Quarterly Bulletin

September 2010

South African Reserve Bank

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Quarterly Economic Review

Introduction

While the global economic recovery continued in the second quarter of 2010, growth was uneven and fragile. Concerns were focused on Greece and a number of other European countries with large fiscal deficits, high sovereign debt ratios and structural economic weaknesses, where fiscal sustainability was doubtful. Yields on these countries' sovereign debt instruments escalated sharply, and it was only after a large support package backed by the European authorities and the International Monetary Fund (IMF) had been announced in May that confidence improved and yields on the bonds in question receded significantly, only to pick up again in the third quarter. Fiscal stimulation was reduced and austerity measures introduced in a number of countries, and in a few instances central banks raised policy interest rates. However, in the major developed economies overall macroeconomic policy remained stimulatory with interest rates unchanged at historically low levels in order to nurture the economic recovery.

Economic growth continued to be more robust in the emerging-market and developing economies, led by China and India. Commodity prices remained strong, providing support to economic activity in resource-rich countries geared to make use of the favourable export opportunities, including many countries on the African continent.

Frail private consumption expenditure, excess capacity and continued high unemployment in a number of advanced economies helped to contain global inflationary pressures in the second quarter of 2010.

In South Africa a further increase in economic activity was registered in the second quarter of 2010, although the pace of expansion decelerated somewhat compared with the first quarter. Lower production of platinum and coal, related to largely temporary factors, mainly contributed to a significant contraction in the real value added by the mining sector. Although growth in the real value added by the manufacturing sector moderated slightly in the second quarter, the utilisation of production capacity showed an increase compared with the previous quarter. Output in the services sector was supported by expenditure related to the 2010 FIFA World Cup™ tournament.

The rate of growth in real gross domestic expenditure slowed in the second quarter of 2010. The pace of increase in real consumption expenditure by households moderated somewhat but remained brisk, especially as far as purchases of durable goods are concerned. The level of real fixed capital formation essentially moved sideways in the second quarter, while the pace of inventory depletion slowed marginally. Real consumption expenditure by government continued to rise firmly, reflecting improved service delivery and the acquisition of military aircraft.

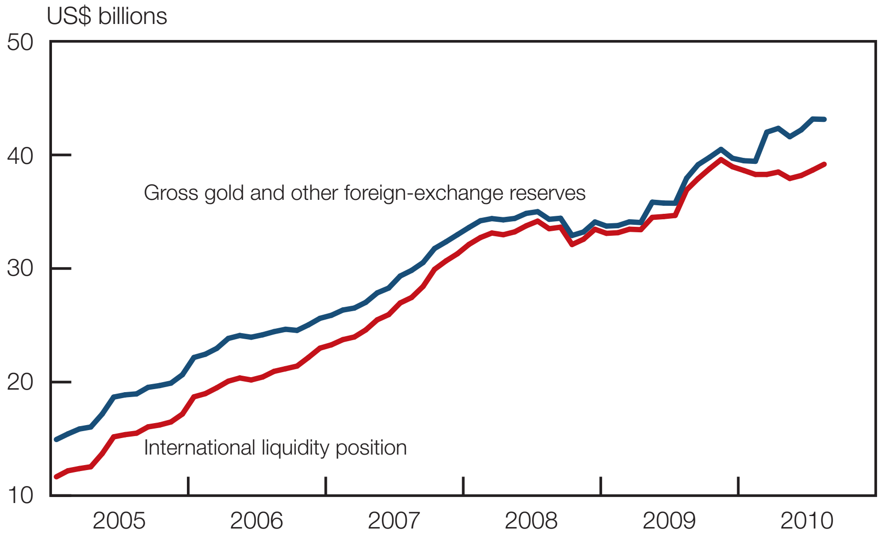
Employment contracted further in the first quarter of 2010, but at a slower pace than before. While the private sector continued to shed jobs, employment numbers in the public sector increased somewhat. Wage settlements continued to moderate in the first half of 2010, while in the third quarter a salary dispute in the public service resulted in strike action.

During the first seven months of 2010 producer price inflation accelerated apace due to base effects and global price developments. By contrast, the targeted consumer price measure of inflation decelerated to below the 6 per cent mark from February and remained within the inflation target band in the six months to July 2010 as the appreciation of the exchange value of the rand and low food price inflation partially offset high administered price inflation.

Export volumes remained lustreless in the second quarter of the year, partly due to setbacks to mining output, whereas import volumes increased. However, the terms of trade improved further and net service receipts were boosted by foreign visitors attending the football tournament, which resulted in the deficit on the current account remaining well contained. Foreign investors maintained strong interest in portfolio investment in emerging-market economies, given interest rate differentials and risk perceptions. They keenly invested in South African bonds, contributing to a sizeable inflow of funds being recorded in the financial account of the balance of payments. Under these circumstances the exchange value of the rand appreciated further while the South African Reserve Bank (the Bank) continued to add to its foreign-exchange reserves.

The sustained accumulation of foreign currency by the Bank had to be offset by liquidity-draining mechanisms in order to maintain orderly liquidity conditions in the money market. Apart from the instruments routinely used so far, to this end the Bank also started using longer-term foreign currency swaps from August 2010. As a consequence the Bank started to reflect on overbought forward position as part of its international liquidity position.

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



The spread of the Bank's standing facility rates above and below the repurchase rate was increased from 50 to 100 basis points with effect from the end of August. Money-market interest rates continued to reflect the level of, and expectations regarding, the repurchase rate. The repurchase rate was lowered by 50 basis points on each occasion in March and in September 2010, reflecting assessments by the Monetary Policy Committee (MPC) of an increasingly favourable inflation outlook. The reduction in September brought the repurchase rate to 6 per cent and the banks' prime lending rate to 9,5 per cent per annum, the first time since 1980 that the prime lending rate stood at less than 10 per cent.

Growth in the broadly defined money supply (M3) recorded a turnaround from a contraction in the first quarter of 2010 to a modest positive growth rate in the second quarter, with both the household and corporate sectors contributing to the increase in M3 deposits. Growth in the banks' loans and advances to the private sector also picked up moderately, reflecting not only demand from the household sector, but also an uptick in the reliance of the corporate sector on bank credit. The fairly subdued growth in the monetary and credit aggregates in the first seven months of 2010 continued to be affected by high debt levels, elevated impaired advances, weak employment prospects and uncertainty caused by the fragile global economic recovery.

Reflecting lower inflation and an appreciating exchange value of the rand, government bond yields have trended lower from recent highs recorded at the beginning of the year. After a notable recovery up to April 2010, share prices receded somewhat and subsequently fluctuated broadly sideways. House price inflation gained some momentum in the first half of 2010, but subsequently started to decelerate.

Fiscal policy remained expansionary during the past year, continuing to play a strongly counter-cyclical role. Government expenditure levels have remained high, supporting further economic recovery. In recent months the economic recovery has had a favourable impact on government revenue, with the result that tax collections have moderately exceeded earlier projections and the deficit, while large, has started to narrow. This is consistent with government's aim gradually to reduce the deficit, broaden the tax base and improve tax compliance.

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

Domestic economic developments[1]

Domestic output

Economic growth in the South African economy moderated in the second quarter of 2010. *Real gross domestic production* increased at an annualised rate of 3,2 per cent in the second quarter of 2010 following an increase of 4,6 per cent in the first quarter. The moderation in economic growth in the second quarter of 2010 could mainly be attributed to a noticeable decline in production volumes in the primary sector and a slower rate of increase in output growth of the secondary sector. By contrast, growth in the tertiary sector accelerated over the period.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sectors	2009					2010	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	-23,8	5,1	-7,6	0,9	-6,0	11,8	-12,5
Agriculture	-5,6	-15,8	-11,8	-7,6	-3,2	3,0	11,6
Mining	-30,7	15,8	-5,8	4,6	-7,2	15,4	-20,8
Secondary sector	-19,4	-6,9	7,0	8,1	-7,2	7,0	5,3
Manufacturing	-25,5	-11,1	7,6	10,1	-10,7	8,4	6,9
Tertiary sector	-0,9	-1,7	0,9	2,2	1,1	2,7	4,0
Non-agricultural sector	*-7,6*	*-1,9*	*1,8*	*3,7*	*-1,5*	*4,4*	*2,7*
Total	**-7,4**	**-2,8**	**0,9**	**3,2**	**-1,8**	**4,6**	**3,2**

Subsequent to an increase at an annualised rate of 11,8 per cent in the first quarter of 2010, the real value added by the *primary sector* contracted at a rate of 12,5 per cent in the second quarter. This decline could mainly be attributed to an exceptionally sharp contraction in the real output of the mining sector.

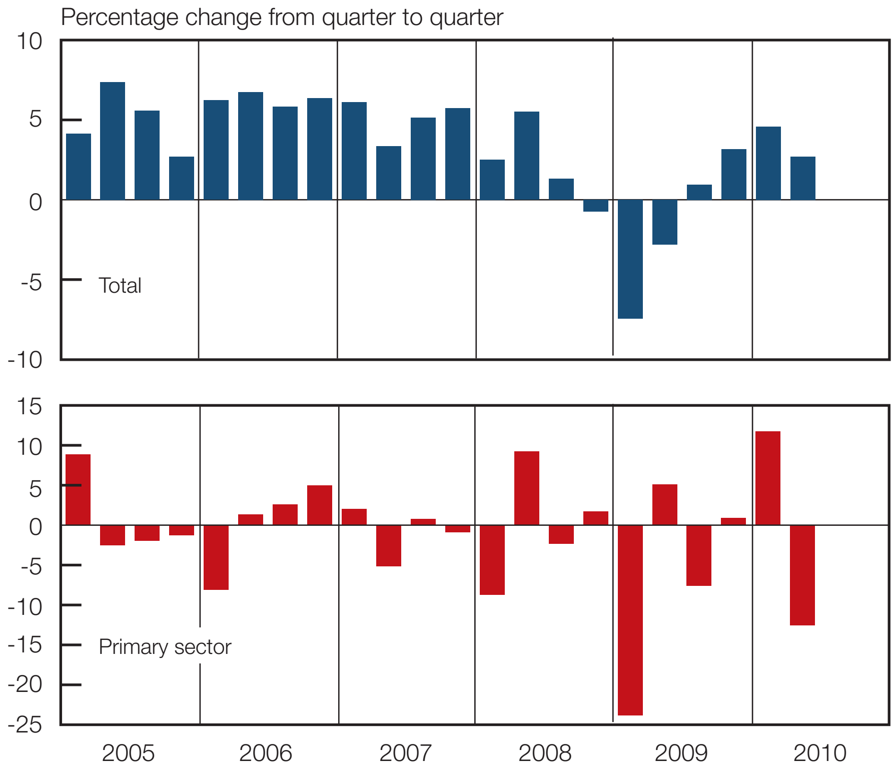
The real value added by the agricultural sector, which contracted by 3,2 per cent in 2009, increased at annualised rates of 3,0 per cent and 11,6 per cent in the first and second quarters of 2010 respectively. The firm increase in the second quarter could mainly be attributed to higher field crop and horticultural production alongside an increase in the output of livestock farming. The commercial maize crop for the 2009/10 season was estimated at 13,1 million tons compared with about 12,0 million tons in the preceding year.

Having increased at an annualised rate of 15,4 per cent in the first quarter of 2010, real value added by the *mining sector* contracted at a rate of 20,8 per cent in the second quarter. The notable decline in total mining production resulted primarily from lower production in the platinum and coal-mining sectors. Platinum production was adversely affected by scheduled maintenance work performed on smelters while the slump in the volume of coal production was mainly caused by industrial action during May 2010 by workers of state-owned logistics provider, Transnet. However, the real value added by the gold-mining subsector increased marginally from the first to the second quarter of 2010.

After increasing at an annualised rate of 7,0 per cent in the first quarter of 2010, growth in real value added by the *secondary sector* decelerated to 5,3 per cent in the second quarter. The moderation in growth was evident in all subsectors of the secondary sector.

Growth in the real value added by the *manufacturing sector* decelerated from a robust annualised rate of 8,4 per cent in the first quarter of 2010 to a still high 6,9 per cent in the second quarter of 2010. Although higher manufacturing production levels were reported by eight of the subsectors, declines were recorded in the basic iron and steel, furniture and other manufacturing subsectors, partly related to reduced exports. The Purchasing Managers' Index (PMI) receded to below the neutral 50 index point level in June 2010 after slowing since March. Nevertheless, the utilisation of production capacity in the manufacturing sector increased further from a level of 79,6 per cent in the first quarter of 2010 to 80,6 per cent in the second quarter as demand conditions improved.

Real gross domestic product



Seasonally adjusted annualised rates

The real value added by the sector that supplies *electricity, gas and water* reversed from an annualised growth rate of 4,9 per cent in the first quarter of 2010 to a rate of contraction of 0,2 per cent in the second quarter. This decline reflected a slower rate of increase in industrial demand for electricity and lower exports to neighbouring countries. Fairly mild winter temperatures in the second quarter and higher electricity prices also contributed to the lower demand for electricity by households.

Growth in real value added by the *construction sector* moderated in the second quarter of 2010 as building activity remained in a firm downward spiral. Growth in the real value added by the construction sector decelerated to an annualised rate of 1,5 per cent in the second quarter of 2010 compared with an increase of 2,1 per cent in the first.

The demand for non-residential buildings increased moderately, while civil construction activity slowed further. A deceleration in government infrastructure expenditure alongside the completion of projects related to the 2010 FIFA World Cup™ tournament contributed to the lower growth in the civil construction sector.

The real value added by the *tertiary sector* increased at an annualised rate of 4,0 per cent in the second quarter of 2010 compared with an increase of 2,7 per cent in the preceding quarter. The improved performance in the second quarter was underpinned by solid growth in all subsectors of the tertiary sector benefiting in part from the football tournament.

The real output of the *commerce sector* increased at an annualised rate of 5,8 per cent in the second quarter of 2010, compared with an increase of 3,3 per cent in the preceding quarter. This improved performance could be attributed to robust growth in the accommodation and wholesale trade sectors along with more moderate growth by the retail and motor-trade subsectors. The catering and accommodation subsector, in particular, benefited noticeably from increased consumer demand during the hosting of the 2010 FIFA World Cup™ tournament.

Growth in the real value added by the *finance, insurance, real estate and business services sector* accelerated somewhat from an annualised rate of 2,5 per cent in the first quarter of 2010 to 3,0 per cent in the second quarter. Increased trading activity in the domestic security markets and in the business services subsectors was partly offset by lower activity in the real-estate subsector, where real rentals in the industrial property market and activity in the residential market decelerated.

The growth in the real value added by the *transport, storage and communication sector* accelerated from an annualised rate of 2,4 per cent in the first quarter of 2010 to 4,5 per cent in the second quarter. Growth in the subsector for land freight transport accelerated, consistent with higher volumes of goods imported and exported. In addition, growth in the real value added by the passenger transport and telecommunication subsectors accelerated considerably during the 2010 FIFA World Cup™ tournament, which boosted the sector's activity levels and revenue.

Real production of *general government services* increased at an annualised rate of 3,6 per cent in the second quarter of 2010, compared with growth of 2,8 per cent recorded in the first quarter. This could mainly be ascribed to an increase in employment by general government.

Real gross domestic expenditure

Growth in aggregate *real gross domestic expenditure* slowed from an annualised rate of 12,1 per cent in the first quarter of 2010 to 2,3 per cent in the second quarter. The slowdown in real gross domestic expenditure resulted primarily from slower growth in real final consumption expenditure by households.

Growth in *final consumption expenditure by households* slowed to an annualised rate of 4,8 per cent in the second quarter of 2010 compared with an increase of 5,7 per cent in the preceding quarter. The moderation in growth resulted from a further contraction in expenditure on services alongside subdued spending on semi-durable goods, together accounting for more than 50 per cent of total household spending. The moderation in spending in these categories more than neutralised increased spending on durable and non-durable goods.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Components	2009					2010	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure:							
Households	-5,8	-5,2	-1,9	1,6	-3,1	5,7	4,8
General government	6,7	0,8	8,2	2,1	4,7	7,3	7,2
Gross fixed capital formation	5,2	-2,5	-6,5	-0,9	2,3	0,2	0,8
Domestic final demand	-1,3	-3,5	-1,0	1,2	-0,6	4,9	4,4
Change in inventories (R billions)*	-6,8	-48,5	-56,9	-38,4	-37,6	-8,7	-7,2
Gross domestic expenditure	**3,3**	**-10,8**	**-1,6**	**4,9**	**-1,8**	**12,1**	**2,3**

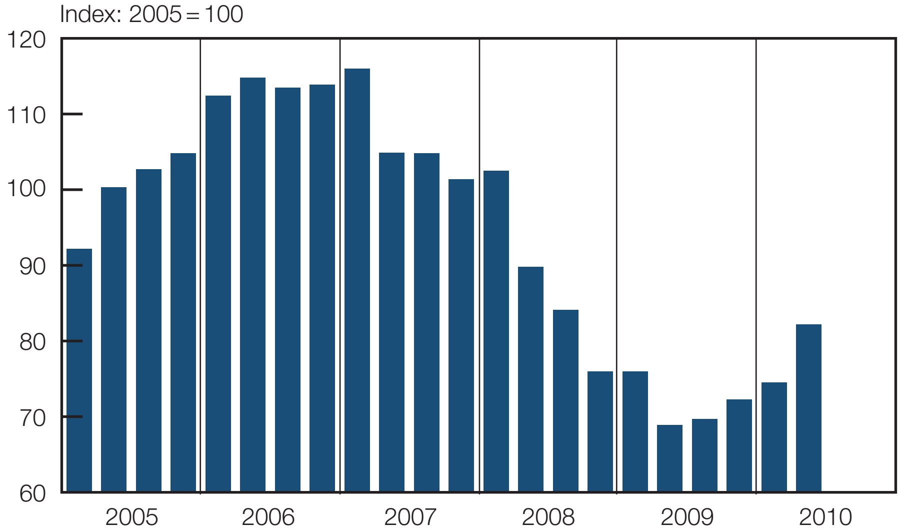
* At constant 2005 prices

Growth in real household expenditure on *durable goods*, which accounts for roughly 7 per cent of total spending by consumers, accelerated from an annualised rate of 16,8 per cent in the first quarter of 2010 to 37,8 per cent in the second quarter. The exuberant spending on durable goods was mainly evident in the categories for personal transport equipment; furniture and household appliances; and durable recreational goods. In addition to stable new vehicle prices, the faster pace of spending on personal transport equipment reflected the low base of expenditure on these items in 2009. Concurrent with the 2010 FIFA World Cup™ tournament, spending on recreational and entertainment goods such as television sets remained brisk in the second quarter of 2010.

Having increased at an annualised rate of 28,4 per cent in first quarter of 2010, real household expenditure on *semi-durable goods* slowed to an annualised rate of 10,6 per cent in the second quarter. The moderation in growth was especially evident in the categories for clothing and footwear; motor car tyres, parts and accessories; and semi-durable recreational and entertainment goods.

Real consumption expenditure on personal transport equipment

Index: 2005 = 100



Seasonally adjusted annualised rates

Following a rebound in real outlays on *non-durable goods* by households from the fourth quarter of 2009 to the first quarter of 2010, expenditure increases advanced from a rate of 9,5 per cent in the first quarter of 2010 to 10,9 per cent in the second quarter. Increased expenditure in the second quarter of 2010 was noticeable in the categories for household fuel and power, consumer goods, and medical and pharmaceutical products. Households' real expenditure on *services* contracted further and declined at an annualised rate of 7,7 per cent in the second quarter of 2010. The decline in spending on services was the net result of real expenditure on travel and accommodation services, indicative of foreign tourists' spending in South Africa, which exceeded expenditure by South African residents temporarily travelling abroad during the period.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

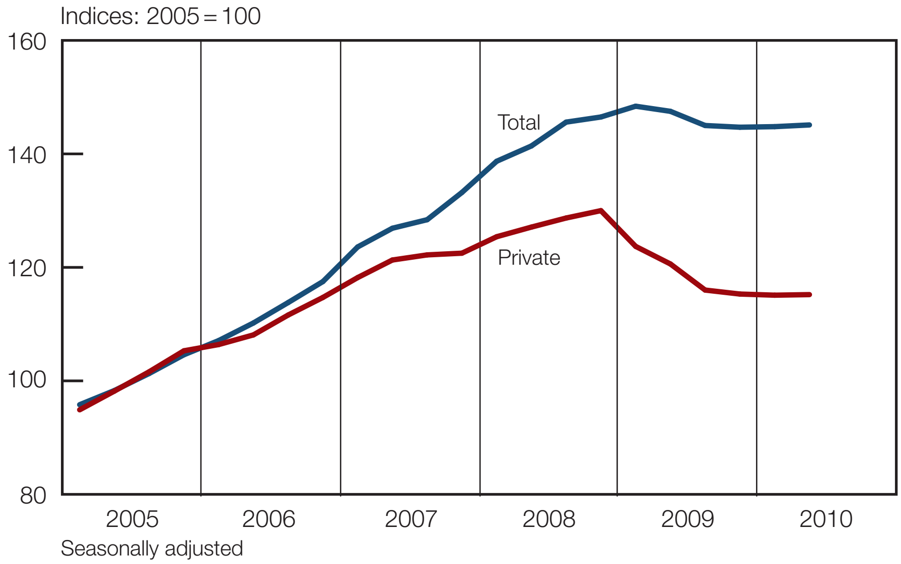
Components	2009					2010	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Durable goods	-8,4	-17,6	0,7	15,2	-11,3	16,8	37,8
Semi-durable goods	1,3	-4,8	-7,2	-0,6	-1,5	28,4	10,6
Non-durable goods	-9,9	-1,7	-5,4	-0,7	-4,4	9,5	10,9
Services	-3,4	-5,4	2,0	1,6	-0,6	-4,6	-7,7
Total	**-5,8**	**-5,2**	**-1,9**	**1,6**	**-3,1**	**5,7**	**4,8**

Real disposable income of households registered brisk annualised rates of increase of 5,1 per cent in the first quarter of 2010 and 4,8 per cent in the second quarter, as wage increases continued to exceed inflation alongside the creation of some temporary jobs to support the 2010 FIFA World Cup™ tournament. Consistent with the slow pace of credit extended to households, the ratio of household debt to disposable income edged lower from 78,7 per cent in the first quarter of 2010 to 78,2 per cent in the subsequent quarter. The ratio of debt-service cost to disposable income receded from 8,2 per cent in the first quarter of 2010 to 8,0 per cent in the second quarter.

After increasing at a buoyant rate of 7,3 per cent in the first quarter of 2010, real final consumption expenditure by *general government* maintained its upward momentum and increased at a rate of 7,2 per cent in the second quarter. This increase reflected, among other factors, the acquisition of four military aircraft, higher salaries and wages, as well as spending on goods and services, in part related to the hosting of the football tournament. Excluding spending on armaments, growth in consumption expenditure by general government decelerated somewhat from an annualised rate of 5,0 per cent in the first quarter of 2010 to 4,7 per cent in the second quarter.

Real *gross fixed capital formation* inched higher at annualised rates of 0,2 per cent in the first quarter of 2010 and 0,8 per cent in the second quarter. The increase in investment activity could be ascribed to higher levels of capital expenditure by private business enterprises and public corporations, and a slower pace of decline in capital spending by general government.

Real gross fixed capital formation



Following five quarters of uninterrupted contraction, real fixed capital outlays by *private business enterprises* increased at an annualised rate of 0,4 per cent in the second quarter of 2010. With the exception of the agricultural sector, real capital investment increased in all subsectors of the private sector in the quarter under review.

Subsequent to four successive quarters of decline, real capital expenditure by the mining sector increased marginally in the second quarter of 2010. The rebound in capital spending by the mining industry could mainly be attributed to the expansion of coal mines due to increased demand for coal from the power utility, Eskom. Despite the completion of certain construction works in time for the 2010 FIFA World Cup™ tournament, the bulk of capital expansion projects by construction companies continued to be driven by infrastructure-related investment. Owing to the expansion of broadband capacity in South Africa to keep pace with the growth in mobile data traffic, real capital expenditure by the communications subsector increased further in the second quarter of 2010.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

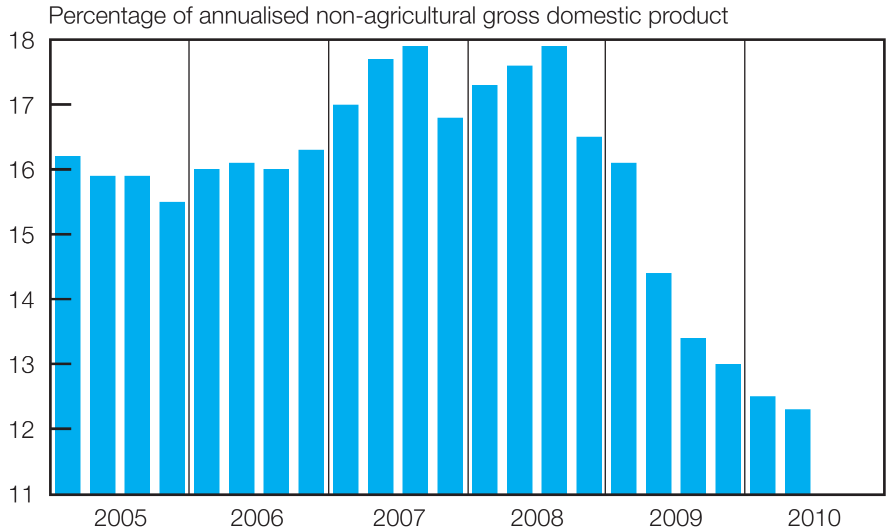
Components	2009					2010	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Private business enterprises	-18,1	-9,5	-14,5	-2,3	-7,0	-0,7	0,4
Public corporations	147,9	21,7	17,0	8,7	40,7	7,4	6,5
General government	-3,2	-6,2	-6,9	-10,0	-1,2	-8,0	-7,2
Total	**5,2**	**-2,5**	**-6,5**	**-0,9**	**2,3**	**0,2**	**0,8**

Real fixed capital expenditure by *public corporations* slowed marginally to an annualised growth rate of 6,5 per cent in the second quarter of 2010 following an increase at a rate of 7,4 per cent recorded in the first quarter. Some projects related to the preparation for the 2010 FIFA World Cup™ tournament came to an end, such as major upgrading activity by the Airports Company of South Africa (ACSA) which was completed before the end of June 2010. However, capital expenditure on the New Multiproduct Petroleum Pipeline (NMPP) from Durban to Gauteng supported momentum in the second quarter. Growth was further supported by the continuous upgrading of, and expansion to, about 561 km of freeway.

Real gross fixed capital formation by *general government* declined at a slightly slower pace in the second quarter of 2010. Activity contracted at an annualised rate of 8,0 per cent in the second quarter of 2010 and 7,2 per cent in the second quarter. The contraction in real spending by general government reflected reduced capital outlays by all levels of general government.

Inventory levels continued to decline in the second quarter of 2010, registering a contraction of R7,2 billion. This, however, is a slight improvement when compared with a decline of R8,7 billion recorded in the first quarter. The slower depletion in inventories in the second quarter of 2010 added 0,3 percentage points to the growth in real gross domestic expenditure during this period.

Industrial and commercial inventories



Seasonally adjusted

The de-accumulation of inventories in the second quarter of 2010 reflected decreased inventory levels in the manufacturing, trade and transport sectors. The run-down in aggregate inventory levels was accompanied by slower growth in real value added in the second quarter of 2010; the ratio of industrial and commercial inventories to non-agricultural gross domestic product declined from 12,5 per cent in the first quarter of 2010 to 12,3 per cent in the second quarter.

Factor income

Growth over four quarters in *total nominal factor income* picked up from 8,2 per cent in the first quarter of 2010 to 9,8 per cent in the second quarter. This reflected increased momentum in the gross operating surpluses of business enterprises in the second quarter of the year.

The year-on-year growth in *total gross operating surpluses* accelerated from 7,4 per cent in the first quarter of 2010 to 10,9 per cent in the second quarter. Accordingly, the share of the gross operating surplus in total factor income edged higher from 50,1 per cent in the first quarter of 2010 to 50,6 per cent in the second quarter. Solid growth was evident in all sectors of the economy, except for the construction and finance, insurance, real-estate and business services sectors. The profits in the construction sector remained under pressure as insufficient demand for buildings and construction works and increased tendering competition continued to hamper their business operations.

Measured over one year, an increase of 8,7 per cent was recorded in *total compensation of employees* in the second quarter of 2010, lower than the rate of 9,1 per cent attained in the first quarter. Increases in total salaries and wages moderated from the first to the second quarter of 2010 as inflation slowed while pressure on turnover and margins in some businesses persisted, contributing to corporate retrenchments. Measured over one year, employment in the economy decreased in the second quarter of 2010. The average level of wage settlements receded to 8,2 per cent in the first half of 2010 compared with a rate of 9,3 per cent in 2009, according to labour consultant Andrew Levy Employment Publications. The ratio of compensation of employees to total factor income decreased from 49,9 per cent in the first quarter of 2010 to 49,4 per cent in the second quarter.

Gross saving

The *national savings ratio*, or gross saving as a percentage of gross domestic product, increased from 16,0 per cent in the first quarter of 2010 to 16,9 per cent in the second quarter. The improvement in the saving performance can be attributed to a reduction in the dissaving by general government. The hosting of the 2010 FIFA World Cup™ tournament provided a boost to otherwise difficult economic conditions, thereby contributing to the improved savings ratio.

Gross saving by the *corporate sector* as a percentage of gross domestic product amounted to 16,1 per cent in both the first and second quarters of 2010. An improvement in the gross operating surplus was offset by higher tax collections from corporate business enterprises.

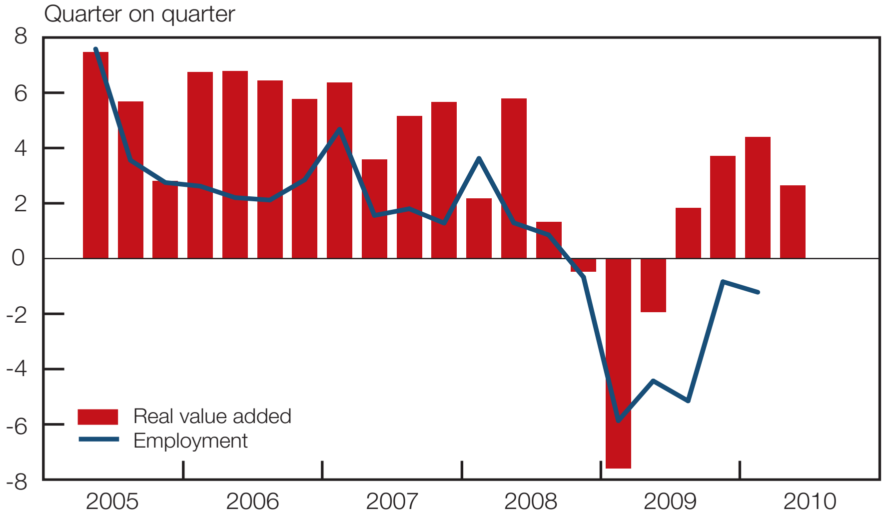
The gross savings rate of the *household sector* remained unchanged from the first quarter of 2010 to the second quarter at 1,6 per cent. The savings ratio, however, improved constantly from the first quarter of 2008, when a ratio of 0,8 per cent was recorded, until the fourth quarter of 2009 when a ratio of 1,7 per cent was achieved.

Gross dissaving by *general government* improved from 1,6 per cent of gross domestic product in the first quarter of 2010 to 0,7 per cent in the second quarter. Rising tax revenues alongside lower levels of current expenditure by general government had a positive effect on the level of saving.

Employment

Job losses continued unabatedly during the first quarter of 2010, despite the accelerating momentum of the recovery in economic activity that had commenced in the third quarter of 2009. The reduction in job opportunities in the first quarter of 2010 was the sixth consecutive quarterly decrease in employment; as seen previously, sustained strong growth is required before the South African economy starts creating jobs on a consistent basis.

Output growth and employment in the non-agricultural sector



Seasonally adjusted annualised rates

According to the *Quarterly Employment Statistics* (*QES*) survey by Statistics South Africa (Stats SA), formal non-agricultural employment contracted further at a seasonally adjusted and annualised rate of 1,2 per cent in the first quarter of 2010. Employment numbers in the private sector contracted by 1,9 per cent in the first quarter of 2010 while public-sector employment increased by 1,2 per cent. Approximately 24 900 jobs were lost in the first quarter of 2010 compared with 127 100 in the corresponding period of 2009. During the first quarter of 2010, sectors affected by job losses were the finance, insurance, real-estate and business services sector; the transport, storage and communication sector; the construction sector; the community, social and personal services sector; and the electricity sector. The public sector, however, expanded its staff complement by about 5 600 during the first quarter of 2010, with all tiers except at national government department level adding to the job register.

Change in enterprise-surveyed formal non-agricultural employment: March 2010

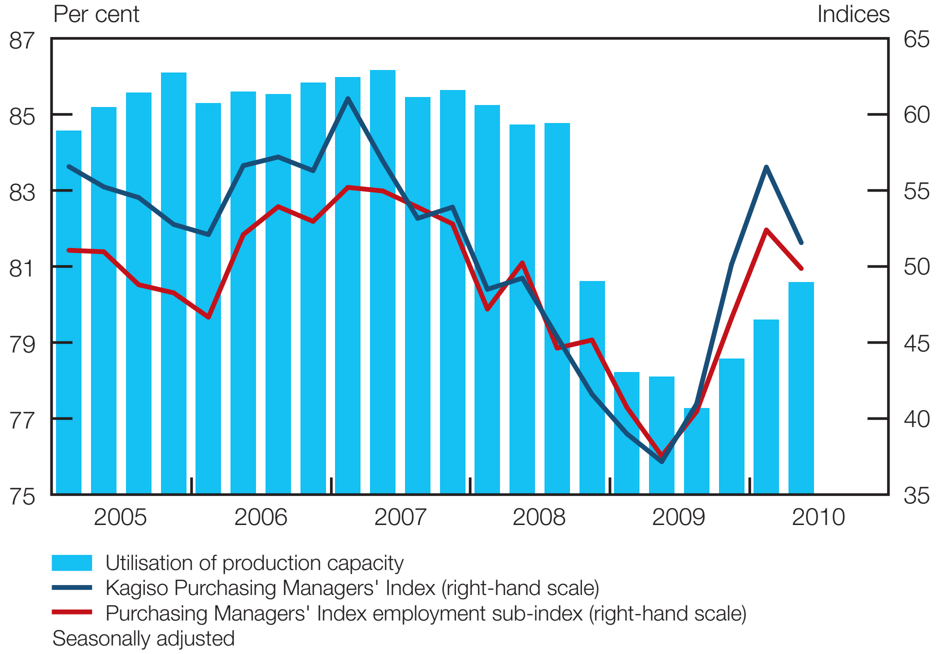
Sector	Over four quarters	Over one quarter*			
		2009			2010
		2nd qr	3rd qr	4th qr	1st qr
Gold mining	-1 800	-2 600	-800	-600	2 200
Non-gold mining	-7 200	-8 500	-6 600	4 000	3 800
Manufacturing	-51 600	-22 400	-19 400	-15 900	6 100
Electricity supply	-3 200	100	-3 000	100	-400
Construction	-50 500	-18 000	-20 500	-5 200	-6 900
Trade, catering and accommodation	-56 400	-15 100	-35 000	-9 000	2 700
Transport, storage and communication	-1 100	-6 100	-7 900	14 400	-1 500
Financial intermediation and insurance	-111 400	-37 600	-48 900	8 400	-33 200
Community, social and personal services	12 900	-4 000	26 300	-6 100	-3 300
Total private sector	-270 400	-114 300	-115 800	-9 800	-30 500
Total public sector	26 000	20 400	7 400	-7 300	5 600
Grand total**	-244 300	-94 000	-108 400	-17 100	-24 900

* Seasonally adjusted
** Components may not add up to totals due to rounding
Source: Statistics SA, *Quarterly Employment Statistics* (QES) survey

In the year to the first quarter of 2010 there was a loss of approximately 244 300 jobs in the formal non-agricultural sector. The private sector pruned some 270 400 jobs during the period which were countered by an increase in employment in the public sector. Job shedding in the private sector occurred in all subsectors, particularly in the construction, electricity, finance, insurance, real-estate and business services sectors. However, the community, social and personal services sector consistently added to its job complement during the past two years.

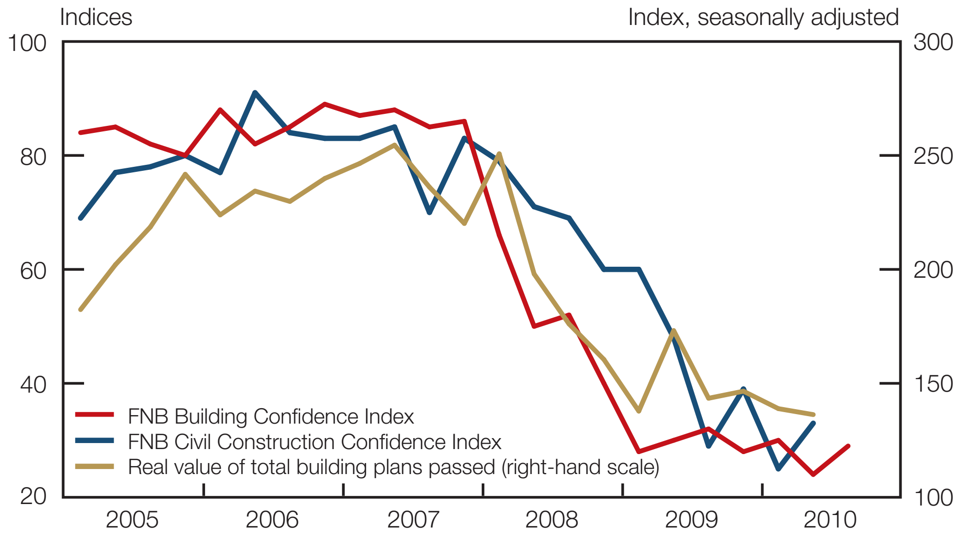
On a quarter-to-quarter, seasonally adjusted and annualised basis, employment levels in the manufacturing sector decreased by 5,2 per cent in the fourth quarter of 2009. This trend was reversed during the first quarter of 2010 when employment levels increased at an annualised rate of 2,1 per cent. The Kagiso Purchasing Managers' Index (PMI) increased sharply to a level of 60,4 index points in February 2010 before receding to 48,4 index points in June, whereafter it increased to 50,3 in August. In April 2010 the seasonally adjusted employment sub-index improved to its highest level in more than two years, before decreasing to below 50 in the four months to August, suggesting a possible deterioration in employment conditions in the manufacturing sector in the short to medium term. By contrast, capacity utilisation in manufacturing rose in both the first and second quarters of 2010.

Manufacturing sector indicators



Construction activity was largely supported by infrastructure-related work programmes during 2009, as the residential building sector experienced a recession and activity in the non-residential building sector stalled. Employment in the construction sector decreased at an annualised rate of 6,5 per cent in the first quarter of 2010. The First National Bank (FNB) Building Confidence Index, which reflects overall business confidence in the building industry, rebounded during the third quarter of 2010, notwithstanding the slight improvement, the industry remained firmly entrenched in a recession. Business confidence of architects increased marginally while that of quantity surveyors, contractors, subcontractors, manufacturers and retailers of building materials declined. The civil construction business confidence improved in the second quarter of 2010, attributable to easing tender competition. Despite this improvement, two-thirds of respondents remained discontented with current business conditions in a sector that is largely dependent on government for projects.

Building plans approved and confidence indices



The non-gold mining sector, which was responsible for the bulk of jobs created in the mining sector during the commodity price boom, cut jobs during most of 2009. However, the sector regained its job-creating capacity during the final quarter of 2009, continuing in the first quarter of 2010. Following the increase in commodity prices from the beginning of 2009, employment growth in the non-gold mining and gold mining sectors amounted to 4,7 per cent and 5,6 per cent respectively in the first quarter of 2010.

Consistent with rising final consumption expenditure by households, employment in the trade, catering and accommodation services sector grew at a seasonally adjusted and annualised rate of 0,7 per cent in the first quarter of 2010 following eight consecutive quarters of contraction. However, over the year to the first quarter of 2010, employment, on balance, continued to decline by 56 400 or 3,3 per cent. Consumer confidence declined marginally but remained high in the second quarter of 2010, after two quarters of increase.

Following four quarters of decline, employment in the finance, insurance, real-estate and business services sector increased momentarily at an annualised rate of 1,9 per cent in the final quarter of 2009, before decreasing again at a rate of 7,2 per cent in the first quarter of 2010. Likewise, employment in the private transport, storage and communication sector contracted in the first quarter of 2010 after registering a short-lived annualised increase of 26,0 per cent in the previous quarter.

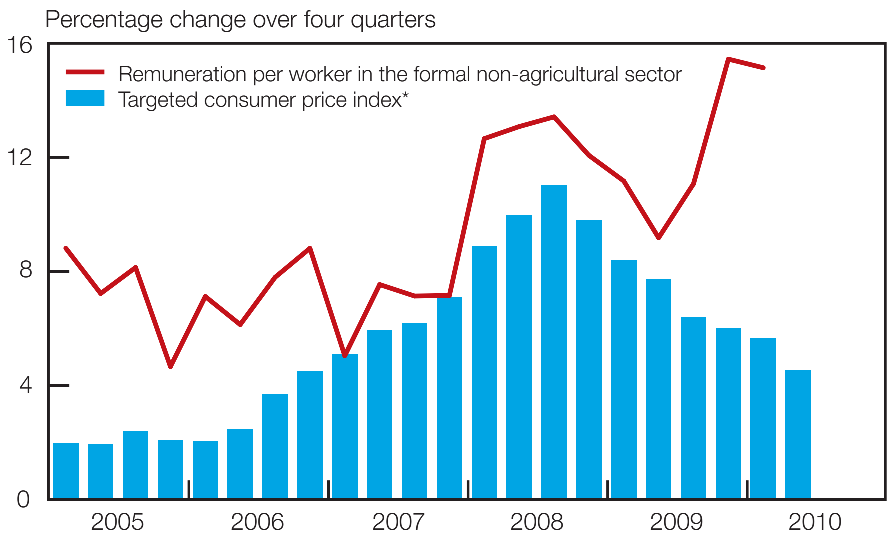
Employment growth in the public sector remained fairly robust throughout the economic downturn as roughly 82 500 jobs have been created since overall employment started contracting in the third quarter of 2008. Acting in a contra-cyclical manner, public-sector employment expanded and rose at an annualised rate of 1,2 per cent in the first quarter of 2010. New employment opportunities were created in the public enterprises and public transport, storage and communication sector, as well as at all tiers of government except at national department level. Public-sector employment increased by 26 000 persons or 1,4 per cent in the year to the first quarter of 2010.

According to the *Quarterly Labour Force Survey* (*QLFS*) by Stats SA, the total number of people employed amounted to 12,7 million in the second quarter of 2010, 1 million less than in the third quarter of 2008. The official unemployment rate remained broadly unchanged at a high 25,3 per cent in the second quarter of 2010. Formal non-agricultural employment decreased by 511 000 in the year to the second quarter of 2010, while a marginal increase in informal-sector employment was recorded, possibly related to work associated with the staging of the 2010 FIFA World Cup™ tournament. However, the number of discouraged work-seekers increased by 390 000 in the year to the second quarter of 2010.

Labour cost and productivity

Following the peak in consumer price inflation in the third quarter of 2008, the year-on-year rate of increase in average salaries and wages per worker started to decelerate in the second quarter of 2009, but remained high despite moderating overall consumer price inflation. According to Andrew Levy Employment Publications wage demands were the prime cause of strike action, which accounted for 98 per cent of working days lost in the first half of 2010.

Consumer prices and average remuneration per worker



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

The rate of increase in average nominal remuneration per worker in the formal non-agricultural sector of the economy amounted to 11,8 per cent in 2009, accelerating to 15,1 per cent in the year to the first quarter of 2010. Over the latter period, increases in average nominal remuneration per worker in the private sector accelerated to 14,1 per cent. Despite widespread job losses in the private sector, all subsectors registered double-digit rates of remuneration increase, ranging from 10,4 per cent in the non-gold mining sector to 26,4 per cent in the electricity-supply sector. Within the public sector, increases in remuneration per worker averaged 16,6 per cent over this period with increases in public-sector enterprises amounting to as much as 33,2 per cent compared with 10,8 per cent at local government level.

According to the Wage Settlement Survey by Andrew Levy Employment Publications, the average wage settlement rate amounted to 8,2 per cent in the first half of 2010, lower than the 9,3 per cent recorded in 2009 as a whole. In the recent past public-sector wage settlements have been somewhat higher than those observed in the private sector and the report expected a continuation of this trend in 2010. During the 2010 public-sector wage negotiations, a large number of public-sector workers embarked on industrial action over wage demands. The strike was suspended after three weeks without final settlement reached, following a government offer of a 7,5 per cent increase. The number of working days lost due to industrial action nationwide increased to 1,25 million in the first half of 2010 from 526 000 in the same period in the previous year.

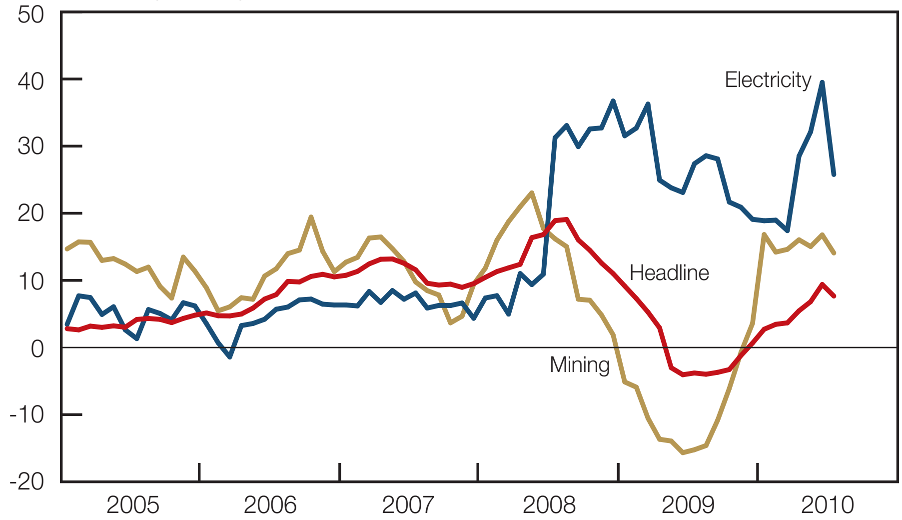
An increase in production by the non-agricultural sector of the economy, combined with further job losses in the sector, resulted in an improvement in labour productivity during the first quarter of 2010. The year-on-year rate of increase in labour productivity accelerated from 3,1 per cent in the fourth quarter of 2009 to 5,0 per cent in the first quarter of 2010. Given a slightly lower rate of increase in average salaries and wages per worker during the first quarter of 2010 and improved productivity, the rate of increase in nominal unit labour cost moderated from 12,0 per cent in the year to the fourth quarter of 2009 to 9,6 per cent in the year to the first quarter of 2010.

Prices

While producer price inflation picked up significantly from negative twelve-month rates in most of 2009 to almost double-digit positive rates by mid-2010, consumer price inflation has trended lower since August 2008 and has remained within the target range in the six months to July 2010, most recently falling below 4 per cent. A combination of economic factors influenced price developments in the domestic economy, with producer prices, for instance, strongly influenced by a resurgence in international commodity prices since the beginning of 2009 and high electricity price increases, only partly countered by an appreciation in the external value of the rand. Consumer prices, being less sensitive to international commodity prices than producer prices, responded more favourably to the counterinflationary forces emanating from low inflation in trading-partner countries, the appreciation in the exchange rate of the rand, substantial surplus capacity in the economy and the resulting intensified competition for business.

Producer prices

Percentage change over twelve months



Deflation in the producer prices of domestic output reverted to inflation in December 2009, accelerating in the following months to July 2010. These price changes were largely due to base effects, higher commodity prices (and, hence, an acceleration in imported producer price inflation), as well as the ongoing elevated electricity price increases announced by Eskom. After being in negative territory in the preceding twelve months, producer price changes of manufactured output also reverted to inflation from April 2010, accelerating to a year-on-year rate of 3,4 per cent in July. Price increases of products of petroleum and coal drove manufactured producer price inflation higher, more recently also reinforced by higher price inflation of tobacco products, footwear, basic metals, non-metallic mineral products, and other manufactured goods. Producer price inflation for electricity more than doubled from a year-on-year rate of increase of 17,4 per cent in March 2010 to 39,5 per cent in June, before moderating to 25,8 per cent in July.

Producer prices of imported commodities decreased right through 2009 but increased from January 2010, reaching a year-on-year rate of increase of 6,5 per cent in May before decelerating to 2,0 per cent in July. Changes in imported producer prices have largely been driven by inflation in the mining and quarrying category, particularly the price of crude petroleum. The producer prices of imported manufactured commodities have been subdued.

The producer prices of food continued to decrease in the year to June 2010. When measured over twelve-month periods, producer price changes of food at both the agricultural and manufacturing levels persisted in deflation. The deflation at the level of producers eventually contributed to the considerable waning in consumer food price inflation.

The moderation in headline consumer price inflation resulted mainly from lower rates of increase in the prices of consumer goods from the third quarter of 2009. Services price inflation has remained at a more elevated level, as shown in the accompanying table, and in July it edged into the inflation target range after 18 months.

Producer and consumer prices

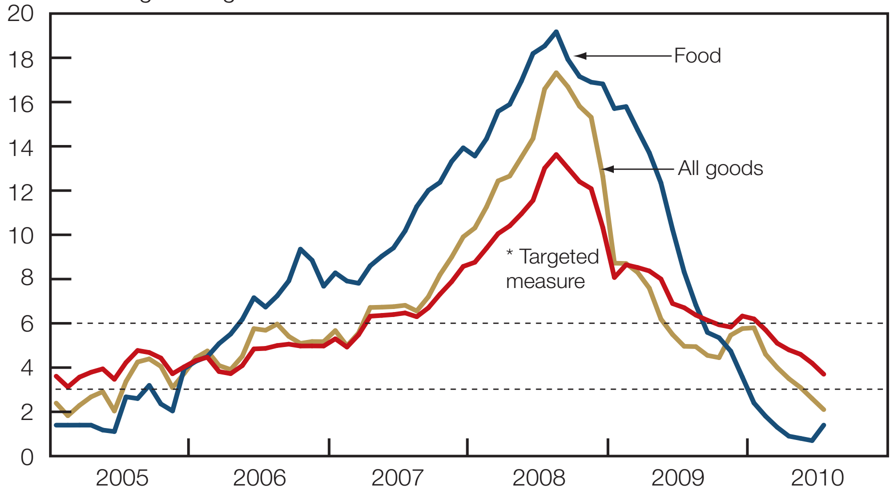
Percentage changes over twelve months

		Producer food prices	Consumer food prices	Consumer goods prices	Consumer services prices	Headline consumer prices
2009:	May	3,4	12,1	7,6	8,4	8,0
	Jun	0,0	9,9	6,2	7,6	6,9
	Jul	-2,0	7,6	5,5	8,0	6,7
	Aug	-2,7	6,2	5,0	8,1	6,4
	Sep	-3,3	4,9	4,9	7,8	6,1
	Oct	-1,6	4,8	4,5	7,4	5,9
	Nov	-2,0	4,0	4,4	7,4	5,8
	Dec	-1,8	2,8	5,5	7,2	6,3
	2009	**1,5**	**9,4**	**6,4**	**8,0**	**7,2**
2010:	Jan	-8,8	1,6	5,8	6,8	6,2
	Feb	-6,0	1,0	4,6	6,8	5,7
	Mar	-4,0	0,5	4,0	6,5	5,1
	Apr	-2,3	0,3	3,5	6,5	4,8
	May	-2,6	0,1	3,1	6,4	4,6
	Jun	-1,3	0,7	2,6	6,1	4,2
	July	-2,1	1,4	2,1	5,4	3,7

So far in 2010, year-on-year consumer goods price inflation has been quite moderate. Being more sensitive to the exchange rate, consumer price changes of durable goods registered negative rates in the five months to July, while semi-durable goods price changes were close to nil. However, the prices of non-durable goods increased at rates in excess of 6 per cent until June 2010 and in July the twelve-month rate receded to 4,6 per cent.

Consumer prices

Percentage change over twelve months



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

Headline consumer services price inflation decelerated slowly from August 2009, remaining above the upper limit of the inflation target range. However, in the year to July 2010, services price inflation amounted to 5,4 per cent. Price increases in excess of the upper limit of the inflation target range have been recorded by services items such as housing utilities (water supply, refuse and sewerage collection, flats), health, education, railway travel, hotel accommodation and insurance.

Based on the classification of individual consumption by purpose (COICOP) categories in July 2010, twelve-month rates of price increase in excess of the upper limit of the inflation target range were registered in six categories having a combined weight of 48,18 per cent in the total index. This is illustrated in the table below.

Headline CPI inflation in COICOP categories

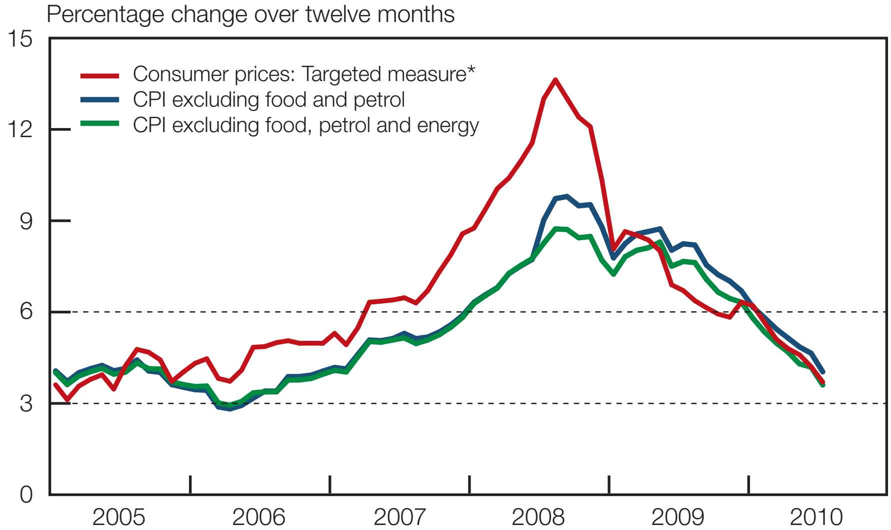
Percentage changes over twelve months

	Weights	July 2010
Alcoholic beverages and tobacco	5,58	9,7
Education	2,19	9,2
Health	1,47	7,5
Clothing and footwear	4,11	7,5
Housing and utilities	22,56	6,4
Restaurants and hotels	2,78	6,4
Miscellaneous goods and services	13,56	5,8
Food and non-alcoholic beverages	15,68	1,4
Transport	18,80	1,1
Household contents, equipment and maintenance	5,86	-0,2
Communication	3,22	-1,3
Recreation and culture	4,19	-2,3
Total headline CPI	100,00	3,7

When the impact of food, non-alcoholic beverages, petrol and electricity prices is excluded from the headline consumer price index, this measure of underlying inflation has decelerated continuously since January 2010 and amounted to a rate of 3,6 per cent in the year to July 2010.

Targeted and underlying consumer price inflation

Percentage change over twelve months



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

Year-on-year administered goods and services price inflation accelerated significantly to a rate of 14,5 per cent in January 2010, whereafter it moderated to 8,6 per cent in July. With the exception of the communication and transport categories, all the other categories within the administered price basket registered above 6 per cent inflation rates and some even double-digit price increases in the year to July 2010. When the effect of petrol and electricity prices is excluded from administered prices, this year-on-year rate of increase moderated to 6,9 per cent in July 2010. Omitting the main drivers of administered price inflation, namely petrol and electricity, from the calculation, this inflation measure still recorded double-digit rates of increase, well above the upper limit of the inflation target range. This may have a bearing on the risk to the inflation outlook in the months ahead.

The Bureau for Economic Research (BER) *Inflation Expectations Survey* conducted in the second quarter of 2010 showed an increase in inflation expectations in the three years to 2012. Inflation was expected to accelerate from 6,3 per cent in 2010 to 6,8 per cent in 2012. Among the three surveyed groups, only the financial analysts expected inflation to fall within the target range in the next two years, while the other groups were of the opinion that inflation would be in excess of the inflation target range.

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2010

Average inflation expected for	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2010	5,0	6,9	7,0	**6,3**
2011	5,7	7,2	6,7	**6,5**
2012	6,0	6,7	6,9	**6,8**

Foreign trade and payments

International economic developments

After contracting for two consecutive quarters, global economic growth turned positive in the second quarter of 2009. The global growth momentum accelerated further in the second half of 2009 and remained strong in the first quarter of 2010, aided by substantial monetary and fiscal policy support measures in most countries. However, financial-market turmoil increased again from mid-April 2010 following the downgrading of Greece, Ireland, Portugal and Spain by rating agencies due to vulnerable public finances. Recent data suggest that global output growth moderated from rates in excess of 5 per cent in the fourth quarter of 2009 and the first quarter of 2010 to a still robust rate of around 4,5 per cent in the second quarter of 2010.

Economic activity in the United States (US) continued to increase in the second quarter of 2010, albeit at a slower pace, reflecting positive contributions from non-residential fixed investment, private consumption expenditure, exports, federal government spending and the restocking of private inventories. The rate of increase was, however, markedly lower due to a significant acceleration in imports and a deceleration in private inventory investment. In recent months, the pace of increase in output and employment appeared to have slowed further. Economic growth in the euro area picked up further in the second quarter of 2010, increasing to a rate of 3,9 per cent compared with 1,3 per cent in the first quarter. The enhanced performance of the euro area was supported by buoyant export growth, especially in Germany, fuelled by the depreciation of the exchange rate. Financial markets also responded positively to the outcome of the recent European Union- (EU) wide bank stress tests. The Committee of European Banking Supervisors confirmed that most European banks were resilient to severe economic and financial shocks, with only 7 of the 91 banks failing to meet the capital requirements. Following robust growth during the first quarter of 2010, Japan's output growth slowed considerably during the second quarter due to the weakening of domestic demand and export growth in response to a slowdown in the restocking of inventories in the Organisation for Economic Co-operation and Development (OECD) and a moderation in the economic growth in China. However, the Tankan survey released by the Bank of Japan suggests positive business sentiment regarding near-term future developments.

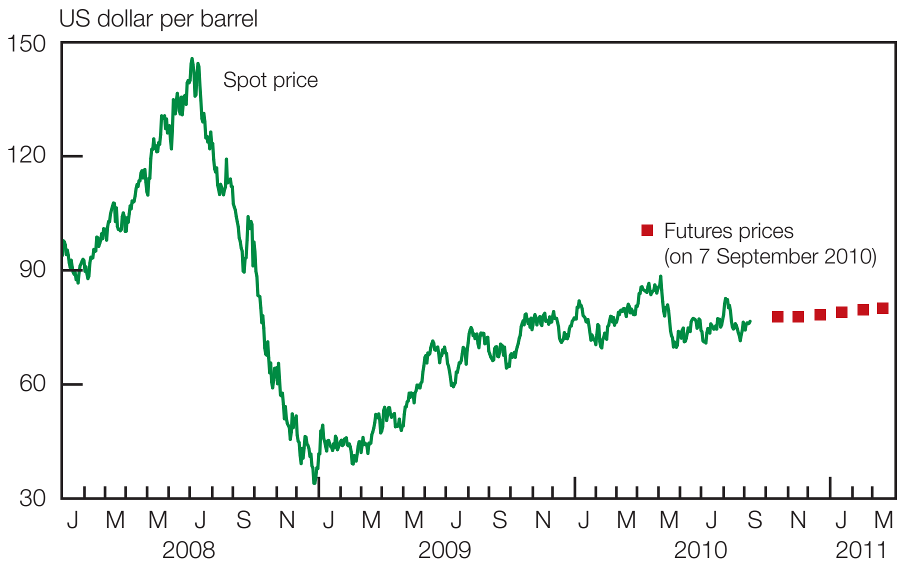
Among emerging-market economies, the deceleration of aggregate growth was mainly caused by slower growth in Asian emerging markets. Chinese output growth slowed markedly to 7,2 per cent in the second quarter of 2010, the first single-digit growth rate since the first quarter of 2009. This moderation came as fixed investment growth slowed as a result of tightening measures aimed at the housing sector and fiscal spending cuts on local government investment projects. The slowdown was also due to inventory adjustment, while retail sales and the export sector continued to expand solidly. The growth momentum and contribution to global growth from the Latin American region improved significantly in the second quarter of 2010. Growth has turned positive in Mexico, Chile and Venezuela, and is expected to remain strong in Argentina and Colombia. However, growth moderated sharply in Brazil during the second quarter. Growth in emerging Europe accelerated in the second quarter of 2010 as a result of the strong performance in Russia and Poland.

The IMF has revised its global growth outlook upwards to 4,6 per cent in 2010, but has left its projections for 2011 unchanged at 4,3 per cent in its latest *World Economic Outlook*

Update (July 2010). These projections reflect the stronger-than-expected economic activity in the first half of 2010 and bleaker prospects for 2011 due to the increasing downside risks following renewed financial instability in Europe. Nevertheless, modest but steady economic recovery in advanced economies and strong growth in many emerging-market and developing economies is still envisaged for the immediate period ahead. Growth in advanced economies was revised upwards to 2,6 per cent in 2010 and left unchanged at 2,4 per cent in 2011, while growth in emerging-market and developing economies was revised upwards to 6,8 per cent in 2010 and downwards to 6,4 per cent in 2011.

Brent crude oil prices declined sharply from almost US$90 per barrel at the beginning of May 2010 to levels around US$70 per barrel towards the middle of the month, amid increased concerns over the European sovereign debt crisis and the sustainability of the global recovery. Although very volatile, crude oil prices gradually increased to a range between US$75 and US$77 per barrel towards the end of June 2010, supported by growing consumption from China (the world's largest energy consumer) and more positive US economic data. Oil prices briefly declined below US$72 per barrel at the beginning of July 2010, but rebounded thereafter to levels above US$80 per barrel at the beginning of August 2010. Oil prices continued to be volatile in August and declined to levels around US$76 per barrel in early September 2010. Futures prices suggest Brent crude oil prices of around US$80 per barrel in the first quarter of 2011.

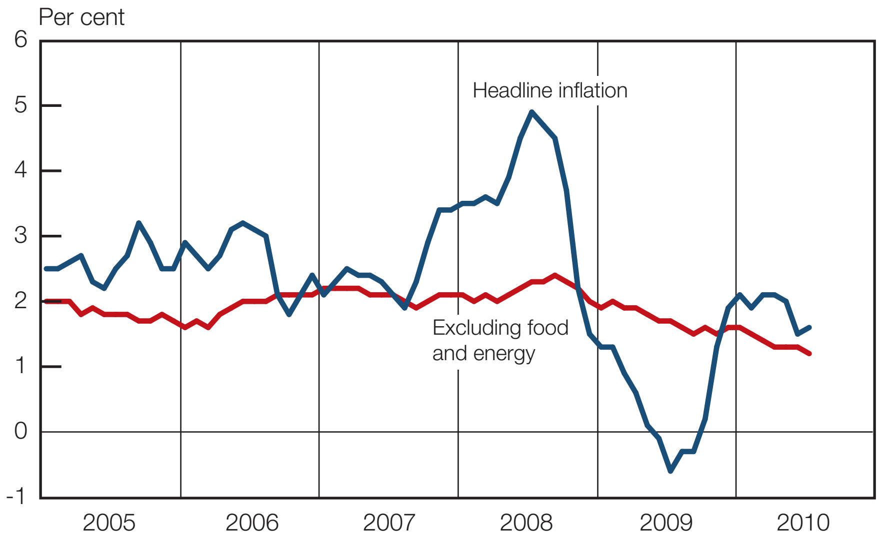
Brent crude oil prices



Source: Bloomberg

Weak private consumption expenditure, excess capacity and the continued high unemployment helped to contain global inflationary pressures in the second quarter of 2010. Headline consumer price inflation in the OECD countries decelerated from an annualised rate of 2,0 per cent in May 2010 to 1,6 per cent in July. Core consumer price inflation (excluding food and energy) also decelerated to 1,2 per cent in July 2010, from 1,3 per cent recorded in the past three months. The latest IMF projections for inflation in advanced economies has been revised downwards to 1,4 per cent in 2010 and 1,3 per cent in 2011. Inflationary pressures are expected to remain subdued in advanced economies due to the low level of capacity utilisation and well-anchored inflation expectations. Inflation in emerging-market and developing economies is projected to average 6,3 per cent in 2010 and 5,0 per cent in 2011.

OECD inflation



Source: OECD

Excluding food and energy, core consumer price inflation in the US and the euro area remained subdued in the second quarter of 2010. The moderation in prices was broad-based across a range of goods and services, consistent with downward pressure on prices from excess capacity. During the second quarter of 2010, headline inflation also gradually slowed in the US and in the euro area, but edged up in July 2010 to 1,2 per cent and 1,7 per cent respectively. Owing to sluggish labour market developments, unit labour cost and real wages are expected to exert limited upward pressure on inflation. Deflation in Japan moderated in the second quarter of 2010, but is likely to continue to weigh on consumer spending. Core consumer prices (excluding fresh food) in Japan fell by 1,1 per cent and headline consumer prices by 0,9 per cent in July 2010.

Consumer price inflation is relatively subdued in most major emerging-market economies. Inflationary pressures have continued to ease in emerging Europe since mid-2008, but started to increase at the beginning of 2010 in Latin America before stabilising in recent months. Emerging Asia experienced an acceleration in consumer prices in the second half of 2009, but more or less stabilised in the first half of 2010. Food prices have been rising steadily since the middle of 2009 across emerging-market economies due to tight supplies, changing weather patterns and rising demand, pointing to a long-term structural change.

A number of central banks tightened monetary policy during the second quarter of 2010 on inflation concerns as the recovery in output strengthened. The Reserve Bank of Australia raised the official cash rate by a cumulative 50 basis points in April and May 2010, but recently left interest rates unchanged. Since June 2010 the Bank of Canada has raised its official interest rate by a cumulative 75 basis points to 1,00 per cent. During the second quarter of 2010 key interest rates were also raised in Brazil, India, Israel, Korea, Malaysia, New Zealand, Norway, Sweden, Taiwan and Thailand. In May 2010 the central banks of the Czech Republic and Russia, however, reduced interest rates to 0,75 per cent and 7,75 per cent respectively to support economic activity.

Current account[2]

Although the increase in economic activity appears to be fragile in a number of economies, the underlying global economic recovery proved to be well under way and only marginally affected by the fallout of the sovereign debt crisis in the GIPS[3] economies. Over and above the austerity measures introduced to constrain the spill-over effects from the crisis in Greece, the crisis had a marginal bearing on the South African economy due to limited trade with these economies. Trade between South Africa and flourishing trading-partner countries, including China, India and certain economies in the euro area continued to benefit South African exporters. At the same time, the volume of imported goods regained some momentum as the private sector raised its expenditure on manufactured goods. Notwithstanding these developments, the deficit on the trade account in the first quarter of 2010 reverted to a surplus of R13,2 billion in the second quarter.

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

3 Greece, Italy, Portugal and Spain.

Balance of payments on current account

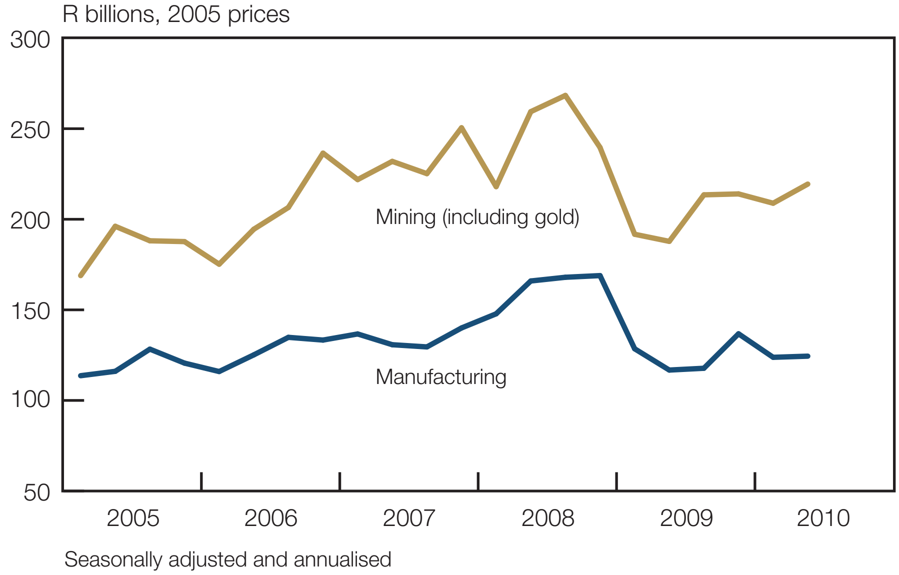
Seasonally adjusted and annualised
R billions

	2009				2010	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	474,3	477,6	528,5	503,7	518,6	552,0
Net gold exports	47,5	53,4	59,2	52,8	49,5	59,0
Merchandise imports	-508,1	-508,7	-562,8	-554,2	-581,0	-597,8
Trade balance	13,7	22,3	24,9	2,3	-12,9	13,2
Net service, income and current transfer payments	-96,0	-97,4	-96,3	-98,9	-103,2	-80,1
Balance on current account	-82,3	-75,1	-71,4	-96,6	-116,1	-66,9
As a percentage of gross domestic product	*-3,5*	*-3,1*	*-2,9*	*-4,0*	*-4,6*	*-2,5*

The improved performance of the trade account was supplemented by a substantial narrowing of the deficit on the services, income and current transfer account with the rest of the world following higher tourist expenses by non-resident visitors attending the 2010 FIFA World Cup™ tournament. As a result, the deficit on the current account of the balance of payments, which had deteriorated to 4,6 per cent of gross domestic product in the first quarter of 2010, contracted markedly to 2,5 per cent in the second quarter.

Having contracted briefly by 3,3 per cent in the first quarter of 2010, the volume of merchandise exports resumed its upward trend and advanced by about 1,0 per cent in the second quarter. The rebound was mainly brought about by a notable increase in the demand for South African-produced mining products. Particularly large increases occurred in the volume of base metals exported to the European region alongside a considerable increase in mineral exports to China, raising the overall volume of mining exports by about 5,0 per cent in the second quarter of 2010. At the same time, the steady resurgence in private consumption expenditure in a number of South Africa's main trading-partner countries raised the demand for domestically manufactured motor vehicles and transport equipment, thereby causing the volume of exported manufactured goods to edge higher by 0,5 per cent. Fruit exports, mainly seasonal citrus fruit, also picked up in the latter part of the second quarter of 2010.

Volume of merchandise exports

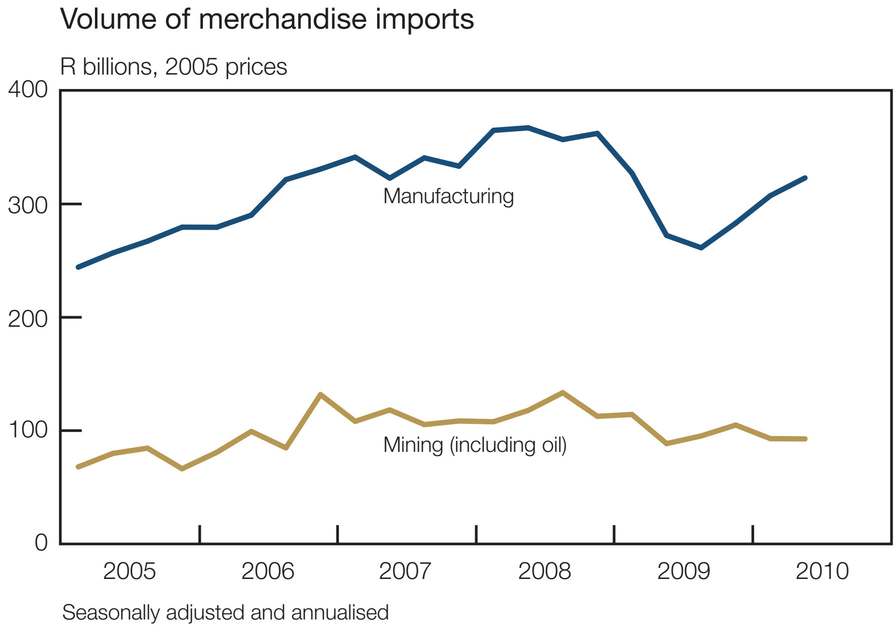


Over and above the increase in the volume of merchandise exports in the second quarter of 2010, the rand price of exports rose by 5,5 per cent as a result of higher international commodity prices. The combined result of price and volume increases raised the proceeds of domestic exporters to R552,0 billion or by 6,4 per cent in the second quarter of 2010, following a decline of 1,9 per cent in the preceding quarter.

Large-scale uncertainty about the potential spill-over effects from the sovereign debt crisis in Greece and the subsequent expectation of increased volatility in global financial markets probably persuaded international investors to adjust their portfolios to preserve wealth. The higher demand for commodity-based assets, mainly supplied by emerging-market economies including South Africa, consequently raised the prices of international commodities by 9,8 per cent in the second quarter of 2010; in the preceding quarter prices rose by 7,2 per cent. Noticeable increases of 4,4 per cent and 7,7 per cent were recorded in the prices of platinum and gold respectively during the second quarter of 2010. The fixing price of gold on the London market advanced by 4,8 per cent in May 2010 and by 2,4 per cent in June, raising the quarterly average from US$1 110 per fine ounce in the first quarter of 2010 to US$1 195 per fine ounce in the second quarter. The realised price of gold in rand terms rose by 9,2 per cent over the period.

The volume of net gold exports increased by 9,2 per cent in the second quarter of 2010, largely attributable to increased demand for physical gold as an investment asset and the demand for jewellery from Asia. The combined effect of increases in both the price and volume of gold exports was a 19,3 per cent increase in the proceeds from net gold exports from R49,5 billion in the first quarter of 2010 to R59,0 billion in the second quarter.

The value of merchandise imports advanced by 2,9 per cent in the second quarter of 2010 after increasing by 3,2 per cent in the first quarter. The higher value of imports in the second quarter of 2010 can be attributed to the underlying demand for foreign-produced goods. The rand price of merchandise imports declined by 0,2 per cent, partly weighed down by the subdued increase in the international price of crude oil, the relative strength in the external value of the rand and low and well-contained inflation in most of South Africa's important trading-partner countries.

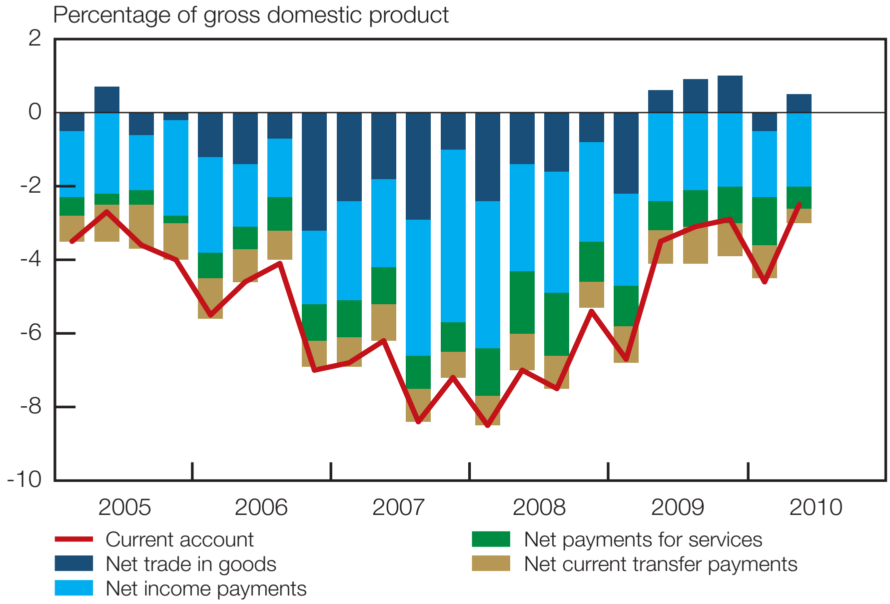


The volume of merchandise imports increased for the third consecutive quarter, rising by 3,1 per cent from the first to the second quarter of 2010. The expansion in import volumes in the second quarter reflected robust increases in the categories for vehicles and transport equipment, including four military aircraft, as well as machinery and electrical equipment. In total, manufactured import volumes increased by about 5 per cent in the second quarter of 2010. At the same time, the volume of imported mining products moved broadly sideways, partly constrained by a decline in the volume of imported crude oil.

Net service, income and current transfer payments to non-residents narrowed substantially from R103,2 billion in the first quarter of 2010 to R80,1 billion in the second quarter. The improvement in the deficit on this account could largely be attributed to lower net payments to non-residents in most of the main categories of the account. Measured as a ratio of gross domestic product, the imbalance shrank from 4,1 per cent in the first quarter of 2010 to 3,0 per cent in the second quarter – a ratio previously recorded in the third quarter of 2005.

Net service payments to non-residents contracted noticeably in the second quarter of 2010, largely as a result of the 2010 FIFA World Cup™ tournament hosted between 11 June and 11 July 2010 which mainly affected travel receipts during the period. (An analysis of tourist receipts is provided in the box on page 26 of this report.) In addition, spending by South African residents temporarily travelling abroad moved broadly sideways during the second quarter of 2010, in part attributable to the attraction of the major sport event leading to the postponement of foreign visits by residents. Gross payments in the category "other services" remained relatively high as a result of payments made for technical services related to infrastructural projects, including the completion of the first phase of the Gautrain project and the finalisation of assignments related to the football tournament.

Current account and its components



Box: Impact of the 2010 FIFA World Cup™ tournament on the travel component of South Africa's balance of payments in the second quarter of 2010

The month-long 2010 FIFA World Cup™ tournament, hosted between 11 June and 11 July 2010, had a positive bearing on various economic variables in South Africa. In the case of some variables, the impact of the tournament became evident long before the event. In preparation for the event, construction activity and capital investment in transport equipment, for example, remained firm throughout 2009. In addition to the positive spin-off from these developments, the country probably benefited most from foreign tourism spending during the time of the tournament.

This box elaborates on the estimates of foreign tourism spending as recorded in the country's balance-of-payments statement for the second quarter of 2010. According to the guidelines of the 5th edition of the *Balance of Payments Manual of the International Monetary Fund (BPM5)*, the "travel" item comprises primarily the acquisition of goods and services by travellers from one economy in another economy during visits of less than one year. Personal expenditure on goods and services by seasonal, border and other non-resident workers in economies other than their home economies are also part of this item. Spending by foreign tourists per se is a subset of the "travel" item.

In the balance of payments, inbound-related tourism activities are recorded as part of exports of goods and services. Exports of goods and services include receipts for services rendered to non-resident travellers; inbound-related tourism activities account for almost 90 per cent of total travel receipts. Expenditure by foreign tourists during the recent 2010 FIFA World Cup™ tournament would have affected South Africa's exports of services in three main categories:

- *Travel,* including items such as food and beverages; accommodation; domestic transport; and gifts and leisure;
- *Transportation,* notably passenger transportation where air fares are paid by non-residents to domestic carriers;
- *Other services*, notably in the category for cultural and recreational services, where ticket sales to non-residents are recorded.

Owing to its consumption-based nature, the measurement of foreign tourism activities is internationally acknowledged as one of the most challenging areas in the macroeconomic statistical framework. Adding to the complexity of the measurement is the fact that tourism-related activities are spread among various industries on the supply side of the economy, affecting, *inter alia*, the retail, transportation and accommodation sectors. Traditional source data and indicators utilised in the measurement and compilation of tourism statistics should, however, be treated cautiously as they may, in many instances, reflect similarities in the retail spending patterns by domestic consumers and foreign tourists. An example of such expenditure would be expenditure on groceries and clothes.

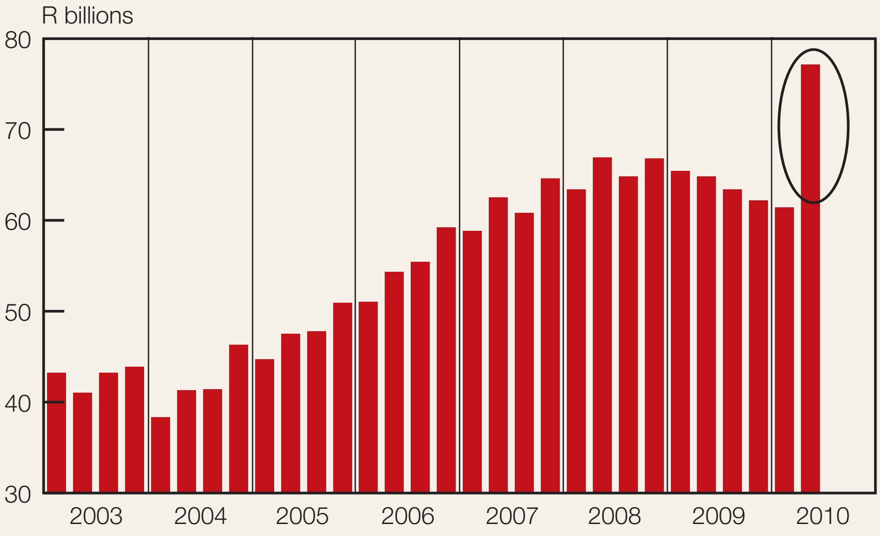
Preliminary estimates suggest that travel receipts benefited substantially from spending by non-residents during the second quarter of 2010. As a result, the historical seasonal pattern of relatively low tourist spending in the second quarter, largely attributable to the winter season in the southern hemisphere, switched around.

The elevated level of spending by foreign football tourists in the second quarter of 2010 is based on a preliminary estimate of around 200 000 additional foreign tourist arrivals. Early indications suggest that approximately two-thirds of the spending occurred during the second quarter of 2010 as the majority of the 64 games took place during June. The increased spending levels were supported by a large proportion of the potentially high per capita income earners from Europe and the United States as almost half of the 32 participating soccer teams came from these two regions.

Total spending by foreign tourists in the second quarter of 2010 is estimated to have amounted to about R15 billion, of which roughly R3,5 billion could be associated with the sport event. Seasonally adjusted and annualised, the additional spending raised travel receipts by almost 26 per cent from the first quarter of 2010 to the second quarter, and by about 19 per cent when compared with the corresponding period a year earlier. The noticeable increase from the first to the second quarter of 2010 represents the first increase in travel receipts since the fourth quarter of 2008. International tourism was severely affected by the unfavourable global economic environment in 2009.

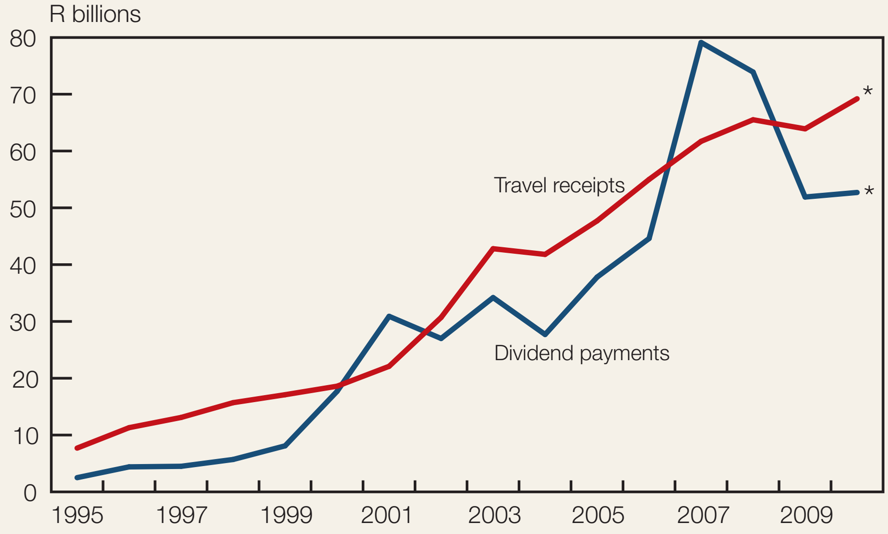
Expenditure by foreign tourists during the soccer event mainly took the form of spending on services such as accommodation, transportation, and food and beverages. Spending on these services is estimated to have collectively accounted for almost 90 per cent of tourism spending, while the remaining 10 per cent was spent on miscellaneous items including gifts, memorabilia and leisure. Although a certain portion of the spending by tourists may have been prepaid, for instance on accommodation, such spending should be recognised against the delivery of the service for eligible inclusion as an international service receipt according to the “accrual” principle applied in the compilation and recording of balance-of-payments statistics.

Travel receipts



Travel receipts accordingly surged to 51 per cent of total receipts for services, income and current transfers in the second quarter of 2010, compared with an annual average of about 42 per cent during the preceding ten years. A further analysis of the composition of the largest inflows and outflows in the overall services account revealed that travel receipts and dividend outflows were the largest items on the opposing sides of the account. During the periods 1995–2000 and 2002–2006, travel receipts fully countered dividend payments. Rising commodity prices, coupled with firm domestic economic growth, caused dividend payments to be much higher than travel receipts in 2007 and 2008. In 2009 the overall deficit on the services, income and current transfer account narrowed as the after-effects of the financial crisis weighed down dividend payments to non-resident investors. This improvement in the account was further complemented by higher travel receipts in the second quarter of 2010. Relative to gross domestic product, the travel receipts increased from 2,4 per cent in the first quarter of 2010 to 2,9 per cent in the second quarter. This magnitude is larger than the typical share of the gross value added of the agriculture, forestry and fishing industry in overall gross domestic product, amounting to around 2,7 per cent.

Travel receipts and dividend payments



* First half of 2010

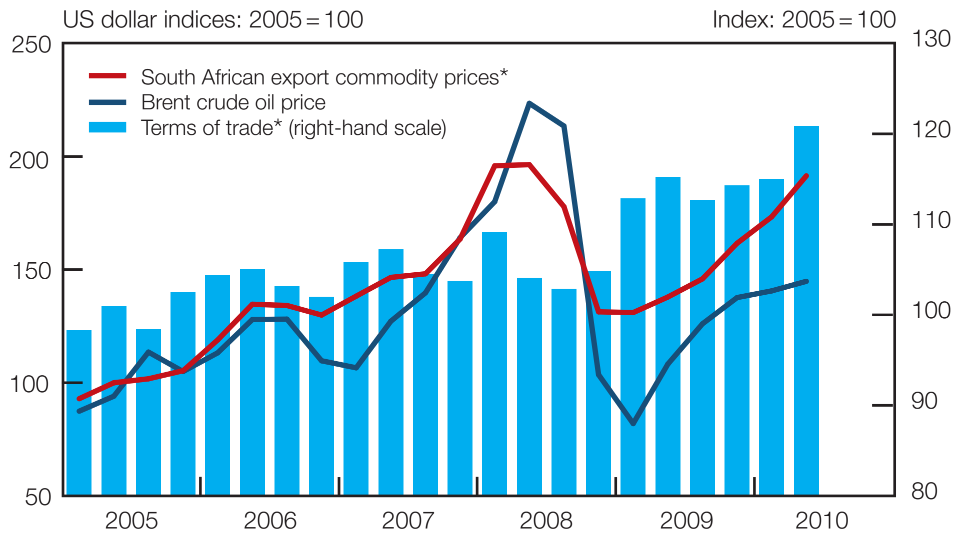
The successful hosting of the 2010 FIFA World Cup™ tournament has made South Africa proud and should help to unleash the potential of the tourism industry, thereby helping to reduce the deficit on the current account.

Although the impact of the tournament on other areas of the balance on the current account seemed to be less prominent, it is probably of value to highlight briefly the extent of receipts in the transportation category. According to the *BPM5*, transportation services include passenger, freight and other transportation services rendered by residents of one economy to residents of another economy. As a result, the use of domestic airlines by foreign tourists to the first point of entry into the country would be captured under the transportation category. At this stage it is estimated that foreign tourists have spent about R2,3 billion on transportation services, representing an increase of 14 per cent compared with the second quarter of 2009.

Following an increase in the first quarter of 2010 from comparatively low levels in the fourth quarter of 2009, gross dividend payments contracted in the second quarter of 2010. Net interest payments to foreign creditors and investors increased marginally over the period. The improvement in the deficit on the overall account was further supplemented by a contraction in net current transfer payments to members of the Southern African Customs Union, consistent with the decline in trade volumes.

South Africa’s terms of trade improved further in the second quarter of 2010 as the rand price of exported goods and services increased further while that of imported goods and services declined marginally. The relatively higher rand price of merchandise exports further supported the improvement in the current-account balance over the period.

Terms of trade and international commodity prices



* Including gold

Financial account

Mounting confidence levels associated with, among other factors, somewhat faster expected growth in emerging-market economies brought about a continuous inflow of capital into South Africa. Inflows on the financial account of the balance of payments (including unrecorded transactions) in the amount of R21,8 billion were recorded in the second quarter 2010 compared with an inflow of R48,6 billion in the first quarter. On a net basis, capital inflows were recorded in the portfolio and other investment categories. The balance on the country's financial account, including unrecorded transactions, amounted to 3,3 per cent of gross domestic product in the second quarter of 2010 compared with 7,8 per cent in the first quarter.

Net financial transactions not related to reserves

R billions

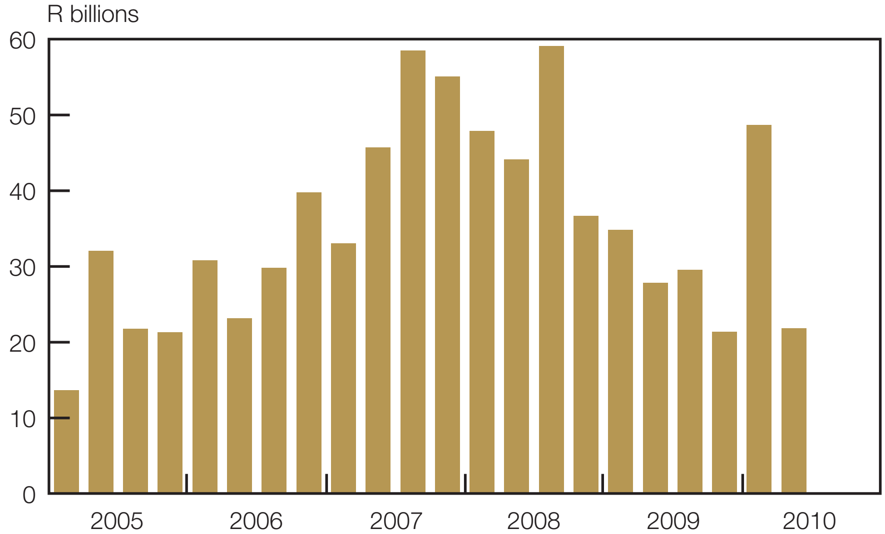
	2009				2010	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	24,9	8,3	4,0	48,3	3,7	1,7
Portfolio investment	29,7	26,3	41,2	107,2	44,1	28,4
Other investment	-27,5	-6,6	-1,3	-42,3	-11,7	-1,5
Change in assets						
Direct investment	-3,7	-2,7	-9,6	-13,5	0,9	-4,2
Portfolio investment	-0,4	-3,6	-9,7	-14,6	-5,5	-2,9
Other investment	4,6	20,1	-1,8	20,7	-1,7	10,1
Total financial transactions*	**27,8**	**29,5**	**21,3**	**113,4**	**48,6**	**21,8**
Financial transactions as a ratio of gross domestic product	*4,7*	*4,8*	*3,4*	*4,7*	*7,8*	*3,3*

* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded a smaller inflow of capital of R1,7 billion in the second quarter of 2010 compared with an inflow of R3,7 billion in the first quarter. The increase in direct investment liabilities in the second quarter of 2010 was mainly due to the acquisition of equity securities in a South African mining company by a non-resident investor.

Balance on financial account



Including unrecorded transactions

As foreign investor sentiment towards emerging-market assets improved, *foreign portfolio investors* increased their holdings of South African equity and fixed interest securities by R28,4 billion in the second quarter of 2010, following an inflow of R44,1 billion in the first quarter. South Africa has recorded an inflow of R179,6 billion in portfolio investment liability capital since the beginning of 2009, of which R98,9 billion arose from the purchase of equity securities and R80,7 billion from the purchase of debt securities.

Other foreign investment into South Africa recorded an outflow of R1,5 billion in the second quarter of 2010 following an outflow of R11,7 billion in the first quarter. The outflow during the second quarter mainly reflected a decrease in non-resident deposits with South African banks, as well as a reduction in loan financing extended to South African banks and despite drawings on long-term loans by parastatals.

South African-owned assets abroad

Direct investment abroad by South African entities recorded an outflow of R4,2 billion in the second quarter of 2010 following an inflow of R0,9 billion in the first quarter of the year. The outflow of capital reflected an increase in the acquisition of foreign entities by South African companies and, in some instances, an increase in their direct investment stake in existing foreign companies.

Portfolio investment abroad (i.e., the acquisition of foreign debt and equity securities) by South African investors came to R2,9 billion in the second quarter of 2010 compared with an amount of R5,5 billion in the first quarter. While South African institutional and individual investors continued to diversify their exposure into foreign portfolio assets, the moderation in the pace of foreign portfolio outflows from the first quarter to the second quarter of 2010 could be ascribed to the volatility in international equity and debt markets following the sovereign debt problems in Europe.

Other outward investment switched around to an inflow of R10,1 billion in the second quarter of 2010 from a capital outflow of R1,7 billion in the first quarter. The inflow of funds in the second quarter was mainly due to a decline in foreign currency deposits with, and loans and advances extended to, foreign banks by the domestic banking sector.

Foreign debt

South Africa's total outstanding foreign debt continued to rise steadily from US$79,3 billion at the end of the fourth quarter of 2009 to US$81,7 billion at the end of the first quarter of 2010. The increase in the country's foreign debt commitments was solely due to an increase in rand-denominated debt. The foreign currency-denominated debt decreased marginally over the period.

The decrease in South Africa's foreign currency-denominated debt during the first quarter of 2010 can mainly be attributed to the decline in foreign claims on the banking sector and to a lesser degree on the public sector. However, the aforementioned decrease was partially countered by the issuance of a US$2 billion bond in the international capital market by the National Treasury. The successful international subscription and issuance of this bond during the period of uncertainty in the global asset market confirmed the positive perception of foreign investors towards South Africa. The country's rand-denominated debt increased during the first quarter of 2010, mainly as a result of the continued net purchases of South African debt securities by non-resident investors in search of higher yield. Non-resident holdings of South African rand-denominated bonds have more than doubled in the year to March 2010.

Foreign debt of South Africa

US$ billions at end of period

	2009				2010
	1st qr	2nd qr	3rd qr	4rd qr	1st qr
Foreign currency-denominated debt...	**41,5**	**41,9**	**42,3**	**42,3**	**42,2**
Bearer bonds	13,3	14,8	15,6	15,4	16,8
Public sector	5,3	5,3	5,8	5,7	5,4
Monetary sector	11,2	10,2	9,4	10,6	9,2
Non-monetary private sector	11,7	11,6	11,5	10,6	10,8
Rand-denominated debt	**26,9**	**32,9**	**34,5**	**37,0**	**39,5**
Bonds	6,6	9,2	9,5	11,6	13,5
Other	20,3	23,7	25,0	25,4	26,0
Total foreign debt	**68,4**	**74,8**	**76,8**	**79,3**	**81,7**
As a percentage of gross domestic product	*26,1*	*28,8*	*29,3*	*27,8*	*26,0*

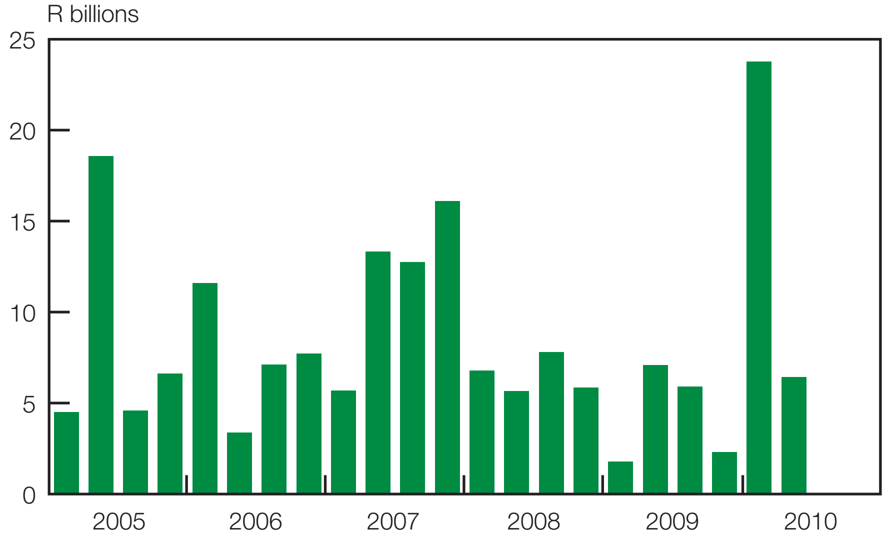
Measured in rand, South Africa's total foreign debt increased from R584 billion at the end of the fourth quarter of 2009 to R599 billion at the end of the first quarter of 2010.

International reserves and liquidity

Net inflows of capital into the South African economy were more than sufficient to finance the deficit on the current account in the second quarter of 2010. The country's net international reserve position consequently improved by R6,4 billion during the period compared with an increase of R23,8 billion in the first quarter.

Measured in US dollar, the value of the gross gold and other foreign reserves of the Bank (i.e., the international reserves before accounting for reserve-related loans) increased marginally from US$42,0 billion at the end of March 2010 to US$42,2 billion at the end of June and further to US$43,1 billion at the end of August. The Bank repaid its outstanding short-term credit facilities during June 2010. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) increased from 20 weeks at the end of March 2010 to 21 weeks at the end of June 2010 as the value of merchandise imports increased at a slower pace than the level of gross reserves.

Change in net foreign reserves



The Bank's international liquidity position remained broadly unchanged at US$38,3 billion from the end of March 2010 to the end of June, before increasing to US$39,2 billion at the end of August. The latter value included on overbought forward position of US$0,5 billion.

Exchange rates

The nominal effective exchange rate of the rand decreased marginally by 0,8 per cent from the end of March 2010 to the end of June, following an increase of 3,9 per cent during the first quarter. The decline in the exchange rate of the rand during the second quarter of 2010 may partly be attributed to international economic developments, especially the sovereign debt crisis in Europe. The exchange rate of the rand performed admirably against the euro during the second quarter of 2010 while it depreciated considerably against the Japanese yen.

The weighted average exchange rate of the rand increased by 1,2 per cent from the end of June 2010 to the end of August partly as a result of US dollar weakness, an unchanged monetary policy stance as announced by the Bank on 22 July 2010 and a further decline in the domestic inflation rate.

Exchange rates of the rand

Percentage change

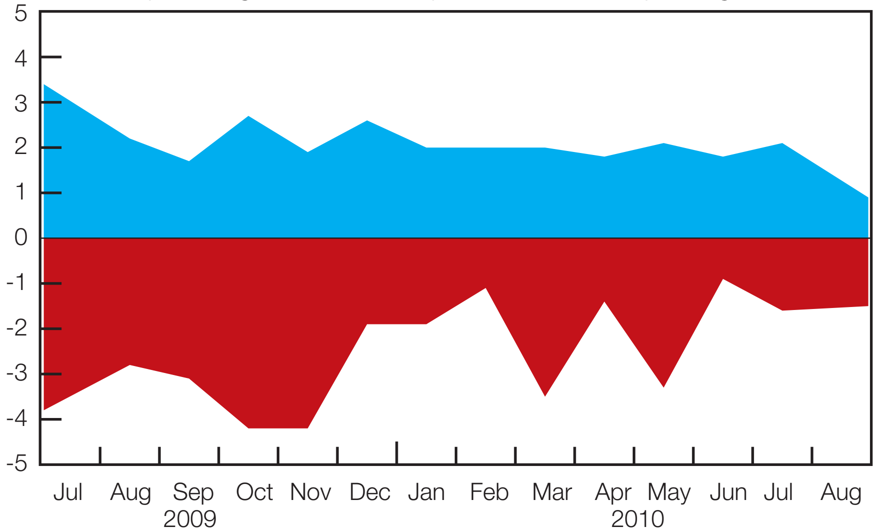
	30 Sep 2009 to 31 Dec 2009	31 Dec 2009 to 31 Mar 2010	31 Mar 2010 to 30 Jun 2010	30 Jun 2010 to 31 Aug 2010
Weighted average*	**1,2**	**3,9**	**-0,8**	**1,2**
Euro	2,0	7,8	5,2	0,0
US dollar	0,5	0,6	-4,2	3,7
Chinese yuan	0,5	0,6	-4,8	4,0
British pound	0,1	7,5	-3,8	1,1
Japanese yen	3,5	1,7	-9,0	-1,4

* Against a basket of 15 currencies

As displayed in the accompanying graph, the nominal effective exchange rate of the rand showed much less volatility during the first half of 2010 compared with the second half of 2009. During the months of January, February, April, June and August 2010 the trade-weighted exchange rate of the rand did not deviate by more than 2 per cent from the mean, while a deviation of more than 2 per cent was observed in all the months during the second half of 2009.

Nominal effective exchange rate of the rand: Variation

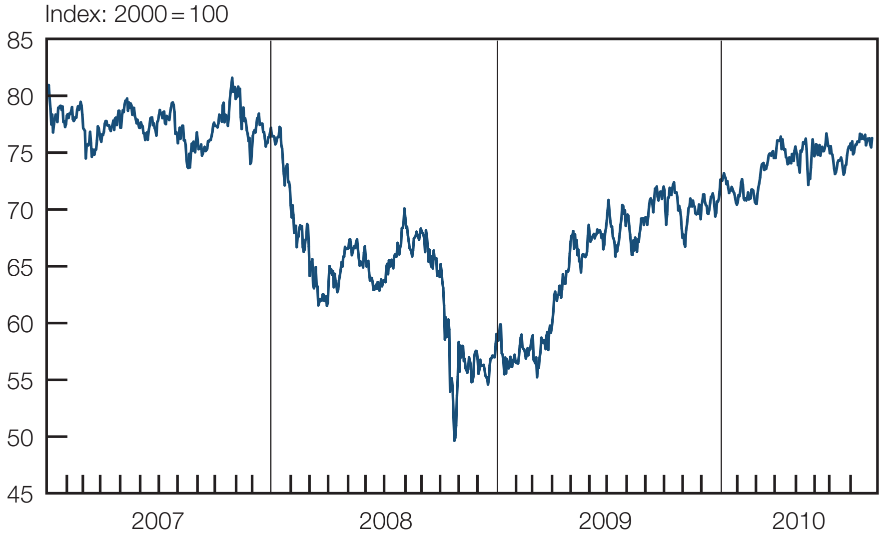
Maximum percentage deviation of daily values from monthly averages



The real effective exchange rate of the rand increased by 11,0 per cent during the 12 months up to June 2010. While the increase in the real effective exchange rate of the rand resulted in a deterioration in the competitiveness of South African exporters, the decline in the volatility of the rand exchange rate provided some stability to business operations and outcomes.

The average net daily turnover in the domestic market for foreign exchange, which decreased to US$14,9 billion in the first quarter of 2010, increased to US$15,3 billion in the second quarter. The increase in the average daily turnover in the domestic market for foreign exchange can be attributed to an increase in resident participation in the foreign-exchange market.

Nominal effective exchange rate of the rand



Monetary developments, interest rates and financial markets

Money supply

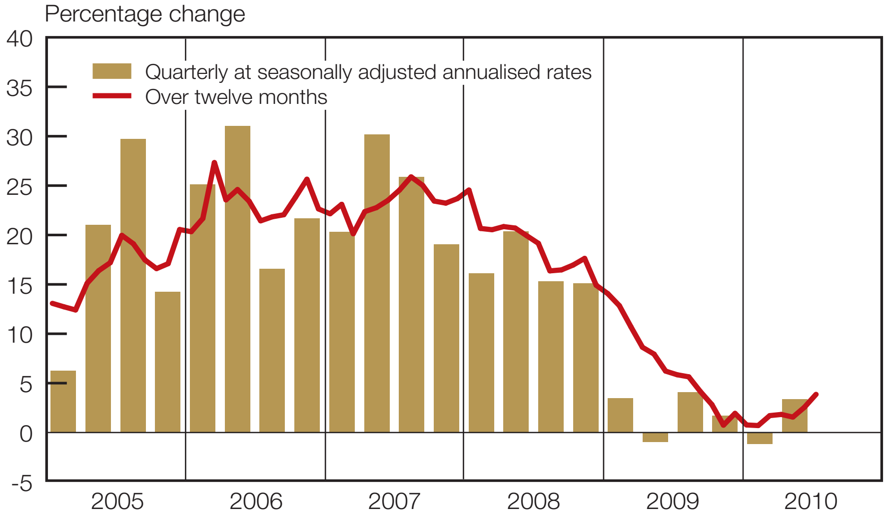
Banking business continued to be constrained by fragile income and balance sheets as a consequence of high household debt levels, elevated impaired advances, weak employment prospects and uncertainty in the global economy. For these reasons growth in the monetary and credit aggregates remained subdued in the first half of 2010, lagging the recovery in economic activity by a substantial margin.

Twelve-month growth in the broadly defined money supply (M3) accelerated from a record low of 0,5 per cent in February 2010 to 3,7 per cent in July, possibly signalling a turnaround in the decelerating growth that commenced in early 2008, and persisted throughout 2009. On a quarterly[4] basis, growth in M3 recovered from a contraction of 1,2 per cent in the first quarter of 2010 to a positive rate of 3,4 per cent in the second quarter.

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

Growth in M3

Percentage change



Growth in cheque and transmission deposits, together with long-term deposits, underpinned the bulk of the increase in the growth in M3 during the second quarter of 2010. By contrast, call and overnight, and other short- and medium-term deposits contracted markedly during the same period. At the same time, notes and coin in circulation also contracted, reflecting a moderation in demand that defied some of the expectations held in connection with the use of cash by football supporters visiting South Africa.

Both the household and corporate sectors contributed to the increase in M3 deposits during the second quarter of 2010. Having risen by R8,9 billion in the first quarter of 2010, the value of M3 deposits increased by a further R25,5 billion in the second quarter, of which the corporate sector accounted for R18,8 billion and the household sector for the balance of R6,7 billion. Twelve-month growth in the M3 deposit holdings of the corporate sector accelerated gradually from growth rates of close to zero at the beginning of 2010 to 2,7 per cent in June and further to 4,2 per cent in July, largely reflecting stronger growth in the deposit holdings of financial companies. At the same time, year-on-year growth in the M3 deposit holdings of the household sector fluctuated in a narrow band of between 1 and 2 per cent during the first six months of 2010 before accelerating somewhat to 2,5 per cent in July.

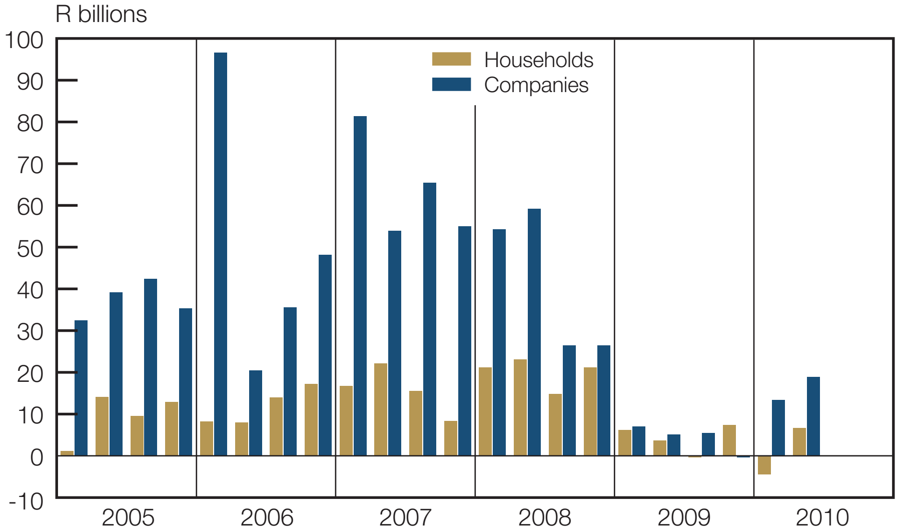
Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2009		2010	
	3rd qr	4th qr	1st qr	2nd qr
Notes and coin	0,5	11,0	17,3	-7,7
Cheque and transmission deposits	10,5	0,2	-7,0	19,6
Call and overnight deposits	12,6	5,6	38,5	-3,8
Other short- and medium-term deposits*	-20,7	-6,0	5,4	-8,9
Long-term deposits**	71,6	23,7	-35,3	16,4
M3	4,1	1,7	-1,2	3,4

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

Contributions to the change in M3 deposits



Statistically, the increase in M3 in the second quarter of 2010 can be explained by significant increases in claims on the private sector and in net other assets and liabilities. Together, these two categories offset the negative growth in net claims on the government sector by a substantial margin. Banks' claims on the private sector continued to increase due to the moderate recovery in the extension of loans and advances. Net other assets increased as growth in other assets exceeded growth in other liabilities, mainly as a result of a rise in loans granted under resale agreements. A high accumulation of government deposits with banks resulted in a decline in net claims on the government sector during the second quarter of 2010.

On an annualised basis, growth in nominal gross domestic product again exceeded the slower growth in M3 during the second quarter of 2010. As a result, the income velocity of circulation of M3 increased further from 1,31 in the first quarter of 2010 to 1,34 in the second quarter.

Statistical counterparts of change in M3

R billions

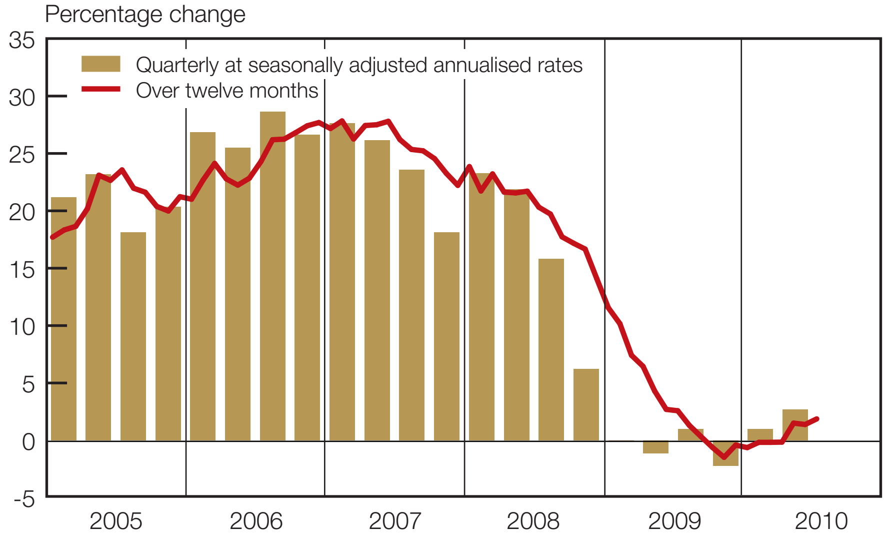
	2009		2010	
	3rd qr	4th qr	1st qr	2nd qr
Net foreign assets	5,3	5,5	42,7	0,5
Net claims on the government sector	21,0	19,3	-30,5	-14,1
Claims on the private sector	-13,6	-0,7	15,6	16,5
Net other assets and liabilities	-7,6	-17,1	-18,9	22,6
Total change in M3	-5,1	7,0	8,9	25,5

Credit extension

Banks' total loans and advances extended to the private sector expanded at a moderate pace during the first half of 2010 after bottoming out in November 2009. The improved growth in total loans and advances appeared against the backdrop of the generally accommodative monetary policy stance and the recovery in economic activity. Growth over twelve months in banks' total loans and advances recovered from an all-time low of minus 1,6 per cent in November 2009, initially remaining in negative territory before returning to positive growth rates of 1,4 per cent in May 2010 and 1,7 per cent in July. On a quarterly basis growth in total loans and advances accelerated from 1,0 per cent in the first quarter of 2010 to 2,7 per cent in the second quarter.

Total loans and advances to the private sector

Percentage change



Mortgage advances remained an important driver of bank credit extension during the second quarter of 2010. However, after responding positively to the recovery in the property market in the first quarter of 2010, growth in mortgage advances lost some momentum during the second quarter. During this period year-on-year growth slowed marginally from 3,9 per cent in January 2010 to 3,4 per cent in June. This is also largely mirrored in the fairly stable level of mortgage advances paid out since the start of the year, despite a rise in new applications received. In July growth over twelve months came to 4,0 per cent.

Quarterly changes in banks' total loans and advances by type

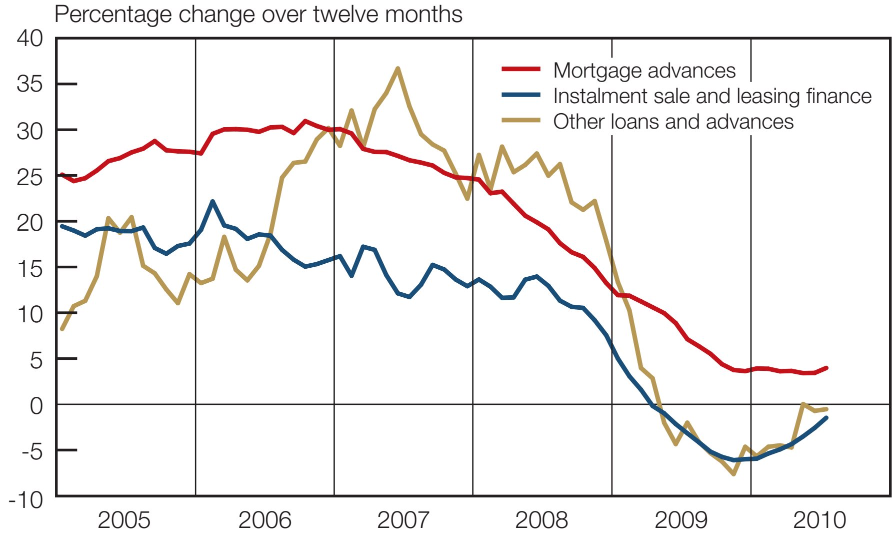
R billions

	2009		2010	
	3rd qr	4th qr	1st qr	2nd qr
Mortgage advances	4,2	8,3	14,7	6,8
Instalment sale credit and leasing finance	-4,3	-1,9	-0,8	0,8
Other loans and advances	-4,8	-5,8	0,3	5,7
Overdrafts	-4,8	-5,6	1,5	-3,8
Credit card advances	0,5	-1,2	0,3	0,0
General advances	-0,5	1,0	-1,4	9,5
Total loans and advances	**-4,9**	**0,6**	**14,1**	**13,3**
Of which: To household sector	7,4	5,7	19,1	11,2
To corporate sector	-12,3	-5,1	-4,9	2,1

Since December 2009 there has been an improvement in the extension of *instalment sale credit and leasing finance*. Twelve-month growth in this credit category reached a low of minus 6,1 per cent in November 2009 before recovering to a still negative rate of 1,5 per cent in July 2010, mainly due to the growth in instalment sales. The improvement in this credit category occurred alongside the steady growth in the demand for motor vehicles since the revival of activity in the automobile industry from the third quarter of 2009. By contrast, *leasing finance* has shown a steady decline since the implementation of the National Credit Act in June 2007.

Loans and advances to the private sector by type

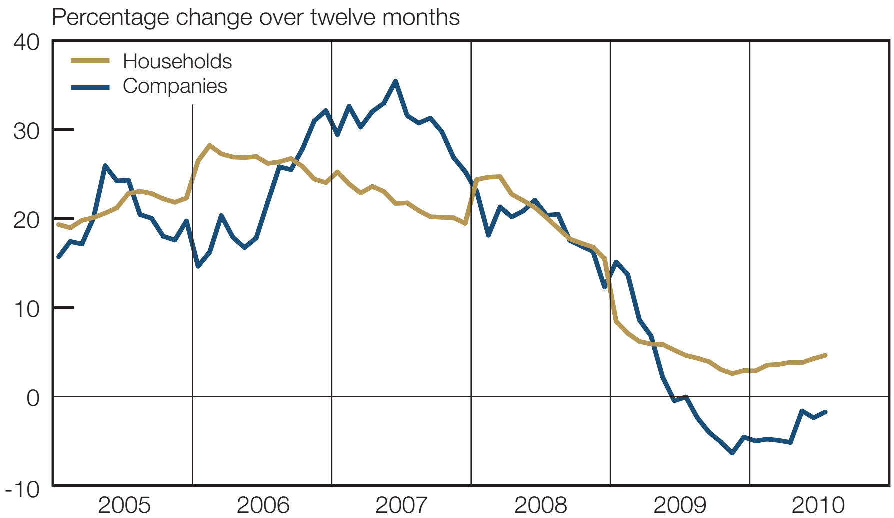
Percentage change over twelve months



Following a long period of declining utilisation of bank credit by the corporate sector, *other loans and advances* briefly recovered from a contraction of 4,7 per cent in April 2010 to a marginally positive twelve-month growth rate in May, before again recording a moderate decline in June and July. The improvement in other loans and advances flowed from the increased utilisation of general loans, which swung around from a negative twelve-month growth rate of 7,9 per cent in November 2009 to a positive 2,1 per cent in July 2010.

The growth in banks' total loans and advances extended to the private sector was again dominated by demand from the household sector during the second quarter of 2010, a continuation of the trend established in the third quarter of 2008. However, the contribution of the household sector to the growth in total loans and advances slowed from R19,1 billion in the first quarter of 2010 to R11,2 billion in the second quarter, while the corporate sector's reliance on bank credit bounced back from a contraction of R4,9 billion in the first quarter to an increase of R2,1 billion in the second quarter. Twelve-month growth in total loans and advances extended to the household sector accelerated from 2,9 per cent in January 2010 to 4,6 per cent in July. Correspondingly, growth over twelve months in credit extended to the corporate sector improved from a negative 5,0 per cent to a negative 1,7 per cent over the same period.

Loans and advances to households and companies

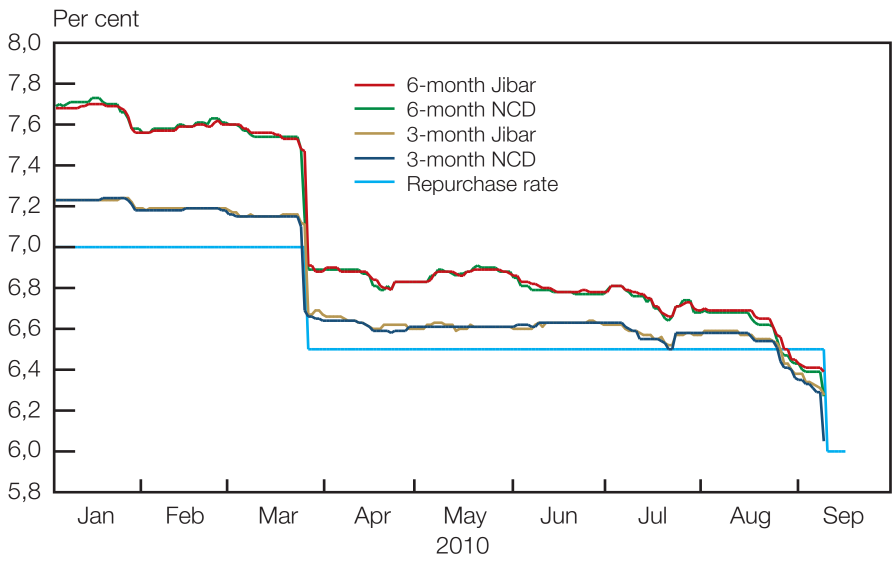


Interest rates and yields

Subsequent to a reduction of 50 basis points at its March 2010 meeting, an unchanged monetary policy stance was deemed appropriate by the Monetary Policy Committee (MPC) at its ensuing meetings and the repurchase rate was maintained at a level of 6,50 per cent up to early September. At its September meeting the MPC reduced the repurchase rate to 6,00 per cent, its lowest level since late 1980. The domestic inflation outlook remained favourable with CPI inflation expected to stay within the inflation target range over the monetary policy projection time horizon. Risks to the inflation outlook included, on the one hand, high wage inflation and administered price increases and, on the other, the strengthening of the exchange value of the rand, while it was noted that the domestic economy remained vulnerable to global uncertainties. The MPC statements discussing developments underlying recent monetary policy decisions are reproduced in full later in this *Bulletin*.

Money-market rates remained fairly stable during the second quarter of 2010, with slightly higher movements registered across longer-dated instruments. For example, rates on six-month negotiable certificates of deposit (NCDs) fluctuated in a broad range between 6,77 per cent and 6,90 per cent during the second quarter of 2010. The three-month Johannesburg Interbank Agreed Rate (Jibar), however, remained relatively stable from the beginning of April 2010 to the end of June, declining by only 4 basis points overall to end the month of June at 6,62 per cent. Subsequently, the Jibar declined by a considerable 22 basis points to 6,38 per cent on 31 August 2010 when market participants discounted the possibility of a repurchase rate cut at the September MPC meeting. The rate stood at 6,31 per cent on 8 September 2010.

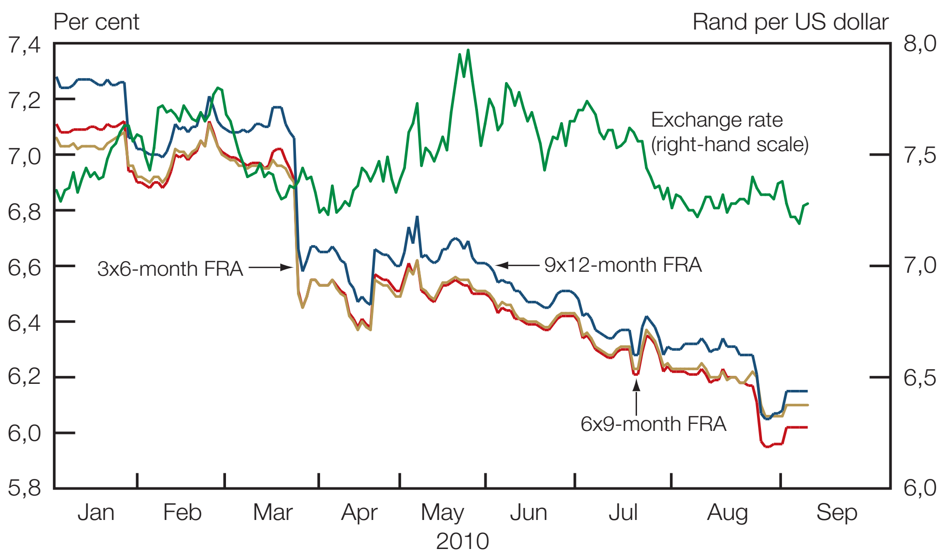
Money-market rates



The 91-day Treasury bill rate exhibited similar behaviour and declined by only 5 basis points overall for the quarter under review to end the month of June at 6,54 per cent, aligned with an increase in demand for these instruments. The Treasury bill rate then declined further by 27 basis points and stood at 6,27 per cent on 8 September 2010.

Rates on forward rate agreements (FRAs), which depict market expectations of future interest rates, broadly tracked the movements in the exchange rate of the rand between April and May 2010, becoming relatively volatile when global risk aversion increased following adverse developments in the euro zone in particular. However, favourable inflation developments caused FRA rates to trend downwards from the beginning of June, anticipating the possibility of a repurchase rate cut ahead of both the July and

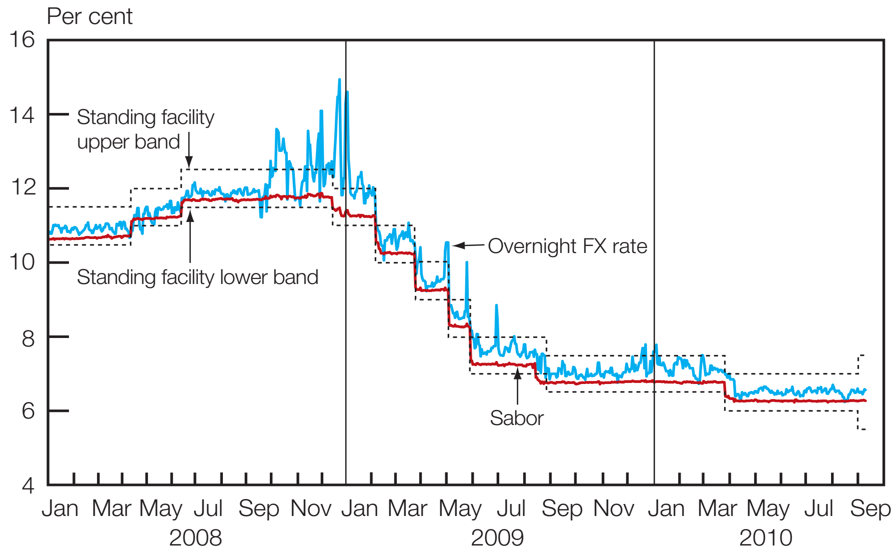
Forward rate agreements and the exchange rate



September MPC meetings. Prominent movements were recorded by the 9x12 FRAs which declined by 37 basis points to 6,28 per cent on 20 July, before increasing to 6,42 per cent on 24 July following the MPC decision to keep the monetary policy stance unchanged. Subsequently, the rates declined by a further 27 basis points ahead of the September MPC meeting and stood at 6,15 per cent on 8 September.

The South African Benchmark Overnight Rate on Deposits (Sabor) displayed limited volatility, varying within a range of 10 basis points while remaining well within the standing facility band during the second quarter of 2010. The Sabor fluctuated between a minimum of 6,23 and a maximum of 6,33 per cent from the beginning of April 2010 to the end of August, reflecting the orderly conditions that prevailed in the interbank market, and stood at 6,28 per cent on 8 September 2010. The implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) declined considerably by 45 basis points during the first week of April 2010 to 6,39 per cent on 7 April 2010, and continued to vary within a broad range of between 6,32 per cent and 6,65 per cent during the period under review, occasionally breaching the lower standing facility limit due to short-term fluctuations in liquidity. On 8 September 2010 the rate stood at 6,58 per cent.

Benchmark overnight rates



The prime overdraft rate and the predominant rate on mortgage loans had remained unaltered at 10,00 per cent since the 50 basis point reduction in March 2010, but were adjusted to 9,50 per cent in September following the reduction of the repurchase rate.

Interest rates on the *RSA government fixed-rate retail bonds* are reviewed by the National Treasury on a monthly basis with reference to yields in the wholesale market. Changes since mid-2009 are depicted in the accompanying table.

Interest rates on RSA government fixed-rate retail bonds

Per cent

Effective from	2-year bond	3-year bond	5-year bond
1 Jul 2009	9,25	9,50	9,75
1 Oct 2009	8,75	9,00	9,25
1 May 2010	8,50	8,75	9,00

The *daily average yield on the R157 government bond* (maturing in 2014/15/16) fluctuated lower from a recent high of 8,61 per cent on 12 January 2010 to 7,26 per cent on 6 September, following the release of better-than-expected consumer inflation data, the appreciation in the exchange value of the rand and strong non-resident demand for domestic bonds. Similarly, the daily closing yield on five-year US government dollar-denominated bonds declined by 101 basis points and that on German government euro-denominated bonds by 119 basis points over the same period. The resultant spread between South African bond yields and international bond yields therefore narrowed marginally, comparing the beginning of 2010 and early September.

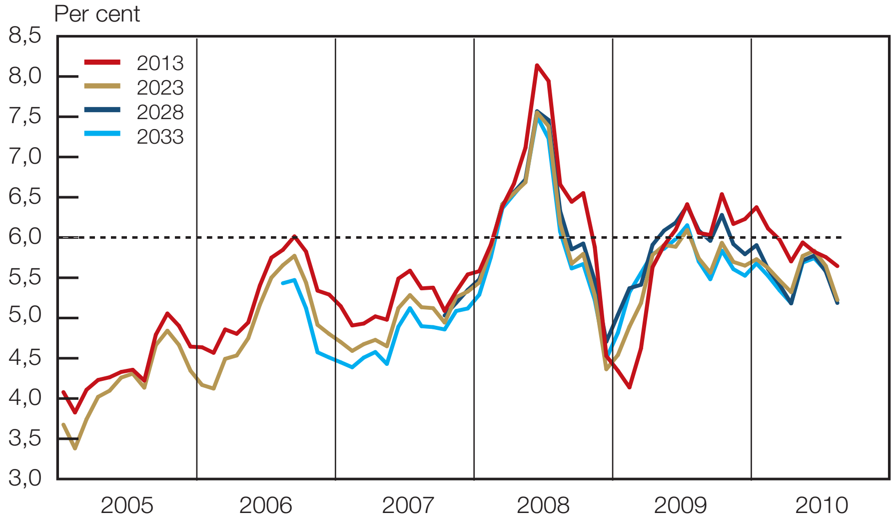
5 The differential between the yields at the extreme long and short ends of the curve.

From 14 January 2010 to 6 September the changes in the overall level of yields led to a downward shift in the *yield curve* across all maturities. Yields on securities at the short end of the maturity spectrum declined by 48 basis points, reflecting easier monetary conditions, while bond yields at the long end declined by a higher 116 basis points on lower inflation expectations following the release of favourable inflation data and the appreciation in the exchange value of the rand. The *yield gap*,[5] therefore, narrowed from 236 basis points on 14 January 2010 to 168 basis points on 6 September.

6 The differential between the nominal yield on conventional bonds and the real yield on inflation-linked bonds within the three-year maturity range.

The resilience of the exchange value of the rand and the release of lower consumer inflation data resulted in the *break-even inflation rate*[6] fluctuating lower from a monthly average of 6,38 per cent in January 2010 to 5,64 per cent in August, as the nominal yield on the conventional government bond declined more pronouncedly than the real yield on the inflation-linked government bond. Break-even inflation rates across all maturities currently indicate inflation expectations that are consistent with the inflation target range of 3 to 6 per cent.

Break-even inflation rates at various maturities



7 The differential between South African government bond yields on rand-denominated debt issued in the domestic market and on dollar-denominated debt issued in the United States in the four-to-five-year maturity range.

The *currency risk premium*[7] on South African government bonds widened from 404 basis points in April 2010 to 477 basis points in June, as the dollar-denominated yield declined while the rand-denominated yield increased. Although the dollar-denominated yield continued lower, the currency risk premium then narrowed to 454 basis points in August following a more pronounced decline in the rand-denominated yield.

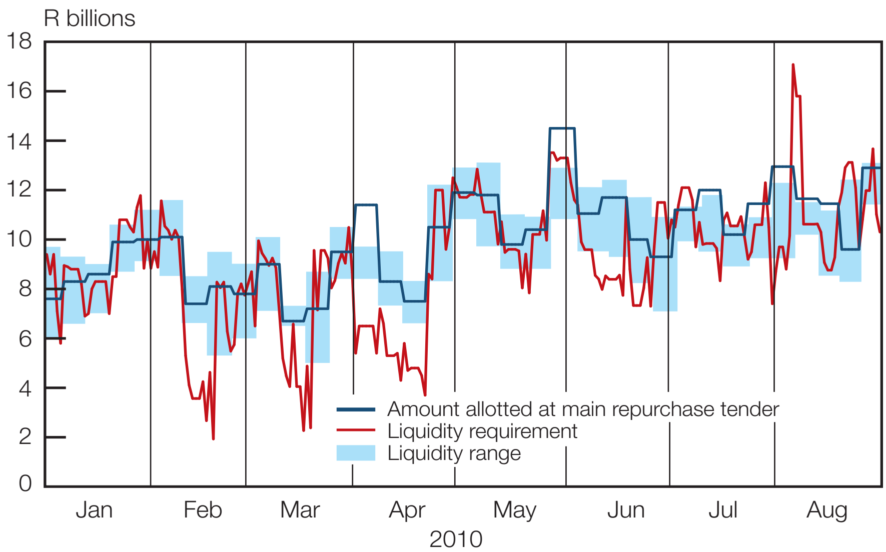
Investors' confidence in emerging markets initially deteriorated somewhat, as indicated by the widening of the JPMorgan Emerging Markets Bond Index Plus (EMBI+) yield spread (above US Treasury yields) from 251 basis points in March 2010 to 337 basis points in June. The spread, however, narrowed again to 303 basis points in August 2010.

During the past 17 months, the narrowing of the *sovereign risk premium* on the South African government US dollar-denominated bonds in the four-year maturity range trading in international markets was interrupted when the spread widened from 102 basis points in April 2010 to 219 basis points in June along with some renewed risk aversion. Subsequently, the sovereign risk premium narrowed again to 183 basis points in August.

Money market

Money-market conditions were characterised by volatility in the daily liquidity requirement of the private-sector banks during the first two quarters of 2010. During this period an increase in issuance of Treasury bills by the National Treasury coincided with a reduction in issues of South African Reserve Bank (SARB) debentures and a decline in long-term reverse repurchase transactions, reducing the drainage effect of the latter instruments in the money market. The daily liquidity requirement fluctuated within a range of R5,1 billion to R12,6 billion during the second quarter of 2010, comparable to a range of between R2,9 billion and R10,3 billion observed during the first quarter. The liquidity provided by the Bank at the weekly main refinancing auctions varied between R7,5 billion and R14,5 billion over the same period, as illustrated in the accompanying graph.

Liquidity requirement, range and amount allotted



During the second quarter of 2010 liquidity to a net amount of R0,2 billion was injected into the money market compared with a net drainage of R3,8 billion in the first quarter. Notes and coin in circulation, and foreign-exchange transactions entered into by the Bank injected liquidity to the value of R11,9 billion into the money market. The liquidity injection was neutralised, to some extent, by an increase in deposits by the government and cash reserve deposits of banks with the Bank, jointly amounting to R7,9 billion. The use of liquidity management instruments (reverse repurchase transactions and SARB debentures) also assisted in draining liquidity to the net value of R5,3 billion.

At the end of August 2010 the Bank implemented certain changes to its monetary policy operational procedures. This included the use of longer-term foreign-exchange swaps with maturities of up to 12 months as an instrument to manage money-market liquidity more effectively. The consequence of conducting longer-term foreign-exchange swap transactions to drain liquidity from the market is that the Bank will reflect an overbought forward position on its monthly releases of official gold and foreign-exchange reserves. In addition, the practice of announcing the estimated ranges of the weekly liquidity requirement was discontinued, and the spread between the rates for standing facilities and the repurchase rate was widened from 50 basis points to 100 basis points below and above the prevailing repurchase rate.

Capital redemption and coupon interest payments on various government bonds amounting to R9,7 billion were effected from the government tax and loan account during the second quarter of 2010, with only R0,1 billion of this amount accruing to the Bank's own bond portfolio.

Money-market liquidity flows

R billions (easing+ tightening-)

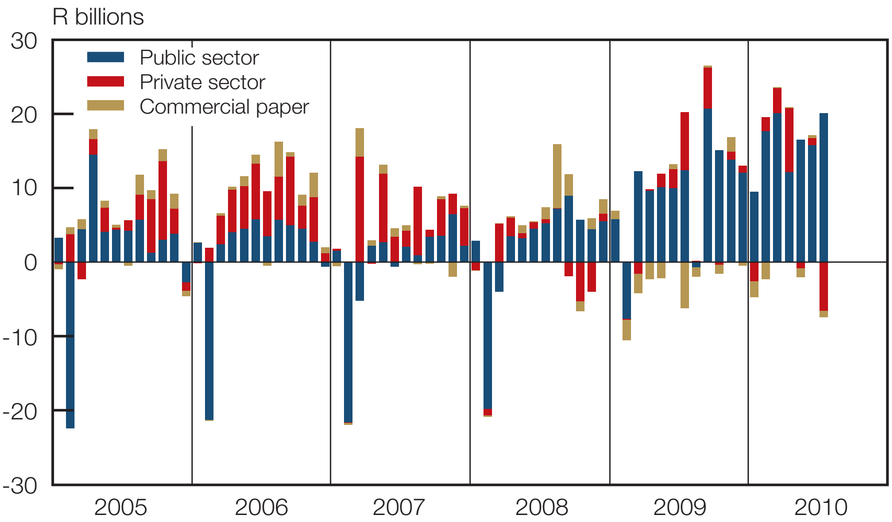
	2010	
	1st qr	2nd qr
Notes and coin in circulation	2,1	2,0
Required cash reserve deposits	-0,3	-1,7
Money-market effect of SARB* foreign-exchange transactions	8,2	9,9
Government deposits with SARB	-22,1	-6,2
Use of liquidity management instruments	-3,8	-5,3
Reverse repurchase transactions	-1,7	5,3
SARB debentures	-2,1	-10,6
Other items net**	12,1	1,5
Banks' liquidity requirement (decrease + increase –)	-3,8	0,2

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

Bond market

The *primary bond market* was quite active in the first seven months of 2010, dominated by public-sector issuances. Net issues of R111 billion were made by the public sector in the first seven months of 2010, compared with net issues of R52,4 billion in the same period of 2009. Issuances of bonds by the private sector also progressed in 2010, although at a slower pace, as net issues of R4,5 billion in the first seven months of 2010 were lower than net issues of R10,8 billion recorded in the same period of 2009. Including net redemptions of R5,8 billion in commercial paper, the total nominal value

Net issues in the primary bond market



of debt instruments issued increased by R110 billion thus far in 2010 to reach R1,0 trillion at the end of July, some 21 per cent higher than in July 2009.

The debt crisis in the euro area continued to depress the supply of, and demand for, rand-denominated bonds in the *European bond markets*, while issues in the *Japanese Uridashi bond market* continued sturdily during the first eight months of 2010. Net redemptions of rand-denominated bonds issued in both markets amounted to R17,3 billion in the first eight months of 2010, following record-high redemptions in rand-denominated bonds issued in the Uridashi bond markets, as shown in the table below.

Rand-denominated bonds issued in international bond markets, January to August

R millions

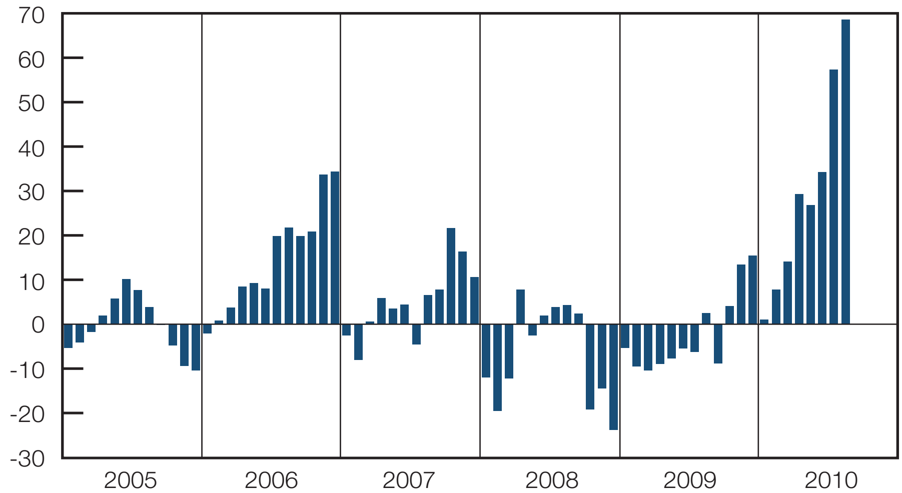
	Eurorand		Uridashi		Total	
	2009	2010	2009	2010	2009	2010
Issues	1 004	4 416	12 827	14 572	13 831	18 988
Redemptions	9 170	16 673	6 882	19 599	16 052	36 272
Net	-8 166	-12 257	5 944	-5 026	-2 222	-17 283

As activity in the secondary bond market gathered momentum during 2010 alongside higher bond prices, *turnover* of R11,6 trillion in the first eight months of 2010 was 15 per cent higher than the value traded in the corresponding period of 2009. The upward bias in turnover was also evident in the daily average turnover during 2010, that reached a high of R86,8 billion per day in August – the highest daily average since August 2009.

Non-residents continued to prefer domestic debt securities to domestic equities, with net purchases of bonds amounting to R20,1 billion in the second quarter of 2010. They increased their holdings by a further R34,4 billion in July and August, recording all-time monthly high net purchases in July. Non-residents' increased local debt securities exposure continued as South Africa offered higher bond yields amid the nervousness and uncertainty associated with the European sovereign debt crisis. Cumulatively, non-residents' net purchases of bonds listed on the JSE Limited (JSE) amounted to no less than R68,6 billion

Annual cumulative net purchases of bonds by non-residents

R billions



in the first eight months of 2010, while the participation rate of non-residents averaged 11 per cent. In the corresponding period of 2009, non-residents' net purchases of local debt securities were only R2,5 billion and their participation rate averaged 12 per cent.

Share market

Although R15,1 billion was raised in March 2010 – the highest monthly level since May 2009 – the total value of *equity capital raised* in the domestic and international primary share markets by companies listed on the JSE remained subdued at R37,3 billion in the first seven months of 2010, some 52 per cent lower than the capital raised in the corresponding period in 2009. Companies with primary listings on the JSE contributed 65 per cent of total equity capital raised in the first seven months of 2010, with the resources, financial and industrial sectors accounting for 66 per cent, 17 per cent and 8 per cent, respectively. Capital was mainly raised through rights issues and waiver of pre-emptive rights to the amounts of R16,6 billion and R8,5 billion over this period.

The total *number of companies listed* on the JSE amounted to 407 at the end of July 2010, with 321 companies on the main board, 74 companies on Alt^{X}, 10 companies on the development and venture capital boards and 2 companies on the Africa Board. Total listing activity in the first seven months of 2010 comprised 7 new listings and 10 delistings compared with 5 new listings and 15 delistings recorded over the same period of 2009. Four companies transferred from Alt^{X} to the main board and one company transferred from the main board to Alt^{X} in the seven months to July 2010.

With share prices on average 26 per cent higher, *turnover* in the secondary share market of R2,0 trillion in the first eight months of 2010 was 12 per cent higher than the R1,8 trillion traded in the corresponding period of 2009. Similarly, the daily average turnover recovered to R11,8 billion in the first eight months of 2010, an increase of 14 per cent compared with the R10,3 billion recorded in the corresponding period of 2009.

Mainly reflecting movements in share prices, the total *market capitalisation* of the JSE at month-ends decreased from R6,1 trillion in March 2010 to R5,6 trillion in June, before edging higher to R5,8 trillion in August. Accounting for only 0,2 per cent of total market capitalisation, the combined market capitalisation of companies listed on Alt^{X} declined from R12,9 billion in April 2010 to R10,3 billion in August. Total market liquidity[8] increased from 47 per cent in 2009 to 52 per cent in the first eight months of 2010.

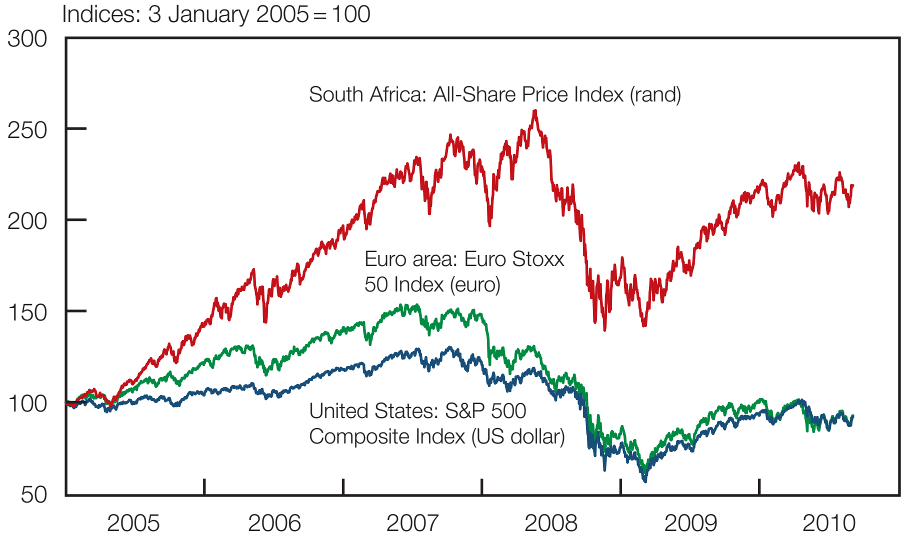
8 The liquidity ratio on the JSE is calculated as the annualised secondary market turnover of shares as a percentage of market capitalisation.

Amid volatile share prices, *non-residents* acquired only R25,7 billion's worth of local equities in the first eight months of 2010, compared with net purchases of R59,9 billion in the corresponding period of 2009. Non-residents' participation in the secondary share market, measured as their purchases and sales as a percentage of total purchases and sales on the JSE, amounted to an all-time low of 13 per cent in May 2010 along with a renewed bout of risk aversion. During the first eight months of 2010, non-residents' participation rate averaged 15 per cent, compared with 18 per cent in the corresponding period of 2009.

The JSE launched the FTSE/JSE Equally Weighted Top 40 Index in July 2010. The constituents of this new index will always be similar to the constituents of the FTSE/JSE Top 40 Index. However, unlike the Top 40 Index where the constituents are weighted according to market capitalisation, each share price has a weight of 2,5 per cent in the new index. The index differs from existing indices, allowing greater risk diversification and benchmarking for performance, particularly in equity portfolios.

Following ongoing concerns regarding the European debt crisis and subsequent slower economic recovery, South African share prices remained volatile along with international equity markets. The *FTSE/JSE All-Share Price Index* (Alsi) fluctuated lower by 12 per cent from its recent high of 29 565 on 15 April 2010 to 26 010 on 1 July, before increasing by 8 per cent to an index value of 27 981 on 6 September. The Alsi was supported by all the major sectors in the market, with the industrial sector recording a gain of 11 per cent from 1 July 2010 to 6 September – outperforming the financial and resources sectors which increased by 8 per cent and 3 per cent respectively. Thus far in 2010 the Alsi, measured in US dollar terms, increased by 4 per cent while the Standard & Poor's (S&P) 500 Composite Index declined by 1 per cent and the Euro Stoxx 50 Index by 7 per cent.

Share prices



The historical *dividend yield* on all classes of shares increased from 1,9 per cent in April 2010 to 2,4 per cent in August. Similarly, the *earnings yield* increased to 5,9 per cent in August 2010, after reaching a record low of 4,8 per cent in February 2010. These increases can be ascribed to lower share prices together with an increase in earnings and dividends declared in the past twelve months. The *price-earnings ratio* for all classes of shares receded from an all-time high of 20,7 recorded in February 2010 to 17,0 in August, but remained above its long-term average of 13,9.

Market for exchange-traded derivatives

Amid the volatile underlying share market, the number of *equity derivatives* contracts traded on the JSE increased by 2 per cent to 99,3 million contracts in the first eight months of 2010 compared with the corresponding period of 2009, contributing to higher turnover in the market.

Although trading activity in *commodity futures and options contracts* on the Commodity Derivatives Division of the JSE increased by 12 per cent to 1,4 million contracts in the first eight months of 2010 compared with the same period of 2009, turnover declined alongside lower domestic grain prices following lower international commodity prices and the appreciation in the exchange value of the rand. The latest *World Agricultural Supply and Demand Estimates* report suggests the continuation of weaker trends in the global consumption and production of agricultural products.

Activity on *Yield-X* strengthened in the first eight months of 2010 as the number of contracts traded was 8 per cent higher compared with the corresponding period of 2009. Movements in foreign-exchange markets encouraged trading in currency futures and options contracts, which continued to dominate activity during the first eight months of 2010. Trade in index and interest rate futures and options contracts contributed the bulk of 47 per cent and 32 per cent of total turnover recorded thus far in 2010.

The number of *warrants* traded during the first eight months of 2010 fell by 41 per cent compared with the corresponding period of 2009, as warrants remained an unfavoured asset class along with low issuances and comparatively high costs. Turnover in all derivatives traded on the JSE during the first eight months of 2010 is indicated in the table below.

Derivatives turnover on the JSE, January to August 2010

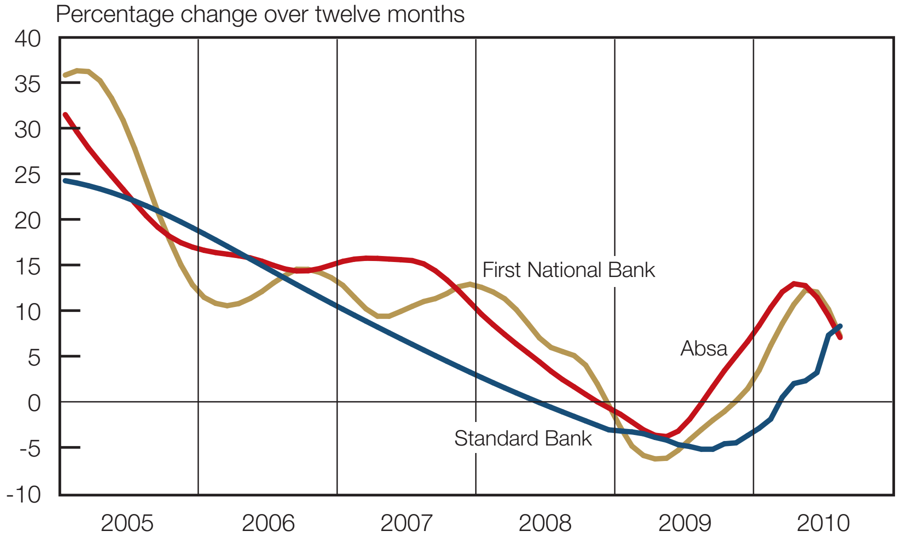
	Value R billions	Change over one year Per cent
Financial futures and options on futures	2 282	24
Warrants	1	-43
Agricultural commodity futures and options........................	146	-9
Interest rate derivatives..	140	41

Real-estate market

From a low base set around mid-2009, domestic house prices picked up significantly, with some barometers of house prices reaching double-digit rates of increase in recent months. After a firm run, however, house price increases lost some of their earlier momentum from the middle of 2010, possibly held back by the still-high levels of household debt, lack of job creation and the related fact that banks have declined around 51 per cent of new bond applications thus far in 2010.

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 3,8 per cent in May 2009 to a positive 12,9 per cent in April 2010, before slowing to 7,1 per cent in August. The year-on-year rate of change in the First National Bank average house price

House prices



improved from a deflation rate of 6,3 per cent in April 2009 to a positive 12,2 per cent in May 2010, before slowing to 7,2 per cent in August. The year-on-year rate of change in the Standard Bank median house price improved from a negative 5,2 per cent in September 2009 to a positive 8,3 per cent in August 2010.

Non-bank financial intermediaries

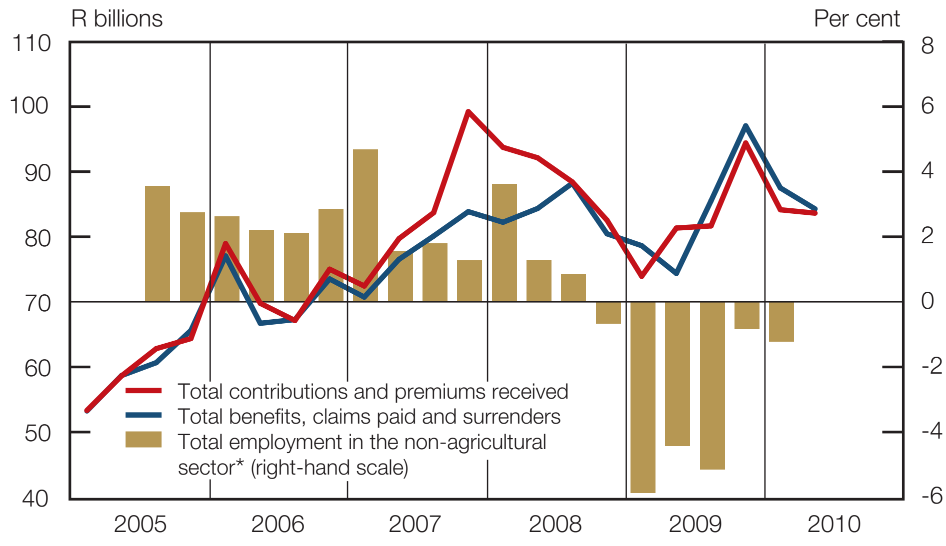
The combined assets of pension and provident funds and long-term insurers account for roughly 77 per cent of the total assets of non-bank financial institutions.[9] Pension and provident funds, and long-term insurers attracted contractual inflows[10] amounting to R83,6 billion in the second quarter of 2010. These inflows reached a record-high of R99,2 billion in the fourth quarter of 2007, alongside higher economic activity. Contractual outflows[11] of these institutions amounted to R84,3 billion in the second quarter of 2010, representing a decline of 4 per cent from the first quarter. In 2009 outflows generally exceeded inflows as the recessionary economic environment culminated in increased benefits and claims paid out to households amid job losses. In the second quarter of 2010, net outflows amounting to R0,7 billion were recorded. Going forward, the current lower interest rate and the pick-up in economic activity are likely to be supportive of inflows.

9 Defined as unit trusts, pension and provident funds and long-term insurers.

10 Consisting of pension funds contributions and insurance premiums received.

11 Consisting of benefits paid, claims paid and surrenders.

Flow of funds: Pension funds and insurers



* Seasonally adjusted quarter-on-quarter percentage change

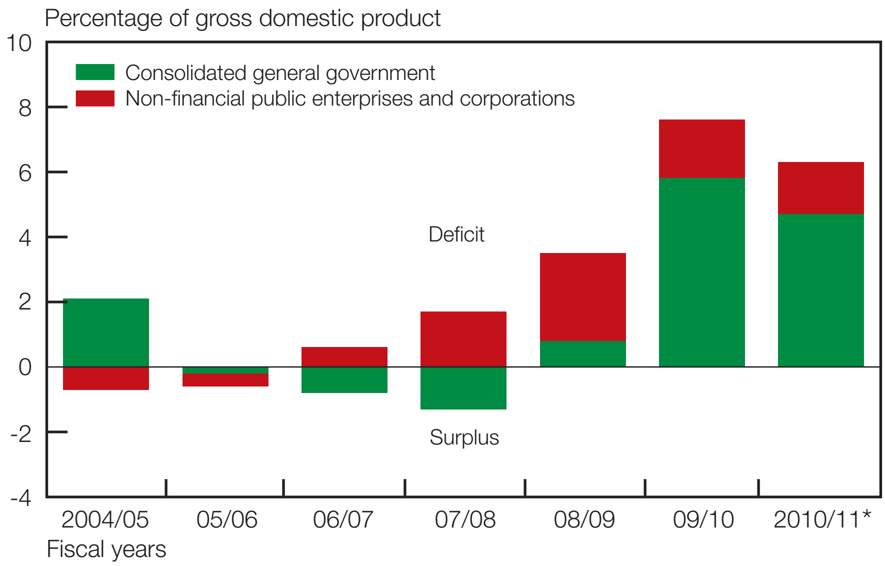
Public finance

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

Non-financial public-sector borrowing requirement[12]

The recessionary forces in the wake of the international financial crisis caused a decline in public-sector revenue which, together with strong expenditure on infrastructure, resulted in the non-financial public sector recording an exceptionally high borrowing requirement in fiscal 2009/10. Government pursued an expansionary fiscal policy to stimulate the economy, and stepped up expenditure to ensure the successful hosting of the 2010 FIFA World Cup™ tournament. Nonetheless, in certain areas spending on infrastructure subsided during the period April–June 2010 as most programmes for the upgrading and building of stadiums and other infrastructure related to the tournament had been completed. Along with improved tax collections, this resulted in the non-financial public sector recording a smaller cash deficit in the first three months of fiscal 2010/11 when compared with the same period a year earlier.

Non-financial public-sector borrowing requirement



* April–June quarter 2010

In the first quarter of fiscal 2010/11, the *non-financial public-sector borrowing requirement* amounted to R41,2 billion – some R11,5 billion lower than in the same period of the preceding fiscal year. The improved borrowing requirement can be attributed to the lower deficit of national government and a turnaround in provincial finances. Social security funds and extra-budgetary institutions recorded surpluses during the period under review.

As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to 6,3 per cent in the April–June quarter of fiscal 2010/11. This was lower than the ratio of 8,9 per cent recorded in the same period of the previous fiscal year. The *Budget Review 2010* projected that this ratio would amount to 10,3 per cent for fiscal 2010/11 as a whole.

The table below summarises the financial activities of the non-financial public sector at various levels of government.

Non-financial public-sector borrowing requirement

R billions

Level of government	Apr–Jun 2009*	Apr–Jun 2010*
Consolidated general government	47,9	30,7
National government	39,9	31,7
Extra-budgetary institutions	-2,0	-0,4
Social security funds	-1,7	-1,9
Provincial governments	2,3	-7,5
Local governments	9,4	8,8
Non-financial public enterprises and corporations	4,7	10,5
Total	52,6**	41,2**
As a percentage of gross domestic product	*8,9*	*6,3*

* Deficit + surplus -
** Components may not add up to totals due to rounding

The *non-financial public enterprises and corporations*' statements indicated that their operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R10,5 billion in the first quarter of fiscal 2010/11. This cash deficit was more than double the cash deficit recorded in the same period a year earlier. Total net investment in non-financial assets amounted to R18,0 billion in the April–June quarter of 2010, compared with R29,8 billion in the corresponding quarter of the previous year. The *Budget Review 2010* estimated that net investment in non-financial assets would amount to R147,0 billion for fiscal 2010/11 as a whole.

Cash receipts from operating activities of *national government* increased by 15,6 per cent in the first quarter of fiscal 2010/11 when compared with the same period a year earlier. Most tax categories showed signs of improvement, which could signal that the economic recovery is gathering momentum. Cash payments for operating activities increased by 7,4 per cent year on year to amount to R184,5 billion in the first three months of fiscal 2010/11. Combining cash flows from operating activities and net investment in non-financial assets resulted in a cash deficit of R31,7 billion in April–June 2010. This was R8,2 billion lower than the cash deficit recorded in the corresponding period a year earlier.

The *Provincial Revenue Fund Statements* indicated a R7,5 billion cash surplus registered by provincial governments in the April–June quarter of 2010. This is a turnaround from the R2,3 billion cash deficit recorded in the same period a year earlier. The *Budget Review 2010* envisaged provincial governments to record a cash surplus of R3,8 billion for fiscal 2010/11 as a whole.

Provincial government revenue – mainly grants from national government – totalled R83,2 billion in the first quarter of fiscal 2010/11 and was 18,5 per cent more than in the April–June quarter of 2009. During the period under review, cash payments for operating activities rose by 7,7 per cent to total R70,6 billion. Of this amount, compensation of employees accounted for the lion's share when compared with other spending categories. Compensation for education and health practitioners recorded an increase of 20,9 per cent when compared with the first quarter of fiscal 2009/10 due to implementation of the occupation-specific dispensation and general salary increases.

Over this period provincial governments' net investment in non-financial assets amounted to R5,1 billion, or 26,7 per cent less than in the April–June quarter of 2009. Provinces increased their deposits with private-sector banks from R8,6 billion to R9,9 billion between March and June 2010. Their overall indebtedness to banks decreased considerably from R2,1 billion to R0,8 billion between these respective dates. Provincial governments' deposits with the Corporation for Public Deposits rose significantly from R0,2 billion to R3,9 billion over the same period.

Extra-budgetary institutions' cash surplus amounted to R0,4 billion in April–June 2010 – substantially lower than the cash surplus recorded in the same period a year earlier. Preliminary estimates indicated that the financial position of *social security funds* improved slightly in the first quarter of fiscal 2010/11, recording a cash surplus of R1,9 billion. This can be compared with a cash surplus of R1,7 billion in the same period a year earlier.

In the April–June quarter of 2010, *local governments'* financial activities resulted in a preliminary cash deficit of R8,8 billion – or R0,7 billion lower than the cash deficit recorded in the same period of the previous fiscal year. This improvement can be ascribed to strong growth in cash receipts buoyed by own revenue collections relative to modest growth in total expenditure as capital spending receded strongly. As a percentage of total revenue, intergovernmental transfers equalled 11,7 per cent during the period under review. In the midst of a somewhat uncertain socio-economic environment that was characterised by poverty and unemployment, service-delivery protests, increased tariffs, and rising levels of outstanding rates and taxes owed to municipalities continued to put pressure on municipal finances.

Net investment in non-financial assets amounted to R10,3 billion in the first three months of fiscal 2010/11 – 10,5 per cent less when compared with the same period a year earlier. The *Budget Review 2010* projected a total amount of R41,3 billion to be spent by local governments on capital-related spending for fiscal 2010/11 as a whole. Although the subdued recovery in the domestic capital market remained fragile, municipalities entered the capital market to fund infrastructure-related expenditure projects. In April 2010 the City of Johannesburg redeemed its first listed bond, valued at R1 billion and issued in April 2004. This brought the cumulative nominal outstanding bond debt issued by municipalities to R10,8 billion at the end of June 2010.

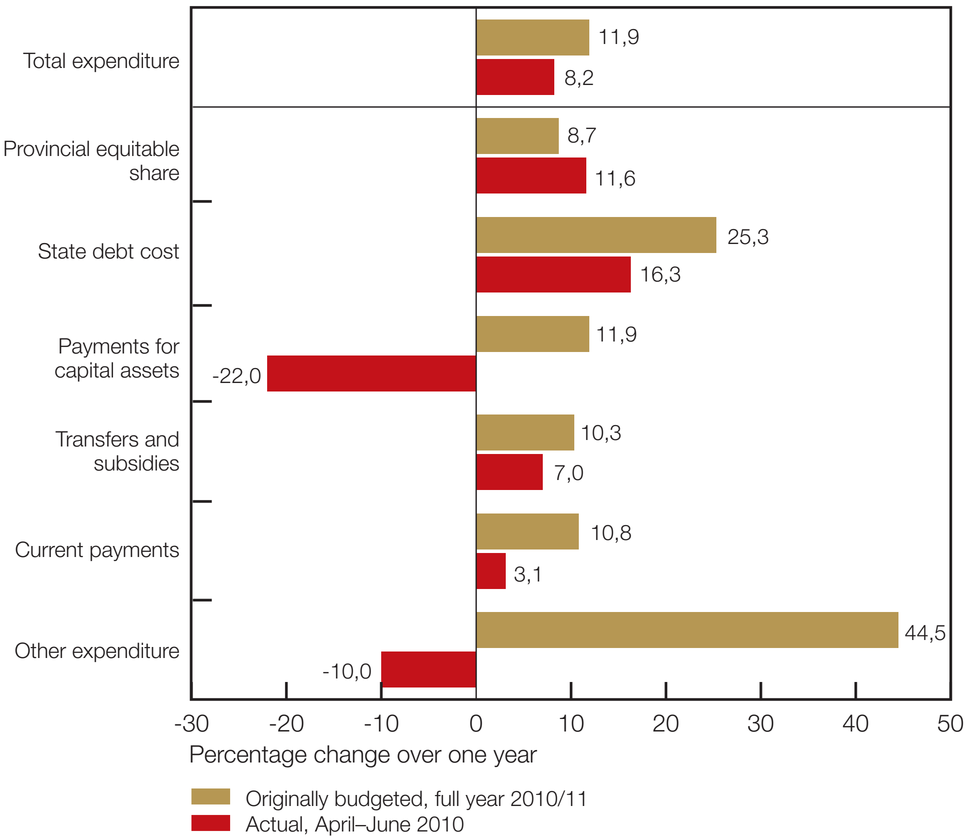
Budget comparable analysis of national government finance

In the first quarter of fiscal 2010/11 national government expenditure amounted to R182,1 billion, or 8,2 per cent more than in the same period a year earlier. Growth in spending was most notable in transfers and subsidies from the Social Services cluster, mainly the Departments of Social Development, Health, and Higher Education and Training. For the period under review, transfers to households by the Department of Social Development increased strongly when compared with the first quarter of fiscal 2009/10. This increase emphasises national government's aim to ensure protection against vulnerability of the poor. The Department of Health paid grants to provinces for HIV/AIDS, training and development of health professionals, and hospital revitalisation, while the Department of Higher Education and Training paid subsidies to higher education institutions. Further contributions were from the Department of Transport, which made transfer payments to provinces, municipalities and public corporations, mainly for public transport infrastructure, road improvements and rail networks. A small portion of the growth in spending was also attributable to the inception of new national departments.

In June 2010 national government transferred R5,0 billion to Eskom as part of the third tranche of a subordinated loan. However, this amount forms part of the financial assets of government and is therefore not included in total expenditure in the GFS[13] analysis.

13 An analysis according to the framework contained in the Government Finance Statistics Manual 2001

National government expenditure in 2010/11



National government expenditure was originally budgeted to amount to R797 billion in fiscal 2010/11, an increase of 11,9 per cent when compared with the previous fiscal year. As a ratio of gross domestic product, national government expenditure amounted to 27,7 per cent in April–June 2010 compared with 28,4 per cent in the same period a year earlier.

During the period under review, interest paid on national government debt equalled R14,3 billion – an increase of 16,3 per cent compared with the same period of the previous fiscal year, resulting from more domestic government bonds and Treasury bills being issued to finance higher expenditure levels.

Equitable share transfers to provinces increased by 11,6 per cent in the first quarter of fiscal 2010/11 compared with the same period a year earlier. Higher equitable share transfers to provinces were earmarked to extend and improve service delivery outcomes in health and education, and put provinces in a better position to help local governments implement the Municipal Finance Management Act.

After taking into account cash-flow adjustments,[14] national government's cash-flow expenditure in the first three months of fiscal 2010/11 equalled R184,0 billion – or 3,7 per cent more than in the same period a year earlier.

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

For the first quarter of fiscal 2010/11 national government revenue amounted to R150,2 billion, a year-on-year rate of increase of 22,7 per cent compared with the same three-month period a year earlier. This increase mirrored improvements in domestic economic activity. National government revenue was originally budgeted to increase by 10,9 per cent to total R643 billion in fiscal 2010/11. As a ratio of gross domestic product, national government revenue amounted to 22,9 per cent in April–June 2010, compared with 20,6 per cent recorded in the same quarter of 2009.

The robust increase in national government revenue was evident in most major tax categories, which reflected the improvement in domestic economic conditions. Taxes on income, profits and capital gains grew by 5,9 per cent year on year in the first quarter of fiscal 2010/11, driven by robust growth in personal income tax collections. Corporate income tax payments rose marginally, suggesting a slow rebound in this tax category.

National government revenue in fiscal 2010/11

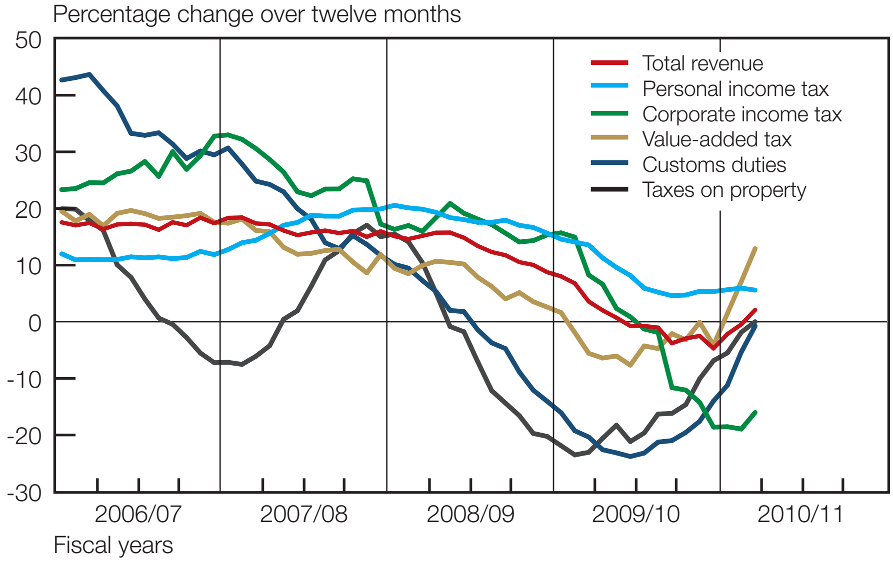
Revenue source	Originally budgeted		Actual Apr–Jun 2010	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	377,7	5,2	89,1	5,9
Income tax on individuals	225,8	9,3	50,2	9,6
Income tax on companies	152,0	-0,4	38,9	1,4
Payroll taxes	8,4	8,4	1,9	4,1
Taxes on property	10,0	12,8	2,2	5,9
Taxes on goods and services	230,6	13,4	52,4	49,4
Value-added tax	164,0	10,9	38,0	61,0
Taxes on international trade and transactions	20,9	7,6	5,0	33,8
Other revenue	10,7	13,1	3,3	32,0
Less: SACU** payments	15,0	-46,3	3,7	-46,3
Total revenue	**643,2**	**10,9**	**150,2**	**22,7**

* Fiscal 2009/10 to fiscal 2010/11
** Southern African Customs Union

During April–June 2010, taxes on goods and services recorded a substantial year-on-year increase of 49,4 per cent, buoyed mainly by value-added tax (VAT) collections. This significant increase owed mostly to the improvement in consumer spending, but also partly to VAT refunds, which decreased by 25,7 per cent year on year. Taxes on international trade and transactions improved due to a recovery in imports and therefore customs duties. This significant increase further signalled a strong recovery in domestic demand. Proceeds from taxes on property increased moderately during the period under review, reflecting signs of recovery in real-estate market activity.

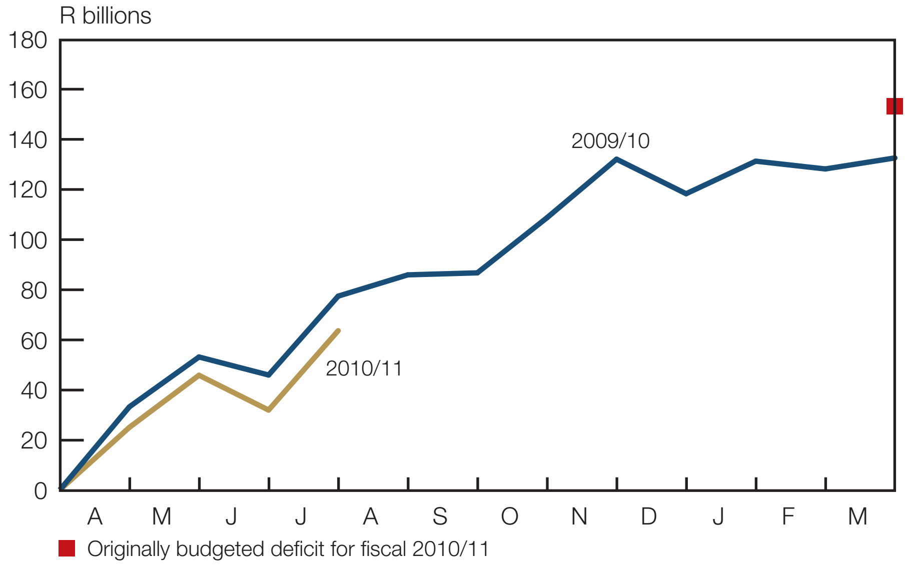
After taking into account cash-flow adjustments, national government's cash-flow revenue equalled R150,2 billion in April–June 2010, or 24,7 per cent more than in the same period a year earlier.

National government rolling twelve-month revenue



The net outcome of national government revenue and expenditure was a cash-book deficit of R31,9 billion in the first quarter of fiscal 2010/11 – some R14,0 billion lower than in April–June 2009, as significantly higher revenue collections outperformed the growth in spending by national government. In February 2010 it was budgeted that the cash-book deficit would amount to R154,0 billion, or 5,7 per cent of estimated gross domestic product for fiscal 2010/11 as a whole. During the period under review, the cash-book deficit amounted to 4,9 per cent as a ratio of gross domestic product compared with a deficit ratio of 7,7 per cent recorded in the first quarter of fiscal 2009/10.

Cumulative deficit of national government



The primary balance[15] amounted to a deficit of R17,6 billion or 2,7 per cent of gross domestic product in the first quarter of fiscal 2010/11. This was lower than the primary deficit of R33,7 billion or 5,7 per cent of gross domestic product recorded in the first quarter of fiscal 2009/10.

15 The deficit calculated by excluding interest payments on government debt from expenditure.

In the first quarter of fiscal 2010/11, the cash-flow deficit before borrowing and debt repayment (shown in the accompanying table) amounted to R33,8 billion – some R23,2 billion lower than in the same period a year earlier.

After taking into account negligible extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement equalled the cash-flow deficit in April–June 2010. This net borrowing requirement was considerably lower than the R53,2 billion recorded in the same period of the previous fiscal year.

The net borrowing requirement was financed through the issuance of debt instruments in the domestic capital market. The dominance of domestic financing over foreign borrowing was testimony to the soundness of the domestic capital market in South Africa. During May 2010, government launched four new bonds – two fixed-income and two inflation-linked – with maturities ranging from seven to thirty years. During June 2010 government raised R3,4 billion from the issuances of these instruments. Net issues of RSA Government Retail Savings Bonds amounted to R0,5 billion, bringing the total balance outstanding of such bonds to R4,7 billion at the end of June 2010.

National government financing in fiscal 2010/11

R billions

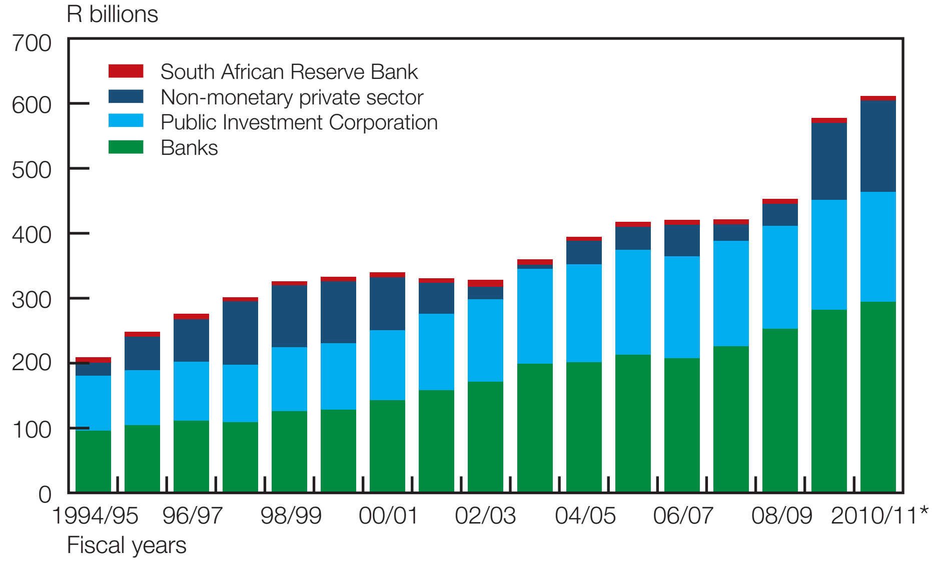
Item or instrument	Originally budgeted 2010/11	Actual Apr–Jun 2010	Actual Apr–Jun 2009
Deficit	174,9[1]	33,8[2]	57,0[2]
Plus: Extraordinary payments	-	0,1	0,0
Cost on revaluation of foreign debt at redemption	0,8	0,2	0,3
Less: Extraordinary receipts	-	0,2	4,1
Net borrowing requirement	**175,7**	**33,8**	**53,2**
Treasury bills	22,0	18,9	26,2
Domestic government bonds	137,7	35,3	19,3
Foreign bonds and loans	12,4	-0,7	6,3
Change in available cash balances[3]	3,6	-19,6	1,5
Total net financing[4]	**175,7**	**33,8**	**53,2**

1 Includes the subordinated loan to Eskom
2 Cash-flow deficit
3 Increase – decrease +
4 Components may not add up to totals due to rounding

Domestic funding from Treasury bills was obtained at an average rate of 6,6 per cent per annum, while domestic long-term nominal yield instruments were sold at an average of 8,8 per cent. The average outstanding maturity of national government's domestic marketable bonds remained unchanged at 122 months between March and June 2010. During this quarter, the distribution of domestic government bonds was spread almost equally between the monetary and non-monetary sectors.

National government recorded net redemptions of foreign bonds and loans to the value of R0,7 billion in the first quarter of fiscal 2010/11. The average outstanding maturity of the foreign marketable bonds of national government decreased from 97 months at the end of March 2010 to 94 months at the end of June, as no new bonds were issued.

Ownership distribution of domestic marketable bonds of national government



As at 31 March of each fiscal year
* As at 30 June 2010

Funding activities increased the available cash balances of national government by R19,6 billion in the first quarter of fiscal 2010/11, bringing these balances to R151,4 billion at the end of June 2010. During the period under review, deposits with the Bank increased by R4,6 billion to R97,9 billion at the end of June 2010.

Domestic debt of national government, as a component of total loan debt, increased from R696 billion to R756 billion between March and June 2010. This increase resulted from higher issuances of domestic debt and the introduction of new instruments to finance the budget deficit. Foreign debt of national government remained broadly unchanged at R99,5 billion between March and June 2010. Total loan debt of national government rose from R796 billion to R856 billion during the period under review. This increase in total loan debt is an indication of the expansionary fiscal policy stance pursued to stimulate the South African economy, following the global economic crisis. Relative to gross domestic product, national government loan debt rose from 32,4 per cent to 34,0 per cent between March and June 2010.

National government finance in July 2010

The trends in the national government finances were broadly sustained when adding the data for July 2010. In the first four months of fiscal 2010/11 national government revenue and expenditure yielded a cash-book deficit of R63,6 billion, some R13,8 billion lower than the deficit recorded in April–July 2009. Higher revenue and slower growth in expenditure contributed to narrowing of the cash-book deficit. After accounting for extraordinary revenue and expenditure, and the cost on revaluation of maturing foreign debt, the net borrowing requirement amounted to R63,3 billion, or R14,6 billion lower than in the first four months of fiscal 2009/10.

Statement of the Monetary Policy Committee

22 July 2010

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

Introduction

International news and discourse are currently dominated by global economic and financial market developments, which continue to weigh on domestic economic growth prospects. Although the immediate concerns relating to the sovereign debt crisis seem to have abated somewhat, significant risks remain. Furthermore, growth in a number of advanced economies appears to be losing some momentum following promising outcomes in the first quarter of the year.

The domestic inflation outlook remains favourable with inflation expected to stay within the inflation target range for some time, against the backdrop of a benign global inflation environment.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas declined to 4,6 per cent in May 2010 from 4,8 per cent in the previous month. The main contributors to the inflation outcome were the categories of housing and utilities (mainly electricity) and miscellaneous goods and services (predominantly insurance costs) which, together, contributed almost 60 per cent to the total inflation outcome. Categories exhibiting very low inflation pressures included food and non-alcoholic beverages, communication and recreation and culture. Indicators of core inflation show that inflation is generally subdued, with CPI excluding food, petrol and energy declining to 4,3 per cent in May compared with 4,7 per cent in the previous month. Inflation excluding all administered prices measured 3,4 per cent.

Producer prices continued the upward trend seen in the past few months, and measured 6,8 per cent in May 2010, compared with 5,5 per cent in April. These increases were driven mainly by commodity and electricity price developments. Food price inflation remained low, with agricultural prices increasing by 0,3 per cent on a year-on-year basis, while manufactured food prices declined by 1,3 per cent over the same period. This suggests that food prices at the consumer level are likely to remain contained for some time.

The outlook for inflation

The CPI forecast of the Bank indicates a relatively unchanged forecast compared with that presented to the previous meeting of the Monetary Policy Committee (MPC). CPI inflation is expected to average 4,5 per cent in the third quarter of 2010, and then increase moderately thereafter. Inflation is expected to remain within the target range during the forecast period, and to measure 5,3 per cent in the final quarter of 2012.

Despite the persistent moderation of inflation within the target range, inflation expectations have remained relatively elevated, albeit with a slight downward trend. According to the survey of inflation expectations conducted by the Bureau for Economic Research (BER) at Stellenbosch University during the second quarter of 2010, average inflation expectations for both 2010 and 2011 have declined by 0,2 percentage points to 6,3 per cent and 6,5 per cent respectively, but have remained unchanged at 6,8 per cent in 2012. Financial analysts are the only category of survey respondents that expect the inflation target to be achieved during the forecast period.

Expectations derived from the markets are similar to those of the financial analysts. The break-even inflation rates, as measured by the yield differential between conventional government bonds and inflation-linked bonds, have declined since the previous meeting of the MPC, and reflect an expectation of the continued attainment of the inflation target over the medium term, although close to the upper end of the range.

The global economic growth outlook remains uncertain. In its July update of the *World Economic Outlook*, the International Monetary Fund raised the forecast for global growth from 4,2 per cent to 4,6 per cent, mainly on the basis of the higher-than-expected performance in the first quarter of the year. However, some moderation is expected in the second half of this year with a high degree of downside risk.

The sovereign debt crisis in Europe appears to have had a short-term respite, but significant longer-term risks and uncertainties persist. The planned fiscal consolidation and austerity programmes in a number of countries are expected to lead to persistently low growth for some time. The economic growth prospects in the United States (US) appear weaker than anticipated, with particular concerns about the continued weakness in the housing market, and an outlook described by US Federal Reserve Chairman Ben Bernanke as "unusually uncertain". At the same time the Chinese authorities have taken steps to moderate the pace of economic growth. The expectation is that we are likely to see an extended period of below-potential growth in a number of regions.

Under these circumstances, global inflationary pressures are expected to remain subdued and are not seen to pose a risk to the domestic inflation environment. The weaker demand conditions are also likely to constrain global commodity price developments, including international oil prices. The price of Brent crude oil has been relatively stable for some time and has averaged around US$74 per barrel since the previous meeting of the MPC, down from the US$82 per barrel average that prevailed during the period between the March and May MPC meetings.

The continued low interest rate environment prevailing in the US and eurozone has resulted in a consistent search for yield, with a number of emerging markets being the recipients of significant capital inflows. South Africa has been no exception. Since the beginning of the year, non-residents have been net purchasers of bonds and equities to the value of around R72 billion, of which about R51 billion were bond purchases.

The rand exchange rate has been relatively volatile in the period since the previous meeting of the MPC, with the rand/dollar exchange rate fluctuating between around R8,10 and R7,43. However, since the beginning of June, the rand has been relatively stable and averaged around R7,60 per US dollar. Much of the underlying volatility can be ascribed to changes in global risk aversion related to events in Europe in particular, which saw a high degree of volatility in the US dollar/euro exchange rate. As a consequence, the rand has fluctuated against other currencies as well. Since the beginning of the year the rand has appreciated against the euro and pound sterling by 9,1 per cent and 2,9 per cent respectively, while it has depreciated by 2,9 per cent against the dollar over the same period. On a trade-weighted basis, the rand has appreciated by about 1,6 per cent since the beginning of the year.

The Bank is very aware of the impact of both the level and volatility of the rand on the economy, particularly the manufacturing, export and import-competing sectors. We are ready to continue to play our part in a considered manner, and discussions with the National Treasury about the various options available to address these issues, as well as the availability of resources to do so are ongoing.

While a range of levels has been proposed by various interest groups or analysts as desired or equilibrium levels – anything from R10,50 to R8,50 against the US dollar – we reiterate that we do not have a target level for the rand. It is very difficult to define with precision the degree of over- or undervaluation of an exchange rate. The approach when assessing this should be guided by a sense of when the value is clearly not consistent with equilibrium, which itself changes from time to time. Moreover, it is important not to underestimate how difficult it is to achieve a particular range of a weaker currency, or how costly this can be. Any actions would also have to be consistent with the inflation target, as there is no point in having a weaker currency if the benefits are simply eroded by inflation.

The recovery in domestic economic growth has continued. Real gross domestic product (GDP) grew at an annualised rate of 4,6 per cent in the first quarter of 2010, driven mainly by the recovery in the manufacturing and mining sectors. However, indications are that second quarter growth was likely to have been less favourable, and the negative output gap is expected to persist for some time. The Bank forecasts economic growth to average around 2,9 per cent during 2010, with the uncertainties emanating from the global economy posing the main downside risks.

The relatively unfavourable outlook can be ascribed in part to an expected slowdown in the manufacturing sector. Growth in this sector in the three months to May 2010 compared with the previous three months measured 1,2 per cent. The Kagiso/BER Purchasing Managers Index has been moderating consistently since its peak in February 2010, and in July the index reflected an expectation of a contraction in the sector. The construction sector also remains under pressure, as evidenced in the 29,9 per cent year-on-year decline in total building plans passed in May. Civil construction is also showing declining activity and, according to the First National Bank (FNB) civil construction survey, the industry is experiencing unsatisfactory business conditions. The Rand Merchant Bank (RMB)/BER Business Confidence Index also declined during the second quarter of 2010. Private sector gross fixed capital formation continued to decline in the first quarter of 2010, albeit at a slower rate of contraction.

There are signs of recovery in domestic household consumption expenditure. In the first quarter of 2010 consumption expenditure grew at a higher-than-expected annualised rate of 5,7 per cent. The recovery was fairly broad-based except for expenditure on services, which remained relatively subdued. The positive trend is expected to have been maintained in the second quarter. Retail trade sales increased at a year-on-year rate of 4,6 per cent in May. However when comparing the three months to May with the preceding three months, an increase of 0,3 per cent was recorded. Consumption expenditure is expected to have received a boost from the 2010 FIFA World Cup™. New vehicle sales increased by 20,7 per cent on a year-on-year basis in June, although they declined by 9,7 per cent relative to the previous month.

The BER retail survey suggests that the outlook for the sector remains fragile. After two consecutive positive quarters, retail business confidence declined in the second quarter of 2010, and overall business conditions, sales volumes and profitability performed worse than expected.

The outlook for household consumption expenditure is being affected by contradictory forces. Positive factors include lower interest rates, lower inflation, positive wealth effects arising from favourable house price and equity market developments, and high levels of real wage increases for those in employment. In the first quarter of 2010 unit labour costs increased by 9,6 per cent compared with the same quarter a year ago. According to Andrew Levy Publications, the average wage settlement rate amounted to 8,2 per cent in the first half of 2010, compared with 9,3 per cent for 2009 as a whole. Wage expectations also remain elevated, according to the BER inflation expectations survey.

Factors constraining consumption expenditure include continued job losses and high levels of household debt and low levels of credit extension to the private sector. According to the Quarterly Employment Statistics survey of Statistics South Africa, employment levels declined further in the first quarter of 2010, as private-sector employment contracted for the seventh consecutive quarter. Youth unemployment is particularly evident.

Growth in bank credit extension to the private sector turned positive in May when growth over twelve months in total loans and advances measured 1,4 per cent, mainly as a result of an increase in credit extension to the corporate sector. Twelve-month growth in mortgage advances has remained stable at levels around 3 per cent since November 2009. There are some indications, as evidenced in the most recent Ernst & Young/BER financial services survey, that in the second quarter of 2010 retail banks loosened their credit criteria somewhat. However, bank lending to consumers may be constrained by the persistently relatively high levels of impaired advances, particularly in relation to retail loans. Demand for loans may also have been negatively affected by the continued high levels of household debt, which measured 78,4 per cent of disposable income in the first quarter of 2010.

The main upside risks to the inflation outlook continue to emanate from cost-push pressures, particularly recent wage settlements and high levels of administered price increases.

Monetary policy stance

The MPC assesses the risks to the inflation outlook as being evenly balanced and views the current monetary policy stance as appropriate. Therefore, the MPC decided to keep the repurchase rate unchanged at 6,5 per cent per annum. The committee is aware of the fragilities and vulnerabilities to the domestic economy, driven in part by global uncertainties. The committee will continue to assess economic and financial developments, and should circumstances warrant it, the appropriate response will be taken, consistent with the Bank’s inflation-targeting mandate.

Statement of the Monetary Policy Committee

9 September 2010

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

Introduction

Since the July meeting of the MPC, domestic inflation has moderated to lower-than-expected levels, and it is anticipated that it will remain within the target range for the rest of the forecast period. Contributing to this development were the further appreciation of the rand exchange rate and the relatively weak domestic demand conditions. The output gap has remained negative and economic growth in the second quarter of 2010 was lower than market expectations. Growth is expected to remain below potential for some time, against the backdrop of a fragile global economy.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas declined to 3,7 per cent in July 2010, compared with 4,6 per cent in May. Goods price inflation measured 2,1 per cent in July, while services inflation, which had been relatively sticky, declined to below the upper level of the target range and measured 5,4 per cent.

The categories of housing and utilities (mainly electricity) and miscellaneous goods and services (predominantly insurance costs) together contributed 2,2 percentage points of the 3,7 per cent inflation outcome. However, electricity price increases were lower than expected. There was also a quick reversal of the influence of the 2010 FIFA World Cup™ on some categories. This was particularly noticeable in the category of hotels which experienced a month-on-month price decline of 11,2 per cent. CPI excluding administered prices measured 2,9 per cent, that is, below the lower limit of the inflation target band.

The recent upward trend in producer price inflation was reversed in July when it measured 7,7 per cent, having peaked at 9,4 per cent in June. Food price inflation remained benign, with agricultural prices increasing by 0,2 per cent on a year-on-year basis, while manufactured food prices declined by 1,0 per cent over the same period. This suggests that food prices at the consumer level are likely to remain contained for some time, notwithstanding higher global food prices.

The outlook for inflation

Partly as a result of the recent lower-than-expected inflation outcomes, the inflation forecast of the Bank was revised downwards, particularly in the short to medium term. Targeted CPI inflation is expected to reach a low point of 3,7 per cent on average in the third quarter of 2010. Inflation is expected to average 4,8 per cent in 2011 and to measure 5,1 per cent in the final quarter of 2012.

The lower inflation trend has had a favourable impact on inflation expectations in the financial markets. Break-even inflation rates, as measured by the yield differential between conventional government bonds and inflation-linked bonds, have declined across all maturities since the previous meeting of the MPC and remain below the 6 per cent level. The Reuters survey of analysts published in September also shows an improvement of expectations, and inflation is expected to average 4,6 per cent and 5,2 per cent in 2010 and 2011 respectively.

The global economic outlook continues to be characterised by heightened uncertainty. Although fears of a reversion to recession in the advanced economies have diminished somewhat, the downside risks remain high. In the course of the year forecasts of global growth have generally been downgraded in the wake of the European sovereign debt crisis, high rates of unemployment in the United States (US) and the euro area, and weak demand in many of the advanced economies. The US economy is expected to experience below-trend growth for some time and doubts remain about the sustainability of the fiscal austerity programmes in some of the southern European economies. A number of Latin American and Asian economies, apart from Japan, have maintained their strong growth performances, but China has experienced a moderate policy-induced slowdown.

While the low-growth global outlook poses a downside risk to prospects for domestic economic growth, inflationary pressures emanating from the advanced economies are likely to remain benign. The hesitant global recovery has also helped to maintain international oil prices in a relatively stable range of between US$70 and US$80 for some time.

These international developments also imply that policy rates are likely to remain abnormally low for an extended period of time in a number of the advanced economies. The resultant search for yield by foreign fund managers has had implications for the rand exchange rate, which remains the main downside risk to the inflation outlook. Since the previous meeting of the MPC, the rand has appreciated by about 4,6 per cent against the US dollar and by 5,6 per cent against the euro. On a trade-weighted basis, the rand has appreciated by 4,0 per cent since the July meeting and by 5,7 per cent since January 2010.

Since the beginning of the year, non-residents have been net buyers of equities and bonds to the value of R100 billion, of which R75 billion were bond purchases. This compares with net purchases of bonds totalling R15,5 billion in 2009 as a whole. Whereas in previous years bond flows appeared to be mainly speculative in nature, the recent developments suggest that there could have been a fundamental shift in these flows. There are indications that a significant proportion of these flows are more long term in nature as foreign pension funds and other fund managers take advantage of higher yields in emerging-market economies. The higher levels of bond market inflows are not unique to South Africa. It is estimated that emerging-market bond funds have recorded year-to-date inflows of US$32 billion, compared with the previous full-year high of US$9,7 billion in 2005.

The appreciating trend of the rand exchange rate has been sustained despite further accumulation of foreign-exchange reserves by the Bank. The Bank does not target a level for the exchange rate, but takes advantage of prevailing conditions to continue to build reserves. However, this is a costly exercise and in order to sterilise the impact on the money market, the Bank is now engaged in longer-term foreign-exchange swap transactions. This, in effect, results in an overbought foreign-exchange position, and adds to the international liquidity position, but not to the gross reserves. Gross reserves will only be affected if and when these swaps are not rolled over, and the Bank takes delivery of the dollars. Any profits or losses will be borne by the National Treasury in keeping with its stated commitment to supporting the Bank in its reserves accumulation efforts.

Domestic economic growth declined in the second quarter of 2010, to a quarter-on-quarter annualised rate of 3,2 per cent, following a growth rate of 4,6 per cent in the previous quarter. The slower growth was due mainly to the 20,8 per cent contraction in the mining sector in this quarter. Growth in the manufacturing sector moderated to 6,9 per cent from 8,4 per cent in the first quarter, while the tertiary sector grew at a rate of 4,0 per cent.

Growth in the second half of 2010 is expected to moderate further. The composite leading business cycle indicator of the Bank declined in May and June, suggesting a slowdown in the pace of recovery in the coming months. Although the Rand Merchant Bank (RMB)/Bureau for Economic Research (BER) Business Confidence Index rebounded markedly in the third quarter following the second quarter decline, the overall index remains below the 50 level, and confidence has remained particularly weak in the manufacturing and construction sectors.

The Kagiso/BER Purchasing Managers' Index increased slightly in August, but it nevertheless points to a deceleration of the growth momentum in the sector. At the same time, manufacturing capacity utilisation, which increased moderately in the second quarter, remains below the long-term average. The construction sector also continues to be under pressure, as evidenced in the low growth in building plans passed, while private-sector gross fixed capital formation is expected to remain subdued. The Bank's forecast of gross domestic product (GDP) growth has declined moderately since the previous meeting of the MPC, with growth now expected to average 2,8 per cent in 2010 and 3,2 per cent in 2011.

Household consumption expenditure has shown some signs of recovery following the contraction during 2009. Growth in real final consumption expenditure by households moderated to an annualised rate of 4,8 per cent in the second quarter of 2010 compared with growth of 5,7 per cent in the first quarter. The impact of the 2010 FIFA World Cup™ on expenditure is unclear at this stage, but some moderation can be expected in coming months. Motor vehicle sales have shown a particularly strong year-on-year recovery, although off a low base. Pre-emptive buying ahead of the introduction of the carbon emissions tax may have contributed to this outcome.

The outlook for household consumption expenditure continues to be affected by contradictory forces. The main negative factors include low levels of credit extension, high levels of household indebtedness, high levels of unemployment and continued job losses.

Underlying credit extension remains weak, but there has been some improvement in the past months. Growth over 12 months in banks' total loans and advances to the private sector measured 1,7 per cent in July; its highest level in over a year. Growth in mortgage advances, which measured 4,0 per cent, was the main driver of this growth. Instalment sale and leasing finance, as well as other loans and advances, continued to contract, but at a slower rate. Within the latter category, general loans exhibited positive year-on-year growth of 2,1 per cent. Growth in the retail portfolios of banks remained weak, and the ratio of impaired advances to gross loans and advances amounted to 5,9 per cent in June, relatively unchanged from the previous quarter. Although banks appear to have relaxed their credit criteria somewhat, they remain relatively cautious and their pricing for risk still appears to be higher than was the case before the crisis.

Consumers are also constrained by high levels of debt, although the cost of servicing the debt has declined in line with lower interest rates. Household debt as a ratio to disposable income has moderated very slowly from its peak of over 80 per cent.

Household consumption expenditure is also expected to be constrained by the continued unemployment trends. According to the Quarterly Labour Force Survey of Statistics South Africa, the unemployment rate increased marginally in the second quarter of 2010 to 25,3 per cent. In the two years to the second quarter of 2010 one million jobs were lost, while the number of discouraged workers increased by 900 000. Consistent with the slowdown in manufacturing and construction, job shedding was most marked in these sectors.

Factors that could provide a positive impetus to household consumption expenditure include lower nominal interest rates, lower inflation, positive wealth effects arising from improving house prices and equity market developments, and high levels of real wage increases for those in employment.

Wealth effects over the past year have been positive, with house prices increasing at year-on-year rates of over 10 per cent. However, in July the rate of increase declined moderately according to both the Absa and First National Bank (FNB) house price indices. The bond market rally has continued, and equity prices have recovered significantly from their lows in the first quarter of 2009, although they remain below pre-crisis levels.

Wage settlements in excess of inflation, while providing a positive impetus to consumption, are also the main upside risk to the inflation outlook. Some wage demands and a number of settlements have been made without regard to the lower inflation outcomes and the improved inflation outlook. Unless accompanied by higher productivity, such settlements could put pressure on domestic prices and impact negatively on our international competitiveness. Such settlements are also likely to have a negative impact on employment trends.

Risks from cost – push pressures are relatively unchanged. Administered price increases, on average, remain at elevated levels and therefore place upside pressures on the inflation outlook. Potential risks emanate from food price increases at the global level, particularly related to wheat prices. However, the impact domestically is expected to be constrained by the relatively strong exchange rate and the recent domestic bumper maize crop.

Monetary policy stance

The assessment of the MPC is that the improved inflation outlook creates sufficient room for monetary policy to provide additional stimulus to the somewhat fragile recovery of the domestic economy, which remains vulnerable to the uncertain global environment.

The MPC has decided to reduce the repurchase rate by 50 basis points to 6,0 per cent per annum with effect from 10 September 2010. The MPC views this action to be consistent with the continued attainment of the inflation target, having given due regard to the risks to the outlook. The scope for further downward movement is seen to be limited, but this will be assessed on an ongoing basis. Our approach remains forward-looking, and is informed by close examination of the data and future developments.

Note on household wealth in South Africa

by K Kuhn

Introduction

Changes in the wealth of the household sector affect final consumption expenditure by households and, accordingly, final demand in the economy. The South African Reserve Bank (the Bank) published official balance-sheet estimates for the household sector for the first time in the June 2006 *Quarterly Bulletin* in an article entitled "Estimating household sector wealth in South Africa" by J Aron, J Muellbauer and J Prinsloo. These estimates, which covered the period from 1975 to 2005, were used as basis for the refinement of the Bank's quarterly estimates of household balance-sheet aggregates for South Africa. Taking account of new sources and standard international practice, the computation of household wealth was enhanced and extended to cover the period since 2005.

The purpose of this note is to highlight the more important refinements made to the computation of household balance-sheet estimates in South Africa, briefly indicating the relevant data sources and to analyse the trends in household wealth since 2005.

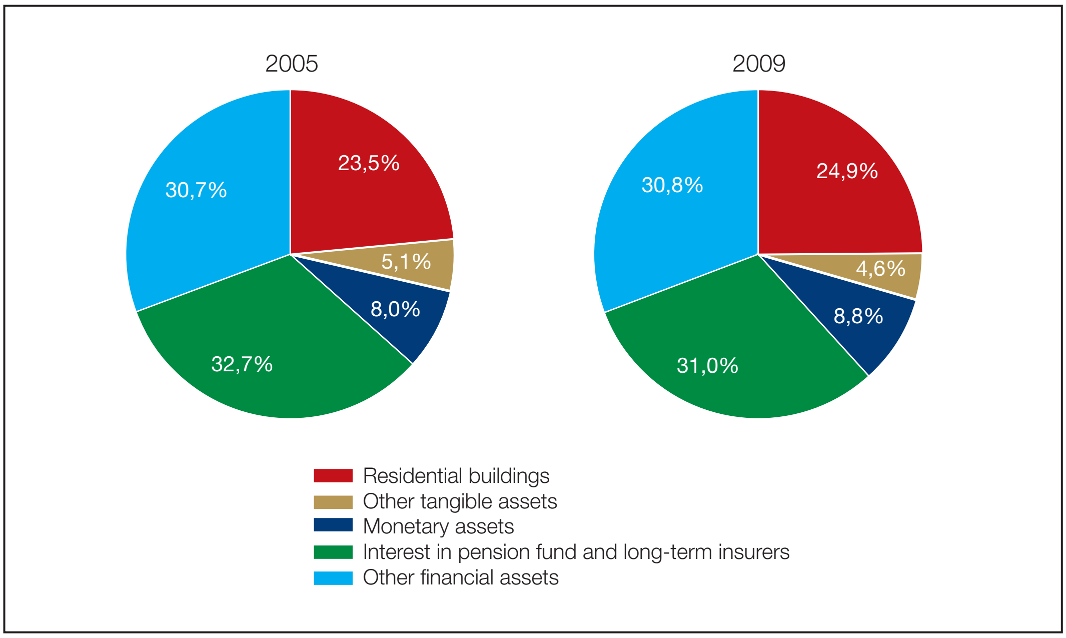
Household balance-sheet aggregates

Assets

Tangible assets

The tangible or non-financial assets of households, non-profit institutions and non-incorporated business enterprises comprise the market value of residential and non-residential buildings, non-agricultural land, construction works (structures), machinery and equipment, computer and related equipment, transport equipment, agricultural land and orchards, and inventories owned by this institutional sector. In total, tangible assets accounted for 29,4 per cent of total household assets in 2009.

Household assets



Balance-sheet estimates for tangible assets were, with the exception of inventories, derived from national accounts capital stock measures. To obtain the market value of these tangible assets, the stock values were multiplied by appropriate asset price indices. The market value of inventories held by the household sector was derived from the book value of the total industry using institutional sector ratios obtained from the Annual Financial Statistics surveys of Statistics South Africa (Stats SA).

Financial assets

The financial assets of the South African household sector comprise assets with monetary institutions; interest in pension funds and long-term insurers; equities, bonds and other domestic financial assets; as well as financial assets abroad. Financial assets constituted 70,6 per cent of total assets in 2009.

Monetary assets

Assets of households with monetary or banking institutions comprise deposits with banks and mutual banks, the Land and Agricultural Bank, and the Postbank. Information concerning deposit holdings was sourced from the Money and Banking Division of the Research Department of the Bank. Estimates were also made of the value of notes and coin in possession of the household sector.

Interest in pension funds and long-term insurers

Households' interest in pension funds includes investment in official and private self-administered pension and provident funds. Data were obtained from relevant institutions submitting information on a quarterly basis to the Bank.

Equities, bonds and other domestic financial assets

The household sector's investment in this group of assets comprises investment in government and public enterprise stock, deposits in participation mortgage-bond schemes, corporate bonds and equities and other, mainly longer-term, deposits. Information is primarily sourced from data submitted to the Bank.

The stock of shares owned by the household sector was estimated by using the flow-of-funds data of ordinary shares held by households. The conversion from book to market value of stocks was done by using the JSE All-Share Price Index, adjusted for trading or management costs.

The market value of the household sector's investment in collective investment schemes was classified as part of equity investment. Investment in such schemes was, however, kept tracked separately to avoid double counting.

In addition, deposits with non-bank financial institutions such as the Public Investment Corporation and with buy-aid associations were incorporated.

Foreign assets

Information regarding the stock of foreign assets owned by the household sector was sourced from the Balance of Payments Division. Among other sources, data were obtained from the Co-ordinated Portfolio Investment Survey conducted annually by the Bank under the auspices of the International Monetary Fund.

Balance sheet of the household sector for selected years

R billions

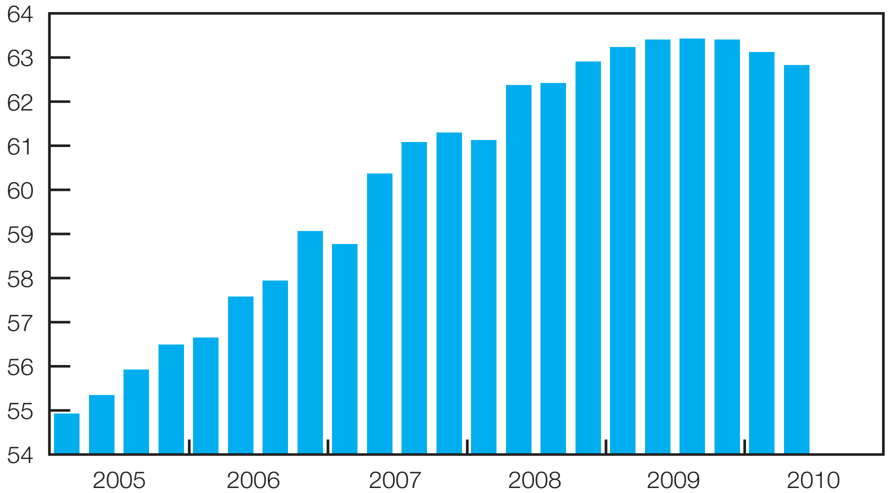
31 December	2005	2006	2007	2008	2009
Tangible assets	1 254,3	1 478,3	1 710,7	1 785,6	1 884,5
Residential buildings	1 029,8	1 237,2	1 446,2	1 496,3	1 592,3
Other tangible assets	224,5	241,1	264,5	289,3	292,2
Financial assets	3 128,7	3 931,5	4 440,2	4 073,0	4 521,7
Assets with monetary institutions	352,0	400,0	463,3	545,8	563,0
Interest in pension funds and long-term insurers	1 431,8	1 791,6	1 970,6	1 946,1	1 984,3
Other financial assets	1 345,0	1 739,8	2 006,3	1 584,1	1 974,4
Total assets	4 383,1	5 409,8	6 150,9	5 858,6	6 406,2
Total household debt	697,1	873,0	1 070,6	1 159,2	1 185,2
Mortgage advances	395,4	517,2	657,8	730,5	752,8
Other debt	301,7	355,8	412,8	428,7	432,4
Net worth	3 686,0	4 536,8	5 080,3	4 699,4	5 221,0
Total liabilities and net worth	4 383,1	5 409,8	6 150,9	5 858,6	6 406,2
Memo item: Net worth including durable consumer goods	*3 965,7*	*4 863,6*	*5 447,2*	*5 091,6*	*5 618,4*

Household debt

Loan financing obtained from the private-banking sector forms the largest part of household debt. Relevant data are collected from monthly regulatory returns submitted to the Bank Supervision Department of the Bank, in compliance with section 90 of the Banks Act (Act No. 94 of 1990). The outstanding debt of the household sector also includes credit extended to non-incorporated business enterprises and to non-profit institutions serving households. Since 2008 more detail regarding sectoral disaggregation has become available, following the introduction of the Basel II framework for banking supervision.

The two main components of household debt are mortgage advances and consumer credit.

Mortgage debt as a ratio of total household debt



Seasonally adjusted

Mortgage advances to households

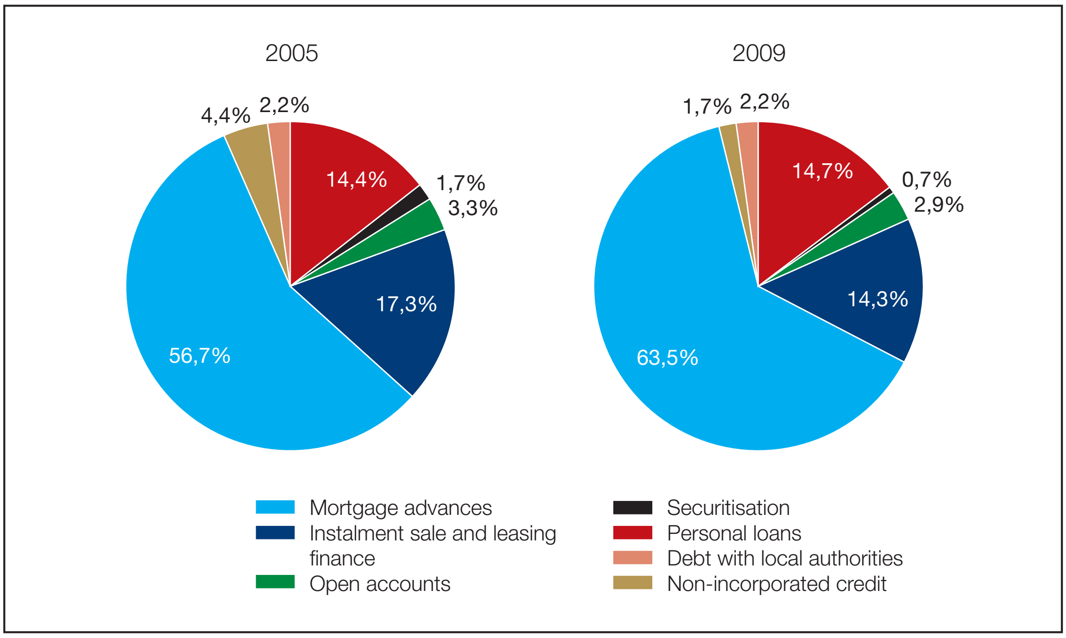
Mortgage advances extended to the household sector represent the largest component of household debt; its share in total debt increased steadily from 56,7 per cent in 2005 to 63,5 per cent in 2009. The information was sourced from monthly regulatory returns submitted to the Bank Supervision Department of the Bank.

Other household debt

Consumer credit accounted for roughly 35 per cent of aggregate household debt in 2009. Credit extension to the consumer was mainly done through open accounts, personal loans, instalment sale transactions, operational and financial lease agreements, and securitisation transactions. Consumer credit also encompasses debt owed to local authorities, information that was sourced from the National Treasury. Debt in arrears to local authorities increased meaningfully in the recent past, raising the level of household debt by about 2 per cent in 2009. Credit extended by buy-aid associations, while a comparatively small component of consumer credit, was obtained from such associations and incorporated in the estimates.

Bank credit extended to non-incorporated business enterprises constituted about 2 per cent of aggregate household debt.

Household debt

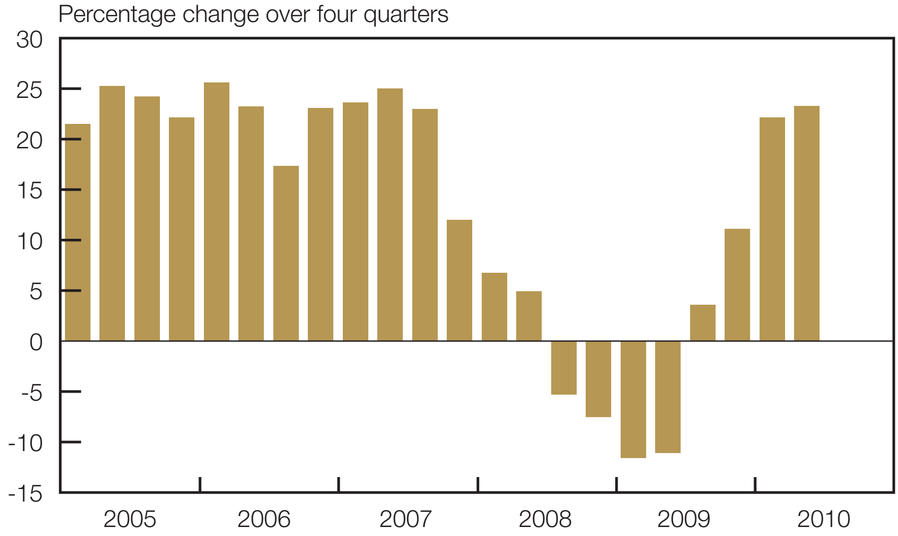


Household wealth

The net wealth of the household sector comprises the total of tangible and financial assets less household liabilities. Up to the second quarter of 2008 increases in the total value of household assets more than matched the increases in the debt levels of the household sector. Growing debt levels are a concern if not matched by a simultaneous increase in the assets of the household sector.

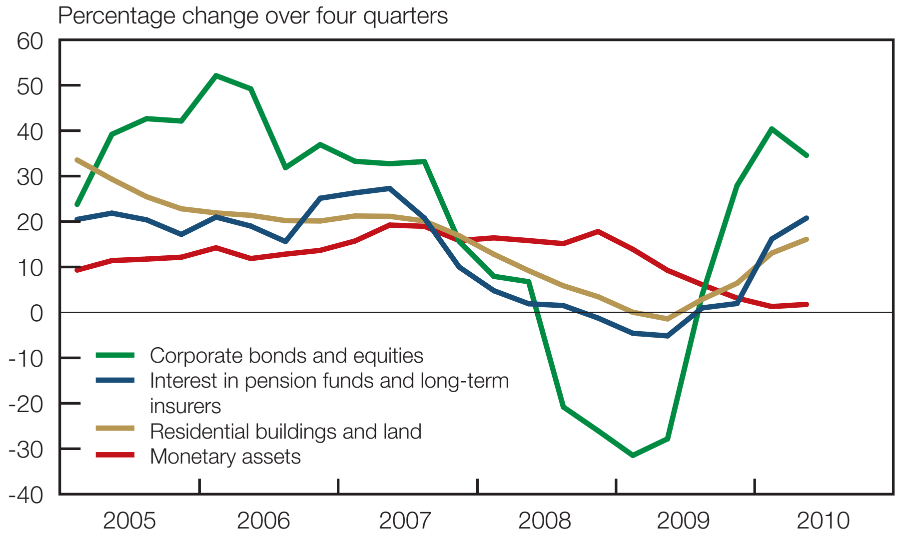
The net wealth of the household sector increased noticeably from the first quarter of 2003 up to the second quarter of 2008, largely reflecting the sharp appreciation in the value of residential property and the surge in equity prices. The global financial crisis that emerged in the latter part of 2007 subsequently spilled over to the South African economy, adversely affecting the net wealth of the household sector as property values declined alongside a sharp fall in the prices of most classes of equity during 2008 and early 2009. However, from the second half of 2009 growth in household wealth started to recover, partly due to the pickup in global and domestic economic activity, which positively affected equity markets. Furthermore, the household sector also benefited from steady increases in house prices from the middle of 2009.

Household net wealth



An analysis of the components of household wealth showed that between 2005 and 2007 holdings of residential property, pension funds and directly held securities were the main contributors to household wealth, as these items rose substantially over the period. From the fourth quarter of 2007 households' holdings of pension fund assets and

Selected assets of the household sector

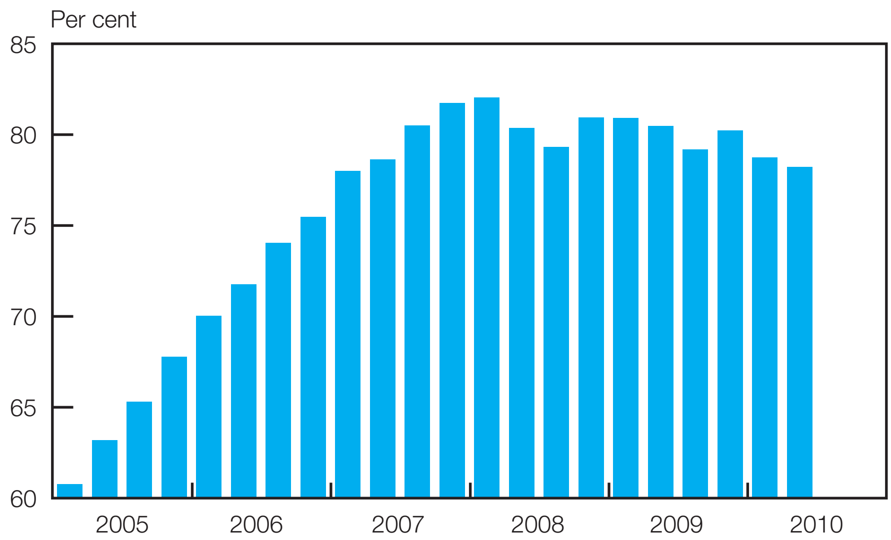


residential property deteriorated somewhat, but started to recover in the second half of 2009. Growth in monetary assets remained broadly unchanged during 2008, but slowed in 2009.

Household debt rose briskly between 2005 and 2007 with this increase mainly driven by the rapidly rising prices of residential property. The substantial debt accumulation was probably encouraged by the relatively low interest rate environment, easier access to credit and the rising number of people in paid employment. Disposable income of households also increased swiftly between 2005 and 2008 following strong growth in compensation of employees and property income. The ratio of household debt to disposable income accordingly reached an all-time high of 82 per cent during the first quarter of 2008.

At the end of 2008 growth in disposable income started to slow substantially as households experienced financial strain. Difficult economic conditions arose from the adverse global economic developments and continuous job losses in the domestic economy. The introduction of relevant provisions of the National Credit Act in June 2007 also affected growth in household debt during this period.

Ratio of household debt to disposable income

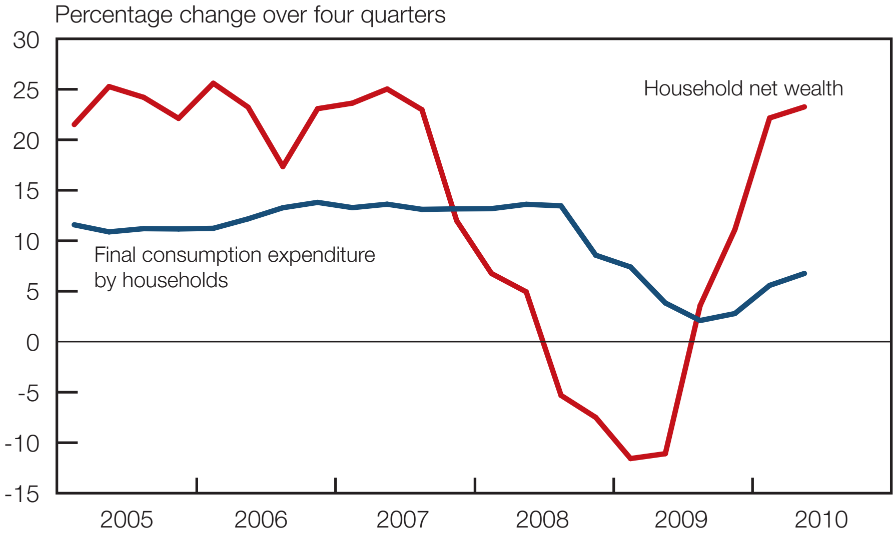


Despite the steady reduction in interest rates since December 2008, factors such as tighter lending conditions, a slowdown in disposable income and large-scale job shedding during 2009 probably constrained the household sector's appetite for debt.

Although the ratio of household debt to disposable income in South Africa has risen sharply in the past five years, it still compares favourably with similar ratios of countries such as the United States, the United Kingdom, Australia and New Zealand. Australia has one of the highest ratios of household debt to disposable income in the world at 155,3 per cent, which may be compared with South Africa's ratio of 80,2 per cent at the end of 2009.

Nominal final consumption expenditure by households increased at an average rate of about 13 per cent during the period 2005 to the third quarter of 2008. However, from the final quarter of 2008 final consumption expenditure of households increased at a substantially slower pace, partly explained by the decline in the net wealth of the household sector during the period.

Final consumption expenditure by households and household wealth



Conclusion

A steady increase in household debt could be misleading if the underlying trend in household assets is not simultaneously taken into account. It is therefore important to complement analysis of changes in the gross debt position of households with analysis of developments in the gross assets of the sector and the resulting changes in net household wealth.

To this end, the computation of comprehensive and timely estimates of household balance-sheet aggregates is invaluable. By adding reliable balance-sheet estimates to the national accounts data sets, the analyses that may be done are broadened significantly.

This note presents a brief summary of methodology used in compiling the assets and liabilities of the balance sheet in time series format. Notable developments in the balance-sheet aggregates were highlighted. These include the integration of stock values for tangible assets benchmarked to the year 2005 and improved estimates of household financial assets, that is, investment in government bonds and public enterprise stock, deposits with financial and other institutions, and ordinary shareholding.

Estimates of household debt were furthermore expanded to include the liabilities of the household sector to various domestic buy-aid associations and local authorities. In addition, improved data on instalment credit, personal loans and mortgage advances extended by banks to consumers were obtained using more detailed returns that became available when the *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II) for banking supervision was introduced. Securitised loans were also added to household debt from the second quarter of 2002.

Research to improve household balance-sheet estimates further will continue, but the advances made are such that estimates of the household sector's net wealth relative to disposable income will in future be disseminated in the statistical tables of the *Quarterly Bulletin*.

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Note on cash holdings and card payments during the 2010 FIFA World Cup™ tournament

by V V Mamba[1]

1 The author is indebted to the major South African banks and the Bank's Financial Surveillance Department for providing data. Data processing work by L DeNysschen and M Teu is gratefully acknowledged, as well as graphic presentations by T Mokoetla and T Buys-du Plessis.

Introduction

Economic activities related to the hosting of the 2010 FIFA World Cup™ tournament were spread over a six-year period, culminating in the month-long actual hosting of the event. The tournament month was expected to be a period of exceptionally buoyant business conditions in the retail and tourism sectors. In turn, this was expected to generate a strong increase in the demand for cash by the public, almost reminiscent of the elevated demand for notes and coin generated by the changeover to the year 2000 (Y2K). This note investigates developments in the holdings of banknotes and coin in circulation, and in card payments at the time of the football tournament.

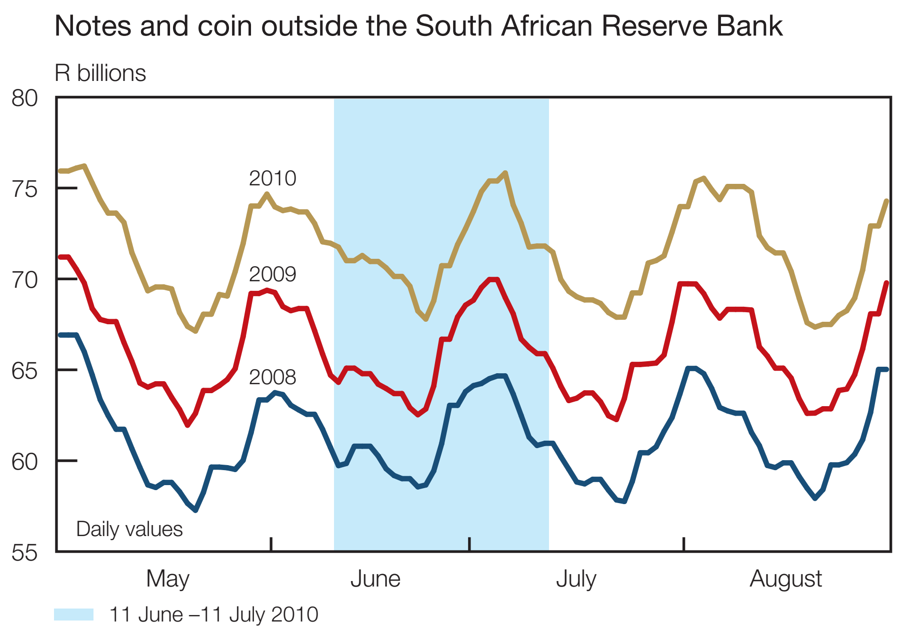
Trends in notes and coin during the tournament

Work on developing the requisite infrastructure for hosting the football tournament started as early as 2004. This culminated in the timely delivery of stadiums, rail, rapid transit systems, new and upgraded airports, road improvements, and Internet, telecommunications and broadcast systems.

It is difficult to isolate the additional expenditure flows related to the actual hosting of the tournament, although the behaviour of a number of transactions-related indicators may provide helpful insights. The level of notes and coin in circulation may offer an indication of the buoyancy of expenditure flows, and may also be helpful for the monetary sector when other major events are to be hosted in future and logistical planning has to be done to ensure that adequate cash supplies are on hand.

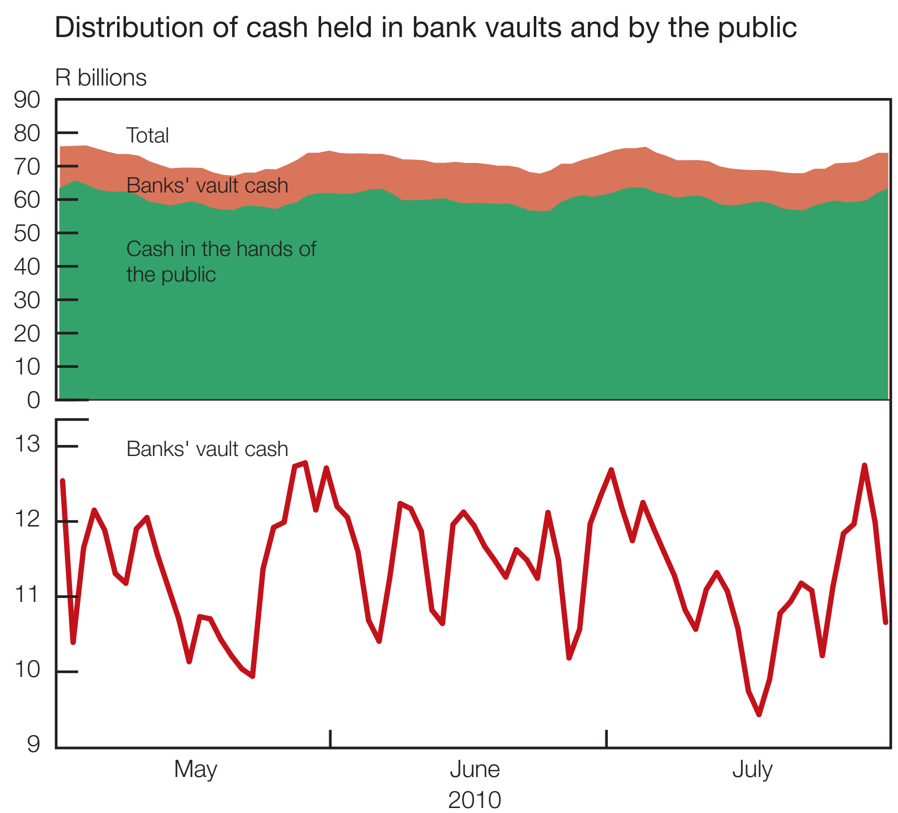
The level of notes and coin circulating outside the South African Reserve Bank (the Bank) follows a distinct monthly cycle. The cycle typically reaches a trough between the twentieth day and the twenty-fourth day of the month, whereafter it rises and peaks between month-end and the fifth day of the following month. With daily data available, how can the *additional* amount of notes and coin in circulation held on account of the tournament be estimated?

The graph on page 75 shows the daily amount of notes and coin in circulation outside the Bank from the beginning of May to the end of August of each year, for 2008, 2009 and 2010. As nominal income and expenditure increase over time, the curve depicting notes and coin in circulation moves higher from year to year. The shaded area on the graph indicates when the FIFA World Cup™ tournament was held. The tournament started on 11 June 2010 and ended on 11 July, but business transactions from tourism and logistics for the event may have predated the start date and gone beyond the end date. Nevertheless, comparing the period 11 June to 11 July 2010 with the same period a year earlier, notes and coin in circulation increased by 8,8 per cent on average. By contrast, the average increase from 1 May to 10 June 2010 compared with the corresponding period a year earlier was 8,1 per cent. Similarly, from 12 July to 31 August 2010 the average year-on-year increase was 8,2 per cent. The "additional" notes and coin in circulation during the tournament may therefore be estimated as around 0,7 per cent of the stock of currency, or R0,5 billion.



During the tournament, notes and coin in circulation outside the Bank recorded a peak of R75,83 billion on 5 July 2010, a few days before the staging of the finals of the tournament. The tournament peak was a paltry R1,87 billion higher than the pre-tournament peak in early June. It is noteworthy that early in April, with the public and school holidays, the highest holdings of currency in 2010 amounting to R77,59 billion were recorded, with the second-highest being registered in early May at R76,21 billion.

Clearly, the hosting of the 2010 FIFA World Cup™ had a quite limited impact on currency in circulation. As noted above, the peaks for April and May surpassed the tournament peak.

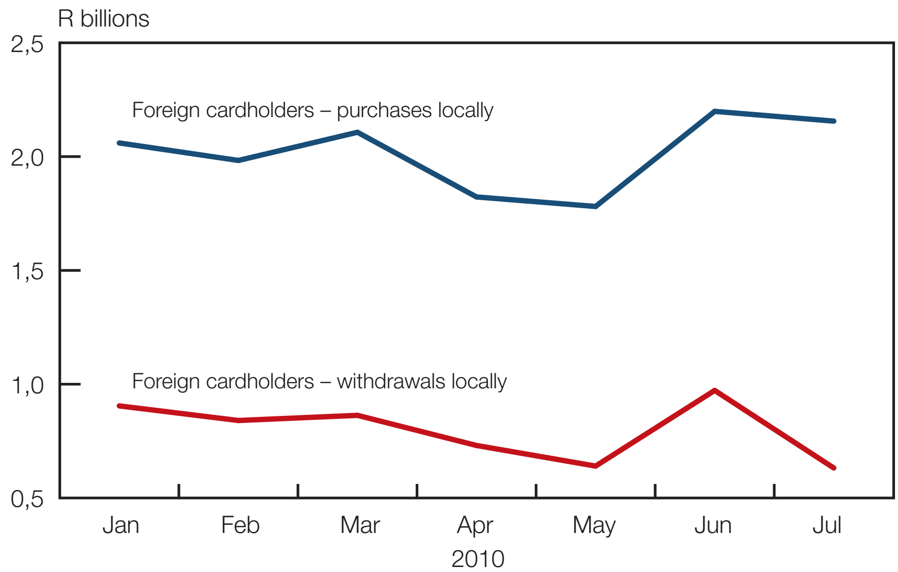


The daily pattern for cash in the hands of the non-bank public resembles that of notes and coin outside the Bank. Commercial banks' vault cash tends to be more volatile, as seen in the accompanying graph. The summation of bank vault cash and cash held by the public together constitute total notes and coin outside the Bank. The cash holdings of the public displays patterns that confirm those already discussed above for currency outside the Bank.

The use of credit and debit cards by foreign cardholders

Given the convenience of card purchases and withdrawals and the payments infrastructure in South Africa which readily accommodates the use of such cards, this method of transacting is chosen by many foreign cardholders. The accompanying graph shows the value of purchases and withdrawals in South Africa by foreign cardholders. While such transactions values are usually quite low in the South African winter months, the football tournament drew numerous non-resident cardholders to South Africa, resulting in a significant increase in transactions values in June and July 2010.

Credit and debit card usage by non-residents in South Africa



Source: Financial Surveillance Department, South African Reserve Bank

Conclusion

From the analysis in this note it is clear that the hosting of the 2010 FIFA World Cup™ tournament had a quite limited impact on the demand for notes and coin in South Africa. It is crudely estimated that the demand for cash was raised by, on average, 0,7 per cent during the tournament month when compared with the periods immediately before and after. However, as could be expected, card payments by non-residents increased more significantly during the event.

Note to tables

National accounts: Ratios of selected data – Table S–150

Refinements were made to the computation of household balance-sheet estimates in South Africa, taking account of new sources and standard international practice. As a result, a series with estimates of the household sector's net wealth relative to disposable income has been added in statistical table S–150.