, South Africa's trade balance with the rest of the world improved consistently throughout 2009. With net service, income and current transfer payments to non-residents remaining broadly unchanged in the second half of 2009, the deficit on the current account of the balance of payments narrowed steadily from 6,7 per cent of gross domestic product in the first quarter of 2009 to 2,8 per cent in the fourth quarter. On a calendar-year basis the deficit on the current account relative to the country's gross domestic product narrowed from 7,1 per cent in 2008 to 4,0 per cent in 2009.

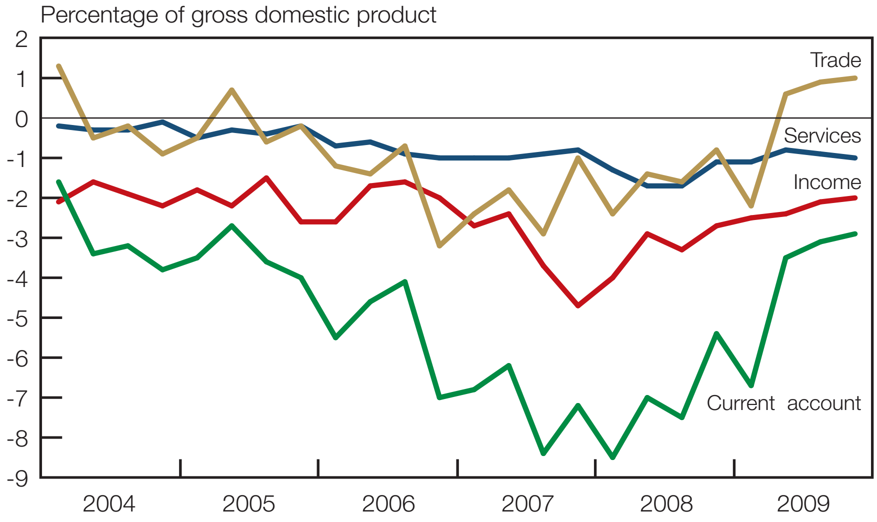
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2008	2009				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	655,8	534,2	474,3	477,6	528,5	503,7
Net gold exports	48,5	51,0	47,5	53,4	59,2	52,8
Merchandise imports	-739,9	-637,0	-508,1	-508,7	-562,8	-554,2
Trade balance	-35,6	-51,8	13,7	22,3	24,9	2,3
Net service, income and current transfer payments	-126,1	-105,8	-96,0	-97,4	-96,3	-98,9
Balance on current account	**-161,7**	**-157,6**	**-82,3**	**-75,1**	**-71,4**	**-96,6**
As a percentage of gross domestic product	*-7,1*	*-6,7*	*-3,4*	*-3,1*	*-2,8*	*-4,0*

The narrowing of the current-account deficit in 2009 could primarily be attributed to an increase in international trade volumes and a concomitant stronger rise in the value of merchandise goods exported from South Africa. South Africa's trade surplus with the rest of the world consequently widened from R22,3 billion in the third quarter of 2009 to R24,9 billion in the fourth quarter. For the year as a whole the trade balance changed from a deficit of R35,6 billion recorded in 2008 to a surplus of R2,3 billion in 2009.

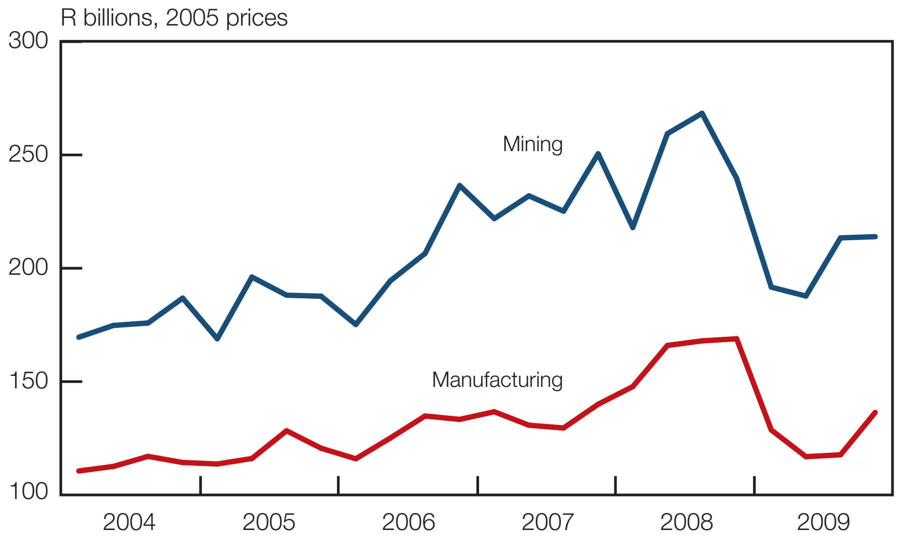
Selected components of the balance on current account



The value of merchandise exports, which receded sharply in the second quarter of 2009 amid a general contraction in global trade volumes, advanced by 0,7 per cent in the third quarter and 10,7 per cent in the fourth quarter. The increase in the fourth quarter of 2009 mainly reflected an increase in the value of manufactured exports, especially in the sub-categories for vehicle and transport equipment and machinery and electrical equipment. The value of agricultural exports also increased notably over the same period, whereas the value of mining exports advanced moderately along with the increase in the international prices of key commodities exported from South Africa. For 2009 as a whole, the value of merchandise exports, excluding gold, was 23,2 per cent lower than in 2008.

As a consequence of the steady recovery in global demand for domestically produced goods, more especially manufactured goods, the volume of merchandise exports advanced by 6,6 per cent from the third to the fourth quarter of 2009. Increased sales of platinum group metals, and of precious and semi-precious stones and pearls to non-residents in the fourth quarter of 2009 were largely offset by a contraction in the volume of mineral exports. Relative to real gross domestic product, the volume of merchandise exports increased from 17,2 per cent in the third quarter of 2009 to 18,2 per cent in the fourth quarter; on average,

Volume of merchandise exports



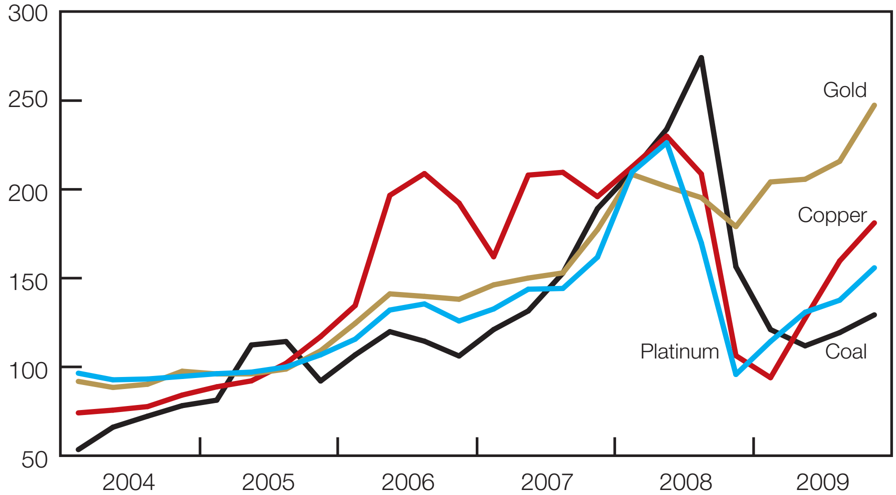
this ratio amounted to 21,6 per cent during the period 2005 to 2008. Despite increases in the physical quantity of exports in the second half of 2009, export volumes still contracted by 22,5 per cent for the year as a whole compared with 2008.

The rand price of goods exported from South Africa, which declined steadily in the middle two quarters of 2009, increased by 3,8 per cent in the fourth quarter. This increase could primarily be explained by the further increase in the dollar value of international commodity prices which was only partly countered by the appreciation in the exchange value of the rand during the period.

International commodity prices, expressed in US dollar terms, strengthened in the fourth quarter of 2009, mainly on account of increased global demand alongside the weakening of the US dollar in foreign exchange markets. For the year 2009 as a whole commodity prices, however, receded by 12 per cent. Pronounced increases were evident in the prices of platinum, copper and coal in the final quarter of 2009. On the London market, the price of gold surged by 14,6 per cent to an average of US$1 101 per fine ounce in the fourth quarter of 2009 before receding to US$1 096 per fine ounce in February 2010. The surge in the dollar price of gold could mainly be attributed to the weakening of the US dollar, de-hedging activity by gold producers, which significantly affected the supply of gold in the second half of 2009, together with a strong rebound in jewellery and investment demand in the final quarter of 2009. After adjustment for the appreciation of the exchange value of the rand, the average realised rand price of gold advanced by 10,2 per cent in the fourth quarter of 2009. The higher rand price of gold combined with a marginal increase in the volume of gold exports, boosted the export earnings of gold producers by 10,9 per cent in the final quarter of 2009.

International prices of selected commodities

US dollar indices: 2005 = 100

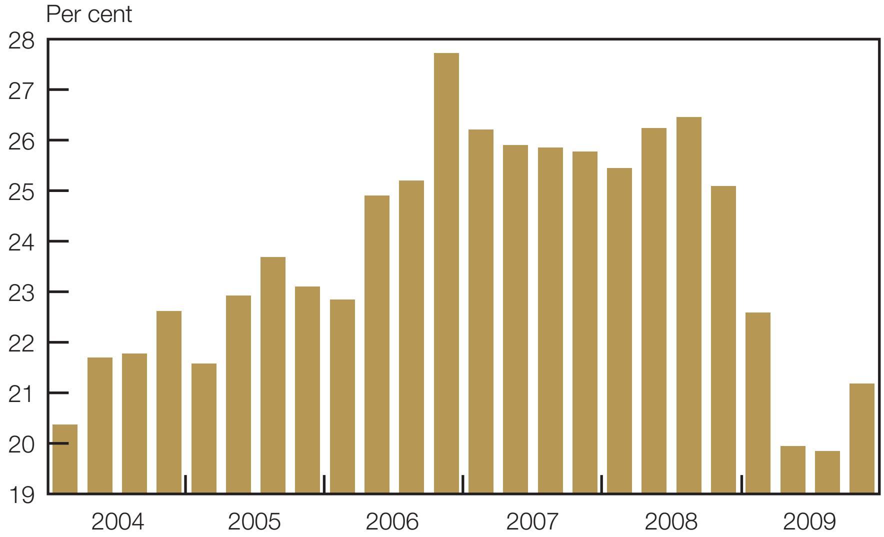


Sources: South African Reserve Bank and other external data sources

Owing to the sharp contraction in global and domestic economic activity in the twelve months to June 2009, the value of merchandise imports declined by no less than 36 per cent from the third quarter of 2008 to the second quarter of 2009 before moving roughly sideways in the third quarter. In the final quarter of 2009, the value of imports rose by 10,5 per cent in tandem with the rebound in domestic production. Partly affected by the strengthening in the nominal effective exchange rate of the rand which, on average, appreciated by 1,7 per cent in the fourth quarter of 2009, the rand prices of imported goods increased by only 2,4 per cent from the third to the fourth quarter.

Following the subdued growth in import prices and a fairly robust increase in gross domestic expenditure, the volume of merchandise imports rose by 8 per cent in the fourth quarter of 2009, having contracted marginally in the third quarter. Increases were noted in the volume of both non-oil imports and crude oil imports. Higher volumes for non-oil imports were evident mainly in the category for manufactured goods where prominent increases were registered in the subcategories for vehicles and transport equipment, chemical products and machinery and electrical equipment. As a result, South Africa's import penetration ratio rose from 19,9 per cent in the third quarter of 2009 to 21,2 per cent in the fourth quarter.

Import penetration ratio



The shortfall on the services, income and current transfer account with the rest of the world improved slightly from the third to the fourth quarter of 2009. However, for the year as a whole, the deficit shrank from R126,1 billion in 2008 to R98,9 billion in 2009, the first contraction since 2003. The significantly smaller deficit in 2009 could primarily be attributed to a sharp contraction in net income payments to non-residents due to a decline in dividends declared on foreign investment in South Africa. At the same time dividend receipts on investments abroad also receded, in part due to the strengthening of the exchange value of the rand. Gross dividend payments to non-resident investors contracted by almost 30 per cent in 2009, reflecting the impact of the slowdown in economic activity on the profit margins of South African companies.

Although the overall deficit on the "services account" narrowed somewhat in the fourth quarter of 2009, gross payments for freight-related activities increased, consistent with the higher volume of merchandise imports. These payments were offset by a decline in dividend payments during the quarter. On the revenue side, gross dividend receipts and tourism-related expenditure in South Africa decreased in the final quarter of 2009 due to the still moderate pace of global economic recovery.

South Africa's terms of trade improved in the fourth quarter of 2009 as the prices of export commodities advanced at a more rapid pace than that of imported commodities.

Financial account

The cross-border flow of capital, especially towards investment in emerging-market economies, gained further momentum in the final quarter of 2009 alongside a revival in real economic activity in most economies. In South Africa the financial account of the balance of payments recorded further capital inflows to the value of R21,3 billion in the fourth quarter of 2009; for the year as a whole, the cumulative net inflows amounted to R113,4 billion. Positive developments in the market for portfolio investment, buoyed by higher yields and favourable domestic economic prospects, continued to attract speculative capital inflows into the country during the fourth quarter of 2009. These capital inflows were supplemented by an inflow of direct investment capital. The balance on the financial account of the balance of payments, including unrecorded transactions, as a percentage of gross domestic product amounted to 3,4 per cent in the fourth quarter of 2009.

Net financial transactions not related to reserves

R billions

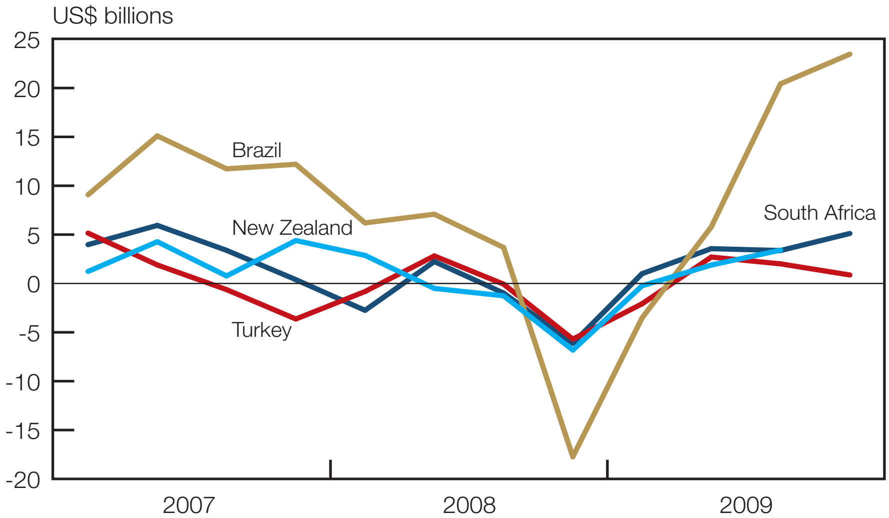
	2008	2009				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	74,4	11,1	24,9	8,3	4,0	48,3
Portfolio investment	-71,5	10,0	29,7	26,3	41,2	107,2
Other investment.......................	47,7	-6,9	-27,5	-6,6	-1,3	-42,3
Change in assets						
Direct investment	26,0	2,5	-3,7	-2,7	-9,6	-13,5
Portfolio investment	-63,4	-0,9	-0,4	-3,6	-9,7	-14,6
Other investment.......................	83,0	-2,2	4,6	20,1	-1,8	20,7
Total financial transactions*...........	**187,5**	**34,8**	**27,8**	**29,5**	**21,3**	**113,4**
Financial transactions as a ratio of gross domestic product.........	*8,2*	*6,0*	*4,6*	*4,8*	*3,4*	*4,7*

* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa increased by R4,0 billion in the fourth quarter of 2009 following an inflow of R8,3 billion in the third quarter. The bulk of the inward movement of capital in the fourth quarter was associated with the acquisition of an equity stake in a South African pharmaceutical company by a non-resident investor. For 2009 as a whole, the inward movement of foreign direct investment capital amounted to R48,3 billion, compared with an inflow of R74,4 billion in 2008.

Portfolio liability flows into selected countries



Source: External central banks and statistical offices

Inward portfolio investment into South African-issued equity and debt securities picked up in the fourth quarter of 2009 and amounted to R41,2 billion during the quarter compared with an inflow of R26,3 billion in the third quarter. Although quarterly portfolio inflows were registered throughout 2009, foreign investors mainly acquired domestic debt securities in the fourth quarter. Cumulatively, portfolio inflows amounted to R107,2 billion in 2009, compared with an outflow of R71,5 billion recorded in the preceding year. The inflow of portfolio-related investment capital into South Africa since the stabilisation of global financial markets was not unique to South Africa. Most emerging-market and commodity-producing economies such as Turkey, New Zealand and Brazil also recorded similar inflows throughout 2009. In comparison with these selected countries, South Africa, with its sound macroeconomic policies, demonstrated a strong ability to attract inward portfolio flows.

Other foreign investment into South Africa recorded an outflow of capital to the value of R1,3 billion in the final quarter of 2009 as the domestic private-banking sector redeemed some of its outstanding rand-denominated loans with non-resident banks. These repayments were, however, partially offset by an increase in the foreign-currency and rand-denominated deposits of non-residents with the domestic private banking sector. The cumulative outflow of capital throughout the year marked the first annual outflow of capital in this category since 2001.

South African-owned assets abroad

Outward direct investment increased by R9,6 billion in the fourth quarter of 2009, having recorded a capital outflow of R2,7 billion in the third quarter. The outflow of capital in the fourth quarter largely reflected a direct investment transaction whereby a domestic pharmaceutical company acquired a foreign manufacturing subsidiary in exchange for equity holding in the South African enterprise. The acquisition of direct investment assets abroad amounted to R13,5 billion in 2009; previously foreign direct investment assets were reduced in 2008.

Foreign portfolio investment by South African institutional investors, which was subdued in the first half of 2009, rebounded in the second half of the year and recorded an outflow of capital to the value of R9,7 billion in the fourth quarter. The acquisition of portfolio assets abroad was probably enticed by the sustained strength of the exchange value of the rand and the return to more normal conditions in global financial markets. On an annual basis, the acquisition of foreign portfolio assets amounted to R14,6 billion in 2009 compared with an outflow of R63,4 billion recorded in 2008. The smaller outflow of capital in 2009 could partly be explained by the fact that financial markets in South Africa were less affected by the turmoil and uncertainty that characterised global financial markets since September 2008. Moreover, the general shortage of liquidity experienced in world financial markets probably encouraged institutional investors to preserve domestic capital for the purpose of meeting local obligations.

Other outward investment from South Africa changed from an inflow of R20,1 billion in the third quarter of 2009 to an outflow of R1,8 billion in the fourth quarter. The outflow of capital mainly reflected an increase in the foreign currency-denominated deposits of the South African banking sector with non-resident banks which more than offset a decline in the offshore rand-denominated deposits of the South African banking sector. For the calendar year 2009 as a whole, capital inflows amounted to R20,7 billion which was considerably lower than the inflow of R83,0 billion registered in 2008.

Foreign debt

South Africa's total outstanding foreign debt increased by US$1,9 billion in the third quarter of 2009 to a level of US$75,9 billion at the end of the quarter. The increase in the country's external debt primarily reflected an increase in rand-denominated foreign debt, as foreign currency-denominated foreign debt rose only marginally over the period.

Foreign debt of South Africa

US$ billions at end of period

	2008		2009		
	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Foreign currency-denominated debt...	**42,1**	**42,0**	**39,4**	**39,8**	**40,0**
Bearer bonds	14,1	14,0	13,3	14,8	15,6
Public sector	5,4	5,3	5,3	5,3	5,7
Monetary sector	11,5	12,1	10,5	9,5	8,7
Non-monetary private sector	11,1	10,6	10,3	10,2	10,0
Rand-denominated debt	**35,0**	**29,8**	**28,0**	**34,2**	**35,9**
Bonds	9,4	8,0	6,6	9,2	9,5
Other	25,6	21,8	21,4	25,0	26,4
Total foreign debt	**77,1**	**71,8**	**67,4**	**74,0**	**75,9**
As a percentage of gross domestic product	*25,8*	*25,9*	*25,7*	*28,5*	*28,9*

The increase in rand-denominated foreign debt could mainly be ascribed to valuation adjustments, as the dollar equivalent of South Africa's rand-denominated debt rose due to the strengthening of the rand against the US dollar from R7,78 per dollar at the end of June 2009 to R7,41 per dollar at the end of September. Although the issuance of a US$500 million international bond by the national government alongside an increase in the foreign borrowing by public corporations raised the level of foreign currency-denominated foreign debt, these capital inflows were almost fully neutralised by a reduction in the foreign currency deposits of non-resident investors with the South African banking sector. Simultaneously, the outstanding external debt balances of the non-monetary private sector declined marginally from the end of the second quarter of 2009 to the end of the third quarter.

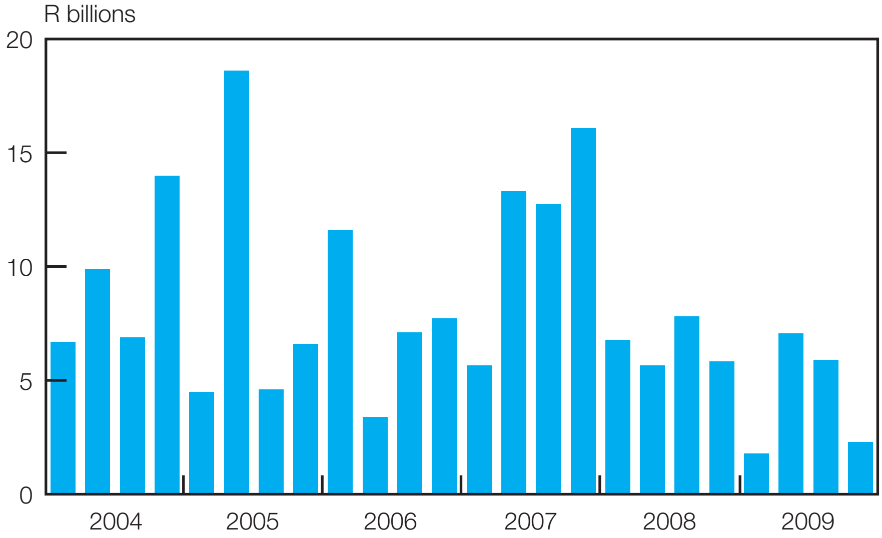
Measured in rand terms, South Africa's foreign debt decreased from R575 billion at the end of June to R563 billion at the end of September 2009. The decrease in rand terms was largely brought about by the appreciation of the rand against the US dollar over this period.

International reserves and liquidity

The deficit on the current account of the balance of payments in the fourth quarter of 2009 was sufficiently financed by a net inflow of capital on the financial account, resulting in a further increase in South Africa's net international reserves due to balance-of-payments transactions. The overall balance of payments accordingly recorded a surplus of R2,3 billion in the fourth quarter of 2009 compared with an increase of R5,9 billion in the third quarter. For the year 2009 as a whole, the country's net international reserves increased by R17,0 billion compared with an increase of R26,1 billion registered in 2008.

The value of the gross gold and other foreign reserves of the Bank (i.e. the international reserves before accounting for reserve-related liabilities) increased steadily from US$39,1 billion at the end of September 2009 to US$39,7 billion at the end of December. Despite this marginal increase, the international reserves advanced by US$5,6 billion from the end of 2008 to the end of 2009. The level of gross foreign reserves at the end of February 2010 amounted to US$39,4 billion. Following a decrease to US$0,35 billion at the end of September 2009, the short-term credit facilities utilised by the Bank remained unchanged until the end of February 2010.

Changes in net foreign reserves



The Bank's international liquidity position increased from US$37,9 billion at the end of September 2009 to US$39,0 billion at the end of December, before receding to US$38,3 billion at the end of February 2010.

Exchange rates

The weighted average exchange rate of the rand increased, on balance, by a further 1,2 per cent during the fourth quarter of 2009. The appreciation in the exchange value of the rand was supported by a persistent rise in international commodity prices, an improved external trade position and positive sentiment towards the country in anticipation of the hosting of the 2010 FIFA World Cup Tournament. In addition, the acceleration in real economic growth and an improved inflation outlook gave further impetus to the exchange value of the rand in the final quarter of 2009.

Exchange rates of the rand

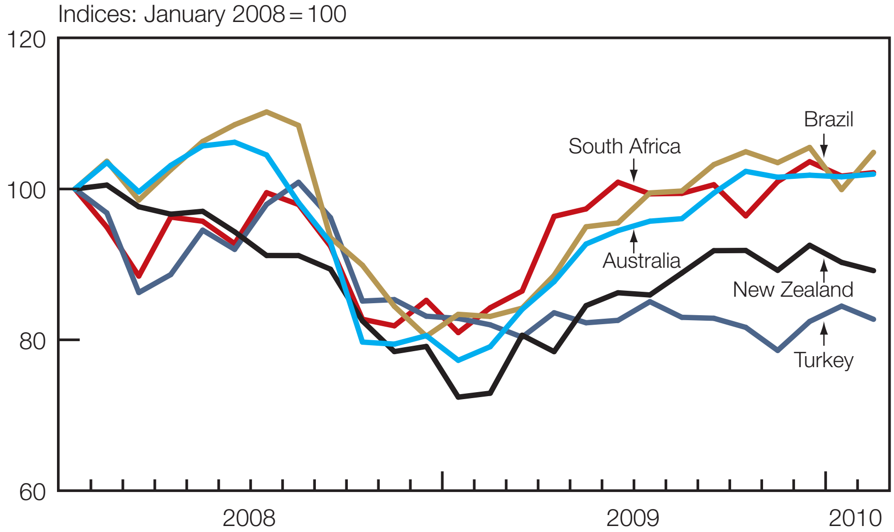
Percentage change

	31 Mar 2009 to 30 Jun 2009	30 Jun 2009 to 30 Sep 2009	30 Sep 2009 to 31 Dec 2009	31 Dec 2009 to 26 Feb 2010
Weighted average*	**17,5**	**2,5**	**1,2**	**-2,8**
Euro	16,7	1,2	2,0	0,5
US dollar	23,8	5,0	0,5	-5,3
Chinese yuan	23,7	4,9	0,5	-5,3
British pound	6,2	8,6	0,1	0,1
Japanese yen	20,3	-1,5	3,5	-8,4

* Against a basket of 15 currencies

On a monthly basis, the exchange rate of the rand remained volatile; the nominal effective exchange rate of the rand decreased, on balance, by 5,4 per cent in October and increased by 3,8 per cent and 3,1 per cent in November and December 2009 respectively. However, for the calendar year 2009 as a whole, the weighted average exchange rate of the rand increased, on balance, by 22,9 per cent compared with a decline of 23,5 per cent in 2008. The strengthening of the US dollar from the end of 2009 to the end of February 2010 caused the nominal effective exchange value of the rand to decline by 2,8 per cent over the period.

Nominal effective exchange rates of selected emerging-market economies



Source: BIS Data Bank

An analysis of the nominal effective exchange rate of selected emerging-market and commodity-producing economies revealed that the domestic currency traced the movement of other emerging-market economies, and that the rebound in most of these currencies was buoyed by the resurgence in international demand for commodities produced by these economies. The observed developments in the currencies of selected emerging-market economies further indicate that the exchange value of the rand seemed to be among the more resilient currencies over the period.

The gradual improvement since 2006 in the international competitiveness of South African products was interrupted when the real effective exchange rate of the rand increased by 22,3 per cent over the twelve months to December 2009.

The average net daily turnover in the domestic market for foreign exchange increased from US$14,5 billion in the third quarter of 2009 to US$15,4 billion in the fourth quarter as non-resident investors increased their participation in the South African equity and debt markets. The value of transactions in which non-residents participated also increased from 75,5 per cent to 77,4 per cent over the same period.

Monetary developments, interest rates and financial markets

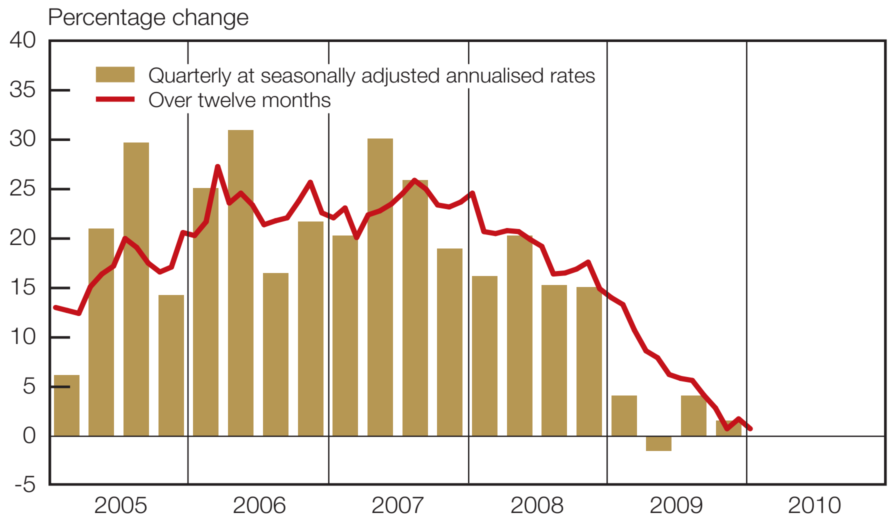
Money supply

Growth in the broadly defined money supply (M3) slowed drastically in the course of 2009, but displayed tentative signs of bottoming out towards the end of the year and in early 2010. The restrained growth in M3 occurred against the backdrop of sluggish economic activity, lower inflation, relatively low returns on M3 deposits, lethargic income and impaired balance sheets in both the corporate and household sectors.

During most of 2009 M3 recorded single-digit year-on-year growth rates; the first time since 2000 that a rate of increase below 10 per cent was registered. After contracting by 1,5 per cent in the second quarter of 2009, the quarterly[3] growth in M3 recovered to positive growth rates of 4,1 per cent in the third quarter and 1,6 per cent in the fourth quarter.

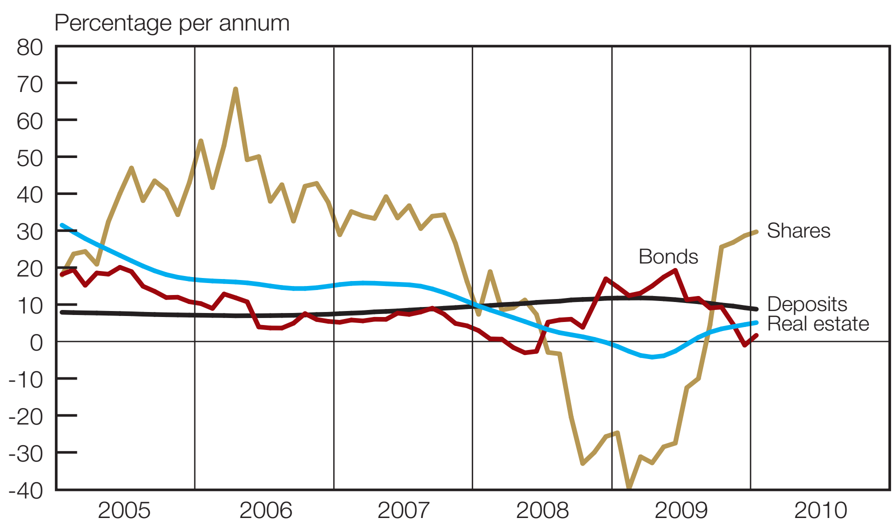
3 The quarter-to-quarter growth rates referred to in this section are based on seasonally adjusted and annualised data.

Growth in M3



Quarter-to-quarter growth in M3 was subdued throughout 2009. Cheque, transmission, call and overnight deposits recorded positive growth in the final three quarters of 2009. Other short- and medium-term deposits were liquidated during this period. However,

Return on selected asset classes



some investors became more risk-averse and returned to the more secure long-term deposits in the third and fourth quarters of 2009. Notes and coin in circulation remained relatively subdued in the second and third quarters, but grew modestly in the fourth quarter of 2009 as the transactions demand for cash picked up, possibly signalling a recovery in economic activity.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2009			
	1st qr	2nd qr	3rd qr	4th qr
Notes and coin	13,6	-1,1	0,6	11,0
Cheque and transmission deposits	-4,2	1,4	10,5	0,2
Call and overnight deposits	-23,5	25,6	12,8	5,6
Other short- and medium-term deposits*	41,9	-11,7	-20,6	-5,9
Long-term deposits**	-26,0	-13,2	73,0	23,9
M3	4,0	-1,5	4,1	1,6

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

Both the household and corporate sectors contributed to the slowdown in M3 deposit holdings during 2009. From R47,6 billion in the fourth quarter of 2008, growth in M3 deposits fell sharply in the subsequent quarters to R3,7 billion in the fourth quarter of 2009. After declining in the third quarter of 2009, deposits of the household sector rose by R7,3 billion in the fourth quarter, while those of the corporate sector contracted by R3,7 billion. The contraction in corporate-sector deposits emanated from non-bank financial companies, while the deposit holdings of non-financial institutions rose somewhat. Growth over 12 months in the M3 deposit holdings of both the household and corporate sectors also followed a downward trajectory in 2009 and remained at single-digit levels for the better part of the year. In January 2010 year-on-year growth in M3 amounted to 0,6 per cent, further down from 1,6 per cent in December 2009.

Statistical counterparts of change in M3

R billions

	2009			
	1st qr	2nd qr	3rd qr	4th qr
Net foreign assets	7,6	20,6	7,5	5,5
Net claims on the government sector	5,6	-5,0	21,0	19,4
Claims on the private sector	27,1	-21,4	-15,1	-1,5
Net other assets and liabilities	-27,1	14,6	-8,3	-19,8
Total change in M3	13,1	8,8	5,0	3,7

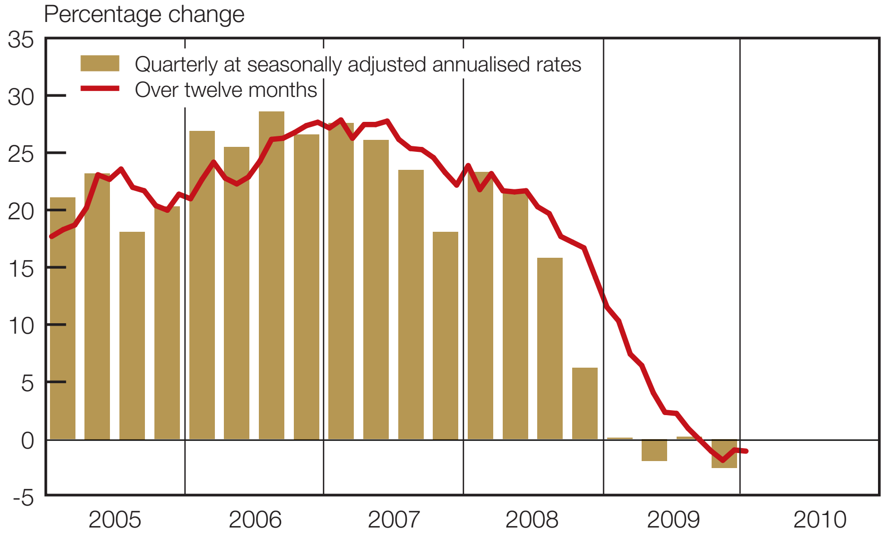
Statistically, the modest increase in M3 during the fourth quarter of 2009 was explained by notable increases in net claims on the government sector and net foreign assets, largely offset by declines in both claims on the private sector and net other assets. The increase in net claims on the government sector could be attributed to an increase in the private banks' holdings of government stock and Treasury bills, which was partially counteracted by an increase in government deposits, largely due to relatively high tax collections in December 2009.

After registering an uninterrupted downward trend since the fourth quarter of 2007, the income velocity of circulation of M3 increased from a record low of 1,22 in the first quarter of 2009 to 1,28 in the fourth quarter as the slow growth in M3 was outpaced by that of nominal gross domestic product.

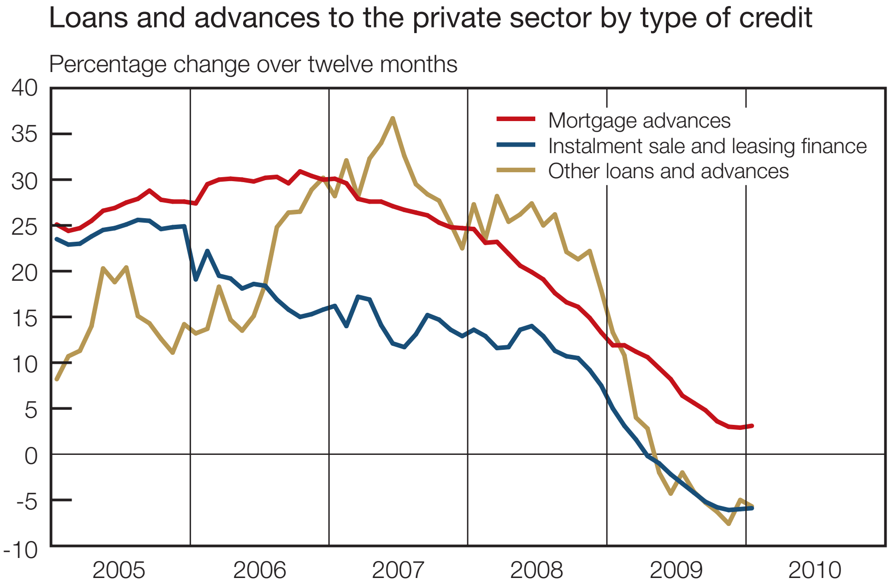
Credit extension

The deceleration in banks' total loans and advances that began in the second half of 2007 extended into 2009, although at a considerably faster pace than in the preceding two years. After entering negative territory in September 2009, twelve-month growth in total loans and advances showed signs of stabilising in December when it eased slightly from an all-time low of -2,0 per cent in November. In January 2010 growth in total loans and advances was measured at -1,2 per cent. The high level of household and corporate indebtedness – also reflected in the high and rising level of impaired advances recorded by banks – continued to dampen the demand for credit. Throughout 2009 the quarter-to-quarter growth in total loans and advances was either negative or only marginally positive, consistent with the generally subdued conditions in the economy.

Total loans and advances to the private sector



During 2009 banks' total loans and advances weakened across all the major categories. However, while most of the credit categories recorded negative growth in 2009, *mortgage advances* retained a modest positive growth rate throughout the year. The month-on-month growth in mortgage advances, which account for just over half of banks' total loans and advances, has picked up steadily in recent months. This turnaround was possibly a reflection of less stringent lending criteria of some banks, relatively low interest rates and a revival of activity in the property market. After reaching a low of 2,8 per cent in December 2009, growth over twelve months in mortgage advances recovered to 3,1 per cent in January 2010.



Quarterly changes in banks' total loans and advances by type

R billions

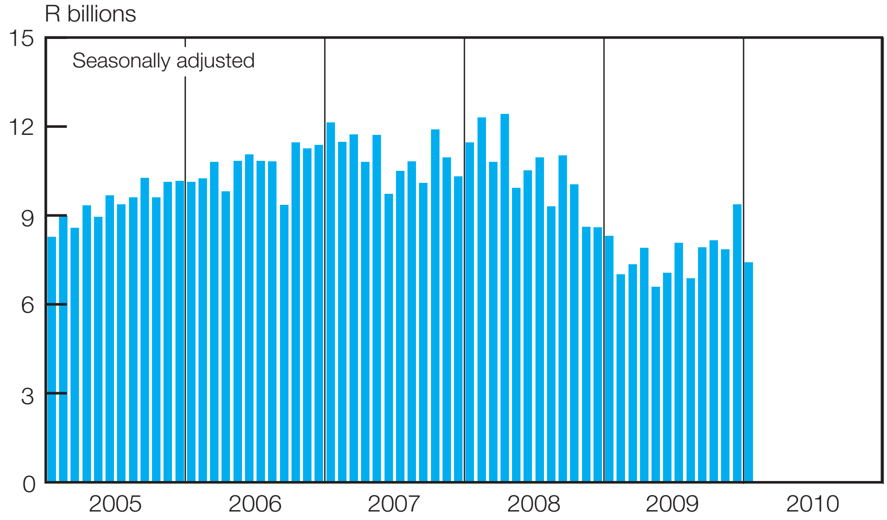
	2009			
	1st qr	2nd qr	3rd qr	4th qr
Mortgage advances	14,3	2,2	3,4	7,3
Instalment sale credit and leasing finance	-3,7	-5,2	-4,3	-1,9
Other loans and advances	-0,7	-19,0	-4,8	-5,9
Overdrafts	2,2	-1,6	-4,8	-5,6
Credit card advances	-0,2	-0,7	0,5	-1,2
General advances	-2,7	-16,7	-0,5	0,9
Total loans and advances	**9,9**	**-22,0**	**-5,8**	**-0,4**
Of which: To household sector	11,7	-1,6	6,6	4,8
To corporate sector	-1,8	-20,5	-12,3	-5,1

Twelve-month growth in *instalment sale and leasing finance* turned negative in April 2009 and reached a rate of contraction of 6,1 per cent in November, before improving to a still negative 5,9 per cent in January 2010. The rate of contraction was contained to some extent by the *instalment sale* category, which recorded month-on-month increases from September 2009; consistent with the turnaround in the demand for motor vehicles. New business payouts related to instalment sale and leasing finance started picking up in recent months, as shown in the accompanying graph on the next page.

Growth in *other loans and advances*, mainly indicative of the low appetite for credit by the corporate sector, recorded a negative year-on-year growth rate of 5,7 per cent in January 2010 and has been in negative territory since May 2009.

In value terms, the net decline in banks' total loans and advances for the year 2009 was the first in recorded history. After increasing by R229,7 billion in 2008, banks' total loans and advances contracted by R18,3 billion in 2009. The slowdown in total loans and advances was especially evident in credit extended to the corporate sector, which declined in all four quarters of 2009, as corporate entities encountered an uncertain economic environment leading to disintermediation. The household sector, which

New business payouts related to instalment sale and leasing finance



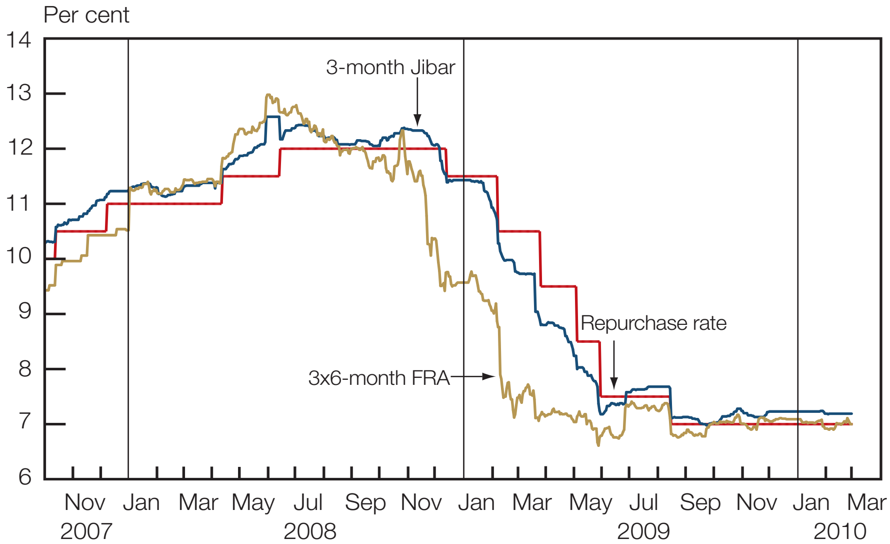
contributed R21,4 billion to growth in total loans and advances in 2009, expanded its reliance on bank credit in the last two quarters of the year but remained constrained by the weak labour market, subdued income growth and strict lending conditions.

Interest rates and yields

At its first meeting in 2010, the Monetary Policy Committee (MPC) left the repurchase (repo) rate unchanged at 7,0 per cent, making it the fourth consecutive MPC meeting at which the rate was maintained at the same level after it had been reduced by a cumulative total of 500 basis points between December 2008 and August 2009. The MPC decision to keep the repurchase rate unchanged was taken against the backdrop of increasing signs of improvement in the domestic economic growth outlook and a relatively favourable longer-term inflation outlook, despite prevailing risks emanating from electricity price increases. The MPC statement discussing developments underlying recent monetary policy decisions is reproduced in full elsewhere in this *Bulletin*.

Following a steep downward trend that started in November 2008, other money-market rates remained fairly stable in the fourth quarter of 2009 and the first two months of

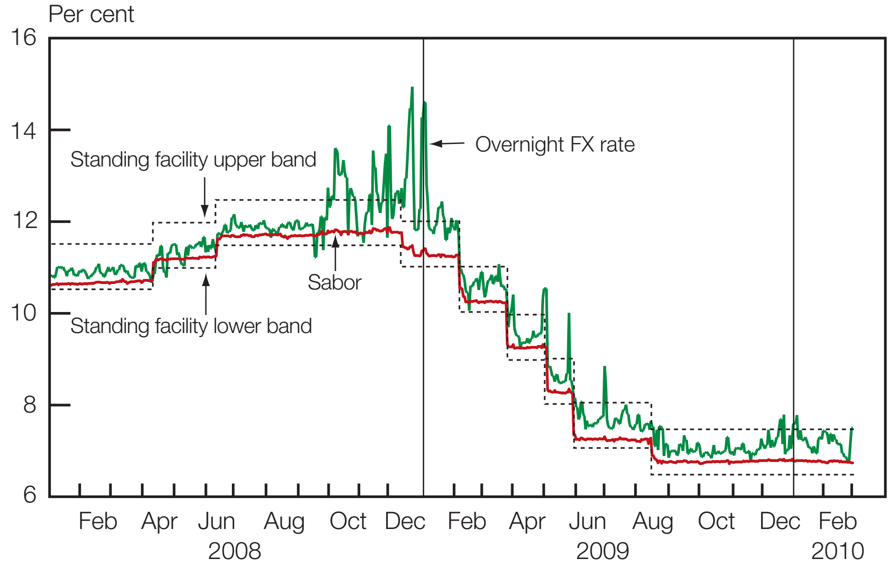
Money-market rates



2010, amid market perceptions that the policy rate-easing cycle was close to an end. The three-month Johannesburg Interbank Agreed Rate (Jibar) consistently fluctuated below the repurchase rate between December 2008 and June 2009 against the backdrop of easing in the money-market funding conditions and expectations of further interest rate decreases. During the subsequent period it fluctuated just above the repurchase rate as expectations of further reductions in the repurchase rate weakened. Similarly, the 91-day Treasury bill rate fluctuated within a narrow range between 6,87 and 7,14 per cent during the fourth quarter of 2009 and the first two months of 2010.

After displaying some volatility in June 2009, rates on forward rate agreements (FRAs) stabilised during the second half of 2009 and remained relatively stable up to early January 2010. More recently the slope of the FRA yield curve suggested a fairly moderate probability of a further rate reduction at the second MPC meeting in March 2010.

Benchmark overnight rates



The South African Benchmark Overnight Rate on Deposits (Sabor) remained fairly stable and well within the standing facility limits in 2009 and early 2010, fluctuating around the 7,0 per cent level since August 2009. The implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) posted relatively steady rates in the fourth quarter of 2009, with the exception of the latter half of December and early January when funding pressures increased due to low market liquidity over the festive season.

Both the prime overdraft rate and the predominant rate on mortgage loans of the private-sector banks broadly emulated the movements in the repo rate and have remained unchanged at 10,50 per cent since August 2009.

Interest rates on the RSA *government fixed-rate and inflation-linked retail bonds* are updated on a monthly and semi-annual basis, as depicted in the following table:

Interest rates on South African government retail bonds

Per cent

Effective from:	2-year bond	3-year bond	5-year bond
Fixed rate:			
1 Jun 2009	9,00	9,25	9,75
1 Jul 2009	9,25	9,50	9,75
1 Oct 2009	8,75	9,00	9,25
	3-year bond	5-year bond	10-year bond
Inflation linked:			
1 Jun 2009	2,25	2,50	2,75
1 Dec 2009	2,25	2,50	3,00

The daily *average yield on the R157 government bond* (maturing in 2014/15/16) increased from a recent low of 7,04 per cent on 18 December 2008 to 8,78 per cent on 3 July 2009. Subsequently, bond yields were volatile reaching 8,17 per cent on 4 March 2010 as the high level of issuance and expected further increased supply of government bonds, and inflation risks emanating from the increase in Eskom electricity tariffs were offset by the effects of the appreciation in the exchange value of the rand and expectations of a possible reduction in the repurchase rate. Similarly, the daily closing yield on the US 5-year bond increased from 1,27 per cent on 18 December 2008 to 2,93 per cent on 8 June 2009, before fluctuating lower to 2,28 per cent on 4 March 2010. Consequently, the spread between the South African R157 bond yield and the US 5-year bond yield widened marginally from 577 basis points on 18 December 2008 to 589 basis points on 4 March 2010.

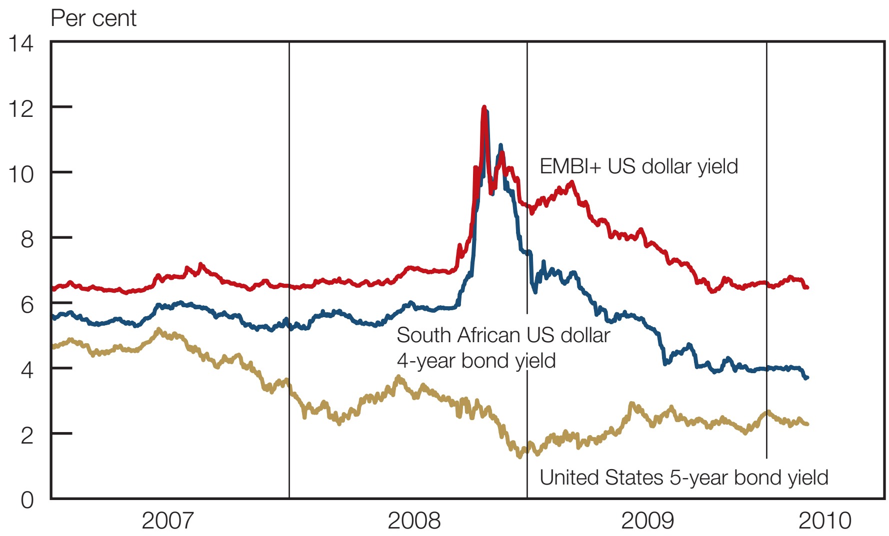
From December 2008 to late August 2009, bond yields at the extreme short end of the *yield curve* moved lower in line with the lowering of the repurchase rate, after which they remained broadly on the same level, anchored to the unchanged repurchase rate. Increases were, however, evident in the medium to long end of the curve. The *yield gap*, measured as the differential between the yields at the extreme long and short ends of the curve, widened from 72 basis points on 13 August 2009 to 198 basis points on 4 March 2010.

Amid bond yield volatility, the *break-even inflation rate* – calculated as the differential between the nominal yield on conventional bonds and the real yield on inflation-linked bonds within the three-year maturity range – fluctuated higher from a recent low of 4,14 per cent in February 2009 to above the 6 per cent level in June and reached 6,54 per cent in October. Subsequently, the break-even inflation rate declined to 6,11 per cent in February 2010, as the nominal yield on conventional bonds declined and the real yield on inflation-linked bonds increased.

The *currency risk premium* on South African government bonds (the differential between South African government bond yields on rand-denominated debt in the four-to-five-year maturity range issued in the domestic market and dollar-denominated debt issued in the US) widened from 34 basis points in January 2009 to 431 basis points in February 2010 as a result of a general increase in the yield on domestic rand-denominated bonds and a noticeable decline in the corresponding yield on dollar-denominated bonds, along with an improvement in sovereign risk.

Investor sentiment towards emerging markets continued to improve, as evidenced by the narrowing of the JPMorgan Emerging Markets Bond Index Plus (EMBI+) yield spread from 718 basis points in November 2008 to 295 basis points in February 2010. Alongside the general narrowing of emerging-market bond spreads, the *sovereign risk premium* on South African government US dollar-denominated bonds in the four-year maturity range trading in international markets narrowed significantly from 720 basis points to 157 basis points over the same period.

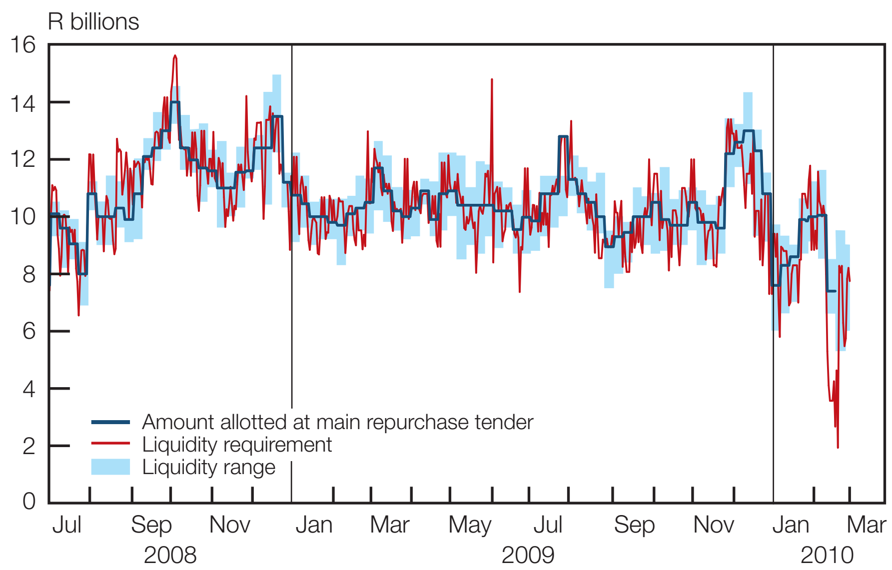
US dollar-denominated bond yields



Money market

Money-market conditions displayed some volatility during the fourth quarter of 2009 and the first two months of 2010. During this period the average daily liquidity requirement of the private-sector banks varied within a broader range of between R13,4 billion and R1,9 billion, compared with a range of between R8,1 billion and R13,3 billion during the third quarter of 2009. The weekly main refinancing auctions also oscillated between

Liquidity requirement, range and amount allotted



R7,6 billion and R13,0 billion over the same period. The lowest levels were registered in December 2009 and early January 2010, coinciding with the period of low market activity over the festive season.

In addition to the use of standing facilities and supplementary repurchase transactions, daily liquidity fluctuations were accommodated through banks' utilisation of their cash reserve accounts. The statistical counterparties of recent money-market liquidity flows are depicted in the accompanying table.

Money-market liquidity flows

R billions (easing + tightening -)

	2009		2010
	3rd qr	4th qr	Jan and Feb
Notes and coin in circulation	-0,7	-8,6	5,4
Required cash reserve deposits	-0,1	-0,1	-0,2
Money-market effect of SARB* foreign-exchange transactions	3,2	7,3	4,6
Government deposits with the SARB	-3,1	3,6	-3,5
Use of liquidity management instruments	-1,2	12,1	-6,4
Reverse repurchase transactions	1,2	3,3	-3,3
SARB debentures	-2,4	8,8	-3,1
Other items net**	1,4	-11,4	-0,1
Banks' liquidity requirement (decrease + increase -)	**-0,5**	**2,9**	**-0,2**

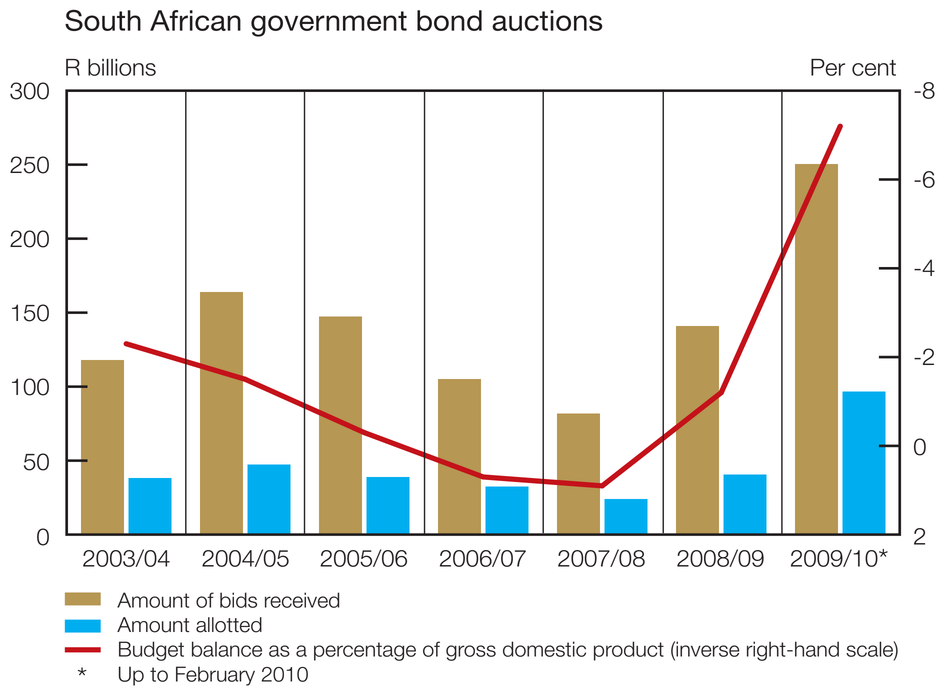
* SARB: South African Reserve Bank
** Mainly comprising public deposits

During the fourth quarter of 2009, notes and coin in circulation and banks' cash reserve deposits with the South African Reserve Bank (SARB) cumulatively drained liquidity to the net value of R8,7 billion. The drainage was more than offset by the use of liquidity management instruments (reverse repurchase transactions and SARB debentures) and foreign exchange transactions, which together injected R19,4 billion worth of liquidity into the money market.

Coupon interest payments on various government bonds amounting to R8,9 billion were effected from the tax and loan account during the fourth quarter of 2009 and the first two months of 2010. Only R0,1 billion of this amount accrued to the Bank's own bond portfolio.

Bond market

Financial shortfalls of the *public sector* continued to be funded mostly locally, with net issues amounting to an all-time high of R113,5 billion in 2009, compared with R27,2 billion in 2008. Public-sector borrowers' demand for funds was buoyed by an increase in infrastructural expenditure by state-owned enterprises and a higher fiscal deficit. The supply of government bonds on auction increased by 139 per cent from fiscal 2008/09 to 2009/10, with the difference between bids received and allotted also rising, indicating strong demand for bonds. National government and state-owned enterprises accounted for 60 per cent and 39 per cent respectively of total funds raised by the public sector in 2009, while the remainder was raised by local governments. In the first two months of 2010 the nominal value of public-sector bonds listed increased by R27,2 billion, bringing the outstanding nominal amount to R680,4 billion.



After recording net redemptions of R2,3 billion in 2008, *private corporate* funding activity in the bond market increased by R18,1 billion in 2009. Activity was largely driven by banks, capitalising on a revival of investor appetite as economic conditions improved and as foreign funding opportunities remained strained. Securitisation, however, remained out of favour. In the first two months of 2010, the private sector maintained a cautious approach to new funding as net redemptions of R0,7 billion were recorded alongside still relatively weak company balance sheets and disappointing corporate earnings.

Funding in the form of *commercial paper* was subdued in 2009 as reflected by net redemptions of R14,9 billion, compared with net issues of R16,5 billion in 2008. This lack of demand for, and supply of, commercial paper continued unabatedly in the first two months of 2010, as net redemptions of R4,4 billion were recorded. The outstanding nominal value of commercial paper listed on the JSE Limited (JSE) therefore declined to R42,5 billion at the end of February 2010. By contrast, the *total outstanding nominal value of bonds* listed on the JSE increased by a marked R118,5 billion in 2009 and a further R22,1 billion in the first two months of 2010 to reach R961,2 billion at the end of February 2010.

In the midst of the recession in major global economies, non-residents' demand for rand-denominated bonds issued in the *Japanese and European bond markets* waned in 2009. Net redemptions of R12,9 billion were recorded in 2009 following net issues of R28,5 billion in 2008, as shown in the table below. Net redemptions of rand-denominated bonds issued in both markets amounted to R2,6 billion in January and February 2010.

Rand-denominated bonds issued in international bond markets

R millions

	Eurorand		Uridashi		Total	
	2008	2009	2008	2009	2008	2009
Issues	15 523	2 114	21 505	15 331	37 028	17 445
Redemptions	7 450	15 270	1 044	15 108	8 494	30 378
Net issues	8 073	-13 156	20 461	223	28 534	-12 933

The value of *turnover* in the secondary bond market declined by 30 per cent from R21,3 trillion in 2008 to R14,9 trillion in 2009, following a decline in volumes traded and higher bond yields. Repurchase agreements continued to account for the bulk of turnover, constituting 66 per cent of the total in 2009. The liquidity ratio, measured as the nominal value of bonds traded in the secondary market relative to the nominal amount in issue, declined from 23 in 2008 to 14 in 2009. This was also reflected in the daily average value traded, which declined by 26 per cent from R84,6 billion to R63,0 billion over the same period. In the first two months of 2010, turnover amounted to R2,1 trillion.

Non-residents increased their holdings of local debt securities by a quarterly record-high amount of R24,3 billion in the fourth quarter of 2009, subsequent to net sales of domestic bonds amounting to R3,4 billion in the third quarter. Further net purchases of R7,8 billion were recorded in the first two months of 2010. Non-residents' interest in the local bond market was mainly supported by a decline in global risk aversion and an increase in domestic bond yields. The cumulative net purchases of domestic debt securities by non-residents amounted to R15,5 billion in 2009 as a whole, compared with net sales of R23,8 billion in 2008. Non-residents' participation in the domestic secondary bond market, measured as their purchases and sales as a percentage of total purchases and sales, amounted to 12 per cent in 2009 compared with a participation rate of 13 per cent in 2008.

Share market

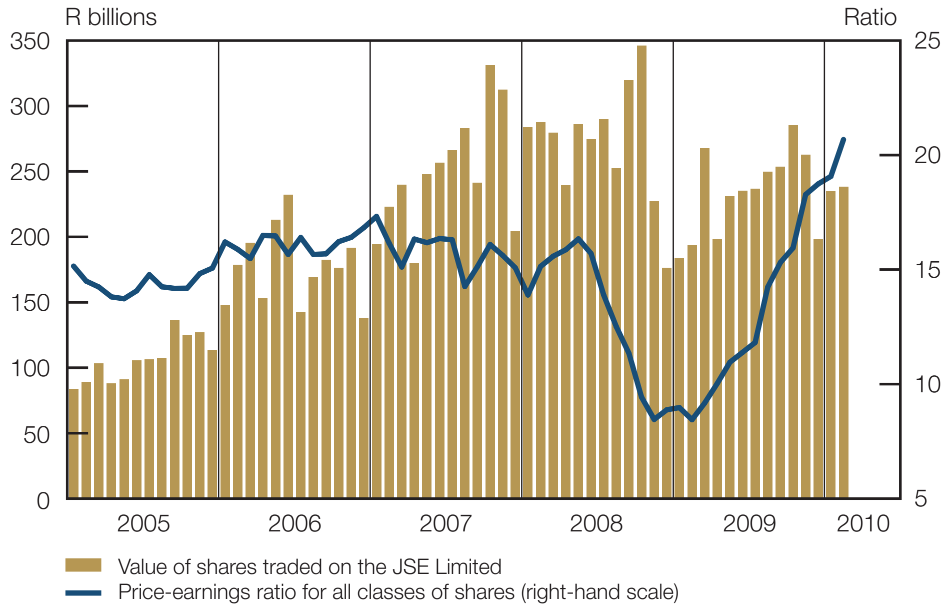
The total value of *equity capital raised in the domestic and international primary share markets* by companies listed on the JSE amounted to R107,0 billion in 2009, no less than 40 per cent more than the R76,7 billion raised in 2008. This increase was mainly supported by a monthly high of R37,6 billion in May 2009; the highest level since October 2005. Of the total amount raised in 2009, the industrial sector was the predominant contributor at 54 per cent, followed by the financial and resources sectors at 25 per cent and 17 per cent respectively. Capital was mainly raised through the acquisition of assets and the waiver of pre-emptive rights, respectively amounting to R55,8 billion and R27,9 billion over the same period. Total capital raised amounted to R0,6 billion in January 2010.

The number of companies listed on the JSE at the end of 2009 amounted to 410, with 10 new listings and 25 delistings recorded during 2009, compared with the 23 new listings and 20 delistings recorded in 2008. Total listings on the Alternative Exchange (Alt^X) came to 76 at the end of 2009, while 322 companies were listed on the main board, and 6 companies on each of the venture and development capital boards. One delisting and no new listings were recorded in January 2010.

Share prices trended upwards in 2009 contributing to progressive quarterly increases in the *total value of shares traded* on the JSE in 2009. However, turnover of R2,8 trillion recorded in 2009 as a whole was still 14 per cent lower than the turnover of R3,3 trillion registered in 2008. On a daily basis, the average turnover also declined from R12,4 billion in 2008 to R10,6 billion in 2009. Turnover in the first two months of 2010 averaged R11,4 billion per day. The value traded on Alt^X of only R2,3 billion in 2009 was 53 per cent lower than the turnover of R5,0 billion recorded in 2008 and the lowest level in three years.

In line with higher share prices, the total *market capitalisation* of the JSE increased by 44 per cent from R4,0 trillion in February 2009 to R5,8 trillion in February 2010. The combined market capitalisation of all companies listed on Alt^X, however, decreased from R20,0 billion in November 2008 to R11,8 billion in February 2010, accounting for only 0,2 per cent of total market capitalisation. Total market liquidity, measured by expressing annualised turnover as a percentage of market capitalisation, declined from 75 per cent in March 2009 to 50 per cent in February 2010.

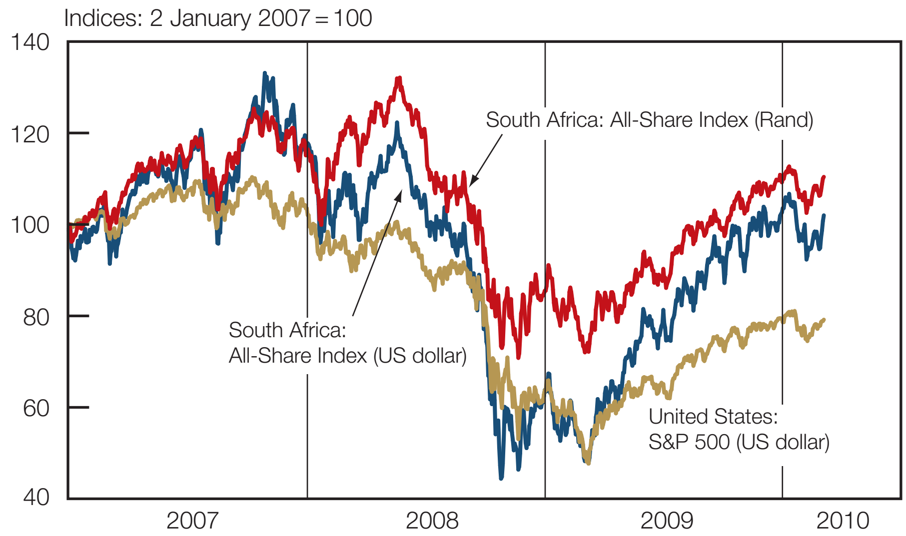
Turnover in the secondary share market



The increased equity exposure of *non-residents* continued in the fourth quarter of 2009 along with some improvement in the general economic outlook and the consequent steady recovery in global markets. Non-residents' net purchases of shares listed on the JSE amounted to R12,6 billion in the fourth quarter of 2009 and a further R6,5 billion in the first two months of 2010 as investor sentiment improved and risk appetite was restored. For 2009 as a whole, non-residents accumulated R75,4 billion worth of South African listed shares, compared with the substantial net sales of R54,4 billion in 2008. Their participation rate in the domestic secondary share market amounted to an all-time annual low of 18 per cent in 2009, compared with 19 per cent in 2008.

The *All-Share Price Index* (Alsi) rallied by 56 per cent from a recent low index value of 18 121 on 3 March 2009 to a peak of 28 347 on 11 January 2010. This movement was supported by an improvement in international equity markets and the good performance of the local resources sector, buoyed by record-high commodity prices and signs of

Share prices



recovery in the global economy. However, negative news such as the depressing pronouncement by the US government regarding the banking sector, reports of monetary policy tightening from China, European sovereign debt afflictions and lower commodity prices weighed somewhat on the share market and the Alsi declined by 2 per cent to an index value of 27 774 on 4 March. Expected price volatility in the local share market, as measured by the South African Volatility Index, declined from 52 per cent at the end of October 2008, when uncertainty was most pronounced, to 22 per cent at the end of October 2009, before increasing to 25 per cent at the end of February 2010.

Prices of financial shares increased by 65 per cent from 3 March 2009 to 4 March 2010, while those of industrial shares increased by 56 per cent and of resources shares by 46 per cent. Similarly, in US dollar terms the Alsi increased by 111 per cent over the same period, outperforming the Standard & Poor's (S&P) 500 Composite Index which rose by 61 per cent. US share prices benefited from the release of better-than-expected US gross domestic product data as well as improved manufacturing data.

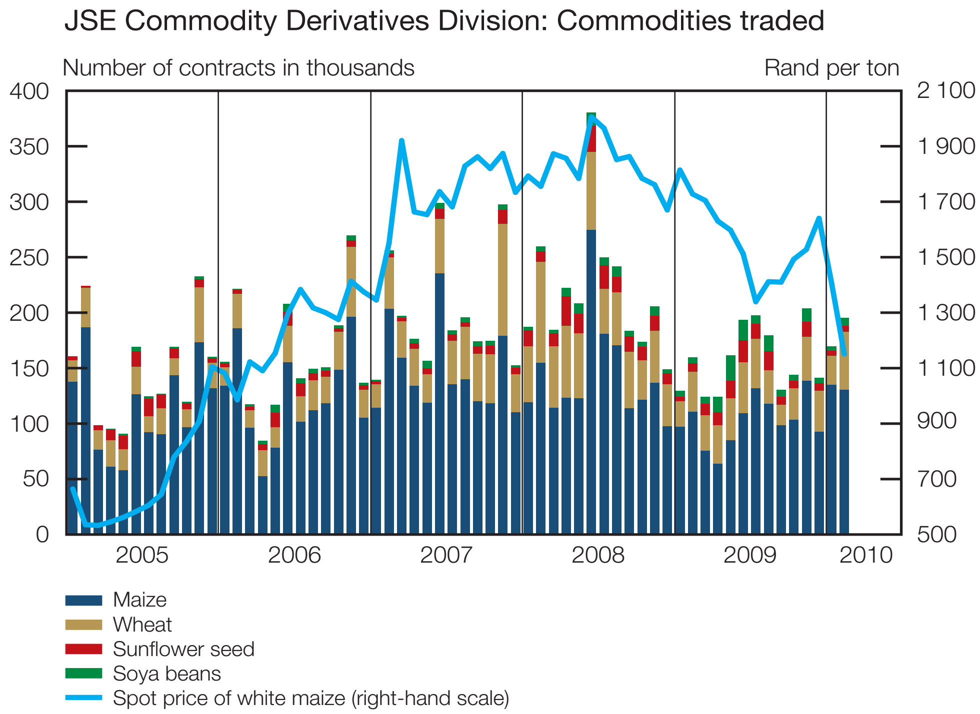
The historical *dividend yield* on all classes of shares decreased from 4,8 per cent in November 2008 to a low of 2,0 per cent in February 2010 – a level broadly similar to that recorded in June 2007. The *earnings yield* also decreased from 11,8 per cent in February 2009 to 4,8 per cent in February 2010. These decreases can be ascribed to lower earnings and dividends declared and higher share prices. Conversely, the *price-earnings ratio* for all classes of shares increased considerably from 8,4 to 20,7 over the twelve months to February 2010.

Market for exchange-traded derivatives

Although activity picked up in the second half of 2009, together with the bullish underlying share market, turnover in *equity derivatives* on the JSE remained subdued compared with 2008 as turnover of R3,2 trillion in 2009 was 35 per cent lower than the value traded in the corresponding period of 2008. Activity in this market moved in tandem with the volatility in the underlying domestic equity market as investors remained uncertain regarding the pace of the global economic recovery. Trading activity continued to be dominated by single-stock (including international derivatives) futures and options contracts, which accounted for 66 per cent of the total number of contracts traded in 2009. Equity index contracts accounted for 92 per cent of the total value of contracts traded in 2009. The first two months of 2010 reflected somewhat weaker trading conditions in the equity derivatives market when compared with the final months of 2009.

Turnover in *commodity futures and options contracts* was 36 per cent lower in 2009 compared with 2008, as trading volumes declined by 28 per cent and the domestic and international prices of agricultural commodities declined. This was amid the effects of the global economic crisis, which dampened overall demand and agricultural business confidence levels. Low agricultural products prices were also due to higher levels of global crop supplies following generally favourable weather conditions as reported in the *World Agricultural Supply and Demand Estimates* report prepared by the US Department of Agriculture.

In December 2009 *Yield-X* diversified and enhanced its product range by introducing and trading futures contracts on the 3-month Jibar instrument, mainly to develop the current product range in order to contend with global futures exchanges. Following the approval from the Bank, the JSE announced that the currency futures and options product range had been extended to include Japanese yen/rand futures contracts from December 2009. Trade in these futures contracts began in January 2010.



Buoyancy in the Yield-X market continued to be supported by developments in the foreign exchange market. As trading activity in this segment soared, the total number of contracts traded reached a high of 8,5 million in 2009, an increase of 37 per cent compared with 2008. Consequently, the total value traded in this market recorded an increase of 36 per cent in 2009 when compared with 2008. Along with the volatility in exchange rates, currency futures and options contracts accounted for the largest share at 93 per cent of total contracts traded in 2009. Trading activity and turnover on the Yield-X market remained brisk in the first two months of 2010.

The equity market of the JSE listed currency reference warrants for the first time in November 2009 in order to allow investors the opportunity to take positions on future movements in the local currency.

Consistent with the lower number of warrants listed, trading activity in the *warrants* market was relatively subdued in 2009 compared with 2008, despite the sturdy recovery in the underlying share market over this period. Turnover in warrants was 16 per cent lower in 2009 after having increased by 23 per cent in 2008. In the first two months of 2010, American-style warrants on constituents of the underlying resources sector, especially the general mining sector, contributed the most to total turnover. Turnover in all derivatives traded on the JSE during the first two months of 2010 is indicated in the accompanying table.

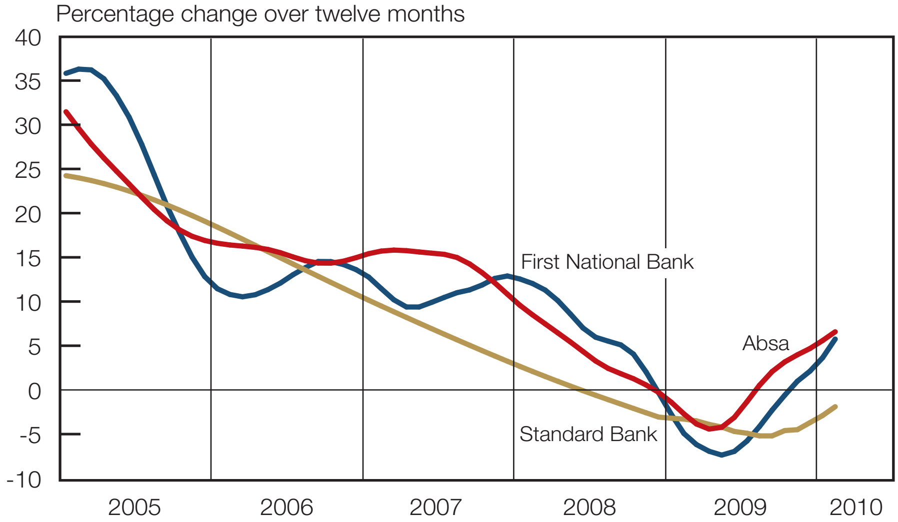
Derivatives turnover on the JSE, January to February 2010

	Value	Change over one year
	R billions	Per cent
Financial futures and options on futures	400	15
Warrants	0,4	-35
Agricultural commodity futures and options	37	-7
Interest rate derivatives	37	31

Real-estate market

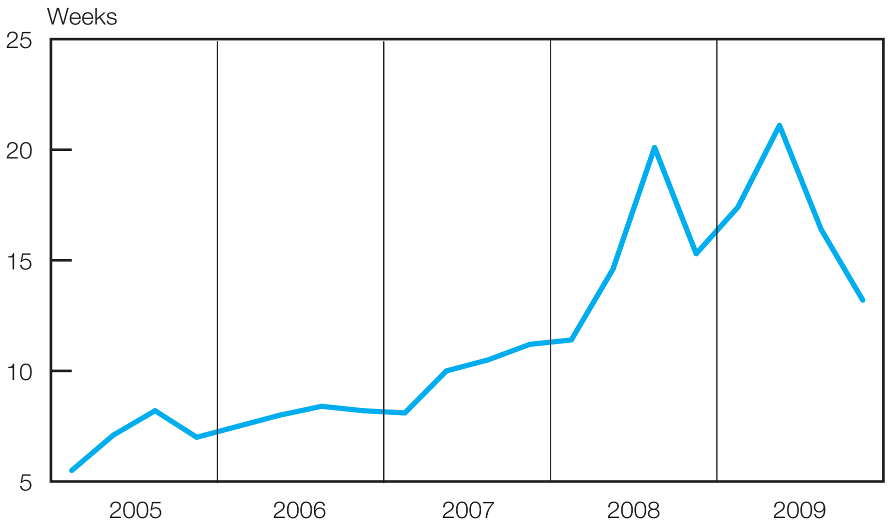
Since property demand remained modest, largely due to subdued income growth, lukewarm confidence levels and debt levels remaining relatively high, conditions in the South African housing market improved moderately and gradually. The lagged effect of the interest rate reductions continued to feed through into the market, with some additional support being provided by banks through easing credit conditions. The year-on-year rate of change in the average price of residential property in the middle segment of the market, as measured by Absa, improved from a negative 4,4 per cent in April 2009 to a positive 6,6 per cent in February 2010. The year-on-year rate of change in the average house price, as measured by First National Bank, followed a similar trend and improved from a negative 7,4 per cent in May 2009 to a positive 5,8 per cent in February 2010. The change in the Standard Bank median house price index improved from a negative year-on-year rate of 5,2 per cent in September 2009 to a negative 1,9 per cent in February 2010.

House prices



The First National Bank Residential Property Barometer measures residential property market activity, perceptions and expectations of South African real-estate professionals.

Average number of weeks that residential properties remain on the market



Source: First National Bank

According to the barometer, the average length of time a residential property remains on the market declined from 21 weeks in the second quarter of 2009 to 13 weeks in the fourth quarter – indicating an improvement in the demand for residential properties.

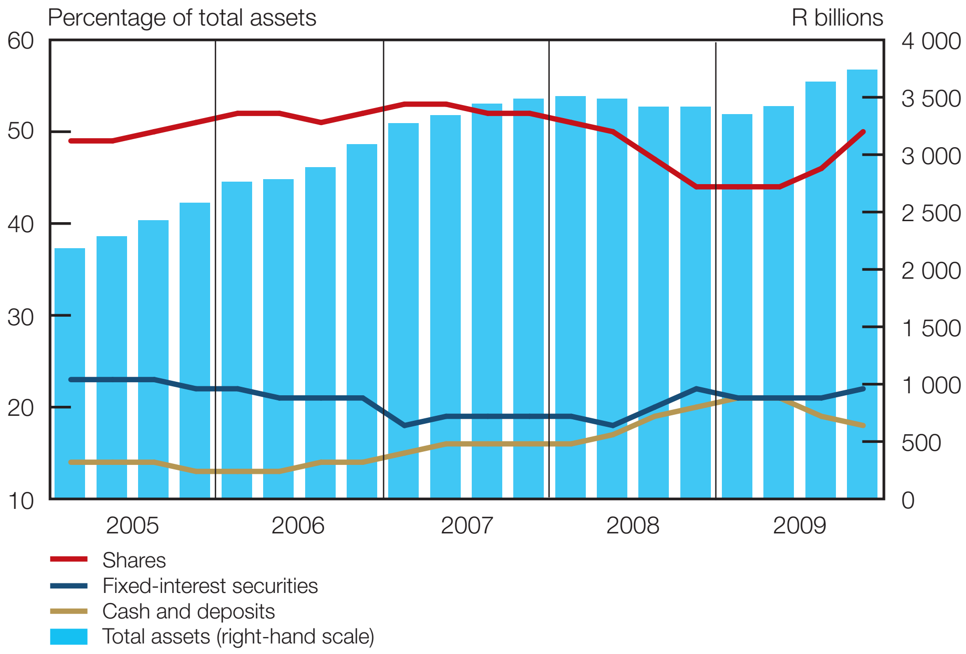
Non-bank financial intermediaries

The domestic financial sector tracked the general global financial disposition in 2009 as reflected in the asset portfolio performance of non-bank financial intermediaries.[4] Equity holdings increased from 44 per cent of total assets in the first quarter of 2009 to 50 per cent in the fourth quarter – lifted by higher share prices and portfolio rebalancing in search for riskier assets. The return of investors to riskier assets was particularly pronounced in the unit trust industry, where the ratio of money-market funds to total assets declined from 36 per cent in the first quarter of 2009 to 30 per cent in the fourth quarter.

4 Defined as unit trusts, pension and provident funds and insurers.

Despite the substantial supply of domestic government bonds, non-bank financial intermediaries' holdings of fixed-interest securities increased slightly from 21 per cent of total assets in the first quarter of 2009 to 22 per cent in the fourth quarter. Holdings of cash and deposits declined from 21 per cent of total assets to 18 per cent during the same period. The total balance sheet of non-bank financial intermediaries increased from R3,3 trillion in the first quarter of 2009 to R3,7 trillion in the fourth quarter.

Assets of selected non-bank financial institutions



Public finance

Non-financial public-sector borrowing requirement[5]

Infrastructure spending by major public corporations and consolidated general government continued on a strong trajectory in the third quarter of the current fiscal year. National government recorded lower tax revenue collections and higher spending, and these developments contributed to a countercyclical widening of the non-financial public-sector borrowing requirement in the first three quarters of fiscal 2009/10.

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

The combined cash flows from operating activities and from investment in non-financial assets of the non-financial public sector resulted in a cash deficit of R167,8 billion in April–December 2009, three times more than the cash deficit recorded in the same period a year earlier. Non-financial public enterprises and corporations along with national government were the major contributors to the cash deficit. This resulted from robust growth in infrastructure spending aimed at supporting sustainable economic growth and social development. The activities of national government resulted in a higher cash deficit as revenue collections trended lower and spending was slightly stronger than anticipated. The non-financial public-sector borrowing requirement relative to gross domestic product amounted to 9,1 per cent in the first nine months of fiscal 2009/10, compared with a borrowing requirement of 3,3 per cent in the corresponding period of the previous fiscal year.

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

Non-financial public-sector borrowing requirement
R billions

Level of government	Apr–Dec 2008*	Apr–Dec 2009*
Consolidated general government	27,2	148,1
National government	19,8	141,6
Extra-budgetary institutions	-6,0	5,1
Social security funds	-10,8	-5,2
Provincial governments	8,4	0,7
Local governments	15,8	16,0
Non-financial public enterprises and corporations	29,7	19,7
Total	56,9**	167,8**
As a percentage of gross domestic product	*3,3*	*9,1*

* Deficit + surplus –
** Components may not add up to the totals due to rounding off of figures

Non-financial public enterprises and corporations recorded a cash deficit of R19,7 billion in April–December 2009, compared with a cash deficit of R29,7 billion a year earlier. This decrease can mainly be attributed to Telkom's financial transactions related to Vodacom during April–September 2009. As expected, net investment in non-financial assets by the major non-financial public enterprises and corporations was sustained and increased by 56,1 per cent in the first nine months of fiscal 2009/10, when compared with the same period of the previous fiscal year. This was a continuation of the upward trend that had been established previously, with Eskom's net investment in non-financial assets of R43,4 billion in 2008/09 already almost double the amount registered in the previous fiscal year.

During the first nine months of fiscal 2009/10, cash receipts from operating activities of *national government* decreased by 6,6 per cent when compared with the same period a year earlier. The decline resulted from below-budgeted tax revenue collections as the economy remained weak with early signs of recovery only coming to the fore quite recently. Furthermore, revenue collections tend to lag economic activity. Cash payments for operating activities increased by 19,1 per cent on a year-on-year basis to amount to R572 billion in the first three quarters of fiscal 2009/10. Net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R141,6 billion in April–December 2009. This was significantly higher than the cash deficit recorded in the corresponding period a year earlier.

An analysis of the *Provincial Revenue Fund Statements* indicated that net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R3,4 billion in the October–December quarter of 2009. This brought the provincial governments' cumulative cash deficit to R0,7 billion for the first nine months of fiscal 2009/10. The April–December 2009 cash deficit can be compared with a cash deficit of R8,4 billion recorded in the same period of the previous fiscal year.

Grants from national government to provincial governments – equitable share transfers and conditional grants earmarked for specific purposes – recorded a year-on-year increase of 18,8 per cent to amount to R219,4 billion in the first three quarters of fiscal 2009/10. During April 2009, National Treasury transferred R4,2 billion as a provincial conditional grant for the Gautrain Rapid Rail Link project. An amount of R2,9 billion has been spent on the project in the first three quarters of fiscal 2009/10. For the period under review, net investment in non-financial assets reached R19,1 billion, a 5,0 per cent increase compared with the same period a year earlier.

Financial activities of provincial governments resulted in an increase in their deposits with private-sector banks from R6,5 billion at the end of March 2009 to R9,1 billion at the end of December. Their overall indebtedness to banks rose from R1,7 billion to R2,6 billion between these respective dates. Provincial governments' deposits with the Corporation for Public Deposits recorded a significant turnaround from a negative balance of R3,3 billion to a positive balance of R10,8 billion between March and December 2009.

Extra-budgetary institutions' cash surplus amounted to R5,1 billion in April–December 2009 – lower than the cash surplus recorded in the same period a year earlier. Preliminary estimates indicated that the financial position of *social security funds* deteriorated significantly in the third quarter of fiscal 2009/10. Despite higher unemployment benefits being paid out, these funds recorded a cumulative cash surplus of R5,2 billion in the first three quarters to fiscal 2009/10, compared with a cash surplus of R10,8 billion in the same period a year earlier.

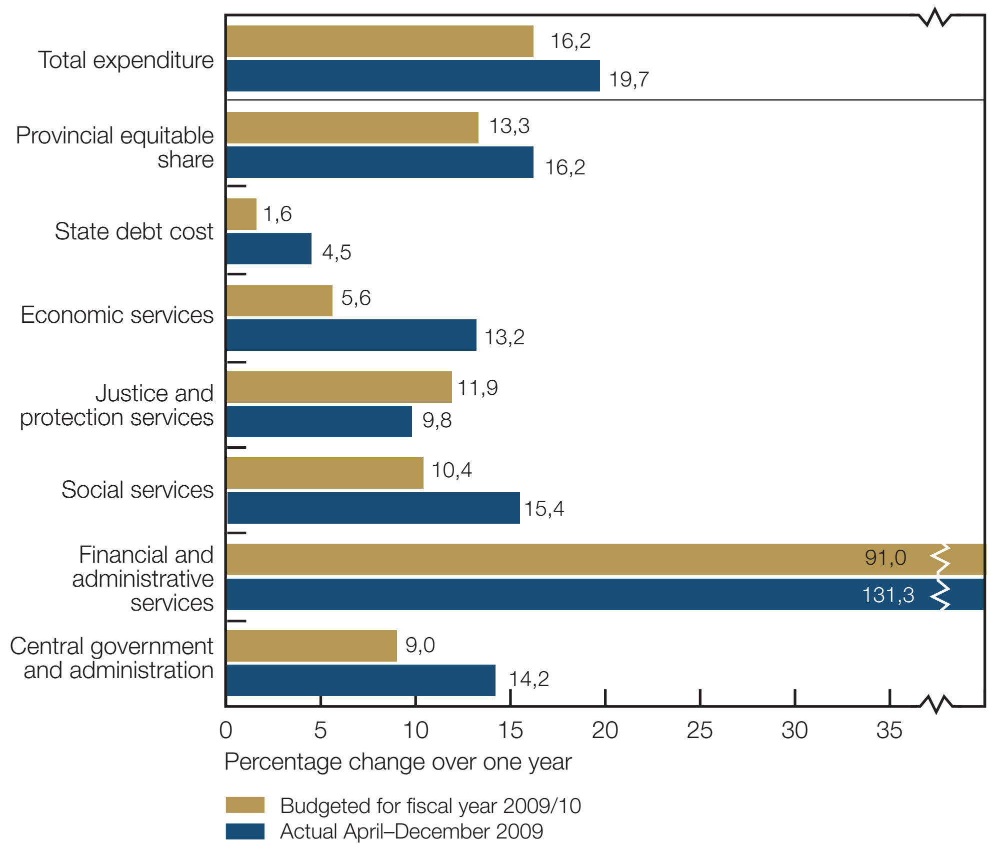
The estimated cash deficit of *local governments* widened in the October–December quarter of 2009 and brought the cumulative cash deficit to R16,0 billion in April–December 2009, slightly higher than the cash deficit recorded in the corresponding period a year earlier. This outcome is associated with a significant rise in municipal operating expense despite a pronounced growth in cash receipts from operating activities. For the period under review, grants received from national and provincial governments amounted to R38,1 billion, an increase of 38,6 per cent compared with the same nine months a year earlier. Included in this amount is the transfer to metropolitan municipalities of R3,9 billion following the implementation of the general fuel levy sharing agreement with national government. During the period under review, net investment in non-financial assets declined somewhat to amount to R32,1 billion – some 1,1 per cent less when compared with the same period of the previous fiscal year.

Budget comparable analysis of national government finance

In the first nine months of fiscal 2009/10, growth in national government expenditure exceeded revised budgetary projections, whereas revenue collections fell short of revised budgetary expectations; hence, a sizeable deficit was recorded.

Spending by national government totalled R557,3 billion in April–December 2009, or 19,7 per cent more when compared with the same nine-month period a year earlier. Countering subdued economic conditions, growth in national government expenditure slightly exceeded revised budget projections. National government expenditure was originally budgeted to total R739 billion, or increase by 16,2 per cent for fiscal 2009/10. However, it was revised upwards by R14,0 billion in the *Medium Term Budget Policy Statement 2009* (MTBPS). The revision highlighted the support for infrastructural development necessary for economic growth and emphasised that government's long-term service delivery priorities would not be compromised by lower growth in revenue collections. As a ratio of gross domestic product, national government outlays amounted to 30,2 per cent in April–December 2009 compared with 26,7 per cent for the same period a year earlier.

National government expenditure



Growth in spending was underpinned by extraordinary transfers and subsidies paid by the Financial and Administrative Services cluster, mainly National Treasury. For fiscal 2009/10, provision was made for financial support for Eskom's capital investment programme to the amount of R30,0 billion. During April–December 2009 an amount of R22,5 billion was transferred as part of the second tranche of the subordinated loan. Further contributions were from the Social Services cluster, driven by the departments of Health and Social Development, along with the Economic Services and Infrastructure

Development cluster. For the period under review, spending by the Department of Social Development increased strongly by 18,8 per cent compared with 9,7 per cent recorded in April–December 2008. This increase emphasised government's priority of improving the livelihood of the poor.

Transfers and subsidies by the Economic Services and Infrastructure Development cluster were mainly from the departments of Cooperative Governance and Traditional Affairs (formerly Provincial and Local Government), and Transport. A subsidy of R4,3 billion was paid by the Department of Transport to support the Passenger Rail Agency of South Africa's (formerly South African Rail Commuter Corporation) implementation of the national passenger rail plan. Funds transferred by the Department of Cooperative Governance and Traditional Affairs included equitable share transfers to local governments and the Municipal Infrastructure Grant.

During the period under review, interest paid on national government debt equalled R40,4 billion – or an increase of 5,5 per cent compared with the same nine-month period a year earlier. This increase exceeded the originally budgeted projection of 1,6 per cent for fiscal 2009/10 as a whole, but was lower than the revised estimate of 10,3 per cent in the MTBPS 2009. Higher growth in interest payments resulted from more domestic government bonds and Treasury bills being issued to finance higher deficit levels. Payments for capital assets were 7,4 per cent less than in the same period a year earlier.

Growth in equitable share transfers to provinces during April–December 2009 broadly followed the MTBPS 2009 revised estimates, which allowed for an increase of 17,7 per cent for fiscal 2009/10 as a whole. The upward adjustment accommodates the implementation of occupation-specific dispensations and general salary increases in the health and education sectors.

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

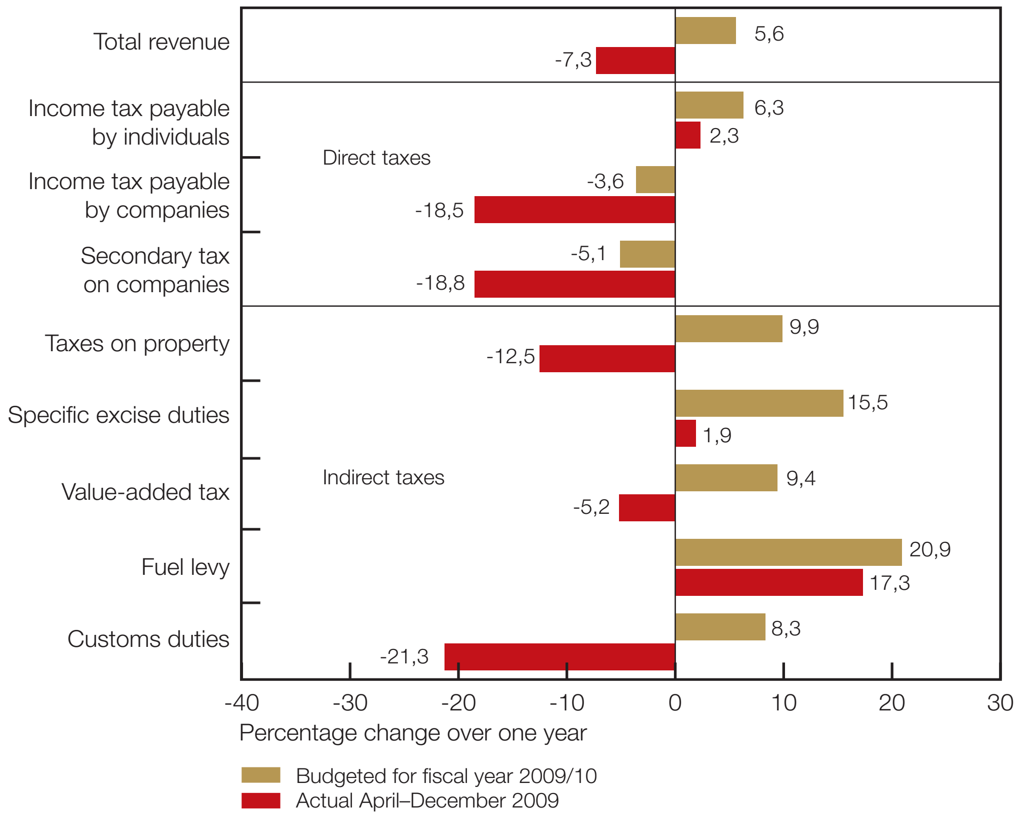
After taking into account cash-flow adjustments,[6] national government cash-flow expenditure equalled R541,2 billion in the first nine months of fiscal 2009/10 – or 15,9 per cent more than in the same period a year earlier.

Revenue collections by national government amounted to R411,5 billion in April–December 2009, a year-on-year rate of decrease of 7,3 per cent when compared with the same nine-month period a year earlier. National government revenue was originally budgeted to *increase* by 5,6 per cent to R643 billion in fiscal 2009/10. However, it was revised downwards in the MTBPS 2009 to R571 billion, a year-on-year rate of *decrease* of 6,2 per cent. As a ratio of gross domestic product, national government revenue amounted to 22,3 per cent in the first nine months of fiscal 2009/10, lower than the ratio recorded in the same period of the previous fiscal year.

The decline in national government receipts was evident in the slowdown reflected by all major tax categories, which mirrored sluggish domestic economic conditions. Notwithstanding the prevailing conditions, the month-to-month rate of decline slowed moderately, indicating a turnaround in economic activity, although the recovery is expected to be slow. The slowdown in taxes on income, profits and capital gains was influenced by a steep decline of 19,0 per cent in the corporate income tax collections sub-category. The decline in corporate income tax far outweighed marginal growth in personal income tax collections, stemming from the decreased profitability and lower earnings of large corporate taxpayers such as financial institutions and mines.

Tax collections from property declined, consistent with sluggish real-estate market activity. The main component of taxes on goods and services – value-added tax (VAT) – recorded a negative growth rate, reflecting a contraction in domestic demand and significantly lower VAT on imports. Taxes on international trade and transactions declined as lower customs duties were collected owing to lower imports alongside subdued international trading conditions. Nevertheless, customs duty collections most recently turned slightly less negative than revised budget projections as imports inched higher, albeit from a low base.

National government revenue



After taking into account cash-flow adjustments, national government cash-flow revenue in April–December 2009 equalled R411,7 billion, or 7,4 per cent less than in the same period a year earlier.

National government revenue in fiscal 2009/10

Revenue source	Originally budgeted Apr 2009–Mar 2010		Actual Apr–Dec 2009	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains	389,0	1,4	259,0	-8,0
Payroll taxes	7,8	5,8	5,8	7,7
Taxes on property	10,4	9,9	6,5	-12,5
Taxes on goods and services	226,5	12,6	142,3	0,0
Taxes on international trade and transactions	25,3	10,9	14,0	-20,6
Other revenue	11,9	-11,3	4,9	-56,6
Less: SACU** payments	27,9	-3,5	20,9	-3,5
Total revenue	643,0	5,6	411,5	-7,3

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

Netting national government revenue and expenditure yielded a cash-book deficit of R145,9 billion for April–December 2009 – almost seven times as much as the cash-book deficit recorded in the same period a year earlier. In the first nine months of fiscal 2009/10, the cash-book deficit had already exceeded the originally budgeted deficit of R95,6 billion for the current fiscal year as a whole by about R50 billion. However, it was consistent with the revised deficit of R182 billion as per the MTBPS 2009. As a ratio of gross domestic product, the deficit amounted to 7,9 per cent in the first three quarters of the current fiscal year, compared with 1,2 per cent a year earlier.

During April–December 2009, the net outcome of national government cash-flow revenue and expenditure was a cash-flow deficit before borrowing and debt repayment of R129,5 billion – substantially higher than in the first nine months of fiscal 2008/09. Extraordinary receipts mainly consisted of R3,9 billion in proceeds from the sale of Telkom shares in Vodacom and R0,5 billion as special dividends from Telkom. Included in the extraordinary payments was an amount of R55,3 *million* as a final payment of government's liability in respect of Saambou Bank. After accounting for extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R126,1 billion in the first nine months of fiscal 2009/10, five times as high as the R25,4 billion recorded in April–December 2008.

National government financing in fiscal 2009/10

R billions

Item or instrument	Originally budgeted 2009/10	Actual Apr–Dec 2009	Actual Apr–Dec 2008
Deficit	95,6	129,5*	22,6*
Plus: Extraordinary payments	0,9	0,6	2,6
Cost on revaluation of foreign debt at redemption	2,3	0,7	2,5
Less: Extraordinary receipts	4,0	4,7	2,4
Net borrowing requirement	**94,8**	**126,1**	**25,4**
Treasury bills	15,4	47,1	10,7
Domestic government bonds	63,7	66,3	23,8
Foreign bonds and loans	6,1	9,9	-0,9
Change in available cash balances**	9,6	2,9	-8,2
Total net financing	**94,8**	**126,1**	**25,4**

* Cash-flow deficit
** Increase – decrease +

As indicated in the table above, the net borrowing requirement was financed through debt instruments issued in the domestic and foreign capital markets. In the current fiscal year, the unanticipated increase in the budget deficit resulted in a sharp increase in Treasury bill issuance. In the *2009 Budget Review*, net issues of domestic Treasury bills were projected at R15,4 billion for fiscal 2009/10. Since then, the amount was revised upwards to R49,7 billion in the MTBPS 2009. During April–December 2009, government raised R47,1 billion from these instruments, almost 95 per cent of the revised amount. Of this amount issued to date, R9,2 billion was from shorter 91-day instruments. For the period under review, net issues of RSA Government Retail Savings Bonds amounted to R2,3 billion, compared with a paltry amount issued during the same period a year earlier.

Domestic long-term funding was obtained at an average rate of 9,0 per cent per annum, while domestic short-term instruments were sold at an average of 7,3 per cent during April–December 2009. The average outstanding maturity of domestic marketable bonds of national government remained unchanged at 123 months between March and December 2009.

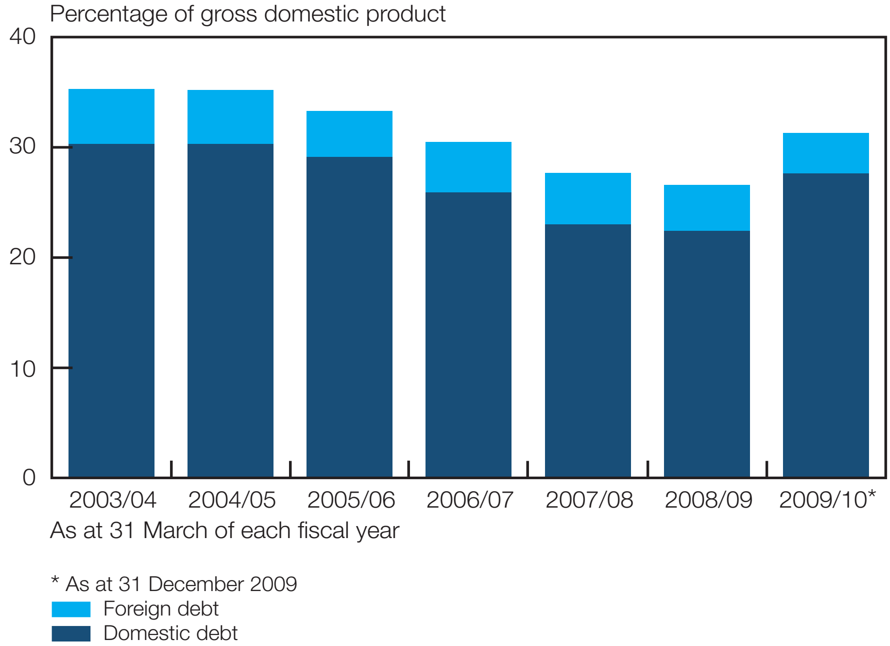
Net issues of domestic government bonds accounted for about 53 per cent of total financing in the period under review, reflecting the dominance of domestic funding over foreign funding. Unlike in fiscal 2008/09, national government has not conducted any switch transactions of domestic government bonds during the first nine months of the current fiscal year. National government raised R16,4 billion through the cumulative issuance of US$2,0 billion ten-year bond in April–December 2009, bringing the net issues of foreign bonds and loans to R9,9 billion in April–December 2009.

The average outstanding maturity of foreign marketable bonds of national government decreased slightly from 77 months at the end of March 2009 to 75 months at the end of December.

During April–December 2009, funding activities decreased government's available cash balances by R2,9 billion, bringing these balances to R98,5 billion at the end of December 2009. Deposits with the Bank increased by R9,7 billion and totalled R79,7 billion at the end of December 2009.

Domestic debt as a proportion of total loan debt increased from 84,2 per cent at the end of March 2009 to 88,2 per cent at the end of December 2009. Between these respective dates, foreign debt as a proportion of total loan debt decreased from 15,8 per cent to 11,8 per cent. The decrease in foreign debt stemmed from high issues of domestic debt instruments and revaluation effects arising from the strengthening exchange value of the rand, despite government recording net issues of foreign bonds and loans.

National government total loan debt



Total loan debt of national government increased from R616 billion to R744 billion between March and December 2009. As a ratio of gross domestic product, total national government loan debt amounted to 30,7 per cent at the end of December 2009 compared with 26,6 per cent at the end of March 2009.

The Budget for the fiscal years 2010/11 to 2012/13

The Minister of Finance tabled his maiden Budget before Parliament on 17 February 2010. It was presented in the context of immense challenges on the global and domestic front, as the global financial crisis left difficult questions for macroeconomic policy-makers and regulators of financial institutions. With the recession challenging established patterns of economic growth, income distribution and global economic imbalances, the 2010 Budget had to be mindful of the subdued and vulnerable condition of the public and private sectors.

In the Budget it was recognised that the global recession had subsided, but that further progress would require continued support from expansionary fiscal and monetary policies alongside careful management of debt and inflation pressures. The South African economy was judged to be on the path to recovery. Sound pre-recession macroeconomic policies ensured that government could respond appropriately to the downturn in the economic cycle, and a strong countercyclical fiscal policy would be maintained to support further economic recovery and robust growth.

A new growth path was outlined in the Budget, emphasising several aspects:

– A concerted effort to reduce joblessness among young people.
– Support for labour-intensive industries.
– Sustaining high levels of public and private investment and raising the savings level.
– Improving the performance of the state, especially with the provision of quality education and training.
– Reforms to increase inclusion and participation in the labour market alongside efforts to improve competition in product markets.
– Keeping inflation low, striving for a stable and competitive exchange rate, and providing a buffer against global volatility.
– Raising productivity and competitiveness, and opening up the economy to investment and trade opportunities that can boost exports.

In the Budget, growth in real gross domestic product was projected to recover to 2,3 per cent in 2010 with the support of expansionary fiscal and monetary policies, public-sector investment and lower inflation, and to rise further to 3,6 per cent by 2012.

Prudent management of public finances over the past decade – signalled by low public debt levels – enabled South Africa to support demand in the economy by sustaining public spending and raising infrastructure investment, despite a significant fall in tax revenue. The Budget provided for tax policy to remain supportive of overall economic recovery by providing relief to vulnerable individuals through compensating for inflation, and for the budget deficit to be brought back to a sustainable position over the medium term. Government aimed to reduce the deficit gradually, broaden the tax base and improve tax compliance to ensure equitable distribution of the burden associated with the cost of public services.

The path to growth and recovery would require much greater focus by government, business and labour. To this end, macroeconomic and microeconomic policies and measures would work in tandem to remove constraints to growth and enhance the economy’s competitiveness. Key interventions required include regulatory reforms that lower business costs and encourage employment, further efforts to enhance investment and savings, and pursuing a more labour-intensive industrial policy.

Fiscal projections: National government[1]

	2009/10		20010/11		2011/12		2012/13	
	Revised estimate		Medium-term estimates					
Fiscal years	R billions	Annual change Per cent	R billions	Annual change Per cent	R billions	Annual change Per cent	R billions	Annual change Per cent
Expenditure	**748,8**	**17,7**	**818,1**	**9,3**	**888,3**	**8,6**	**964,3**	**8,6**
State debt cost[2]	57,6	5,9	71,4	23,9	88,5	24,0	104,0	17,6
Current payments	119,2	15,1	130,9	9,8	141,6	8,2	148,9	5,1
Transfers and subsidies	530,6	15,8	579,7	9,3	634,8	9,5	674,1	6,2
Payments for capital assets	8,7	-1,1	9,3	6,9	10,7	14,9	13,3	25,0
Payments for financial assets[3]	32,8		20,9		0,8		-	
Contingency reserve and unallocated funds	-		6,0		12,0		24,0	
Expenditure as a ratio of GDP[4]	*30,6%*		*30,3%*		*29,9%*		*29,3%*	
Revenue	**571,5**	**-6,1**	**643,2**	**12,6**	**721,7**	**12,2**	**807,9**	**11,9**
Revenue as a ratio of GDP[4]	*23,3%*		*23,8%*		*24,3%*		*24,5%*	
Budget balance[5] before borrowing and debt repayment	**-177,3**		**-174,9**		**-166,6**		**-156,4**	
Deficit –/surplus + as a ratio of GDP[4]	-7,2%		-6,5%		-5,6%		-4,7%	
Deficit –/surplus + as a ratio of GDP[4]: October 2009 MTBPS[6]	-7,6%		-6,2%		-5,0%		-4,2%	

1 Components may not add up to totals due to rounding
2 Includes interest, management cost and the cost of raising loans
3 Consists mainly of lending to public corporations or making equity investments in them for policy purposes. Previously included in transfers and subsidies
4 GDP is gross domestic product
5 Deficit – surplus +
6 *Medium Term Budget Policy Statement* 2009

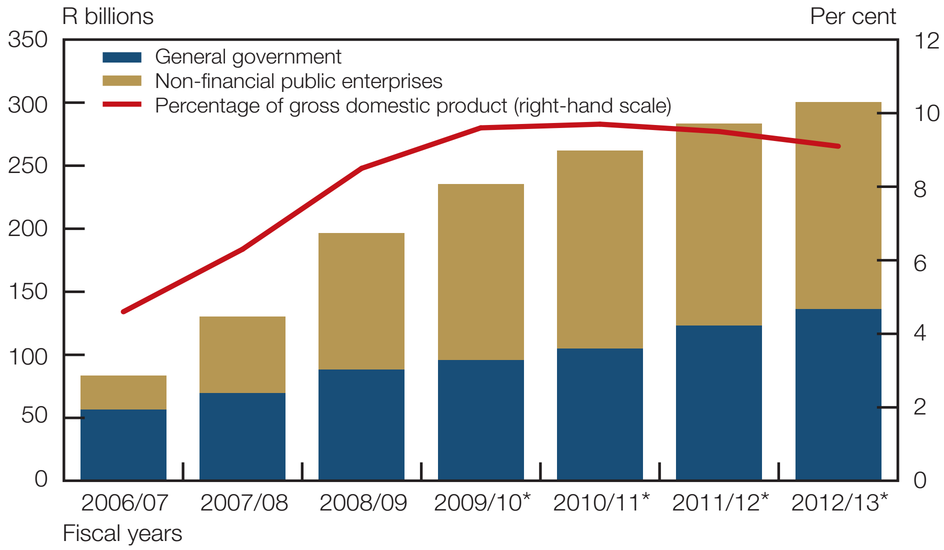
Debt-service costs were expected to increase at an average annual rate of 21,8 per cent over the medium term. The rise was due to the higher borrowing requirement, which outweighed savings obtained from stronger currency and lower short-term interest rates.

To enhance the social security system, the Minister of Health established an advisory committee on National Health Insurance (NHI). Research has focused on enabling a feasible transition to an NHI model over the next five years.

Falling employment during the recession made the quest for a solution to South Africa's jobs crisis even more pressing, while the gap between real wages and productivity was particularly high for young and lower-skilled workers, contributing to disproportionately high youth unemployment. A concerted effort would be made to reduce joblessness among young people, linked to a comprehensive package of policy measures to boost long-term employment. Furthermore, economic reforms would aim to raise the economy's growth rate and labour absorption capacity.

Total public-sector infrastructure spending was estimated to total R846 billion over the medium term (to 2012/13). Just over half of the spending would be undertaken by non-financial public enterprises. Other levels of government – inclusive of public-private partnerships – would account for the remainder. Non-financial public enterprises would embark on infrastructure investment through construction of power stations, upgrading transport infrastructure and building water distribution capacity. Construction of Eskom's power plants would make up 36,5 per cent of expected total infrastructure spending.

Public-sector infrastructure expenditure



* *Budget Review 2010*

A significant slowdown in household consumption expenditure, falling employment, and declining imports and exports led to a steep cyclical decrease in tax revenue. Revised national government revenue for fiscal 2009/10 was projected to be R71,5 billion lower than the R643 billion announced in February 2009. Total national government revenue was projected to increase by 12,6 per cent to an amount of R643 billion in fiscal 2010/11. Revenue would grow at an average rate of 12,2 per cent per annum over the three-year budget period, to total R808 billion in fiscal 2012/13.

The 2010 Budget projected that South Africa's continued commitment to its trading partners in the Southern African Customs Union (SACU) in terms of the revenue-sharing formula would result in a revenue charge of R27,9 billion in fiscal 2009/10, followed by R15,0 billion in 2010/11. Lower imports adversely affected revenue collections and amounts to be distributed to customs-union countries over the medium term.

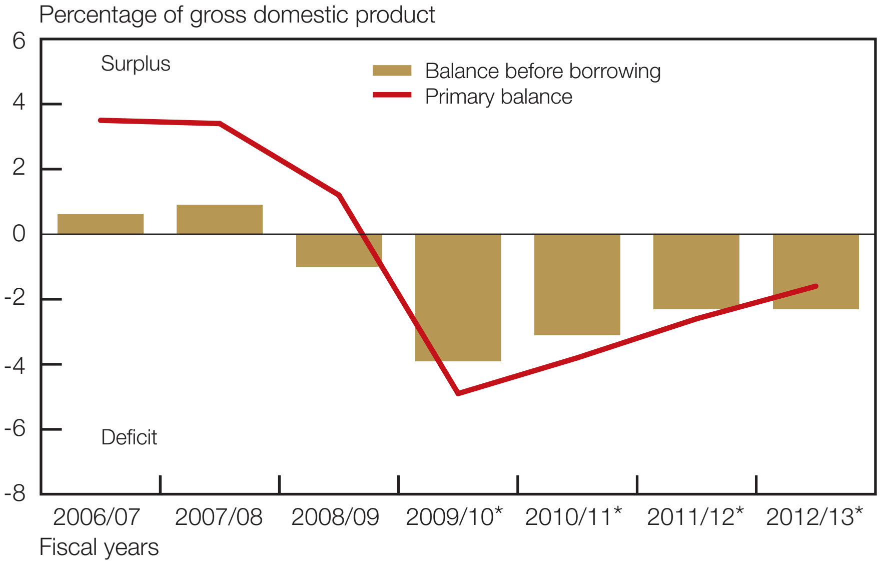
Tax adjustments announced in the Budget included, among others, adjustments to personal income tax brackets, the merger of retirement and retrenchment lump sum payments, the repeal of standard income tax on employees (SITE) with effect from 1 March 2011, as well as a voluntary disclosure programme for taxpayers. The 2010/11 tax proposals would result in a reduction of total estimated tax revenue by R0,5 billion.

Netting the revised national government revenue and expenditure in fiscal 2009/10 yields a projected deficit of R177 billion before borrowing and debt repayment – about R4 billion lower than the cash-book deficit projected in the MTBPS 2009. As a ratio of gross domestic product, the deficit was expected to amount to 7,2 per cent in fiscal 2009/10 and decrease to an average of 5,6 per cent over the medium term.

It was projected that the primary balance, (i.e., revenue net of non-interest expenditure) would amount to a *deficit* of 4,9 per cent of gross domestic product in fiscal 2009/10.

This would be in stark contrast to the *surplus* of 1,2 per cent of gross domestic product recorded in the previous fiscal year. The primary deficit was expected to narrow over the medium term as revenue growth was projected to exceed growth in government spending, bringing the average primary deficit over this period to a deficit of 2,7 per cent of gross domestic product.

National government budget balance



* *Budget Review 2010*

The net borrowing requirement would be financed through debt instruments issued in both domestic and foreign capital markets, as indicated in the table below. Government would continue with domestic bond switches in order to manage refinancing risk, and in so doing also reduce domestic loan redemptions.

Extraordinary payments were estimated to amount to R0,7 billion in fiscal 2009/10. These payments include losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) of R0,2 billion in fiscal 2008/09 and revaluation losses of R0,4 billion on the conversion of foreign currency.

National government financing

R billions

Item or instrument	Revised estimate	Medium-term estimates		
	2009/10	2010/11	2011/12	2012/13
Deficit	**177,3**	**174,9**	**166,6**	**156,4**
Plus: Extraordinary payments	0,7	–	–	–
Cost on revaluation of foreign debt at redemption	0,9	0,8	1,0	-0,6
Less: Extraordinary receipts	6,5	–	–	–
Net borrowing requirement	**172,3**	**175,7**	**167,6**	**155,8**
Domestic government bonds issued	114,0	137,7	129,1	117,1
Foreign bonds and loans	9,9	12,4	14,9	15,2
Change in available cash balances*	-1,3	3,6	3,6	3,6
Total net financing	**172,3**	**175,7**	**167,6**	**155,8**

* Increase – decrease +

The cost on revaluation of foreign loans at redemption was projected to total R0,9 billion in fiscal 2009/10. Extraordinary receipts to the amount of R6,5 billion were projected for fiscal 2009/10. This amount includes R1,7 billion in premiums on bond transactions and proceeds of R0,2 billion from government's liquidation of its investment in the South African Special Risks Insurance Association (SASRIA). Also included were receipts of R3,9 billion from the sale of Telkom's 15 per cent share in Vodacom to Vodafone. Revaluation profits of R0,2 billion on the conversion of foreign currency and a special dividend of R0,5 billion from Telkom were also included.

Government's cash balances were projected to increase by a modest R1,3 billion in fiscal 2009/10 and decrease by R3,6 billion in each of the subsequent three fiscal years.

Most of the borrowing requirement would be financed domestically, both in 2009/10 and over the medium term. Government bonds issued in the domestic capital market would be the most important instrument, followed by Treasury bills, whereas foreign bond issues and loans would take third place. Among domestic capital market instruments, nominal fixed-income bonds would be the most important source of financing, although inflation-linked bond issuance was also expected to play a significant role.

Government planned to step up its borrowing in the foreign capital market to around US$2 billion to US$3 billion per year, due to significant investor demand for South African credit exposure and to cover government's total foreign currency commitments. An €1 billion export credit agency financing structure for the purchase of eight military transport aircraft for the Department of Defence had not been entered into, due to the cancellation of the purchase.

It was projected that the national government gross loan debt would increase from R796 billion at the end of fiscal 2009/10 to R1,0 *trillion* at the end of 2010/11. As a ratio of gross domestic product, it was expected that gross loan debt would increase from 32,5 per cent to 37,1 per cent between these two dates. Further increases in gross loan debt were envisaged over the medium term, reaching 43,1 per cent of gross domestic product in fiscal 2012/13.

Consolidated national and provincial, and social security funds expenditure was projected to increase from R835 billion in fiscal 2009/10 to R1,1 *trillion* in 2012/13 – or 32,1 per cent of estimated gross domestic product. Over the medium term, expenditure was projected to grow at an average annual rate of 8,2 per cent, compared with the actual growth rate of 17,2 per cent per annum over the previous three years.

Combined social spending (mainly health, education and social welfare) was estimated to amount to R422 billion in fiscal 2009/10 and increase at an average annual rate of 8,8 per cent over the three-year budget period. Expenditure on protection services was estimated to increase from R111 billion in fiscal 2009/10 to R138 billion in fiscal 2012/13. The annual rate of growth in spending on protection services was expected to average 7,7 per cent over the three-year period. Combating crime and corruption remained one of government's top priorities. Over the next three years an additional amount of R2,2 billion would be allocated to effect a new salary structure in the South African National Defence Force.

Public-sector borrowing requirement

R millions

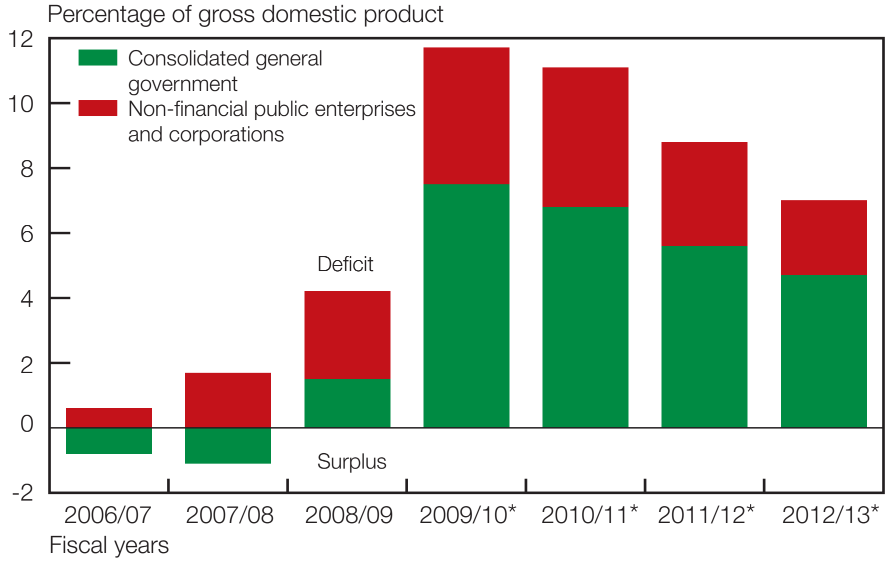
Level of government	Revised estimate*	Medium-term estimates*		
	2009/10	2010/11	2011/12	2012/13
National government	171 461	174 904	166 588	156 417
Extra-budgetary institutions	3 952	5 451	-5 110	-6 714
Social security funds	-5 373	-8 029	-8 203	-8 253
Provincial governments	1 869	-3 765	-3 656	-5 107
Local authorities and local enterprises	12 481	13 755	16 799	18 657
General government borrowing**	**184 390**	**182 315**	**166 418**	**155 001**
Percentage of gross domestic product	*7,5%*	*6,8%*	*5,6%*	*4,7%*
Non-financial public enterprises	104 004	117 356	93 711	77 375
Public-sector borrowing requirement**	**288 394**	**299 671**	**260 129**	**232 375**
Percentage of gross domestic product	*11,8%*	*11,1%*	*8,8%*	*7,1%*

* Deficit + surplus –
** Calculations may not add up to the totals due to rounding off of figures

The public-sector borrowing requirement was budgeted to amount to R288 billion in fiscal 2009/10 and projected to rise slightly further in 2010/11 before receding to R232 billion in fiscal 2012/13. It was projected to reach 11,8 per cent of gross domestic product in 2009/10 – substantial by historical standards, but consistent with the severe recessionary conditions. The countercyclical widening of the general government deficit in response to deterioration in the economic outlook contributed to the increased borrowing requirement, as did increased infrastructure spending by non-financial public enterprises.

Non-financial public-sector borrowing requirement

Percentage of gross domestic product



** Budget Review 2010*

The borrowing requirement was expected to recede to 7,1 per cent of gross domestic product by 2012/13, reflecting a cyclical improvement in the economy, rising tax collections and higher revenue flows to public enterprises.

Statement of the Monetary Policy Committee

26 January 2010

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

Introduction

The longer-term inflation outlook remains relatively favourable, notwithstanding some base effects that are likely adversely to affect the inflation outcomes in the short term. Domestic consumption expenditure remains under stress and there are no perceived risks to the inflation outlook from this source. Despite the continued contraction of private-sector gross fixed capital formation, the domestic economic growth outlook appears to have improved, but is expected to remain below the potential output growth for some time. The global economy is characterised by an uneven recovery across regions and some risks persist, while the global inflation outlook appears to be contained.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas declined from 6,1 per cent in September 2009 to 5,9 per cent and 5,8 per cent in October and November respectively. The categories of housing and utilities, and miscellaneous goods and services remained the single biggest contributors to the inflation outcome in November, having contributed 1,7 and 1,5 percentage points respectively. These categories were mainly driven by electricity and insurance cost increases. Food price inflation continued to moderate and measured 4,0 per cent in November, while administered prices excluding petrol and paraffin increased by 11,0 per cent, primarily as a result of electricity price increases.

Producer prices declined at year-on-year rates of 3,3 per cent and 1,2 per cent in October and November respectively. The underlying producer price trends in the food sector remained favourable for further moderation in food price inflation at the consumer level. In November agricultural prices increased at a year-on-year rate of 0,9 per cent, while manufactured food prices declined by 1,1 per cent.

The outlook for inflation

CPI inflation is expected to increase to above the target range in the coming three months, due to technical base effects related to petrol price changes. Current forecasts indicate that inflation could measure around 6,5 per cent in December and January, before moderating in the subsequent months. Because of the forward-looking nature of monetary policy, the focus of the Monetary Policy Committee (MPC) is on the longer-term expected trend of inflation. The CPI inflation forecast by the South African Reserve Bank (the Bank) is predominantly unchanged since the November forecast. In line with market forecasts, inflation is expected to return to within the inflation target range on a sustained basis in March 2010, and remain within the target range until the end of the forecast period in the final quarter of 2011, when it is forecast to average 5,4 per cent.

Since the previous MPC meeting, Eskom has modified its tariff application to the National Energy Regulator of South Africa (NERSA). Given the continued uncertainty related to the electricity tariff increases, the forecast does not make provision for the full multi-year increases of 35 per cent requested by Eskom, and electricity price increases of 25 per cent in 2010 and 2011 are assumed. The outcome of the Eskom application is expected to be announced in February.

The most recent inflation expectations survey conducted by the Bureau for Economic Research (BER) at Stellenbosch University shows that in the fourth quarter of 2009 there were no significant changes in expectations compared with the previous survey. According to the survey, inflation is expected to average 7,5 per cent in 2010 and 7,7 per cent in 2011. While both business and trade union respondents continued to expect inflation to remain outside the target range, the forecasts of financial analysts deteriorated moderately but remained within the target range. The latter forecasts were in line with the Reuters survey, which in January showed that market analysts expect inflation to average 5,7 per cent and 5,8 per cent in 2010 and 2011 respectively.

The demand-side pressures on inflation have been persistently weak, and the MPC remains of the view that there are no significant upside risks to the inflation outlook emanating from this source.

Real final consumption expenditure by households has contracted on a quarter-on-quarter annualised basis since the third quarter of 2008. In the third quarter of 2009 household consumption expenditure declined by 2,0 per cent. This weak trend appears to have continued in the final quarter of 2009. Real retail trade sales declined at a year-on-year rate of 6,6 per cent in November 2009 and by 5,9 per cent in the three months to the end of November compared with the same period in 2008. Wholesale trade sales also declined in November. New vehicle sales continue to show some signs of improvement, but nevertheless contracted by 7,2 per cent in December on a year-on-year basis. Consumer confidence appears to have improved, however, as reflected in the First National Bank (FNB)/BER consumer confidence index which recorded its highest reading since the first quarter of 2008.

Adverse employment trends and employment insecurity are likely to constrain household consumption expenditure. According to Statistics South Africa's Quarterly Employment Statistics, employment levels decreased further during the third quarter of 2009, despite a more favourable growth performance. Formal non-agricultural employment declined by 4,2 per cent in this quarter, representing almost 110 000 jobs. Employment is expected to lag the growth recovery.

Credit extension to the private sector reflects the weak demand and tight credit supply conditions, and is also seen as a constraint on spending. There are, however, indications that the strict lending criteria applied by banks in response to higher perceived risk and rising impaired advances may be easing. In November 2009 impaired advances as a percentage of total gross loans and advances increased to 5,9 per cent from 5,8 per cent the previous month. Total loans and advances to the private sector contracted by 2,0 per cent in November compared with the previous year. This was the third consecutive month of credit contraction. The only component of credit extension that recorded positive nominal growth was mortgage advances, which grew at a 12-month rate of 3,0 per cent. These developments were also reflected in the level of household debt, where the ratio of household debt to disposable income declined from 80,1 per cent in the second quarter of 2009 to 79 per cent in the third quarter. This relatively high level of debt is expected to continue to constrain consumption expenditure.

While the combination of increased unemployment, the lack of access to credit and the need to repair impaired household balance sheets is expected to dominate consumption trends in the coming quarters, there have been some positive developments with respect to wealth effects. House prices have shown signs of improvements, with the Absa and FNB house price indices showing positive but moderate growth. Equity prices have recovered somewhat since their lows in March of 2009, but the recent equity market decline both domestically and abroad shows that some volatility may persist in line with uncertainty relating to the sustainability of the global recovery.

There are continued signs that the domestic economic recovery is under way following the 0,9 per cent annualised gross domestic product (GDP) growth rate measured in the third quarter of 2009. However, the recovery is expected to remain relatively subdued and below the potential growth rate of the economy for some time. The forecast of the Bank is that GDP growth will average 2,0 per cent in 2010 and 3,0 per cent in 2011. Nonetheless, it could take some time until pre-recession levels of output are reached. The more positive outlook is in line with the continued positive trends seen in the composite leading business cycle indicator of the Bank, which increased strongly again in November. The coincident indicator also exhibited a slight upward movement. These trends are in line with the more positive outlook seen in the Rand Merchant Bank (RMB)/BER business confidence index during the fourth quarter of 2009.

The manufacturing sector has also shown signs of some recovery and is expected to contribute positively to the 2009 fourth quarter growth outcome. The physical volume of manufacturing production declined at a year-on-year rate of 4,7 per cent in November, but increased by 3,9 per cent in the three months to November compared to the previous three months. The Kagiso Purchasing Managers Index (PMI) also reflected a positive outlook in November and December. However, the manufacturing sector may be constrained by weak domestic demand, while external demand will be impacted by the strength of the global recovery as well as, in part, by exchange rate developments.

The rand has remained a positive factor from an inflation perspective. However, the MPC is cognisant of the negative impact of the rand's movements during the past year on some sectors of the economy. Since the previous MPC meeting, the rand/dollar exchange rate has fluctuated between around R7,28 and R7,73. On a trade-weighted basis, the rand has remained more or less unchanged since the previous meeting. Much of the volatility of the exchange rate during this period can be explained by general volatility in the international foreign exchange markets where the US dollar fluctuated in a range of US$1,41 and US$1,51 against the euro.

With the decline of risk aversion in global markets, emerging markets in general, including South Africa, have also had to deal with significant capital inflows. These inflows have put upward pressure on a number of emerging market currencies. Intervention to prevent these appreciations is often costly and not always effective. At the same time, the possibility of reversals of these flows, should global sentiment change, poses a risk to the exchange rate outlook in these countries.

The global recovery has continued with relatively strong performances in some of the emerging-market economies. However, risks and vulnerabilities still remain, particularly in a number of countries in the euro area, and the recovery is expected to remain relatively slow in some economies that are important export destinations for South African goods. Unsustainable fiscal positions, as well as the need to reverse previous unconventional monetary policy interventions, may also pose a risk to the global growth outlook. The global environment remains benign from an inflation perspective. Despite moderately higher commodity prices, there are no significant risks to the global inflation outlook.

Other supply-side or exogenous factors are not expected to impart a significant upside risk to the inflation forecast. International oil prices appear to have stabilised somewhat over the past months and moderate increases have been assumed over the forecast period. The outlook for food price inflation, as reflected in producer prices and futures prices, is favourable and these prices are unlikely to pose an upside risk to the inflation outlook for some time despite higher food prices in international markets.

The risk to the inflation outlook emanating from wage developments appears to have subsided somewhat. Wage settlements are still in excess of inflation, but have been declining in nominal terms. Average nominal remuneration per worker in the formal non-agricultural sector moderated to 7,6 per cent in the third quarter of 2009, while the nominal unit labour cost increase in the third quarter compared with the same quarter the previous year measured 5,7 per cent.

Electricity price increases remain the single biggest risk to the inflation outlook. There is the risk that increases granted to Eskom could be markedly higher than those assumed in the Bank's forecast, and there is also the risk that the second-round effects of these increases may be underestimated by the forecasting model.

Monetary policy stance

The MPC noted that inflation is likely to remain close to the upper end of the target range over the forecast period and is of the view that the risks to this outlook are fairly evenly balanced. Electricity price increases pose the biggest upside risk, counteracted by the weak state of domestic demand. Against this background the MPC has decided to keep the repurchase rate unchanged at 7,0 per cent per annum.

Notes to tables

Share prices – Table S–32

The real-estate share price index column was removed as the index was discontinued. The industrial consumer goods economic group index was added.

Public Investment Corporation: Liabilities – Table S–35

The columns containing funds received from public enterprises, and short-term and long-term funds received from non-residents were removed, as data are no longer reported for these indicators.

Short-term insurers: Assets – Table S–39

The column containing loans to the public sector was removed as data are no longer reported for this indicator.

Official and private self-administered pension and provident funds – Table S–41

Data for fiscal years were removed as values are published with quarterly frequency.