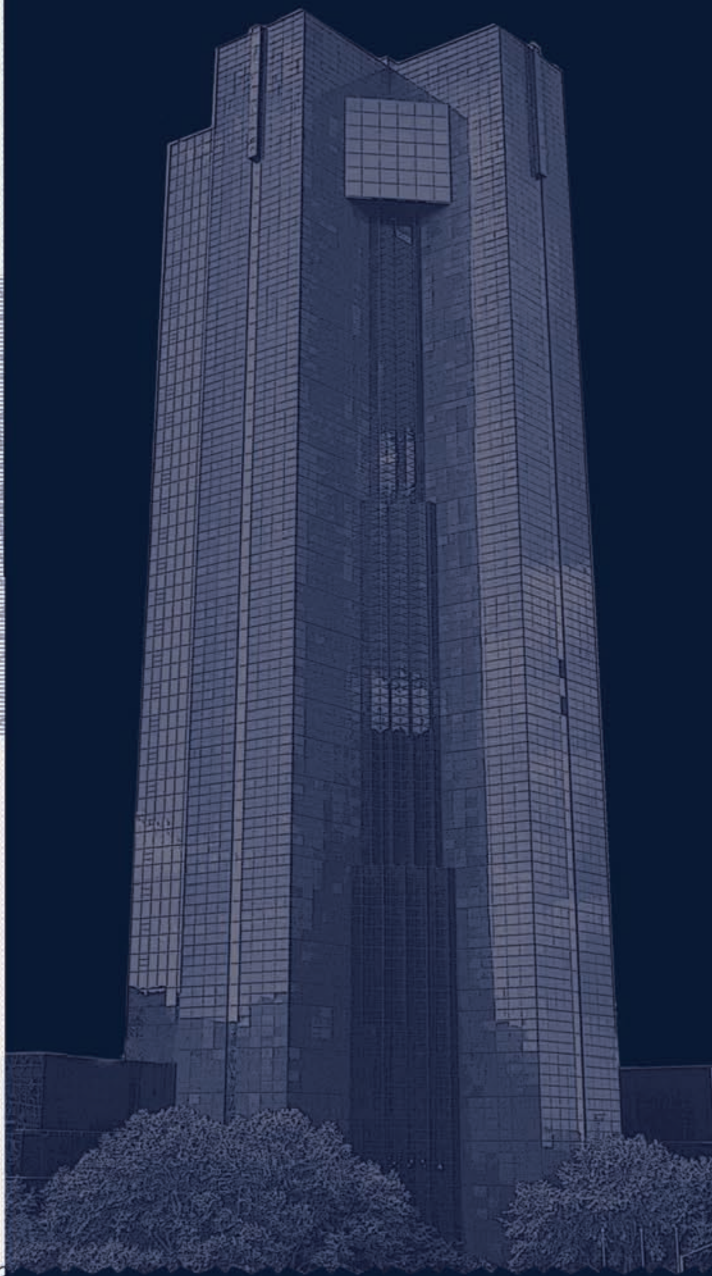

Quarterly Bulletin

September 2011

South African Reserve Bank

90th Anniversary

Quarterly Bulletin

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No. 261

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90th

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Introduction

The pace of recovery in the advanced economies slowed considerably in the second quarter of 2011 as confidence was impaired by the intensification of the fiscal credibility crisis in the euro area and uncertainty about the raising of the federal debt ceiling in the United States (US). Perceptions of sovereign debt risks in the euro area worsened, spreading to Italy and Spain as the progress made by authorities in extending support mechanisms fell short of expectations. By late July 2011 an extension of the resources available to facilitate the rollover of debt and financing of fiscal shortfalls was agreed, partly allaying earlier concerns. In early August the US political structures concluded an agreement to raise the federal debt ceiling just in time to avert financial default, but the process involved and the projected deficit path prompted one of the credit rating agencies to downgrade the credit rating of US sovereign debt. Second-quarter global growth was also held back by the reverberations of the natural disaster that struck Japan in March.

Parallel to the anaemic growth in the advanced economies, economic activity in the developing economies also registered a slower pace of increase in the second quarter of 2011. Growth moderated across a broad spectrum of countries, including China, India, Brazil and Russia. In sub-Saharan Africa most countries continued on a path of recovery, with the speed of the recovery varying between countries but with economic activity in general buoyed by strong export commodity prices. Commodity prices remained relatively high notwithstanding the moderation in global growth, partly because of the high commodity intensity and projected robustness of the growth process in China. At the same time, the international price of gold was bolstered as general uncertainty reinforced the precious metal's attractiveness as a safe-haven investment that has the benefit that it is not the liability of any institution.

Global inflation accelerated further in the second quarter of 2011 mainly due to further increases in certain commodity prices, with price pressures more pronounced in emerging-market than in advanced economies. Central banks in many emerging-market economies accordingly tightened monetary policy by raising interest rates and, in some instances, reserve requirements. Most advanced economies did not tighten monetary policy during the period under review, although the European Central Bank (ECB) raised its policy interest rate in April and July 2011.

Following the brisk pace of economic expansion recorded in the first quarter of 2011, real growth in the South African economy slowed substantially in the second quarter to an annualised rate of only 1,3 per cent. While activity in the tertiary sector expanded further, real value added in the main goods-producing sectors contracted notably in the second quarter. Agricultural output declined in the face of a smaller maize crop than that yielded in 2010 and the impact of heavy rainfall which impacted negatively on field crop and livestock production. Despite attractive international prices of mining commodities, mining activity receded as safety-related production stoppages and technical problems at certain mines contributed to a pronounced contraction in the real output of platinum group metals, while the production of coal, diamonds and gold also declined. Activity in the manufacturing sector recorded a substantial contraction in the second quarter of 2011. This was spread across several subsectors, including the manufacturing of motor vehicles, parts and accessories, which was adversely affected by supply constraints originating from disaster-stricken Japan.

In the tertiary sector the pace of real growth accelerated marginally in the second quarter, buoyed by an increase in value added by the general government sector and higher growth in the transport sector, underpinned by increases in the volume of imports and exports. By contrast, growth in the finance sector decelerated significantly in the quarter under review, while a slight deceleration was recorded in the trade sector.

The real disposable income of households continued to rise in the second quarter of 2011, but at a slower pace. This was reflected in a significant slowdown in the rate of growth in real final consumption expenditure of the household sector, as expenditure on services came close to stagnation and growth in spending on durable goods lost some of its earlier vigour. While households continued to incur more debt, this was proportionately less than the increase in their disposable income, thus resulting in a further decline in the household debt ratio.

Real final consumption expenditure by government contracted marginally in the second quarter of 2011, essentially because the high spending on armaments in the first quarter was not repeated in the second. Excluding military equipment, the underlying trend in government spending remained firmly upward in the first half of the year.

Growth in real fixed capital formation accelerated further in the second quarter to an annualised rate of increase in excess of 4 per cent. All three of the main institutional sectors recorded broadly similar rates of increase in capital formation. In the case of the general government sector, real capital spending rose for the first time after nine quarters of contraction as provincial and local governments stepped up expenditure on housing and construction works. Public corporations continued to invest more in the areas of electricity and transport in order to alleviate bottlenecks and facilitate growth. Capital formation by private business enterprises gathered momentum, propelled by the agricultural and mining sectors, which faced relatively attractive product prices, and the communication sector, driven by technology and competition. Inventory investment slowed somewhat from the first to the second quarter of 2011, alongside the slower growth in aggregate domestic production and expenditure.

With economic growth slowing, household-based survey information shows that employment increased very little in the second quarter of 2011; because the labour force expanded significantly at the same time, the unemployment rate rose further over the period. Average wage settlements moderated somewhat in the first half of 2011 if compared with the same period in 2010. Consumer price inflation, which had hovered around 6 per cent in the opening months of 2010, decelerated to twelve-month rates of less than 4 per cent in late 2010 and early 2011 as the significant output gap and relatively strong exchange value of the rand impacted on inflation. However, as 2011 progressed consumer price inflation picked up renewed momentum, fuelled especially by the prices of food, petrol and electricity. It has, nevertheless, remained within the target range.

While overall real gross domestic expenditure recorded a subdued pace of increase in the second quarter, it was nevertheless accompanied by a further increase in the volume of imports. At the same time, export volumes also rose moderately. Combined with a marginally larger shortfall on the services, income and current transfer account with the rest of the world, these developments resulted in a slightly larger second-quarter deficit on the current account of the balance of payments, amounting to 3,3 per cent of gross domestic product.

The deficit on the current account in the second quarter of 2011 was sufficiently financed by an inflow of capital on the financial account of the balance of payments. Net purchases of South African debt securities by non-residents constituted the largest single source of financing, followed by direct investment inflows mainly directed to the domestic trade, mining and manufacturing sectors. At the same time, South African entities acquired more assets abroad. Turnover in the domestic market for foreign currency receded moderately but still remained elevated in the second quarter, while the effective exchange value of the rand declined marginally over the period and declined further in July and August.

Following a reduction in November 2010, the repurchase rate of the South African Reserve Bank (the Bank) has subsequently remained at 5,5 per cent. In the relatively low interest rate environment, the pace of increase in bank loans and advances to the domestic private sector rose moderately in the first seven months of 2011. The earlier contractions in bank lending to the corporate sector made way for increases, albeit muted, while growth in instalment sale credit and “other” loans and advances picked up notably.

Money-market conditions remained stable in the first eight months of 2011. In the capital market strong non-resident demand for South African bonds, moderate inflation and a somewhat smaller projected public-sector borrowing requirement contributed to a decline in bond yields. South African share prices registered a recent high in mid-February 2011 but subsequently fluctuated lower alongside declining prices on international share markets, reflecting renewed concerns regarding prospects for the US, euro area and global economy in general.

South African house price increases remained hesitant in the first eight months of 2011 as employment gains remained muted, reinforcing the subdued property market turnover and slow pace of increase in mortgage lending. Housing construction activity also remained in the doldrums.

The non-financial public-sector borrowing requirement was marginally higher in the April–June quarter of 2011 than in the corresponding period in 2010, largely on account of a larger national government deficit. While income tax paid by companies picked up significantly in the period concerned, value-added tax collections fell below earlier projections, consistent with the slowdown in domestic expenditure during the quarter. The sizeable deficit was partly shaped by countercyclical considerations, and was readily financed through the issuance of domestic government bonds. As a result, in June 2011 the national government's gross loan debt rose above R1,0 *trillion* for the first time ever.

Domestic economic developments

Domestic output[1]

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

The pace of real output growth in the South African economy slowed considerably in the second quarter of 2011. Following growth at a revised annualised rate of 4,5 per cent in the first quarter of 2011, the pace of increase in *real gross domestic product* decelerated to only 1,3 per cent in the second quarter. This disappointing performance could mainly be attributed to a contraction in the real output of the goods-producing sectors of the economy – the real value added by both the primary and secondary sectors decreased, while growth in the real value added by the tertiary sector edged higher in the second quarter of 2011.

Goods-producing sectors: Contribution to overall gross domestic product

Discouragingly, growth in real gross domestic product excluding the volatile primary sector also moderated steeply from an annualised rate of 5,5 per cent in the first quarter of 2011 to 1,6 per cent in the second quarter.

The real value added by the *primary sector* continued to decline at an annualised rate of 5,2 per cent in the second quarter of 2011, following a contraction of 3,9 per cent in the first quarter. Production in the agricultural and mining sectors declined over the period.

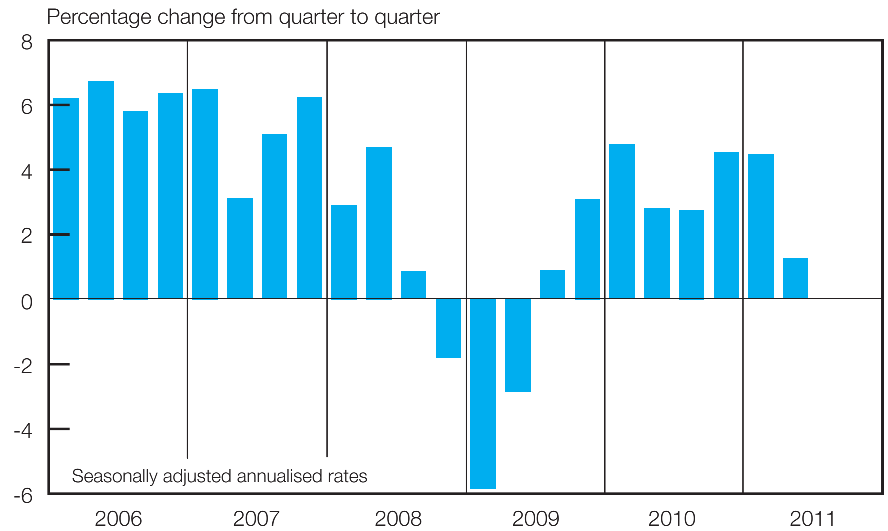
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2010					2011	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	14,7	-15,0	28,3	15,8	4,3	-3,9	-5,2
Agriculture	4,9	13,6	16,3	12,5	0,9	-3,7	-7,8
Mining	18,7	-24,5	33,7	17,1	5,8	-4,0	-4,2
Secondary sector	6,9	4,3	-3,8	3,6	4,1	11,1	-5,2
Manufacturing	8,3	5,7	-4,9	4,1	5,0	14,5	-7,0
Tertiary sector	2,6	4,6	2,0	3,5	2,2	3,7	4,0
Non-primary sector	*3,7*	*4,5*	*0,5*	*3,5*	*2,7*	*5,5*	*1,6*
Total	4,8	2,8	2,7	4,5	2,8	4,5	1,3

The real output of the *agricultural sector* contracted at an annualised rate of 7,8 per cent in the second quarter of 2011 – its second consecutive quarterly decline following a revised decrease of 3,7 per cent in the first quarter. Poor weather conditions in particular hampered the harvesting of the bulk of South Africa's field crop in the second quarter, resulting in lower output volumes. The size of the commercial maize crop for 2011 is estimated at 10,7 million ton, lower than the 12,8 million ton harvested in 2010. Wet conditions as a result of heavy rainfall also affected livestock production in the second quarter of 2011.

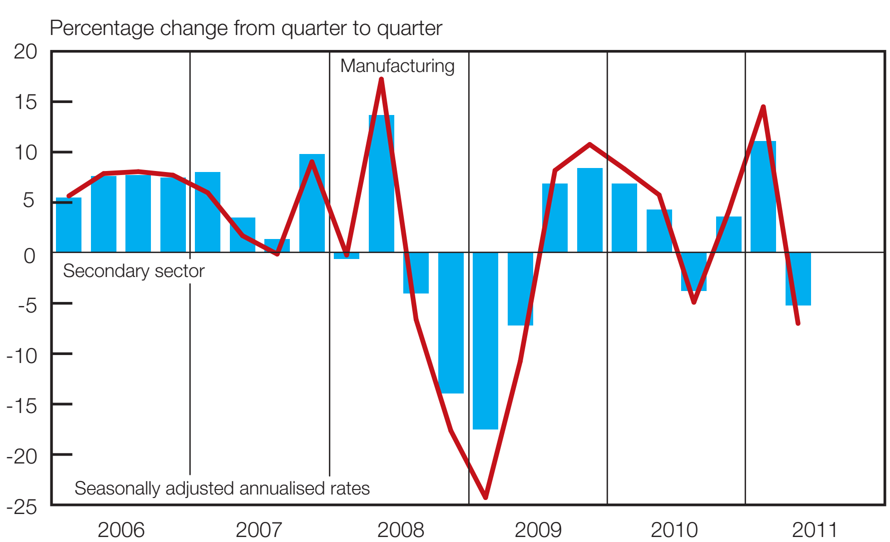
Real gross domestic product



In the *mining sector* real value added declined further at an annualised rate of 4,2 per cent in the second quarter of 2011. Mining production contracted partly in response to weaker global economic conditions and the concomitant lower demand for certain mining commodities. Pronounced decreases were recorded in the production of the platinum group metals, although declines were also registered in the production of coal, diamonds and gold. The mining of platinum group metals was adversely affected by increased safety-related production stoppages and technical problems experienced at certain mines.

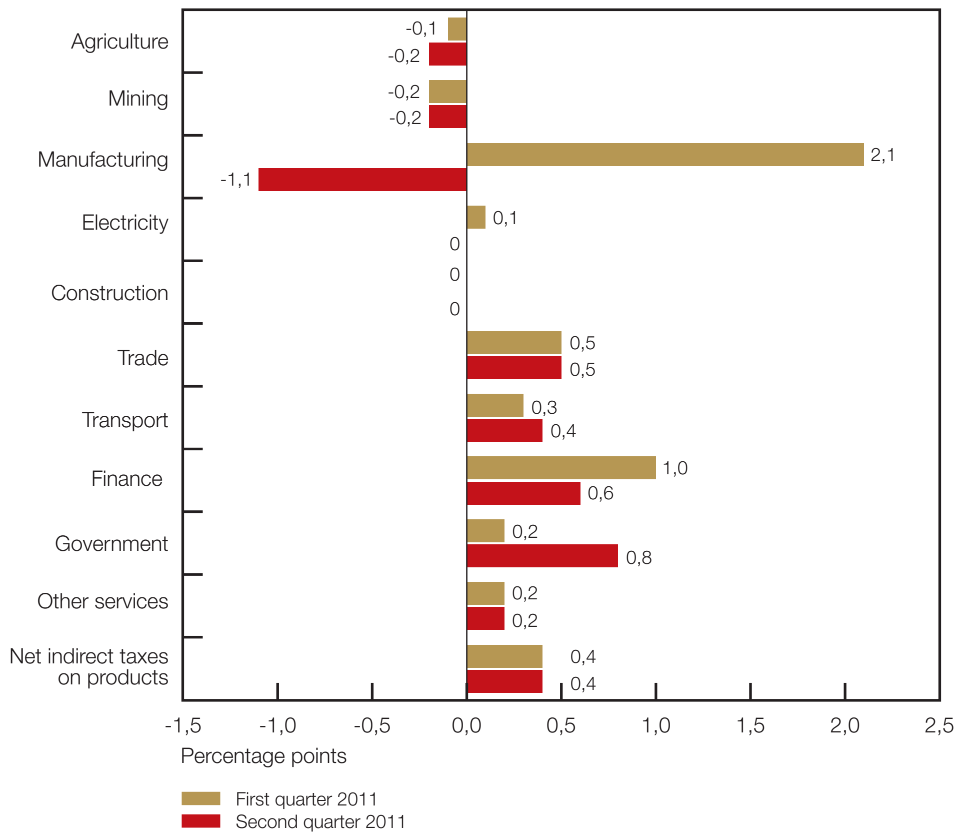
After having increased at an annualised rate of 11,1 per cent in the first quarter of 2011, the real value added by the *secondary sector* contracted at a rate of 5,2 per cent in the second quarter. This disappointing performance was mainly due to a substantial contraction in activity of the manufacturing sector.

Real gross domestic product: Secondary sector



Subsequent to a robust increase of 14,5 per cent in the first quarter of 2011, the real value added by the *manufacturing sector* declined at a rate of 7 per cent in the second quarter, subtracting 1,1 percentage point from the overall rate of economic growth. Following the high base set in the first quarter of 2011, the weakness in production was broad-based, with pronounced decreases registered in the subsectors responsible for the manufacturing of motor vehicles, parts and accessories; wood and wood products, paper, publishing and printing; food and beverages; and petroleum, chemical products, rubber and plastic products.

Contribution to real gross domestic product growth



The negative impact of the natural disaster in Japan in March 2011 became evident in the second quarter when the production of motor vehicles was adversely affected by supply disruptions in the component segment of the sector. In addition to supply constraints originating from Japan, the motor vehicle manufacturing sector also had to face rising costs, increased wage demands, the relative strength of the rand which impacted negatively on export competitiveness, as well as subdued growth in the euro area.

More recently global economic conditions in general have also deteriorated, thereby contributing to sluggish activity in the local export-orientated industries. In addition, deteriorating business activity in the domestic market continued to translate into excess production capacity in the manufacturing sector. Capacity utilisation inched higher to 81,1 per cent in the second quarter of 2011, still well below levels attained during the previous upward phase in the business cycle.

The real value added by the *electricity, gas and water sector* increased moderately at an annualised rate of 0,9 per cent in the second quarter of 2011, compared with an increase of 3,3 per cent in the first quarter. Contrary to household demand for electricity, which increased as the country was gripped by freezing winter temperatures, industrial demand slowed, consistent with lower output levels.

Following virtually no growth in the first quarter of 2011, activity in the *construction sector* expanded hesitantly in the second quarter. The marginal acceleration in growth resulted from a modest rise in civil construction work.

The pace of growth in the real value added by the *tertiary sector* increased somewhat from an annualised rate of 3,7 per cent in the first quarter of 2011 to 4 per cent in the second quarter.

Growth in the real value added by the *trade sector* decelerated from an annualised rate of 4,4 per cent in the first quarter of 2011 to 4,1 per cent in the second quarter, reflecting slower output growth in the retail and motor trade subsectors. The lack of availability of certain vehicle components from Japan negatively impacted the production of certain product lines in South Africa and, together with shortages of various models sourced from Japan, resulted in lower growth in the motor trade subsector. By contrast, the real output of the wholesale trade subsector increased firmly in the second quarter of 2011.

Growth in the real value added by the *transport, storage and communication sector* accelerated marginally from an annualised rate of 3,6 per cent in the first quarter of 2011 to 4,1 per cent in the second quarter. Increased growth resulted from an improved performance in the transport sector, accompanied by continuous steady growth in the communication subsector. The stronger transport activity in the second quarter was broadly consistent with the increase in merchandise import and export volumes.

The pace of growth in real value added by the *finance, insurance, real-estate and business services sector* moderated from an annualised rate of 4,8 per cent in the first quarter of 2011 to 2,9 per cent in the second quarter. Even though slower growth was fairly widespread, it was particularly noticeable in activity in the equity, bond and other financial markets. The low level of activity in the banking sector in the second quarter reflected hesitant domestic demand conditions and relatively low levels of business and consumer confidence in the country.

In contrast to the general slowdown from the first to the second quarter of 2011, growth in the real value added by the *general government sector* accelerated from an annualised rate of 1,8 per cent in the first quarter to 5,7 per cent in the second quarter mainly due to the higher level of employment in the sector.

Real gross domestic expenditure

Consistent with the moderation in domestic production, growth in *real gross domestic expenditure* decelerated from an annualised rate of 7,9 per cent in the first quarter of 2011 to 1,3 per cent in the second quarter. This deceleration primarily resulted from a contraction in real final consumption expenditure by general government alongside slower, although still firm, growth in real final consumption expenditure by households. Real inventory investment slowed while real gross fixed capital formation accelerated meaningfully over the period.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Component	2010					2011	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure							
Households	5,5	4,4	5,7	4,8	4,4	5,2	3,8
General government	7,1	7,1	-0,8	3,9	4,6	9,5	-0,1
Gross fixed capital formation	-2,8	1,2	1,0	1,5	-3,7	3,1	4,1
Domestic final demand	**4,1**	**4,3**	**3,5**	**4,0**	**2,8**	**5,6**	**3,1**
Change in inventories (R billions)*	-7,9	-7,6	-0,9	1,1	-3,8	9,3	5,6
Gross domestic expenditure	10,9	3,2	6,6	2,4	4,2	7,9	1,3

* At constant 2005 prices

Following a robust increase of 5,2 per cent in the first quarter of 2011, growth in *real final consumption expenditure by households* slowed to an annualised rate of 3,8 per cent in the second quarter. The slower pace of increase in spending by households was fairly broad based, with spending being partly constrained by underlying inflationary pressures that affected the disposable income of households.

Real outlays on *durable goods* decelerated from an annualised rate of increase of 21,5 per cent in the first quarter of 2011 to a still-high rate of 12,5 per cent in the second quarter. Alongside increased spending on computers and related equipment, expenditure on most other durable goods categories slowed in the second quarter. Consistent with slow growth in credit extension to households, expenditure on durable goods financed by bank credit moderated in the second quarter of 2011.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2010					2011	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Durable goods	39,2	45,4	13,4	5,0	24,0	21,5	12,5
Semi-durable goods	30,2	9,8	-4,8	4,6	6,5	8,6	8,8
Non-durable goods	12,1	-2,3	2,9	0,2	2,1	3,4	3,6
Services	-10,3	0,7	9,3	8,8	1,9	1,9	0,7
Total	5,5	4,4	5,7	4,8	4,4	5,2	3,8

After having accelerated notably in the fourth quarter of 2010 and the first quarter of 2011, real expenditure on *semi-durable goods* increased further at an annualised rate of 8,8 per cent in the second quarter. Expenditure on most categories of semi-durable goods increased in the second quarter of 2011, with the strongest pace of increase recorded in spending on clothing and footwear. The persistent decline in the prices of both clothing and footwear boosted expenditure on this category, while households also geared up for cold winter temperatures to a greater extent than in previous years. However, spending on motor vehicle tyres, parts and accessories, as well as on recreational and entertainment goods continued to decline in the second quarter.

Households' real spending on *non-durable goods* increased at an annualised rate of 3,6 per cent in the second quarter of 2011, roughly similar to the pace recorded in the preceding quarter. Spending on most non-durable goods categories increased in the second quarter of 2011. Real expenditure on household fuel and power decelerated in the face of high prices, while spending on recreational and entertainment goods also edged lower. In addition, spending on *services*, the largest category of spending by households, registered a slower pace of increase in the second quarter of 2011.

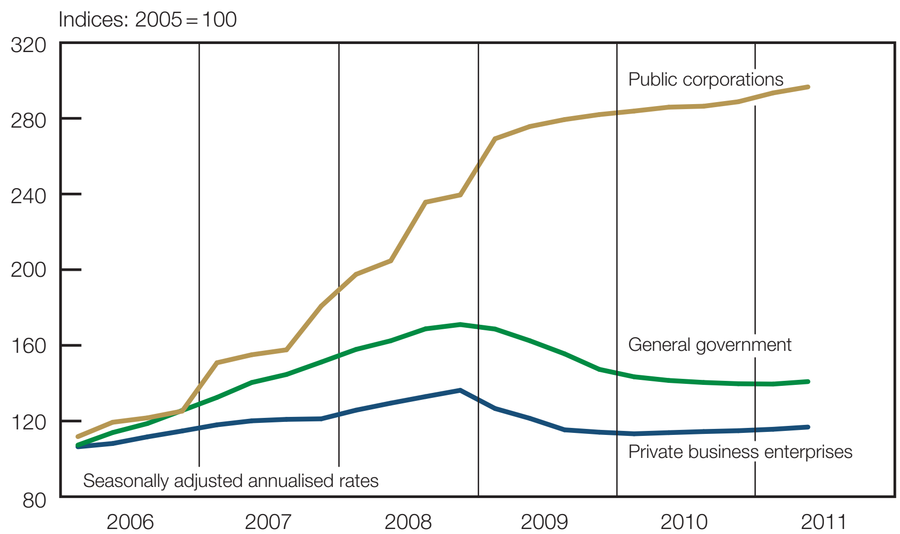
Following an annualised increase of 5,4 per cent in the first quarter of 2011, growth in the real *disposable income of households* slowed to 4,1 per cent in the second quarter. Simultaneously, the nominal level of household debt increased further in the second quarter of 2011, albeit at a slower pace, indicating that households were somewhat less inclined to incur additional debt. Sustained caution among consumers was reflected in the ratio of household debt to disposable income, which trended further downwards from 76,8 per cent in the first quarter of 2011 to 75,9 per cent in the second quarter. At the same time, the slower growth in household debt alongside the relatively low interest rate environment contributed to the marginally lower ratio of debt-service cost to disposable income in the second quarter of 2011.

Real *final consumption expenditure by general government* contracted at an annualised rate of 0,1 per cent in the second quarter of 2011, following an increase of 9,5 per cent in the first quarter of the year. The decline in real spending by general government in the second quarter could mainly be explained by the fact that no armaments were acquired by government in terms of the country's defence procurement programme. If spending on armaments is excluded from the data, real government expenditure increased at an annualised rate of 4,3 per cent in the first quarter of 2011 and 4,8 per cent in the second quarter.

Real compensation of government employees edged higher in the second quarter of 2011 as a result of additional workers that were temporarily recruited to assist with the local municipal elections in May 2011. Furthermore, real government consumption expenditure on non-military goods and non-wage services increased at a steady pace over the same period.

Growth in real *gross fixed capital formation* accelerated from an annualised rate of 3,1 per cent in the first quarter of 2011 to 4,1 per cent in the second quarter. Consequently, the change in gross fixed capital formation contributed 0,7 percentage points to growth in real gross domestic expenditure in the second quarter of 2011 compared with a 0,6 percentage point contribution in the first quarter. Among the three institutional sectors, the public corporations continued to record the strongest growth in capital spending, although capital formation by general government and private business enterprises gained some momentum in the second quarter of 2011.

Real gross fixed capital formation by institutional sector



Growth in real gross fixed capital formation by *private business enterprises* gathered further momentum and accelerated from an annualised rate of 2,7 per cent in the first quarter of 2011 to 4 per cent in the second quarter. Higher capital outlays by the agricultural, mining and transport, storage and communication sectors contributed to the faster pace of increase in capital spending by private business enterprises during the period.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Component	2010					2011	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Private business enterprises	-2,9	2,2	2,0	1,6	-4,4	2,7	4,0
Public corporations	2,6	2,9	0,7	3,3	3,5	6,6	4,4
General government	-10,3	-5,3	-3,0	-1,9	-10,9	-0,5	3,8
Total	-2,8	1,2	1,0	1,5	-3,7	3,1	4,1

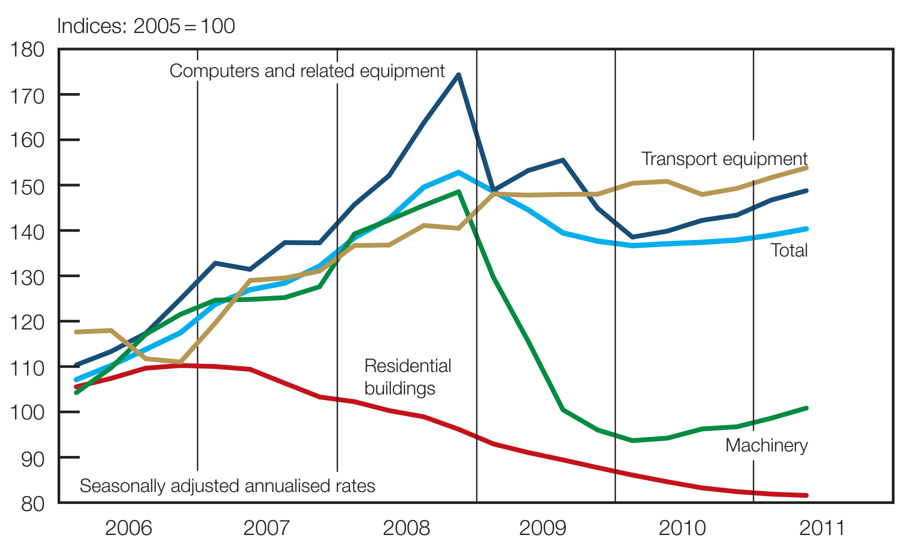
Real capital spending by the agricultural sector continued at a steady pace, boosted by prospects of relatively high commodity prices and the competitive pricing of agricultural equipment largely due to the relative strength of the rand. Expansion in the mining sector continued to be driven by global demand, which gave rise to further capital outlays for the development of coal, gold and platinum mines. Broadband capacity constraints in South Africa, fierce competition and an increased number of subscribers contributed to ongoing capital outlays on the fibre-optic and cellular networks by enterprises in the communication sector.

Real fixed capital expenditure by *public corporations* increased at a brisk annualised pace of 4,4 per cent in the second quarter of 2011, moderately below the rate of 6,6 per cent in the preceding quarter. Capital expenditure by the electricity and transport sectors remained vigorous. Eskom raised its capital spending on especially vehicles and machinery and other equipment as work on its ongoing projects continued, notably the construction of the Medupi, Kusile and Ingula power stations. Transnet's ongoing capital projects, in particular the new multi-product pipeline, gave rise to increased expenditure, especially on machinery and equipment, and construction works.

Having contracted uninterruptedly for nine consecutive quarters, real gross fixed capital expenditure by *general government* increased by 3,8 per cent in the second quarter of 2011 as provincial and local government departments stepped up capital spending in the areas of housing and construction works. In addition, capital outlays by local government increased in order to source alternative methods of energy production.

Classified by type of asset, the increase in real fixed investment activity in the second quarter of 2011 stemmed mainly from higher spending on machinery, transport equipment, and computers and related equipment. Real outlays on residential buildings contracted slightly further over the period as conditions in the real-estate market remained subdued, continuing the trend of the past four years.

Real gross fixed capital formation by type of asset



The level of *real inventory* accumulation slowed from the first to the second quarter of 2011 – real inventory investment (annualised, at 2005 prices) amounted to R5,6 billion in the second quarter of 2011 compared with R9,3 billion in the first quarter. The slower accumulation of inventories was evident in most of the sectors, with the exception of the mining and manufacturing sectors.

In the mining sector there was a notable build-up of coal inventories. In the manufacturing sector the accumulation of inventories was achieved through higher crude oil imports in order to replenish existing low stock levels, brought about by maintenance work conducted on refineries during the first quarter of 2011. Consequently, the level of industrial and commercial inventories as a percentage of non-agricultural gross domestic product increased further from 11,4 per cent in the first quarter of 2011 to 11,8 per cent in the second quarter.

Factor income

The year-on-year growth in total *nominal factor income* slowed from a rate of 11,1 per cent in the first quarter of 2011 to 9,6 per cent in the second quarter. This was the result of slower growth in both the compensation of employees and the gross operating surplus of business enterprises.

The rate of increase in *compensation of employees,* measured over four quarters, moderated marginally from 10 per cent in the first quarter of 2011 to 9,5 per cent in the second quarter. Employment growth remained lacklustre while the average level of wage settlements remained around 7,5 per cent in the first half of 2011. Consequently, the ratio of compensation of employees to total factor income edged lower from 49,8 per cent in the first quarter of 2011 to 49,5 per cent in the second quarter.

Measured over one year, growth in the economy's *gross operating surplus* decelerated to a rate of 9,6 per cent in the second quarter of 2011, well below the rate of increase of 12,2 per cent attained in the first quarter. By contrast, the share of gross operating surplus in total factor income inched higher from 50,2 per cent in the first quarter of 2011 to 50,5 per cent in the second quarter. The operating surplus of the manufacturing sector decelerated due to lower production levels brought about by the disruption in the supply of vehicle parts and accessories during the period under review. Furthermore, lower commodity prices and weaker domestic and global consumption contributed to the slower growth in the operating surplus.

Gross saving

The *national saving* ratio decreased from 16,3 per cent in the first quarter of 2011 to 16,1 per cent in the second quarter. This marginal change in the saving performance resulted from lower general government saving, largely offset by higher saving by households and the corporate sector. As simultaneously nominal gross capital formation edged higher, the need for foreign capital to finance capital formation increased slightly. This was evident in the moderate although slightly larger deficit on the current account, and accompanying modest increase in the foreign financing ratio from 15,8 per cent in the first quarter of 2011 to 17 per cent in the second quarter.

Gross saving by the *corporate sector* as a percentage of gross domestic product increased from 15 per cent in the first quarter of 2011 to 15,6 per cent in the second quarter. The improvement in the saving performance was due to moderate growth in the gross operating surpluses of incorporated business enterprises that was partially offset by higher tax payments and sustained high dividend payments.

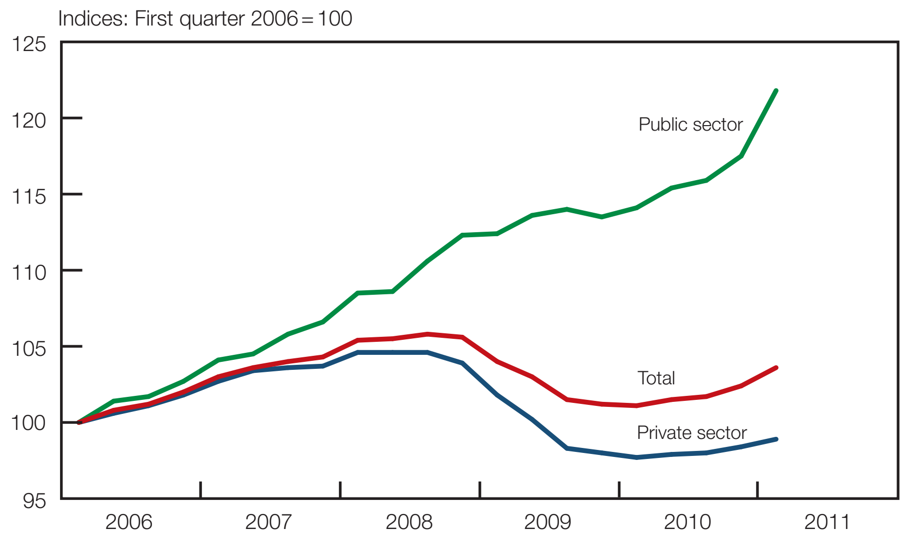
The gross saving ratio of *households* increased from 1,5 per cent in the first quarter of 2011 to 1,6 per cent in the second quarter. Households maintained a fairly constant level of saving amid difficult economic conditions. Growth in disposable income that was marginally above increases in household consumption expenditure contributed to improved household saving in the current quarter.

The saving ratio of *general government* decreased in the second quarter of 2011 and the government continued to dissave. Collections of value-added tax and personal income tax were subdued in the quarter under review, indicating continued sluggish economic conditions. This was, however, partly neutralised by well-contained government consumption expenditure. Consequently, gross dissaving by general government as a percentage of gross domestic product worsened marginally from 0,3 per cent in the first quarter of 2011 to 1 per cent in the second quarter.

Employment

Despite having been in an upward phase of the business cycle since September 2009, the South African economy has struggled to create employment on an adequate scale. Whereas enterprise-surveyed data show that an estimated 377 000 jobs were lost in the formal non-agricultural sector between the third quarter of 2008 and the low point in employment reached in the first quarter of 2010, the economy only regained an estimated 202 000 jobs in the subsequent year to the first quarter of 2011.

Total formal non-agricultural employment



Seasonally adjusted

Source: Statistics South Africa, *Quarterly Employment Statistics* Survey

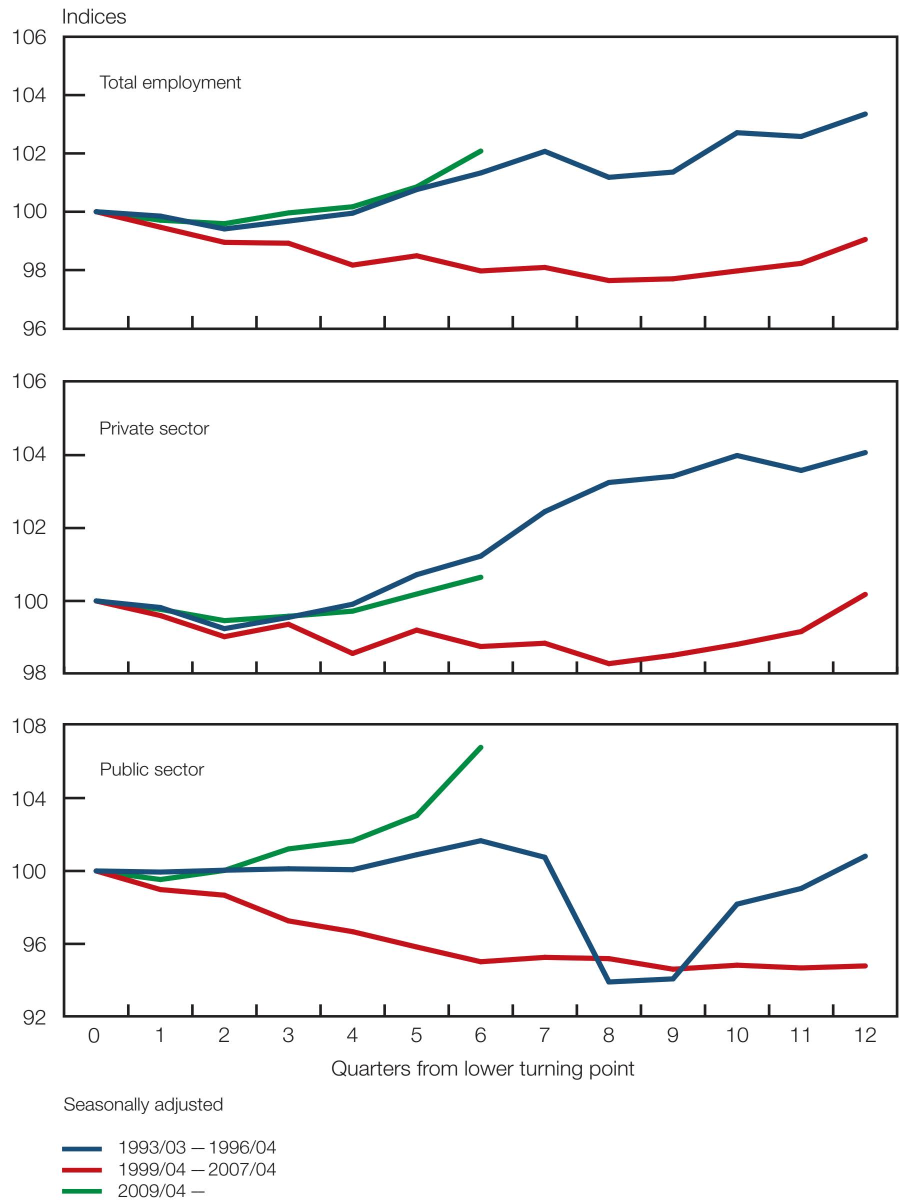
As indicated in the graphs on page 13, which compare the movements in formal non-agricultural employment during the most recent three upward phases of the South African business cycle,[2] total employment rose at a slightly faster pace during the current upward phase when compared with the preceding two upward phases. This development was entirely due to meaningful increases in public-sector employment. Private-sector employment growth, which currently still lags the pace of increase in employment registered during the 1993–1996 upward phase, is nevertheless outperforming growth attained during the first two years of the previous upward phase that commenced in September 1999 and ended 33 quarters later in November 2007. Some gains in total employment during that phase only occurred after nine quarters.

2 Third quarter 1993 to fourth quarter 1996; fourth quarter 1999 to fourth quarter 2007; and the current upswing starting in the fourth quarter of 2009.

Since the current upward phase in the South African business cycle started in September 2009, a total number of 169 000 employment opportunities have been created, of which 128 000 jobs were created in the public sector alone. The public sector's share of total employment is currently 24 per cent. The manufacturing and gold-mining sectors have not as yet shown any significant recovery in employment numbers since the start of the most recent upward phase.

Focusing on most recent employment statistics, the *Quarterly Employment Statistics (QES)* survey of Statistics South Africa (Stats SA) shows that formal non-agricultural employment increased further in the first quarter of 2011 as the series recorded its fourth consecutive quarterly increase. Increases occurred in both the public and private sectors during the period. Public-sector employment rose at an annualised rate of 15,3 per cent, outpacing the 1,9 per cent increase recorded in the private sector by a fair margin. The surge in employment numbers in the public sector could largely be attributed to the creation of almost 56 000 job opportunities in the category *other public enterprises*, the bulk of which was temporary workers employed by the Independent Electoral Commission of South Africa to assist with the municipal elections held in May 2011. The lacklustre growth in private-sector employment reflected, among other factors, subdued global economic activity; sluggish demand in certain more labour-intensive

Formal non-agricultural employment during the latest three upward phases in the South African business cycle



sectors; technological renewal; a scarcity of skilled labour; rising unit labour costs; the relative strength of the exchange value of the rand and strong productivity gains in some competing economies, which eroded the international price competitiveness of domestic producers; various bottlenecks; and low business confidence levels.

Employment gains in the private sector during the first quarter of 2011 were broad-based, with job losses only recorded in the private transport, storage and communication services sector. Pronounced first-quarter employment gains expressed at annualised rates were noted in the non-gold mining sector (10,2 per cent); the construction sector (6,9 per cent); the community, social and personal services sector (3,9 per cent); and the finance, insurance, real-estate and business services sector (1,4 per cent). However, in the manufacturing and electricity sectors, employment levels increased only marginally.

As a consequence, overall formal non-agricultural employment increased at a seasonally adjusted and annualised rate of 5,0 per cent in the first quarter of 2011, roughly equal to 100 000 new job opportunities, bringing the level of enterprise-surveyed formal non-agricultural employment to 8,3 million.

Changes in employment

	Cumulative job losses (-) gains (+)		Change over one quarter			
			2010			2011
	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 1st qr 2011	2nd qr	3rd qr	4th qr	1st qr
Finance, insurance, real-estate and business services	-166 700	51 600	17 600	7 800	19 800	6 400
Manufacturing	-112 200	-21 800	-16 000	-11 100	3 700	1 600
Trade, catering and accommodation services	-78 500	20 200	3 100	14 800	-500	2 800
Construction	-50 700	-8 900	-5 000	-2 700	-7 900	6 700
Total mining	-35 000	19 300	3 100	4 700	2 300	9 200
Gold-mining	-8 100	-8 100	-2 200	-3 200	-3 200	500
Other mining	-26 800	27 400	5 300	7 900	5 500	8 700
Electricity	-3 400	2 900	1 000	800	900	100
Private transport, storage and communication services	-2 000	-2 200	1 300	-4 000	2 200	-1 600
Community, social and personal services	13 400	13 400	2 300	-1 700	8 600	4 100
Private sector	**-435 000**	**74 500**	**7 400**	**8 600**	**29 100**	**29 300**
Provinces	51 600	41 200	11 300	10 100	15 000	4 800
Local governments	14 700	9 300	4 900	-200	2 000	2 500
National departments	-1 100	14 000	7 200	-1 000	400	7 400
Other public-sector enterprises	-1 900	61 200	-600	500	5 200	56 200
Public transport, storage and communication services sector	-4 900	2 100	-500	-1 100	3 800	-200
Public sector	**58 400**	**127 800**	**22 300**	**8 300**	**26 400**	**70 700**
Grand total	**-376 600**	**202 300**	**29 700**	**16 900**	**55 500**	**100 000**

Seasonally adjusted

Source: Statistics South Africa, *Quarterly Employment Statistics (QES)* Survey

On a year-on-year basis, employment gains in the private sector accelerated from 0,4 per cent in the fourth quarter of 2010 to 1,2 per cent in the first quarter of 2011, while employment growth in the public sector accelerated from 3,5 per cent to 6,7 per cent over the same period. In total, employment increased by 2,5 per cent, or 202 000 jobs in the year to the first quarter of 2011.

Buoyant growth in manufacturing production in the first quarter of 2011 was not accompanied by strong employment gains during the period. In fact, employment growth moderated somewhat from the final quarter of 2010 to the first quarter of 2011. Disappointingly, the Kagiso Purchasing Managers Index (PMI), reflecting purchasing managers' expectations in the manufacturing sector, declined sharply in the four months to July 2011. The plunge from 53,9 index points in June 2011 to 44,2 index points in July represented the second-largest decline between any two periods since late 1999, and was exacerbated by industrial action in the manufacturing sector. Consistent with the overall trend in the PMI, the sub-index for employment dropped from 47,7 to 39,1 index points, emphasising the dismal prospects for job creation in the manufacturing sector.

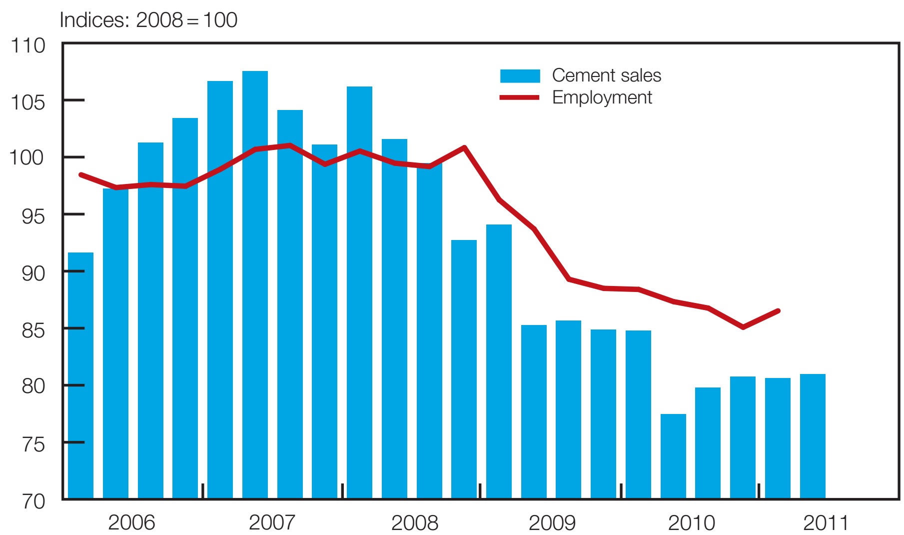
In the mining sector, employment gains occurred predominantly in the non-gold mining industry, reflecting the relatively strong demand for South African commodities by especially Asian and other emerging-market economies, alongside elevated commodity prices. Employment numbers in the non-gold mining sector consequently increased steadily throughout 2010 and continued to advance in the first quarter of 2011. By contrast, the gold-mining sector shed jobs during the last three quarters of 2010, before expanding its staff complement only marginally in the first quarter of 2011.

The creation of additional capacity to meet the increased electricity demand contributed to a steady increase in employment numbers in the electricity, gas and water sector, although the pace of increase moderated somewhat in the first quarter of 2011. On a year-on-year basis, employment growth in the electricity sector, however, accelerated from 4,6 per cent in the fourth quarter of 2010 to 5,2 per cent in the first quarter of 2011, confirming the authorities' commitment to upgrading existing electricity-generating and transmission facilities.

Brisk increases in demand in the first quarter of 2011 underpinned employment gains in the trade, catering and accommodation services sector, and in finance, insurance, real-estate and business services which, together, account for around 42 per cent of total formal non-agricultural sector employment. Job creation in these sectors benefited from strong consumer spending in the opening months of 2011.

Employment in the construction sector, which contracted unabatedly in 2009 and 2010, increased by 6 700 jobs in the first quarter of 2011. Subdued public- and private-sector fixed investment, and extremely low confidence levels in the building and construction industries contributed to the moderate employment growth in the sector. According to the First National Bank/Bureau for Economic Research at Stellenbosch University (FNB/BER) Civil Construction Confidence Index, confidence levels fell from 27 in the fourth quarter of 2010 to 21 in the first quarter of 2011. A reading of 21 – the lowest level in 11 years – indicates that only one out of five civil contractors had rated prevailing business conditions as satisfactory during the period. In the second quarter the index inched higher to a reading of 23 as cement sales also rose marginally.

Employment in the construction sector and national cement sales



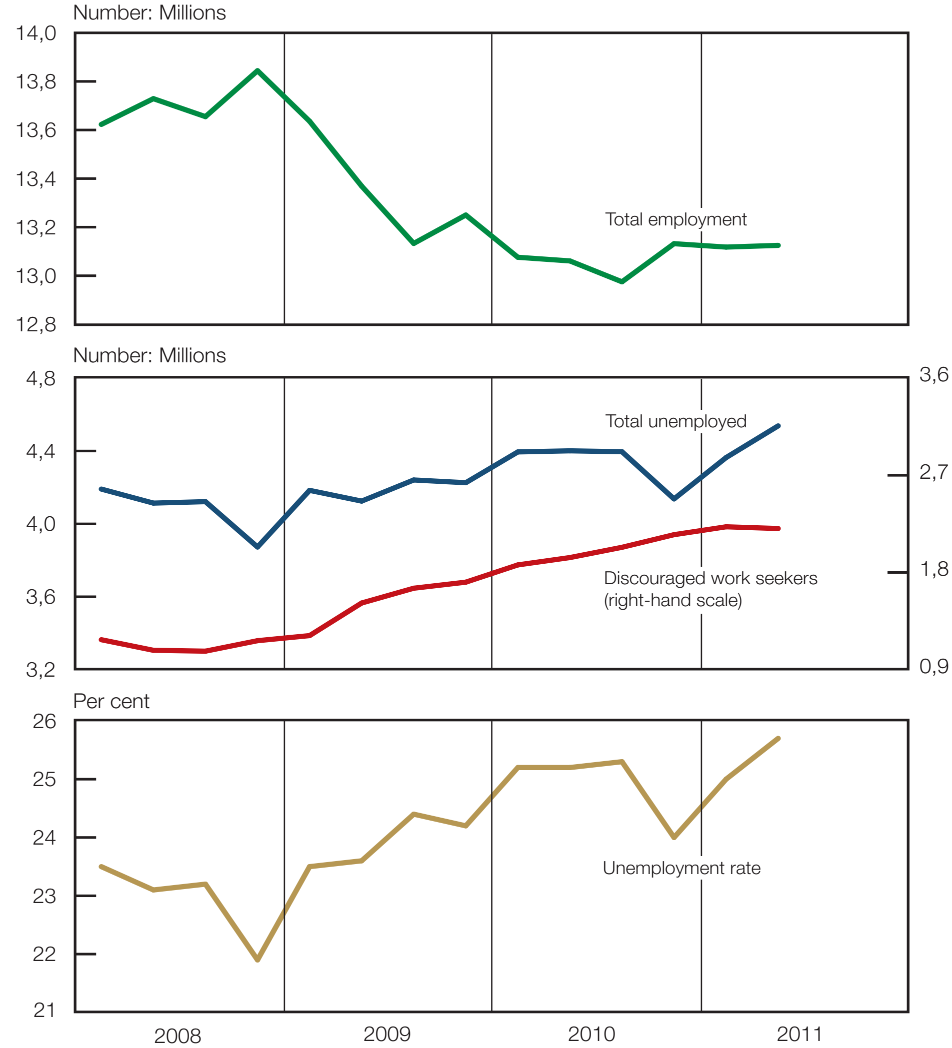
Seasonally adjusted

As noted, employment in the public sector continued to increase steadily during the most recent economic recession. Measured on a year-on-year basis, public-sector employment growth accelerated from 3,5 per cent in the fourth quarter of 2010 to 6,7 per cent in the first quarter of 2011. With the exception of other public-sector enterprises, which included a large number of temporary workers as already indicated, the highest increase was recorded by the provinces (4,1 per cent), followed by local governments (3,9 per cent) and national departments (3,4 per cent).

According to the household-based *Quarterly Labour Force Survey* (QLFS) published by Stats SA, the number of employed people rose by a mere 7 000 in the second quarter of 2011 compared with the preceding quarter.[3] However, the number of unemployed rose by 174 000, expanding the number of people in the labour force by 181 000. As a result, the official unemployment rate increased from 25,0 per cent in the first quarter of 2011 to 25,7 per cent in the second quarter. Of concern is the number of discouraged work-seekers in the economy, which increased by roughly 600 000 to 2,2 million during the current upward phase in the business cycle.

3 Preliminary seasonal adjustment of this relatively short quarterly time series indicates that seasonally adjusted employment rose by 39 000 in the second quarter of 2011.

Labour market developments



Not seasonally adjusted

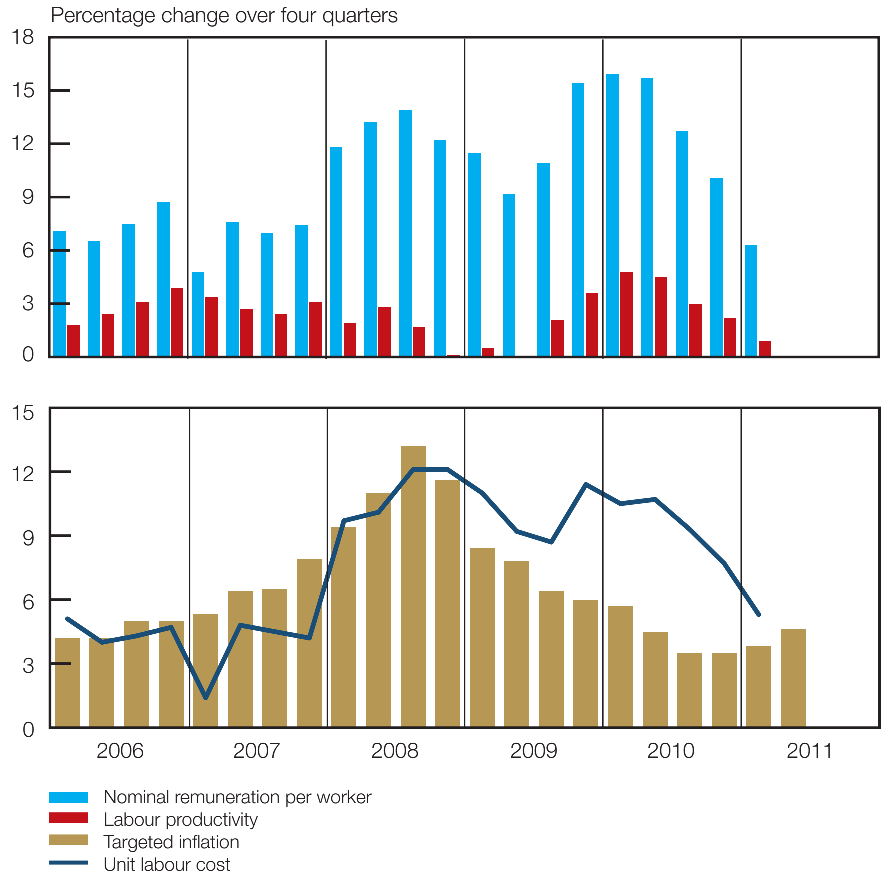
Source: Statistics South Africa, *Quarterly Labour Force Survey*

Labour cost and productivity

Year-on-year headline consumer price inflation moderated meaningfully from a high of 13,2 per cent in the third quarter of 2008 to 3,8 per cent in the first quarter of 2011. By contrast, the year-on-year rate of increase in the nominal remuneration per worker in the formal non-agricultural sector of the economy remained elevated during the period, recording rates generally in excess of 10 per cent. The rate of increase, however, slowed to 10,1 per cent in the final quarter of 2010, before moderating even further to 6,3 per cent in the first quarter of 2011. Increases in remuneration per worker remained high in the gold-mining sector (14,5 per cent over the year to the first quarter of 2011); the manufacturing sector (10,7 per cent); the construction sector (10,2 per cent); the private transport, storage and communication sector (10,3 per cent); and the trade, catering and accommodation services sector (7,9 per cent). Lower increases were recorded in the finance, insurance, real-estate and business services sector; and in the community, social and personal services sector.

According to the Wage Settlement Survey conducted by Andrew Levy Employment Publications, the average wage settlement rate amounted to 8,2 per cent in 2010. Wage settlements thereafter moderated to 7,5 per cent in the first half of 2011. Management's initial offers ranged from 3,5 per cent to 9 per cent and averaged 6 per cent, compared with a rate of 6,5 per cent a year earlier. Initial wage demands from trade unions ranged between 9,5 per cent and 30 per cent, and averaged 15,1 per cent, compared with 16 per cent demanded over the corresponding period a year earlier. Furthermore, the number of working days lost due to strike action fell from 1,25 million in the first half of 2010 to 400 000 in the first half of 2011.

Remuneration per worker, labour productivity and nominal unit labour cost in the formal non-agricultural sector



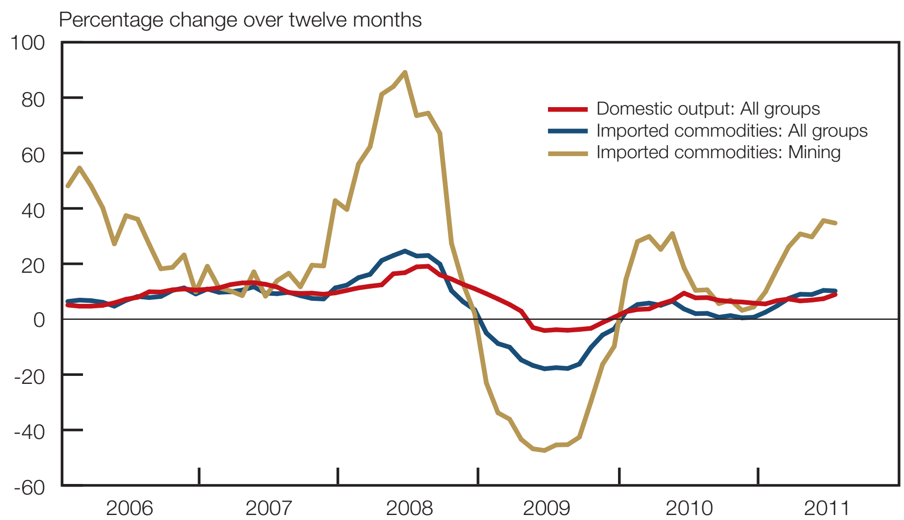
Increases in real output of the non-agricultural sector of the economy in the year to the first quarter of 2011 continued to outpace that of overall formal non-agricultural employment, but by a smaller margin than before. Accordingly, economy-wide labour productivity growth decelerated further from 2,2 per cent in the fourth quarter of 2010 to 0,9 per cent in the first quarter of 2011. The rate of increase in labour productivity in the manufacturing sector, however, accelerated over the same period as growth in manufacturing output outpaced employment gains. The moderation in productivity growth per worker in the formal non-agricultural sector was exceeded by the deceleration in increases in average salaries and wages per worker in the first quarter of 2011, resulting in a moderation in year-on-year growth in nominal unit labour cost from 7,7 per cent in the fourth quarter of 2010 to 5,3 per cent in the first quarter of 2011, the latter value being consistent with the inflation target range.

Prices

Headline consumer price inflation accelerated from a low of 3,2 per cent in the year to September 2010 to 5,3 per cent in the year to July 2011, nevertheless remaining within the inflation target range of 3 to 6 per cent for 18 consecutive months after entering it in February 2010. The main drivers of the upward trend in consumer price inflation were the food and non-alcoholic beverages and transport categories. Producer price increases for domestic output moderated in the second half of 2010 from a peak year-on-year rate of 9,4 per cent in June 2010 to a low of 5,5 per cent in January 2011, before accelerating to 8,9 per cent in July 2011, particularly as a result of accelerating electricity prices.

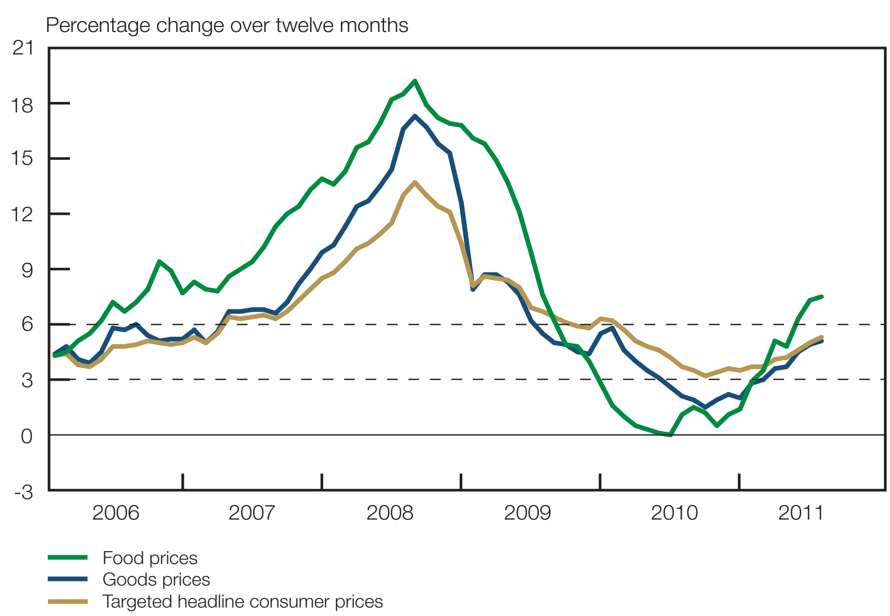
The fundamental drivers of the acceleration in domestic producer price inflation were imported commodity prices and specifically price increases in the imported agricultural and mining categories. Imported producer price inflation accelerated markedly from 0,5 per cent in November 2010 to 10,4 per cent in June 2011, before moderating to 10,2 per cent in July. Imported producer price inflation at the agricultural level accelerated to 13,6 per cent in April 2011, before moderating in ensuing months to 5,0 per cent in July. Owing to a steep increase in international crude oil prices, producer price inflation for imported commodities accelerated notably over the period. Crude oil prices, however, receded somewhat in May and June 2011, before rising again in July, while imported producer price inflation at the manufacturing level remained subdued.

Producer prices of domestic output and imported commodities



The moderation in headline consumer price inflation since September 2008 continued until September 2010, accelerating steadily thereafter to 5,3 per cent in the year to July 2011. The acceleration in headline CPI inflation resulted mainly from an acceleration in the rates of increase in the prices of consumer goods. Year-on-year consumer goods price inflation moderated to below the lower limit of the inflation target range in June 2010, amounting to 1,5 per cent in September, before accelerating to 5,1 per cent in July 2011. In the consumer goods basket, the food and the housing and utilities categories registered rates of increase above the upper limit of the inflation target range, amounting to 7,5 per cent and 12,8 per cent respectively in July 2011.

Consumer prices



Twelve-month headline consumer services price inflation decelerated to within the inflation target range in July 2010, moderating in subsequent months to 4,5 per cent in February 2011, before accelerating to 5,5 per cent in July 2011. In the consumer services basket, price increases in the health, transport and education categories exceeded the upper limit of the inflation target range in July 2011.

Consumer goods and services price inflation

Percentage change over twelve months

	2011					
	Feb	Mar	Apr	May	Jun	Jul
Headline CPI	**3,7**	**4,1**	**4,2**	**4,6**	**5,0**	**5,3**
Goods price inflation	3,0	3,6	3,7	4,5	4,9	5,1
Durable goods	-2,6	-2,5	-2,3	-2,3	-2,7	-2,1
Semi-durable goods	0,7	0,4	1,0	1,6	1,8	1,7
Non-durable goods	5,8	6,7	6,8	7,6	8,5	8,6
Services price inflation	4,5	4,6	4,7	4,7	5,2	5,5

Twelve-month producer food price changes continued to register rates of deflation up to January 2011, led by declines in the producer prices of food at especially the agricultural level. Price changes of food at the manufactured level reverted to inflation from November 2010 and continued to increase in ensuing months up to July 2011 when it amounted to 6,3 per cent. At the agricultural level a period of producer food price deflation lasting 26 consecutive months made way for inflation, when it accelerated markedly to 8,9 per cent in May 2011 before moderating again to 5,0 per cent in July. Total producer food price changes moved from deflation lasting 19 months to inflation from February 2011, amounting to year-on-year rates of 5,4 per cent in June 2011 and 5,9 per cent in July.

Year-on-year consumer food price inflation decelerated markedly to 1,1 per cent in July 2010 but subsequently picked up considerably and amounted to 7,5 per cent in July 2011. Over the same period, processed food price inflation accelerated from 1,2 per cent to 8,9 per cent, while unprocessed food price inflation accelerated from 0,9 per cent to 6,2 per cent.

Food price inflation at the producer and consumer level

Percentage change over twelve months

	Weight	July 2010	July 2011
Total producer prices	100,00	7,7	8,9
Agricultural food prices	3,89	-4,4	5,0
Manufactured food prices	5,87	-0,9	6,3
Total producer food prices	**9,76**	**-2,2**	**5,9**
Total consumer prices	100,00	3,7	5,3
Unprocessed food prices	7,48	0,9	6,2
Processed food prices	6,79	1,2	8,9
Total consumer food prices	**14,27**	**1,1**	**7,5**

Lower food prices continued to put downward pressure on consumer price inflation up to September 2009, resulting in headline consumer price inflation, excluding food and non-alcoholic beverage prices, being higher than the headline inflation rate. The situation was reversed from March 2011 when food prices again started increasing at elevated rates, exerting upward pressure on consumer price inflation.

When comparing changes in the prices of the various food categories from July 2010 (when food price inflation amounted to 1,1 per cent) to July 2011 (when food price inflation accelerated to 7,5 per cent), price increases of almost all the different food categories accelerated over this period. Price changes in three categories went from rates of decline in July 2010 to rates of increase in July 2011, with the oils and fats category moving from a rate of decline of 4,3 per cent in July 2010 to a rate of increase of 24,1 per cent a year later. Of all the food categories, only inflation in the prices of milk, eggs and cheese as well as fish and vegetables decelerated in the year to July 2011. Price changes of meat, representing the highest individual weight of all the different food categories, reversed from a rate of decline of 0,1 per cent to a rate of increase of 11,3 per cent over the period.

Food price inflation

Percentage change over twelve months according to product group

	Weight	July 2010	July 2011
Bread and cereals	3,08	-3,3	9,6
Meat	4,59	-0,1	11,3
Fish	0,66	3,8	2,4
Milk, eggs and cheese	1,79	1,6	1,1
Oils and fats	0,53	-4,3	24,1
Fruit	0,47	2,2	3,8
Vegetables	1,63	9,0	-0,3
Sugar, sweets and desserts	0,77	4,8	8,9
Other foods	0,75	2,2	6,9
All food products	14,27	1,1	7,5
Total headline CPI	100,00	3,7	5,3

If the impact of the more volatile food, non-alcoholic beverages and petrol prices is excluded from the calculation of the headline consumer price index, underlying year-on-year inflation amounted to 4,3 per cent in July 2011, being indicative of underlying inflationary pressures remaining fairly well contained. If, in addition, energy prices (predominantly electricity) are excluded from the calculation of headline consumer price inflation, an even lower rate of 3,9 per cent results.

The indication that inflationary pressures are still fairly well contained is corroborated when price changes are analysed according to the classification of individual consumption by purpose (COICOP) categories. The twelve-month increase of only three of the twelve categories exceeded the 6 per cent upper limit of the inflation target range in July 2011. Of the remaining categories, five recorded price increases within the inflation target range, while four of the categories registered rates of increase below the lower limit of the inflation target range in July 2011. The three categories that increased at rates above 6 per cent in July 2011, with a combined weight of 40,43 per cent, included food and non-alcoholic beverages, housing and utilities and education.

Headline CPI inflation in COICOP categories

Percentage change over twelve months

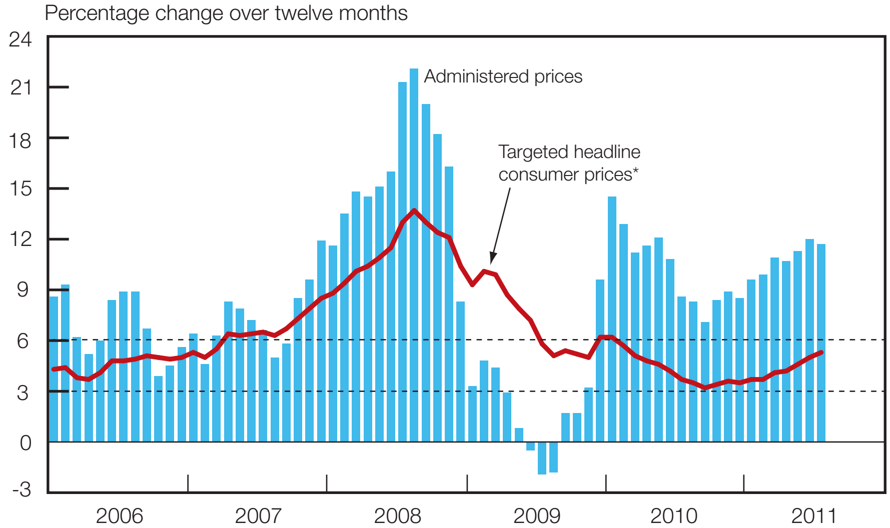
	Weights	July 2011
Communication	3,22	-1,1
Recreation and culture	4,19	0,5
Household content and services	5,86	1,7
Clothing and footwear	4,11	2,2
Miscellaneous goods and services	13,56	4,4
Health	1,47	5,2
Transport	18,80	5,3
Restaurants and hotels	2,78	5,4
Alcoholic beverages and tobacco	5,58	6,0
Housing and utilities	22,56	6,9
Food and non-alcoholic beverages	15,68	7,4
Education	2,19	8,6
Total headline CPI	100,00	5,3

Contrary to headline consumer price inflation remaining within the inflation target range, administered price inflation registered rates of increase well above the upper limit of the inflation target range, with some categories in the administrative price basket even increasing at double-digit rates during the first seven months of 2011.

Twelve-month administered price inflation accelerated notably from 7,1 per cent in September 2010 to 12,0 per cent in June 2011, before receding somewhat to 11,7 per cent in July, marking the twentieth consecutive month that the inflation rate for administered prices had exceeded the upper limit of the inflation target range. During this period, petrol prices increased by R1,85 cents/litre, while the year-on-year increase in electricity prices amounted to 18,9 per cent. With the exception of communication and television licences, prices of all other component products in the administered prices basket increased at year-on-year rates in excess of the upper limit of the inflation target range in July 2011. If the effect of petrol prices is excluded from the calculation of administered prices, the rate decreases to 9,3 per cent in the year to July 2011. If electricity prices are also excluded, the rate of increase in administered prices amounted to 6,8 per cent in July 2011.

Targeted inflation and administered prices

Percentage change over twelve months



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

Inflation expectations, as reflected in the survey conducted by the BER in the second quarter of 2011, remained unchanged at 5,3 per cent for 2011. Inflation expectations for 2012 were revised slightly upwards from 5,7 per cent to 5,8 per cent. Annual average CPI inflation is therefore expected to accelerate from 4,3 per cent in 2010 to 5,3 per cent in 2011, before rising to 5,8 per cent in 2012 and remaining at this level in 2013. This is the first time since the third quarter of 2007 that annual average CPI inflation expectations have fallen within the target range over the whole three-year forecast period. Households have raised their inflation expectations for the first time since the third quarter of 2009. They now expect CPI inflation to average 6,1 per cent in 2011 – up from 5,8 per cent previously.

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2011

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2011..	5,0	5,4	5,5	5,3
2012..	5,7	5,8	6,1	5,8
2013..	5,5	6,0	5,9	5,8

Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

Preliminary estimates suggest that the global economic recovery moderated significantly to an estimated annualised rate of around 2,5 per cent in the second quarter of 2011. Economic growth in excess of 5 per cent was registered in the year to June 2010, followed by a somewhat slower pace of increase of about 4 per cent in the second half of 2010 and the first quarter of 2011.

Global economic growth

Source: South African Reserve Bank calculations based on data from the IMF, national statistical offices and JPMorgan

According to the June 2011 International Monetary Fund (IMF) *World Economic Outlook Update*, the global economy is expected to expand by 4,3 per cent in 2011 and 4,5 per cent in 2012. The IMF also expects a slowdown in the second quarter of 2011, to be followed by a pickup in global activity in the second half of the year. The JPMorgan global manufacturing Purchasing Managers Index (PMI), however, declined from an average of 53,4 index points in the second quarter of 2011 to a more than two-year low of 50,1 index points in August 2011, suggesting that the rebound in global manufacturing production in the second half of 2011 may be weaker than initially projected.

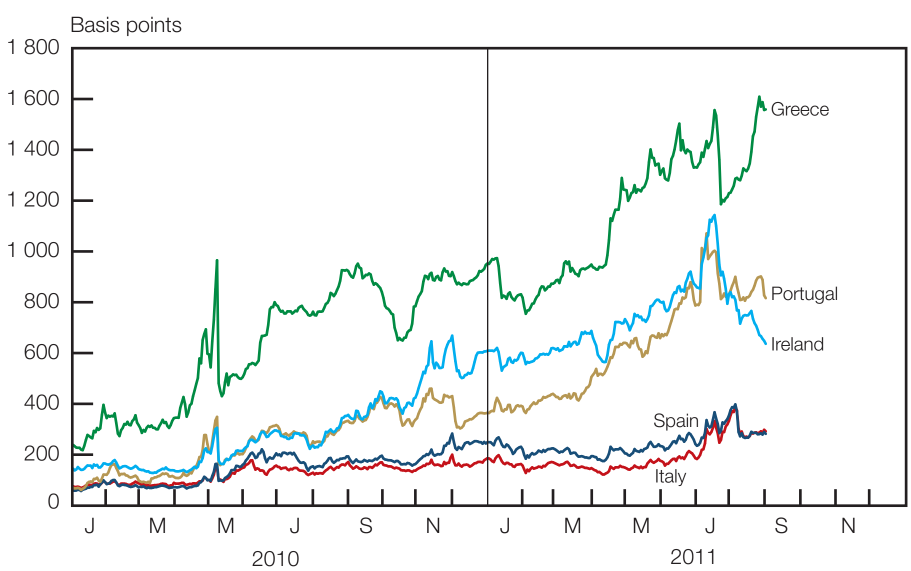
Global economic developments in the second quarter of 2011 were largely dominated by worldwide supply-chain disruptions following the earthquake and tsunami in Japan, heightened uncertainty about the sovereign debt crisis in peripheral European countries and concerns about the fiscal situation in the US. Although the pace of economic recovery slowed in recent months, annualised real output growth in the US accelerated from 0,4 per cent in the first quarter of 2011 to 1,0 per cent in the second quarter, mainly driven by positive contributions from non-residential fixed investment, exports, personal consumption expenditure and federal government spending.

The US federal debt reached the statutory limit of US$14,3 trillion in mid-May 2011, forcing the Treasury to consider extraordinary measures to fund government operations. Failure to raise the debt ceiling would have meant that these extraordinary measures would have been exhausted on 2 August 2011. The risk of a possible default in the US was imminent and the major credit rating agencies indicated in June 2011 that they would consider downgrading the credit rating of US debt securities. These negative perceptions adversely affected the exchange value of the US dollar against most major currencies. Eventually, the US Congress passed legislation authorising an increase in the US debt ceiling just before the 2 August deadline. However, Standard & Poor's (S&P), a credit rating agency, nevertheless lowered its long-term sovereign credit rating of the US from "AAA" to "AA+" on fears that the fiscal consolidation plans that the US Congress and the Administration had agreed to, would fall short of the amount necessary to stabilise the general government debt burden by the middle of the decade.

Although most recently economic activity in Japan showed signs of improvement following the natural disasters that struck the country, real output continued to contract, recording annualised rates of decline of 3,6 per cent in the first quarter of 2011 and 1,3 per cent in the second quarter. Industrial production fell by 2,8 per cent in July 2011 compared with declines of 1,7 per cent and 5,5 per cent in the preceding two months – signalling a gradual moderation of supply constraints. The quarterly Reuters Tankan survey of large manufacturers dropped meaningfully in the second quarter of 2011, revealing that sentiment among motor vehicle manufacturers had deteriorated by a record reading. The Shoko Chukin small business sentiment index also declined significantly during the second quarter of 2011, but rebounded in July.

After recording annualised growth of 3,4 per cent in the first quarter of 2011, the growth momentum in the euro area moderated to 0,7 per cent in the second quarter. The weaker growth in the euro area was largely due to slower growth in member countries such as Germany, France and the Netherlands. Increasing concerns about fiscal problems in Greece, Portugal and Ireland during the first half of 2011 resulted in a downgrading of these countries' sovereign credit ratings. The spreads of yields between 10-year benchmark government bonds of peripheral European countries and German government bonds of similar maturity consequently widened sharply following these developments.

Sovereign yield spreads of selected countries vis-à-vis German government bonds



Source: Bloomberg

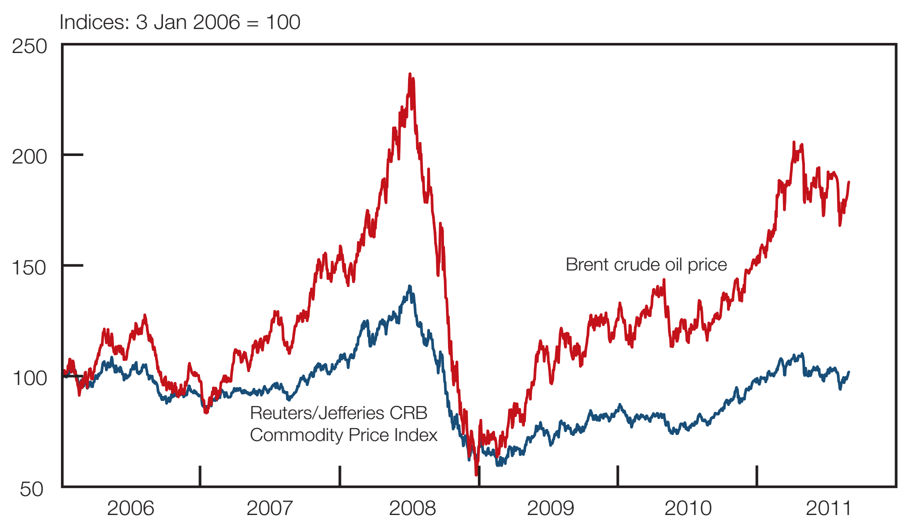
The spreads on Portuguese government bonds declined in early May 2011, following the European Union (EU)–IMF rescue package of €78 billion, but increased again after it had become evident that Greece would need an additional bailout package. In an attempt to avert the sovereign debt contagion spreading to other European countries, in July 2011 EU Heads of State agreed to a new funding programme for Greece, estimated at €109 billion which is subject to private bondholder participation. Spreads on government bonds from Greece, Ireland and Portugal fell sharply, but started to increase in Italy and Spain in early August 2011 due to concerns about their excessive levels of government debt.

The latest available estimates suggest that real output growth in emerging markets moderated sharply in the second quarter of 2011. These effects were widespread with most emerging markets experiencing a moderation in economic growth. The slowdown in emerging Asia was due to the moderation of growth in China, India, Indonesia and the Philippines, and to a contraction in output registered in Thailand. Growth in Latin America also slowed in the second quarter of 2011, mainly due to slower growth in Brazil, Argentina, Colombia, Peru and Ecuador, and to a decline in output recorded in Venezuela. The slower growth registered in emerging Europe was underpinned by a significant moderation of growth in Russia and Hungary.

Most countries in the sub-Saharan region are recovering from the slowdown after the global financial crisis. The speed of the recovery, however, varies between countries. Growth is expected to average 5,5 per cent in 2011 and 5,9 per cent in 2012.

The Brent crude oil price reached levels of US$127 per barrel in early April 2011 due to the conflict in Libya, but has since retreated somewhat due to increased output from Saudi Arabia, the release of strategic crude oil reserves by the International Energy Agency (IEA) and concerns about the euro area debt crisis and the US approaching its public debt limit. However, the IEA's decision not to continue releasing oil from emergency reserves and the announcement of a second bailout package for Greece in July 2011 again contributed to higher crude oil prices. Furthermore, production outages in non-Organization of the Petroleum Exporting Countries (OPEC) countries, a weaker US dollar and prospects for higher seasonal demand in the third quarter of 2011 kept crude oil prices above US$115 per barrel during most of July 2011. Concerns about global growth, however, resulted in a sharp decline in oil prices in early August 2011, reaching levels of around US$104 per barrel at the beginning of the second week. Oil prices have since increased to levels of around US$115 per barrel towards the end of August 2011, partly due to lower US crude oil inventories, concerns that bad weather conditions could disrupt US oil supplies and speculation that the US economy could recover if the Federal Reserve provides further stimulus. In its August 2011 *Oil Market Report*, the IEA lowered global oil demand for 2011 to 89,5 million barrels per day and projected global oil demand at 91 million barrels per day in 2012.

Oil and commodity prices



Source: Bloomberg

Global inflation accelerated further in the second quarter of 2011 mainly due to high commodity prices, with price pressures being more pronounced in emerging-market economies. According to the June 2011 IMF *World Economic Outlook Update*, projected inflation in advanced economies was revised upwards by 0,4 percentage points to 2,6 per cent in 2011 and left unchanged at 1,7 per cent in 2012. Inflation in emerging-market and developing economies was left unchanged at 6,9 per cent in 2011 and revised upwards by 0,3 percentage points to 5,6 per cent for 2012. Annual consumer price inflation in the US has accelerated sharply since the end of 2010, before stabilising at 3,6 per cent in July 2011. Core inflation also increased in the past six months, reaching 1,8 per cent in July 2011. Consumer prices in Japan also rose on account of higher commodity prices, with core price changes moving to positive territory. Annual harmonised index of consumer prices (HICP) and core inflation for the euro area trended upwards during the second quarter of 2011, reaching 2,7 per cent and 1,6 per cent in June 2011, before moderating to 2,5 per cent and 1,2 per cent in July respectively.

Inflationary pressures have edged upwards in most emerging-market economies. Among the major emerging-market economies, inflationary pressures remained elevated in Russia, Turkey, China, India, Brazil and Argentina. Consumer price inflation in China accelerated further, reaching 6,5 per cent in July 2011. Inflationary pressures are expected to persist due to high commodity prices and the overheating pressures in some major emerging-market economies. The IMF has noted that inflationary pressures in emerging-market economies have become increasingly broad-based, in part due to elevated demand pressures.

Monetary policy remained accommodative in all the major advanced economies. However, the ECB raised its main refinancing rate in April and July 2011 in an attempt to contain higher inflation expectations. Renewed tensions in financial markets, however, prompted the ECB in early August 2011 to conduct a liquidity-providing supplementary longer-term refinancing operation with a maturity of approximately six months. The ECB also decided to purchase Italian and Spanish government bonds in order to stabilise financial markets. By contrast, the US Federal Open Market Committee (FOMC) has maintained its policy rate at between 0 and 0,25 per cent since December 2008 in view of the very low level of resource utilisation and subdued outlook for inflation over the medium term, and has indicated that it was likely to keep interest rates exceptionally low at least through mid-2013. The FOMC has also finalised its bond purchasing programme on schedule. The Bank of Japan has held its policy rate steady since October 2010, but has since introduced a number of measures to assist economic growth. The Bank of England has also recently voted to hold rates at a record-low level despite inflationary pressures in order to support the fragile economic recovery. The Swiss National Bank reduced its policy rate on 3 August 2011 partly in an effort to weaken the strong Swiss franc.

Central banks in many emerging-market economies have tightened monetary policy by raising interest rates and reserve requirement ratios several times. China, like several other emerging-market economies, has implemented a number of measures to reduce domestic liquidity and dampen demand for housing. The central banks of China, Chile, India, Korea, Poland, Russia, South Korea, Taiwan and Thailand have recently increased their key policy rates in an attempt to stabilise rising inflationary pressures.

Current account[4]

The pickup in global demand alongside elevated international commodity prices boosted the export earnings of South African producers and brought about a steady widening of the surplus on the trade account of the balance of payments throughout 2010. In the first half of 2011 however, imports rose more strongly than exports, resulting in smaller trade surpluses in both the first and second quarter. These developments, together with a moderate increase in the shortfall on the services, income and current transfer account of the balance of payments, gave rise to a widening of the current-account deficit from 1 per cent of gross domestic product in the fourth quarter of 2010 to 3,1 per cent and 3,3 per cent respectively in the first and second quarters of 2011.

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

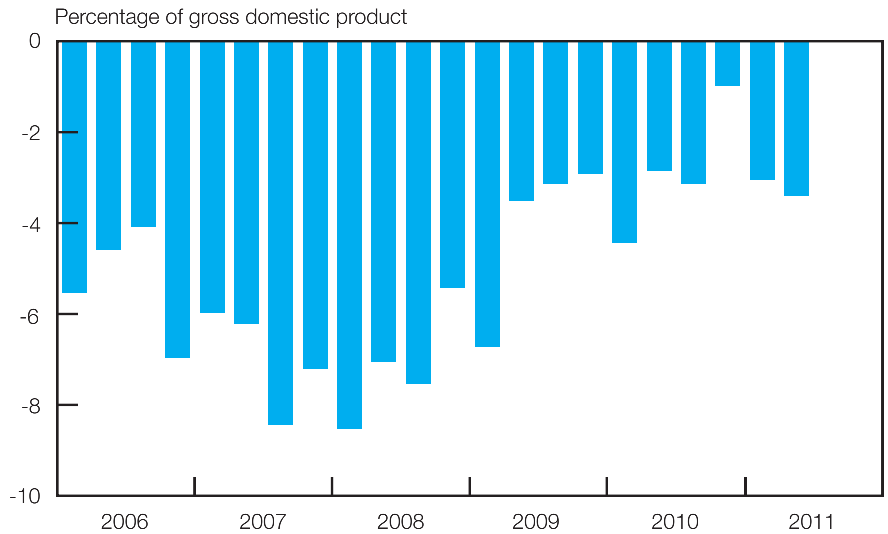
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2010				2011	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	549,7	585,5	613,1	565,9	620,4	641,7
Net gold exports	61,9	61,5	62,9	59,5	63,3	69,9
Merchandise imports	-600,5	-618,0	-600,5	-598,2	-661,7	-696,4
Trade balance	**11,1**	**29,0**	**75,5**	**27,2**	**22,0**	**15,2**
Net service, income and current transfer payments	-85,9	-113,5	-103,0	-102,2	-109,8	-110,6
Balance on current account	**-74,8**	**-84,5**	**-27,5**	**-75,0**	**-87,8**	**-95,4**
As a percentage of gross domestic product	*-2,9*	*-3,1*	*-1,0*	*-2,8*	*-3,1*	*-3,3*

Successive supply shocks that affected global economic activity in early 2011 led to an uneven moderation in demand from some of South Africa's trading-partner countries. However, owing mainly to increased demand from Asia which countered lower demand from certain advanced economies, South Africa's export earnings advanced further in the second quarter of 2011.

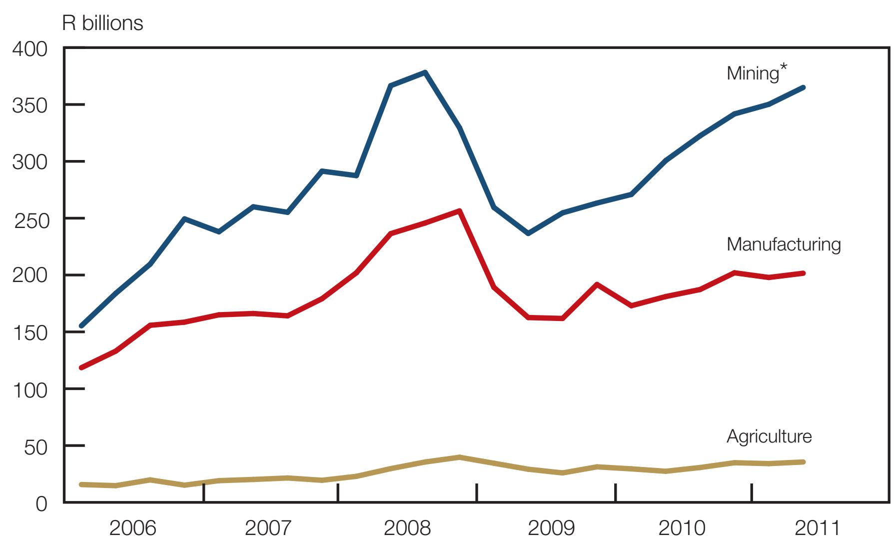
Balance on current account



Seasonally adjusted and annualised

Notwithstanding ongoing concern about the sovereign debt of a number of countries in the euro area, the volume of goods exported to Europe and Asia increased noticeably partly on account of firmer demand for especially platinum and domestically manufactured vehicles and transport equipment. Having contracted by 3,6 per cent in the first quarter of 2011, the volume of merchandise exports rose by 3,7 per cent in the second quarter, in part also reflecting the low base in the preceding quarter. Despite this improved export performance, the ratio of real merchandise exports to real gross domestic product was still significantly lower than similar ratios attained between 2005 and 2008.

Value of merchandise exports



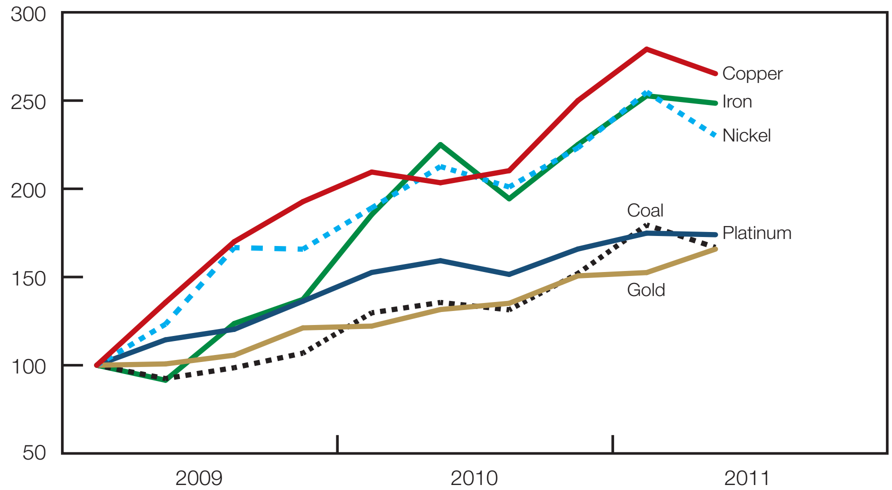
* Excluding gold

Seasonally adjusted and annualised

Although international commodity prices moved broadly sideways in US dollar terms from the first quarter to the second quarter of 2011, the rand price of a basket of South African mining exports declined over the period due to the appreciation of the rand against the US dollar. The value of merchandise exports accordingly advanced by 3,4 per cent in the second quarter of 2011 following an increase of 1,2 per cent in the first quarter.

International prices of selected South African export commodities

US dollar indices: First quarter 2009 = 100



The fixing price of gold on the London market, however, increased by 8,7 per cent from US$1 385 per fine ounce in the first quarter of 2011 to US$1 506 per fine ounce in the second quarter, reflecting investors' increased appetite for gold as a safe haven investment amid the prevailing uncertainty in global financial markets. The price of gold surged to US$1 881 per fine ounce on 23 August 2011, affected by large-scale global portfolio allocations in favour of commodities and by speculative transactions in the wake of the downgrading of US government debt by one of the credit rating agencies, sovereign debt concerns in Europe and weakening global growth.

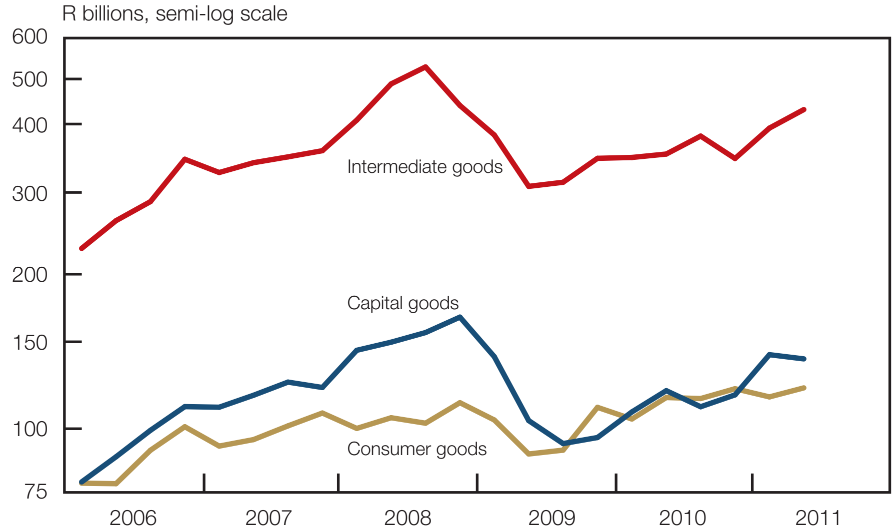
Despite the moderate appreciation in the quarterly average exchange value of the rand against the US dollar, the realised rand price of South Africa's net gold exports increased by 5,5 per cent from the first quarter of 2011 to the second quarter. Moreover, the volume of net gold exports advanced by 4,6 per cent, after declining for three consecutive quarters. Domestic gold producers benefited from the surge in the demand for gold by, among others, various central banks amid uncertainty in global financial markets. Central banks that increased their gold holdings included Korea, Russia and Mexico. The value of South Africa's net gold exports consequently increased by 10,3 per cent over the period.

The value of merchandise imports, which increased strongly in the first quarter of 2011, rose by a further 5,2 per cent in the second quarter, primarily due to an increase in the volume of imported goods. Higher international wholesale prices, along with an increase in international crude oil prices, gave rise to somewhat higher import prices over the same period.

The domestic demand for imported intermediate goods gained further momentum in the second quarter of 2011. An analysis of merchandise import values by region indicates that the supply from Asia outstripped that of Europe and the US over the period. Imports from Asia to an important extent comprised crude oil originating from Saudi Arabia and Iran. The volume of crude oil imports surged by 10,1 per cent in the second quarter of 2011, whereas the volume of non-oil merchandise imports increased by 3,3 per cent. Non-oil imports were largely dominated by the importation of machinery and electrical equipment, in particular audio-visual, digital and computer equipment. Spending on these products was probably underpinned by technological considerations and increases in the disposable income of households. The importation of machinery from Europe also picked up somewhat, consistent with the steady advancement of capital expenditure since 2010. Although the domestic demand for imported vehicles and transport equipment contracted somewhat in the second quarter of 2011, it remained fairly firm, still exceeding levels registered in 2010.

An analysis of imports according to stages of production indicates that the imports of intermediate goods, including crude oil, increased considerably compared with more moderate increases in the imports of consumer goods in the second quarter of 2011. At the same time the value of imported capital goods declined somewhat.

Merchandise imports according to stage of production



Seasonally adjusted and annualised

The deficit on the services, income and current transfer account widened marginally from R109,8 billion in the first quarter of 2011 to R110,6 billion in the second quarter. The moderately larger deficit in the second quarter can mainly be ascribed to an increase in net current transfer payments to the rest of the world, which was only partly offset by a decrease in net services and income payments.

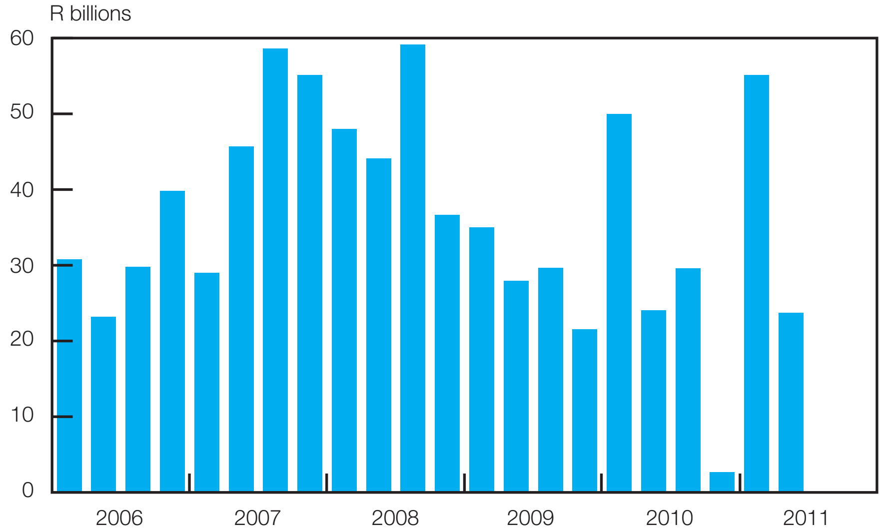
Lower net service payments in the second quarter of 2011 were mainly brought about by higher travel receipts and lower payments for services of a technical nature (in the category "other services") rendered by non-resident parties. These services were largely related to infrastructural activities, including the Gautrain Project which neared completion in the second quarter of 2011. Higher gross dividend receipts reduced net income payments in the second quarter of 2011 as gross dividend payments to foreign investors remained virtually unchanged over the period. When comparing the first half of 2011 with the corresponding period in 2010, gross dividend payments to, and receipts from, non-resident investors rose by a roughly similar magnitude. At the same time, net current transfers to the other members of the Southern African Customs Union (SACU) increased on the basis of a partial recovery in trade in merchandise as a new fiscal year commenced.

The rand prices of both exports and imports increased in the second quarter of 2011. Although the prices of non-gold exports declined marginally, these declines were more than offset by increases in the prices of gold exports and non-factor services rendered to non-residents. Import prices, however, rose more strongly over the period. This caused South Africa's terms of trade to recede somewhat in the second quarter of 2011.

Financial account

Ongoing concerns about sovereign debt in a number of peripheral countries in the euro area, the outlook for global economic growth and the delayed increase in the debt ceiling in the US prompted renewed risk awareness among international investors. Despite these developments, foreign portfolio investors continued to accumulate domestic equity and debt securities, while longer-term foreign investors continued to expand their direct investment assets in South Africa. The net capital inflow on the financial account of the balance of payments (including unrecorded transactions) accordingly amounted to R23,7 billion in the second quarter of 2011 compared with an inflow of R55,1 billion in the preceding quarter.

Balance on financial account



Including unrecorded transactions

Foreign-owned assets in South Africa

Inward *direct investment* into South Africa rose to R12,3 billion in the second quarter of 2011, thereby registering the largest quarterly inflow since the second quarter of 2009. According to early indications, direct investment inflows emanated primarily from the US, China and Japan, and were mainly directed to the domestic wholesale and retail trade, mining and manufacturing sectors. The inward movement of direct investment capital was, however, partly countered by a disinvestment transaction whereby a United Kingdom-based company sold its equity stake in a South African company operating in the finance, insurance, real-estate and business services sector.

Net financial transactions not related to reserves

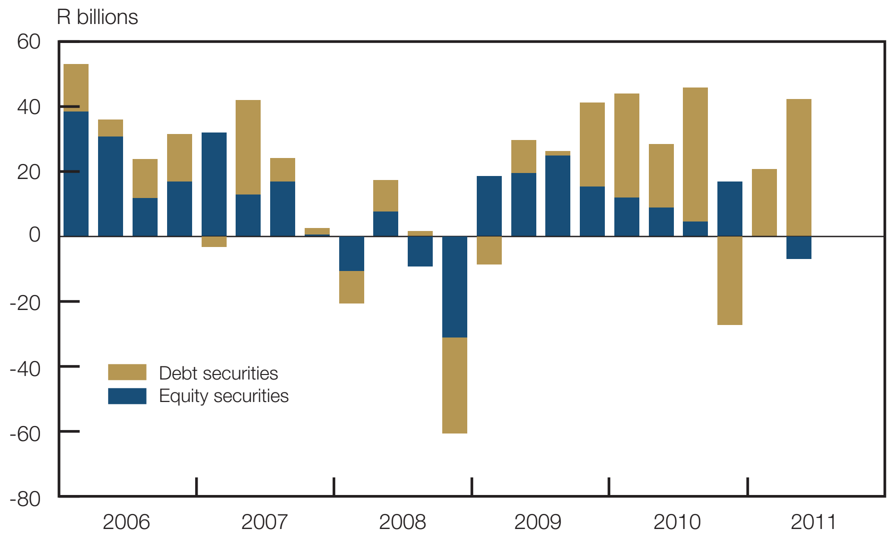
R billions

	2010				2011	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	2,9	1,1	4,3	11,4	5,0	12,3
Portfolio investment	28,4	45,8	-10,4	107,9	20,8	35,1
Other investment	-1,5	15,1	13,3	10,9	1,9	9,7
Change in assets						
Direct investment	-3,3	-7,0	6,9	-3,3	-11,2	-6,0
Portfolio investment	-2,2	-9,7	-10,8	-28,3	-22,1	-9,5
Other investment	10,2	-6,5	-18,0	-17,7	31,7	-19,3
Total financial transactions*	24,0	29,5	2,6	106,0	55,1	23,7
As a percentage of gross domestic product	*3,6*	*4,3*	*0,4*	*4,0*	*7,8*	*3,3*

* Including unrecorded transactions

Non-resident *portfolio investors* continued to accumulate South African equity securities through the JSE Limited (JSE) in the second quarter of 2011. These capital inflows were, however, more than neutralised by the repatriation of foreign investors' minority equity stakes in a South African company that was sold to a foreign direct investor company. Over the same period, non-resident investors displayed an increased appetite for South African debt securities, consistent with South Africa's favourable sovereign ratings and sound macroeconomic framework. In total, the country's portfolio investment liabilities increased by R35,1 billion in the second quarter of 2011 compared with a capital inflow of R20,8 billion registered in the first quarter; in both instances through debt securities.

Portfolio liabilities: Investment flows



Other investment liabilities recorded an inflow of R9,7 billion in the second quarter of 2011 compared with an inflow of capital in the amount of R1,9 billion in the preceding quarter. The inward movement of capital mainly reflected the increase in foreign currency deposits placed with domestic banks. The inflow of capital was further supplemented by long-term foreign loans extended to domestic banks and public corporations.

South African-owned assets abroad

Outward *direct investment* by South African companies increased by a further R6,0 billion in the second quarter of 2011 following an increase of R11,2 billion in foreign direct investment assets during the first quarter. This outflow of direct investment capital was mainly concentrated in the manufacturing and the wholesale and retail trade sectors. On a smaller scale, direct foreign investment assets were also obtained in subsidiaries classified in the mining and the community, social and personal services sectors in the second quarter of 2011.

Despite the prevailing uncertainty in the global financial markets, South African investors raised their *foreign portfolio assets* by a further R9,5 billion in the second quarter of 2011. In the first half of 2011 institutional investors and individuals accumulated foreign portfolio assets to the value of R31,6 billion; for the year 2010 as a whole, the net acquisition of foreign portfolio assets came to R28,3 billion.

Other foreign investment abroad recorded an outflow of capital in the amount of R19,3 billion in the second quarter of 2011 compared with an inflow of R31,7 billion in the preceding quarter. In contrast to the preceding quarter, these outflows emanated mainly from an increase in domestic banks' foreign currency deposits with non-resident banks amid growing uncertainty and volatility in global financial markets.

Foreign debt

South Africa's total outstanding foreign debt increased from US$99,0 billion at the end of December 2010 to US$103,1 billion at the end of March 2011. This rise was mainly brought about by a further increase in the country's foreign currency-denominated debt, while rand-denominated debt declined marginally.

Foreign debt of South Africa

US$ billions at end of period

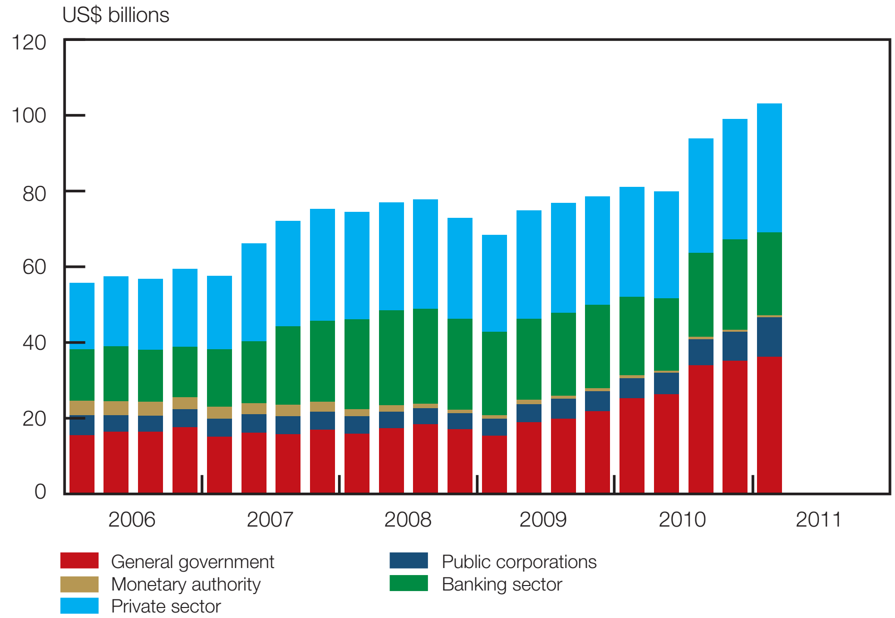
	2010				2011
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Foreign currency-denominated debt	42,1	40,9	43,5	45,2	49,8
Bonds	16,8	16,0	17,0	16,5	21,1
Other:					
Public sector	5,4	5,5	6,1	6,5	7,1
Monetary sector	9,2	8,3	9,1	10,3	9,0
Non-monetary private sector	10,7	11,1	11,3	11,9	12,6
Rand-denominated debt	39,0	39,0	50,4	53,8	53,3
Bonds	13,5	15,2	22,7	24,6	24,7
Other	25,5	23,8	27,7	29,2	28,7
Total foreign debt	81,1	79,9	93,9	99,0	103,1
As a percentage of gross domestic product	*26,0*	*24,1*	*27,3*	*27,2*	*27,0*
As a percentage of total export earnings	*93,0*	*85,8*	*95,0*	*95,2*	*93,8*

The issuance of foreign currency-denominated bonds by the national government, parastatals and private non-banking sector companies on international capital markets mainly accounted for the increase in foreign currency-denominated external debt. Problems in the Middle East and North Africa (MENA) region and the ongoing sovereign debt crisis in Europe did not materially affect foreign investors' appetite for domestic bonds. The 30-year Yankee bond issued by the South African government in the first quarter of 2011 has the longest maturity of any international bond ever issued by a domestic institution, and raised the level of foreign-denominated bonds issued by public authorities to non-resident investors by US$750 million. The upgrading of infrastructure and the development of new projects furthermore prompted public corporations to borrow abroad to finance these projects. At the end of March 2011, the outstanding foreign debt of public corporations amounted to US$10,5 billion compared with US$5,3 billion at the end of March 2010.

Rand-denominated debt, in dollar terms, declined marginally as repayments made on loans under repurchase agreements fully offset an increase in foreign deposits with South African banks.

Foreign debt

US$ billions



Expressed in rand terms, the country's outstanding foreign debt increased from R656 billion at the end of December 2010 to R699 billion at the end of March 2011 as the exchange rate of the rand, on balance, depreciated against the dollar. Owing to the acceleration in South Africa's real economic growth rate and enhanced export performance, the ratio of foreign debt to gross domestic product declined from 27,2 per cent at the end of December 2010 to 27,0 per cent at the end of March 2011, while the ratio of foreign debt to export earnings decreased from 95,2 per cent to 93,8 per cent over the same period.

International reserves and liquidity

South Africa's overall balance of payments (i.e., the change in the country's net international reserves due to balance-of-payments transactions), which recorded a surplus of R32,2 billion in the first quarter of 2011, registered a much smaller surplus of R2,4 billion in the second quarter, reflecting the slower pace of capital inflows.

Measured in US dollar, the gross gold and other foreign reserves of the Bank (i.e., the official international reserves of the country before accounting for reserve-related liabilities) increased marginally from US$49,3 billion at the end of March 2011 to US$50,0 billion at the end of June 2011, and further to US$51,4 billion at the end of August. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) remained roughly unchanged at approximately 19 weeks during the first half of 2011.

The Bank's international liquidity position increased from US$44,7 billion at the end of March 2011 to US$47,2 billion at the end of June before rising to US$49,1 billion at the end of August, largely on account of further forward purchases of foreign currency by the Bank.

Exchange rates

Subsequent to a decline of 5,0 per cent in the first quarter of 2011, the nominal effective exchange rate of the rand decreased by a further 1,5 per cent from the end of March 2011 to the end of June. The rand depreciated most notably against the euro and the Japanese yen, partly as a result of the rescue packages granted to certain European countries to avoid sovereign debt restructuring and to assist Japan in recovering from the natural disaster experienced earlier in the year. However, the exchange value of the rand was cushioned by strong demand for high-yielding assets, elevated commodity prices, and a sizeable inward foreign direct investment transaction in which a non-resident party acquired the majority equity stake in a domestic retail and wholesale group during the period.

Exchange rates of the rand

Percentage change

	30 Sep 2010 to 31 Dec 2010	31 Dec 2010 to 31 Mar 2011	31 Mar 2011 to 30 Jun 2011	30 Jun 2011 to 31 Aug 2011
Weighted average*	5,4	-5,0	-1,5	-4,0
Euro	7,3	-8,2	-2,0	-3,1
US dollar	5,1	-2,4	0,0	-3,5
Chinese yuan	3,6	-3,0	-1,3	-4,7
British pound	7,8	-6,2	0,8	-5,1
Japanese yen	2,8	-0,7	-2,8	-8,0

* Against a basket of 15 currencies

Elevated commodity prices and a weaker US dollar partly supported the external value of the rand in April 2011. Following this, the nominal effective exchange rate of the rand decreased in May 2011 before increasing once again in June, when it was affected by the depreciation of the euro and the British pound. During July and August 2011, the nominal effective exchange value of the rand decreased by 4,0 per cent as the rand depreciated against all major currencies.

The real effective exchange rate of the rand decreased by 0,7 per cent in the year to June 2011 but increased by 1,3 per cent on a month-to-month basis in the same month.

The average net daily turnover in the domestic market for foreign exchange decreased from US$23,3 billion in the first quarter of 2011 to US$22,6 billion in the second quarter. This decrease could largely be attributed to a decline in the value of non-resident swap transactions, which decreased from US$11,1 billion per day to US$9,5 billion per day over the period. As a result, the share of domestic banks (i.e., authorised dealers in foreign exchange) in the turnover in the domestic market for foreign exchange gained some ground.

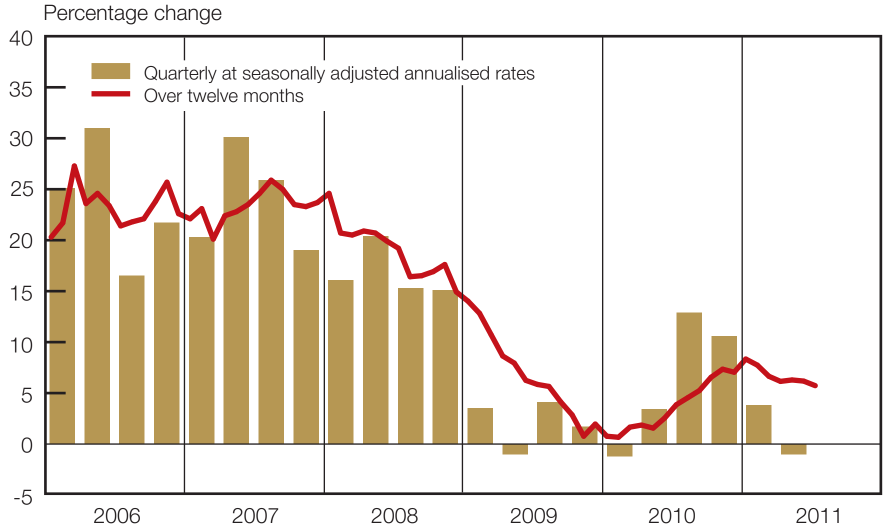
Monetary developments, interest rates and financial markets

Money supply

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

The quarterly[5] growth in the broadly defined money supply (M3) declined continually from a post-recession high of 12,9 per cent in the third quarter of 2010 to a negative rate of 1,0 per cent in the second quarter of 2011. The twelve-month growth in M3 accelerated to a recent peak of 8,2 per cent in January 2011, from which it retreated and subsequently fluctuated around a level of 6 per cent during the three months to June. In July the yearly growth in M3 amounted to 5,6 per cent. The slowdown in M3 during this period mostly resulted from a moderation in corporate-sector deposits, partly reflecting the weaker pace of growth in income and expenditure alongside the reallocation of available funds to higher-yielding investment instruments by some corporate investors. The decline in corporate-sector deposits was partly offset by steady growth in deposit holdings of the household sector.

Growth in M3



The maturity structure of the monetary aggregates revealed a preference for precautionary cash holdings and transactional deposits during the second quarter of 2011, probably affected by uncertain near-term economic growth prospects. Although long-term deposits rebounded from negative growth in the first quarter of 2011, second-quarter growth still remained relatively low compared to the high rates of increase recorded in the last three quarters of 2010, with little incentive for investors to step up exposure to low-yielding long-term depository investments.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2010		2011	
	3rd qr	4th qr	1st qr	2nd qr
Notes and coin	4,9	6,9	6,2	8,6
Cheque and transmission deposits	15,0	24,4	-15,2	3,4
Call and overnight deposits	4,2	-1,1	32,0	9,8
Other short- and medium-term deposits*	-1,9	8,8	13,1	-11,4
Long-term deposits**	61,1	17,3	-15,4	2,8
M3	12,9	10,6	3,8	-1,0

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

The growth rate of notes and coin in circulation gained further momentum as demand for cash increased alongside rising inflation, extended public holidays in the second quarter of 2011 and the low opportunity cost of holding currency rather than deposits.

The overall increase in M3 deposits amounted to R17,2 billion in the second quarter of 2011, up from weak growth of R1,8 billion in the first quarter. In the second quarter the household sector was the dominant driver behind the growth in M3, contributing R18,7 billion to the overall increase, with the corporate sector decreasing its deposit holdings by R1,5 billion. The high growth in M3 deposit holdings of the household sector – mainly concentrated in the month of June – was the highest growth recorded since the fourth quarter of 2008.

Year-on-year growth in M3 deposits of the household sector accelerated from 3,2 per cent in April 2011 to 5,4 per cent in July 2011, the highest growth rate recorded since September 2009. By contrast, growth in the M3 deposit holdings of the corporate sector assumed a declining trend from the beginning of 2011, decelerating from 7,1 per cent to 5,7 per cent over the same period.

M3 holdings of households and companies

As in recent quarters, a substantial part of the expansion in M3 during the second quarter of 2011 could be explained statistically by the increase in banks' claims on the private sector, which was mainly related to growth in loans and advances. The increase in M3 was also supported by an increase in net foreign assets. Net claims on the government sector contracted somewhat in the second quarter of 2011, resulting from a rise in government deposits following significant corporate tax collections in the month of June 2011. The category "net other assets and liabilities" extended its decline to a fourth consecutive quarter.

Statistical counterparts of change in M3

R billions

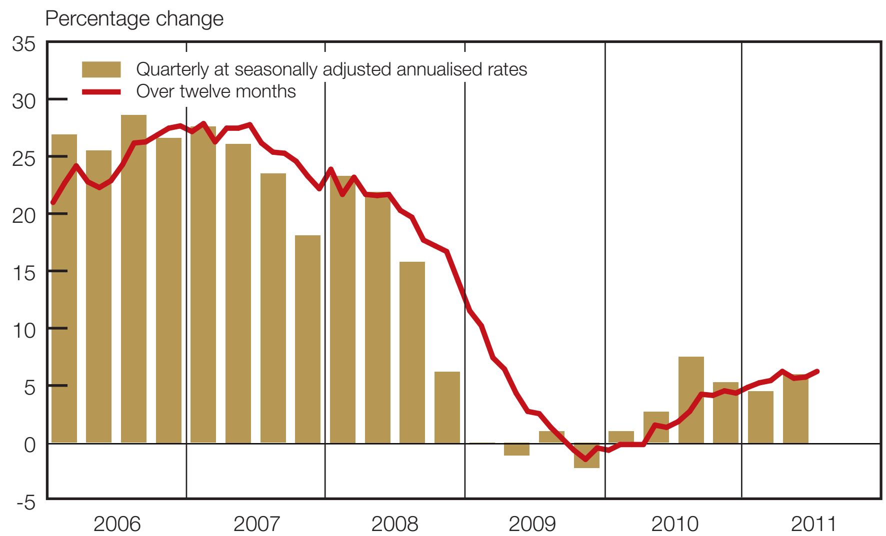
	2010		2011	
	3rd qr	4th qr	1st qr	2nd qr
Net foreign assets	4,6	10,9	31,5	8,7
Net claims on the government sector	9,6	13,3	-37,0	-3,7
Claims on the private sector	55,0	20,9	10,2	20,1
Net other assets and liabilities	-12,0	-2,0	-2,9	-8,0
Total change in M3	57,3	43,2	1,8	17,2

The combined effect of continued growth in nominal gross domestic product, together with the contraction in the quarterly average level of M3, was a further increase in the income velocity of circulation of M3 to 1,38 in the second quarter of 2011, from 1,37 in the first quarter.

Credit extension

Despite some moderation in May and June 2011, growth in banks' total loans and advances extended to the private sector maintained a steady pace of growth in the first half of the year. Twelve-month growth in banks' total loans and advances picked up from 4,7 per cent in January 2011 to 6,1 per cent in April before moderating to 5,6 per cent in June. A growth rate of 6,1 per cent was recorded in July. The moderation in growth of credit extension to the private sector from a recent high in the third quarter of 2010 was rooted in many factors. Household debt remained high, while the slow recovery in job creation did not create many new borrowers. Working capital requirements of the non-financial corporate sector remained weak in the face of excess production capacity. The banking sector continued to place more emphasis on prospective borrowers' cash flows in the evaluation of loan affordability, and less on non-cash collateral.

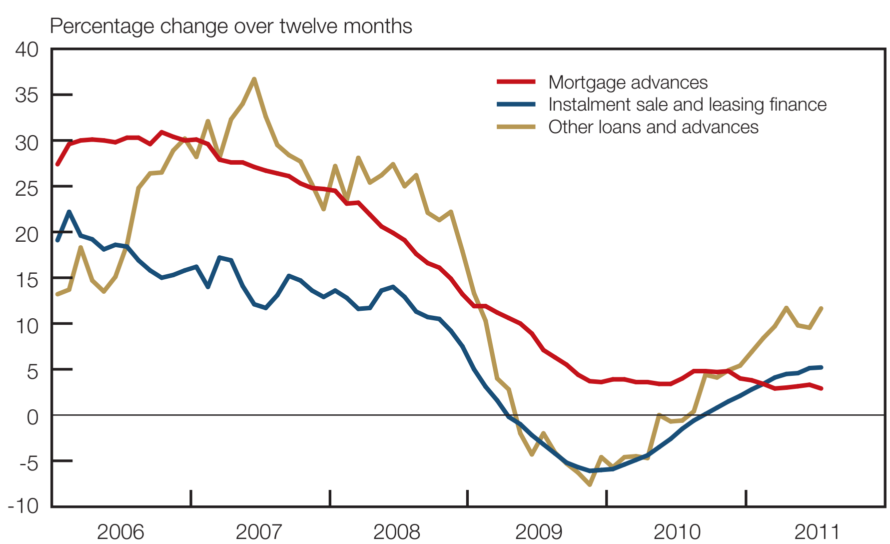
Total loans and advances to the private sector



The quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances accelerated from 4,5 per cent in the first quarter of 2011 to 6,0 per cent in the second quarter.

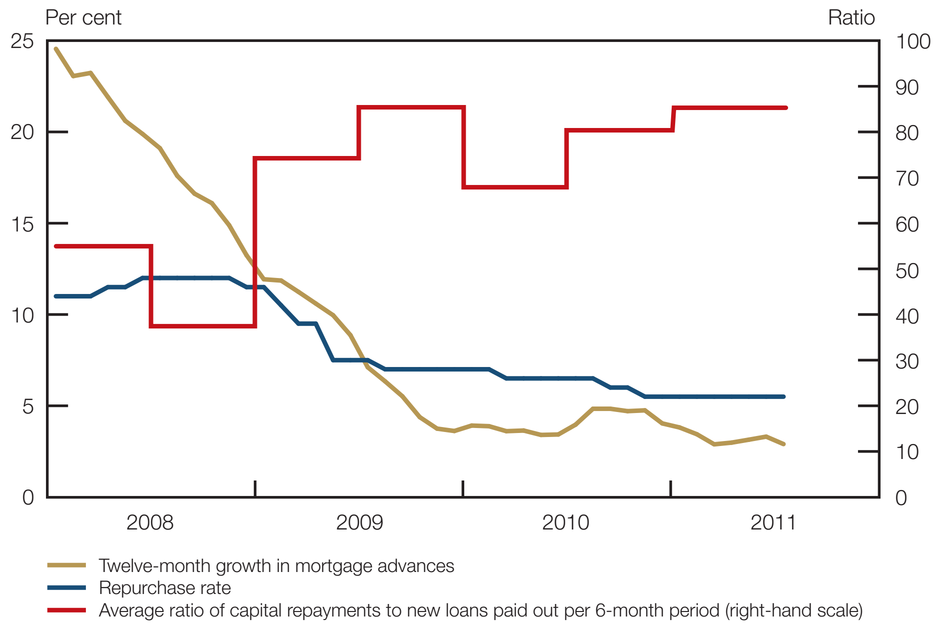
All credit categories contributed positively towards the increase in total loans and advances in the second quarter of 2011, with *mortgage advances* recording the highest absolute increase, followed by *other loans and advances*.

Loans and advances to the private sector by type



Mortgage advances maintained their growth momentum during the first half of 2011, albeit at quite modest levels, with some differentiation between residential and commercial mortgages. In the second quarter of 2011, growth in mortgage advances was boosted by an increase in the extension of commercial mortgage advances, against the backdrop of moderately improving sales volumes, stabilising rentals and rising occupancy levels of business premises. Measured over twelve months, growth in commercial mortgage advances accelerated from 1,9 per cent in March to 4,5 per cent in July. By contrast, year-on-year growth in residential mortgage advances decelerated from 3,0 per cent to 2,2 per cent over the same period. Consequently, twelve-month growth in aggregate mortgage advances levelled out at rates of around 3,2 per cent in the seven months to July. Capital repayments on existing mortgage bonds have risen somewhat in relation to new loans paid out since the second half of 2010, following a lower average level of interest rates, partly contributing to the moderate growth in mortgage advances in recent months.

Growth in mortgage advances



During the second quarter of 2011, *instalment sale credit and leasing finance* increased at a slower pace when compared to the preceding quarter, consistent with the slowdown in the demand for motor vehicles during the period. Notwithstanding the slowdown, the year-on-year growth rate in this credit category continued to improve to a two-and-a-half-year high of 5,2 per cent in July 2011.

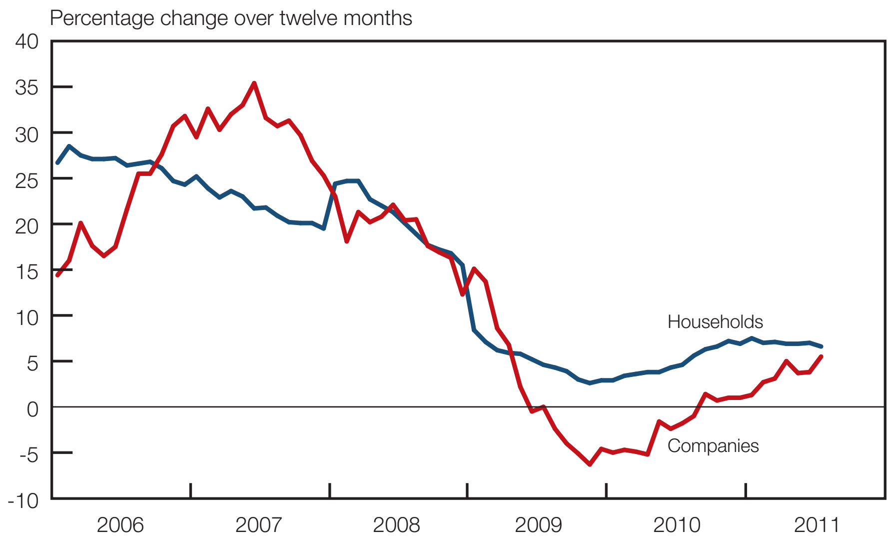
Quarterly changes in banks' total loans and advances by type

R billions

	2010		2011	
	3rd qr	4th qr	1st qr	2nd qr
Mortgage advances	18,4	0,6	3,6	11,3
Instalment sale credit and leasing finance	2,2	2,9	3,9	3,1
Other loans and advances	27,7	-0,1	27,3	5,1
Overdrafts	1,2	-1,6	3,6	0,7
Credit card advances	0,5	0,2	1,1	1,5
General advances	26,1	1,4	22,5	2,9
Total loans and advances	**48,3**	**3,4**	**34,8**	**19,5**
Of which: To household sector	28,6	11,8	22,4	11,8
To corporate sector	19,7	-8,4	12,4	7,7

A sharp deceleration in the volatile subcategory of general loans to the corporate sector contributed to a significant slowdown in other loans and advances in the second quarter of 2011. Measured over twelve months, growth in other loans and advances decelerated from 11,7 per cent in April 2011 to 9,5 per cent in June, before recovering to 11,6 per cent in July.

Loans and advances extended to households and companies



Both the household and corporate sectors played a role in the slower growth in banks' total loans and advances during the second quarter of 2011. Nevertheless, the household sector remained the main driver of credit demand, accounting for 61 per cent of the overall increase of R19,5 billion during this period. Growth over twelve months in credit extended to the household sector averaged around 7,0 per cent during the first seven months of 2011, while that of loans and advances extended to the corporate sector reached a high of 5,5 per cent in July 2011, up from 3,1 per cent in March.

Interest rates and yields

The Monetary Policy Committee (MPC) again left the repurchase rate unchanged at 5,5 per cent at its fourth meeting of the year, held in July 2011. The decision was informed by a reasonably contained underlying inflationary trend with well-anchored inflation expectations, a fragile domestic economic recovery, continued global uncertainties and the relatively strong exchange

Money-market rates

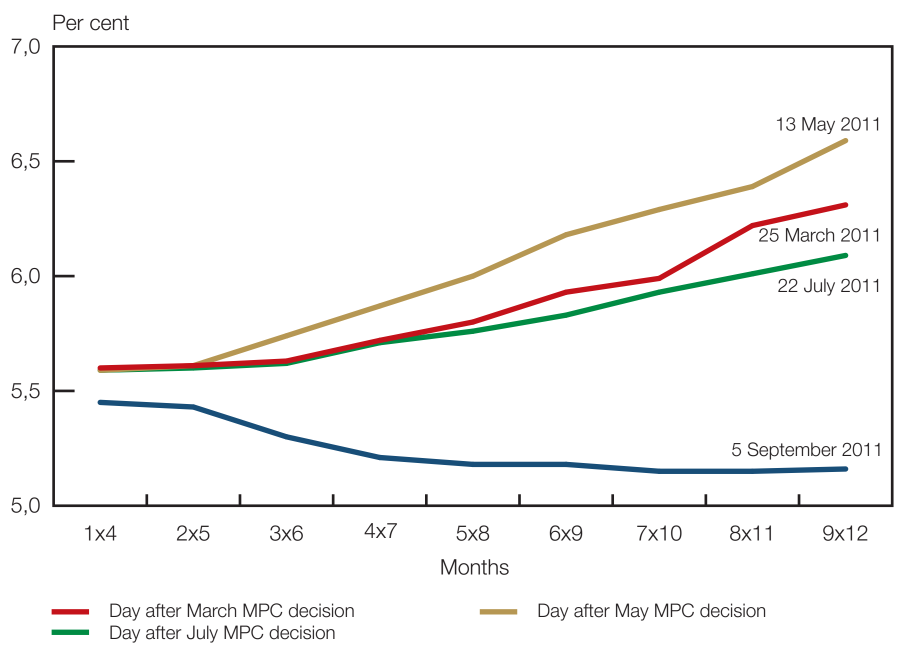
value of the rand despite heightened global risk aversion. Underlying inflation pressures continued to be of a cost-push nature, with food and oil price developments remaining the major risks to the inflation outlook. Although some domestic inflationary pressures surfaced during the assessment period, these risks were mitigated by the uneven growth in the domestic economy and the contagion effects stemming from sovereign debt concerns abroad. The MPC statement discussing developments underlying the recent monetary policy decision is reproduced in full on page 60 of this *Quarterly Bulletin.*

Money-market rates remained fairly stable and continued to hover around historically low levels during the second quarter of 2011 and early in the third quarter, with slight increases registered across longer-dated instruments, for example, the three-month Johannesburg Interbank Agreed Rate (Jibar) remained virtually unchanged at 5,58 per cent between 26 January 2011 and 2 September, emulating the unaltered repurchase rate. The six-month Jibar rate increased more notably from a low of 5,67 per cent on 6 January 2011 to a recent high of 5,92 per cent on 17 May, as market participants started adding a premium to medium-term money-market instrument yields, partly due to exchange rate and inflation concerns. Since then the rate fluctuated lower, reaching 5,69 per cent on 2 September.

The rate on 91-day Treasury bills displayed a moderate upward trend, rising from 5,44 per cent to 5,49 per cent between 20 May and 2 September.

Rates on forward rate agreements (FRAs) were marked by volatility during the second quarter of 2011 but recorded consistent declines from mid-June. Despite rising inflationary pressures and heightened global risk aversion, the 9x12-month FRA rate, for instance, eased substantially from a high of 6,61 per cent on 16 May 2011 to 5,20 per cent on 2 September 2011. Other FRA rates across the maturity spectrum also followed suit as market participants pushed out their expectations of monetary policy tightening, partly related to mounting uncertainty about the strength of the domestic economic recovery and a lacklustre global growth outlook.

Forward rate agreement yield curves



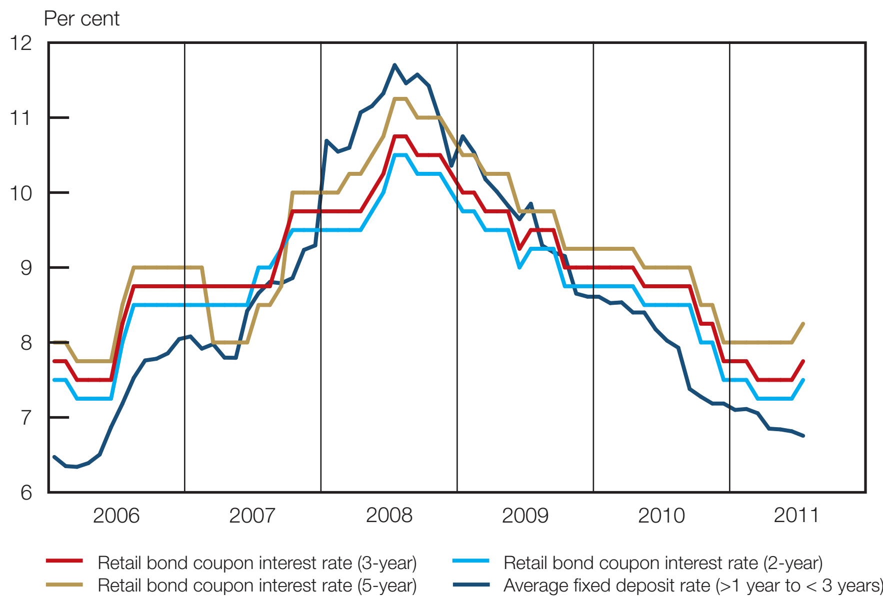
Consistent with the orderly conditions in the overnight interbank market, the South African Benchmark Overnight Rate (Sabor) remained fairly stable and fluctuated within the standing facility limits during the second quarter of 2011. The Sabor fluctuated between a minimum of 5,25 per cent and a maximum of 5,30 per cent in the second quarter of 2011, and stood at 5,26 per cent on 2 September 2011. The implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) displayed some month-end pressures between

May and August 2011, and fluctuated between 5,00 per cent and 6,05 per cent from May to August 2011. On 2 September the rate stood at 5,63 per cent.

The prime overdraft rate and the predominant rate on mortgage loans have remained unchanged at 9,0 per cent since November 2010.

In July 2011 interest rates on RSA *government fixed-rate retail bonds* were all raised by 25 basis points – their first increase since mid-2009. The average deposit rate on one-to-three-year fixed deposits fell below retail bond interest rates in the past 21 months.

RSA retail bond interest rates and deposit rates



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

Despite rising inflation, the daily average *yield on the R157 government bond* (maturing in the years 2014/15/16) fluctuated lower from 7,94 per cent on 4 February 2011 to 6,45 per cent on 1 September, alongside the appreciation in the exchange value of the rand and strong demand for local bonds by non-residents. The medium to long end of the *yield curve* therefore moved lower from the end of March 2011 to the end of August. As the extreme short end of the curve remained broadly anchored to the unchanged repurchase rate, the *yield gap*[6] narrowed from 377 basis points on 30 March 2011 to 298 basis points on 1 September. The daily closing yield on the US 5-year bond followed a similar trend as domestic bond yields, receding from 2,37 per cent on 11 February 2011 to 0,94 per cent on 1 September. Consequently, the spread between the South African R157 bond yield and the US 5-year bond yield narrowed slightly from 566 basis points on 4 February 2011 to 551 basis points on 1 September.

7 The differential between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds within the two-year maturity range.

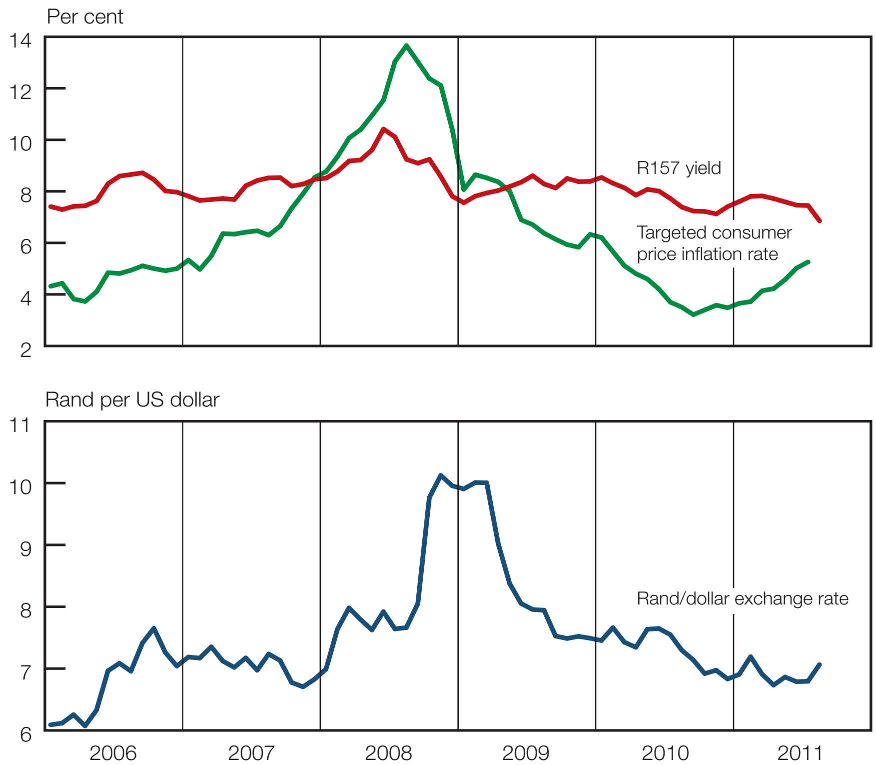
8 The differential between South African government bond yields on rand-denominated debt issued in the domestic market and on dollar-denominated debt issued in the US in the three-year maturity range.

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

While the real yield on inflation-linked bonds continued lower, the nominal yield on conventional government bonds declined more pronouncedly over the past seven months. Accordingly, the *break-even inflation rate*[7] fluctuated lower from 5,94 per cent on 7 February 2011 to 5,34 per cent on 1 September. Despite this decline in the yield on the domestic rand-denominated bonds, the *currency risk premium*[8] on South African government bonds widened from 421 basis points in February 2011 to 484 basis points in July. This was as a result of an even more significant decline in the yield on the dollar-denominated bond as it increasingly became apparent that US policy interest rates would stay very low for longer. Subsequently, the currency risk premium narrowed to 391 basis points in August as the yield on the rand-denominated bond declined considerably, while the yield on the dollar-denominated bond remained broadly on the same level.

Volatility and nervousness were evident as the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[9] yield spread above US government bonds fluctuated wider from 245 basis points in October 2010 to 321 basis points in August 2011. Both the international (VIX) and domestic

Government bond yield, inflation and the exchange rate

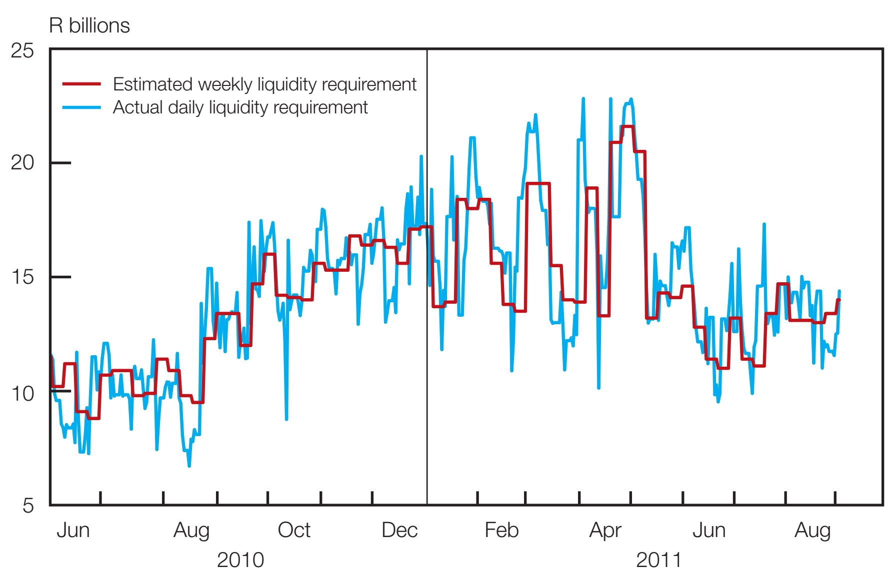


(SAVI) measures of market volatility increased over this period. The continued nervousness in the markets could be attributed to, among other things, the fears of contagion in the eurozone debt crisis, debt concerns in the US and political instability in the MENA region. The *sovereign risk premium* on South African government US dollar-denominated bonds in the three-year maturity range trading in international markets also widened slightly from 131 basis points in November 2010 to 138 basis points in August 2011.

Money market

Money-market liquidity continued to fluctuate during the second quarter of 2011. During this period, the actual daily liquidity requirement of the private-sector banks varied within a broad range of between R9,8 billion and R22,8 billion, slightly wider than the estimated liquidity requirement, which oscillated between R11,4 billion and R21,6 billion.

Liquidity requirement



During the second quarter of 2011, money-market liquidity conditions were characterised by a net injection of liquidity to the value of R1,3 billion. The Bank, spurred on by favourable exchange rate movements, injected R28,0 billion worth of liquidity as it purchased foreign-exchange reserves. The use of liquidity management instruments injected additional liquidity to the value of R3,4 billion. The excess liquidity in the money market was mainly neutralised by public-sector deposits with the Bank amounting to R24,4 billion, as well as notes and coin in circulation, and required cash reserve deposits, which jointly drained liquidity amounting to R4,0 billion.

Money-market liquidity flows

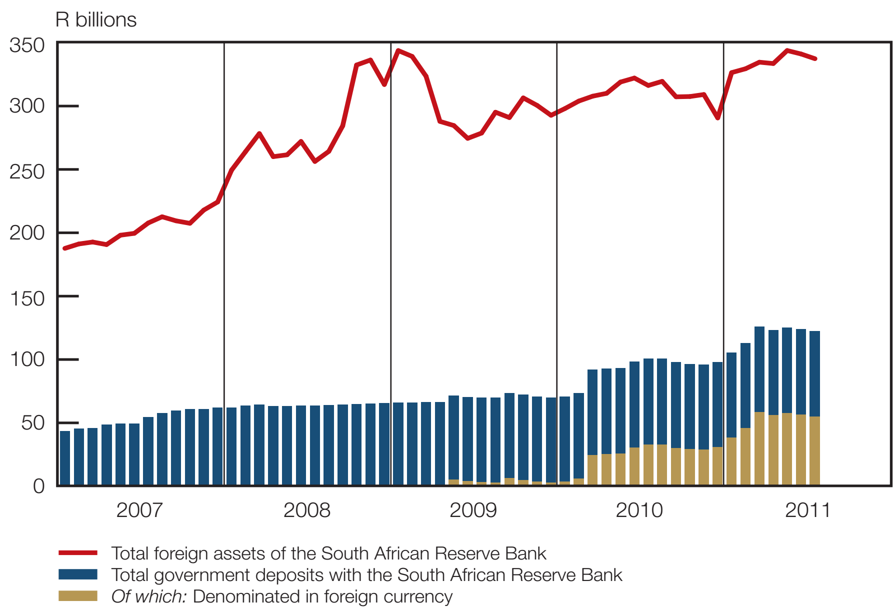
R billions (easing + tightening –)

	2011	
	1st qr	2nd qr
Notes and coin in circulation	4,2	-2,6
Required cash reserve deposits	-1,0	-1,3
Money-market effect of SARB* foreign-exchange transactions	28,5	28,0
Public-sector deposits with the SARB	-27,9	-24,4
Use of liquidity management instruments	-8,4	3,4
Reverse repurchase transactions	-2,6	2,0
SARB debentures	-5,8	1,4
Other items net	2,5	-1,8
Banks' liquidity requirement (decrease + increase –)	**2,1**	**1,3**

* SARB: South African Reserve Bank

After a significant increase up to the first quarter of 2011 government deposits with the Bank levelled out in the second quarter. In July government deposits with the Bank edged lower, mainly on account of a decline in foreign currency deposits.

Foreign reserves and government deposits



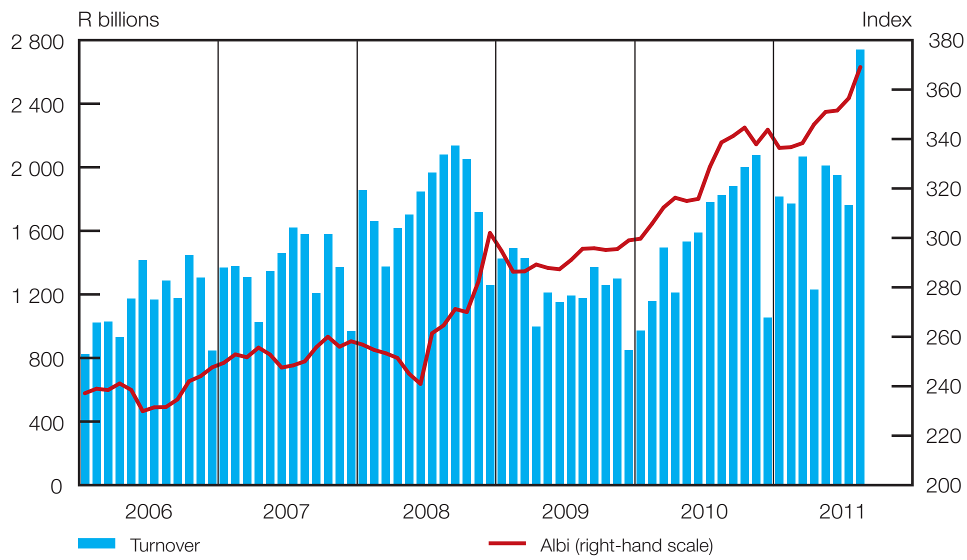
Coupon interest payments on various government bonds amounting to R17,1 billion were effected from the government tax and loan account during the five months to August 2011, R0,1 billion of which accrued to the Bank.

Bond market

Bond issuances by the public sector in the *primary bond market* continued sturdily during 2011, with net issues of R99,8 billion in the seven months to July. Net issues by the private sector, however, dwindled in the second quarter of 2011 to R2,3 billion from R23,6 billion in the first quarter. Funding in the form of commercial paper remained subdued from 2009, recording net redemptions of R8,1 billion in the first seven months of 2011. The total outstanding nominal value of debt securities listed on the JSE therefore increased by R119 billion thus far in 2011 to reach R1,3 trillion at the end of July. Although outstanding amounts of bonds issued by both the public and private sectors increased by 11 per cent in the first seven months of 2011, the total outstanding amount of debt securities rose by 10 per cent, dragged down by the contraction in commercial paper.

Turnover in the *secondary bond market* generally remained brisk over the past year, as bond prices were, on average, higher than the previous year. The value of turnover in the first eight months of 2011 amounted to R15,3 trillion, which was 33 per cent higher than the value traded in the corresponding period of 2010. The All-Bond Index (Albi) recorded a gain of 9 per cent from August 2010 to August 2011. The sustained ability of South African bonds to render positive returns can mainly be ascribed to sturdy coupon interest payments, the continued appreciation in the exchange value of the rand and net purchases of bonds by non-residents.

Secondary bond market turnover and bond price index



Despite the euro area debt crisis and resultant downgrades by rating agencies, rand-denominated bond issues in the *European bond markets* remained brisk in 2011 with net issues of R5,5 billion in the first seven months, compared with net redemptions of R6,6 billion recorded in the same period of 2010. The issuance of rand-denominated bonds by non-residents in the *Japanese Uridashi bond market* remained subdued in 2011, with net redemptions of R1,4 billion being recorded in the seven months to July, as indicated in the accompanying table.

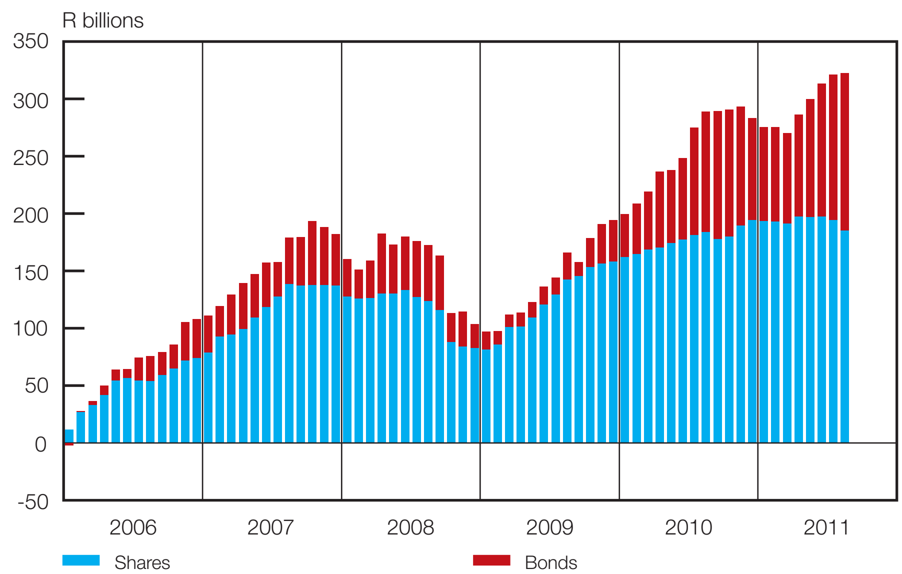
Rand-denominated bonds issued in international bond markets, January to July

R millions

	Eurorand		Uridashi		Total	
	2010	2011	2010	2011	2010	2011
Issues	3 746	9 432	12 713	5 046	16 459	14 478
Redemptions	10 348	3 930	17 760	6 488	28 108	10 418
Net	-6 602	5 502	-5 047	-1 442	-11 649	4 060

The second quarter of 2011 was dominated by the European sovereign debt problems and concerns over slow US economic growth. This combination enhanced *non-residents*' demand for safer assets, as reflected in the high net purchases of domestic bonds of R37,0 billion in the second quarter of 2011, followed by net purchases of R21,5 billion during July and August. From the end of 2009, the reallocation of investment portfolios was characterised by a notable shift from equities to debt securities. The shift was mainly underpinned by higher yields offered by local bonds and investors seeking safety in government bonds following adverse economic conditions, political changes and natural disruptions. Net purchases of bonds by non-residents took off from October 2009, as shown in the accompanying graph.

Cumulative net purchases by non-residents



Share market

The *capital raised* by companies listed on the JSE in the domestic and international primary share markets of R59,4 billion in the first seven months of 2011 was 59 per cent higher than the R37,3 billion raised in the corresponding period of 2010. Companies with primary listings on the JSE contributed 70 per cent of the total capital-raising activity in the first seven months of 2011. The financial sector accounted for 42 per cent of total funds raised, followed by the industrial and resources sectors at 35 per cent and 20 per cent respectively. Over the same period, the bulk of the capital, namely R31,8 billion, was raised through the issuance of securities for acquisition of assets or merger with another company.

The total number of *companies listed* on the JSE reached 408 at the end of July 2011, with 331 companies on the main board, 69 companies on the Alt^X exchange, 3 companies each on the development (DCM) and venture capital boards (VCM) and 2 companies on the Africa board. In the first seven months of 2011 the listing activity on Alt^X consisted of 2 new listings, 2 inward transfers from the VCM and main board, 1 delisting and 2 outward transfers to the main board. Total listing activity, in turn, comprised 9 new listings and 8 delistings, compared with 7 new listings and 10 delistings over the same period of 2010.

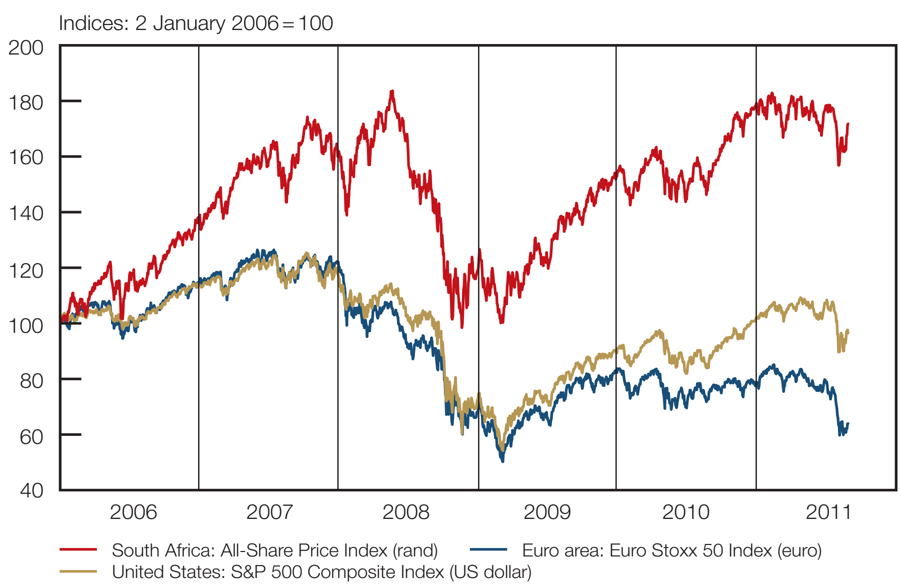
Although Alt^X gained one listing on a net basis, turnover on Alt^X remained subdued in the first eight months of 2011 – amounting to R817 million compared with R937 million in the corresponding period of 2010. After recording a recent quarterly high of R850 billion in the first quarter of 2011, total *turnover in the secondary share market* receded to R739 billion in the second quarter as share prices declined. However, in the first eight months of 2011, turnover of R2,2 trillion was still 8 per cent higher than the value of R2,0 trillion traded in the corresponding period of 2010. Lower share prices dragged the total *market capitalisation* of the JSE lower from an all-time high of R6,9 trillion in April 2011 to R6,6 trillion in August. Total market liquidity[10] therefore increased from 45 per cent in 2010 to 50 per cent in the first eight months of 2011.

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

Non-residents' risk appetite for domestic listed shares diminished during the second quarter of 2011. Amid recent unfavourable financial market events, and as is customary in the risky nature of equity, non-residents remained wary. They limited their exposure to shares to net purchases of only R6,0 billion during the second quarter of 2011, after recording net sales of R3,1 billion in the first quarter of 2011. During the first eight months of 2011, non-residents' net sales of South African-listed shares amounted to R9,4 billion, compared with a net accumulation of R25,8 billion recorded during the corresponding period of 2010. Their participation rate, measured as their purchases and sales as a percentage of the total value of shares traded on the JSE, averaged around 15 per cent in 2010 and in the first eight months of 2011.

The volatility in *South African share prices* during 2011 was amplified by concerns over the euro area, US debt problems and fluctuating commodity prices. The FTSE/JSE All-Share Price Index (Alsi) declined by 14 per cent from a recent high of 33 094 index points on 14 February 2011 to reach an index value of 28 391 on 8 August on the back of renewed concerns about the US economy, before recovering by 9 per cent to 1 September. In US dollar terms, the Alsi declined by 3 per cent from 14 February 2011 to 1 September, while the S&P 500 Composite Index and the Euro Stoxx 50 Index also declined by 10 per cent and 24 per cent respectively over the same period.

Share prices



Along with lower share prices, the historical *dividend yield* on all classes of shares increased from 2,1 per cent in January 2011 to 2,9 per cent in August, while the *earnings yield* increased from 5,6 per cent to 7,7 per cent over the same period, as a result of higher dividend and earnings declarations. Conversely, the *price-earnings ratio* for all classes of shares decreased from 17,9 in January 2011 to 12,9 in August.

Market for exchange-traded derivatives

Although turnover in *equity derivatives* contracts traded on the Equity Derivatives Division (EDD) of the JSE tapered off in the second quarter of 2011 alongside the bearish underlying share market, the value traded in the seven months to July 2011 was still higher compared with the same period of 2010.

In July 2011 the Commodity Derivatives Division (CDD) of the JSE expanded its foreign-referenced commodity product range to include cash-settled Chicago Board of Trade soft red winter wheat futures contracts.

Trading activity in *commodity futures and options contracts* on the CDD rose by 17 per cent to reach 1,4 million contracts in the first seven months of 2011 when compared with the same period of 2010 as elevated domestic agricultural commodity prices bolstered turnover. Despite the strength in the exchange value of the rand, local grain prices continued to increase against the backdrop of rising international grain and oil prices; increasing domestic electricity tariffs, which threatened irrigation farming; and lower local supply of certain commodities. The increase in agricultural commodity prices seemed likely to contribute to further increases in domestic consumer food inflation. Maize contracts, particularly white maize, accounted for the largest share at 56 per cent of the total number of contracts traded in the first seven months of 2011.

In June 2011 the JSE introduced new currency contracts on *Yield-X*, the *interest rate derivatives market* of the JSE, namely knock-out barrier option contracts – aimed at allowing investors more flexibility and creating diversified trading strategies.

Activity on *Yield-X* continued at a robust pace in the first seven months of 2011 as the number of contracts traded increased by 60 per cent to 7,6 million contracts compared with the corresponding period of 2010. Developments in the foreign-exchange markets supported trade in currency futures and options contracts, which continued to dominate trade at 92 per cent of total activity during the period under review. Turnover on Yield-X therefore remained buoyant in the first seven months of 2011.

In tandem with the weaker underlying share market, the recovery in the *warrants market* of the JSE was fragile as trading activity subsided from April 2011 to August. Turnover in all derivatives traded on the JSE during the first seven months of 2011 is indicated in the accompanying table.

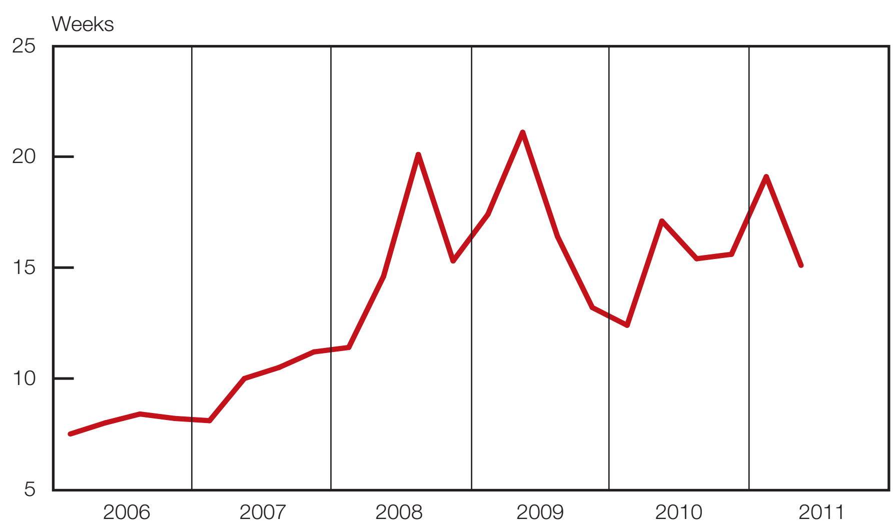
Derivatives turnover on the JSE, January to July 2011

	Value (R billions)	Change over one year (Per cent)
Equity futures and options on futures	2 304	12
Warrants	0,6	-48
Commodity futures and options	196	60
Interest rate derivatives	163	38

Real-estate market

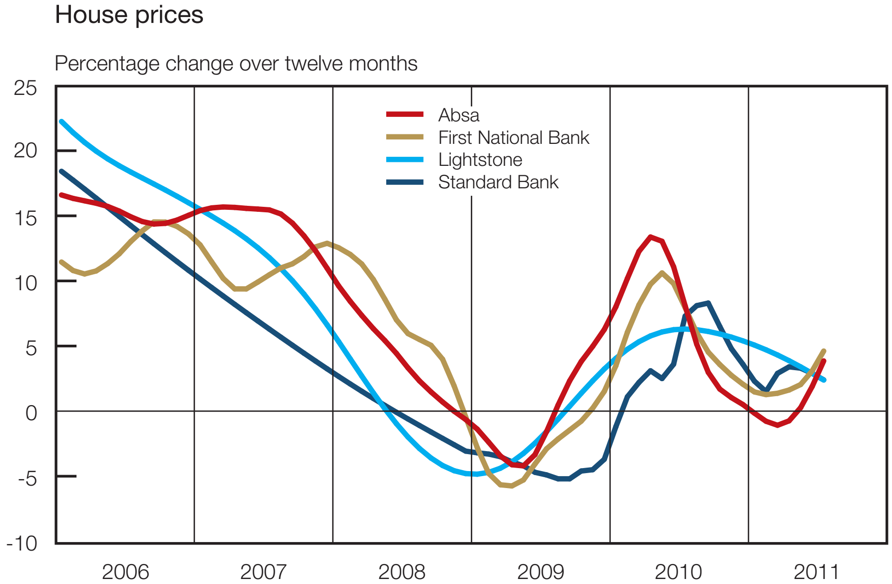
The prolonged aftermath of the financial crisis left a large number of households with impaired credit records. Along with slow job creation, this continued to engulf the domestic housing market, making it difficult to take advantage of the low-interest rate environment. Although moderate signs of stabilisation were evidenced by a slight reduction in the average time properties remained on the market, the average of 15 weeks in the second quarter of 2011 was long compared to the vibrant property market days of 2006 when it was 8 weeks.

Average number of weeks that residential properties remain on the market



Source: First National Bank

Some of the house price barometers have also recently reflected a moderate acceleration in house prices.

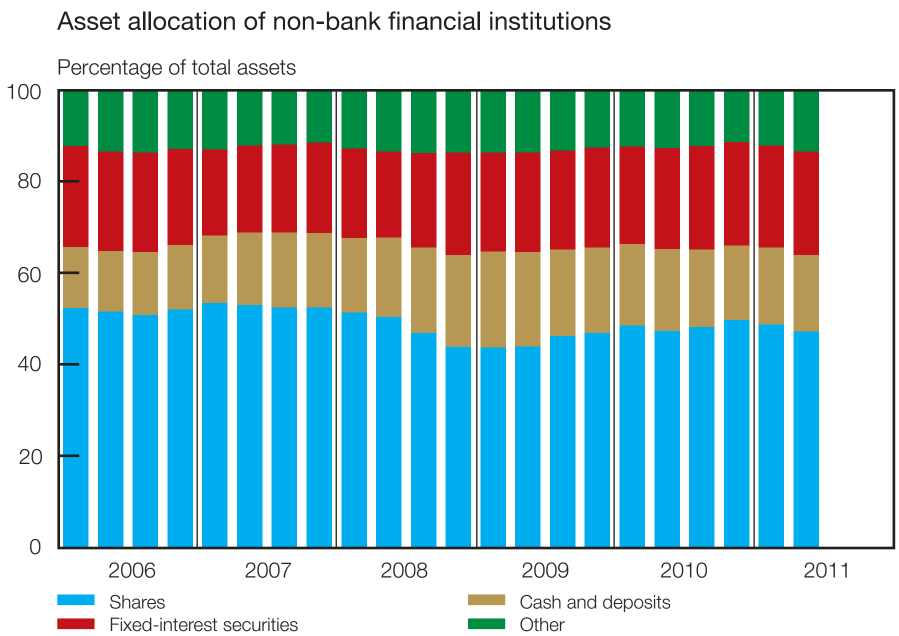


In line with the Consumer Protection Act, 2008 (Act No. 68 of 2008), which came into effect as of 1 April 2011, the Estate Agency Affairs Board (EAAB) has granted a three-month extension to all illegally operating estate agents. The extension of the amnesty period is aimed at ensuring that all practising estate agents are registered and fully compliant for the protection of the consumer.

Non-bank financial intermediaries

The aggregate balance sheet of non-bank financial institutions[11] remained unchanged at R4,4 trillion in both the first and second quarters of 2011. The asset holdings continued to be dominated by traditional asset classes, namely shares, bonds and cash, which, when combined, accounted for 86 per cent of the total assets in the second quarter of 2011. The asset allocation structure is a reflection of the investment strategies pursued by these intermediaries and investment limits placed by regulation.

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



In tandem with lower equity prices, which were, among other things, due to a deterioration in the global economic outlook and sovereign debt concerns in developed economies, the proportion of funds allocated to shares declined from 49 per cent in the first quarter of 2011 to 47 per cent in the second quarter.

Holdings of fixed-interest securities rose by 1 percentage point of total assets from the first quarter of 2011 to 23 per cent in the second quarter, supported by higher bond prices. Meanwhile, the share of holdings of paper issued by state-owned enterprises in total fixed-interest securities remained at 16 per cent of total assets over the same period, against the backdrop of lower issuances due to some improvements in their cash flows. Declining bond yields are likely to weigh negatively on the investment income of these institutions, which tend to provide them with stable cash flows during periods of uncertainty. The reallocation of assets from equities to conservative fixed-interest securities indicated a return of risk aversion in the financial markets and some moderation in investors' sentiment.

At the same time, the percentage of assets held in the form of cash and cash equivalent instruments was 17 per cent in the first and second quarters of 2011.

The Code for Responsible Investing in South Africa (CRISA), which provides guidance on how institutional investors should execute investment analysis and activities so as to promote effective and sound governance, was released in July 2011 by the Institute of Directors of Southern Africa. All local institutional investors and institutional service providers will be subjected to CRISA requirements from 1 February 2012.

Public finance

Non-financial public-sector borrowing requirement[12]

The *non-financial public-sector borrowing requirement* amounted to R44,5 billion in the first quarter of fiscal 2011/12 – some R4,5 billion higher than in the same period of the preceding fiscal year. The larger borrowing requirement emanated mainly from higher cash deficits recorded by national government and municipalities.

As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to 6,2 per cent in the first quarter of fiscal 2011/12. This was higher than the ratio of 6,1 per cent recorded in the same period of the previous fiscal year. The *Budget Review 2011* projected that this ratio would amount to 9,5 per cent for fiscal 2011/12 as a whole. Financial activities at various levels of the non-financial public sector are summarised in the accompanying table.

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

Non-financial public-sector borrowing requirement

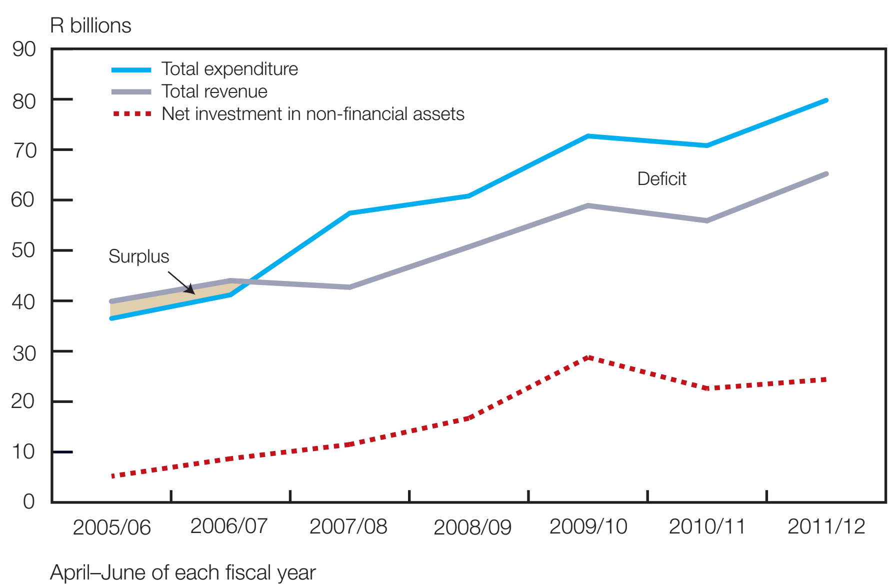
R billions

Level of government	Apr–Jun 2010*	Apr–Jun 2011*
Consolidated general government	25,2	29,9
National government	31,2	35,8
Extra-budgetary institutions	-0,4	-2,2
Social security funds	-1,9	-2,5
Provincial governments	-7,5	-7,2
Local governments	3,8	6,1
Non-financial public enterprises and corporations	14,9	14,5
Total**	40,1	44,5
As a percentage of gross domestic product	*6,1*	*6,2*

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

Preliminary data show that *non-financial public enterprises and corporations* recorded an estimated cash deficit of R14,5 billion in the first quarter of fiscal 2011/12. The deficit was R0,4 billion lower when compared with the cash deficit recorded in the corresponding period a year earlier. The cash deficit narrowed slightly due to prominent growth in total receipts, which remained high and outpaced the slower growth in total expenditure.

Finances of non-financial public enterprises and corporations



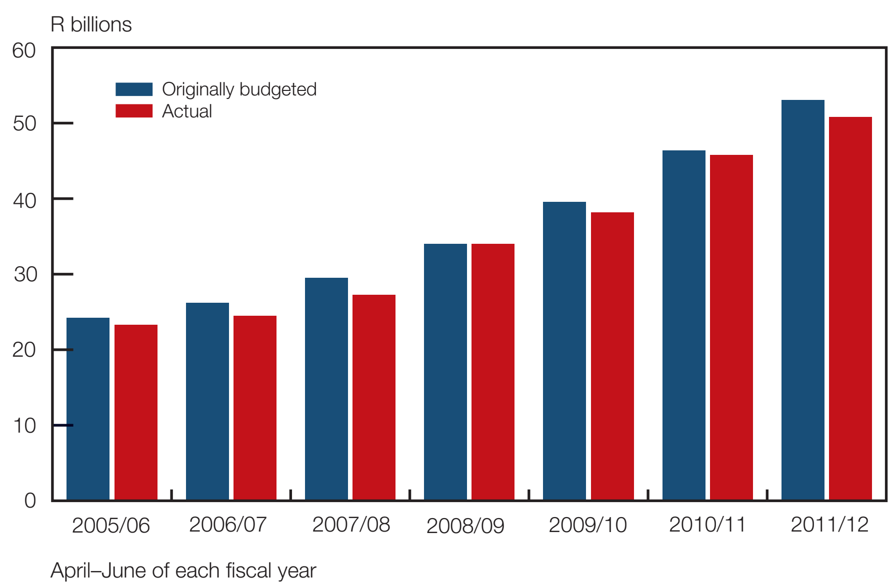
During the period under review, net investment in non-financial assets amounted to R24,4 billion or 8,2 per cent higher than in the same period of the previous fiscal year. State-owned entities continued to support infrastructure investment in areas such as energy, transport, water and sanitation. The *Budget Review 2011* projected that infrastructure investment by major state-owned entities would remain at a high level, reaching R137 billion in fiscal 2011/12 before slowing to average R117 billion over the medium term. Non-financial public enterprises – mainly Eskom and Transnet – accounted for the largest share of government's capital infrastructure programmes. Borrowing by these enterprises would continue to support their capital investment programmes.

An analysis of *national government* finance statistics indicates that cash receipts from operating activities increased by 7,8 per cent in the first quarter of fiscal 2011/12 when compared with the same period a year earlier. Cash payments for operating activities increased by 9,0 per cent to amount to R201 billion in the first three months of fiscal 2011/12 when compared with the same three-month period of the previous fiscal year. Netting cash flow from operating activities and net investment in non-financial assets resulted in a cash deficit of R35,8 billion in April–June 2011, higher than the cash deficit recorded in the corresponding period a year earlier.

Provincial governments recorded a cash surplus of R7,2 billion in the first quarter of fiscal 2011/12, slightly smaller than the cash surplus of R7,5 billion recorded in the same period of the preceding fiscal year. The *Budget Review 2011* provided for a provincial cash surplus of R1,1 billion in fiscal 2011/12 as a whole.

Total provincial revenue, predominantly boosted by grants from national government, amounted to R90,9 billion during the first quarter of fiscal 2011/12. Combined provincial grants accounted for about 44 per cent of total national government revenue and was comprised of equitable share transfers of R72,1 billion and conditional grants of R16,5 billion. Together, these grants increased at a year-on-year rate of 9,2 per cent during April–June 2011. The *Budget Review 2011* projected that the conditional grant allocation would amount to R69,4 billion in fiscal 2011/12. Several changes to the conditional grants framework have been introduced to align planning and implementation with sector needs. These include the restructuring of the infrastructure grant, and the implementation of a new conditional grant to replace inappropriate and unsafe school structures.

Provincial government compensation of employees



Provincial government expenditure amounted to R83,7 billion in the first quarter of fiscal 2011/12, or 10,6 per cent more than in the same period of fiscal 2010/11. The bulk of provincial government expenditure was on personnel costs, which amounted to R50,6 billion, or 60,4 per cent of total expenditure.

In June 2011 the Gautrain Project reached the end of its 57th month since the effective date when construction had commenced, indicating that the project had overrun the planned development period by two months. During the first quarter of fiscal 2011/12, R0,4 billion was spent on this project, bringing the total amount spent so far to R30,5 billion. Including spending on the Gautrain Project for the first three months of fiscal 2011/12, net investment in non-financial assets amounted to R5,5 billion, or 8,3 per cent higher than in the corresponding period of the previous fiscal year.

The provincial budget balance resulted in an increase in provincial governments' deposits with the Corporation for Public Deposits, from R3,4 billion at the end of March 2011 to R5,8 billion at the end of June. At the same time, their deposits with private banks increased from R9,7 billion to R13,5 billion, while their overall indebtedness to banks decreased slightly from R0,7 billion to R0,6 billion between these respective dates.

Extra-budgetary institutions' cash surplus amounted to R2,2 billion in April–June 2011, thereby exceeding the cash surplus recorded in the same period a year earlier. The *Budget Review 2011* envisaged that extra-budgetary institutions would record a deficit of R7,2 billion for fiscal 2011/12 as a whole. Preliminary estimates indicate that the financial position of *social security funds* improved moderately, recording a cash surplus of R2,5 billion, compared with a cash surplus of R1,9 billion in April–June 2010. Estimates in the *Budget Review 2011* indicated that social security funds would record a surplus of R10,8 billion in the current fiscal year. Social security schemes continued to play a crucial role in providing conditional income support to unemployed workers and injured road users. Government also supplied unconditional income support to more than 14 million people in the form of social grants. This forms part of the social wage bill, which includes access to housing, transport, sanitation, health services and basic infrastructure.

In the April–June quarter of 2011, *local governments*' financial activities resulted in a preliminary cash deficit of R6,1 billion; this was R2,3 billion more than the cash deficit recorded in the same period of the previous fiscal year. This deterioration can be ascribed to slower growth in cash receipts relative to stronger growth in total local government expenditure.

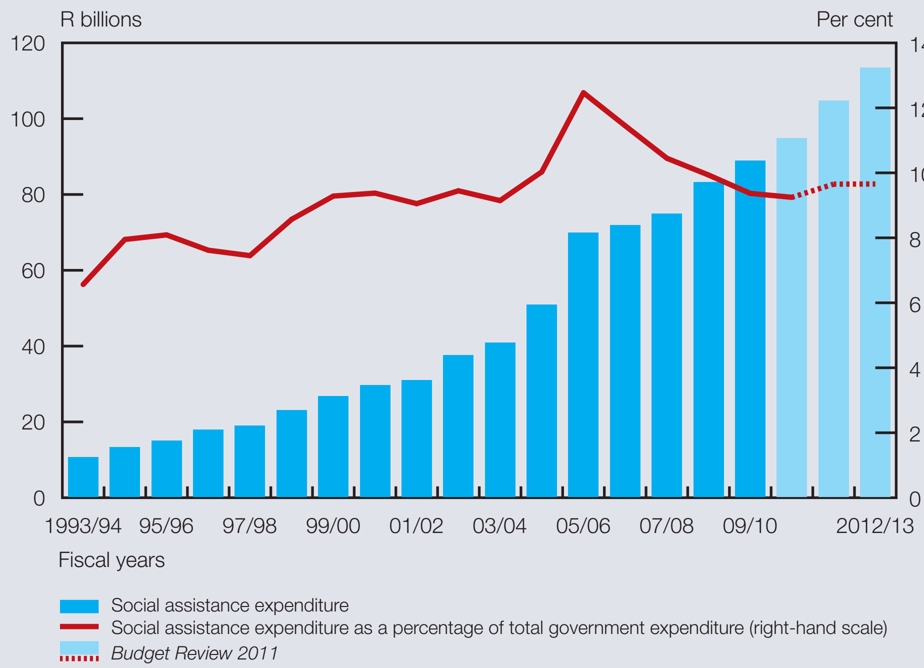
Municipal own revenue increased by 6,3 per cent to amount to R37,1 billion, accounting for 70 per cent of total local government revenue during the period under review. Sales of electricity and gas, together with property rates received, were the main sources of municipal own revenue, and rose by 27,0 per cent and 15,6 per cent respectively during April–June 2011. Total intergovernmental transfers received by local governments increased significantly from R4,2 billion to R15,9 billion in the first quarter of fiscal 2011/12. This increase was to support municipalities to address infrastructure backlogs and ensure continued expansion of access to basic services. Furthermore, the higher transfers would assist municipalities to deal with the rising cost of purchasing bulk electricity. The *Budget Review 2011* projected that municipalities would receive R74,2 billion as their equitable share transfer from the main budget and an amount of R8,6 billion would be transferred under the general fuel levy sharing arrangement.

Total expenditure by local governments showed strong growth, mainly because of the sharp acceleration in purchases of goods and services during the period under review. Net investment in non-financial assets amounted to R10,3 billion, or 3,2 per cent higher when compared with the corresponding period a year earlier.

Box 1: Social grant expenditure in post-democratic South Africa

South Africa is a country characterised by high unemployment, a skewed distribution of income and a large number of the population living in poverty. As such, social security grants are seen as a means of alleviating poverty and countering some of its long-term effects. In fiscal 1994/1995, after the country's first democratically elected government had been voted into power, expenditure on social grants amounted to R10 billion or 6,6 per cent of total general government expenditure. At the time, social grants were distributed to some 2,9 million recipients, and included the State Old Age Grant, War Veterans' Grant, Maintenance Grant, Care Dependency Grant, Foster Child Grant and Grant-in-Aid. By fiscal 2009/2010 expenditure on social grants amounted to R89 billion or 9,4 per cent of total general government expenditure. The Child Support Grant was introduced in the late 1990s and the Maintenance Grant was phased out.

Social assistance expenditure



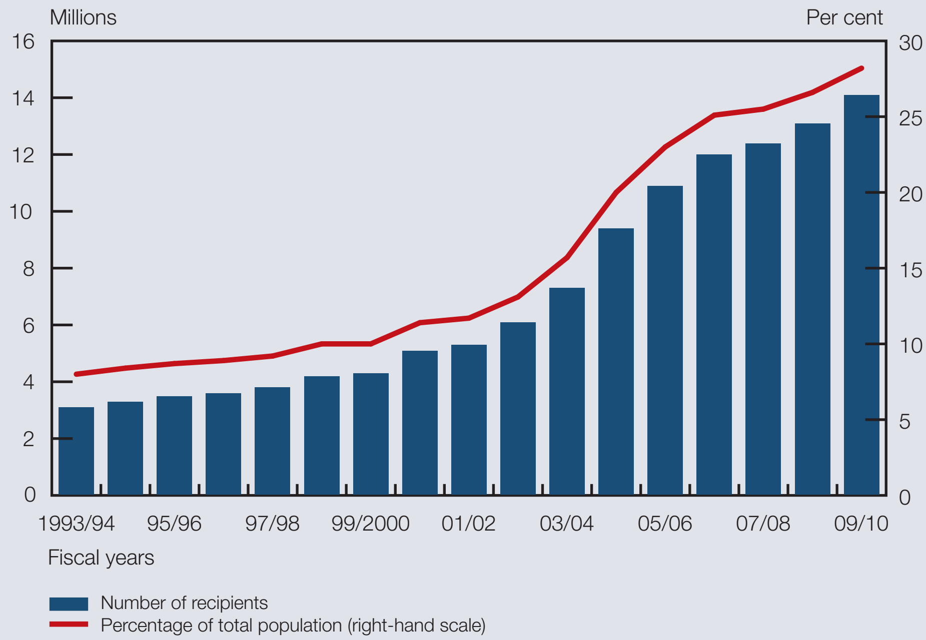
The sizeable increase in social grant expenditure and the number of recipients can be attributed to the following factors:

- Amendments to the qualifying age of men for the State Old Age Pension, which was lowered from 65 to 60 in 2010.
- Changes to the *means test* threshold, which is used to determine eligibility for social grant assistance.
- The gradual extension of the eligible age for the Child Support Grant; as of fiscal 2013/14 children will be eligible for the grant up to their 18th birthday.

By December 2010 over 14 million people were receiving social grants in South Africa, amounting to 28,2 per cent of the total population and more than four times the number of recipients in 1994. The average growth rate in the number of beneficiaries exceeded 10 per cent per annum over this period.

In fiscal 2010/11 the Child Support Grant was the largest by number of recipients, involving over 10 million children who represented about 69 per cent of the total head count of social grant beneficiaries. The Old Age Grant involved 3 million recipients but was the largest in terms of expenditure at R33,8 billion in fiscal 2010/11. In the *Budget Review 2011* expenditure on social assistance grants was projected to increase at an average annual rate of 10,6 per cent between fiscal 2010/11 and 2013/14.

Number of social grant recipients



Source: South African Social Security Agency and Statistics South Africa

The accompanying table details the monthly grant amounts at five-yearly intervals. A comparison with the headline consumer price index indicates that the increases in grants have generally kept up with inflation.

Grant amount per month

Rand

Type of grant	Jul 1995	Apr 2000	Apr 2005	Apr 2010
Grant for the aged	410	520	780	1 080
Grant for the disabled	410	520	780	1 080
War veterans' grant	428	538	798	1 100
Maintenance: Parent	410	107,5	0	0
Maintenance: Child	127	33,5	0	0
Care dependency	410	520	780	1 080
Foster child	288	374	560	710
Grant-in-aid	66	94	170	250
Child support grant	0	100	180	250
Memo: Headline consumer price index	*100*	*136*	*177*	*244*

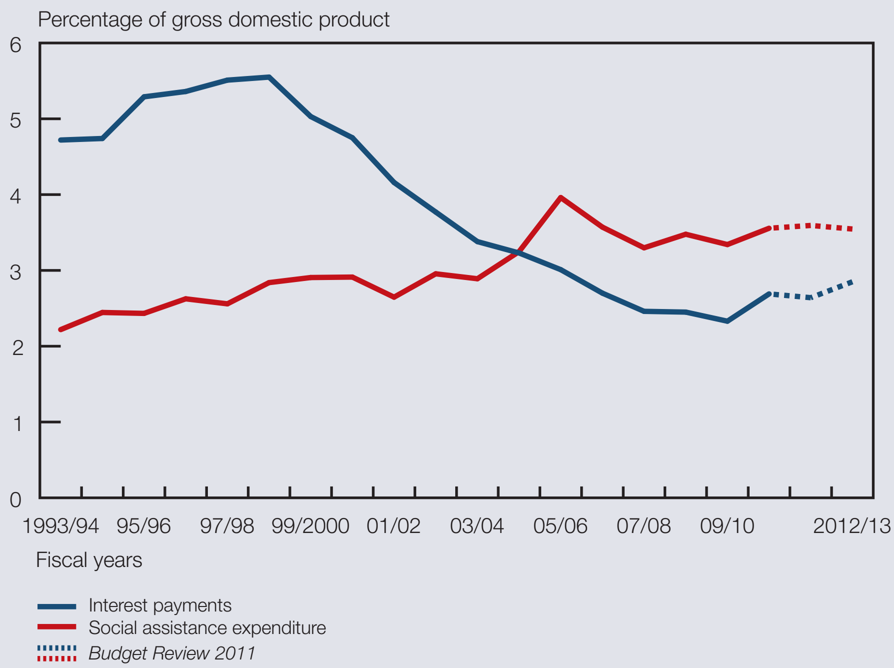
Source: National Treasury, *Budget Review* (various issues); Statistics South Africa; and South African Reserve Bank calculations.

Over the period under review, social grant expenditure as a percentage of gross domestic product has been rising gradually, from 2,1 per cent in 1994 to 3,3 per cent in 2010. This stood in contrast to interest payments on government debt which have been declining gradually, from a peak of 5,5 per cent of gross domestic product in 1999 to 2,3 per cent in 2010.

Social grants represent a crucial safety net for millions of South Africans living in poverty. Nevertheless, caution must be exercised to ensure that the growth in social assistance expenditure is sustainable in the context of society's tax burden and economic growth potential.

While government should guard against fostering a society that is dependent on these grants for subsistence rather than engaging in economic activity to earn a living, a sustainable system distributing social grants to the most vulnerable people is an important element of a caring society.

Social assistance expenditure and interest payments



Budget comparable analysis of national government finance

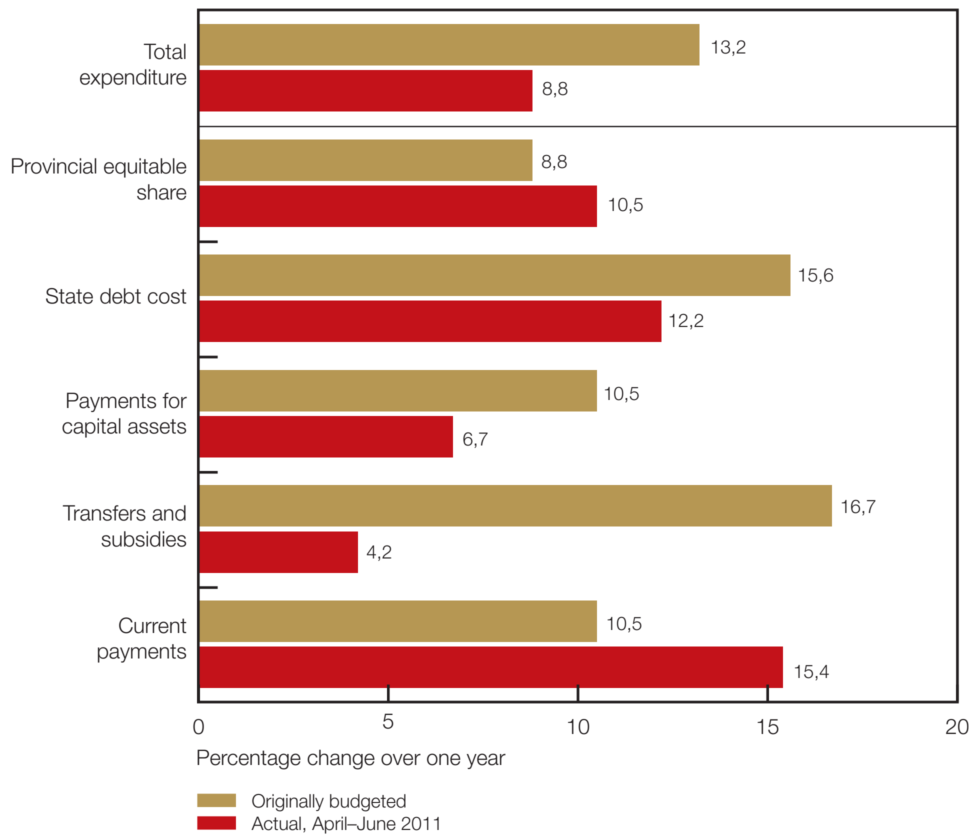
National government expenditure amounted to R198 billion during the April–June quarter of fiscal 2011/12, a year-on-year rate of increase of 8,8 per cent when compared with the same period a year earlier. The *Budget Review 2011* projected that national government expenditure would increase at a rate of 13,2 per cent and amount to R888 billion in fiscal 2011/12 as a whole. As a ratio of gross domestic product, national government expenditure amounted to 27,4 per cent in April–June 2011 compared with 27,7 per cent in the same period a year earlier.

Growth in national government spending was underpinned by higher current payments, along with transfers and subsidies. The rise in current payments was mainly driven by the Justice, Crime Prevention and Security Cluster, in particular the Department of Police. Higher spending by this department was to build overall capacity in terms of additional personnel numbers to boost visible policing, detective services and crime intelligence, and to promote access to justice. Furthermore, the department would invest in physical resources such as basic equipment and capital infrastructure, and would continue with its skills development programme.

Transfers and subsidies by the Departments of Basic Education, and Higher Education and Training, alongside the Department of Health, gained momentum when compared with the same period of the previous fiscal year. The Department of Basic Education made transfers to provinces for the recently introduced school infrastructure backlog grant and the education infrastructure conditional grant. Further allocations were made to expand the conditional grant to provinces for the national school nutrition programme. The higher spending by the Department of Higher Education also arose due to the addition of the further education and training colleges' conditional grants and transfers to the National Student Financial Aid Scheme and increased transfers to universities to support infrastructure renewal, academic programmes and graduate outputs in scarce and critical skills.

Increased transfers and subsidies by the Department of Health to provinces were to strengthen prevention programmes through the HIV/AIDS conditional grants, aimed, among other things, at enabling provinces to expand access to antiretroviral treatment significantly and implement an HIV counselling and testing campaign. Other grants to provinces were aimed at health infrastructure planning across provinces and for the strengthening of tertiary hospital services.

National government expenditure for fiscal 2011/12



Interest paid on national government debt equalled R16,0 billion in the first quarter of fiscal 2011/12, an increase of 12,2 per cent when compared with the corresponding period of fiscal 2010/11. The increase in interest payments resulted from higher issuances of domestic government bonds and Treasury bills to finance the higher budget deficit levels in the previous fiscal years. Interest payments were budgeted to amount to R76,5 billion in fiscal 2011/12, an increase of 15,6 per cent compared with fiscal 2010/11.

Equitable share transfers to provinces amounted to R72,1 billion in the first quarter of fiscal 2011/12, an increase of 10,5 per cent when compared with the first three months of fiscal 2010/11. The *Budget Review 2011* indicated that this spending category would increase by 8,8 per cent to amount to R288 billion in fiscal 2011/12. Growth in equitable share transfers to provinces was to extend and improve service delivery outcomes in the health and education sectors. This spending category was budgeted to account for over a third of total national government expenditure and continued to constitute a major source of provincial revenue.

After taking cash-flow adjustments[13] into account, national government's cash-flow expenditure equalled R195 billion during the first three months of fiscal 2011/12; this was 5,8 per cent more than in the same period a year earlier.

National government revenue amounted to R161 billion in the first three months of fiscal 2011/12, reflecting a year-on-year rate of increase of 7,4 per cent compared with April–June 2010. The increase in national government receipts was underpinned by taxes on income, profits and capital gains, together with taxes on international trade and transactions. Revenue of national government was originally budgeted to increase by 9,1 per cent to a total of R730 billion during fiscal 2011/12. As a ratio of gross domestic product, national government

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

revenue amounted to 22,3 per cent in April–June 2011, compared with 22,8 per cent in the first quarter of fiscal 2010/11.

National government revenue in fiscal 2011/12

Revenue source	Originally budgeted		Actual Apr–Jun 2011	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains ...	418,3	10,1	99,1	11,2
Income tax on individuals	*254,2*	*11,4*	*55,2*	*10,1*
Income tax on companies	*164,2*	*8,1*	*43,8*	*12,6*
Payroll taxes	9,2	5,8	2,4	25,6
Taxes on property	9,6	5,4	2,0	-7,9
Taxes on goods and services	273,9	9,9	54,4	3,9
Value-added tax	*200,9*	*9,4*	*37,7*	*-0,6*
Taxes on international trade and transactions	30,3	12,5	5,3	6,2
Other revenue	10,3	-20,9	3,5	4,4
Less: SACU** payments	21,8	21,5	5,4	45,2
Total revenue	729,9	9,1	161,3	7,4

* Fiscal 2010/11 to fiscal 2011/12
** Southern African Customs Union

Taxes on income, profits and capital gains increased by 11,2 per cent year on year compared with the first quarter of fiscal 2010/11. This increase was driven by growth in receipts from corporate income taxes, alongside a strong increase in personal income tax collections, due to higher provisional payments. Receipts from taxes on income, profits and capital gains were originally budgeted to increase by 10,1 per cent for full fiscal 2011/12.

During the period under review, taxes on payroll and workforce (a relatively small component of total tax revenue) recorded a substantial increase relative to the first three months of the previous fiscal year. This increase resulted from the consolidation of monthly collections of the Skills Development Levy into one single account, but classification delays altered the base from which the change is calculated.

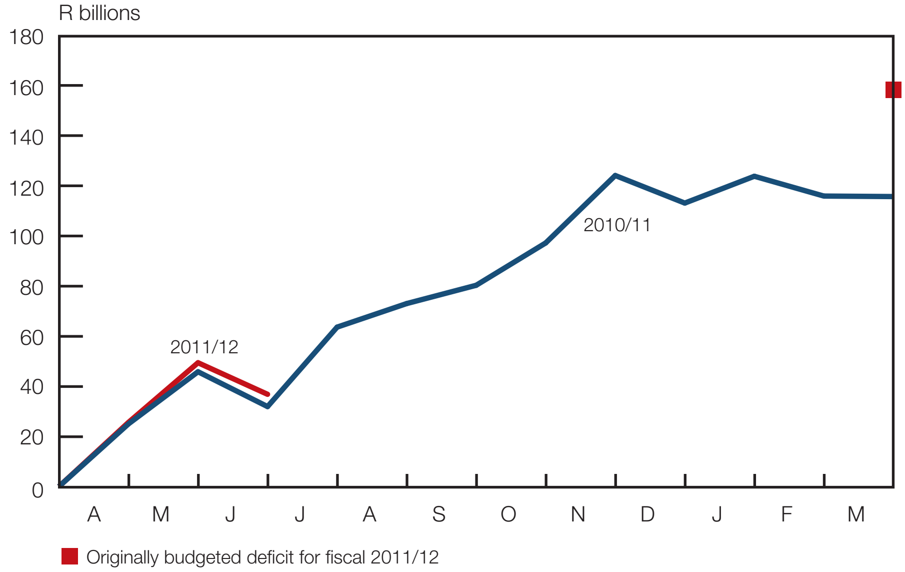
Taxes on property showed signs of weakness and reflected higher exemption thresholds and sluggish conditions in the real-estate and financial markets. Proceeds from taxes on goods and services recorded a moderate increase, resulting from strong growth in the fuel levy and excise duties, despite a marginal decrease in value-added tax (VAT) revenue.

Domestic VAT was lower – influenced by a moderation in consumer demand and weaker-than-expected production and retail sales. However, VAT on imports was higher due to imports of machinery, vehicles, aircrafts and parts. Proceeds from customs duties increased by 15,1 per cent year on year in April–June 2011, feeding through to collections from taxes on international trade and transactions. This significant increase reflected a strong recovery in domestic demand for vehicles and other intermediate imports.

After taking cash-flow adjustments into account, national government's cash-flow revenue in April–June 2011 mirrored the cash-book revenue trend and was R11,2 billion more than the corresponding period a year earlier.

The net outcome of national government revenue and expenditure was a cash-book deficit before borrowing and debt repayment of R36,8 billion in the first three months of fiscal 2011/12. This deficit was R4,9 billion higher than the cash-book deficit recorded in the same quarter of fiscal 2010/11. Faster growth in national government spending, which slightly exceeded the moderate increase in revenue collections, contributed to the widening deficit. The cash-book deficit was originally budgeted to amount to R158 billion in fiscal 2011/12 as a whole.

Cumulative deficit of national government



In the first quarter of fiscal 2011/12 the primary balance[14] amounted to a deficit of R20,8 billion, or 2,9 per cent of gross domestic product. This may be compared with a primary deficit of R17,6 billion, or 2,7 per cent of gross domestic product recorded in the first three months of the previous fiscal year.

14 The deficit/surplus recalculated by excluding interest payments from total expenditure.

The net result of national government cash-flow revenue and expenditure was a cash-flow deficit before borrowing and debt repayment of R33,2 billion in April–June 2011 – some R0,6 billion below the cash-flow deficit recorded in the corresponding period a year earlier. Extraordinary payments consisted of losses on the conversion of foreign currency transactions of R0,4 billion and losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) to the value of R0,1 billion. After accounting for extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R33,8 billion in the first quarter of fiscal 2011/12, unchanged in relation to April–June 2010.

The net borrowing requirement was financed in the domestic money and capital markets. This reflected the sustained dominance of domestic funding over foreign borrowing, facilitated by the soundness and reliability of the domestic financial markets in South Africa.

National government financing in fiscal 2011/12

R billions

Item or instrument	Originally budgeted 2011/12	Actual April–June 2011	Actual April–June 2010
Deficit	158,2	33,2*	33,8*
Plus: Extraordinary payments	0,2	0,5	0,1
Cost on revaluation of foreign debt at redemption	0,2	0,1	0,2
Less: Extraordinary receipts	0,1	0,0	0,2
Net borrowing requirement	158,6	33,8	33,8
Treasury bills	22,0	7,4	18,9
Domestic government bonds	135,9	33,3	35,3
Foreign bonds and loans	5,2	-1,0	-0,7
Change in available cash balances**	-4,5	-6,0	-19,6
Total net financing***	158,6	33,8	33,8

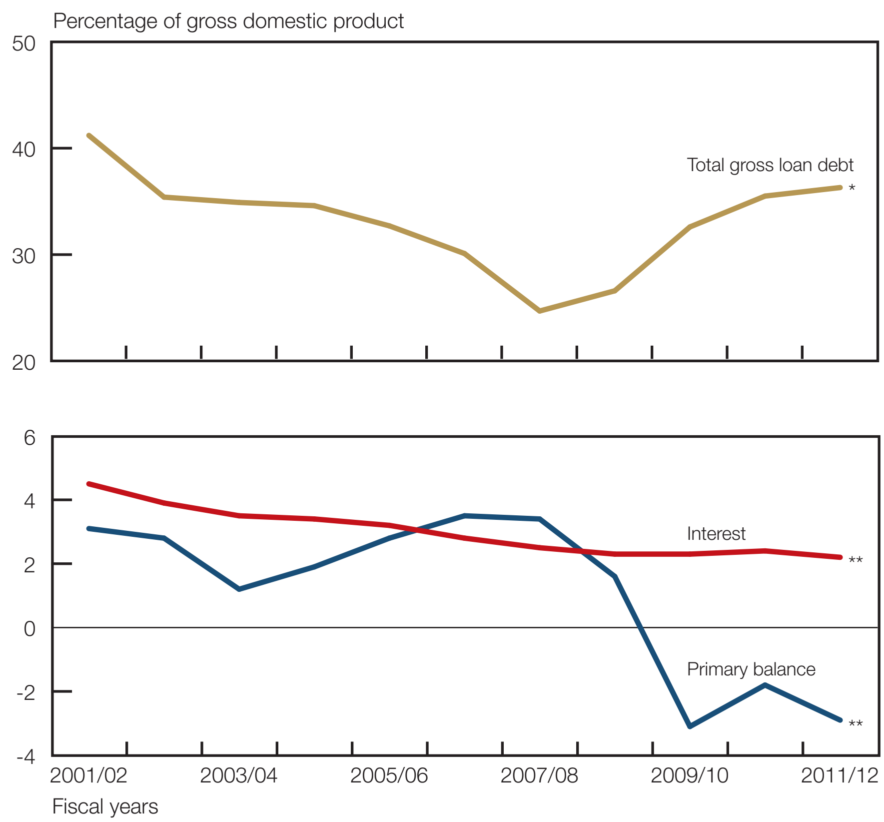
* Cash-flow deficit
** Increase – decrease +
*** Components may not add up to totals due to rounding

Domestic financing through Treasury bills was obtained at an average interest rate of 5,5 per cent, while domestic long-term nominal yield instruments were sold at an average rate of 8,5 per cent per annum. The average outstanding maturity of national government's domestic marketable bonds remained unchanged at 126 months between March and June 2011.

National government recorded net redemptions of foreign bonds and loans of R1,0 billion in April–June 2011. Between March and June 2011, the average outstanding maturity of foreign marketable bonds of national government decreased slightly from 102 months to 99 months. Despite the net redemptions, foreign debt remained broadly unchanged at around R98 billion between these respective dates.

Funding activities increased the available cash balances of national government by R6,0 billion during the period under discussion, bringing the level of these balances to R180 billion as at 30 June 2011. Deposits with the Bank decreased from R129 billion as at 31 March 2011 to R127 billion at the end of June.

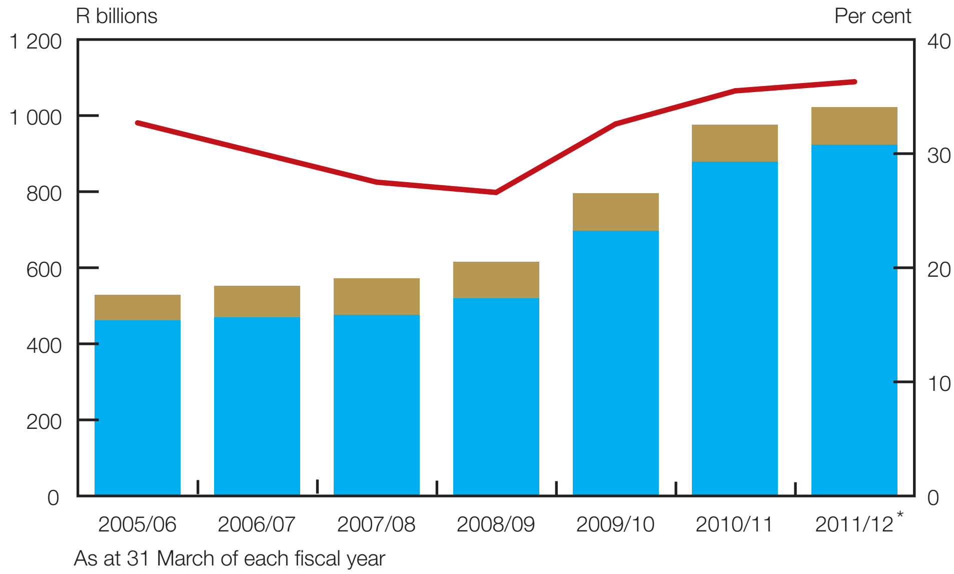
National government debt sustainability indicators



* As at 30 June 2011
** April–June 2011

Given the liquid and efficient nature of the domestic money and capital markets, domestic debt of national government accounted for 90 per cent of total gross loan debt. Domestic debt accelerated sharply from R878 billion to R923 billion between March and June 2011. The firm increase in domestic debt can be attributed to the issuance of more Treasury bills and domestic long-term bonds.

National government total gross loan debt



* As at 30 June 2011
Domestic debt
Foreign debt
Total gross loan debt as a percentage of gross domestic product (right-hand scale)

Combining domestic and foreign debt, total gross loan debt of national government rose from R976 billion as at 31 March 2011 to R1,0 *trillion* as at 30 June 2011. Relative to gross domestic product, the total gross loan debt of national government increased from 35,5 per cent to 36,3 per cent during the period under discussion.

Statement of the Monetary Policy Committee

21 July 2011

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

Since the previous meeting of the Monetary Policy Committee (MPC), the global economic outlook has deteriorated. Events in the eurozone appear to have entered a new phase, with the focus moving from the peripheral countries to some of the larger economies in the region. The global systemic risks posed by any failure to overcome the sovereign debt crisis are enormous, and are exacerbated by the potential failure to resolve the debt ceiling crisis in the United States (US). These events are taking place against the backdrop of a slowdown in growth in many of the advanced economies.

The domestic economic recovery has continued, but in a hesitant manner. The strong performance of the economy in the first quarter of the year is unlikely to have been repeated in the second quarter, and growth prospects will also be dependent on global developments. Domestic inflation has been increasing in line with expectations, driven mainly by cost-push pressures, but more broad-based pricing pressures are beginning to emerge.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas increased to 5,0 per cent in June 2011, from 4,6 per cent in May. As was the case in the previous few months, the main contributions to the inflation outcome came from food, housing and utilities, and transport categories which, together, accounted for 3,6 percentage points of the 5,0 per cent outcome in June. Food price inflation continued its marked upward trend, measuring 7,3 per cent in June, from 6,3 per cent in May. Petrol and electricity prices increased at rates of 21,4 per cent and 19,0 per cent respectively in June. Administered price inflation excluding petrol was unchanged in June at 9,3 per cent.

The underlying inflation trends have remained relatively moderate. In May and June CPI excluding food and petrol measured 3,7 per cent and 3,9 per cent respectively, while CPI excluding food, petrol and electricity measured 3,2 per cent and 3,5 per cent in these months.

Year-on-year producer price inflation has displayed some volatility in recent months, partly as a result of commodity price fluctuations. Producer prices increased by 6,6 per cent and 6,9 per cent in April and May respectively, compared with 7,3 per cent in March. Price increases in electricity and products of petroleum and coal were major contributors to the PPI outcome, but there were also significant increases in food prices, which had until recently remained subdued. Agricultural prices increased by 6,8 per cent in May, from 2,1 per cent in April, while manufactured food prices increased at rates of 3,4 per cent and 4,8 per cent in April and May respectively.

The inflation forecast of the Bank has shown a slight near-term deterioration since the previous meeting of the MPC. Inflation is now expected to breach marginally the upper end of the target range in the final quarter of 2011, and to average 6,3 per cent in the first quarter of 2012. Thereafter it is expected to remain at the upper end of the target range for the next two quarters, before declining somewhat in the final quarter of the year. The forecast period has been extended to the end of 2013 and inflation is expected to decline gradually during the year, to measure 5,6 per cent in the final quarter of 2013. The Bank's forecast of core inflation shows a moderately rising trend, peaking at around 5 per cent in the second quarter of 2012.

Inflation expectations for 2011 as reflected in the survey conducted by the Bureau for Economic Research (BER) at Stellenbosch University had been declining for six consecutive quarters, but remained unchanged in the second quarter of 2011. Expectations for 2012 increased marginally, but remained within the target range, and declined for 2013. The average inflation expectation for the three main categories of respondents was 5,3 per cent for 2011 and 5,8 per cent for the next two years.

Inflation expectations as measured by the Reuters survey of financial analysts showed very little change when compared to the forecasts at the time of the previous MPC meeting, with inflation expected to remain, on average, within the upper end of the target range until the end of 2013. Inflation expectations as reflected in the break-even inflation rates of the inflation-linked bonds have moderated slightly since the previous meeting.

The MPC assesses the risks to the global economic environment to be on the downside, and continued weakness in the economies of the US and United Kingdom has extended the likely duration of monetary accommodation, particularly in the face of declining fiscal stimuli.

Risks relating to debt sustainability in peripheral Europe have intensified, with further ratings downgrades to some countries. The focus has also moved beyond the periphery to larger countries such as Spain and Italy. As long as the sovereign debt crisis is unresolved, confidence will not be restored and periodic bouts of risk aversion can be expected to contribute to a high degree of volatility in financial markets. There are concerns that a disorderly write-down of this debt could have systemic implications because of the high exposure of European banks to the debt of these countries.

By contrast, there are encouraging trends in other parts of the world. The reconstruction of the Japanese economy in the wake of the natural disasters has begun to have some positive impact on that country's growth rate. Growth in emerging markets has generally remained strong, and fears of a marked slowdown in Chinese growth have been allayed somewhat by robust second quarter growth performance.

Global inflation has been driven primarily by food and oil price developments. There are, however, some indications that these price pressures may have peaked. Both the International Monetary Fund and Food and Agricultural Organization food price indices have shown a flattening out since the beginning of the year. International oil prices have contributed to, and in turn have also been constrained by, the slowdown in global growth.

The bouts of risk aversion relating to developments in the euro area have impacted on the volatility of the rand exchange rate. Since the previous MPC meeting, the rand has fluctuated within a range of R6,67 and R7,02 against the US dollar. The current level of the rand exchange rate against both the dollar and the euro has remained more or less unchanged since the previous MPC meeting. In recent months the rand has also been affected by a number of actual and expected direct investment transactions, and by net purchases of bonds and equities by non-residents totalling around R32,6 billion since the beginning of May. Net bond purchases by non-residents amounted to R34,1 billion, while net sales of equities amounted to R1,5 billion.

From a macroeconomic perspective, the rand has remained relatively strong despite heightened global risk aversion, and despite continued purchases of foreign exchange by the Bank with the support of National Treasury. Between September 2009 and August 2010, the rand dollar exchange rate fluctuated in the range of around R7,40 to R7,80. Since September of 2010, the rand has generally traded in the range of around R6,60 to R7,00, apart from a short period in early 2011 when it breached the R7,20 level.

The domestic economic recovery remains fragile. Annualised GDP growth in the first quarter of 2011 measured 4,8 per cent, driven primarily by a 14,5 per cent growth in the manufacturing sector. This performance is not expected to be sustained in the second quarter: the monthly data for manufacturing-sector output in April and May suggest that unless there is a major upside surprise in June, the positive contribution of the sector to second quarter growth is likely to be minimal. The Kagiso Purchasing Managers Index, while still indicating positive growth in the sector, has declined for three consecutive months. Some of the slowdown in manufacturing can be ascribed to temporary factors such as the impact of the earthquake in Japan on the global motor industry supply chain. The outlook for the sector will also be influenced by developments in Europe, which is a significant market for South African-manufactured exports. Growth in the physical volume of mining production was weak in April and May.

Growth in gross fixed capital formation improved in the first quarter of 2011 to register an annualised growth rate of 3,1 per cent. This was mainly due to the higher levels of investment by public corporations. Growth in private-sector fixed capital formation, while rising, was still subdued at 2,7 per cent.

Despite the expected growth slowdown in the second quarter, the forecast of the Bank for gross domestic product growth in 2011 and 2012 remains unchanged at 3,7 per cent and 3,9 per cent respectively, while growth in 2013 is expected to average 4,4 per cent. With a potential output growth rate of around 3,5 per cent, the estimates of the Bank show that the output gap, although closing, is still negative at around 2,5 per cent. This is consistent with the fact that the levels of output in both the manufacturing and mining sectors are still below pre-crisis levels, as is the level of capacity utilisation in the manufacturing sector. Business confidence, as reflected in the Rand Merchant Bank/Bureau for Economic Research Business Confidence Index, reversed its positive trend when it declined to below the neutral 50 level in the second quarter of 2011. Confidence in the construction sector remains at an extremely low level, and the real value of new building plans passed declined further in April.

Household consumption expenditure, which grew at an annualised rate of 5,2 per cent in the first quarter of 2011, has been the main driver of the domestic growth recovery. There are indications that this growth may have moderated in the second quarter. The robust growth in real retail sales in April was more than offset in May when a month-on-month decline of 4,7 per cent was measured, while the year-on-year growth rate was zero. New vehicle sales increased by 12,6 per cent year on year, but declined by 4 per cent in the second quarter compared with the previous quarter. The First National Bank/Bureau for Economic Research Consumer Confidence Index increased marginally in the second quarter of 2011, but remains below levels reached in 2010.

The MPC expects household consumption expenditure to be constrained by a number of factors, including subdued credit market conditions, high levels of household debt, negative wealth effects and persistently high rates of unemployment.

Growth in total loans and advances extended by banks to the private sector remain relatively subdued and grew at a year-on-year rate of 5,5 per cent in May, compared with 6,0 per cent in April. Growth in "other loans and advances" , particularly general loans, was the major driver, as growth in mortgage loans – the largest category of loans – was restrained at around 3 per cent, in line with the weak housing market. The subdued state of the credit markets reflects in part the high levels of consumer indebtedness, which measured 77 per cent of personal disposable income in the first quarter of 2011. The ratio of impaired advances to gross loans and advances has remained at elevated levels for some time but declined marginally to 5,73 per cent in May.

Wealth effects have been negatively affected by the subdued housing market. The various house price indices indicate that house prices are falling in real terms, although there appears to be some positive nominal growth. While the JSE Limited is at relatively high levels, it is vulnerable to correction in the event of a significant global slowdown. Although household net wealth to disposable income has recovered somewhat since the recession, it is still below the peak reached in 2007.

Employment trends have been improving slowly. According to the Quarterly Employment Survey of Statistics South Africa, formal non-agricultural employment increased by 2,6 per cent in the first quarter of 2011, compared with the first quarter of 2010. This represented an increase of 212 000 jobs, just over half the number of formal-sector jobs lost during the crisis. The majority of jobs created have been in the public sector and the recovery in employment in the private sector remains slow.

Wage settlement rates have been declining, with Andrew Levy Employment Publications reporting an average overall wage settlement rate in collective bargaining agreements of 7,5 per cent in the first half of 2011, compared with 8,2 per cent in 2010 as a whole. Similarly, nominal unit labour costs, which account for productivity changes, moderated to 5,2 per cent in the first quarter of 2011, from 7,7 per cent in the fourth quarter of 2010. However, given that most of the wage negotiations take place in the second half of the year, and that some of the recent high-profile settlements appear to have reversed the moderating trend, this positive outcome could change. Should these higher trends set a precedent for other wage settlements, this could represent a significant upside risk to the inflation outlook. The high trends in executive remuneration increases are also cause for concern.

Food and oil price developments remain the major risks to the inflation outlook. As noted above, international food prices appear to have levelled out. Domestic food price inflation has lagged global trends, and further increases can be expected in the near term. However, these increases could be constrained should the favourable global developments persist.

The price of Brent crude oil, currently at around US$117 per barrel, is at levels similar to those prevailing at the time of the previous meeting of the MPC. The price has experienced some volatility in recent weeks, particularly following the release of oil stocks by the International Energy Agency in June, when the price declined to US$106 per barrel. Although supply conditions are expected to remain tight, further upside potential is likely to be constrained by the uncertain global growth outlook. These developments allowed for a 31 cent per litre reduction in domestic petrol prices in July, following a 2 cent per litre decline in June. However, an increase is expected in August.

The view of the MPC continues to be that the underlying inflation pressures are mainly of a cost-push nature, notwithstanding signs of a possible moderate increase in underlying inflation. Despite the upside risks posed by cost-push factors, the MPC sees a number of downside risks to the inflation outlook, with the risks being seen to be delicately balanced. These risks include the continued fragile nature of the domestic recovery and risks posed by the ramifications of a possible disorderly debt default in the eurozone.

It is, however, recognised that should there be unexpectedly high inflation outcomes, particularly with respect to underlying inflation trends, this could impact negatively on inflation expectations, which to date appear to be relatively well anchored. For this reason, the MPC is not complacent and will remain vigilant and continue to monitor closely any indications of second-round effects on inflation emanating from these cost pressures and from the changing risk profile of the inflation outlook.

In the light of the above, the MPC has decided to keep the repurchase rate unchanged at 5,5 per cent per annum, for the time being. The MPC will not hesitate to respond timeously to signs that threaten to move inflation out of the target range on a sustained basis.

Note to tables

Local governments: Liabilities and assets – Table S–75

The tables have been amended to cover the instruments and sectors on the balance sheet of local governments in conformity with recommendations contained in the *Government Finance Statistics [GFS] Manual 2001*.