

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.

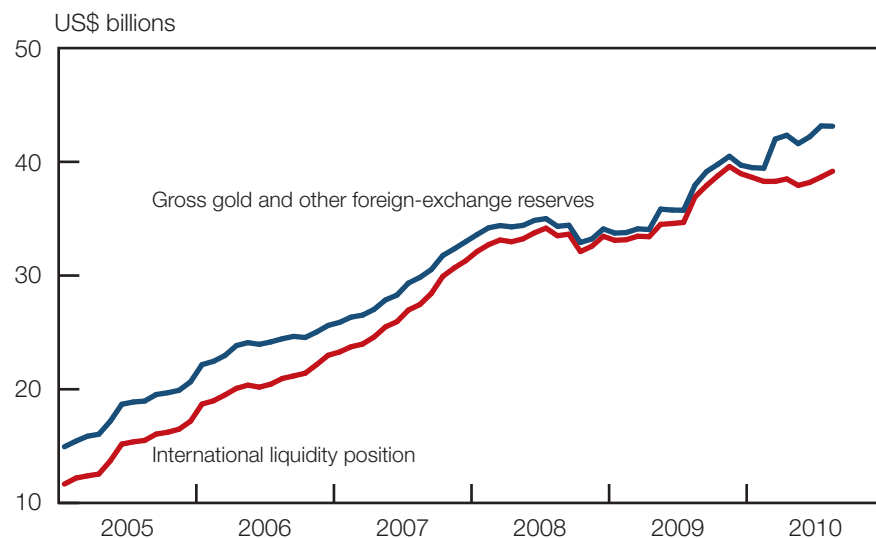
During the first seven months of 2010 producer price inflation accelerated apace due to base effects and global price developments. By contrast, the targeted consumer price measure of inflation decelerated to below the 6 per cent mark from February and

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 an 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 developments¹

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 |
| <i>Non-agricultural sector.....</i> | <i>-7,6</i> | <i>-1,9</i> | <i>1,8</i> | <i>3,7</i> | <i>-1,5</i> | <i>4,4</i> | <i>2,7</i> |
| Total | -7,4 | -2,8 | 0,9 | 3,2 | -1,8 | 4,6 | 3,2 |

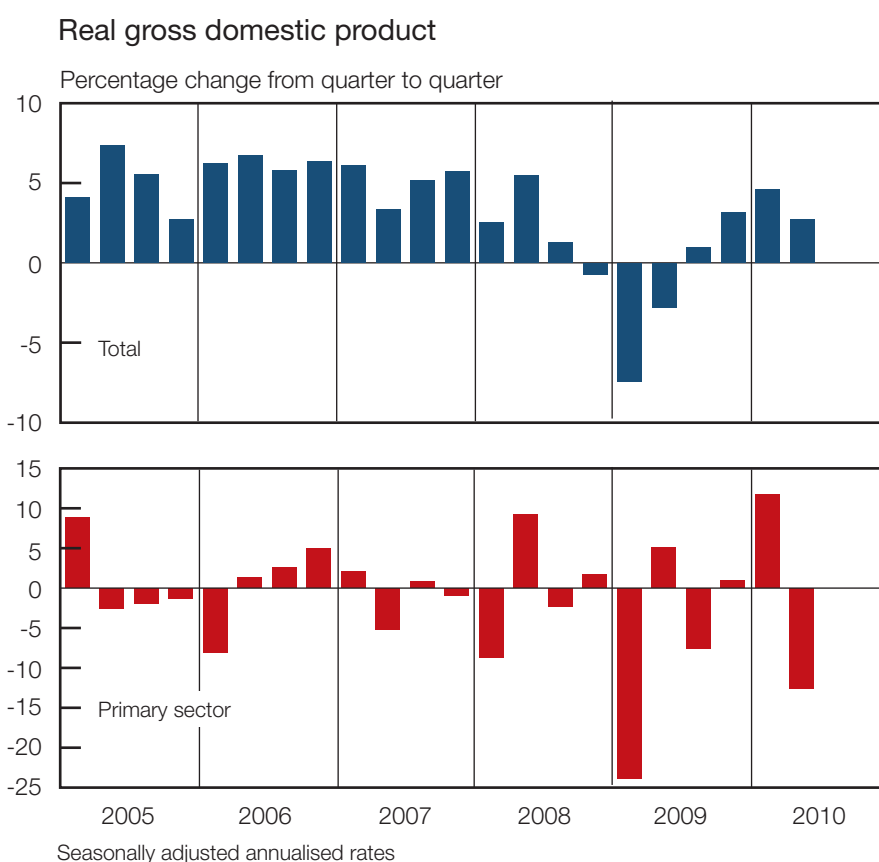
Subsequent to an increase at an annualised rate of 11,8 per cent in the first quarter of 2010, the real value added by the *primary sector* contracted at a rate of 12,5 per cent in the second quarter. This decline could mainly be attributed to an exceptionally sharp contraction in the real output of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



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

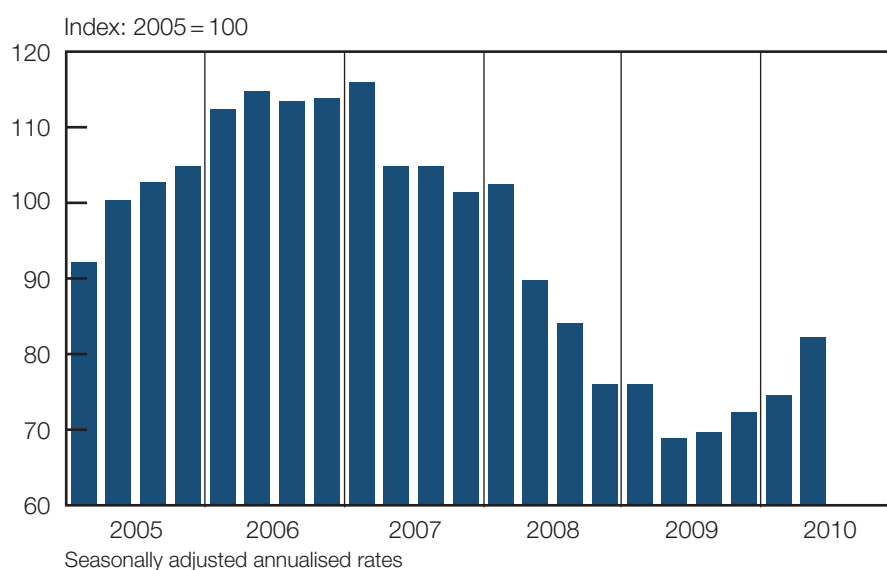
| Components | 2009 | | | | | 2010 | |
|---|------------|--------------|-------------|------------|-------------|-------------|------------|
| | 1st qr | 2nd qr | 3rd qr | 4th qr | Year | 1st qr | 2nd qr |
| Final consumption expenditure: | | | | | | | |
| Households..... | -5,8 | -5,2 | -1,9 | 1,6 | -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



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

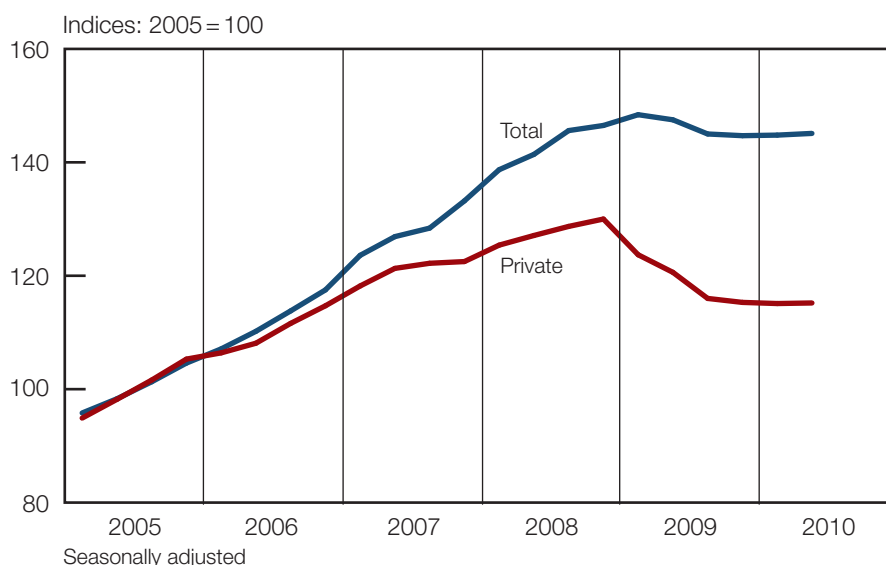
| Components | 2009 | | | | | 2010 | |
|--------------------------|-------------|-------------|-------------|------------|-------------|------------|------------|
| | 1st qr | 2nd qr | 3rd qr | 4th qr | Year | 1st qr | 2nd qr |
| Durable goods | -8,4 | -17,6 | 0,7 | 15,2 | -11,3 | 16,8 | 37,8 |
| Semi-durable 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 |

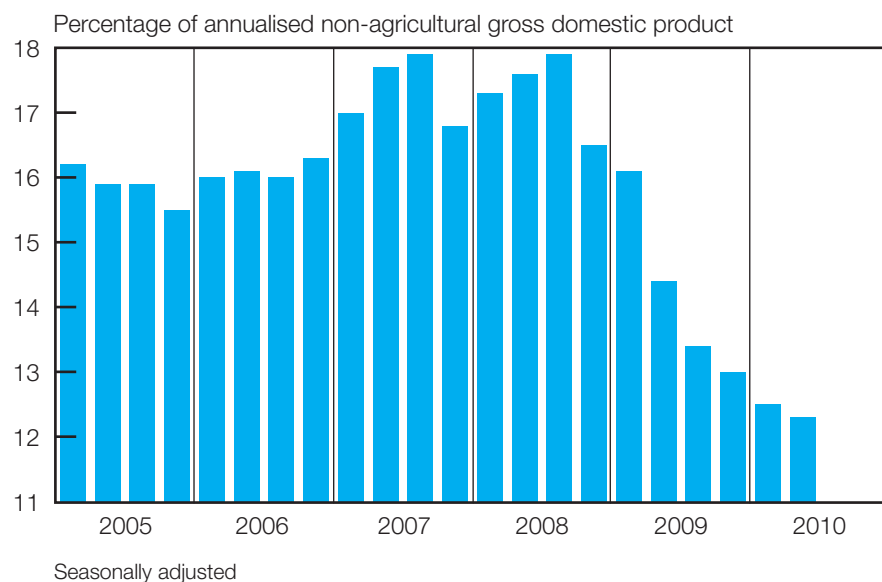
Real fixed capital expenditure by *public corporations* slowed marginally to an annualised growth rate of 6,5 per cent in the second quarter of 2010 following an increase at a rate of 7,4 per cent recorded in the first quarter. Some projects related to the preparation for the 2010 FIFA World Cup™ tournament 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



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.

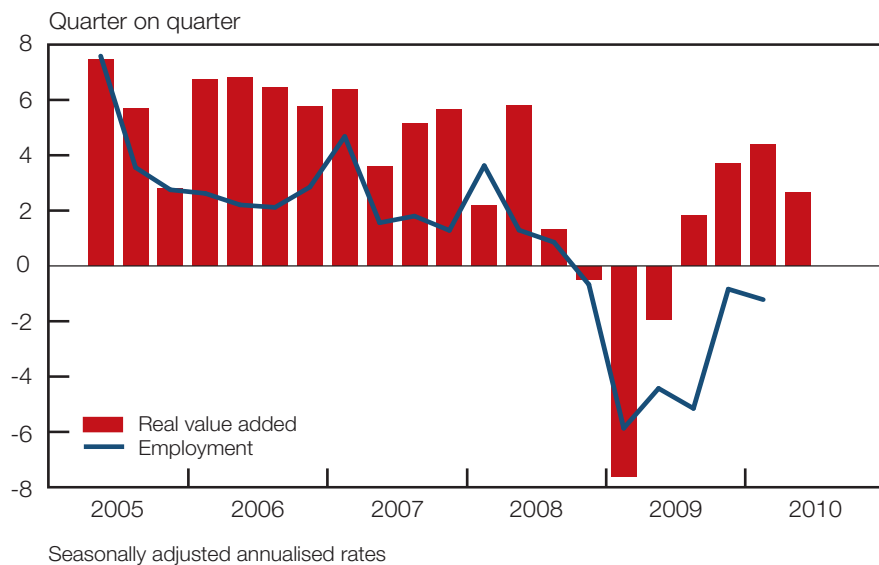
The gross savings rate of the *household sector* remained unchanged from the first quarter of 2010 to the second quarter at 1,6 per cent. The savings ratio, however, improved constantly from the first quarter of 2008, when a ratio of 0,8 per cent was recorded, until the fourth quarter of 2009 when a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



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 |

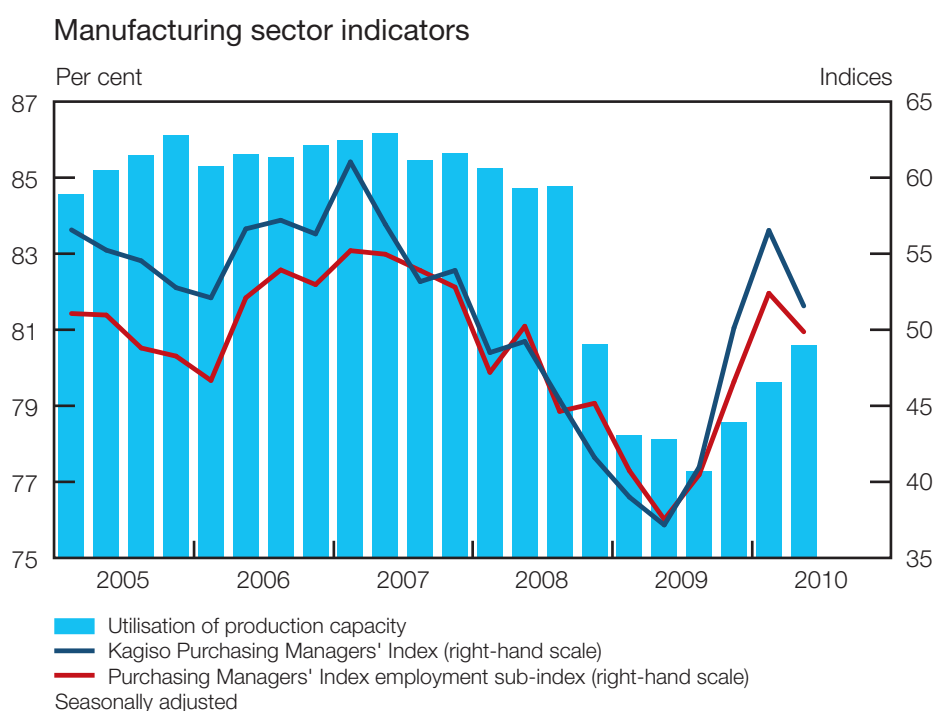
* Seasonally adjusted

** 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.

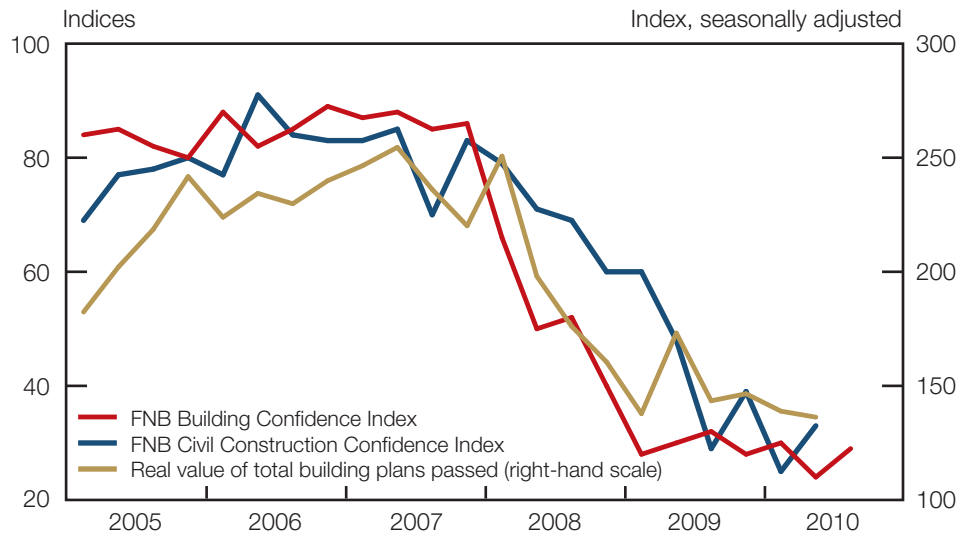
On a quarter-to-quarter, seasonally adjusted and annualised basis, employment levels in the manufacturing sector decreased by 5,2 per cent in the fourth quarter of 2009. This trend was reversed during the first quarter of 2010 when employment levels increased at an annualised rate of 2,1 per cent. The 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.



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.

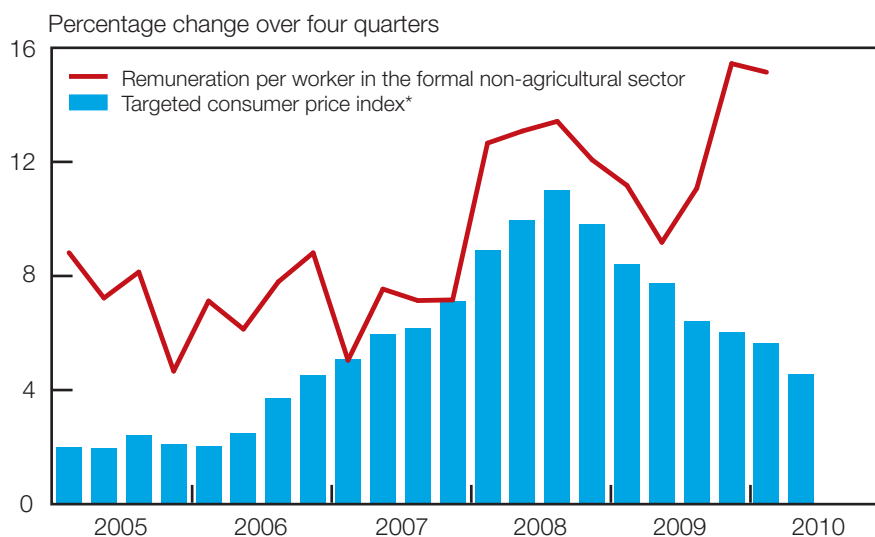
Employment growth in the public sector remained fairly robust throughout the economic downturn as roughly 82 500 jobs have been created since overall employment started contracting in the third quarter of 2008. Acting in a contra-cyclical manner, public-sector employment expanded and rose at an annualised 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.

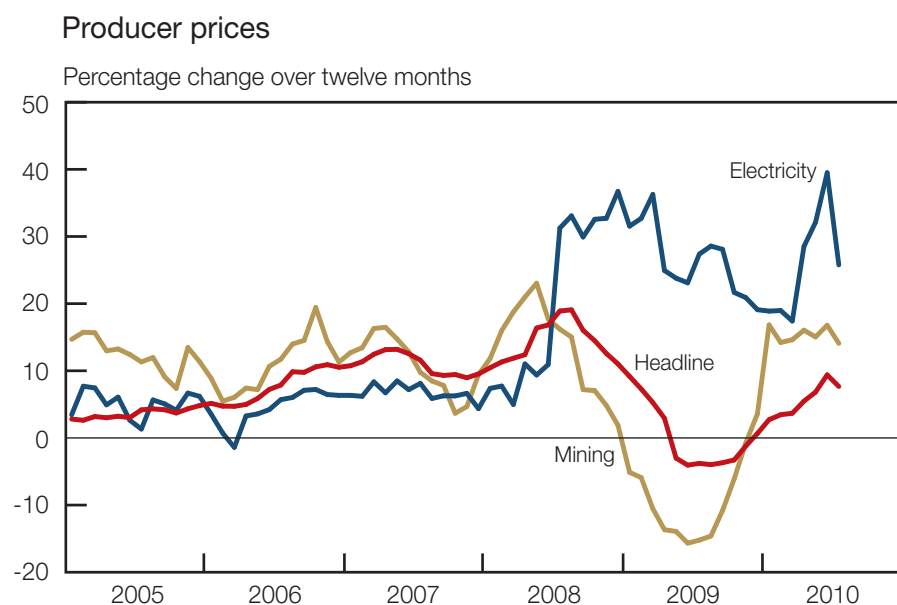
According to the Wage Settlement Survey by Andrew Levy Employment Publications, the average wage settlement rate amounted to 8,2 per cent in the first half of 2010,

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.



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.

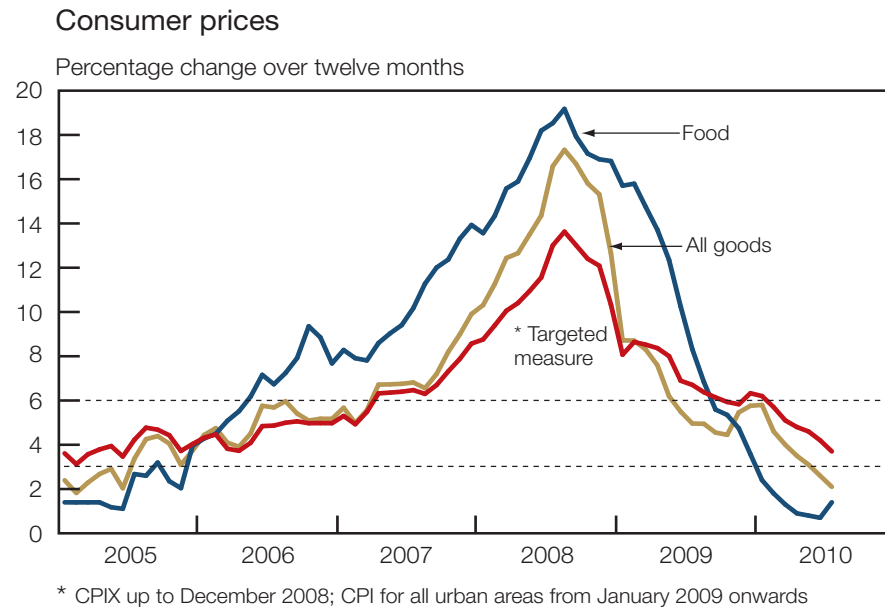
The moderation in headline consumer price inflation resulted mainly from lower rates of increase in the prices of consumer goods from the third quarter of 2009. Services price inflation has remained at a more elevated level, as shown in the accompanying table, and in July it edged into the inflation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



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.

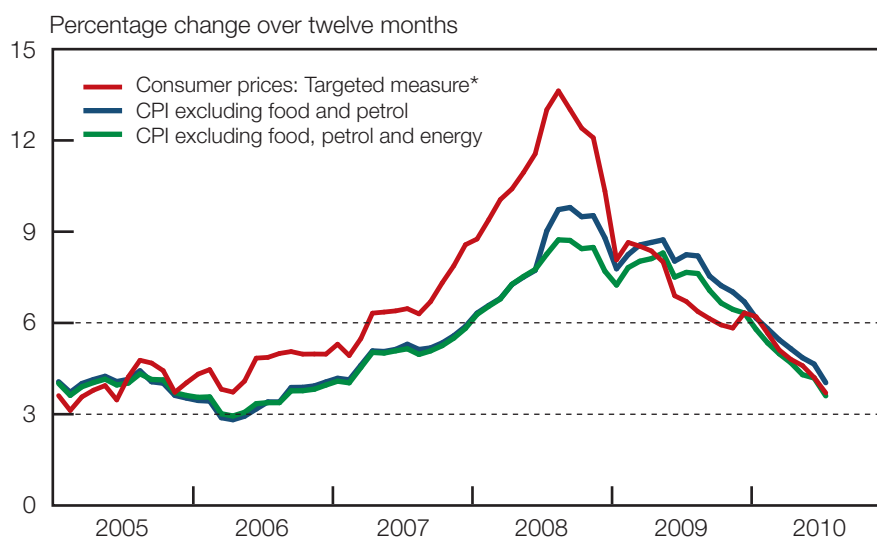
Headline CPI inflation in COICOP categories

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



* 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.

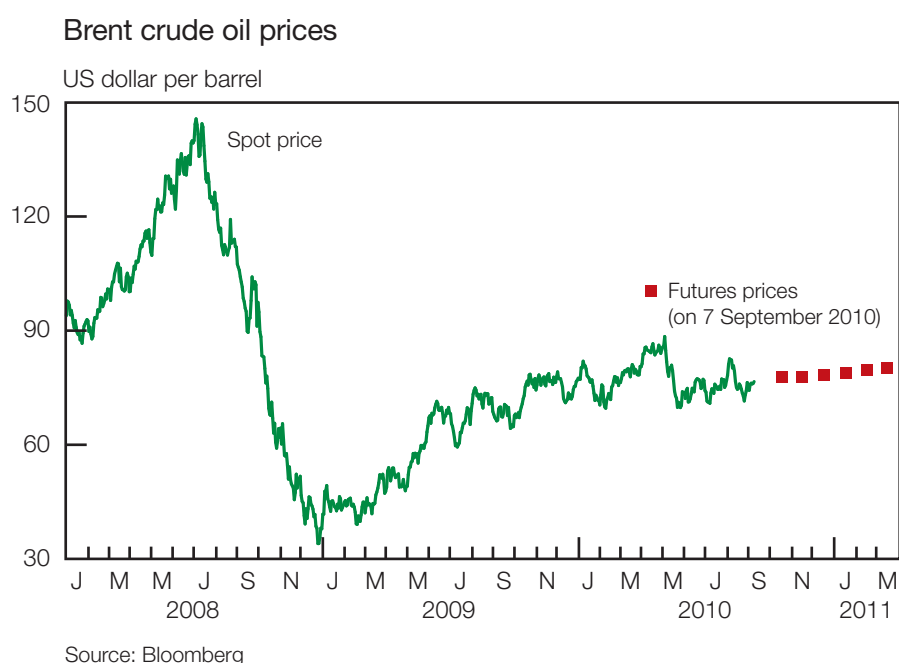
Economic activity in the United States (US) continued to increase in the second quarter of 2010, albeit at a slower pace, reflecting positive contributions from non-residential fixed investment, private consumption expenditure, exports, federal government spending and the restocking of private inventories. 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*

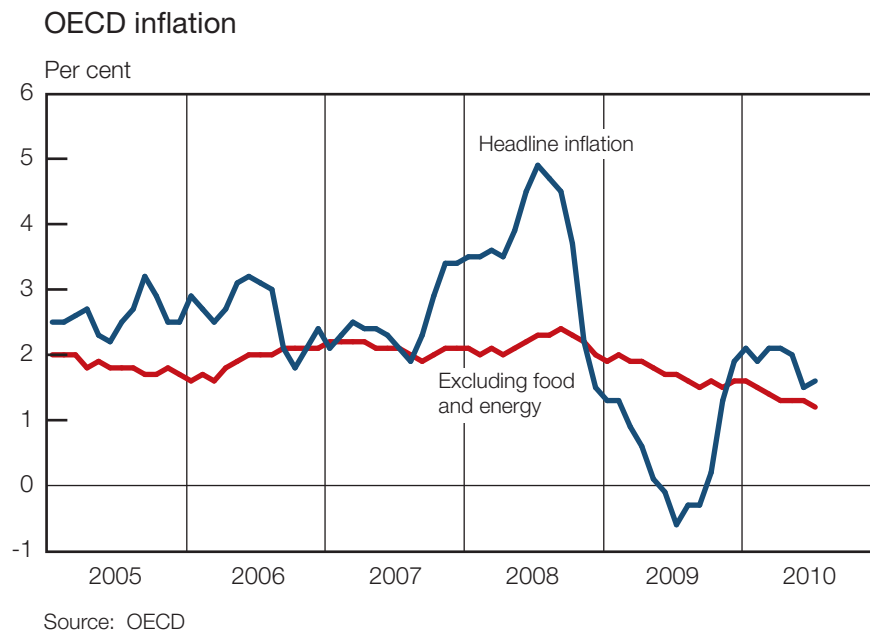
Update (July 2010). These projections reflect the stronger-than-expected economic activity in the first half of 2010 and bleaker prospects for 2011 due to the increasing downside risks following renewed financial instability in Europe. Nevertheless, modest but steady economic recovery in advanced economies 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.



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.



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 account²

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 GIPS³ 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

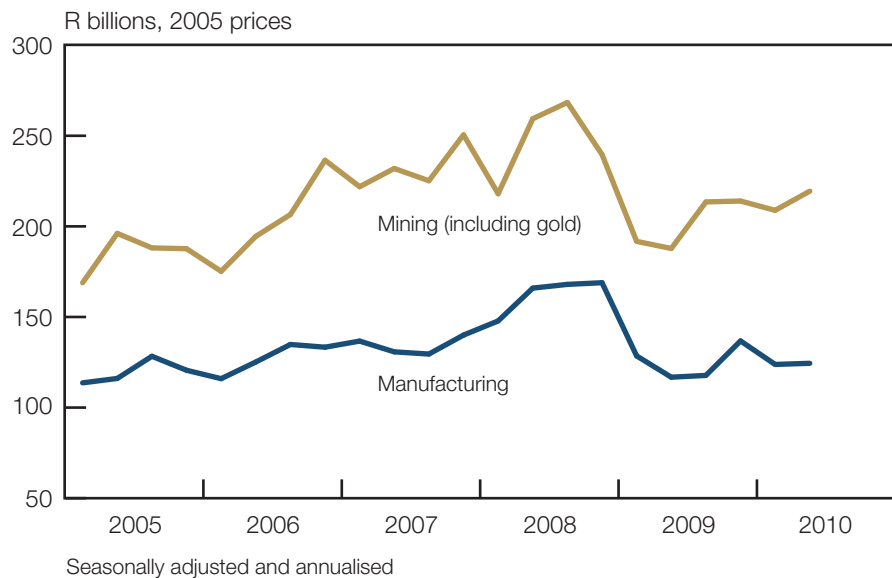
Seasonally adjusted and annualised
R billions

| | 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 |
| <i>As a percentage of gross domestic product</i> | -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



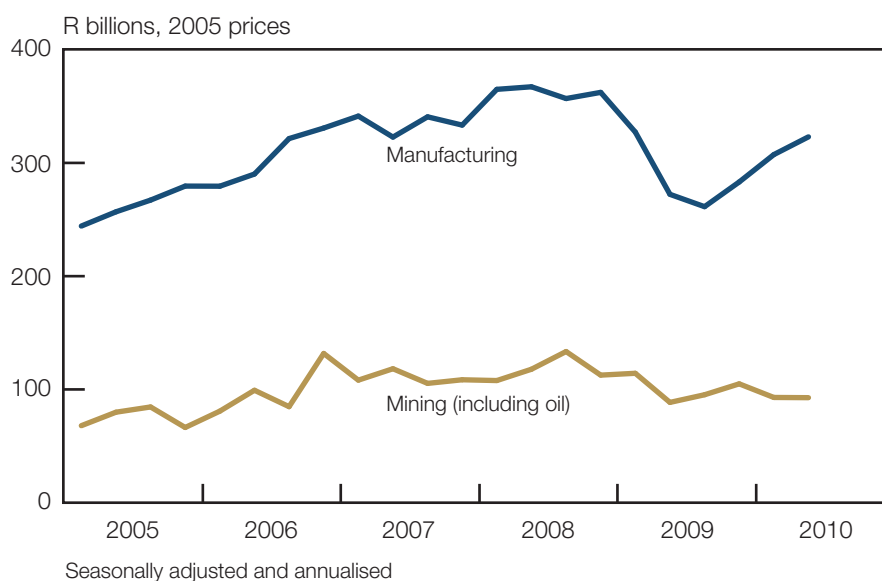
Over and above the increase in the volume of merchandise exports in the second quarter of 2010, the rand price of exports rose by 5,5 per cent as a result of higher international commodity prices. The combined result of price and volume increases raised the proceeds of domestic exporters to R552,0 billion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

Volume of merchandise imports

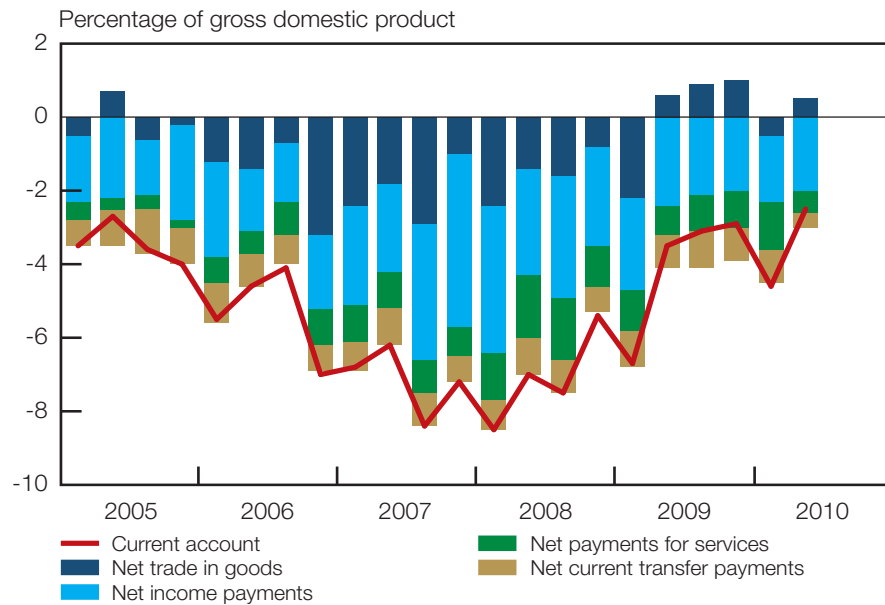


The volume of merchandise imports increased for the third consecutive quarter, rising by 3,1 per cent from the first to the second quarter of 2010. The expansion in import volumes in the second quarter reflected robust increases in the categories for vehicles and transport equipment, including four military 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.

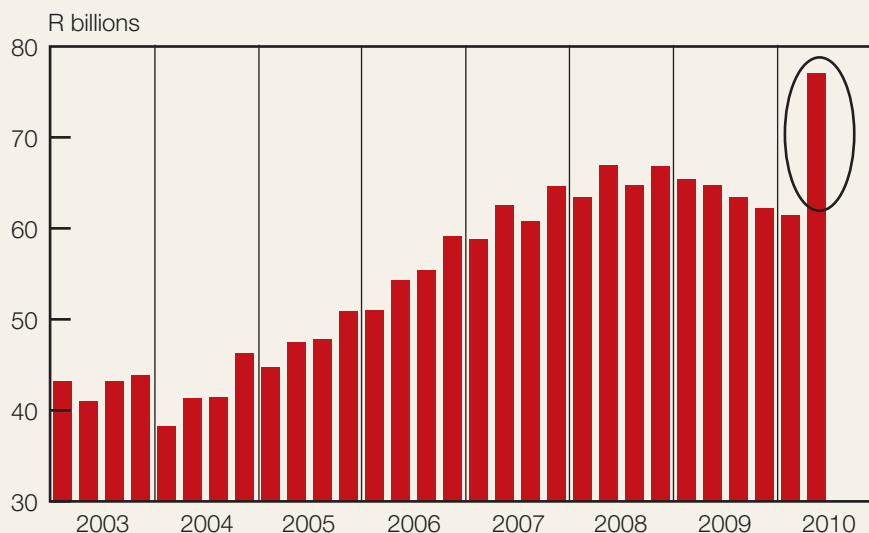
Preliminary estimates suggest that travel receipts benefited substantially from spending by non-residents during the second quarter of 2010. As a result, the historical seasonal pattern of relatively low tourist spending in the second quarter, largely attributable to the winter season in the southern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

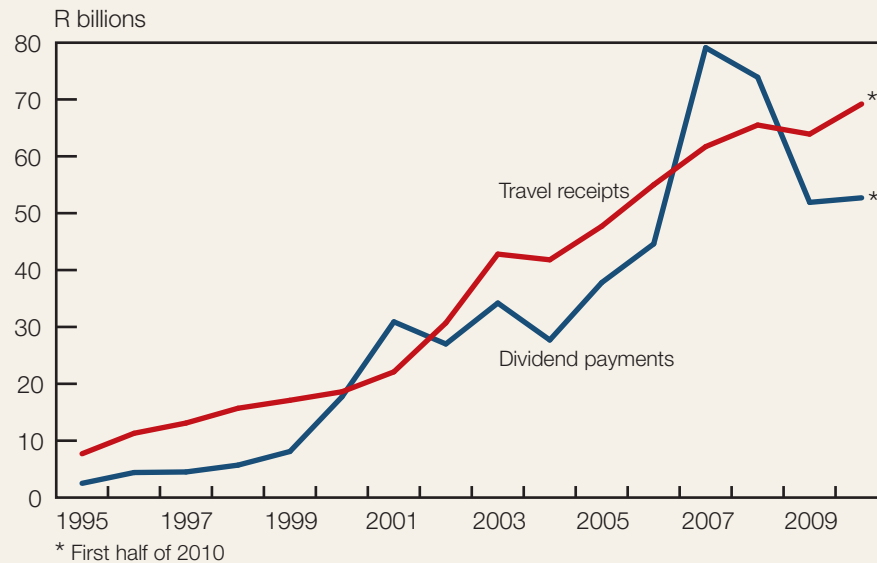
Travel receipts



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



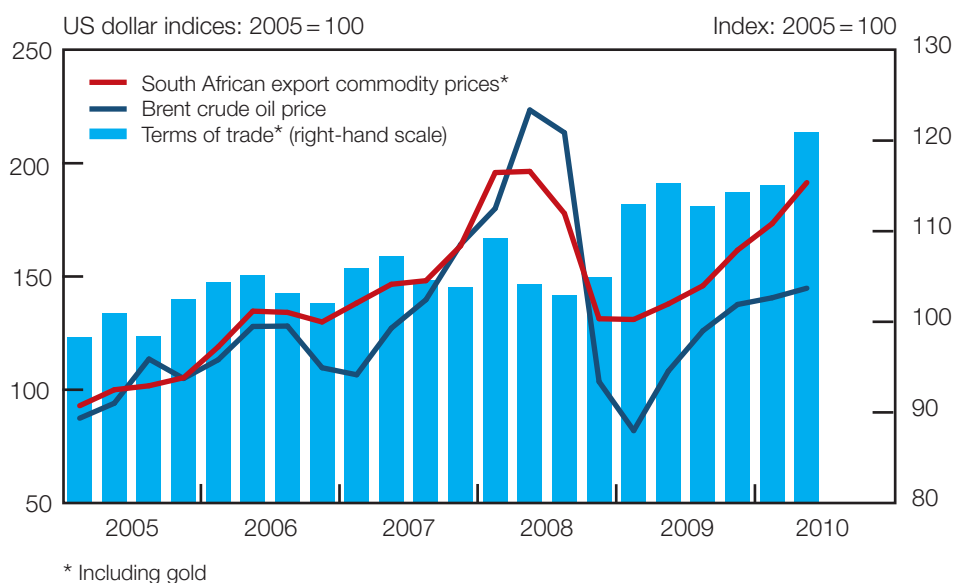
The successful hosting of the 2010 FIFA World Cup™ tournament has made South Africa proud and should help to unleash the potential of the tourism industry, thereby helping to reduce the deficit on the current account.

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



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

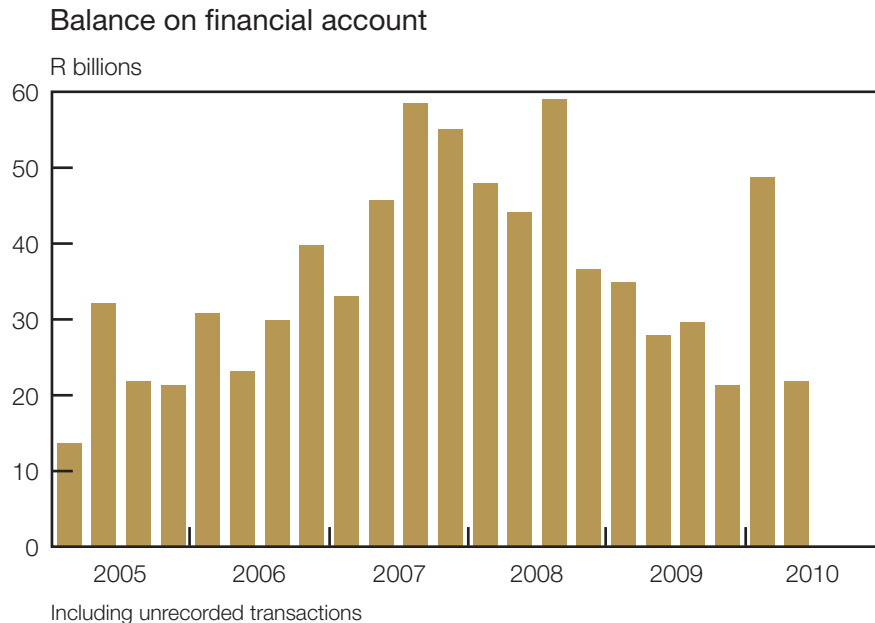
R billions

| | 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 |
| <i>Financial transactions as a ratio of gross domestic product</i> | <i>4,7</i> | <i>4,8</i> | <i>3,4</i> | <i>4,7</i> | <i>7,8</i> | <i>3,3</i> |

* 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.



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

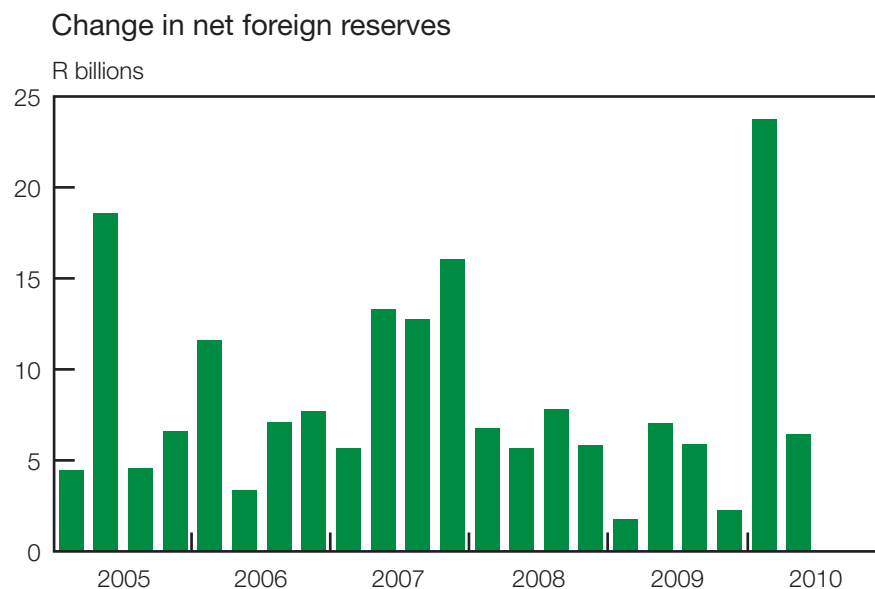
| | 2009 | | | | 2010 |
|---|-------------|-------------|-------------|-------------|-------------|
| | 1st qr | 2nd qr | 3rd qr | 4rd qr | 1st qr |
| Foreign currency-denominated debt... | 41,5 | 41,9 | 42,3 | 42,3 | 42,2 |
| Bearer bonds..... | 13,3 | 14,8 | 15,6 | 15,4 | 16,8 |
| Public sector..... | 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 |
| <i>As a percentage of gross domestic product.....</i> | <i>26,1</i> | <i>28,8</i> | <i>29,3</i> | <i>27,8</i> | <i>26,0</i> |

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.



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 an 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

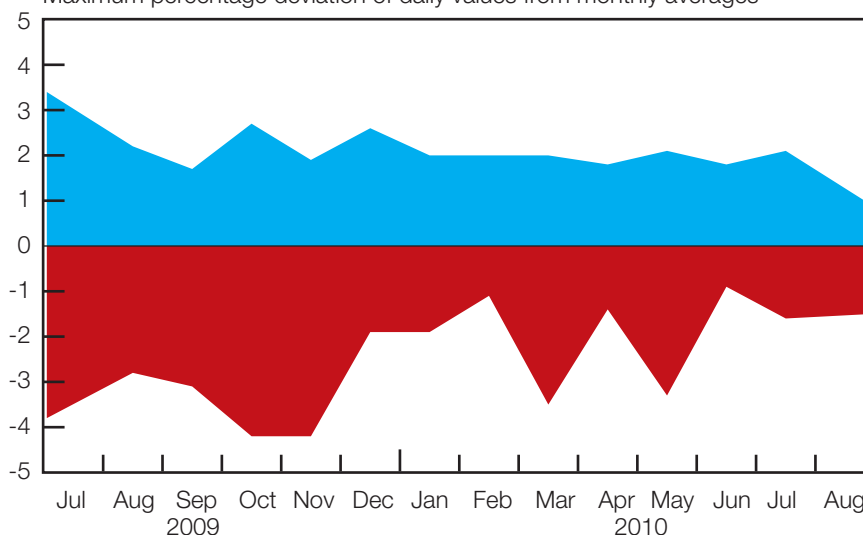
| | 30 Sep 2009 to 31 Dec 2009 | 31 Dec 2009 to 31 Mar 2010 | 31 Mar 2010 to 30 Jun 2010 | 30 Jun 2010 to 31 Aug 2010 |
|-------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Weighted average* | 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

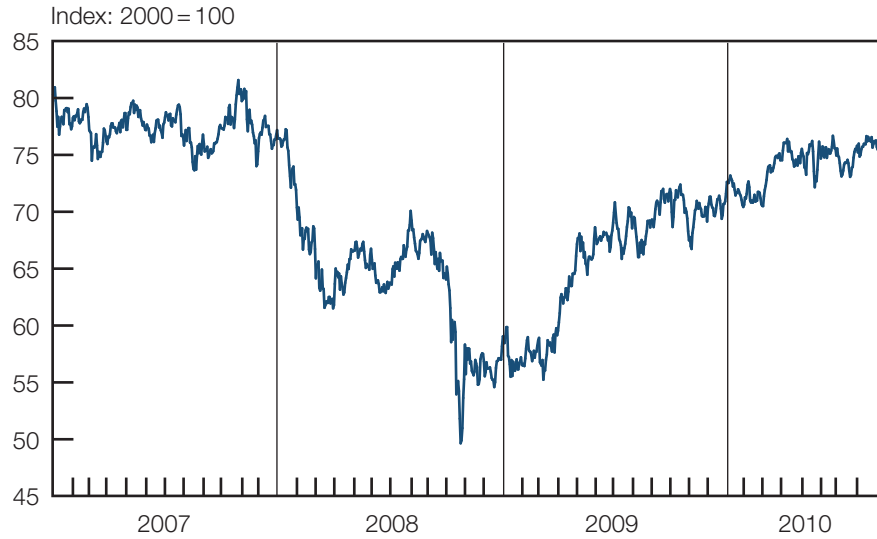
Maximum percentage deviation of daily values from monthly averages



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



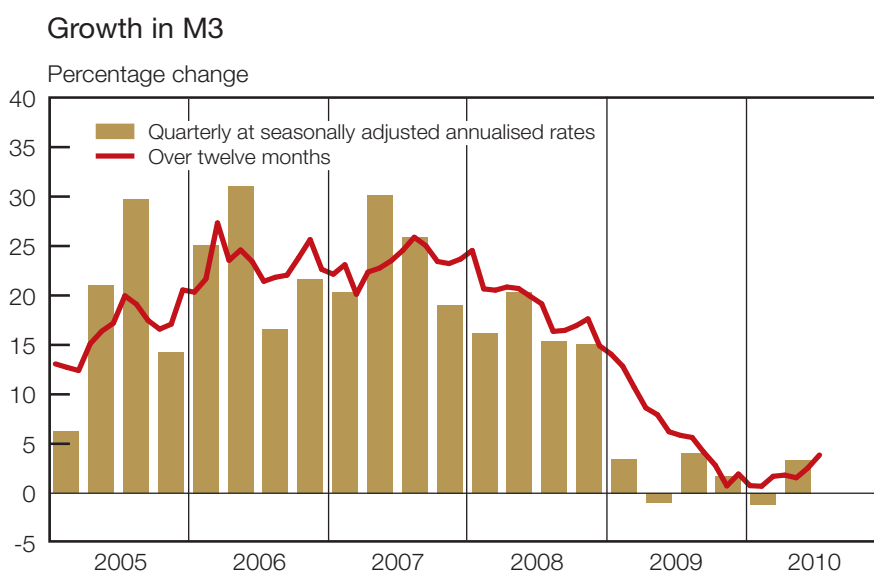
Monetary developments, interest rates and financial markets

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 quarterly⁴ 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 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

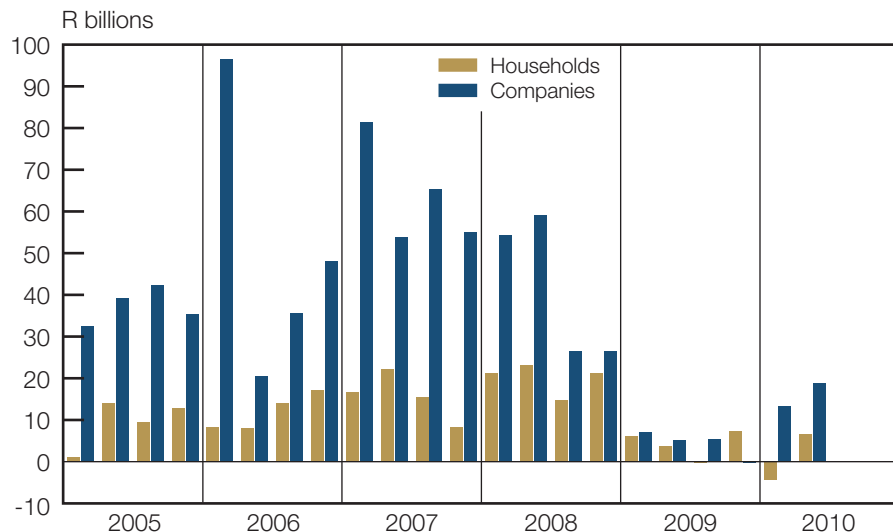
Per cent at seasonally adjusted annualised rates

| | 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

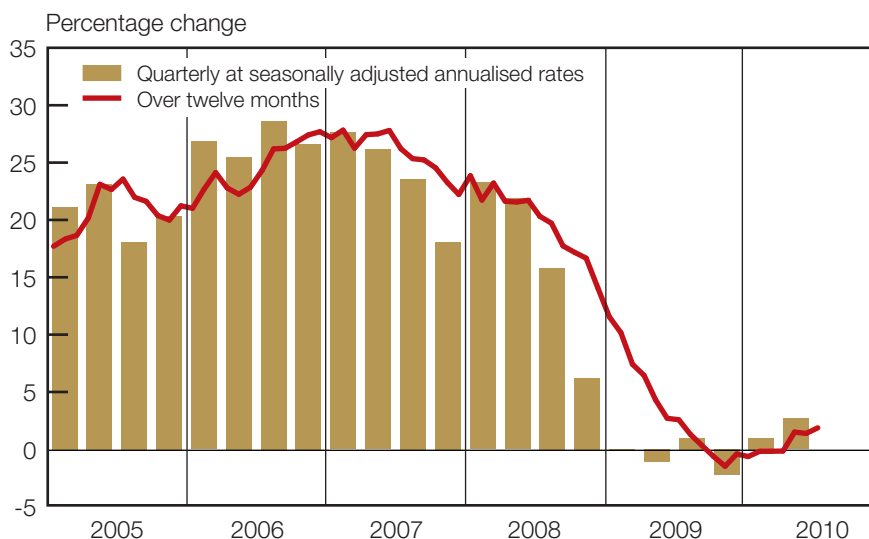
R billions

| | 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



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.

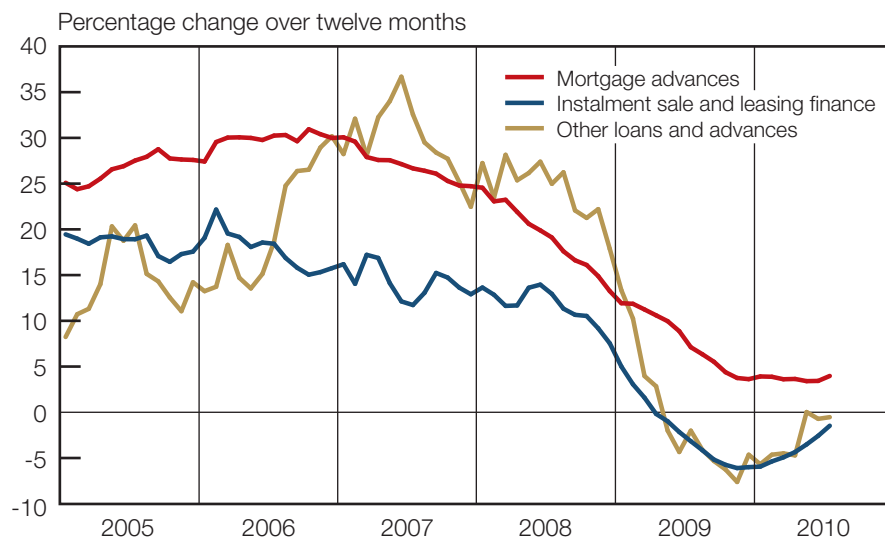
Quarterly changes in banks' total loans and advances by type

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 |
| <i>Of which:</i> To household sector | 7,4 | 5,7 | 19,1 | 11,2 |
| To corporate sector | -12,3 | -5,1 | -4,9 | 2,1 |

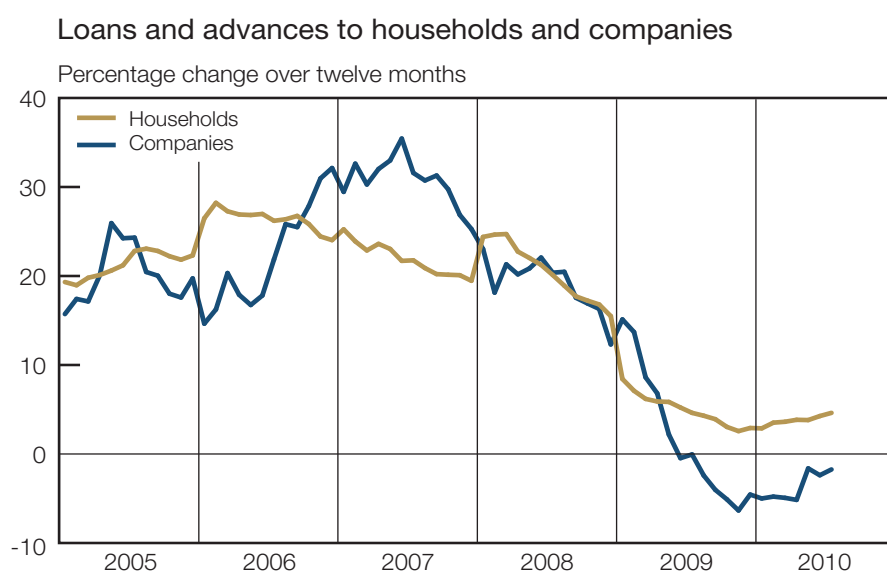
Since December 2009 there has been an improvement in the extension of *instalment sale credit and leasing finance*. Twelve-month growth in this credit category reached a low of minus 6,1 per cent in November 2009 before recovering to a still negative rate of 1,5 per cent in July 2010, mainly due to the 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



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.



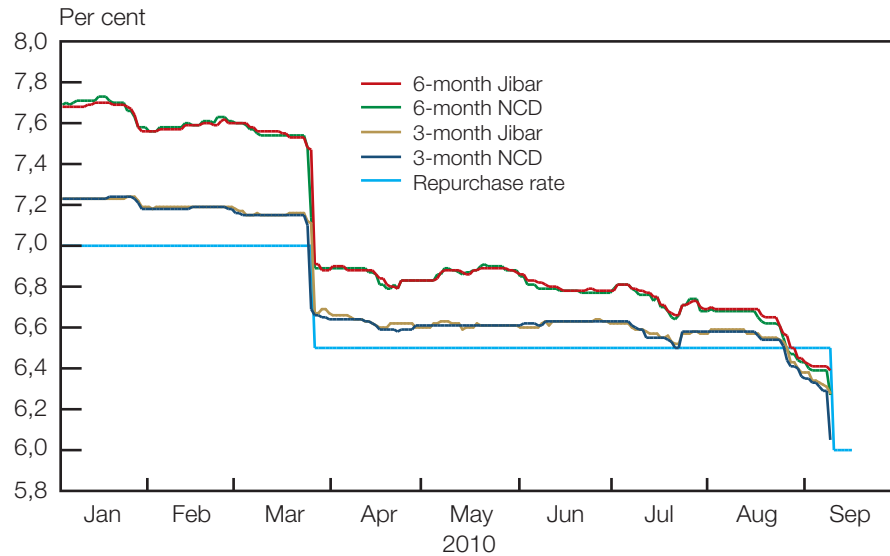
Interest rates and yields

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.

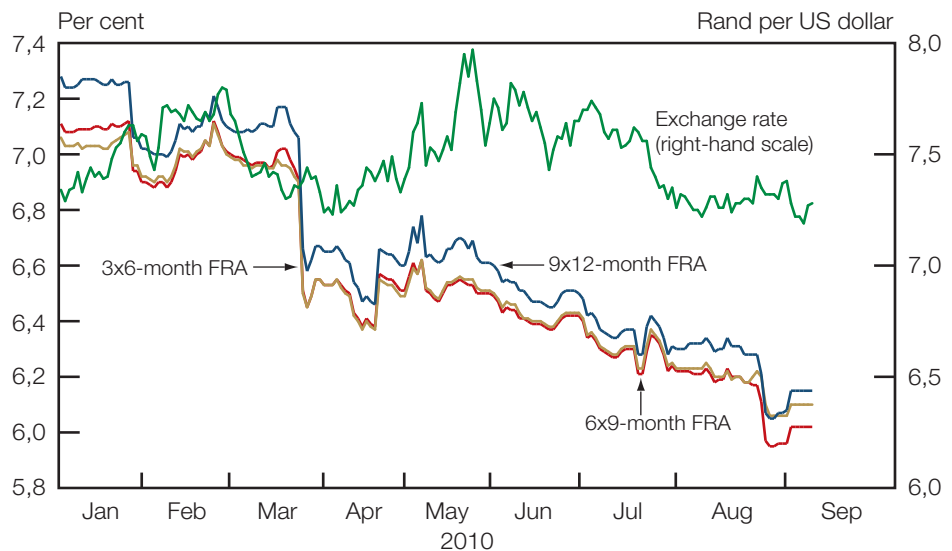
Money-market rates



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

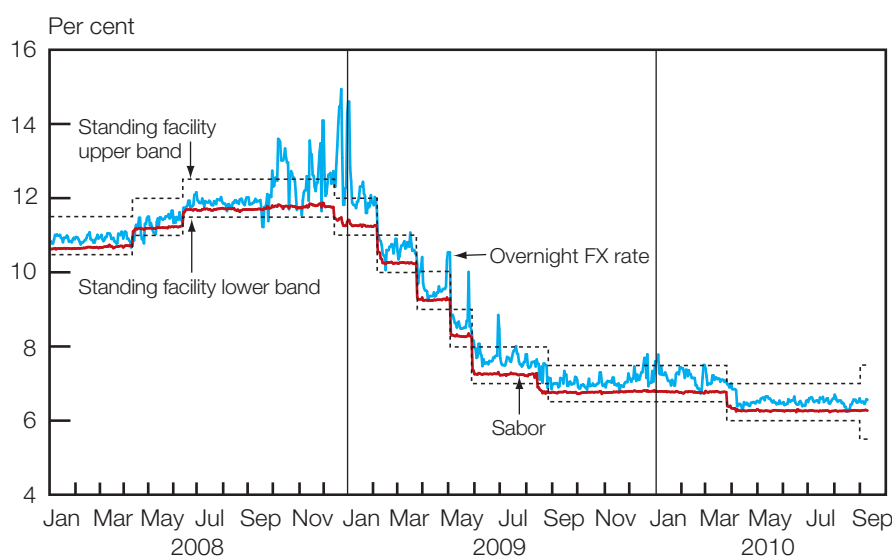
Forward rate agreements and the exchange rate



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.

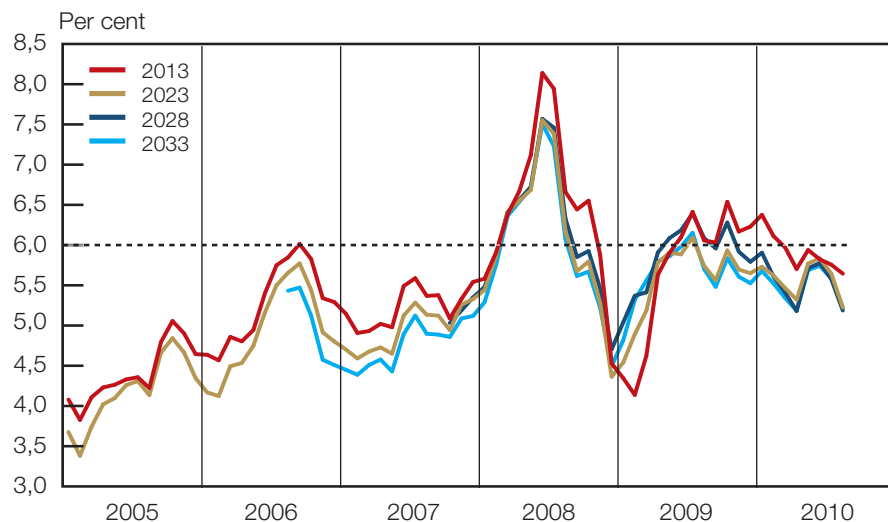
5 The differential between the yields at the extreme long and short ends of the curve.

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.

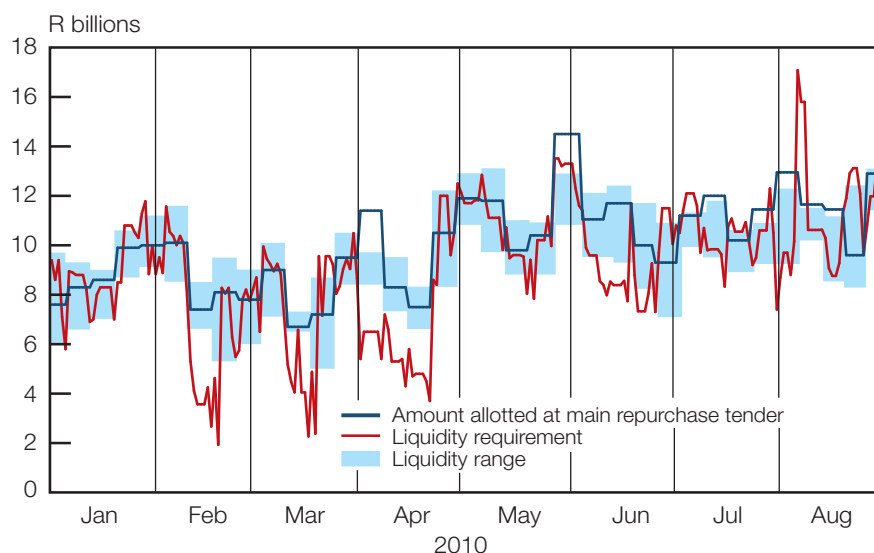
Investors' confidence in emerging markets initially deteriorated somewhat, as indicated by the widening of the JPMorgan Emerging Markets Bond Index Plus (EMBI+) yield spread (above US Treasury yields) from 251 basis points in March 2010 to 337 basis points in June. The spread, however, narrowed again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

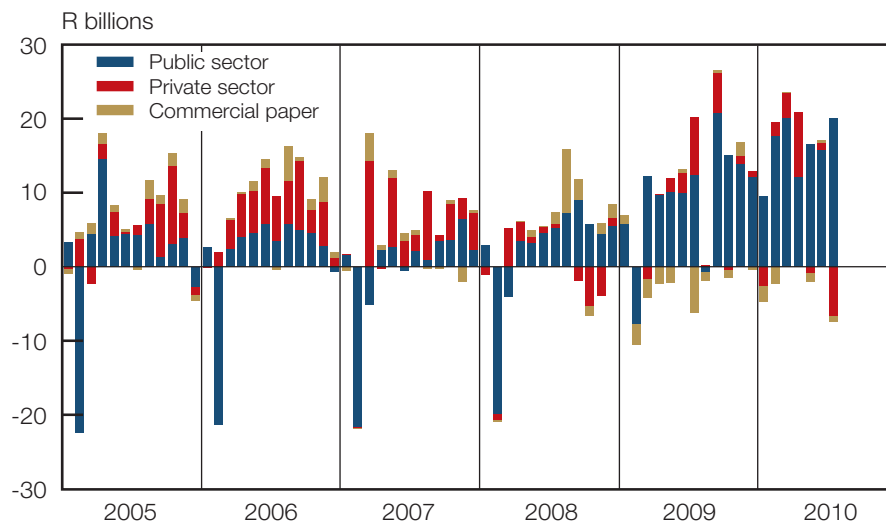
* SARB: South African Reserve Bank

** 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

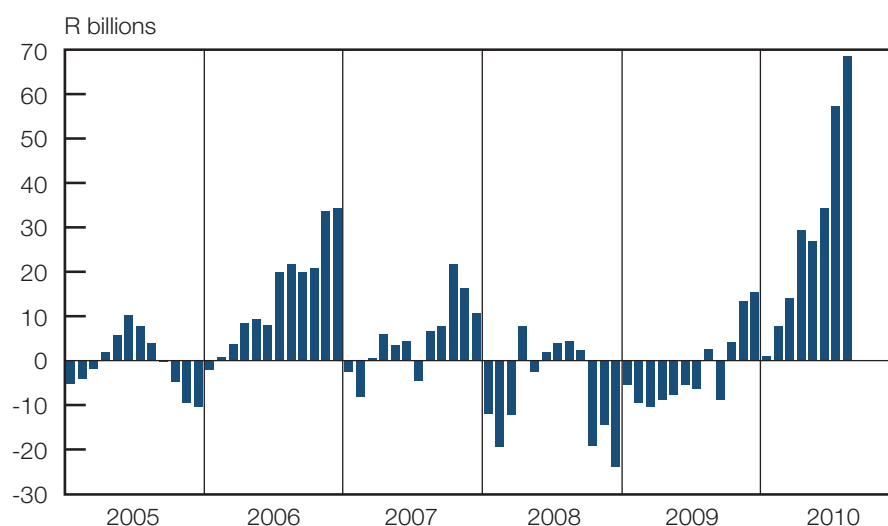
R millions

| | 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



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 liquidity⁸ increased from 47 per cent in 2009 to 52 per cent in the first eight months of 2010.

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.

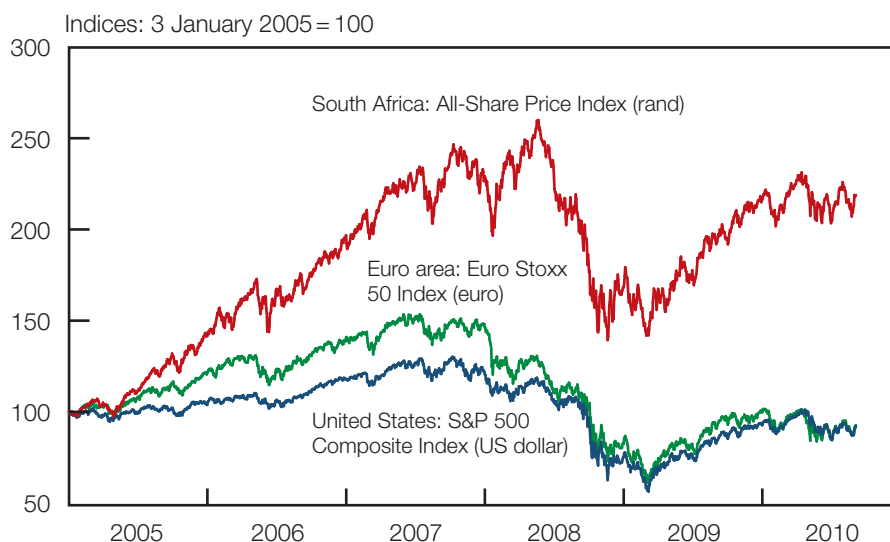
The JSE launched the FTSE/JSE Equally Weighted Top 40 Index in July 2010. The constituents of this new index will always be similar to the constituents of the FTSE/JSE Top 40 Index. However, unlike the Top 40 Index where the constituents are weighted according to market capitalisation, each share price 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

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

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.

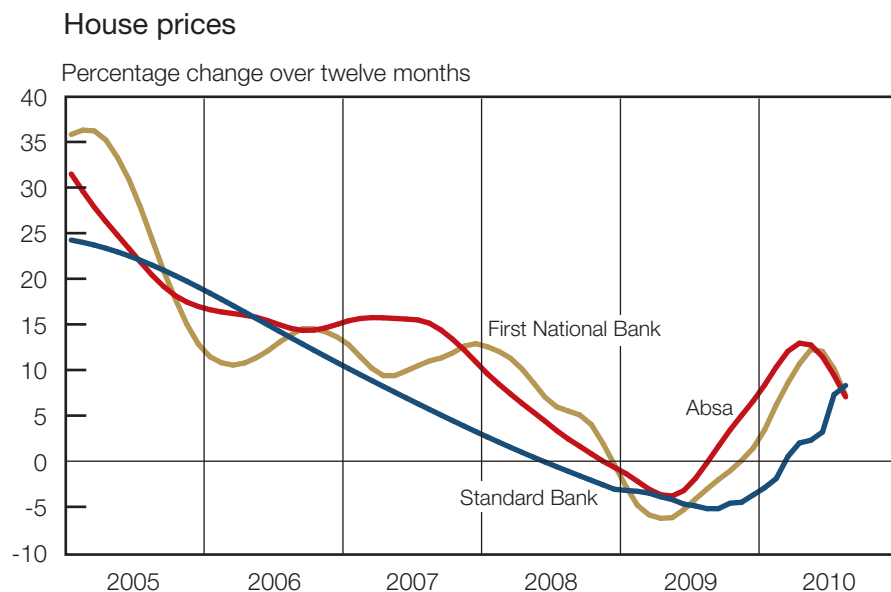
Derivatives turnover on the JSE, January to August 2010

| | 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



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.

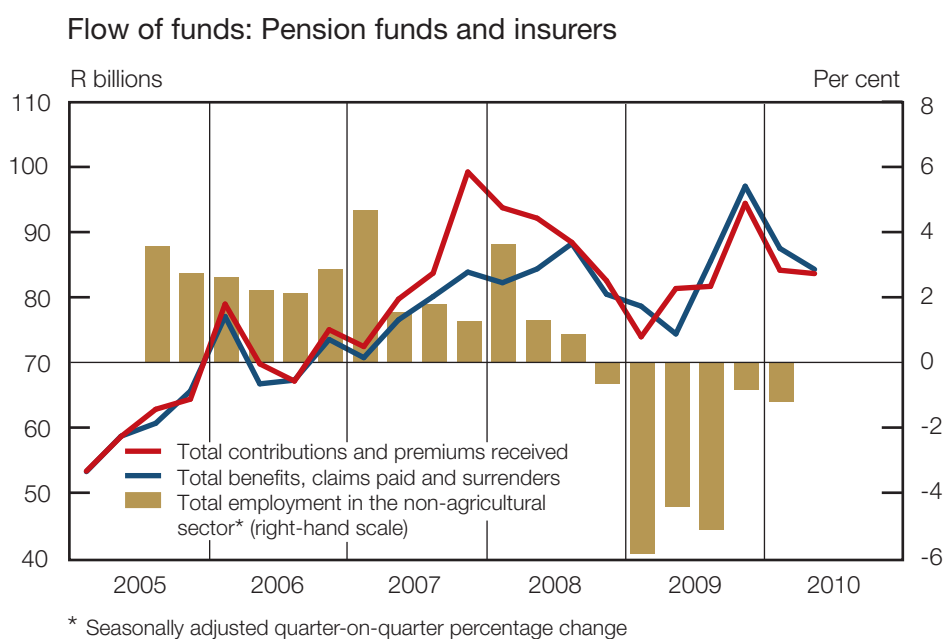
Non-bank financial intermediaries

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 inflows¹⁰ 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 outflows¹¹ 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.

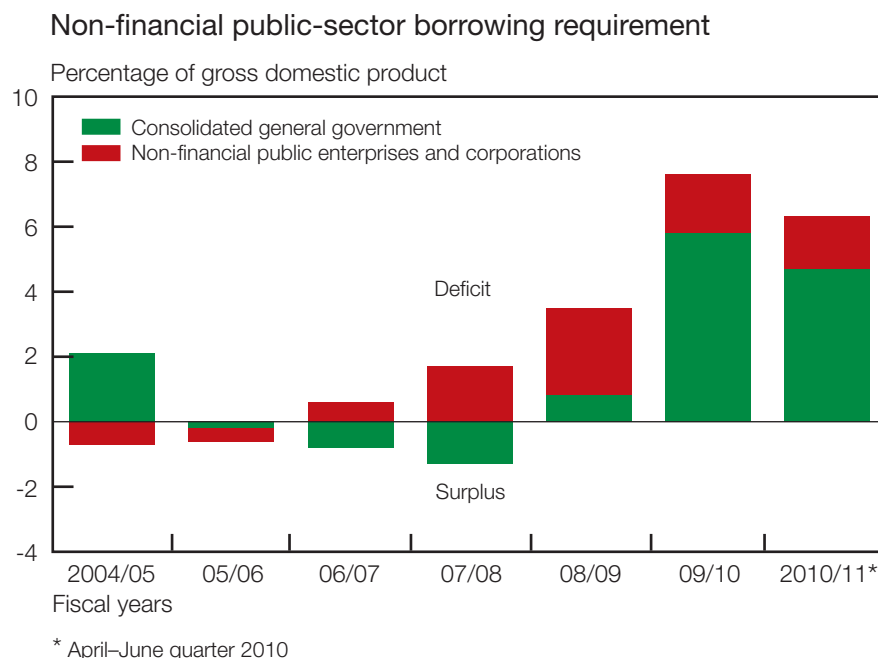


Public finance

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 requirement¹²

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.



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** |
| <i>As a percentage of gross domestic product.....</i> | <i>8,9</i> | <i>6,3</i> |

* 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.

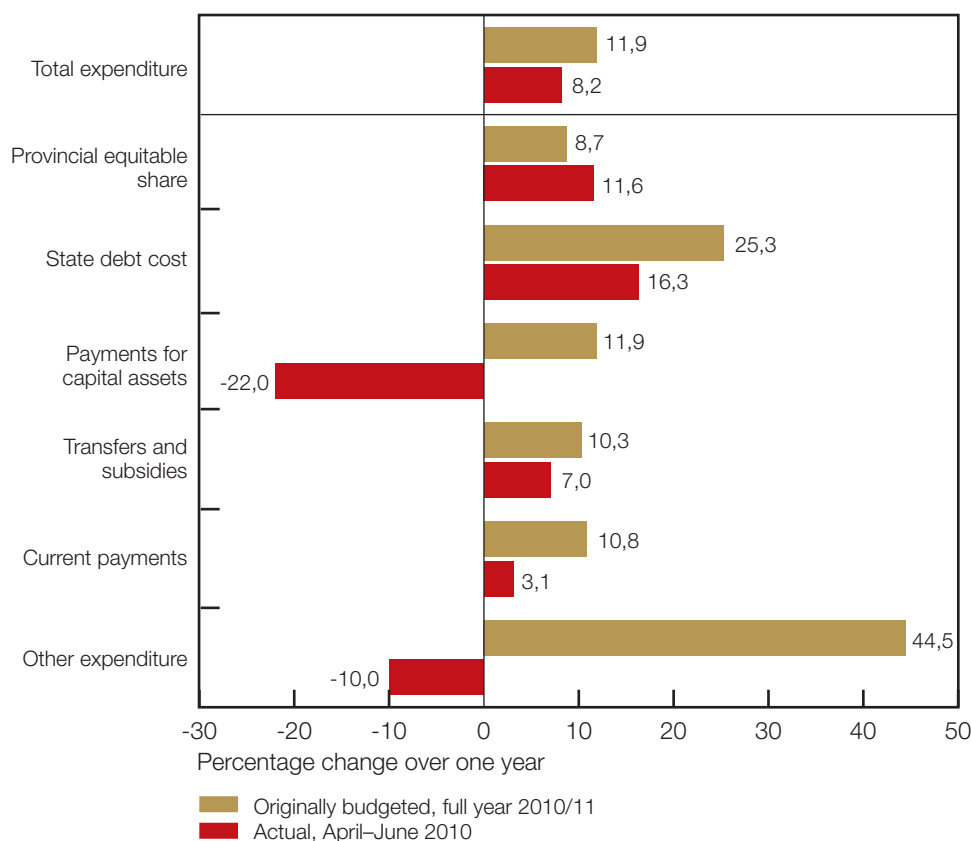
Budget comparable analysis of national government finance

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 GFS¹³ 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 |

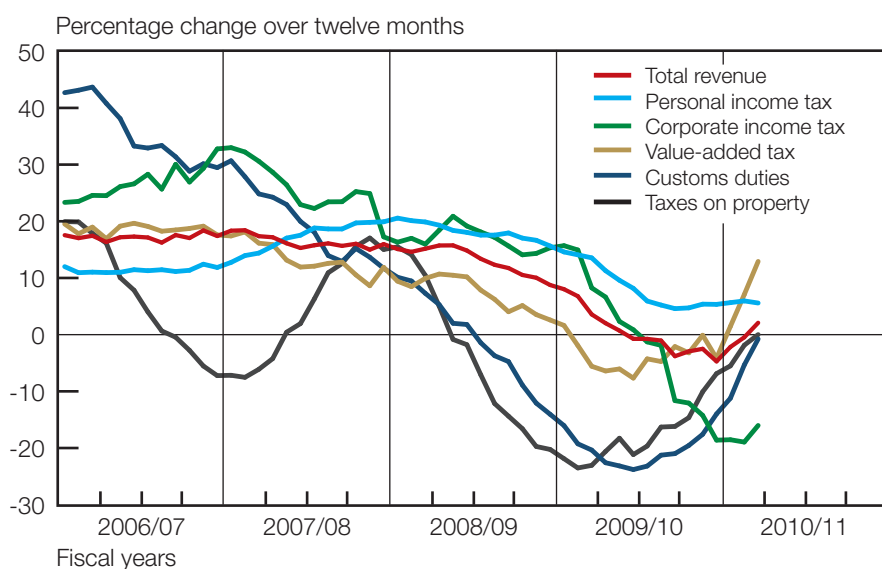
* Fiscal 2009/10 to fiscal 2010/11

** 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.

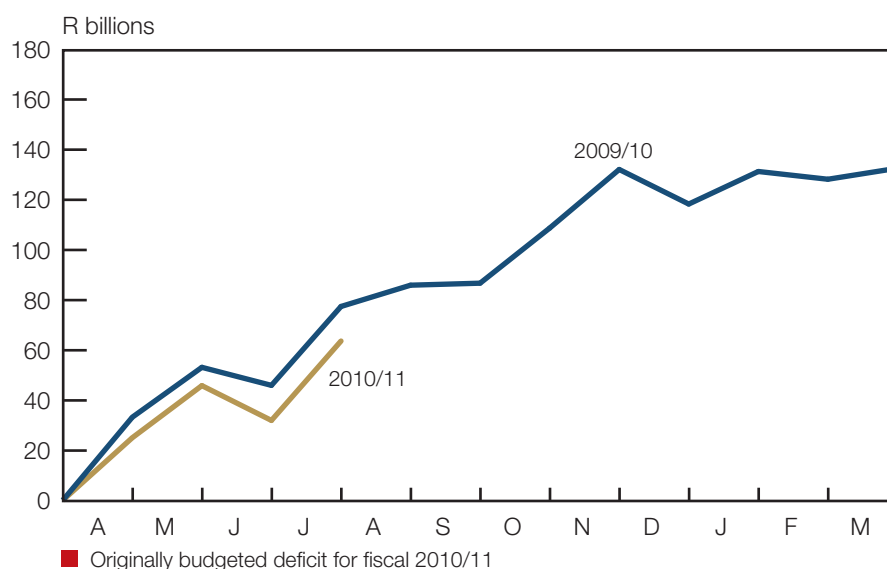
After taking into account cash-flow adjustments, national government's cash-flow revenue equalled R150,2 billion in April–June 2010, or 24,7 per cent more than in the same period a year earlier.

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 balance¹⁵ 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 |
| <i>Plus:</i> Extraordinary payments | - | 0,1 | 0,0 |
| Cost on revaluation of foreign debt at redemption ... | 0,8 | 0,2 | 0,3 |
| <i>Less:</i> 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 financing⁴ | 175,7 | 33,8 | 53,2 |

1 Includes the subordinated loan to Eskom

2 Cash-flow deficit

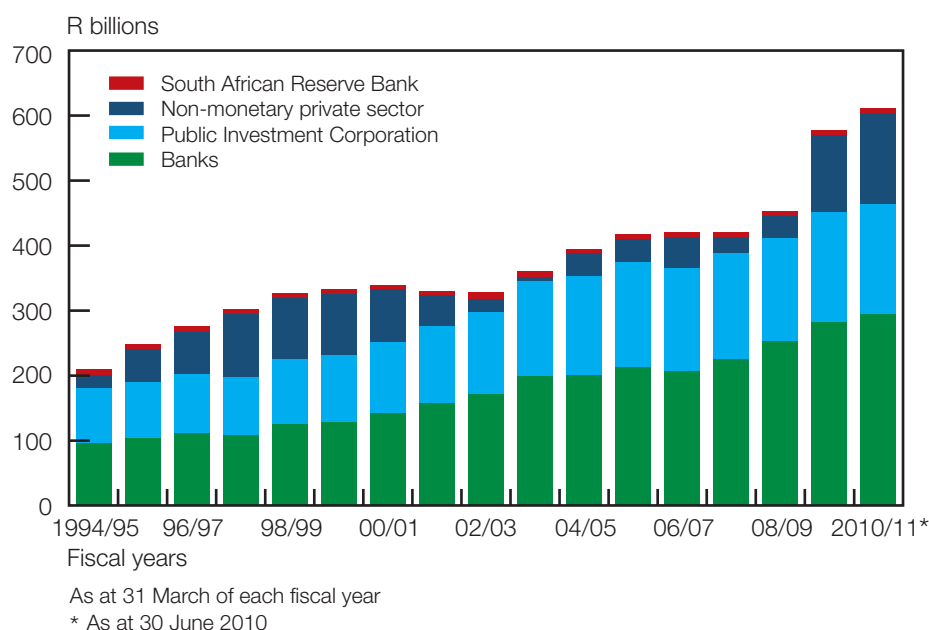
3 Increase – decrease +

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



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.