Quarterly Bulletin

March 2012

South African Reserve Bank

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Contents

Quarterly Economic Review

Introduction

Economic growth in the advanced economies was disappointingly weak in the second half of 2011 as the sovereign debt crisis continued to plague Europe, dampening confidence levels and economic activity on the continent and beyond. While actions towards stronger fiscal consolidation continued in the interest of fiscal sustainability, in many instances this exacerbated the deterioration in economic activity, in turn lowering tax collections and making it more difficult to achieve the planned reduction in government deficits. Given this fragile situation, monetary policies in the major advanced economies remained accommodative in order to support growth, and a number of central banks joined forces at the end of November 2011 to provide additional liquidity support to global money markets.

Throughout 2011 growth in the emerging-market economies remained considerably more robust than in the mature economies. Real output growth in emerging-market economies in general nevertheless moderated in the fourth quarter of 2011, while global trade volumes remained relatively flat. While global uncertainty eased somewhat in early 2012 with progress apparently being made with the resolution of the crisis in the euro area, serious concerns continued to cloud the economic landscape. Nevertheless, real output growth in the United States (US), the world's largest economy, accelerated notably in the final quarter of 2011, and a number of economic indicators suggested that the US recovery was gaining further traction in the beginning months of 2012.

Most international commodity prices remained high in 2011, supported by the generally stronger growth outcomes in emerging-market economies, supply constraints and geopolitical tensions. This was reflected in food and energy prices which, in turn, contributed to upward pressure on inflation in 2011. In early 2012 oil prices surged further as tensions around Iran flared higher. Looking ahead, however, global consumer price inflation seemed likely to slow in the medium term, with an easing of demand in both advanced and emerging-market economies and stabilisation of commodity prices.

In sub-Saharan Africa growth was generally robust, supported by firm prices of export commodities and, in some instances, rising production volumes as additional capacity was brought on stream. However, in most countries the picture was clouded by inflation, which in several instances picked up to fairly high double-digit rates.

In South Africa growth in real gross domestic product accelerated to an annualised rate of 3,2 per cent in the final quarter of 2011 as activity in the mining and manufacturing sectors recovered, following two quarters of decline induced by factors such as industrial action, mining fatalities and safety inspection shutdowns. Gold and coal made the largest contributions to the higher mining output in the fourth quarter, while the improvement in manufacturing was widespread but most prominent in the manufacturing of wood and wood products, paper, publishing and printing, and basic iron and steel. Real value added by the agricultural sector contracted further in the fourth quarter. By contrast, the tertiary sector maintained relatively strong growth throughout 2011, although the pace of increase moderated somewhat in the fourth quarter. The real value added by government recorded strong growth in the fourth quarter of the year, partly on account of the population census. Growth in the trade sector moderated somewhat although it remained relatively high, while the finance, insurance, real-estate and business services sector also recorded slower growth over the period. Overall utilisation of production capacity in the economy remained fairly low, although bottlenecks were encountered in areas such as electricity generation and the transport of bulk mining products.

Among the domestic expenditure components, real household consumption expenditure continued to expand briskly. After a slight hesitation in the middle quarters of 2011 its pace of increase picked up in the final quarter as consumption expenditure continued to track growth in real disposable income. The lower interest rate environment was supportive of household consumption expenditure, along with the gradually declining level of household indebtedness which had receded from more than 82 per cent of annual disposable income in 2008 to less than 76 per cent at the end of 2011. Spending on durable goods remained the strongest-growing category within overall household consumption expenditure, recording double-digit rates of increase throughout 2011.

Real final consumption expenditure by government picked up in the fourth quarter of 2011 as government purchased military equipment alongside rising real expenditure on public servants' salaries and wages.

Growth in real fixed capital formation gained momentum in each successive quarter of 2011. This pattern of acceleration was observed across all three main institutional groupings, but with the most significant turnaround recorded by general government which had moved from a contraction in the first quarter of 2011 to a brisk rate of expansion in the final quarter of the year as progress was made with housing, construction works and water projects. Capital spending by public corporations increased apace in the final quarter of 2011, led by Eskom's power station projects and Transnet's debottlenecking of its pipeline, port and rail capacity. In the private sector real fixed capital formation rose over a broad front in the fourth quarter of 2011. Manufacturers expanded their warehouse and transport capacity, mining companies continued responding to favourable commodity prices, and telecommunications companies invested more in information technology-related products. Following a long period of stagnation, a marginal increase in real spending on residential buildings was recorded in the final quarter of 2011.

The aggregate level of real inventories continued to rise in the final quarter of 2011, reflecting rising stocks in the wholesale and retail trade subsectors as sales volumes trended higher. This was partly countered by a decline in motor trade inventories and in the maize component of agricultural stocks-in-trade.

Aggregate employment trended higher over 2011 as the economy continued to expand, while the number of discouraged work-seekers also rose somewhat, culminating in a reduction in the unemployment rate. The average wage settlement rate in 2011 amounted to 7,7 per cent, lower than in 2010, while the pace of increase in unit labour cost also decelerated somewhat.

After having remained within the target range for 21 consecutive months, consumer price inflation breached the upper limit of the target range from November 2011. The acceleration to levels in excess of 6 per cent was mainly driven by the prices of food, petrol and electricity. Excluding these components, the rate of underlying consumer price inflation also picked up notably over the past year but still remained marginally below the midpoint of the inflation target range.

The favourable prices of key export commodities were reflected in an overall improvement in the terms of trade in 2011, although this measure weakened moderately in the final quarter of the year. Reflecting brisk domestic expenditure, imports rose more strongly than exports in 2011, culminating in a deterioration in the trade balance. The trade balance switched from surpluses earlier in the year to a deficit in the final quarter. By contrast, the deficit on the services, income and current transfer account narrowed significantly in the fourth quarter of 2011 as dividend payments to non-residents declined following exceptionally large payments in the third quarter. This offsetting effect was large enough to result in a modest narrowing of the deficit on the current account to 3,6 per cent of gross domestic product in the fourth quarter of 2011. The deficit for the full year 2011 nevertheless widened by half a percentage point to 3,3 per cent of gross domestic product. This was again more than fully financed by a net inflow on the financial account of the balance of payments. All the inward investment categories recorded inflows in the final quarter of 2011, with foreign direct investment making the largest contribution. The direct investment inflows emanated mainly from the United Kingdom (UK) and China, and were largely directed towards the mining, communication and financial intermediation sectors.

Swings in international risk appetite continued to feed through to the exchange value of the rand and other emerging-market currencies, with rising uncertainty regarding the prospects for the euro area and other developed economies perversely being reflected in a withdrawal of funds from developing markets by international investors – the so-called flight to familiarity. From an already low level, the effective exchange value of the rand depreciated further in October and

November 2011 but recovered in December as international investors found some consolation in major central banks' co-ordinated injection of liquidity into the global financial system, and in positive economic data released by some developed countries. The rand appreciated further in January and February 2012 as the International Monetary Fund (IMF) announced its intention to raise its lending capacity to countries in need and as tentative progress was made in resolving the sovereign debt crisis in Europe.

Growth in the M3 money supply accelerated in the second half of 2011, while the pace of increase in banks' loans and advances to the domestic private sector also trended somewhat higher. A strong uptake of general loans by both the corporate and the household sectors was observed over the period, partly reflecting the active promotion of these types of loans by a number of banks. Growth in instalment sale credit benefitted from robust consumer demand for motor vehicles. By contrast, mortgage lending waned further in 2011 and was quite weak in the final quarter of the year, consistent with the subdued conditions in the real-estate market. This was mirrored in the poor performance of house prices in 2011 and early 2012, with the luxury segment of the market the most under siege.

Nominal money-market interest rates have since late November 2010 been quite stable at 30-year lows, anchored by the repurchase rate which has been maintained at 5,5 per cent by the South African Reserve Bank (the Bank). Adjusting nominal rates for expected inflation, real money-market interest rates have also been quite low during this extended period. Rates on forward rate agreements seem to suggest that since late 2011 market participants have seen the likelihood of any further reduction in policy rates as quite remote, not least because inflation accelerated to levels above the target range.

The South African President committed government to a coordinated drive to improve South Africa's infrastructure in his State of the Nation address early in 2012. This commitment forms a key component of the strategy to raise the country's growth rate and reduce unemployment, and found expression in the National Budget tabled in February 2012. Allocations to public-sector capital formation were raised, with due emphasis on the need for efficiency and prompt execution of capital projects, and on the imperative to restrain government's wage bill. Indications were that government revenue would be somewhat stronger in 2011/12 than the projections made in the October 2011 *Medium Term Budget Policy Statement (MTBPS)*. Government would continue to support the economic recovery, following a countercyclical fiscal path within the context of fiscal sustainability. Deficits would be reduced gradually to ensure stabilisation of the national government debt ratio at prudent levels towards the end of the three-year planning period. The budget estimates provided for marginally smaller fiscal deficits than in earlier official projections.

South African share prices, buoyed by positive trends in share prices on major international bourses, relatively high commodity prices, firm domestic expenditure and the infrastructure drive, increased notably towards the end of 2011 and soared to all-time-high levels in early 2012. Share market turnover also reached a record high in 2011. Turnover in the secondary bond market picked up considerably in 2011, while bond yields fluctuated lower in late 2011 and early 2012, first discounting the impact of slower economic growth and later the effects of rand appreciation on inflation.

While liquidity conditions in some of the developed economies remained strained, requiring exceptional support from central banks, conditions in the South African money market remained orderly in 2011 and early 2012, as had been the case throughout the international financial crisis. In January 2012 the Bank announced further refinements to its monetary policy operational procedures, effective from 1 March 2012. These refinements are of a technical nature and are designed to eliminate minor frictions which were sometimes encountered in the Bank's extension of repurchase finance to the money market. The range of maturities on the Bank's reverse repurchase transactions and debenture issues would also be expanded.

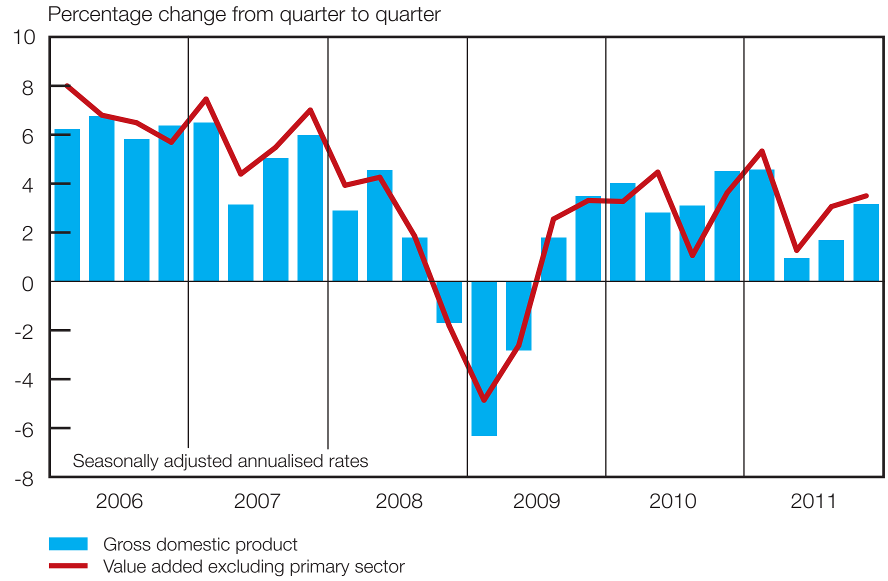
Domestic economic developments

Domestic output[1]

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

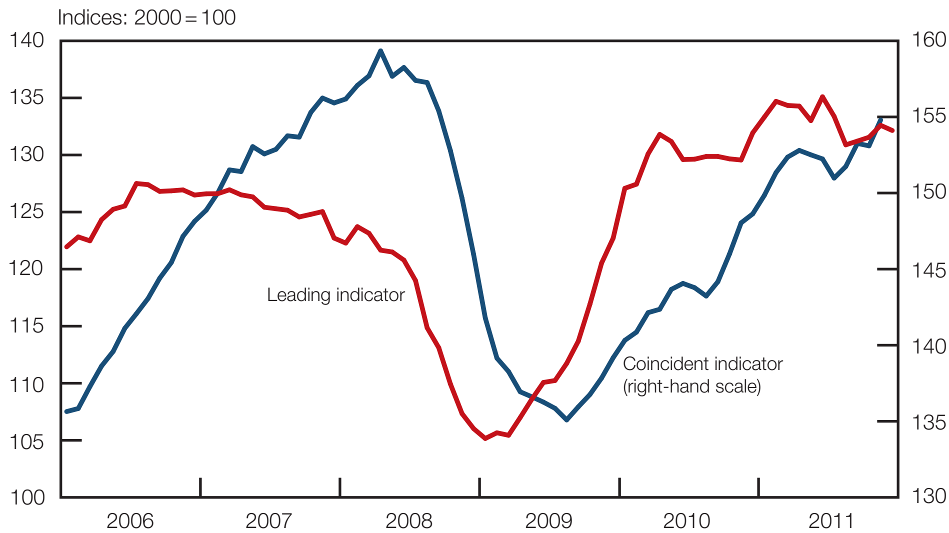
Following fairly sluggish growth in the middle quarters of 2011, economic activity in South Africa picked up pace in the fourth quarter of 2011 – real economic growth nearly doubled from an annualised rate of 1,7 per cent in the third quarter of 2011 to 3,2 per cent in the final quarter. The buoyancy of real output in the fourth quarter largely reflected the normalisation of production in mining and manufacturing, following the disruptive impact of industrial action in the preceding quarter. Firm growth was recorded in the real value added by the secondary and tertiary sectors, while the real output of the primary sector contracted at a much slower pace than in the third quarter of 2011. Underpinned primarily by a steady expansion in activity in the services sector of the economy throughout 2011, real gross domestic product increased by 3,1 per cent in the year as a whole, following an increase of 2,9 per cent in 2010.

Real gross domestic product



Excluding the performance of the generally more volatile primary sector, growth in the real value added by the *non-primary sector* accelerated to an annualised rate of 3,5 per cent in

Composite business cycle indicators



the fourth quarter of 2011. The growth performance of the South African economy is consistent with the upward trend – and hesitation around the middle of the year – in the composite coincident business cycle indicator in 2011. The composite leading business cycle indicator followed a broadly sideways trend over the period.

The real value added by the *primary sector* declined at an annualised rate of 1 per cent in the fourth quarter of 2011 compared with a decline of 14,7 per cent in the third quarter. The much slower pace of contraction was the net result of a moderation in the pace of decline in agricultural output, assisted by an increase in mining production in the final quarter of 2011.

The real value added by the *agricultural sector* contracted unabatedly throughout 2011, declining at an annualised rate of 5 per cent in the fourth quarter of the year. The somewhat slower rate of contraction in the fourth quarter could partly be explained by an increase in livestock production, which partly offset declines in other subsectors. For the year 2011 as a whole, real output of the agricultural sector contracted by 0,4 per cent compared with an increase of 0,5 per cent in 2010. Production in 2011 was adversely affected by the lower production of maize, as the crop harvested decreased from 12,8 million tons in the 2009/10 production year to 10,4 million tons in the 2010/11 production year. Unfavourable weather conditions contributed to the contraction as some areas experienced prolonged dry spells, followed by rainy periods. Yield losses were aggravated by harvesting difficulties during this period.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

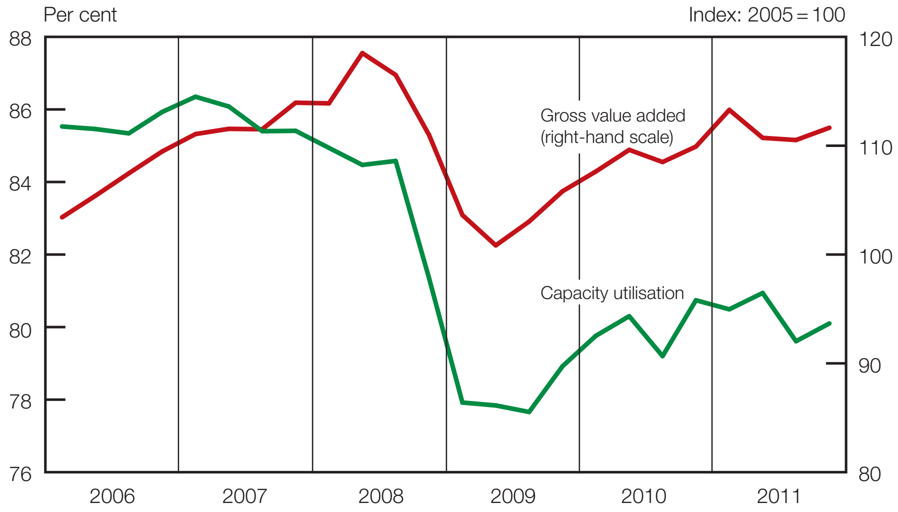
Sector	2010	2011				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sector	4,0	-4,7	-6,0	-14,7	-1,0	0,0
Agriculture	0,5	-4,8	-9,5	-6,9	-5,0	-0,4
Mining	5,5	-4,6	-4,5	-17,8	0,7	0,2
Secondary sector	4,3	10,1	-6,5	-0,5	3,5	2,1
Manufacturing	5,4	12,8	-8,8	-0,7	4,2	2,4
Tertiary sector	2,3	3,8	4,0	4,2	3,5	3,6
Non-primary sector	*2,8*	*5,3*	*1,3*	*3,1*	*3,5*	*3,3*
Total	2,9	4,6	1,0	1,7	3,2	3,1

In the *mining sector*, the real value added increased at an annualised rate of 0,7 per cent in the fourth quarter of 2011, having declined at a rate of no less than 17,8 per cent in the third quarter. The turn for the better in the mining sector in the final quarter of 2011 could primarily be attributed to improved production by especially the gold and coal mining industries. The quarter-to-quarter expansion in gold production reflected increases in both the quantity and quality of ore milled during the period. Coal production was underpinned by increased demand from Eskom, the country's primary utility responsible for power generation. However, for the calendar year 2011 as a whole, mining production advanced by only 0,2 per cent compared with a brisk rate of 5,5 per cent in 2010. The slower pace of increase in 2011 reflected challenging domestic and global market conditions. Domestically, factors such as wage disputes, work disruptions caused by electricity constraints, and a higher incidence of safety inspection shutdowns and mining fatalities restrained production over the period, while domestic confidence levels were dampened by talk of the nationalisation of mines. Fragile global economic conditions furthermore hampered mining production as the demand for commodities from Europe, Japan and North America remained suppressed.

Following a contraction in the third quarter of 2011, the real value added by the *secondary sector* increased at an annualised rate of 3,5 per cent in the fourth quarter. This increase could be ascribed to a rebound in the real value added by the manufacturing sector, increased production of electricity, gas and water, and a marginal further improvement in construction-related activities. For the year 2011 as a whole, however, the real value added by the secondary sector increased at a slower pace than in the preceding year.

Following two consecutive quarters of decline in manufacturing production, the real value added by the *manufacturing sector* recovered in the final quarter of 2011. Subsequent to the adverse impact of large-scale industrial action and subdued demand in the third quarter, manufacturing production increased at an annualised rate of 4,2 per cent in the fourth quarter of 2011, contributing 0,6 percentage points to the overall performance of the economy during the period. The resurgence in manufacturing production was evident in the subsectors responsible for the manufacturing of wood and wood products, paper, publishing and printing and basic iron and steel, non-ferrous metal products, metal products and machinery. By contrast, production declined in the subsectors manufacturing textiles, clothing, leather and footwear; radio, television and communication apparatus; and motor vehicles, parts and accessories and other transport equipment. Consistent with higher production levels, capacity utilisation in the manufacturing sector rose from 79,6 per cent in the third quarter of 2011 to 80,1 per cent in the final quarter.

Manufacturing: Real gross value added and capacity utilisation



Seasonally adjusted

Real manufacturing production increased at a slower pace in 2011, reflecting, *inter alia*, prevailing subdued domestic economic conditions and lower international demand. With close to 30 per cent of manufactured exports destined for the euro area and UK, fortunes in this area are important to South Africa's manufacturing export performance. Relatively weak demand conditions in Europe are expected to restrain activity in the domestic manufacturing sector in the short to medium term, necessitating a greater focus on competitiveness and diversification of markets.

Consistent with the increase in mining and manufacturing production, the real value added by the sector generating *electricity, gas and water* increased at an annualised rate of 1,2 per cent in the fourth quarter of 2011 following a decline of 2,6 per cent in the third quarter. The higher level of production also allowed for increased electricity exports despite reserve margins shrinking over the period. While electricity production edged higher, Eskom has warned that the supply and demand ratio of electricity is expected to remain tight over the next few years in anticipation of its new power stations coming into operation. According to the power utility, many of the existing power stations will, in the meantime, require preventative maintenance in order to enhance their performance and to maintain safety standards, temporarily reducing the available generation capacity in the system.

The real value added by the *construction sector* expanded at an annualised rate of 1,9 per cent in the fourth quarter of 2011, that is, at a pace broadly similar to that of the preceding quarter. Demand for residential and non-residential buildings and construction activity picked up marginally in the final quarter of 2011.

The *tertiary sector* maintained relatively strong quarter-to-quarter growth throughout the calendar year 2011 although the pace of increase moderated somewhat in the fourth quarter. Growth in the real value added by the tertiary sector slowed from an annualised rate of 4,2 per cent in the third quarter of 2011 to 3,5 per cent in the fourth quarter. Robust growth in real value added by the government sector was partly neutralised by slower growth in the trade and finance, insurance, real-estate and business service subsectors over the period.

Growth in the real value added by the *trade sector* slowed from an annualised rate of 6,1 per cent in the third quarter of 2011 to a still buoyant 5,2 per cent in the fourth quarter. Activity in the motor trade subsector slowed somewhat in the final quarter of 2011, in part due to lower demand for new motor vehicles by the car rental industry. By contrast, the real value added by the retail sector increased over the period notwithstanding prevailing economic uncertainty and higher inflation. For the year 2011 as a whole, the real value added by the trade sector increased by 4,4 per cent compared with an increase of 3,5 per cent in 2010. The stronger growth in 2011 could be attributed to the improved performance of most of the subsectors.

Real economic activity in the *transport, storage and communication sector* strengthened from an annualised growth rate of 2,3 per cent in the third quarter of 2011 to 2,9 per cent in the fourth quarter. Higher growth resulted from an improved performance of the land transport sector, with both freight and passenger transport activity increasing. This was accompanied by continuous steady growth in real value added by the communication subsector over the period.

Having recorded annualised growth of 4,5 per cent in the third quarter of 2011, growth in the real value added by the *finance, insurance, real-estate and business services sector* moderated to 2,3 per cent in the final quarter. Trade volumes in the equity and bond markets receded somewhat over the period. By contrast, the real value added by the banking sector increased substantially over the period due to increased demand for financial services. Overall growth in the real value added by this sector accelerated from 2 per cent in 2010 to 3,5 per cent in 2011, mainly attributable to improved growth in deposits with and credit extension by commercial banks.

The real value added by the *general government sector* increased firmly at an annualised rate of 4,4 per cent in the fourth quarter of 2011 following an increase of 4,2 per cent in the third quarter. For the year 2011 as a whole, growth in the real value added by general government accelerated to 3,9 per cent from 2,7 per cent in 2010, primarily due to steady growth in employment levels in the course of 2011.

Real gross domestic expenditure

Growth in aggregate *real gross domestic expenditure* accelerated robustly following a low point in the second quarter of 2011 and amounted to 5,1 per cent in the fourth quarter of 2011. This rate of growth, the highest since the third quarter of 2010, primarily resulted from increases in real final consumption expenditure by the household sector and general government, alongside sustained firm growth in real gross fixed capital formation. For the calendar year 2011 as a whole, real gross domestic expenditure increased by 4,3 per cent, that is, at a slightly faster pace than in the preceding year.

Real gross domestic expenditure

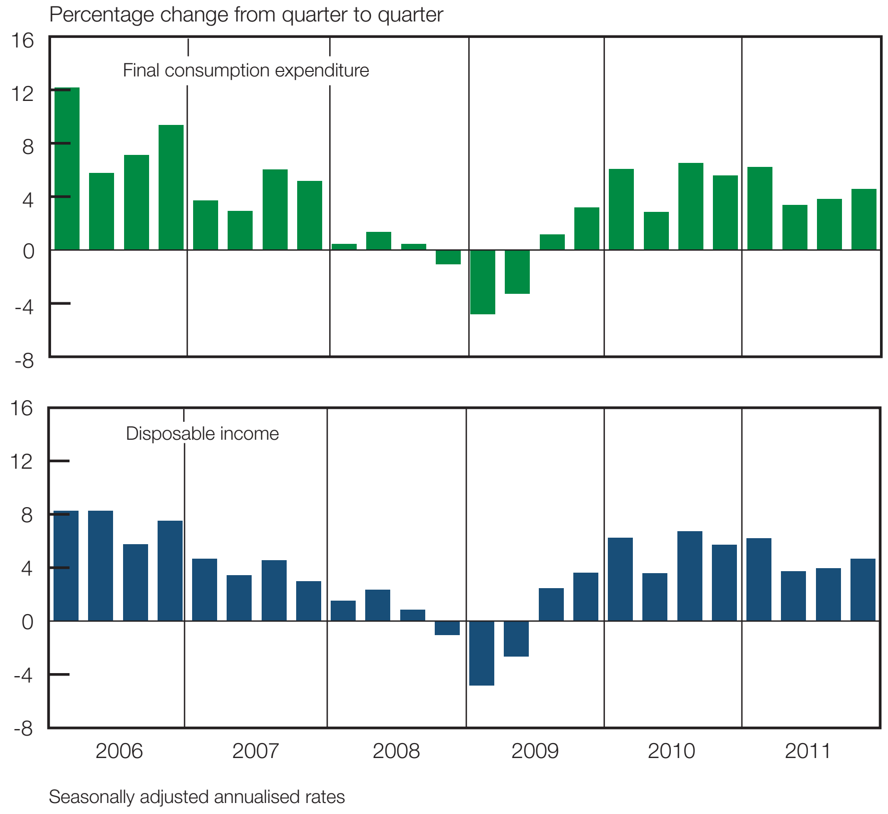
Percentage change at seasonally adjusted annualised rates

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

* At constant 2005 prices

Real final *consumption expenditure by households* maintained its firm underlying momentum in the fourth quarter of 2011. Having increased by 3,4 per cent and 3,8 per cent in the second and third quarter of 2011 respectively, consumer spending expanded further at a robust rate of 4,6 per cent in the final quarter. This faster pace of spending was consistent with a further increase in disposable income of households and positive wealth effects. The sustained growth in real spending by households was evident across all expenditure categories, with spending on services in particular regaining momentum.

Real final consumption expenditure and disposable income of households



Real expenditure by households advanced by 5 per cent in the calendar year 2011, notably faster than the pace of increase of 3,7 per cent in 2010. This was the highest annual growth rate recorded in household spending since the closing stages of the previous upward phase in the South African economy in 2007.

Real outlays by households on *durable goods* remained buoyant in the final quarter of 2011. Spending on durable goods increased at an annualised rate of 16,6 per cent in the fourth quarter, that is, at a slightly slower pace than in the preceding quarter. This sustained strong growth was well aligned with a noticeable increase in credit extension over the period. Real outlays on most categories of durable goods increased at brisk, albeit marginally lower, rates than in the third quarter of 2011. Spending on computers and related equipment, and on transport equipment, increased at a faster pace in the fourth quarter of 2011 compared with the preceding quarter, partly reflecting market penetration by new products.

Growth in spending on *semi-durable goods* accelerated marginally in the fourth quarter of 2011. Annualised growth in real spending on semi-durable goods accelerated from 6,7 per cent in the third quarter of 2011 to 7,3 per cent in the fourth quarter, reflecting a pick-up in real outlays on almost all goods in the semi-durable goods category. Purchases of motor car tyres, parts and accessories and miscellaneous goods, however, lost some momentum in the fourth quarter of 2011.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2010	2011				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods	18,1	19,6	13,5	17,5	16,6	15,7
Semi-durable goods	2,0	12,5	7,8	6,7	7,3	7,0
Non-durable goods	1,3	5,0	2,1	2,0	2,2	2,9
Services	3,4	2,9	1,0	1,4	2,9	3,8
Total	**3,7**	**6,2**	**3,4**	**3,8**	**4,6**	**5,0**

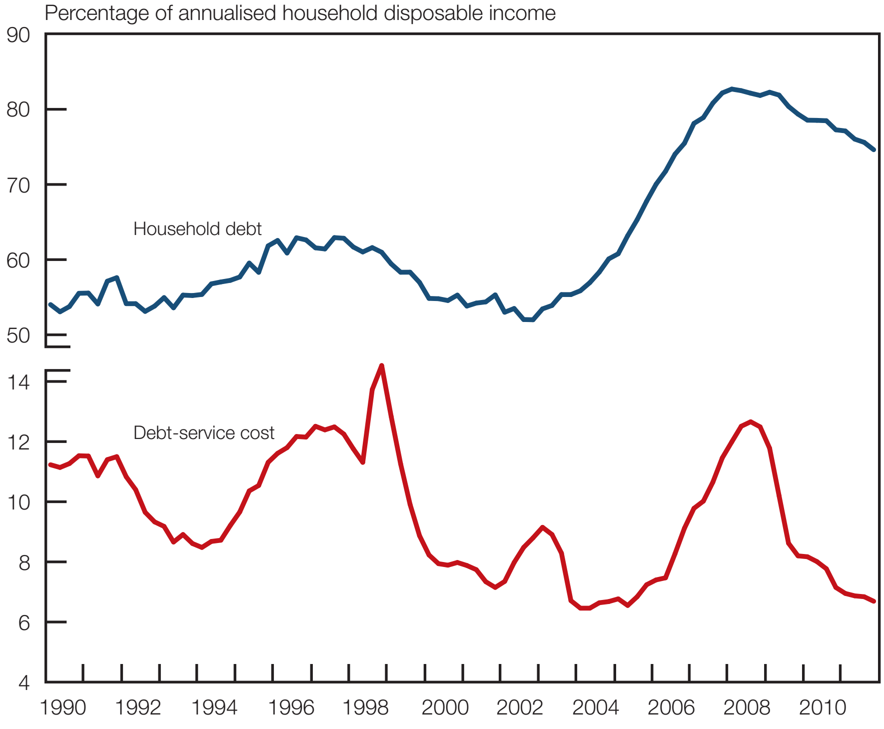
Real outlays on *non-durable goods* increased at a broadly similar pace in the final three quarters of 2011. Spending on non-durable goods increased at an annualised rate of 2,2 per cent in the fourth quarter of 2011 following growth of 2 per cent in the third quarter. Lower spending on household consumer goods and on recreational and entertainment goods was counteracted by stronger growth in spending on all other non-durable categories over the period.

Household real expenditure on *services* rose at an annualised rate of 2,9 per cent in the fourth quarter of 2011, following an increase of 1,4 per cent in the third quarter. Pronounced increases were registered in spending on especially miscellaneous services over the period.

Growth in *real disposable income of households* accelerated from an annualised rate of 3,9 per cent in the third quarter of 2011 to 4,7 per cent in the fourth quarter, reflecting improved employment levels during this period. For the calendar year 2011, the real disposable income of households increased by 5,2 per cent, meaningfully faster than the rate of increase of 4,2 per cent recorded in 2010.

In support of growth in expenditure on durable and semi-durable goods, household debt edged higher in the fourth quarter of 2011. Despite the higher level, overall growth in household

Household debt and debt-service ratios



Seasonally adjusted

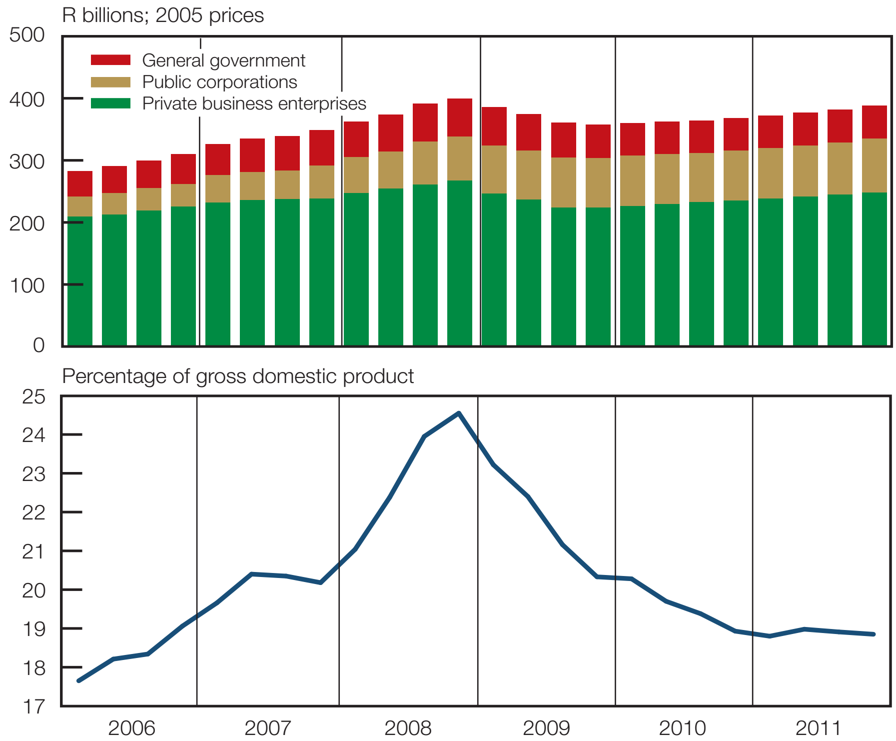
debt was slower than growth in disposable income, not only in the fourth quarter but right through 2011. Owing to the relatively slow pace of borrowing against solid increases in income, the ratio of household debt to disposable income declined from 77,1 per cent in the first quarter of 2011 to 74,6 per cent in the final quarter. Having reached a peak of more than 12 per cent in 2008, the household debt-service cost ratio trended downwards from 7,8 per cent in 2010 to less than 7 per cent in 2011, a ratio last recorded in 2005.

The ratio of *net wealth to disposable income of households* moderated in the fourth quarter of 2011. Measured over a year, growth in financial assets tapered off further in the fourth quarter of 2011, while growth in non-financial assets remained lacklustre as residential property price increases continued to lose momentum.

Having expanded at a rate of 4,8 per cent in the third quarter of 2011, real *final consumption expenditure by general government* increased by 7,3 per cent in the fourth quarter. This strong growth could partly be attributed to the acquisition of two aircraft as part of the government's defence procurement programme. Real government spending on non-wage goods and services increased due to additional expenses associated with the population census in 2011. Growth in real compensation of employees accelerated at a slightly slower pace than in the preceding quarter. If spending on armaments is excluded from the calculation, annualised growth in real government consumption expenditure accelerated from 4,8 per cent in the third quarter of 2011 to 5,3 per cent in the fourth quarter. Relative to the country's gross domestic product, consumption expenditure by general government remained broadly unchanged in the second half of 2011 at a ratio just below 22 per cent.

Growth in *real gross fixed capital formation* advanced from an annualised rate of 5,9 per cent in the third quarter of 2011 to 7,2 per cent in the fourth quarter. Among the three institutional sectors, public corporations recorded the strongest acceleration in capital spending, although capital formation by private business enterprises and general government also gained further momentum in the final quarter of 2011. Despite the advances in fixed capital formation, its level as a percentage of gross domestic product remained low. As a percentage of gross domestic

Gross fixed capital formation



Seasonally adjusted

product, capital expenditure moved from a recent high of 24,6 per cent recorded in the fourth quarter of 2008, to levels around 19 per cent throughout 2011. Nevertheless, fairly strong quarter-to-quarter increases in aggregate capital spending during the course of 2011 resulted in annual growth of 4,4 per cent following a contraction of 1,6 per cent in 2010.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

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

Growth in real capital outlays by the *private sector* increased from an annualised rate of 5,4 per cent in the third quarter of 2011 to 6,2 per cent in the fourth quarter. Mining companies more or less maintained their pace of capital spending, buoyed by fairly strong demand and relatively favourable commodity prices. Capital spending was particularly pronounced in the gold, coal and iron ore mining sectors. In the coal mining sector, increased capital spending was recorded against the background of rising domestic demand for energy and thermal coal needs from the rest of the world. Investment activity in the manufacturing sector was aimed at expanding warehouse and transport capacity. Capital expenditure in the transport and communications sector continued its upward trajectory, supported by spending to expand existing networks. In the finance and real-estate sector a marginal increase in real spending on residential buildings was recorded in the final quarter of 2011.

Real fixed capital expenditure by *public corporations* gathered further momentum on account of an acceleration in capital spending by Eskom and Transnet, mainly on existing projects. Eskom stepped up expenditure on vehicles, machinery and equipment as the Medupi, Kusile and Ingula power station projects progressed further; the first power from Medupi is expected to feed into the grid by May 2013.

Transnet's ongoing projects, especially the new multi-products pipeline, gave rise to increased spending on machinery, equipment and construction works. In addition to the procurement of more locomotives, spending on cranes and the expansion of port facilities also increased meaningfully over the period. The South African National Roads Agency Limited (SANRAL) continued with the upgrading of the road network, including the resealing and repaving of existing roads. The Passenger Rail Agency of South Africa (PRASA) continued to improve its rail and electrical systems, while the Airports Company of South Africa (ACSA) continued with the improvement of facilities, including the runways and taxiways at the East London Airport.

The accelerated growth in real gross fixed capital expenditure by *general government* was maintained in the fourth quarter of 2011. This was supported by provincial and local government capital spending in the areas of housing, construction works and water projects, including the construction of waste and water treatment facilities.

The level of *real inventory* holdings increased by R4,9 billion in the fourth quarter of 2011, with the most notable increases recorded in the agricultural and commerce sectors, alongside a slower accumulation of inventories in other sectors. In the commerce sector real inventory holdings rose in the fourth quarter of 2011, reflecting rising stocks in the wholesale and retail trade components as sales volumes continued to increase. This was partly countered by a decline in the level of motor trade inventories and a depletion of the maize component of agricultural stocks-in-trade. In the mining sector, gold inventory levels continued to decline over the period.

Factor income

The rate of increase in total *nominal factor income*, measured over four quarters, amounted to 10,3 per cent in the fourth quarter of 2011, lower than the rate of 11,8 per cent recorded in the third quarter. The slower growth in the fourth quarter reflected the slower pace of increase in both compensation of employees and gross operating surpluses over the period. For the year 2011 as a whole, nominal factor income increased at a rate of 10,8 per cent, more or less the same rate attained in 2010.

The rate of increase in the aggregate *gross operating surplus* in the economy, measured over four quarters, declined from 14,2 per cent in the third quarter of 2011 to 12,8 per cent in the final quarter. Compressed profit margins were particularly pronounced in the sectors supplying electricity, gas and water; trade, transport, storage and communication; and finance. By contrast, relatively buoyant conditions prevailed in the agricultural, mining and manufacturing sectors. Despite rapidly rising input costs, high output prices boosted the fourth-quarter 2011 operating surpluses of the mining and agricultural sectors. On a full calendar year basis, the economy's aggregate gross operating surplus rose by 12 per cent in 2011, markedly higher than the rate of increase of 10,2 per cent recorded in 2010. Apart from favourable commodity prices, operating surpluses benefitted from the depreciation of the exchange rate of the rand, which increased the pricing power of businesses and widened operating margins.

The growth over four quarters in total *compensation of employees* decelerated from 9,5 per cent in the third quarter of 2011 to 8 per cent in the fourth quarter. Remuneration increases occurred at a slower pace in the mining, finance and general government sectors. However, increases in compensation of employees accelerated in the agriculture, manufacturing, electricity, construction, trade, and transport and communication sectors.

In 2011 as a whole, the growth in total compensation of employees decelerated to 9,6 per cent, notably slower than the rate of 11,5 per cent registered in 2010. This was partly due to wage settlements which were lower in 2011 than in 2010.

Gross saving

South Africa's *national savings ratio* or gross saving as a percentage of gross domestic product increased marginally from 15,6 per cent in the third quarter of 2011 to 16,3 per cent in the fourth quarter. The increase followed a moderation in the pace of dissaving by general government, while household saving remained stable and the gross saving of the corporate business enterprises deteriorated somewhat. Notwithstanding the fourth-quarter increase, the country's annual saving ratio declined marginally from 16,6 per cent in 2010 to 16,4 per cent in 2011. As growth in capital formation exceeded growth in savings, the country's dependency on foreign capital to finance gross capital formation increased from 14,5 per cent in 2010 to 16,9 per cent in 2011.

The savings ratio of the *corporate sector* deteriorated from a rate of 16,1 per cent in the third quarter of 2011 to 15,9 per cent in the fourth quarter. Higher operating surpluses of business enterprises were offset by, *inter alia*, increased company tax payments. On an annual basis, the gross saving of the corporate sector as a ratio of gross domestic product declined from 17,1 per cent in 2010 to 16,1 per cent in 2011. Dividend and tax payments increased substantially during the course of 2011, reflecting improved trading conditions.

General government continued to dissave. The rate of dissaving by government, however, moderated from 2,1 per cent of gross domestic product in the third quarter of 2011 to 1,3 per cent in the fourth quarter. This improvement resulted mainly from an increase in the collection of company tax, value-added tax and custom duties. Expressed as a ratio of gross domestic product, government's dissaving improved from a rate of 2,1 per cent in 2010 to 1,3 per cent in 2011.

Gross saving by the *household sector* as a percentage of gross domestic product remained at 1,6 per cent in the third and fourth quarter of 2011. Although disposable income improved somewhat in the fourth quarter, this was matched by increased expenditure by households, thereby keeping savings under pressure. Consequently, the household savings ratio was maintained a level of 1,6 per cent in both 2010 and 2011.

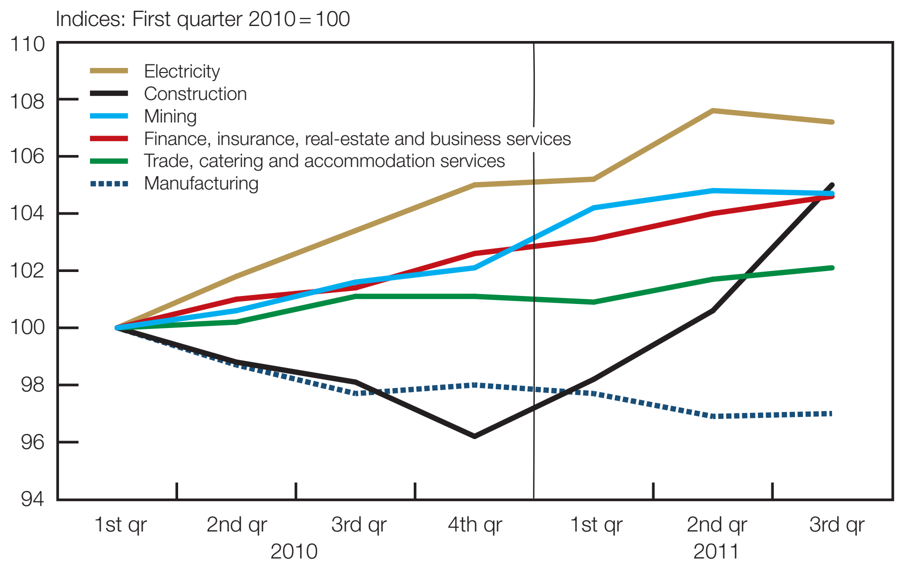
Employment

The formal non-agricultural sector of the South African economy has regained approximately two thirds of the job losses recorded during the contraction phase in the labour market between the fourth quarter of 2008 and the first quarter of 2010. According to the *Quarterly Employment Statistics (QES)* survey conducted by Statistics South Africa (Stats SA), enterprise-surveyed formal non-agricultural employment, adjusted for seasonal variation, increased by 254 000 persons from the second quarter of 2010 to the third quarter of 2011.[2] Of these additional job opportunities, around 45 per cent were created in the public sector. The *QES* furthermore indicated that formal non-agricultural employment increased at an annualised rate of 2,5 per cent in the third quarter of 2011, adding 47 000 jobs and raising the level of formal non-agricultural employment to 8,4 million.

2 The *QES* data reported in this section are seasonally adjusted, unless stated to the contrary.

The latest increase extended the current period of employment growth to six consecutive quarters, and reflected employment gains in both the public and private sector. Public-sector employment levels increased at an annualised rate of 1,4 per cent in the third quarter of 2011, while private-sector employment advanced at an annualised rate of 2,6 per cent – the fastest rate of increase since the first quarter of 2008.

Formal non-agricultural employment in selected sectors



Seasonally adjusted
Source: Statistics South Africa, *Quarterly Employment Statistics* survey

The pace of increase in private-sector employment has accelerated in each successive quarter since the first quarter of 2011, suggesting that employment creation by the private sector is gathering momentum. Employment gains in the private sector during the third quarter of 2011 were fairly broad-based, apart from the gold-mining sector and the private community, social and personal services sector where job shedding occurred. Significant employment gains were registered in the construction sector (recording an annualised increase of 18,6 per cent), the private transport, storage and communication sector (10,9 per cent), the non-gold mining sector (3,4 per cent) and the finance, insurance, real-estate and business services sector (2,5 per cent). By contrast, the gold-mining sector shed a further 3 400 jobs in the third quarter of 2011, equal to an annualised pace of contraction of 8,7 per cent.

Consistent with the countercyclical way in which the public sector expanded its labour force from the start of the global financial crisis, the sector increased its employment level at an annualised rate of 1,4 per cent in the third quarter of 2011 as national and provincial governments expanded their workforce, countering declines at local government level and in other public-sector enterprises. This brought the total number of people employed in the public sector to 2,0 million – roughly 24 per cent of total formal non-agricultural employment.

Employment levels in the manufacturing sector increased marginally at an annualised rate of 0,5 per cent in the third quarter of 2011, roughly equal to 1 500 jobs. In the year to the third quarter of 2011 the sector, however, still lost around 8 400 jobs. Employment levels in the manufacturing sector have receded steadily from a high of 1,6 million in 1995 to an estimated 1,1 million in 2011, reflecting the strong competitive forces and productivity imperatives in the sector. More recently, manufacturing production volumes rose significantly in the fourth quarter of 2011. This, in turn, caused an increase in the average number of hours worked by factory workers alongside fewer retrenchments in the sector. These improvements were, however, clouded somewhat by the recent downgrades of growth prospects in the world's largest economies by the International Monetary Fund (IMF). The employment sub-index of the Kagiso Purchasing Managers Index (PMI) also recorded a value below the neutral level of 50 for the sixth consecutive quarter in the fourth quarter of 2011.

Change in enterprise-surveyed formal non-agricultural employment

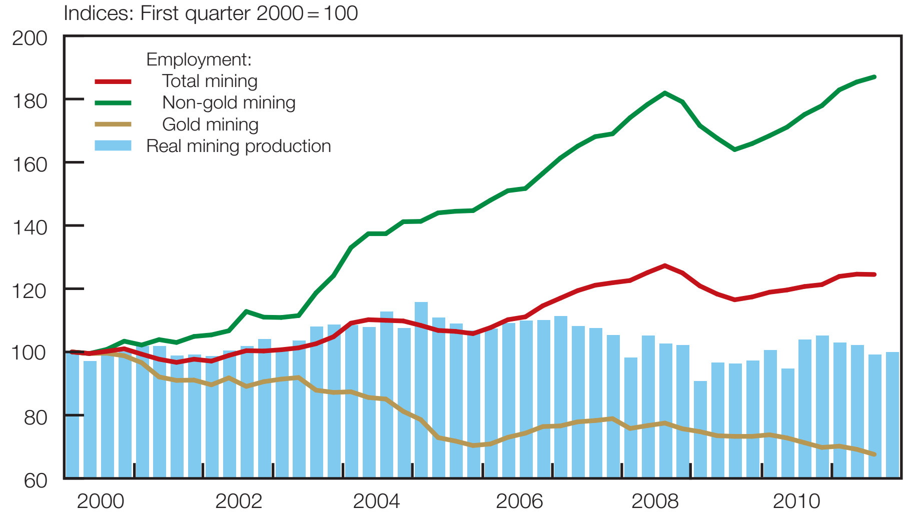
Sector	Quarterly changes				Change over four quarters to third quarter of 2011	
	2010	2011				
	4th qr	1st qr	2nd qr	3rd qr	Number	Per cent
Mining	2 300	10 700	2 800	-300	15 600	3,1
Gold mining	-3 200	700	-2 100	-3 400	-8 000	-5,2
Non-gold mining	5 500	10 000	5 000	3 100	23 600	6,8
Manufacturing	3 700	-3 600	-10 100	1 500	-8 400	-0,7
Electricity supply	900	100	1 400	-200	2 100	3,7
Construction	-7 900	7 900	10 300	18 200	28 500	7,0
Trade, catering and accommodation services	-500	-2 800	13 600	6 200	16 500	1,0
Transport, storage and communication	2 200	-700	-700	6 600	7 400	2,9
Finance, insurance, real-estate and business services	19 800	9 200	15 100	11 100	55 100	3,1
Community, social and personal services	8 600	2 000	-800	-3 000	6 800	1,6
Total private sector	**29 200**	**22 700**	**31 600**	**40 100**	**123 500**	**2,0**
National, provincial and local government	17 400	14 800	34 200	11 900	78 200	4,6
Public-sector enterprises	8 900	55 900	-54 500	-4 800	5 500	2,4
Total public sector	**26 300**	**70 700**	**-20 400**	**7 200**	**83 800**	**4,4**
Grand total	**55 500**	**93 300**	**11 200**	**47 300**	**207 300**	**2,5**

Seasonally adjusted
Numbers may not add up due to rounding

The South African government's concerns regarding the employment situation in the manufacturing sector were reflected in the announcement by the Minister of Finance of a R25 billion economic support package in the *Medium Term Budget Policy Statement* (*MTBPS*) in October 2011. These funds were earmarked to be spent over the following six years to improve the competitiveness of the manufacturing sector and thus to support the recovery of the economy. The economic support package includes mechanisms to boost productivity and innovation in industries that have demonstrated long-term competitive potential. Incentives to facilitate public and private investment in economic infrastructure, and to make industrial development and special economic zones more attractive are also under consideration.

Employment in the mining sector decreased marginally in the third quarter of 2011, representing the first quarterly decrease since the third quarter of 2009. The quarter-to-quarter decline in employment levels could be attributed entirely to an acceleration in the pace of labour paring in the gold-mining sector – the annualised pace of contraction accelerated from 5,5 per cent in the second quarter of 2011 to 8,7 per cent in the third quarter. At the same time, the pace of employment gains in the non-gold mining sector moderated further to 3,4 per cent in the third quarter of 2011. Activity in the mining sector was adversely affected in the third quarter of 2011 by fairly widespread industrial action, safety-related shaft closures, electricity supply and rail transport constraints and drawn-out processes associated with especially the granting of water licences needed to open new mines.

Real output and employment in the mining sector



Seasonally adjusted

Job creation in the electricity-generation sector was dominated by the longer-term imperative to raise capacity in the sector rather than by the business cycle. Employment levels in the sector increased steadily from a low in the fourth quarter of 2004 to levels roughly matching those previously attained in 1998. Although employment in the electricity-generation sector inched lower in the third quarter of 2011, this was out of character. Sustained capital spending to meet the increased electricity demand in the country supports a rising trend in job creation in the sector.

Notwithstanding the slowdown in global economic growth and the moderation in domestic economic activity in the middle quarters of 2011, real retail sales continued to grow apace, positively impacting employment growth in this sector.

Real retail sales and employment in the trade sector

Seasonally adjusted

Following a two-year period of uninterrupted labour paring in the construction sector amid depressed and uncertain market conditions, employment levels picked up meaningfully in the first three quarters of 2011, increasing at seasonally adjusted and annualised rates of 8,1 per cent, 10,5 per cent and 18,6 per cent respectively.

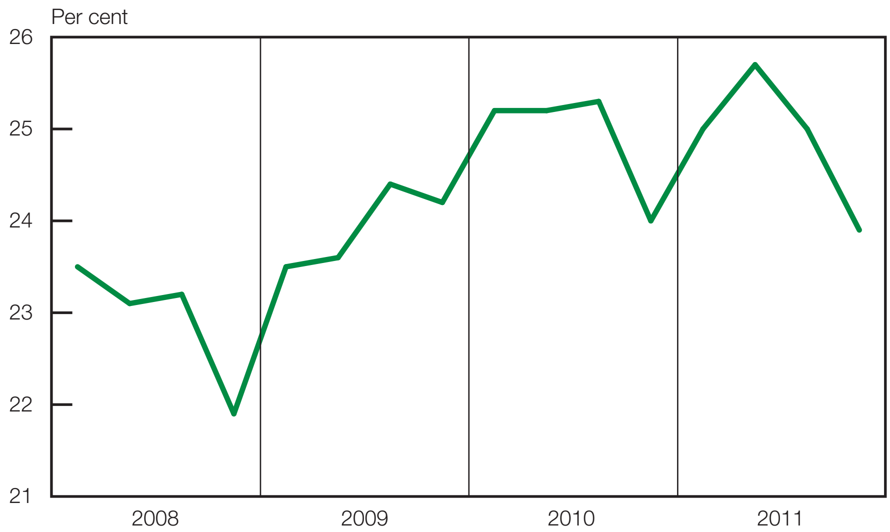
According to the Civil Construction Survey conducted in the third quarter of 2011 by First National Bank (FNB) and the Bureau for Economic Research (BER) at Stellenbosch University, short-term prospects for the civil construction industry improved somewhat, albeit at a fairly slow and uneven pace. Increased construction activity reflected a continuation of work undertaken by various public corporations, such as the resumption of construction activity at the Medupi and Kuseli power stations following earlier labour disputes that had adversely affected operations. The mining sector raised capital spending associated with construction works mainly to sustain existing capacity. Increased activity in the building sector in the third quarter of 2011 was consistent with higher sales and manufacturing of building materials.

According to the *Global Employment Trends 2012* report of the International Labour Organisation (ILO), the global unemployment backlog is currently estimated at around 200 million – approximately 27 million more than at the start of the financial crisis in 2008. Moreover, roughly 400 million new jobs will be required over the next decade to avoid a further increase in unemployment levels.

3 The *QLFS* data reported in this section are not seasonally adjusted unless stated to the contrary, due to the relatively few datapoints that are available.

The *Quarterly Labour Force Survey (QLFS)* conducted by Stats SA indicated that South Africa's official unemployment rate had declined from 25,0 per cent in the third quarter of 2011 to a still-high 23,9 per cent in the fourth quarter.[3] The number of unemployed people decreased by about 198 000 in the fourth quarter, while the number of employed people increased by around 179 000. This positive trend was unfortunately somewhat obscured by the fact that the discouraged work-seekers (who have given up actively searching for a job and are not included among the number of unemployed) increased by 111 000 in the fourth quarter. The extent to which the discouraged work-seekers now form part of the apparently ever-increasing not-economically active population, in turn, lowered the labour force participation rate from 54,6 per cent in the third quarter of 2011 to 54,3 per cent in the fourth quarter.

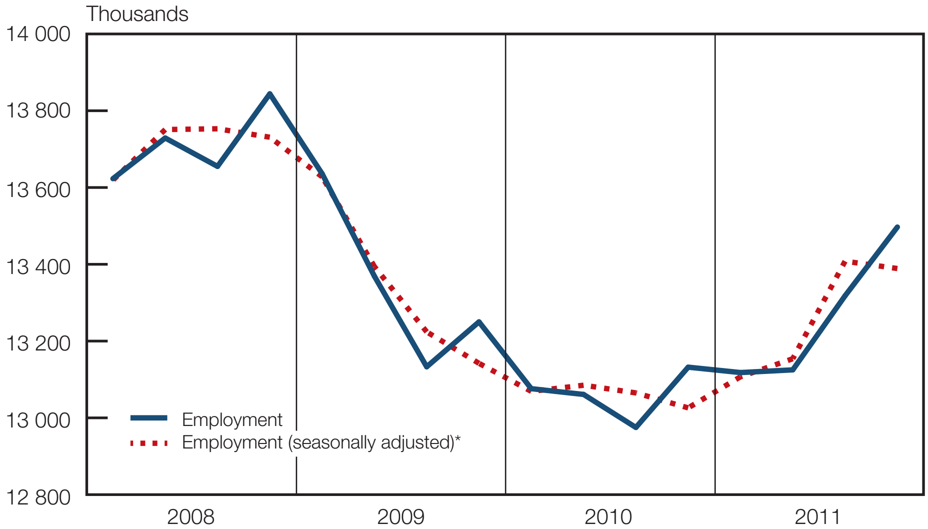
Official unemployment rate



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

The increase in employment from the third to the fourth quarter was strongly influenced by seasonal factors, since especially the trade, catering and accommodation services sector tends to employ seasonal workers towards the year-end. Accordingly, the seasonally adjusted number of people employed (as estimated by the South African Reserve Bank) moved essentially sideways in the fourth quarter of 2011, against the increase of 179 000 recorded in the unadjusted data. These trends are depicted in the accompanying graph.

Total employment



* Seasonally adjusted by the South African Reserve Bank
Source: Statistics South Africa, *Quarterly Labour Force Survey*

Labour cost and productivity

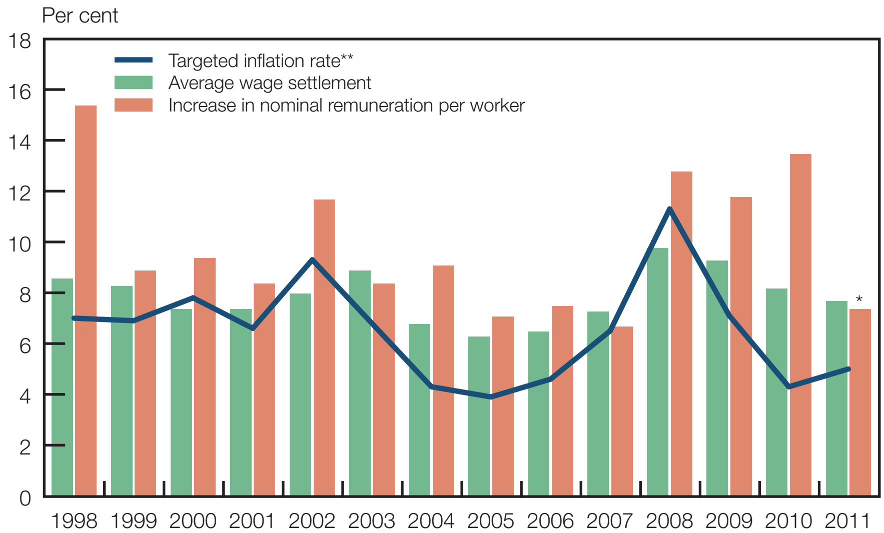
Having decelerated notably from a recent high year-on-year rate of 15,9 per cent in the first quarter of 2010 to 6,4 per cent in the first quarter of 2011, the pace of increase in nominal remuneration per worker in the formal non-agricultural sector reaccelerated to 7,2 per cent in the second quarter of 2011 and 8,6 per cent in the third quarter. The renewed acceleration in nominal remuneration growth per worker can be attributed to a marked increase in public-sector remuneration. In the third quarter of 2011 nominal remuneration per worker increased at high year-on-year rates, especially in the mining sector (10,1 per cent), the manufacturing sector (7,4 per cent) and the electricity sector (7,3 per cent). The finance, insurance, real-estate and business services sector, and the construction sector registered increases amounting to 5,3 per cent and 4,5 per cent respectively. In the public sector, however, the nominal remuneration per worker increased at rates well in excess of 10 per cent at national department and provincial level, amounting to 13,9 per cent and 18,6 per cent respectively in the year to the third quarter of 2011. Year-on-year increases in average nominal remuneration per worker in the private sector amounted to 6,3 per cent in the third quarter of 2011, markedly lower than the 13,7 per cent increase in public-sector remuneration over the same period.

Although some of these increases in sectoral remuneration appear to be high and well above consumer price inflation, cognisance should be taken of the fact that compositional staff changes may occur within an enterprise, affecting the total remuneration cost of the company. For instance, an enterprise may substitute lower-paid workers with higher-paid, better-qualified workers during a restructuring process. When calculating the year-on-year increase in remuneration per worker, what at first glance could be perceived as very high general wage increases to a company's workforce could in fact be a change in the staff composition. This distortion may be countered by looking at the wage settlement rate – the wage increase that is normally afforded all workers independent of the compositional staff structure within the company – as more representative of labour cost pressures.

According to the Wage Settlement Survey conducted by Andrew Levy Employment Publications, the average wage settlement rate moderated from 8,2 per cent in 2010 to 7,7 per cent in 2011 – slightly higher than the average settlement rate of 7,5 per cent recorded in the first half of the year. The number of working days lost due to industrial action more than halved from 14,6 million during 2010 – a level recorded largely on account of strike activity in the public sector – to 6,2 million in 2011.

Labour productivity increases in the formal non-agricultural sector of the economy slowed from 0,9 per cent in the year to the second quarter of 2011 to 0,3 per cent in the year to the third quarter, as the 2,5 per cent increase in total formal non-agricultural employment was barely exceeded by the 2,9 per cent increase in real output of the non-agricultural sector of the economy. Over the same four quarters, the real fixed capital stock outside of agriculture rose by 3,5 per cent. The year-on-year pace of increase in labour productivity in the manufacturing sector also decelerated from 3,1 per cent in the second quarter of 2011 to 2,9 per cent in the third quarter.

Wage settlements, nominal remuneration per worker and targeted inflation



* Average for the first three quarters of 2011
** CPIX up to December 2008; CPI for all urban areas from January 2009 onwards
Sources: Andrew Levy Employment Publications; Statistics South Africa

Owing to the deceleration in productivity growth and the acceleration in nominal remuneration growth per worker in the third quarter of 2011, nominal unit labour cost increases picked up from 6,2 per cent in the year to the second quarter of 2011 to 8,3 per cent in the year to the third quarter. However, the year-on-year rate of increase in nominal unit labour cost in the manufacturing sector decelerated from 6,5 per cent to 4,4 per cent over the same period as growth in nominal remuneration moderated and manufacturing output per worker increased.

Prices

Despite an environment of lacklustre growth and subdued levels of demand, both producer and consumer price inflation accelerated markedly during 2011 primarily due to exogenous supply-side factors. Accordingly, producer price inflation for domestic output accelerated from 6,0 per cent in 2010 to 8,4 per cent in 2011, while consumer price inflation quickened from 4,3 per cent to 5,0 per cent over this period.

Year-on-year producer price inflation almost doubled from 5,5 per cent in January 2011 to 10,6 per cent in October, mainly due to steep increases in international commodity prices alongside a depreciation in the exchange value of the rand in the latter part of the year, inflating the rand prices of commodities. The pace of price increases of mining products surged to a peak rate of 17,7 per cent in the year to September 2011, while prominent increases were also noted in the prices of food, electricity and products of petroleum and coal in the course of 2011. The prices of petroleum and coal products increased by as much as 33,1 per cent in the year to November 2011, while price increases in electricity amounted to 26,0 per cent in the year to January 2012. Nevertheless, from its October 2011 peak, overall producer price inflation moderated to 8,9 per cent in the year to January 2012 as the prospects for global economic growth deteriorated, giving rise to a softening of some commodity prices.

Year-on-year headline consumer price inflation accelerated steadily from a recent low of 3,2 per cent in September 2010 to 6,0 per cent in October 2011. After having remained within the inflation target range for 21 consecutive months, consumer price inflation breached the upper limit of the inflation target range in November and December 2011, in both instances amounting to 6,1 per cent, before accelerating further to 6,3 per cent in January 2012. The notable acceleration in consumer price inflation could largely be attributed to pronounced increases in the prices of consumer goods. Year-on-year consumer goods price inflation, after having accelerated to within the inflation target range in March 2011, breached the upper limit of the inflation target range in October, thereafter accelerating further to 6,7 per cent in December and subsequently moderating to 6,5 per cent in January 2012. The acceleration in consumer goods price inflation was mainly driven by a marked pick-up in the prices of non-durable goods which reached a twelve-month rate of increase of 11,1 per cent in November 2011. Key contributors to the acceleration in non-durable goods price inflation include food, petrol and other liquid fuels, and electricity. Within the consumer goods basket, the food and non-alcoholic beverages, alcoholic beverages and tobacco, as well as the housing and utilities categories all registered annual average rates of increase in excess of the upper limit of the inflation target range of 6 per cent in 2011.

Alongside the acceleration in consumer goods price inflation, twelve-month headline consumer services price inflation accelerated to 5,6 per cent in December 2011, and 5,9 per cent in January 2012. Services price inflation nevertheless still remained within the inflation target range, and by January 2012 had done so for 19 consecutive months. Within the consumer services basket, the prices of transport, education and health services nevertheless increased at rates in excess of 6 per cent throughout 2011.

Changes in food prices have been one of the main drivers of increased inflation pressures during the past year. The twelve-month rate of change in the producer prices of food switched from deflation to inflation in February 2011, accelerating notably in ensuing months to 10,0 per cent in September 2011, before moderating to 9,0 per cent in January 2012. This upward trajectory resulted from a gradual acceleration in food price inflation at both the manufacturing and agricultural level to 10,9 per cent and 5,4 per cent respectively in January 2012 – agricultural food prices had peaked at a year-on-year rate of 11,9 per cent in October 2011. On average, producer food price changes moved from a rate of decrease of 2,7 per cent in 2010 to a rate of increase of 5,3 per cent in 2011.

Producer and consumer food price inflation

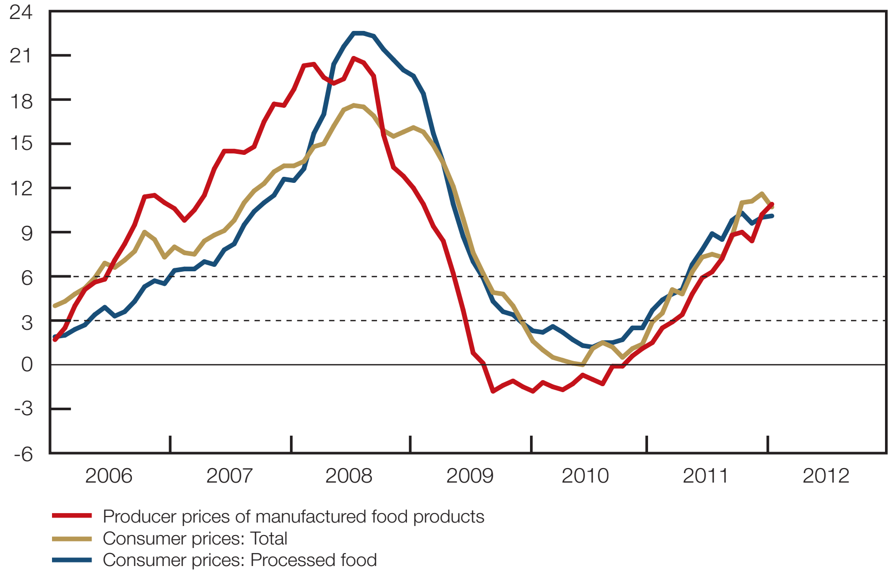
Percentage change over twelve months

Component	Weights	2010	2011	Jan 2012
Producer prices of agricultural food	3,89	-5,9	4,3	5,4
Producer prices of manufactured food	5,87	-0,8	5,9	10,9
Total producer food prices	**9,76**	**-2,7**	**5,3**	**9,0**
Consumer prices of unprocessed food	7,48	-0,2	7,1	11,3
Consumer prices of processed food	6,79	1,9	7,5	10,1
Total consumer food prices	**14,27**	**0,8**	**7,3**	**10,7**

Following elevated producer food price increases, consumer food price inflation accelerated markedly from 0,8 per cent in 2010 to 11,6 per cent in the year to December 2011. The surge in consumer food price inflation in 2011 reflected substantial increases in the prices of both unprocessed and processed food. Prices of unprocessed food increased by 7,1 per cent in 2011, while the prices of processed food increased by 7,5 per cent.

Food price inflation

Percentage change over twelve months



Rising international food prices, partly through import and export parity pricing practices, contributed to the rise in domestic food prices in 2011. Moreover, the acceleration in domestic consumer food price inflation became increasingly broad-based, with year-on-year price increases in seven of the nine components within the consumer food basket exceeding 6 per cent in January 2012. On average, inflation in five of the nine components exceeded the upper limit of the inflation target range in 2011, while none of these components had increased at rates in excess of 6 per cent in 2010. Most concerning among these increases is the marked acceleration in meat price inflation (representing almost a third of the total consumer food basket) from 0,5 per cent in 2010 to 10,9 per cent in 2011 and no less than 16,7 per cent in the year to December 2011. Bread and cereal prices (representing almost 22 per cent of the total food basket) also increased notably at an annual average rate of 6,9 per cent in 2011, following a rate of decrease of 1,6 per cent in 2010. The prices of oils and fats increased by more than 20 per cent in 2011, constituting the highest rate of increase of all the food categories.

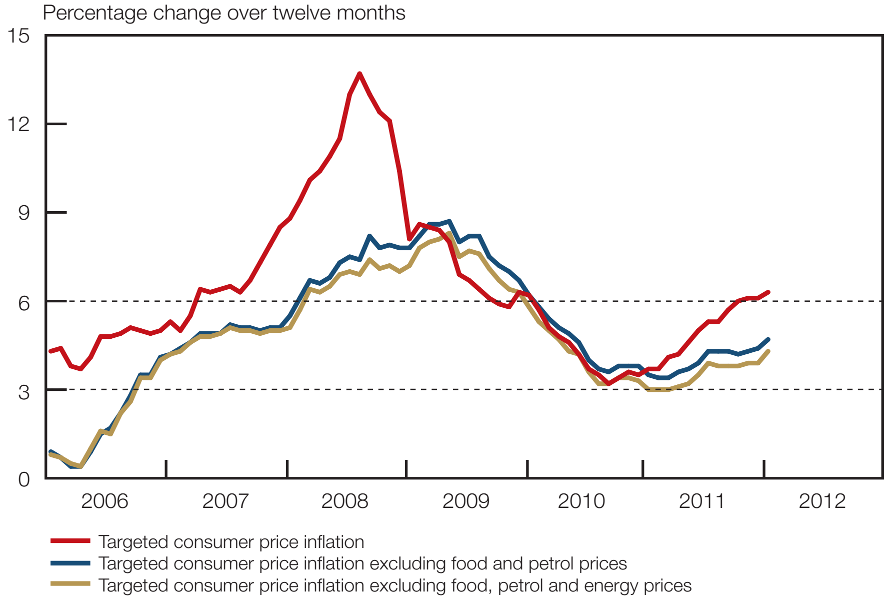
Consumer food price inflation

Percentage change over twelve months

Component	Weights	2010	2011	Jan 2012
Bread and cereals	3,08	-1,6	6,9	10,1
Meat	4,59	0,5	10,9	14,3
Fish	0,66	2,7	2,8	8,1
Milk, cheese and eggs	1,79	2,1	0,7	4,3
Oils and fats	0,53	-5,0	20,9	15,2
Fruit	0,47	4,1	6,0	4,7
Vegetables	1,63	1,2	4,1	10,4
Sugar, sweets and desserts	0,77	5,8	9,8	14,1
Other foods	0,75	3,8	5,5	7,4
All food products	14,27	0,8	7,3	10,7

When the impact of the more volatile food, non-alcoholic beverages and petrol prices is omitted from the calculation of targeted headline consumer price inflation, underlying inflation decelerated to a year-on-year rate of 3,4 per cent in February and March 2011, before accelerating gradually to 4,4 per cent in November and December and further to 4,7 per cent in January 2012. When also excluding the impact of electricity prices from the calculation, year-on-year consumer price inflation accelerated to only 3,9 per cent in July 2011 and remained broadly at this rate up to December, suggesting relatively muted underlying inflation pressures in the domestic economy, before accelerating further to 4,3 per cent in January 2012.

Underlying measures of consumer price inflation



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

An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories confirms that underlying inflationary pressures remained reasonably restrained in the economy throughout 2011. The annual average rates of change in eight of the twelve categories did not exceed the upper limit of the inflation target range in 2011, with half recording price increases that fluctuated between 3 to 6 per cent, and the other half registering rates of change below 3 per cent. The four categories that increased at rates in excess of 6 per cent in 2011, together accounting for almost half of the consumer price basket, include (i) food and non-alcoholic beverages; (ii) alcoholic beverages and tobacco; (iii) housing and utilities; and (iv) education. The four categories that increased at rates within the inflation target range in 2011 have a combined weight of around 37 per cent, while the four categories that increased at rates below the lower limit of the inflation target range collectively account for 17 per cent in the total index.

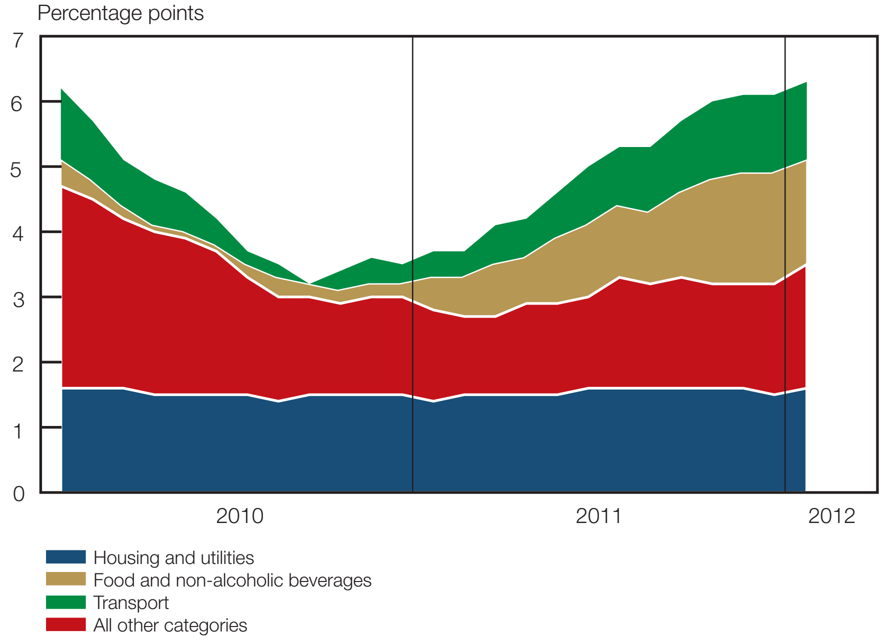
Headline CPI inflation in COICOP categories

Percentage change over twelve months

Category	Weights	2010	2011	Jan 2012
Food and non-alcoholic beverages	15,68	1,4	7,1	10,3
Alcoholic beverages and tobacco	5,58	9,2	6,1	6,3
Clothing and footwear	4,11	1,9	2,3	3,8
Housing and utilities	22,56	6,6	6,6	6,6
Household content, maintenance and equipment	5,86	0,4	1,4	2,2
Health	1,47	7,5	5,8	5,2
Transport	18,80	2,7	4,9	6,8
Communication	3,22	-1,6	-1,7	-1,5
Recreation and culture	4,19	0,2	-0,6	-0,3
Education	2,19	9,4	8,7	8,6
Restaurants and hotels	2,78	7,1	4,9	5,6
Miscellaneous goods and services	13,56	6,8	4,1	5,7
All items headline CPI	100,00	4,3	5,0	6,3

A comparison of the contribution of selected categories to the annual percentage change in the headline consumer price index indicated that the acceleration in inflation in 2011 was largely driven by food and petrol price increases. While the inflationary pressures within the housing and utilities category remained fairly stable at an elevated level throughout the year, inflation pressures emanating from the "other" remaining categories seemed to have picked up only marginally in the first half of 2011, before levelling off in the second half of the year. This finding further suggests that inflation pressures have not yet become pervasive throughout all the categories of the consumer price basket, with the so-called second-round effects of food and petrol price increases not yet visible.

Contribution of selected categories to the annual percentage change in the consumer price index



Administered price inflation continued to make a significant contribution to the upward trend in consumer price inflation, registering rates of increase well above the upper limit of the inflation target range, with some categories within the administrative price basket even increasing at double-digit rates throughout 2011. Twelve-month administered price inflation accelerated continuously from 9,6 per cent in January 2011 to 13,4 per cent in November 2011, before moderating somewhat to 11,6 per cent in January 2012, marking a two-year period that the inflation rate for administered prices has been above the upper limit of the inflation target range. Although marked increases in petrol and electricity prices were mainly responsible for the acceleration in administered price inflation throughout 2011, all other administered prices increased at rates in excess of the upper limit of the inflation target range, with the exception of the prices of communication and television licences.

When excluding the effect of petrol prices from the calculation of administered prices, this twelve-month rate of increase accelerated to 9,3 per cent in May 2011 before moderating to 8,7 per cent in November and December, and accelerated again to 8,8 per cent in January 2012. Notwithstanding the initial cushioning effect provided by the appreciation in the exchange value of the rand, the inland price of 95 octane petrol increased by a cumulative 278 cents per litre from September 2010 to February 2012. If electricity prices are also excluded from the above-mentioned calculation, the rate of increase in administered prices amounted to 6,4 per cent in the year to September 2011 and remained at this level up to December, before moderating to 6,1 per cent in January 2012.

Inflation expectations, as reflected by the Inflation Expectations Survey conducted by the BER in the fourth quarter of 2011, have increased moderately but nevertheless remained anchored around the upper limit of the inflation target range. Inflation is expected to average 6,1 per cent in 2012, compared with 5,9 per cent expected in the previous survey – representing a third consecutive quarterly upward revision in expectations. Expectations for 2013 also increased moderately from 5,9 per cent to 6,0 per cent. All categories of respondents revised their forecasts upwards for 2012 and 2013, except for business executives whose expectations for consumer price inflation in 2013 remained unchanged at 6,3 per cent.

Headline consumer price inflation expectations

Per cent, as surveyed in the fourth quarter of 2011

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2011	5,1	5,7	5,7	5,5
2012	5,9	6,2	6,3	6,1
2013	5,6	6,3	6,1	6,0

Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

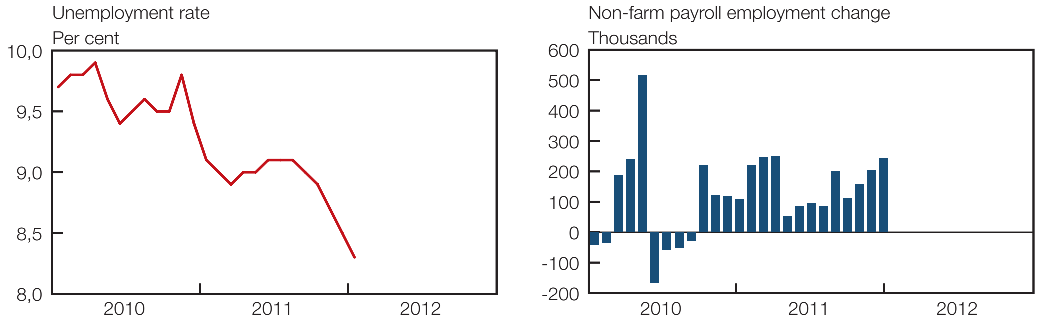
International economic developments

Global economic growth slowed significantly from 3,7 per cent in the third quarter of 2011 to 2,6 per cent in the fourth quarter, mainly on account of slower output growth in advanced economies. While the growth momentum also moderated in emerging economies, the region still remains the main driving force underpinning global growth.

Global economic growth prospects have deteriorated in recent months. The IMF has downgraded its world growth projections in the January 2012 *World Economic Outlook Update* by 0,7 percentage points to 3,3 per cent in 2012 and by 0,6 percentage points to 3,9 per cent in 2013, citing the projected contraction in the euro area as the main reason for this downgrade. The downside risks to the global growth outlook have increased due to the sovereign debt crisis and bank deleveraging in the euro area; insufficient progress with fiscal consolidation in the US and Japan; a possible hard landing in key emerging economies; and geopolitical oil supply risks. Projected output growth in sub-Saharan Africa was also downgraded by 0,3 percentage points to 5,5 per cent in 2012 and by 0,2 percentage points to 5,3 per cent in 2013.

The US economy expanded by 3,0 per cent in the final quarter of 2011, the most rapid quarterly growth in a year and a half. Economic growth was underpinned by positive contributions from inventory investment, personal consumption expenditure and exports. The Chicago Federal Reserve Bank National Activity Index increased in January 2012 to its highest value since March 2011, suggesting that US economic growth was slightly above its historical trend. US labour market conditions have improved beyond earlier expectations, with more new jobs being created and the unemployment rate falling from 9,8 per cent in November 2010 to 8,3 per cent in January 2012. The US manufacturing purchasing managers index increased to 54,1 in January 2012, before edging down to 52,4 in February. The recovery in the US is, however, expected to proceed at a more modest pace in the near future due to continuing household deleveraging, fiscal consolidation and possible spillovers from Europe.

United States labour market indicators



Seasonally adjusted
Source: United States Bureau of Labor Statistics

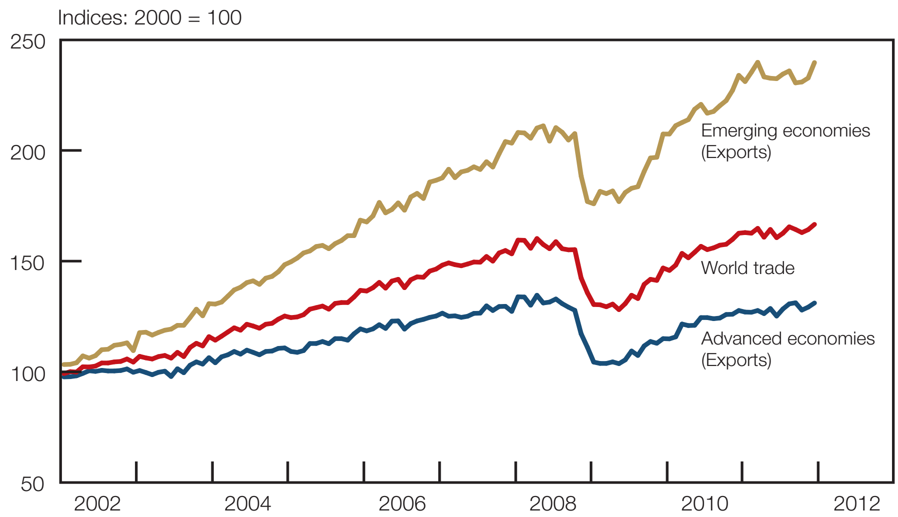
After surging by 7,1 per cent in the third quarter of 2011, Japan's economy contracted by 0,7 per cent in the fourth quarter. This decline in economic activity was mainly due to weak exports undermining the recovery experienced in the previous quarter. In addition, Japanese exports were also affected by the strength of the yen, weak external demand and the floods in Thailand.

The euro area economy contracted in the fourth quarter of 2011 by 1,3 per cent as the escalating debt crisis in euro peripheral member countries started to weigh on the region's growth. Economic conditions in the euro area are expected to remain subdued in the face of tighter lending standards by European banks, a further tightening in fiscal policy in many countries, and high and rising unemployment. The euro area Finance Ministers agreed in February 2012 to a second bailout package for Greece, amounting to €130 billion. Financial markets still remained concerned that Greece would be unable to keep to the terms of the agreement given that economic conditions continued to deteriorate.

Real output growth in emerging economies decelerated somewhat in the fourth quarter of 2011. Despite higher growth in China, economic growth in emerging Asia slowed in the fourth quarter of 2011. Much of the slowdown in the region was due to weaker external demand as the euro area crisis intensified. The growth momentum in Latin America also moderated somewhat in the fourth quarter. Countries such as Brazil, Mexico and Venezuela registered subdued growth rates. Growth in emerging Europe is, however, expected to have improved slightly in the fourth quarter due to stronger growth performances in Russia and Turkey.

World trade volumes remained relatively flat in the fourth quarter of 2011, with annual growth slowing from 6,1 per cent in August 2011 to 2,5 per cent in December. Much of this weakness was due to contracting export volumes in Japan and the euro area. Growth in trade volumes in emerging markets have slowed recently, mainly due to weakness in emerging Asia.

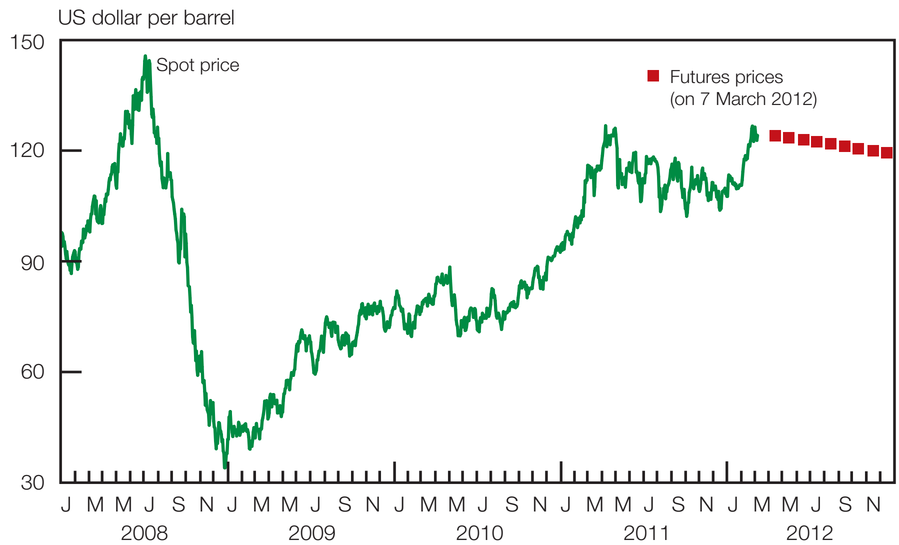
World trade volume



Source: CPB Netherlands Bureau for Economic Policy Analysis

Brent crude oil prices have increased notably since mid-December 2011, reaching levels of around US$126 per barrel in early March 2012 before moderating somewhat to US$124 per barrel on 7 March 2012. Geopolitical tensions surrounding Iran and the Middle East, as well as the severe cold weather conditions across Europe provided support for crude oil prices. The

Brent crude oil prices



Source: Bloomberg

most recent moderation of crude oil prices was due to the lowering of China's economic growth targets and news that negotiations over Iran's nuclear programme could resume.

The International Energy Agency (IEA) forecasts global oil demand to average 89 million barrels per day and 90 million barrels per day in 2011 and 2012 respectively. The 2012 forecast was revised downwards on account of global economic weaknesses affecting world oil demand. During the fourth quarter of 2011, global oil demand averaged 89,5 million barrels per day, broadly unchanged from the previous quarter. This was 0,3 per cent higher than the same quarter a year ago. Oil demand in the US, Europe (notably France, Germany, Italy, Spain and the UK), Saudi Arabia and Mexico declined during the fourth quarter of 2011 compared with the previous quarter, while demand increased in China, India, Russia and Korea. Oil supply from the Organization of the Petroleum Exporting Countries (OPEC) rose in the fourth quarter of 2011 to 36,4 million barrels per day, driven by higher output in Libya, Venezuela, Saudi Arabia, Kuwait, Algeria and Angola, while output declined in Iran and Nigeria. Brent crude oil futures prices dated 7 March 2012 were around US$122 per barrel for delivery in the third quarter of 2012 and around US$120 per barrel for delivery in the fourth quarter.

Global consumer price inflation was projected to slow in the medium term, with an easing of demand in both advanced and emerging economies, and stabilisation of commodity prices. The IMF expected advanced economy inflation to average 1,6 per cent and 1,3 per cent in 2012 and 2013 respectively, from 2,7 per cent in 2011. In emerging economies, consumer price inflation was projected to average 6,2 per cent and 5,5 per cent in 2012 and 2013 respectively, from 7,2 per cent in 2011.

In order to ease strains in financial markets, the US Federal Reserve, the European Central Bank (ECB), the Bank of Canada, the Bank of England, the Bank of Japan and the Swiss National Bank announced on 30 November 2011 a co-ordinated central bank action plan to lower the pricing of the US dollar liquidity swap arrangements by 50 basis points to provide liquidity support to the global money markets. In recent months a number of central banks have reduced their official policy rates in order to support economic growth. The ECB lowered its key interest rates in early December 2011 by 25 basis points, following a similar decrease in November, and announced additional enhanced credit support to strengthen bank lending and liquidity in the euro area money market. In December 2011 the Reserve Bank of Australia decided to lower its cash rate by 25 basis points as the developments in Europe were expected to weigh on economic activity in Australia and the inflation outlook being consistent with a modest reduction in interest rates. The central banks of Denmark, Israel, Norway and Sweden also lowered interest rates partly due to concerns about the European sovereign debt crisis. In addition, the central banks of Japan and England continued easing monetary policy by increasing their asset purchase programmes in February 2012. The Bank of Japan increased its programme by ¥10 trillion to ¥65 trillion, while the Bank of England increased its programme by £50 billion to £325 billion.

The central banks in emerging economies such as Brazil, Chile, Indonesia and Thailand have lowered interest rates in recent months partly due to concerns about the fallout of events in Europe. The Bank of India, however, recently raised its policy rate due to concerns about inflation. The central bank of Hungary raised its base rate in November 2011 to protect the forint after the country's credit rating had been downgraded, and in a number of African countries such as Ghana, central bank rates were also increased in the face of inflation pressures. The People's Bank of China reduced the reserve requirement ratio for banks by 50 basis points in November 2011 and again in February 2012 to boost liquidity and support economic growth.

Current account [4]

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

Varying degrees of risk awareness and subdued business confidence emanating from the sovereign debt crisis in the eurozone area continued to affect global trade and financial flows. The stagnation in world trade volumes during 2011, alongside rising domestic expenditure and imports in South Africa, manifested in the steady narrowing of South Africa's trade surplus with the rest of the world from the first quarter of 2011 before switching to an annualised deficit of R17,1 billion in the fourth quarter. On an annual basis, South Africa's trade surplus with the rest of the world shrank from R27,2 billion in 2010 to R16,4 billion in 2011, notwithstanding the diversification in the country's export markets and favourable prices of exports.

The shortfall on the services, income and current transfer account with the rest of the world contracted noticeably in the fourth quarter of 2011, offsetting the deterioration in the trade balance; the deficit on the current account of the balance of payments accordingly narrowed over the period. Relative to the country's gross domestic product, the deficit on the current account decreased from 4,1 per cent in the third quarter of 2011 to 3,6 per cent in the fourth quarter. Owing mainly to the sharp deterioration in the ratio in the second half of the year, the current-account deficit widened to 3,3 per cent of gross domestic product in 2011; in 2010, this ratio had amounted to 2,8 per cent.

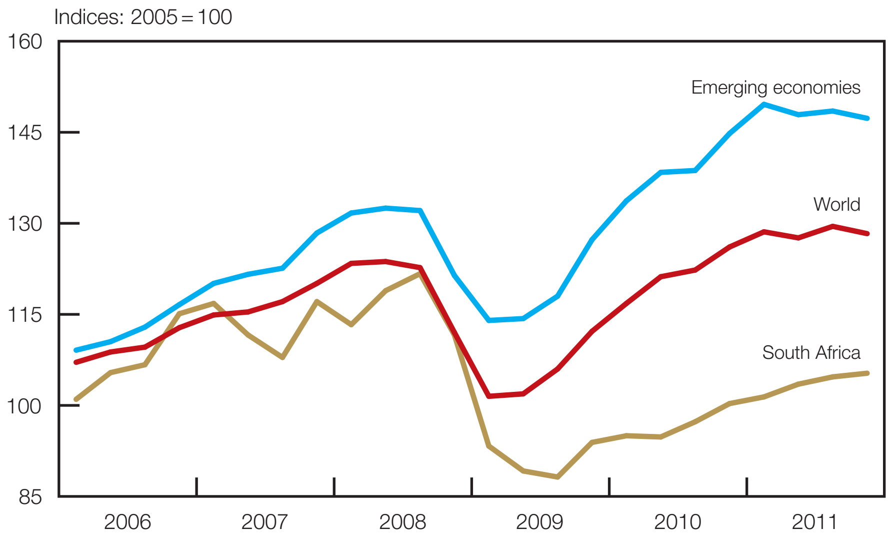
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2010	2011				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	565,9	645,8	652,4	671,8	714,8	671,2
Net gold exports	59,5	62,3	70,4	83,5	85,0	75,3
Merchandise imports	-598,2	-667,6	-696,9	-739,0	-816,9	-730,1
Trade balance	27,2	40,5	25,9	16,3	-17,1	16,4
Net service, income and current transfer payments	-102,2	-115,3	-114,4	-137,8	-93,1	-115,2
Balance on current account	-75,0	-74,8	-88,5	-121,5	-110,2	-98,8
As a percentage of gross domestic product	*-2,8*	*-2,6*	*-3,0*	*-4,1*	*-3,6*	*-3,3*

The volume of South Africa's *merchandise exports*, having increased steadily since the first quarter of 2010, rose only marginally by 1,3 per cent in the fourth quarter of 2011. This marginal increase was achieved despite the contraction in the aggregate volume of merchandise exports of all emerging-market economies, as depicted in the accompanying graph. Vibrant economic activity in the American and Asian regions offset the impact of weaker demand from Europe on South African exporters. The recovery in the volume of South Africa's manufactured exports

Volume of merchandise exports

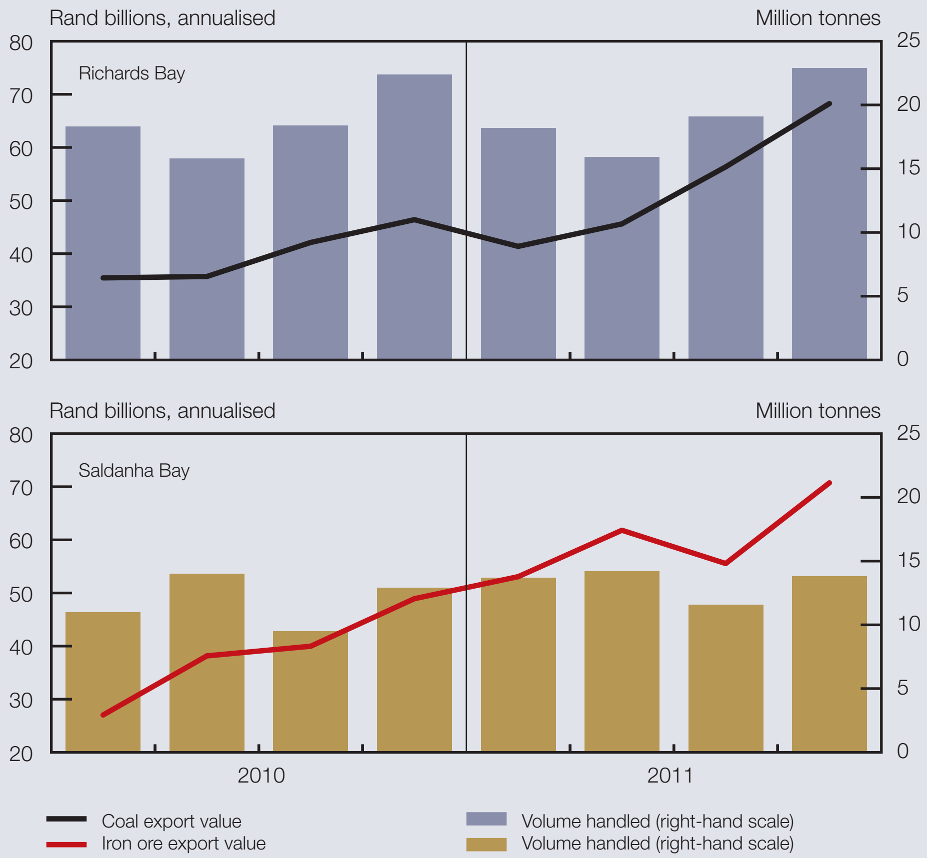


Sources: Bloomberg and South African Reserve Bank was, however, interrupted in the fourth quarter of 2011, largely on account of the weaker performance of the European economy affecting domestic exporters of, in particular, machinery and electrical equipment, and vehicles and transport equipment. By contrast, an increase in the volume of mining and agricultural products destined for Asia, and to a lesser extent, the US, was noted over the period.

Box 1: Richards Bay and Saldanha Bay exports

According to the statistics of goods handled through the Richards Bay harbour – primarily a port for coal exports – export volumes of bulk cargo increased by 19,9 per cent in the fourth quarter of 2011. Over the same period, the quantity of bulk cargo, mainly iron ore, handled at the Saldanha Bay harbour advanced by 19,2 per cent. Significant portions of these bulk mining exports were destined for China, India and Japan, supplying users such as steel mills and thermal coal power stations.

Bulk cargo volume handled and export value of selected mining products

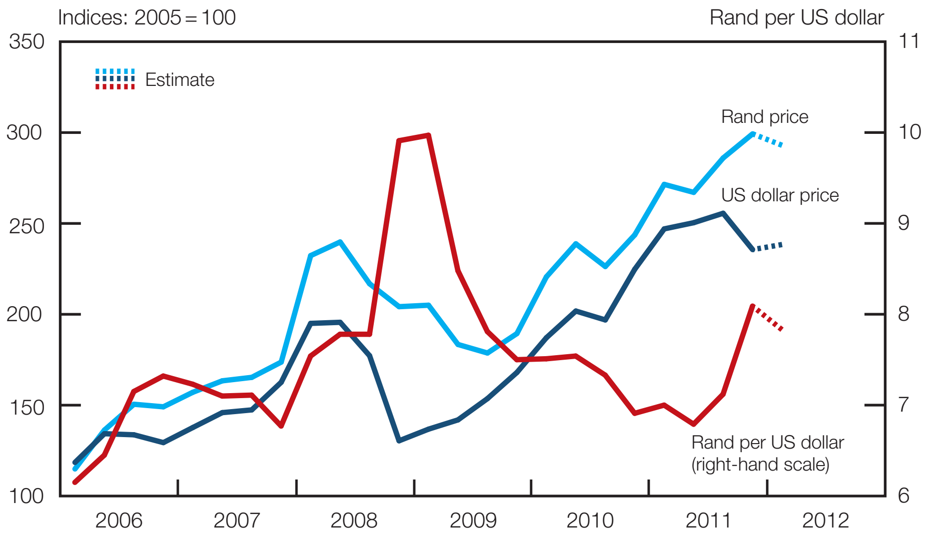


Sources: National Port Authority and South African Revenue Services

The worsening global economic outlook and subdued international demand caused most commodity prices to retract somewhat in the closing months of 2011. The price of a basket of South African-produced export commodities (excluding gold) accordingly receded by about 10,0 per cent in dollar terms in the fourth quarter of 2011 as the prices of base metals and agricultural raw materials declined. Nonetheless, the overall rand price of merchandise exports rose by 5,0 per cent over the period, supported by the depreciation in the exchange value of the rand. Mainly driven by price developments, the value of export earnings of domestic producers advanced by 6,4 per cent from R671,8 billion in the third quarter of 2011 to R714,8 billion in the fourth quarter.

Gold export earnings were sustained throughout the calendar year 2011, mainly due to the elevated price of gold. The strengthening of the nominal effective exchange rate of the US dollar during the fourth quarter of 2011 following favourable US economic data, profit-taking and the rebalancing of investment portfolios as the year drew to an end caused the fixing price of gold on the London market to decline by 1,1 per cent to a still-high US$1 683 per fine ounce over the period. The depreciation of the exchange rate of the rand during the final quarter of 2011, however, cushioned the earnings of domestic gold producers by lifting the average realised rand price of net gold exports by 12,0 per cent in addition to offsetting a 9,0 per cent decline in the physical quantity of gold exports.

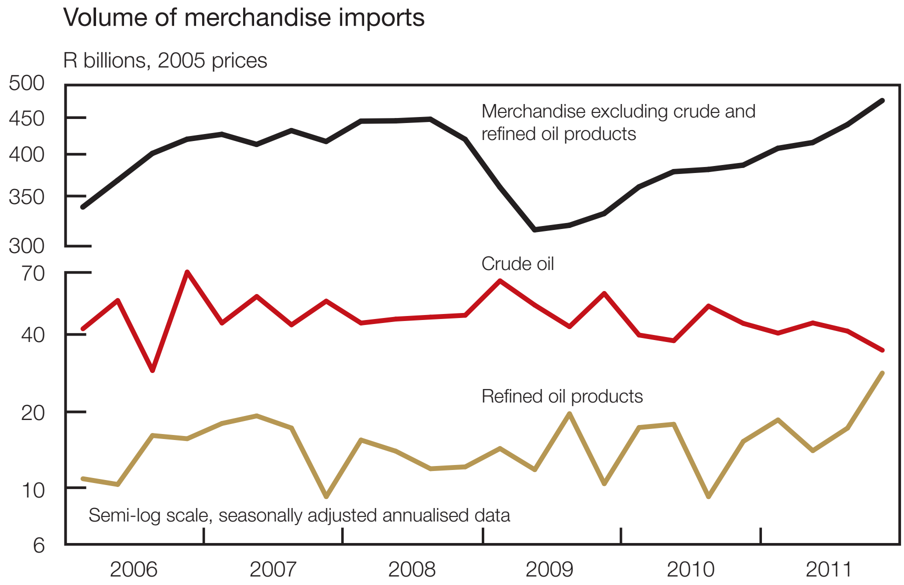
South African commodity prices and the exchange rate



As expected, the increase in gross domestic expenditure in the fourth quarter of 2011 was accompanied by a notable surge in the volume of non-oil imports, more specifically in the categories for mining products and manufactured goods. The increase in the volume of mining imports could partly be attributed to the temporary closure of a prominent domestic steel plant, compelling consumers of steel to supplement the shortfall from abroad. Furthermore, imports of refined mineral products, including petrol and diesel, also rose on account of a brief interruption in the operations of some domestic refineries in the fourth quarter of 2011. As expected with this substitution, the volume of crude oil imports declined over the period. The domestic demand for imported manufactured goods remained strong with notable increases in the imports of machinery and electrical equipment as well as vehicles and transport equipment. Collectively, the proportion of imported goods required to satisfy domestic expenditure advanced from 23,9 per cent in the third quarter of 2011 to 24,7 per cent in the fourth quarter. This ratio has been growing consistently since the first quarter of 2011, bringing the annual ratio to 23,6 per cent compared with 21,8 per cent in 2010.

The increased volume of trade among emerging-market economies was accompanied by a steady increase in global inflation, in part due to elevated levels of international crude oil prices. As a result, the higher prices of imported products alongside a weaker domestic currency raised the rand price of merchandise imports by a further 5,4 per cent in the fourth quarter of 2011. Almost equal increases in the price and volume of imported goods raised the value of merchandise imports by 10,5 per cent over the period. On an annual basis, the value of merchandise imports advanced meaningfully by 22,1 per cent.

South Africa's terms of trade weakened in the fourth quarter of 2011 as a result of a slower pace of increase in the rand price of exports of goods and services relative to that of imports. On an annual basis, the terms of trade, however, still improved when the calendar year 2011 is compared with the preceding year.



The negative imbalance on the services, income and current transfer account narrowed noticeably by about R45 billion in the fourth quarter of 2011 to R93 billion. Relative to the country's gross domestic product, the deficit amounted to 3,0 per cent – fairly moderate compared with recent history. The smaller deficit in the fourth quarter of 2011 can mainly be ascribed to significantly lower gross dividend payments following exceptionally large dividend declarations in the third quarter.

Travel-related spending in South Africa by non-residents increased by only 4,3 per cent in the fourth quarter of 2011 but advanced by around 22 per cent when compared with the corresponding period of the preceding year. The extent of the quarterly increase in travel expenditure by non-residents over the period was buoyed by foreign delegates' spending at the environmental Conference of the Parties (COP17) held in Durban towards the end of 2011. However, for 2011 as a whole, travel receipts grew by 4,4 per cent, partially impacted by the artificially high base that was established by the hosting of the 2010 FIFA World Cup™. Spending on foreign travel by South African residents declined for the second consecutive quarter in the fourth quarter of 2011, culminating in a contraction of almost 7 per cent for the year as a whole. The contraction in the second half and for the year as a whole in part reflected the tight local economic circumstances and the impact of the steady depreciation in the value of the rand over the period. Net payments in the category "other services" also contracted, thereby contributing to the improved deficit on the overall account.

Financial account

Ongoing financial market turbulence in the euro area, associated with the sovereign debt problems of Greece and other peripheral countries in the region, dampened investors' appetite for financial assets in emerging-market economies. During the period, financial flows to and from emerging-market countries largely reflected the extent of trade relations between those economies and the euro area region. Against this background, the gradual diversification of South African trade towards South-East Asia and Africa, alongside the attractiveness of South Africa's mineral resources and relatively firm credit ratings secured further net inflows of capital into the country in the fourth quarter of 2011. The net inward movement of foreign capital through the financial account of the balance of payments (including unrecorded transactions) amounted to R19,9 billion in the fourth quarter of 2011 compared with an inflow of R34,5 billion in the third quarter. Cumulatively, the net inflow of capital amounted to R131,3 billion in 2011, substantially more than the net capital inflow of R106,0 billion registered in 2010. While the net inflow of capital edged higher in 2011, the composition of these flows simultaneously changed somewhat compared to 2010 (see Box 2 on page 32).

Net financial transactions not related to reserves

R billions

	2010	2011				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	9,0	5,2	15,4	2,8	18,7	42,1
Portfolio investment	107,9	20,8	35,1	-21,4	12,5	47,0
Other investment	7,9	-0,9	13,9	11,5	7,2	31,7
Change in assets						
Direct investment	0,6	-12,7	-1,6	12,9	6,0	4,6
Portfolio investment	-33,5	-21,1	-10,5	-9,9	-3,0	-44,5
Other investment	-22,1	33,5	17,0	8,7	-28,8	-3,6
Total financial transactions*	106,0	53,5	23,4	34,5	19,9	131,3
As a percentage of gross domestic product	*4,0*	*7,5*	*3,2*	*4,6*	*2,6*	*4,4*

* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa increased substantially to R18,7 billion in the fourth quarter of 2011 compared with an inflow of R2,8 billion in the third quarter. These capital inflows emanated mainly from the UK and China, and were largely directed towards the mining, communications and financial intermediation sectors. Cumulatively, direct investment inflows came to R42,1 billion in 2011, notably more than the inflow of R9,0 billion registered in 2010. As a ratio of gross domestic product, the direct investment inflows rose from 0,3 per cent in 2010 to 1,4 per cent in 2011.

Inward *foreign portfolio investment* turned around from an outflow of R21,4 billion in the third quarter of 2011 to an inflow of R12,5 billion in the fourth quarter. Foreign investors' confidence in emerging-market economies was partly restored in the final quarter of 2011 as central banks reiterated their commitment to injecting liquidity into the global financial markets. In addition, apparent progress made with the conclusion of a second bailout package for Greece by European leaders boosted international investors' appetite for domestic debt securities over the period. Non-resident investors nevertheless continued to dispose of domestic equity securities in the final quarter of 2011. As a result of increased risk aversion in the second half of 2011, portfolio investment liabilities increased by R47,0 billion for the year as a whole, markedly lower than the inflow of R107,9 billion recorded in 2010.

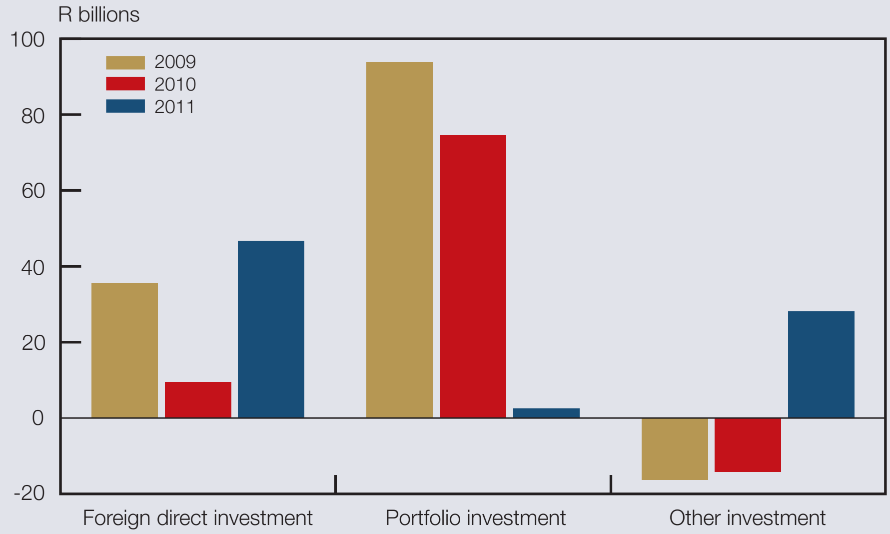
Other investment into South Africa recorded a smaller inflow of R7,2 billion in the fourth quarter of 2011 compared with the inflow of R11,5 billion registered in the third quarter. The inward movement of capital in the fourth quarter of 2011 mainly reflected an increase in long-term loans extended to the South African banking sector as well as an increase in non-resident deposits with domestic banks. For 2011 as whole, inflows of other foreign investment capital amounted to R31,7 billion compared with inflows of R7,9 billion in 2010.

Box 2: Composition of net capital flows

An analysis of the composition of gross inward capital flows into South Africa in 2011 relative to similar flows at the start of the recovery in global financial markets, seemed to suggest a shift away from portfolio investment to foreign direct and other investment inflows. The deficit on the current account of the balance of payments in 2009 and 2010 was primarily financed by net portfolio flows into the country.

As the shift in domestic trading patterns materialised throughout 2011, South Africa registered a visible increase in net foreign direct investment, mainly emanating from the United Kingdom and the North American, African and Asian regions. Simultaneously, other investment flows to the domestic private banking sector switched from an outflow in 2009 and 2010 to an inflow in 2011, partly related to foreign loan finance secured to finance increased spending on infrastructural development and to support trade finance. Net portfolio flows receded gradually from 2009 to 2010 but declined abruptly in 2011 as international investors became more risk-averse amid uncertainty in global financial markets.

Composition of net capital flows



South African-owned assets abroad

Outward direct investment recorded an inflow (a reduction in foreign direct investment assets) of R6,0 billion in the fourth quarter of 2011 following a more significant inflow of R12,9 billion in the third quarter. The loan repayment to a South African parent company in the communications sector fully offset the outward investment of domestic companies. For 2011 as a whole, direct investment inflows amounted to R4,6 billion following an inflow of R0,6 billion in 2010.

During the fourth quarter of 2011 the acquisition of *foreign portfolio investment* assets by South African entities took place at a much slower pace than in preceding quarters, registering an outflow of R3,0 billion. This smaller outflow could, among other factors, be attributed to a decrease in the risk appetite for international portfolio assets amid prevailing uncertainty in global financial markets and the depreciation in the exchange value of the rand against most major currencies over the period. On an annual basis, outward portfolio investment amounted to R44,5 billion in 2011 compared with an outflow of R33,5 billion in 2010.

Other outward investment from South Africa recorded an outflow of R28,8 billion in the fourth quarter of 2011. This capital outflow partly reflected a substantial increase in foreign currency-denominated deposits of South African banks with their foreign counterparts. For the year 2011 as a whole, outflows amounted to R3,6 billion – significantly less than the outflow of R22,1 billion registered in 2010.

Foreign debt

South Africa's total outstanding external debt decreased from US$114,7 billion at the end of June 2011 to US$107,8 billion at the end of September – the first decline to be recorded since the second quarter of 2010. Expressed as a ratio of the country's gross domestic product, the amount of outstanding foreign debt decreased from 28,5 per cent to 25,9 per cent over the period. South Africa's rand-denominated debt, expressed in US dollars terms, declined sharply from US$61,2 billion at the end of June 2011 to US$56,1 billion at the end of September, mainly due to the depreciation in the exchange value of the rand against the US dollar. Over the same period, foreign currency-denominated debt decreased from US$53,5 billion to US$51,6 billion.

South Africa's external debt

US$ billions at end of period

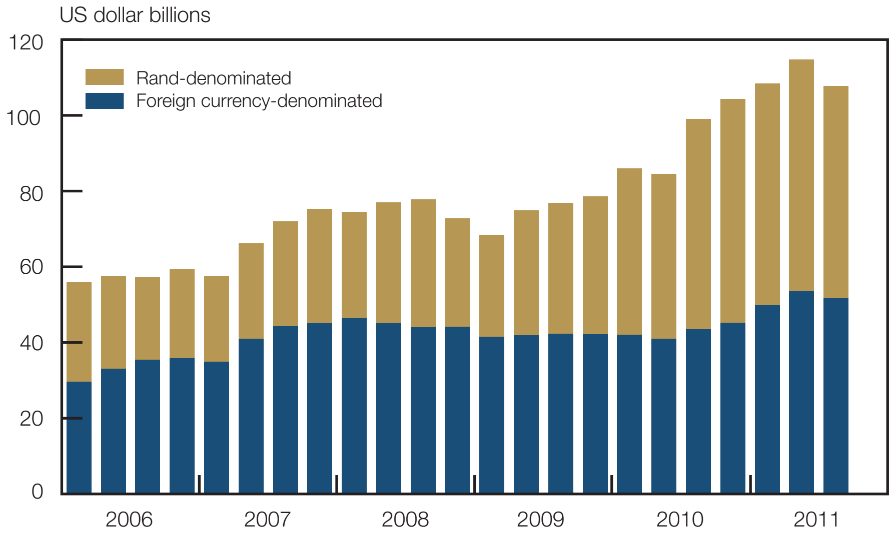
	2010		2011		
	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Foreign currency-denominated debt	43,5	45,2	49,8	53,5	51,6
Bearer bonds	17,0	16,5	21,1	22,2	21,3
Other	26,5	28,7	28,7	31,3	30,3
Public sector	6,1	6,5	7,1	7,8	7,8
Monetary sector	9,1	10,3	9,0	11,0	10,0
Non-monetary private sector	11,3	11,9	12,6	12,5	12,5
Rand-denominated debt	55,5	59,2	58,5	61,2	56,2
Bonds	22,7	24,6	24,6	29,7	27,9
Other	32,8	34,6	33,9	31,5	28,3
Total foreign debt	99,0	104,4	108,3	114,7	107,8
As a percentage of gross domestic product	*28,6*	*28,7*	*28,3*	*28,5*	*25,9*
As a percentage of total export earnings	*100,2*	*100,3*	*98,4*	*98,4*	*88,0*

The decrease in foreign currency-denominated debt in the third quarter of 2011 was largely brought about by revaluation changes following the strengthening of the US dollar against the euro, the redemption of long-term foreign currency-denominated loans and the withdrawal of non-resident investors' foreign currency deposits with domestic banks. These outflows were only partly offset by foreign finance extended to a domestic parastatal to fund expansion programmes.

Affected by the depreciation in the exchange rate of the rand, the country's external debt expressed in rand terms increased by R87 billion, from R778 billion at the end of the second quarter of 2011 to R865 billion at the end of the third quarter.

Despite the change in the ratings outlook for South Africa's sovereign debt from stable to negative by Moody's and Fitch rating agencies late in 2011 and in early 2012, the South African government successfully issued a US$1,5 billion 12-year international bond in January 2012 at a coupon rate of 4,67 per cent. This followed a US$750 million 30-year bond issue in March 2011 at the coupon rate of 6,25 per cent.

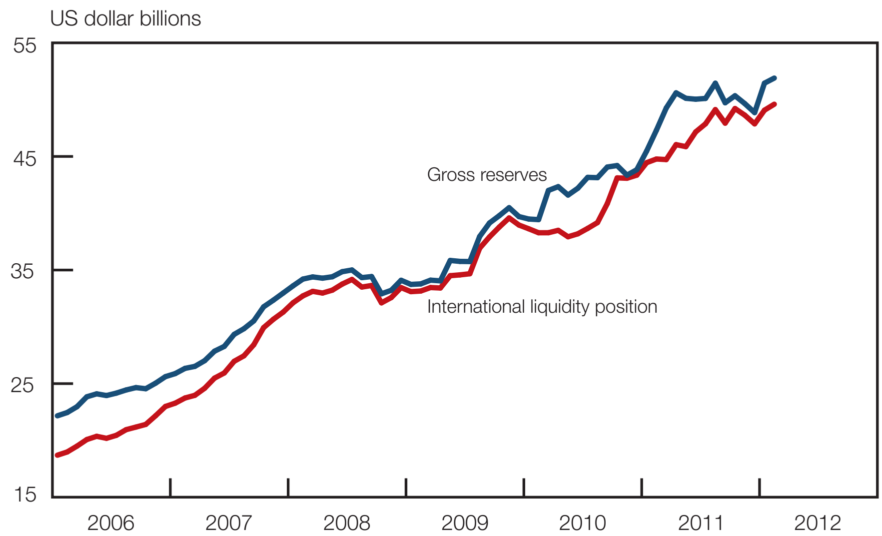
Total external debt



International reserves and liquidity

South Africa's overall balance-of-payments position (i.e., the change in the country's net international reserves due to balance-of-payments transactions) deteriorated by R1,4 billion in the fourth quarter of 2011 following a decline by R0,4 billion in the third quarter. Despite the decline in net international reserves in the second half of 2011, the country's net international reserves still increased by R32,7 billion for the year as a whole.

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



Measured in US dollars, the value of South Africa's gross gold and other foreign reserves (i.e., the international reserves of the Bank before accounting for reserve-related liabilities) declined from US$49,7 billion at the end of September 2011 to US$48,9 billion at the end of December, before increasing to US$51,9 billion at the end of February 2012. The country's gross international reserves rose, on balance, by US$5,6 billion and US$4,1 billion in 2009 and 2010 respectively. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) declined marginally from 20,6 weeks at the end of September 2011 to 19,7 weeks at the end of December.

The international liquidity position remained broadly unchanged at US$47,9 billion from the end of September 2011 to the end of December, but increased to US$49,6 billion at the end of February 2012.

Exchange rates

The ebb and flow of confidence in international financial markets continued to feed through to emerging-market currencies, which often exhibited highly correlated exchange rate movements. Subsequent to the decline, especially during the third quarter of 2011, the nominal effective exchange rate of the rand, on balance, inched higher by 0,7 per cent in the fourth quarter. The moderate strengthening in the exchange value of the rand in the final quarter of 2011 mainly occurred during December when the domestic currency appreciated by 4,6 per cent against a basket of 15 of South Africa's most important trading-partner countries. From the end of September 2011 to the end of November, the domestic currency depreciated by 3,7 per cent with sizeable losses noted against the US dollar, Chinese yuan and the British pound. The improved performance of the rand during December could partly be attributed to the co-ordinated action by major central banks to inject liquidity into the global financial system and positive economic data from some developed countries, including the US.

Exchange rates of the rand

Percentage change

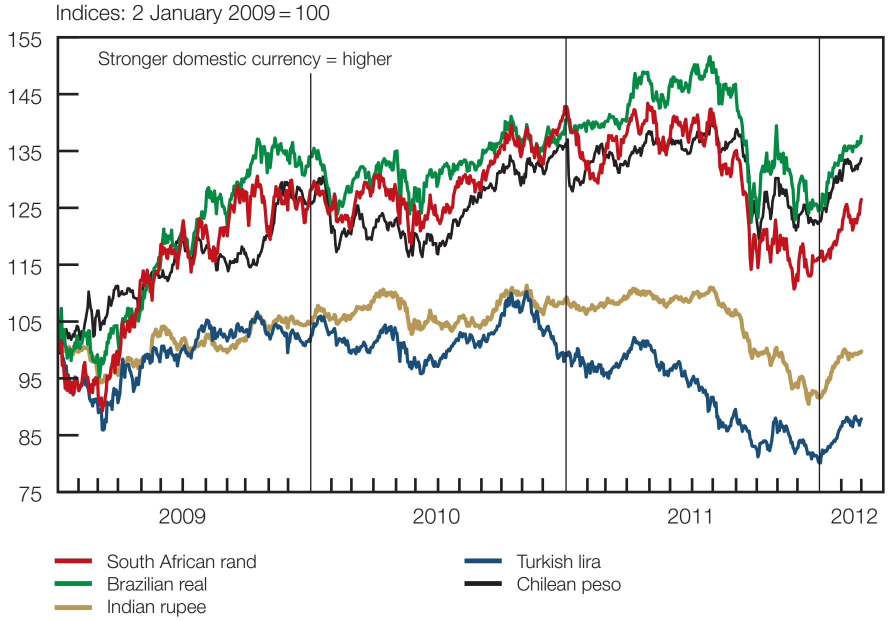
	31 Mar 2011 to 30 Jun 2011	30 Jun 2011 to 30 Sep 2011	30 Sep 2011 to 31 Dec 2011	31 Dec 2011 to 29 Feb 2012
Weighted average*	-1,5	-12,5	0,7	6,4
Euro	-2,0	-9,5	3,3	4,3
US dollar	0,0	-15,5	-1,3	8,7
Chinese yuan	-1,3	-16,6	-2,6	8,7
British pound	0,8	-13,2	-0,2	5,3
Japanese yen	-2,8	-19,3	-0,3	12,9

* Against a basket of 15 currencies

The domestic currency continued to strengthen in January and February 2012 as the IMF announced its intention to increase the lending capacity to countries in need. The decision by Moody's in the middle of February 2012 simultaneously to downgrade the ratings of the sovereign debt of six European countries, including Italy, did not have a major impact on the domestic currency as it had been anticipated, given the earlier downgrading of these economies by the rating agency Standard and Poor's.

The graph on page 36 indicates the performance of selected emerging-market currencies, including the South African rand, which mostly depreciated in the course of 2011. On balance, the trade-weighted exchange rate of the rand declined by 17,6 per cent in 2011. The real effective exchange rate of the rand declined by 13,7 per cent from the end of December 2010 to the end of December 2011, improving the external price competitiveness of South African exporters in international markets.

Selected exchange rates: US dollar per domestic currency unit



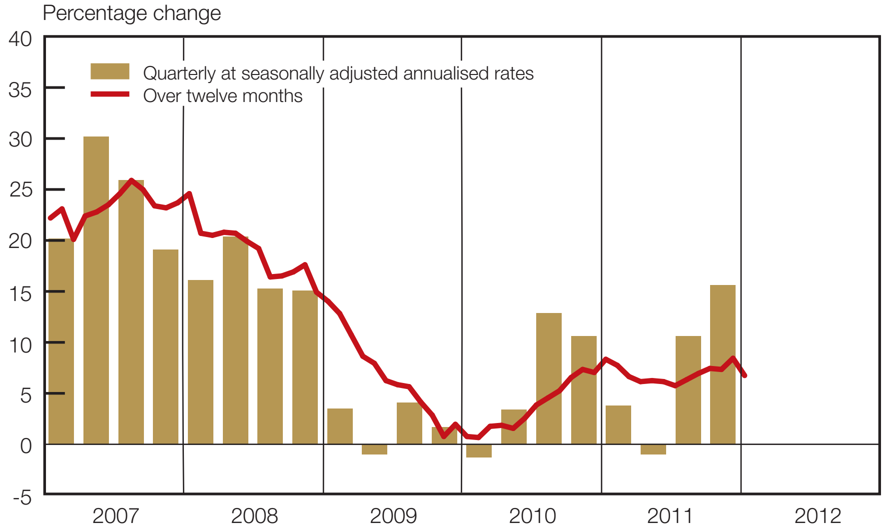
The average net daily turnover in the domestic market for foreign exchange decreased by 8,3 per cent from US$22,3 billion in the third quarter of 2011 to US$20,4 billion in the fourth quarter. This decrease was partly attributable to non-residents' participation in the swap market, which contracted from an average of US$8,2 billion per day to US$7,4 billion per day over the period.

Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) picked up in the second half of 2011, emulating the pattern in 2010 when weak growth in the first half of that year was also followed by stronger momentum in the second half. The slower growth in the money supply in the first half of 2011 mirrored the slowdown in domestic economic activity at that time, weighed down by global economic problems. The stronger M3 growth performance in the second half of 2011 partly reflected strong turnover and rising prices in the financial markets, improved production and expenditure, generally rising inflation, and an improvement in employment creation.

Growth in M3



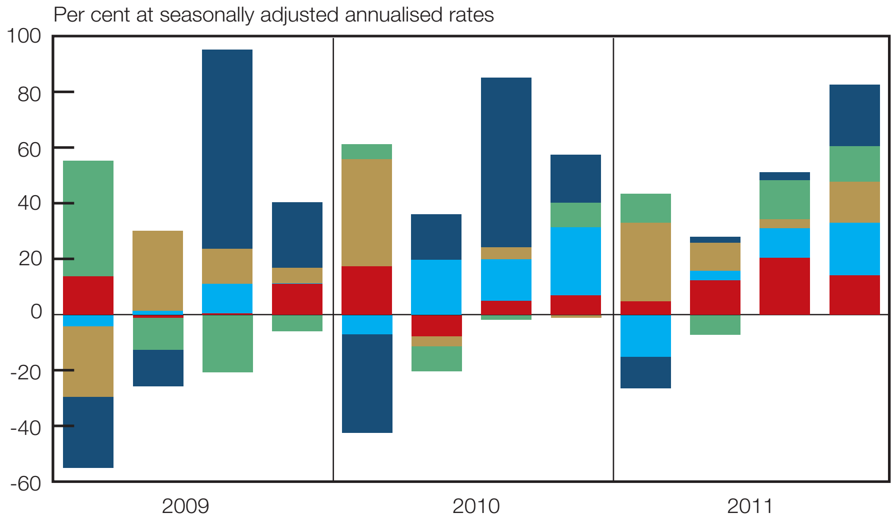
The year-on-year growth in M3 reached an eleven-month high of 8,3 per cent in December 2011, up from a recent low of 5,6 per cent in July 2011. Growth rates in excess of 10,0 per cent were last recorded in the first quarter of 2009 and an annual average growth rate of 6,8 per cent was realised in 2011 compared to 3,5 per cent in 2010. In January 2012, growth over twelve months moderated somewhat to 6,6 per cent.

The firm revival in M3 growth was also mirrored in the quarterly growth rates[5] of 9,3 per cent in the third quarter and 14,0 per cent in the fourth quarter of 2011. Such high growth rates were previously observed in the second half of 2010.

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

Analysed by maturity, the recovery in the demand for monetary assets in the second half of 2011 was broad-based. Notes and coin in circulation outside the monetary sector was the most important driver of monetary growth in the third quarter of 2011, but lost some momentum in the fourth quarter despite continuing to record double-digit growth. Following sluggish growth during the first three quarters of 2011, long-term deposits regained favour in the fourth quarter and became the dominant driver behind the overall increase in M3 during this period. The other M3 deposit categories also registered strong growth during the fourth quarter.

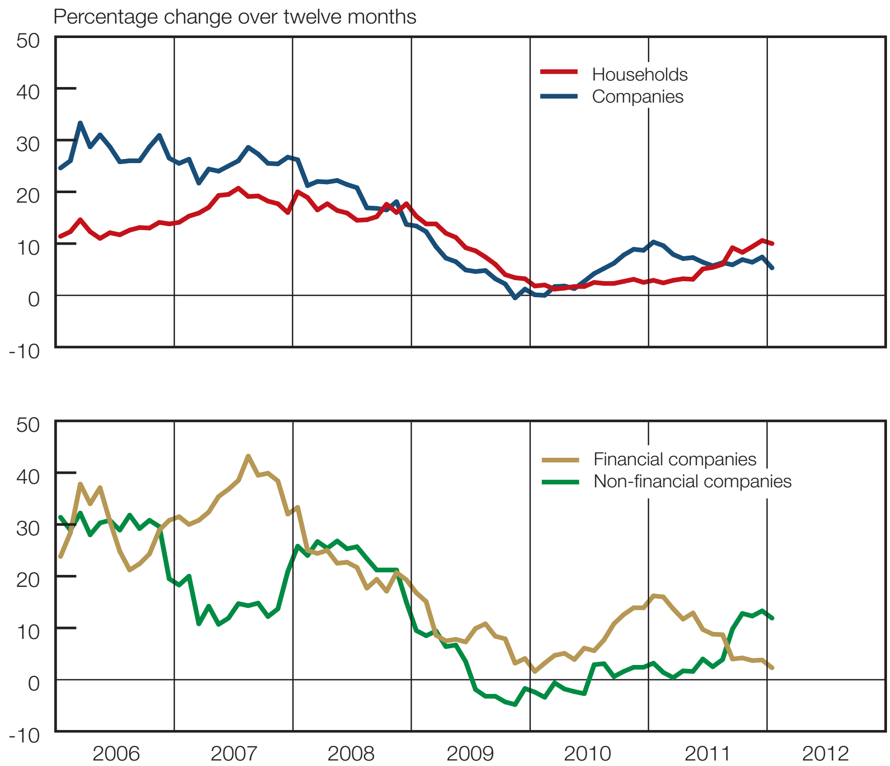
Maturity analysis of growth in M3



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

The overall increase in M3 amounted to R76,9 billion in the fourth quarter of 2011, only marginally higher than the R76,3 billion recorded in the third quarter. The cumulative growth in M3 deposits amounted to R172,2 billion in 2011, compared to R134,9 billion and R34,0 billion in 2010 and 2009 respectively. The corporate sector expanded its M3 deposit holdings by R60,0 billion in the fourth quarter, contributing 78 per cent to money supply growth during this period, while the household sector accounted for the balance of R16,8 billion or 22 per cent. Despite the healthy growth in corporate-sector deposits, year-on-year growth in M3 deposits of the household sector actually surpassed that of the corporate sector during the last four months of 2011.

M3 holdings of households and companies



Twelve-month growth in the M3 deposit holdings of the household sector accelerated to 10,6 per cent in December 2011, up from 6,0 per cent in August, while growth in deposits of the corporate sector improved only moderately from 6,3 per cent to 7,4 per cent over the same period. In January 2012 deposits by the household sector recorded year-on-year growth of 10,0 per cent, while that of the corporate sector rose by 5,3 per cent.

In the corporate sector, private non-financial institutions were the dominant contributors to growth in deposit holdings in the fourth quarter of 2011. This sector accounted for approximately 70 per cent of the overall increase in corporate sector deposits in 2011. By contrast, with low interest rates on deposits and prices of alternative asset classes rising, non-bank financial companies curtailed the growth in their M3 deposit holdings as the year progressed.

As in recent quarters, in an accounting sense the increase in M3 during the fourth quarter of 2011 could mainly be explained by the increase in banks' claims on the domestic private sector. The rise in M3 was further supported by increases in net other assets and liabilities, and net foreign assets. Net claims on the government sector contracted, primarily as a result of a significant increase in government deposits, aided by stronger corporate income tax collections.

Statistical counterparts of change in M3

R billions

	2011				
	1st qr	2nd qr	3rd qr	4th qr	Year
Net foreign assets	31,5	8,7	16,9	25,3	82,5
Net claims on the government sector	-37,0	-3,7	26,8	-12,9	-26,7
Claims on the private sector	10,2	20,4	60,6	37,0	128,2
Net other assets and liabilities	-2,9	-8,2	-28,1	27,4	-11,8
Total change in M3	1,8	17,2	76,3	76,9	172,2

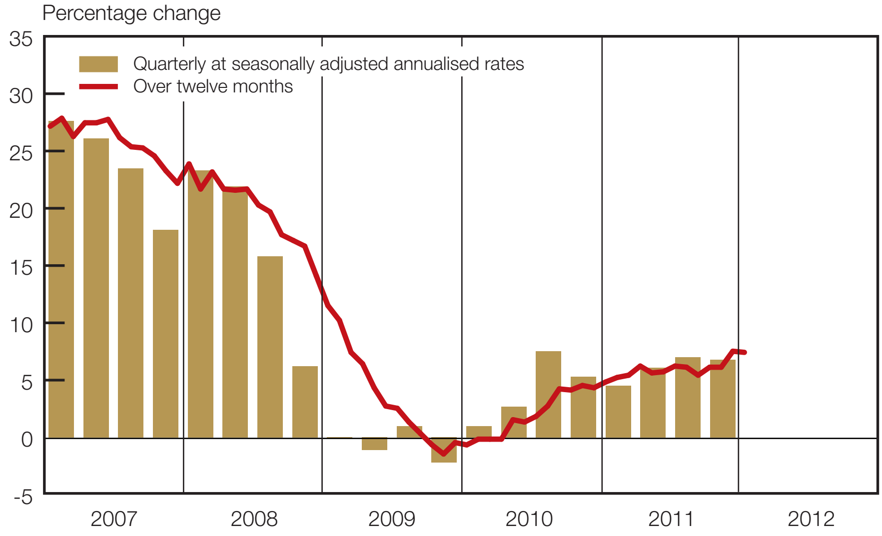
After displaying an uninterrupted upward trend from 1,33 in the third quarter of 2010 to 1,39 in the third quarter of 2011, the income velocity of circulation of M3 levelled out in the fourth quarter when the growth in M3 deposits matched the growth in nominal gross domestic product during the period.

Credit extension

Growth in banks' total loans and advances extended to the private sector remained fairly subdued during 2011, coinciding with the slow pace of expansion in domestic economic activity despite the lowest level of nominal interest rates in three decades. However, some signs of a pickup in credit extension became evident in the second half of 2011 when twelve-month growth in total loans and advances accelerated to 7,4 per cent in December, after it had fluctuated around 6 per cent for most of the preceding eight months. In January 2012, year-on-year growth in total loans and advances amounted to 7,3 per cent as vehicle finance and personal loans continued to support the demand for credit.

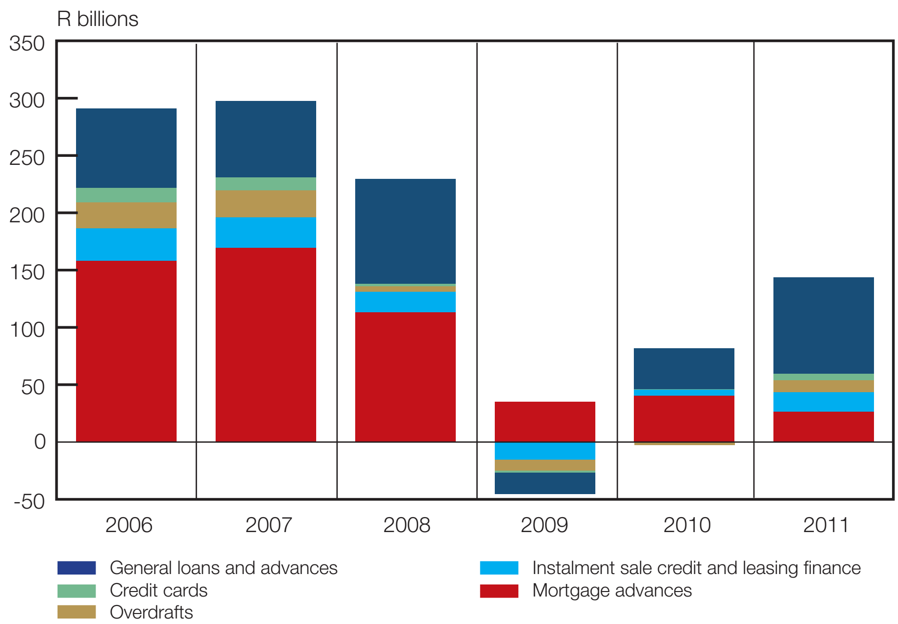
The quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances increased from 6,5 per cent in the third quarter of 2011 to 6,9 per cent in the fourth quarter. Despite the slow improvement in the growth rate, the rate of increase remained higher than in 2009 and the first half of 2010, suggesting that the revival in credit extension was developing momentum.

Total loans and advances to the private sector



Other loans and advances became the fastest-growing credit category in 2011, accounting for 70 per cent of the total increase in loans and advances for the year as a whole. Measured over twelve months, growth in other loans and advances, which consist of bank overdrafts, general loans and credit card advances, reached a three-year high of 15,3 per cent in December 2011. Robust growth in other loans and advances emanated from a strong uptake of general loans by the corporate and household sectors, buoyed by the active promotion of these types of loans by certain banks. In January 2012 year-on-year growth in other loans and advances moderated slightly to 14,9 per cent.

Growth in outstanding balance per credit extension category



Whereas mortgage advances traditionally constituted the bulk of activity in previous years, growth in this credit category waned in 2011. The period proceeding the 2009 recession was characterised by an extensive upswing in mortgage credit extension which contributed to oversupply in the property market. In that context, the subsequent disproportionate weakening in real-estate activity impacted negatively on growth in mortgage advances in the post-recession period. Mortgage advances, which constituted 57 per cent of the overall increase in total loans and advances in 2007, had a share of only 18 per cent in the overall increase in 2011, while general loans escalated from a share of 22 per cent to 59 per cent over the same period. From a post-2009 peak of 4,8 per cent in November 2010, growth over twelve months in mortgage advances receded to 1,9 per cent in August 2011 – the lowest growth in recorded history. The growth rate then picked up moderately to 2,4 per cent in January 2012.

Quarterly changes in banks' total loans and advances by type

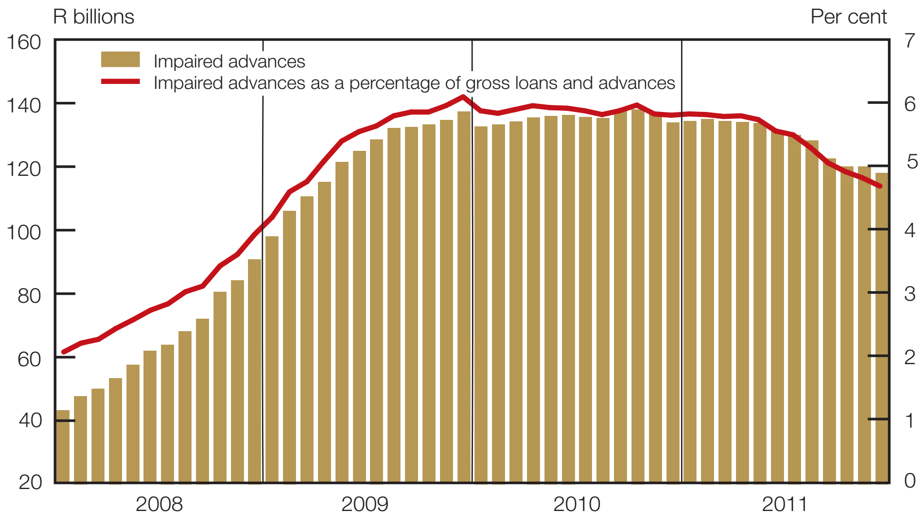
R billions

	2011			
	1st qr	2nd qr	3rd qr	4th qr
Mortgage advances	3,6	11,3	7,3	4,1
Instalment sale credit and leasing finance	3,9	3,2	1,8	8,0
Other loans and advances	27,3	5,1	35,2	32,6
Overdrafts	3,6	0,7	0,4	6,0
Credit card advances	1,1	1,5	1,1	1,8
General advances	22,5	2,9	33,7	24,9
Total loans and advances	**34,8**	**19,6**	**44,3**	**44,7**
Of which: To household sector	26,4	12,4	9,0	27,6
To corporate sector	8,4	7,2	35,3	17,1

Twelve-month growth in *instalment sale credit and leasing finance* continued its upward trend during 2011 to end the year at 7,0 per cent. Growth in instalment sale credit continued to benefit from lively consumer demand for motor vehicles in an environment of low interest rates. In January 2012 growth in the combined instalment sale and leasing finance credit category came to 7,2 per cent, the highest growth rate since December 2008.

Bank credit extended to the household sector outperformed that to the corporate sector during the fourth quarter of 2011. Consequently, out of the overall increase of R143,4 billion in total loans and advances to the private sector in 2011, R75,4 billion was extended to the household sector and R68,0 billion to the corporate sector. Measured over twelve months, growth in total loans and advances to the corporate sector picked up from 0,9 per cent in January 2011 to 8,7 per cent in January 2012. By contrast, twelve-month growth in credit extension to households initially receded from 7,8 per cent in January 2011 to 5,5 per cent in September, before recovering to 6,8 per cent in December and 6,1 per cent in January 2012. Historically, a major part of the credit extended to households constituted mortgage advances.

Impaired advances

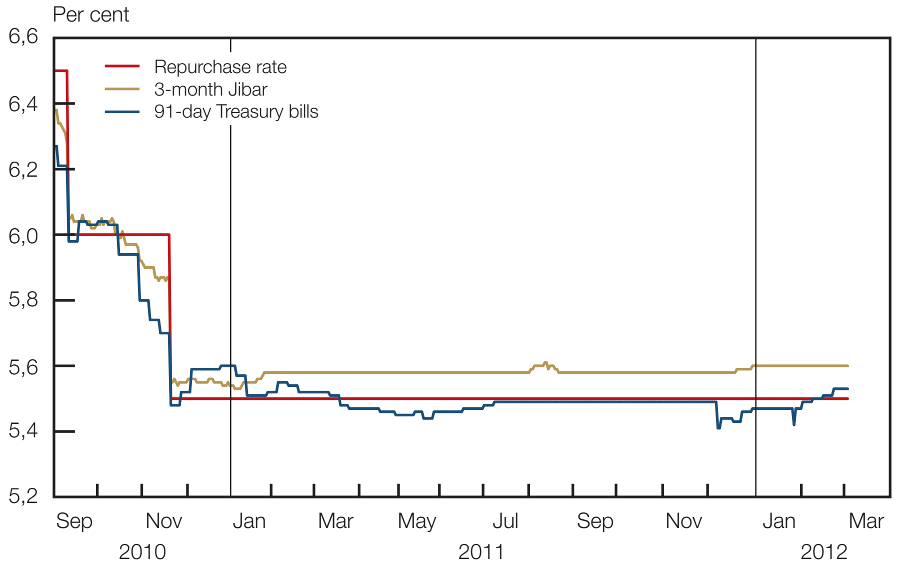


The moderate growth in credit extension with banks focused on quality lending, together with the low interest rate environment and high wage increases contributed to an improving trend in impaired advances in 2011. Write-offs and other re-structuring initiatives undertaken by banks also contributed to the first significant improvement in impaired advances since the start of the financial crisis in 2008.

Interest rates and yields

The Monetary Policy Committee (MPC) maintained an unchanged monetary policy stance at all its meetings in 2011 as the risk of contagion from the euro area sovereign debt crisis persisted, negatively affecting the domestic growth outlook and softening the risks to the inflation outlook somewhat. The policy stance was again kept unchanged at the January 2012 meeting; while inflation was projected to remain marginally above the upper end of the target range for the whole of 2012, it would return to within the target range in the first quarter of 2013. The MPC statement discussing developments underlying recent monetary policy decisions is reproduced in full on page 68 of this *Quarterly Bulletin*.

Money-market rates

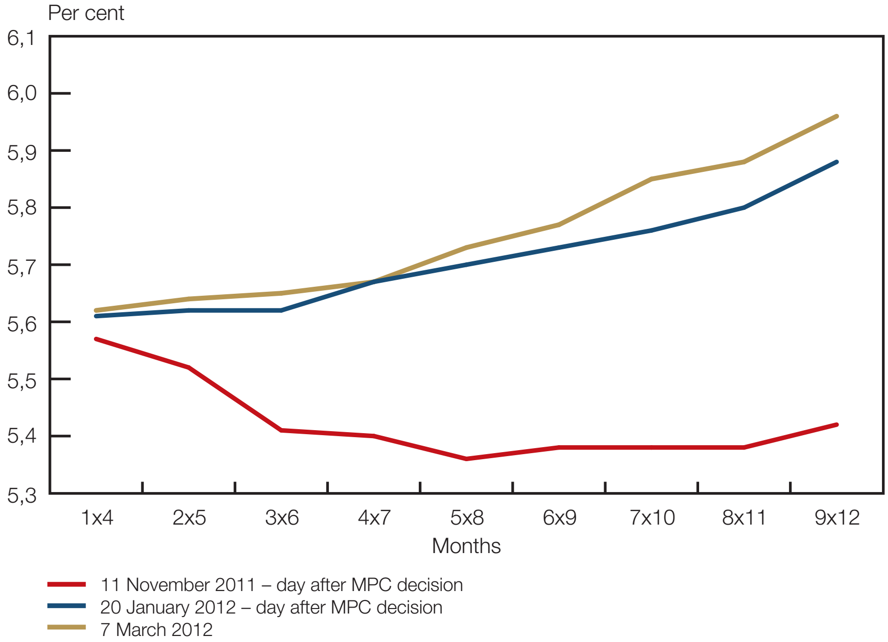


Alongside the unchanged repurchase rate, money-market interest rates also displayed limited fluctuations during the fourth quarter of 2011. After having remained essentially unchanged at about 5,58 per cent for most of the year, the three-month Johannesburg Interbank Agreed Rate (Jibar) edged slightly higher towards the end of December 2011 and remained at 5,60 per cent in the subsequent period to 7 March 2012.

The tender rate on 91-day Treasury bills remained virtually unchanged at 5,49 per cent for most of the fourth quarter of 2011, but fell back to a record-low of 5,41 per cent on 7 December 2011, partly reflecting heightened demand for short-term government paper during this period. Thereafter, the rate edged higher to around 5,53 per cent in the first week of March 2012.

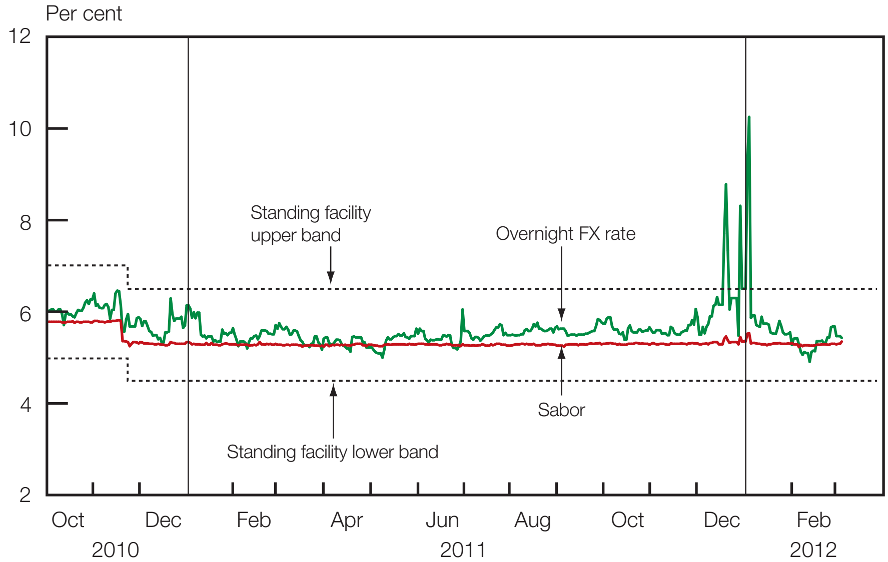
Forward rate agreements (FRAs), on balance, edged higher during the fourth quarter of 2011, adding a premium for rising domestic inflation and the depreciation in the exchange rate of the rand. The 6x9-month FRA rate reached a recent low of 5,12 per cent on 8 November 2011 before fluctuating higher to 5,74 per cent on 20 January 2012. Subsequently, the rate levelled out to mid-February before increasing to 5,77 per cent on 7 March as expectations were shaped by factors such as fluctuations in the exchange value of the rand. Since the monetary policy meeting held in November 2011, the FRA yield curve has shifted higher across all maturities as market players saw little further prospects of additional policy accommodation in 2012.

Forward rate agreement yield curves following recent MPC decisions



Funding conditions in the South African overnight interbank market remained largely accommodative during the fourth quarter of 2011. However, some liquidity strains were experienced towards the end of the year due to typical seasonal demand. The implied rate on one-day rand funding in the foreign-exchange market (overnight FX rate) displayed high volatility between 20 December 2011 and 4 January 2012, and breached the upper end of the standing facility band of 6,50 per cent on numerous occasions. However, liquidity conditions quickly normalised in the new year with the overnight foreign-exchange rate decreasing to well within the standing facility ranges. On 7 March 2012 the rate stood at 5,43 per cent.

Benchmark overnight rates

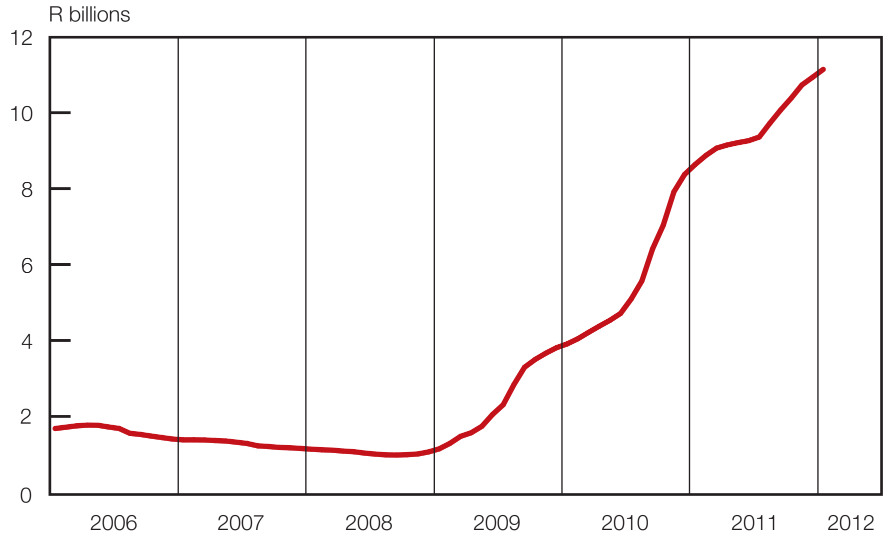


The South African Benchmark Overnight Rate on Deposits (Sabor) held steady in 2011 with mild fluctuations towards year-end, not least due to currency fluctuations. The rate reverted to its previous levels in January 2012 and stood at 5,28 per cent on 7 March.

The prime overdraft rate and the predominant rate on mortgage loans have remained unchanged at 9,00 per cent since the 50 basis point reduction in November 2010.

Interest rates in the bond market were consistent with a subdued economic environment. Interest rates on the *RSA government fixed-rate retail bonds* were last reset in September 2011 with a 25 basis point cut across all maturities, ranging between 7,25 per cent and 8,00 per cent. Although the amount in issue of all retail bonds increased sturdily by 31 per cent in 2011, growth was slower than the marked 120 per cent increase in 2010.

Amount in issue of South African retail bonds



From a recent low of 6,29 per cent on 6 September 2011, the daily average *yield on the R157 government bond* (maturing in 2014/15/16) increased to 7,09 cent on 25 November, mainly as a result of the depreciation in the exchange value of the rand and the release of higher-than-expected inflation data. The bond yield then fluctuated lower to 6,72 per cent on 7 March 2012 in response to the appreciation in the exchange value of the rand, firm demand for local bonds by non-residents, the release of lower-than-expected inflation data and weak economic data, which reduced expectations of a possible repurchase rate increase. This resulted in lower break-even inflation rates across all maturities thus far in 2012, as the real yield on inflation-linked bonds declined to a lesser extent than the nominal yield. Given the generally downward trend of the nominal yield on domestic rand-denominated bonds, the *currency risk premium*[6] on South African government bonds narrowed from 546 basis points in July 2011 to 435 basis points in October. Subsequently, the premium widened to 489 basis points in February 2012, amplified by the decline in the yield on foreign currency-denominated South African bonds.

The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[7] yield spread above US government bonds narrowed from 422 basis points in September 2011 to 334 basis points in February 2012 as investor confidence in the capital markets of emerging markets improved. Similarly, the *sovereign risk premium* on South African government US dollar-denominated bonds in the two-year maturity range trading in international markets decreased from 182 basis points in November 2011 to 136 basis points in February 2012.

Credit ratings and bond yields are explained in more detail in Box 3 on page 45.

6 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 two-to-three-year maturity range.

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

Box 3: Credit ratings and bond yields

A number of credit rating agencies specialise in the evaluation of the credit risk attached to sovereign and corporate debt obligations. The table accompanying this box shows how the market yields on United States (US) dollar-denominated government bonds issued by a selection of countries vary, along with the sovereign credit ratings of each of those countries as rated by Moody's, a prominent rating agency. Bonds rated Baa or higher are classified as "investment grade", while bonds rated below that level are classified as "sub-investment grade" or "speculative grade", colloquially sometimes referred to as "junk bonds".

Apart from credit risk, bond yields are also influenced by a variety of factors, such as the liquidity of the bond and country-specific factors. The relationship between yields and sovereign credit ratings is therefore not purely linear, but is characterised by some outliers, as illustrated by Italy which is classified among the A3 bonds (see table). Nevertheless, it would appear that moving from the highest rating (Aaa) to the lowest rating that is still regarded as investment grade (Baa3) would roughly involve an additional 3 to 5 percentage points in annual yield. As may be expected, yields on bonds within the lowest sub-investment grade categories are very high.

A selection of yields on US dollar-denominated sovereign bonds, 7 March 2012

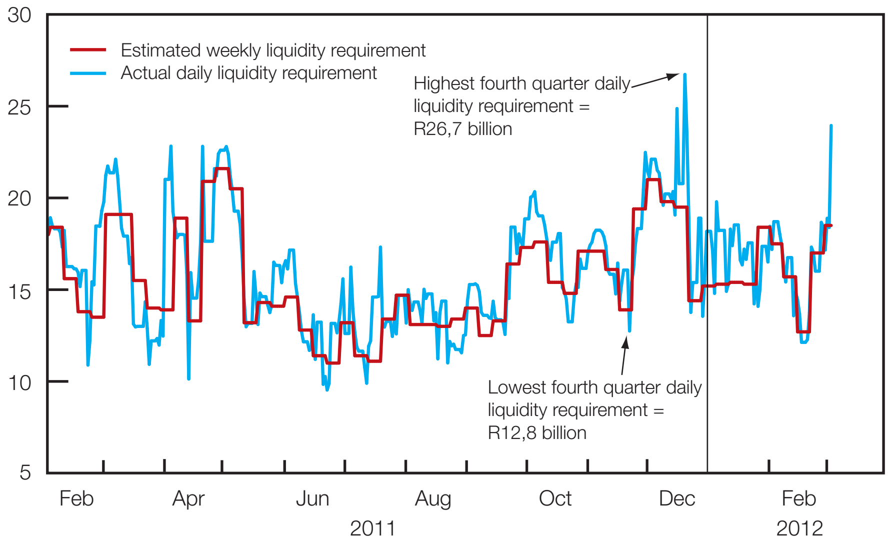
Country	Bond yield (Per cent*)	Moody's rating	Rating explanation	
United States	1,96	Aaa	Aaa: Highest quality, with minimal credit risk	Investment grade
Chile	2,92	Aa3	Aa: High quality and subject to very low credit risk	
Poland	4,18	A2	A: Upper-medium grade and subject to low credit risk	
Malaysia	3,54	A3		
South Africa	**3,86**	**A3**		
Italy	6,15	A3		
Mexico	3,36	Baa1	Baa: Subject to moderate credit risk – medium grade, may possess certain speculative characteristics	
Russia	3,92	Baa1		
Brazil	3,09	Baa2		
Colombia	3,21	Baa3		
Namibia	5,01	Baa3		
Latvia	5,40	Baa3		
Romania	6,15	Baa3		
Barbados	6,85	Baa3		
Turkey	5,20	Ba2	Ba: Have speculative elements, subject to substantial credit risk	Sub-investment grade
Georgia	6,36	Ba3		
Sri Lanka	6,55	B1	B: Speculative and subject to high credit risk	
Dominican Republic	7,03	B1		
Senegal	8,23	B1		
Ukraine	9,49	B2		
Venezuela	11,79	B2		
Belize	18,58	Caa1	Caa: Of poor standing and subject to very high credit risk	
Argentina	34,61	Ca	Ca: Highly speculative and likely in, or very near, default, with some prospect of recovery of principal and interest	
Greece**	113,21	C	C: Lowest-rated class, typically in default, with little prospect for recovery of principal or interest	

* Rates on US dollar-denominated bonds in the 8 to 17 years maturity range
** Greece only has a US dollar-denominated bond with a one-year remaining maturity
Source: Bloomberg, Moody's and South African Reserve Bank

Money market

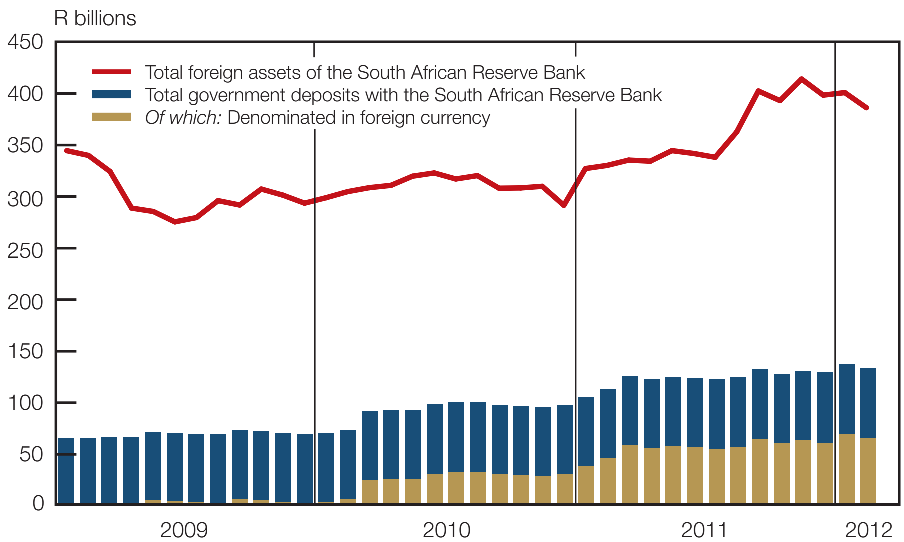
Money-market liquidity conditions registered notable variation during the fourth quarter of 2011. The actual daily liquidity requirement of private-sector banks intermittently breached the estimated liquidity requirement and varied within a broad range between R12,8 billion and R26,7 billion, compared to a narrower range between R9,9 billion and R18,9 billion recorded during the third quarter of 2011. Moderate fluctuations in liquidity were evident thereafter up to early March 2012.

Liquidity requirement



During the final quarter of 2011, the money market, on balance, experienced a net injection of liquidity amounting to R0,5 billion. Notes and coin in circulation, alongside minor amounts of required cash reserve deposits and reverse repurchase transactions, drained liquidity to the value of R17,5 billion. The drainage was mainly neutralised by allowing SARB debentures to mature along with a decrease in government deposits with the Bank, which jointly injected liquidity amounting to R14,5 billion.

Foreign reserves and government deposits



Government deposits with the Bank decreased by R3,1 billion in the fourth quarter of 2011, mainly attributable to a decrease of R3,4 billion in foreign currency-denominated deposits which counteracted a modest R0,3 billion increase in domestic currency-denominated deposits. Government deposits again increased by R4,5 billion in the two months to February 2012, mainly as a result of an increase in foreign currency-denominated deposits as the proceeds of the recent US$ 1,5 billion international government bond issue was placed with the Bank.

Money-market liquidity flows

R billions (easing + tightening –)

Item	2011	
	Jul–Sep	Oct–Dec
Notes and coin in circulation	-5,0	-15,4
Required cash reserve deposits	-1,9	-0,5
Money-market effect of SARB* foreign-exchange transactions	1,8	0,1
Government deposits with the SARB	-8,3	3,1
Use of liquidity management instruments	1,2	9,8
Reverse repurchase transactions	-0,7	-1,6
SARB debentures	1,9	11,4
Other items net	9,5	3,4
Banks' liquidity requirement (decrease + increase –)	**-2,7**	**0,5**

* SARB: South African Reserve Bank

In January 2012 the Bank announced further refinements to its monetary policy operational procedures to complement the changes made in August 2010 and March 2011. The changes, effective from 1 March 2012, enhance the effectiveness of the Bank's open-market operations and include the following:

– In instances where the weekly main repurchase auction is over-subscribed a pro rata allocation of the amounts tendered by banks will be made, up to the announced average daily liquidity requirement for the week

– Two- and five-day main repurchase transactions will be implemented during the week of the MPC meetings to address the lack of synchronisation between the Bank's main repurchase auctions and the interest rate announcements of the MPC

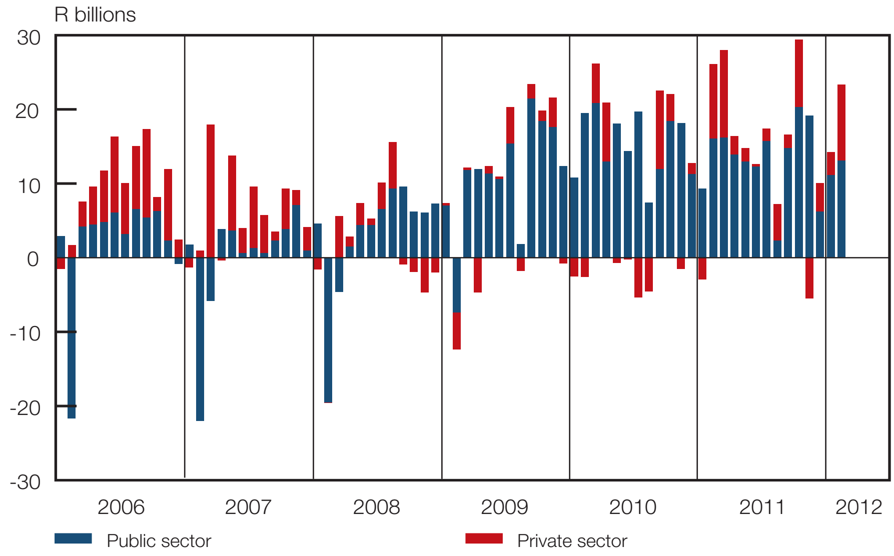
– Seven and fourteen-day maturities on SARB debentures and reverse repurchase transactions will also become available, in addition to the 28- and 56-day maturities currently on offer.

Coupon interest payments on various government bonds amounting to R13,9 billion were paid out from the government tax and loan account during the fourth quarter of 2011. In the first two months of 2012 coupon interest payments amounted to R1,7 billion. No redemption payments fell due during this period.

Bond market

Activity in the bond market remained brisk in 2011. After robust net issues of R196 billion in 2010, net issuances (including commercial paper) in the *primary bond market* reached an annual record high of R200 billion in 2011. This consisted of net issues by the public sector of R159 billion, R39 billion by the private sector and R2 billion by non-residents. The total outstanding nominal value of debt securities listed on the JSE Limited (JSE) increased further by R34,4 billion in the first two months of 2012 to reach R1,4 trillion at the end of February 2012. The bulk of the issuances on the JSE were fixed-rate coupon instruments accounting for 71 per cent, followed by inflation-linked bonds at 14 per cent and floating rate notes at 12 per cent of the total. The general demand for bonds, particularly government bonds, generally continues to cover issuance by a sound margin with bid-to-cover ratios well above 2,5 times.

Funding in the primary bond market



National government also raised R12,0 billion in the international markets during January 2012, when National Treasury issued a US$1,5 billion 12-year bond with a coupon rate of 4,665 per cent at a spread of 270 basis points over equivalent US Treasuries.

In 2011, turnover in the *secondary bond market* of R22,9 trillion or on average R90,8 billion per trading day was 23 per cent higher than the value traded in 2010, alongside higher volumes traded and, on average, higher bond prices. More than half of this turnover was generated by the banking sector, followed by other financial institutions at 29 per cent, as shown in the accompanying table. Non-residents also made a meaningful contribution to turnover and liquidity. Total liquidity[8] in the bond market increased from a ratio of 14 times per annum in 2010 to 15 in 2011. In the first two months of 2012 the annualised liquidity ratio remained at 15, with daily average turnover amounting to R93,3 billion.

8 The nominal value of bonds traded relative to the nominal amount in issue, in times traded per annum.

Turnover in the secondary bond market across sectors, 2011

Sector	Share (Per cent)
Non-residents	12
Monetary authority	3
Banks	54
Other financial institutions	29
Public non-financial corporate sector	2
Total	100

Despite the eurozone debt crisis, issuances in the *European and Uridashi bond markets* were almost in equal proportions in 2011. The nominal value of rand-denominated bonds issued totalled R35,9 billion in 2011, which was 45 per cent higher than the R24,8 billion issued during 2010. This, together with lower redemptions, contributed to net issues of R20,0 billion in both markets during 2011, compared with net redemptions of R23,0 billion in 2010. Issuer interest in rand-denominated bonds continued in 2012, but together with high scheduled redemptions net redemptions of R1,5 billion were recorded in the two months to February. The continued growth in these markets is another indication of the demand for local instruments.

Non-resident investors' quest for higher yields were precipitated by a series of debt problems in major economies, compounded by the protracted recovery from the previous financial downturn, which prompted lower interest rates globally. The South African bond market continued to benefit under these circumstances, due to the country's relatively low sovereign debt burden and attractive nominal yield differential. Accordingly, substantial foreign net buying has been recorded since 2010. After net accumulation of local debt securities to the value of R42,0 billion in 2011 – which followed record annual high net purchases of R52,0 billion in 2010 – non-residents increased their bond portfolio by a further R11,4 billion during the first two months of 2012. Their trading activity, measured as their purchases and sales as a percentage of the total value of bonds traded on the JSE, amounted to 13 per cent in 2010 and 12 per cent in 2011.

Share market

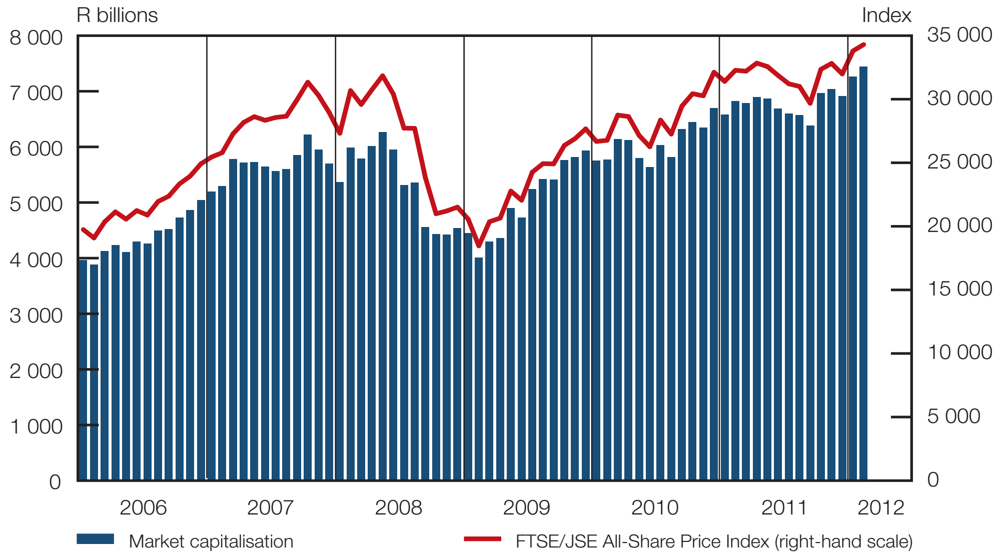
Overall, the JSE performed well as it continued to attract healthy levels of new capital during 2011. Despite the volatility in the equity market, the value of *equity capital raised* of R87,5 billion in 2011 outstripped the equity funding of R80,9 billion in 2010 by 8 per cent. The share in the total capital-raising activity contributed by companies with primary listings on the JSE has improved markedly since 2009, when a share of 53 per cent was recorded. This may be compared with a level of 72 per cent in 2010 and 71 per cent in 2011. The financial sector was the main contributor to the capital-raising activity in 2011 at 41 per cent, followed by the industrial and the resources sectors' contributions of 31 per cent and 25 per cent respectively. Equity financing amounted to R8,7 billion in the first two months of 2012.

The total *number of companies listed* on the JSE at the end of 2011 amounted to 406, with 16 new listings and 17 delistings recorded during 2011, compared with the 14 new listings and 17 delistings recorded in 2010. Total listings on the Alternative Exchange, Alt^{X}, came to 66 at the end of 2011, while 332 companies were listed on the main board; 3 each on the venture and development capital boards, and 2 listings on the Africa board. In January and February 2012 there were no new listings and 5 delistings.

Higher share prices contributed to a 10 per cent increase in total *turnover* in the secondary share market, rising from R3,0 trillion in 2010 to R3,3 trillion recorded in 2011. Daily turnover averaged R13,1 billion in 2011 – the highest daily average for any calendar year – before increasing further to R13,5 billion in the first two months of 2012. The total *market capitalisation* on the JSE increased by 17 per cent from R6,4 trillion in September 2011 to an all-time high of R7,4 trillion in February 2012, in line with unsurpassed high share prices. Market liquidity[9] increased from 45 per cent in 2010 to 48 per cent in 2011, still much lower than the 72 per cent recorded in 2008, when share prices previously reached record-high levels.

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

Market capitalisation and share prices on the JSE Limited



Non-residents' negative sentiment towards the local share market continued to reflect nervousness surrounding financial markets, slower economic growth and a preference for flight to the familiarity of their home markets. Non-residents' net selling of domestic listed shares to the value of R17,2 billion in 2011 were followed by further net sales of R7,9 billion during the first two months of 2012. Despite declining slightly from 16 per cent in 2010, their trading activity on the domestic secondary share market remained strong at 14 per cent of total turnover in 2011.

Domestic share prices soared to all-time-high levels in early 2012 along with a decline in risk aversion. The *FTSE/JSE All-Share Price Index (Alsi)* breached the 34 000 level as it increased by 21 per cent from 8 August 2011 to an all-time high of 34 387 index points on 3 February 2012 – this was 3 per cent higher than the previous record high on 22 May 2008. The Alsi was bolstered by expectations of a solution to the eurozone sovereign debt crisis, higher international equity markets and higher commodity prices, among other factors. Thereafter the Alsi subsided marginally by 2 per cent to 7 March. The Alsi, in US dollar terms, increased by 7 per cent from 8 August 2011 to 7 March 2012, while the Standard and Poor's (S&P) 500 Composite Index increased by 21 per cent over the same period.

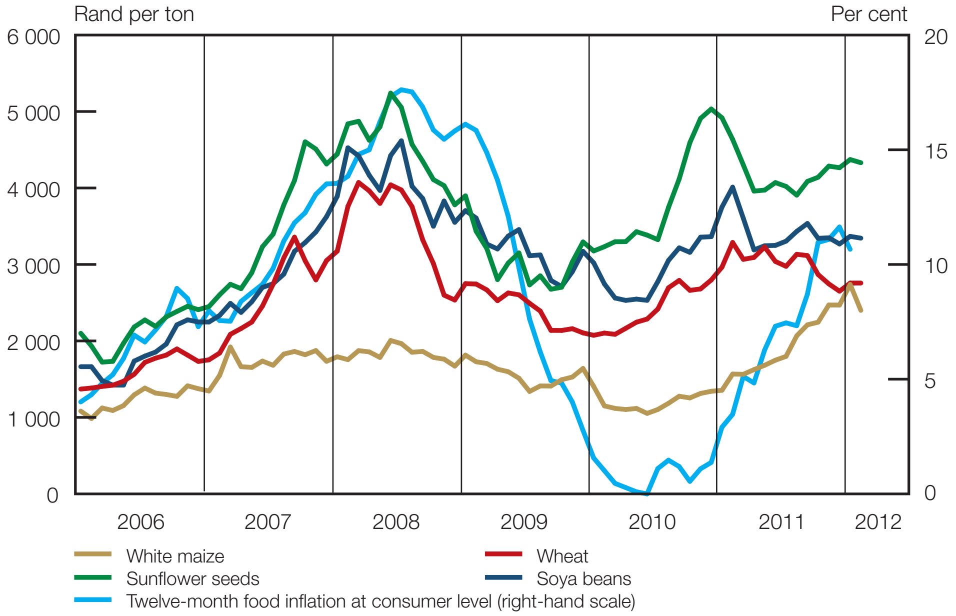
The historical *dividend yield* on all classes of shares declined from 2,9 per cent in August 2011 to 2,8 per cent in February 2012, while the *earnings yield* receded from 7,7 per cent to 7,2 per cent over the same period; both declines were incited by the more pronounced increase in share prices than in earnings and dividends declared. Conversely, the *price-earnings ratio* for all classes of shares increased from 12,9 in August 2011 to 14,0 in February 2012.

Market for exchange-traded derivatives

Despite the lower number of *equity derivative contracts* traded on the Equity Derivatives Division (EDD) of the JSE, turnover on the EDD was 19 per cent higher in 2011 compared with 2010, in line with higher average prices recorded in the underlying equity market. The number of equity contracts traded during the first two months of 2012 was more than those traded during the same period of 2011, thus contributing to higher turnover.

Slower global economic growth did little to dampen the increase in domestic agricultural commodity prices trading on the Commodity Derivatives Division (CDD) of the JSE during 2011. The rise in local agricultural commodity prices was due mainly to higher international oil and grain prices, and supply disruptions related to unfavourable weather conditions. This increase continued to feed through to food inflation. In the first two months of 2012 trading activity on the CDD of 454 thousand *commodity futures and options contracts* was 9 per cent higher than during the same period of 2011.

Agricultural commodity prices and food inflation



The number of contracts traded on *Yield-X*, the interest rate and currency derivatives market of the JSE, increased to an all-time annual high of 15,1 million contracts in 2011. The increase in trade was more pronounced in currency futures and options contracts, amid elevated volatility in the foreign-exchange markets. To increase flexibility and enable diversified trading strategies for participants, the JSE introduced various currency exchange-traded products in this market during 2011. Investors' uncertainty regarding developments in the interest rate market engendered increased hedging activity as reflected in a 54 per cent increase in the number of contracts traded in 2011 compared with 2010. Total trading remained brisk at 2,0 million contracts in the first two months of 2012.

In line with the lower average number of *warrants* listed and traded, turnover decreased by 18 per cent in 2011 compared with 2010. The volume of warrants traded amounted to 0,9 billion in the first two months of 2012. Turnover in all derivatives traded on the JSE during the first two months of 2012 is indicated in the table below.

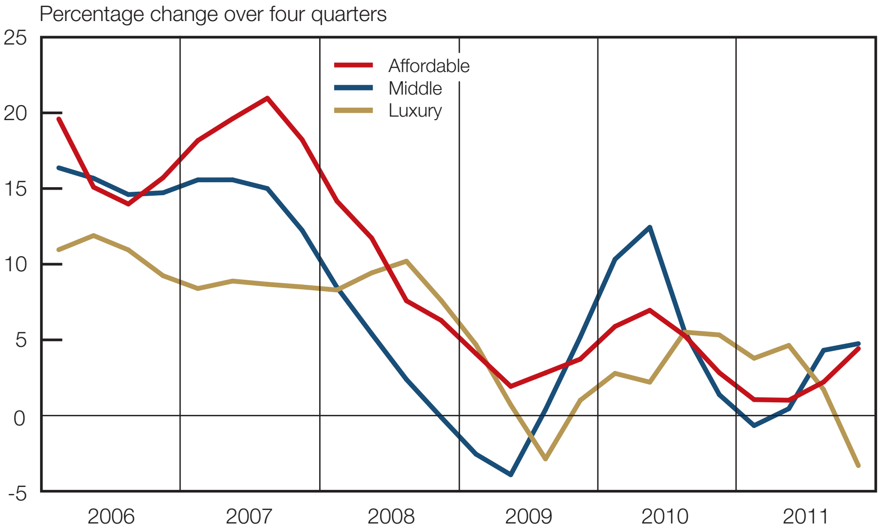
Derivatives turnover on the JSE, January to February 2012

Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity futures and options on futures	480	3
Warrants	0,2	-2
Commodity futures and options	72	34
Interest rate and currency derivatives	68	9

Real-estate market

Against the background of households' financial pressures, sluggish economic activity and the absence of further stimulus from interest rate reductions, growth in house prices remained subdued in 2011 and early 2012. The luxury segment of the market was the worst performer, compared with restrained increases in the affordable and middle segments in 2011. The average time residential properties remained on the market increased to 17,6 weeks in the fourth quarter of 2011.

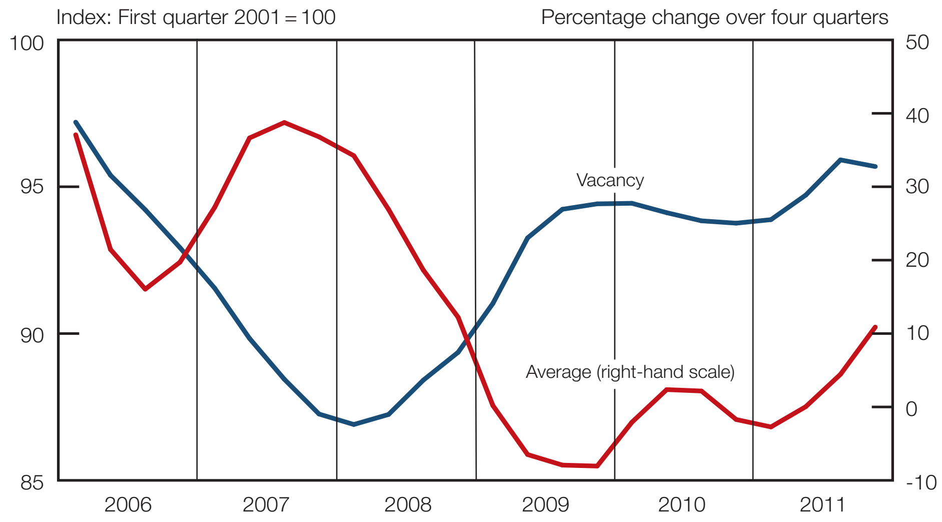
House price changes by market segment



Source: Absa

The commercial property market, which includes retail, industrial and office space, also showed signs of strain. Vacancy rates increased during 2011, signalling further price pressures in this segment of the market.

Commercial real-estate market



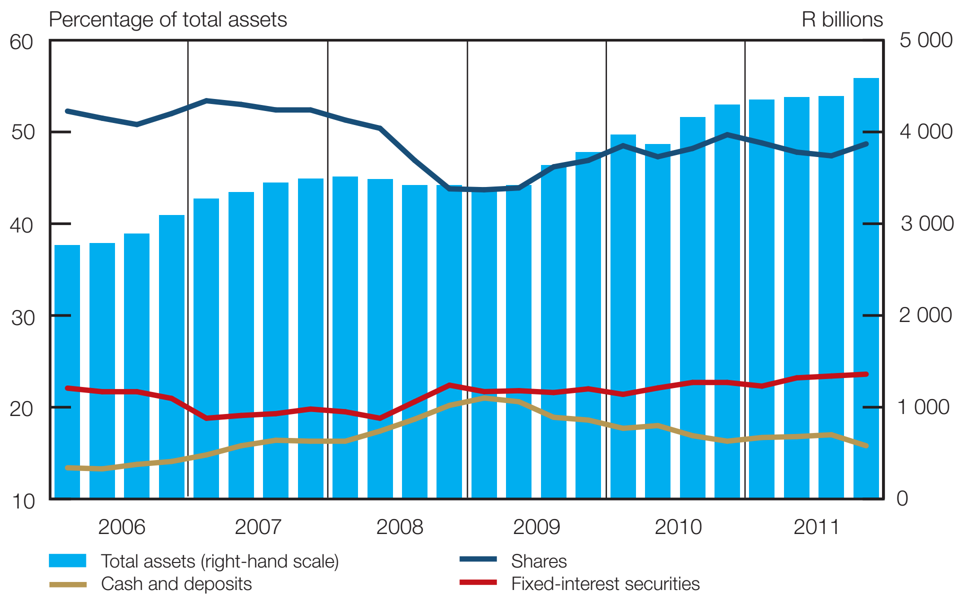
Source: First National Bank

Non-bank financial intermediaries

10 Consisting of insurers, pension and provident funds and unit trusts.

The impact of unfavourable market conditions on non-bank financial institutions[10] was reflected in a shift from riskier assets to conservative investment classes and in a lower level of inflows in 2011. Nevertheless, the balance sheet of these intermediaries grew noticeably by 7 per cent over the year from December 2010 to reach R4,6 trillion in December 2011.

Asset holdings of selected non-bank financial intermediaries



Holdings of ordinary shares as a percentage of total assets declined in the first three quarters of 2011 against the backdrop of lower share prices and an uncertain economic environment, before rebounding to 49 per cent in the fourth quarter as share prices picked up. Holdings of fixed-interest securities by non-bank financial intermediaries grew at a moderate pace in 2011, increasing its share in total assets to around 24 per cent in the fourth quarter. Investment in bonds issued by state-owned enterprises fell slightly to 15 per cent of total fixed-interest securities over the same period, along with a moderation in domestic issuances by these corporations. The growth in the balance sheets of non-bank financial institutions may have positive spin-off effects on the financial position of households through positive wealth effects.

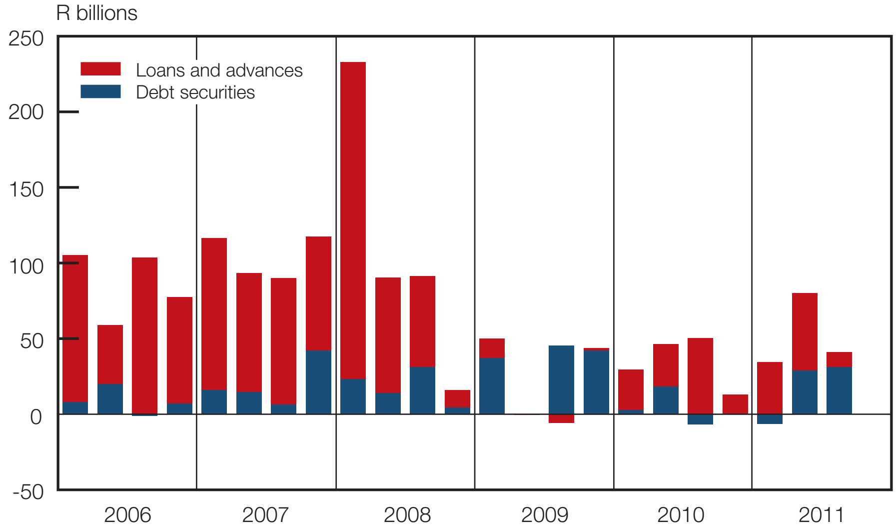
Inflows to non-bank financial intermediaries were somewhat subdued in 2011, which reflected the high unemployment rate and moderation in the disposable income of households. This was particularly evident in the unit trust industry, where net sales of units almost halved from 2010 to R44,4 billion in 2011 – the lowest since 2004.

Flow of funds

Notwithstanding the lingering concerns about sovereign debt conditions in the eurozone, market volatility, capital flight from emerging-market assets and negative global economic growth outlook, inflows from non-residents into the domestic economy continued in the third quarter of 2011. The *foreign sector* increased its funding to the domestic economy largely by extending loans to both banks and non-bank private businesses and by acquiring debt securities. Over the same quarter, the total flow from the sector into the domestic economy amounted to R22,3 billion, contributing to a total cumulative amount of R132 billion in the first three quarters of 2011.

The level of financial intermediation through the use of debt securities increased by 7 per cent from R29,1 billion recorded in the second quarter of 2011 against the backdrop of lacklustre global economic activity, weaker business confidence and protracted debt problems in Europe. By contrast, the *financial intermediaries sector* recorded a lower flow of R10,0 billion in total loans and advances, as households and companies held back on their credit acquisition during the third quarter of 2011. Mortgage loans extended, for example, declined by 44 per cent in the third quarter of 2011 from R20,9 billion recorded a quarter earlier. The intermediaries recorded flows amounting to R249 billion in the third quarter of 2011, bringing the sector's total flows to R486 billion for the first three quarters of 2011, a 22 per cent increase over the same period earlier.

Financial intermediaries'* lending by instrument type

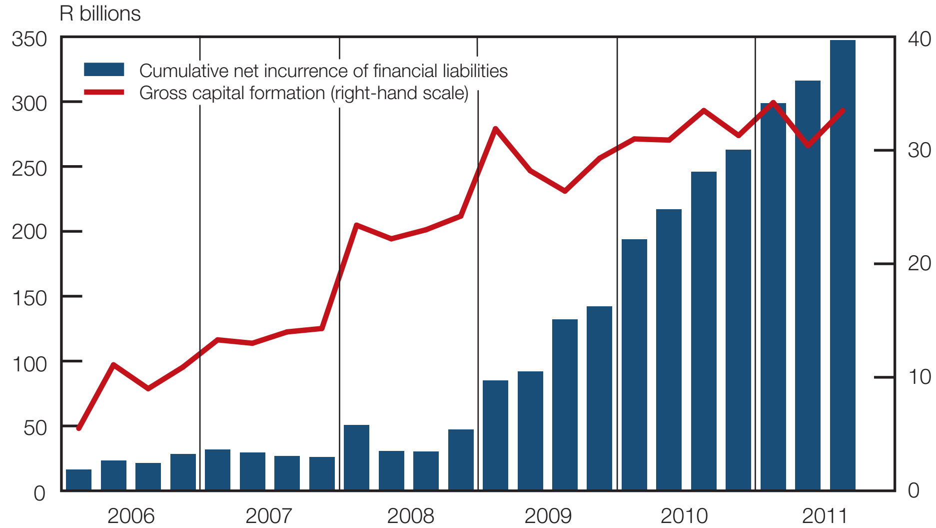


* Financial intermediaries relate to both bank and non-bank institutions

The *general government sector* incurred a deficit of R60,4 billion in the third quarter of 2011, of which R31,9 billion was financed in the domestic market through the issuance of long-term government bonds, Treasury bills and municipal bonds. Insurers and pension funds acquired the bulk of the bonds, while the Treasury bills were mainly taken up by banks. Third-quarter government funding exceeded the amount recorded a quarter earlier, as government increased its gross capital spending by 4 per cent to R20,7 billion in order to improve public services.

Collectively, *corporate business enterprises* undertook gross capital spending to the amount of R109 billion during the third quarter of 2011. Public corporations acquired long-term loans amounting to R26,9 billion during the quarter, bringing their cummulative net incurrence of liabilities to R347 billion. These enterprises also used their own funds amounting to R4,6 billion to supplement proceeds from loan acquisition to fund the economy's infrastructural needs. Their capital expenditure amounted to R33,5 billion in the third quarter of 2011 as large capital projects made progress.

Public enterprises' funding and capital formation



Similarly, private-sector companies incurred gross capital spending of R75,9 billion during the third quarter, financed mainly by acquiring mortgage loans, bank loans and advances; and other loan stock and preference shares.

During the third quarter of 2011, the low levels of household-sector borrowing were mirrored in household consumption activity. The sector's borrowing was made up of R8,3 billion in loans and advances; and R3,3 billion in mortgage loans. This uninspiring level of activity was caused by, among other things, continued fragility of household balance sheets.

Public finance

Non-financial public-sector borrowing requirement[11]

The financial activities of the *non-financial public sector* resulted in a cash deficit of R32,4 billion in the October–December quarter of 2011, compared with a cash deficit of R44,7 billion in the same period a year earlier. This brought the cash deficit of the non-financial public sector in April–December 2011 to R152 billion, or R20,9 billion higher than in the first nine months of fiscal 2010/11. The higher borrowing requirement stemmed mainly from higher cash-flow deficits recorded by the non-financial public enterprises and corporations and the national government, together with a lower surplus recorded by provincial governments.

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

Non-financial public-sector borrowing requirement

R billions

Level of government	Apr–Dec 2010*	Apr–Dec 2011*
Consolidated general government	100,3	105,7
National government	112,0	117,2
Extra-budgetary institutions	-0,8	-5,4
Social security funds	-9,0	-8,0
Provincial governments	-9,9	-6,2
Local governments	8,0	8,1
Non-financial public enterprises and corporations	31,0	46,5
Total**	**131,3**	**152,2**
As a percentage of gross domestic product	*6,4*	*6,8*

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

As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to 6,8 per cent in the first nine months of the current fiscal year. This was slightly higher than the ratio of 6,4 per cent recorded in the same period of the previous fiscal year. Financial activities at various levels of the non-financial public sector are summarised in the accompanying table.

Non-financial public enterprises and corporations recorded a preliminary cash deficit of R46,5 billion, some R15,5 billion higher when compared with the cash deficit recorded in the same period a year earlier. Growth in total cash receipts remained positive whereas operating expenses showed a notable decrease. The substantial growth in infrastructure-related spending contributed to the sizable deficit.

Particularly from fiscal 2006/07, state-owned enterprises contributed significantly to South Africa's economic growth and development agenda through accelerated infrastructure spending in areas such as transport, telecommunications, water and electricity. During April–December 2011 net investment in non-financial assets amounted to R99,0 billion, R42,3 billion more than in the same period a year earlier. In support of capital expansion programmes, government-approved guarantees to non-financial public corporations totalling an estimated amount of R142 billion in fiscal 2011/12, thereby expanding financing options and lowering the cost of funding. Nonetheless, it remains government's policy that public corporations should largely borrow against their balance sheets in order to reduce government's contingent liabilities and promote efficiency.

During the first nine months of fiscal 2011/12, an analysis of *national government* finance statistics indicated that cash receipts from operating activities of national government increased by 11,8 per cent when compared with the same period a year earlier. Cash payments for operating activities increased by 10,3 per cent year on year to amount to R656 billion in April–December 2011. Grants to other levels of government accounted for 59,0 per cent of the total expenses compared with 58,0 per cent recorded in the corresponding period of fiscal 2010/11. Netting cash flow from operating activities and net investment in non-financial assets resulted in a cash deficit of R117 billion in the first nine months of fiscal 2011/12. This was R5,2 billion higher than the cash deficit recorded in the corresponding period a year earlier.

In the first three quarters of fiscal 2011/12 *provincial governments*' financial activities resulted in a cash surplus of R6,2 billion. This was lower than the cash surplus of R9,9 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, primarily driven by grants from national government, amounted to R278 billion during April–December 2011. Provincial grants, which included equitable share transfers and conditional grants allocated for specific purposes, amounted to R270 billion in the period under review. These grants increased at a year-on-year rate of 10,0 per cent from April to December 2010.

Provincial government expenditure amounted to R272 billion in April–December 2011, or 12,1 per cent more than in the same period of the previous fiscal year. Pronounced growth in provincial expenditure was driven by personnel costs, which amounted to R163 billion. Spending in this category was 12,3 per cent higher when compared with April–December 2010.

In December 2011 the Gautrain Project reached its sixty-third month of development, with one section not yet operational mainly due to water problems. During the first nine months of fiscal 2011/12, R1,2 billion was spent on this project, bringing the cumulative amount spent on it to R31,3 billion. Including the April–December 2011 Gautrain spending, net investment in non-financial assets amounted to R19,3 billion in the first three quarters of fiscal 2011/12, or 13,9 per cent higher when compared with the same period of the previous fiscal year.

The provincial budget surplus 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 R7,1 billion at the end of December 2011. At the same time, their deposits with private banks increased from R9,7 billion to R12,5 billion. Their overall indebtedness to banks decreased from R0,7 billion to R0,6 billion between these respective dates. Notwithstanding these generally favourable trends at the aggregate level, problems in a number of provincial government departments led to National Treasury temporarily taking control of their financial management.

Preliminary data indicated that *local governments*' cash deficit amounted to R8,1 billion during the first nine months of fiscal 2011/12. This was R0,1 billion higher than the cash deficit recorded during the first nine months of fiscal 2010/11.

Cash receipts from operating activities increased by 13,6 per cent, to amount to R174 billion during the first nine months of fiscal 2011/12. This was mainly the result of a significant rise of 20,4 per cent in municipal own revenue, to amount to R128 billion during the first nine months of fiscal 2011/12 as increases in electricity tariffs took their toll. During April–December 2011 grants from national and provincial government amounted to R46,2 billion, or R0,8 billion less when compared with the corresponding period a year earlier. Included in this amount were fuel levy transfers to metropolitan municipalities of R5,7 billion.

The municipalities' cash payments for operating activities amounted to R147 billion during the first nine months of fiscal 2011/12, or R16,0 billion more compared with the same period a year earlier. Higher cash payments for operating activities were mainly driven by purchases of bulk water and electricity, which increased by 21,3 per cent over the period, together with compensation of employees which rose by 9,2 per cent.

During April–December 2011, net investment in non-financial assets amounted to R35,5 billion, some R4,9 billion more when compared with the same period of the previous fiscal year. A number of municipalities stepped up the provision of infrastructure.

Extra-budgetary institutions recorded a cash surplus of R5,4 billion in the first nine months of fiscal 2011/12 – significantly higher than the cash surplus recorded in the same period a year earlier. The high surplus was on account of an increase in cash receipts – mainly transfers from national government – which outpaced the rise in expenditure by these institutions.

Preliminary estimates indicated that the financial position of *social security funds* deteriorated slightly during the period under review. This level of government recorded a cash surplus of R8,0 billion in the first three quarters of fiscal 2011/12, which was R1,0 billion less than in the same period a year earlier.

Budget comparable analysis of national government finance

In the first nine months of fiscal 2011/12 national government spending increased at a slower pace when compared with the February 2011 budgeted projections, while growth in revenue collections exceeded budgeted expectations, particularly from October to December 2011, resulting in a substantially narrower cash-book deficit when compared with budgeted projections.

National government spending totalled R647 billion in the first three quarters of the current fiscal year, which represented a year-on-year rate of increase of 10,7 per cent. This increase was lower than both the originally budgeted increase of 13,3 per cent and the increase of 13,2 per cent projected in the *Medium Term Budget Policy Statement 2011 (MTBPS)* for the full fiscal year.

As a ratio of gross domestic product, national government outlays amounted to 28,7 per cent in April–December 2011, compared with 28,6 per cent recorded in the same period a year earlier.

Growth in spending was driven mostly by current payments along with transfers and subsidies. The increase in current payments emanated from higher spending by Stats SA and the Department of Police. Current payments by Stats SA constituted 68,0 per cent of total current expenditure in the Financial and Administrative Services cluster, emanating from the Census 2011 which has a total budget of R1,7 billion. Current expenditure by the Department of Police increased by 8,3 per cent and accounted for 52,1 per cent of total current payments in the Justice, Crime Prevention and Security cluster. Higher spending by this department was to improve overall capacity through the employment of additional personnel to enhance visible policing.

Growth in transfers and subsidies amounted to 11,7 per cent year on year, with the Social Services cluster contributing the most in the national sphere of government. The increase in transfers by this cluster emanated from the Departments of Education, Health and Social Development. In the area of education, higher spending was mostly for school buildings so as to eradicate inappropriate infrastructure. In addition, state bursary schemes would increase poor learners' access to further education and training colleges, combined with conditional grants and transfers to the National Student Financial Aid Scheme.

Increased transfers and subsidies by the Department of Health were meant to strengthen prevention programmes through the HIV/AIDS conditional grants. Further grants to provinces were aimed at improving health facilities and modernising medical equipment in preparation for the National Health Insurance system which would see the first pilot programmes launched in 2012/13. The Department of Social Development accounted for 58,3 per cent of total transfers and subsidies by the Social Services cluster. This increase resulted from higher transfer payments to households, which are administered by the South African Social Security Agency.

Although payments for capital assets represent a small component of total expenditure, it showed substantial growth between April and December 2011. The increase in payments for capital assets was buoyed by various departments. Spending by the Department of Police was for investment in capital infrastructure, technological enhancements and the upgrading of information technology networks. Capital spending by the Department of Water Affairs was for bulk water infrastructure, the building of a dam and ancillary infrastructure such as pipelines. Capital expenditure by the Department of Public Works was for the expanded public works programme, with the Department of Justice and Constitutional Development paying for the construction of new courts and magistrate's offices.

Between April and December 2011, interest paid on national government debt amounted to R53,7 billion, or 14,8 per cent more than in the first nine months of fiscal 2010/11. The increase in interest payments was broadly in line with the originally budgeted projections and resulted from higher issuances of domestic government bonds and Treasury bills to finance the higher deficit.

Equitable share transfers to provinces were in line with budgeted projections and increased by 8,9 per cent compared with the same period a year earlier. Growth in equitable share transfers to provinces was to extend and improve service delivery outcomes in the health and education sectors, and allow provincial governments to assist municipalities with the implementation of the Municipal Finance Management Act.

Provision was made in the *Budget Review 2011* for R8,6 billion to be paid from the National Revenue Fund (NRF) to metropolitan municipalities as their share of the general fuel levy. These funds were meant to boost metropolitan municipalities' budgets for road and transportation infrastructure, given the link between fuel sales and road usage. In April–December 2011 the transfers from the NRF for this purpose amounted to R5,7 billion, representing a year-on-year increase of 13,7 per cent compared with April–December 2010.

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

After taking cash-flow adjustments[12] into account, national government's cash-flow expenditure equalled R647 billion in the first nine months of fiscal 2011/12 – or 8,2 per cent more than in the same period a year earlier.

During the first nine months of fiscal 2011/12, national government revenue amounted to R527 billion or 11,7 per cent more than in April–December 2010. Revenue was originally budgeted to rise at a rate of 9,1 per cent to total R730 billion during fiscal 2011/12. However, it was revised downwards in the *MTBPS 2011* to amount to R719 billion, a year-on-year rate of increase of 7,4 per cent. Following strong collections in October, November and especially December 2011, it seems likely that the downward revision was too pessimistic.

As a ratio of gross domestic product, national government revenue amounted to 23,4 per cent in the first nine months of fiscal 2011/12, compared with 23,1 per cent recorded in April–December 2010.

Both personal and corporate income tax recorded strong increases in the period under review. Recording robust collections in the third quarter of fiscal 2011/12, corporate income tax displayed the strongest increase, mainly on account of higher provisional payments by large companies.

In April–December 2011, taxes on property continued to decline as collections from transfer duties and securities transfer tax continued to fall. This reflected higher exemption thresholds and poor economic activity in the real-estate market. Transfer duty collections decreased considerably, falling by 26,7 per cent in the first nine months of fiscal 2011/12 compared with the corresponding period a year earlier. Revenue from securities transfer tax declined marginally by 0,6 per cent year on year during the first three quarters of fiscal 2011/12. However, the third-quarter collections were less subdued than those in the earlier two quarters of the current fiscal year.

National government revenue in fiscal 2011/12

Revenue source	Originally budgeted Apr 2011–Mar 2012		Actual Apr–Dec 2011	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	418,3	10,1	305,9	12,9
Income tax on individuals	*254,2*	*11,4*	*175,8*	*10,0*
Income tax on companies	*164,2*	*8,1*	*130,0*	*17,0*
Payroll taxes	9,2	5,8	7,4	19,9
Taxes on property	9,6	5,4	5,9	-12,5
Taxes on goods and services	273,9	9,9	189,6	9,9
Value-added tax	*200,9*	*9,4*	*136,5*	*8,5*
Taxes on international trade and transactions	30,3	12,4	23,2	20,5
Other revenue	10,3	-20,9	11,2	10,0
Less: SACU** payments	21,8	21,5	16,3	15,3
Total revenue	729,9	9,1	526,8	11,7

* April–December 2010 to April–December 2011
** Southern African Customs Union

Proceeds from taxes on goods and services recorded a solid increase, boosted by brisk growth in collections from VAT and fuel levy, along with a strong increase in receipts from excise duties. Domestic VAT recorded a moderate increase, influenced by improved consumption expenditure, while VAT on imports increased significantly mainly due to higher imports of machinery, vehicles and pharmaceutical products.

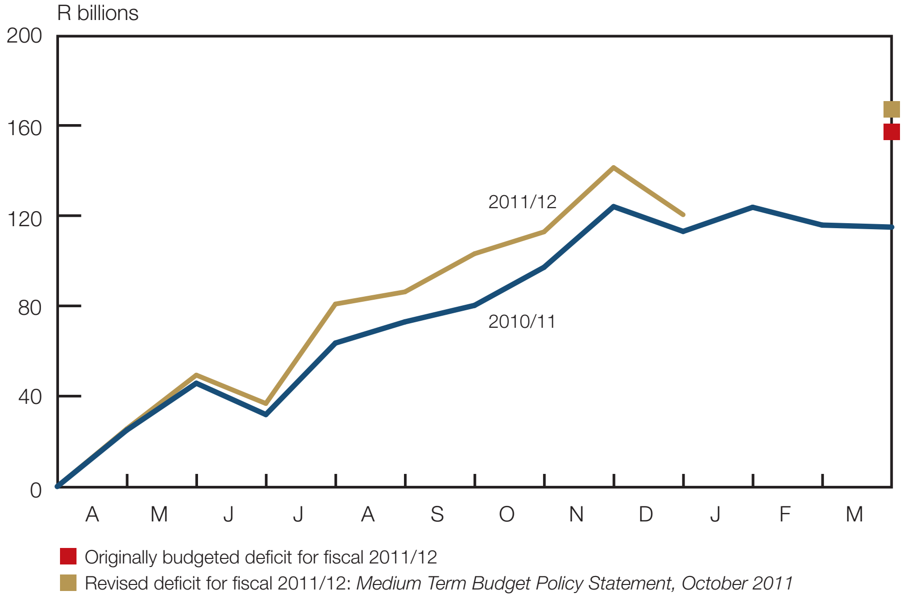
Collections from taxes on international trade and transactions increased strongly between April and December 2011. Buoyant growth in this tax category was underpinned by solid collections in customs duties, not least owing to higher vehicle and clothing imports.

In the first nine months of fiscal 2011/12 an amount of R16,3 billion was paid to the Southern African Customs Union, a year-on-year increase of 15,3 per cent.

National government's cash-flow revenue equalled R528 billion in April–December 2011, or 11,8 per cent more than in the same period of the previous fiscal year.

Netting national government revenue and expenditure resulted in a cash-book deficit before borrowing and debt repayment of R120 billion for the first nine months of fiscal 2011/12. This deficit was R7,4 billion higher than the cash-book deficit recorded in the corresponding period of fiscal 2010/11. Owing to strong tax revenue collections in December 2011, the deficit narrowed somewhat when compared to the first eight months of the fiscal year. The cash-book deficit was originally budgeted to amount to R158 billion in fiscal 2011/12, but was revised upwards to R169 billion in the *MTBPS 2011*. Following the strong revenue in December 2011, the latter estimate now seems likely to be too high.

Cumulative deficit of national government



The primary balance[13] reached a deficit of R66,8 billion, or 3,0 per cent as a ratio of gross domestic product, in the first nine months of fiscal 2011/12. This could be compared with an almost identical primary deficit of R66,3 billion, or 3,2 per cent of gross domestic product recorded in April–December 2010.

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

The net outcome of national government cash-flow revenue and expenditure was a cash-flow deficit of R119 billion in April–December 2011, R6,4 billion lower than the deficit recorded in the corresponding period in fiscal 2010/11. Extraordinary payments comprised losses on the conversion of foreign currency transactions of R0,3 billion and losses on the Gold and Foreign Exchange Contingency Reserve Account to the value of R0,1 billion. Included in extraordinary receipts were mainly the profits on conversion of foreign currency transactions. After allowing for extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement almost equalled the cash-flow deficit. This could be measured against a net borrowing requirement of R126 billion recorded in the first nine months of fiscal 2010/11.

As indicated in the table below, the major funding instruments were government bonds issued in the domestic financial market and Treasury bills. The market appetite for these instruments enabled government to finance the largest portion of the deficit domestically. Between March and December 2011, net issues of RSA Government Retail Savings Bonds amounted to R2,0 billion, bringing the outstanding balance to R11,5 billion at the end of December 2011.

National government financing in fiscal 2011/12

R billions

Item or instrument	Originally budgeted 2011/12	Actual Apr–Dec 2011	Actual Apr–Dec 2010
Deficit	158,2[1]	119,1[2]	125,4[2]
Plus: Extraordinary payments	0,2	0,5	0,7
Cost on revaluation of foreign debt at redemption	0,2	0,4	0,3
Less: Extraordinary receipts	-	0,9	0,6
Net borrowing requirement	158,6	119,1	125,9
Treasury bills	22,0	33,7	39,5
Domestic government bonds	135,9	97,6	102,2
Foreign bonds and loans	5,2	-2,1	-1,6
Change in available cash balances[3]	-4,5	-10,1	-14,3
Total net financing[4]	158,6	119,1	125,9

1 *Budget Review 2011*
2 Cash-flow deficit
3 Increase – decrease +
4 Components may not add up to totals due to rounding

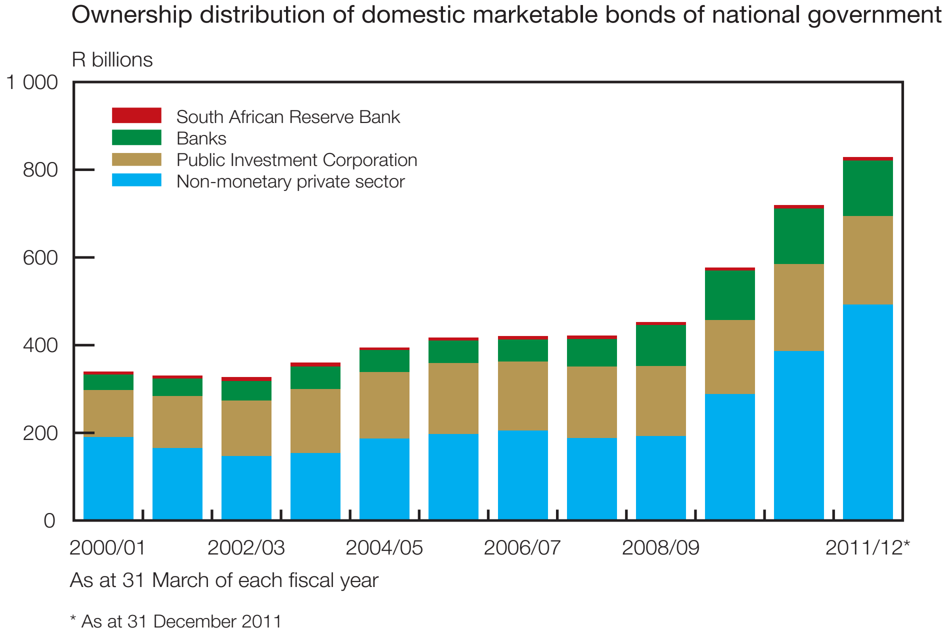
Domestic financing through Treasury bills attracted an average interest rate of 5,5 per cent, while domestic long-term government bonds were issued at an average rate of 8,4 per cent per annum. The average outstanding maturity of national government's domestic marketable bonds increased from 126 months to 132 months between March and December 2011.

Net redemptions of foreign bonds and loans of national government to the value of R2,1 billion were recorded during the first nine months of fiscal 2011/12. The average outstanding maturity of foreign marketable bonds of national government decreased from 102 months at the end of March 2011 to 95 months as at 31 December 2011.

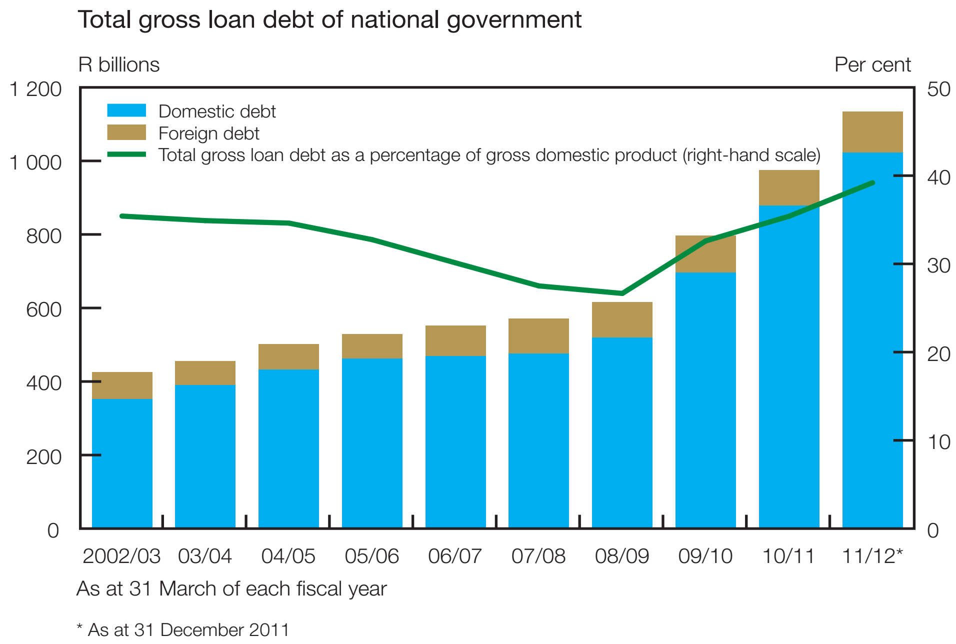
National government's funding activities increased its available cash balances by R10,1 billion in April–December 2011, bringing these balances to a level of R189 billion as at 31 December 2011. Between March and December 2011, deposits with the Bank decreased by R13,2 billion to R121 billion.

Domestic debt of national government increased from R884 billion at the end of March to R1,0 *trillion* at the end of December 2011. The strong acceleration emanated from higher issuances of domestic debt instruments, with domestic debt accounting for about 90 per cent of total gross loan debt.

Despite net redemptions recorded in the first nine months of fiscal 2011/12, foreign debt rose from R97,9 billion to R111 billion during the period under review, following the depreciation of the rand against other major currencies.



Total gross loan debt of national government, consisting of domestic and foreign debt, increased substantially from R982 billion as at 31 March 2011 to R1,1 *trillion* as at 31 December 2011. Total gross loan debt of national government relative to gross domestic product rose from 35,7 per cent to 38,6 per cent during the period under discussion.



The Budget for the fiscal years 2012/13 to 2014/15

Fiscal policy stance

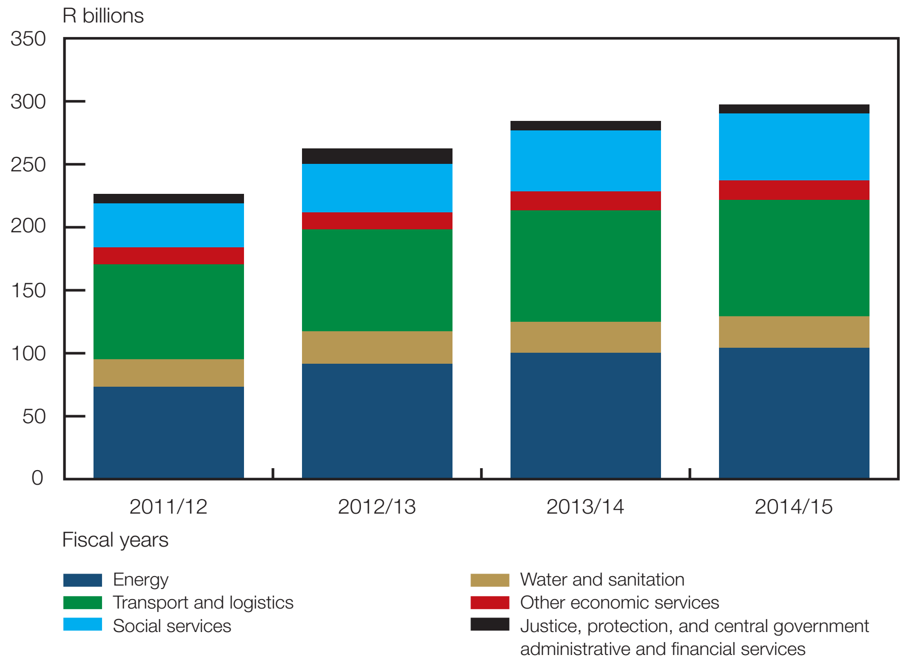
On 22 February 2012 the Minister of Finance presented the National Budget to Parliament, guided by the challenges of growth, job creation and poverty reduction. The Budget gave effect to the fiscal stance outlined in the *MTBPS 2011* by setting out a fiscal framework that would narrow the budget deficit, support the economy, strengthen capital investment and improve public service performance. Government would continue to pursue countercyclical fiscal and monetary policies to support growth and investment, coupled with stable and low inflation to protect the living standards of low-income households and workers.

Growth in real gross domestic product was expected to amount to 2,7 per cent in 2012. Buoyant household consumption expenditure, improved business confidence and investment, rising exports and improved public-sector infrastructure spending were expected to boost economic growth to reach 3,6 per cent in 2013 and 4,2 per cent in the year thereafter. Headline consumer price inflation was projected to increase from an average of 5 per cent in 2011 to 6,2 per cent in 2012. This increase would stem from food price inflation, rising administered prices and higher prices of imported goods due to a somewhat weaker rand exchange rate. Inflation would then fall back into the target range in the subsequent two years.

Over the medium term, the deficit would be reduced and public debt stabilised. The budget deficit of national government was expected to fall from 5,2 per cent of gross domestic product in fiscal 2011/12 to 3,6 per cent in fiscal 2014/15. At the same time, the public-sector borrowing requirement was projected to decline over the medium term. To create space for more resources to be allocated to capital and other priority areas, growth in compensation of government employees would need to moderate. In this regard, in addition to normal pay progression, the 2012 Budget made provision for a 5 per cent cost of living adjustment for civil servants. As the economy recovers and fiscal consolidation proceeds, government borrowing would moderate, with gross loan debt of national government projected to peak at 42,4 per cent of gross domestic product in fiscal 2014/15. Government would continue to finance its borrowing needs mainly in the domestic capital market.

The labour market had shown signs of improvement over 2011, with total employment rising by 2,8 per cent between December 2010 and December 2011. However, unemployment remained high at 23,9 per cent. The *Budget Review 2012* projected that the economy would add 850 000 new jobs over the next three years, with 80 per cent of them in the private sector. This would lower the unemployment rate to about 23 per cent in 2014. Most of these jobs would be concentrated in services and construction due to steady growth in domestic demand and infrastructure expenditure, augmented by a pickup in residential investment which was expected during the outer years of the forecast.

Public-sector infrastructure expenditure by function



Source: *Budget Review 2012*

With a growing economy and population, South Africa's infrastructure needs remain critical, reflecting decades of underinvestment. From the mid-1990s government began to increase capital spending, with a sharp rise after 2003 as prudent management of the economy created the fiscal space for long-term investment. Private-sector capital formation had also increased strongly, rising by 84 per cent between 2002 and 2008. The country's investment in infrastructure gained momentum in the years leading up to the 2010 FIFA World Cup™, and was set to expand further as a core element of the national growth and development strategy. To strengthen the economy and fabric of communities, the country's electricity, water, transport and telecommunications networks were being upgraded and extended.

Public-sector infrastructure spending amounted to 6,5 per cent of gross domestic product during fiscal 2010/11 and was expected to average 7,7 per cent over the three-year projection period, amounting to R845 billion. About R3,2 *trillion* worth of large-scale projects were under consideration or in progress. Expenditure on infrastructure development by function is detailed in the accompanying graph, with energy, transport and logistics accounting for the largest shares.

As announced in the State of the Nation Address, the Presidential Infrastructure Co-ordination Commission would give new impetus to the planning and implementation of major capital projects, raising the level of investment spending and contributing to industrial and regional development. Eskom's two large coal-fired plants – Medupi and Kusile – are under construction and expected to start operating in 2013 and 2014, with full electricity generation expected by 2017 and 2018 respectively. Government had also increased its investment in the transport, logistics and water sectors in recent years and planned several large projects over the next two decades.

Fiscal projections: National government[1]

Fiscal years	Revised estimate		Medium-term estimates					
	2011/12		2012/13		2013/14		2014/15	
	R billions	Annual change (Per cent)	R billions	Annual change (Per cent)	R billions	Annual change (Per cent)	R billions	Annual change (Per cent)
Expenditure	891,2	10,7	969,4	8,8	1 053,8	8,7	1 139,6	8,1
State debt cost[2]	76,6	15,7	89,4	16,6	100,8	12,8	109,0	8,2
Current payments	149,3	13,8	158,6	6,3	168,9	6,4	179,7	6,4
Transfers and subsidies	653,3	13,5	698,7	7,0	753,4	7,8	807,0	7,1
Payments for capital assets	11,2	5,5	15,2	35,3	18,6	22,3	19,4	4,4
Payments for financial assets[3]	0,8	-	1,6	-	0,3	-	0,5	-
Contingency reserve and unallocated funds	-	-	5,8	-	11,9	-	24,0	
Expenditure as a ratio of GDP[4]	*29,8%*		*29,4%*		*29,1%*		*28,5%*	
Revenue	734,6	9,7	799,3	8,8	894,3	11,9	997,2	11,5
Revenue as a ratio of GDP	*24,5%*		*24,2%*		*24,7%*		*24,9%*	
Budget balance[5] before borrowing and debt repayment	-156,6		-170,0		-159,5		-142,4	
Balance as a ratio of GDP								
February 2012 Budget	*-5,2%*		*-5,2%*		*-4,4%*		*-3,6%*	
October 2011 MTBPS[6]	*-5,7%*		*-5,5%*		*-4,8%*		*-3,7%*	

1 Components may not add up to totals due to rounding
2 Includes interest, management cost and the cost of raising loans
3 Consists mainly of lending to public corporations or making equity investments in them for policy purposes. Previously included in transfers and subsidies
4 Gross domestic product
5 Deficit – surplus +
6 *Medium Term Budget Policy Statement, October 2011*

Providing affordable housing and addressing the special disparities of South Africa's urban landscapes were incorporated in the Budget as policy priorities. The persistence of large informal settlements had necessitated a shift towards developing services sites, security of tenure and affordable rental housing. In support of this outcome, over the next three years R50,5 billion was allocated for low-income housing and upgrading informal settlements in secondary cities, as well as about R27 billion for upgrading informal settlements in large cities.

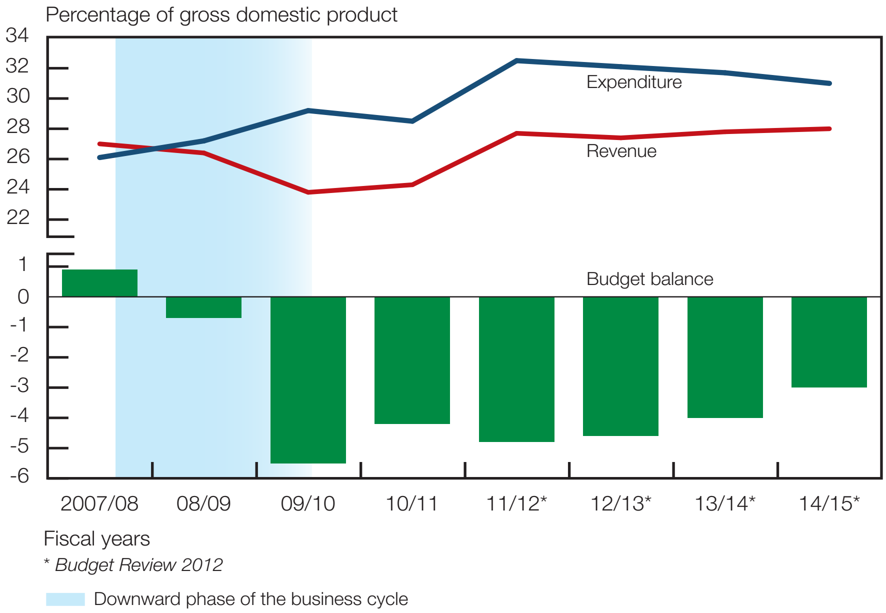
In order to build and expand health-care capacity in South Africa, the National Health Insurance (NHI) system would be phased in over a 14-year period, starting with pilot projects in fiscal 2012/13. The new system would require funding over and above current budget allocations to public health.

National government revenue was projected to increase by 8,8 per cent to amount to R799 billion in fiscal 2012/13. Revenue would rise at an average rate of 10,7 per cent per annum over the three-year budget period, totaling R997 billion in fiscal 2014/15. As a ratio of gross domestic product, national government revenue was estimated to average 24,6 per cent over the medium term.

The tax proposals in the *Budget Review 2012* were aimed at improving the fairness of the tax system by increasing the effective capital gains tax, proposing measures to encourage household saving for retirement and other needs, adjusting personal income tax brackets for inflation and providing tax relief for small business. Furthermore, the budget outlined reforms to the tax treatment of contributions to retirement savings and further reforms to the tax treatment of medical scheme contributions. As is customarily the case, excise duties on alcoholic beverages and tobacco were also raised.

Netting the revised national government revenue and expenditure was expected to yield a cash-book deficit before borrowing and debt repayment of R157 billion in fiscal 2011/12. This would be R21,2 billion lower than the deficit recorded in the previous fiscal year and substantially lower than the cash-book deficit foreseen in the *MTBPS 2011*. The lower deficit could be attributed to a recovery in national government revenue, combined with slower growth in expenditure. As a ratio of gross domestic product, the national government deficit was projected to amount to 5,2 per cent in fiscal 2011/12 before declining to an average of 4,4 per cent over the medium term.

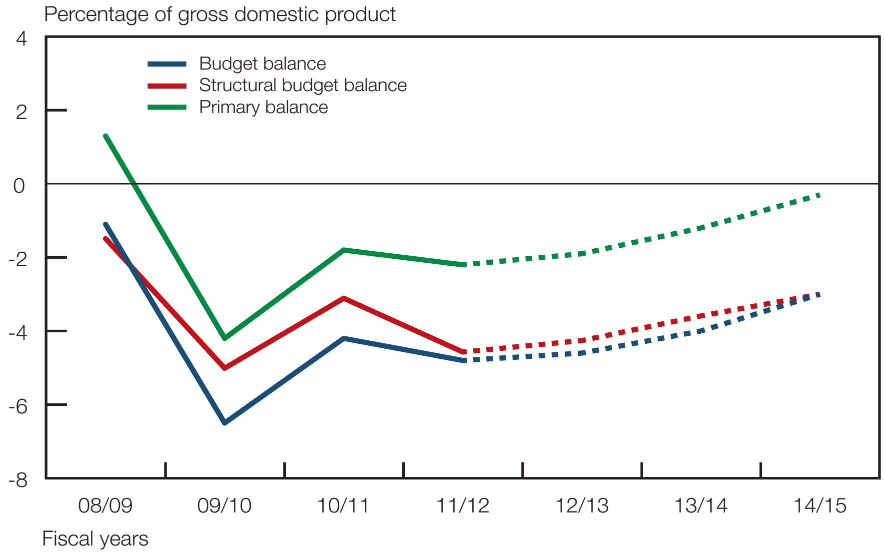
National government finances



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

The primary balance [14] was expected to reach a deficit of 2,7 per cent of gross domestic product in fiscal 2011/12, compared with 2,4 per cent in fiscal 2010/11. The primary deficit was expected to narrow over the medium term, bringing the average primary deficit to 2,1 per cent of estimated gross domestic product.

Consolidated government: Actual, primary and structural budget balance



Source: *Budget Review 2012*

National government's net borrowing requirement would continue to be mainly financed through domestic long-term loans. Domestic short-term loans were revised to increase by R20,8 billion in fiscal 2011/12, comprising of Treasury bill issuance including borrowing of surplus cash from the broader public sector through the Corporation for Public Deposits. Over the medium term, Treasury bill net issuance was expected to average R21,3 billion per annum, with a concentration in longer-dated maturities.

National government financing

R billions

Item or instrument	Revised estimate	Medium-term estimates		
	2011/12	2012/13	2013/14	2014/15
Deficit	**156,6**	**170,0**	**159,5**	**142,4**
Plus: Extraordinary payments	0,5	0,0	-	-
Cost on revaluation of foreign debt at redemption	0,5	-2,3	0,6	0,7
Less: Extraordinary receipts	4,4	1,2	1,5	1,5
Net borrowing requirement	**152,3**	**171,2**	**157,4**	**140,2**
Treasury bills	20,8	22,0	22,0	20,0
Domestic government bonds issued	139,9	120,0	130,4	114,3
Foreign bonds and loans	9,1	-5,2	-4,2	-1,0
Changes in available cash balances*	-17,6	34,3	9,2	6,9
Total net financing**	**152,3**	**171,2**	**157,4**	**140,2**

* Increase – decrease +
** Components may not add up to totals due to rounding

Government aimed to introduce five new bonds in fiscal 2012/13, two fixed-income bonds and three inflation-linked bonds. To improve liquidity and manage refinancing risk, government would reintroduce bonds with the maturity split over three years, similar to the current *R157* and *R186* benchmark bonds.

Over the medium term, national government intends to borrow US$3 billion in global markets to maintain benchmarks in major currencies and meet part of its foreign currency commitments.

National government's available cash balances were projected to increase by R17,6 billion in fiscal 2011/12 but to decline in the outer years of the medium-term projection period.

Gross loan debt of national government was estimated to increase from R1,2 trillion to R1,7 trillion between fiscal 2011/12 and 2014/15. As a ratio of gross domestic product, it was projected that gross loan debt would increase from 40,1 per cent to 42,4 per cent during the period under discussion.

Consolidated government expenditure was estimated to increase from R973 billion in fiscal 2011/12 to amount to R1,2 *trillion* in fiscal 2014/15. As a ratio of gross domestic product, consolidated expenditure was projected to equal 32,5 per cent in fiscal 2011/12 and was expected to amount to 31,0 per cent in fiscal 2014/15. Over the medium term, non-interest government expenditure was expected to grow by an annual average of 8,4 per cent, compared with annual average growth of 11,1 per cent over the previous three years. State debt cost, in contrast, would increase by 12,5 per cent over the same period, compared with an annual average increase of 12,1 per cent over the previous three years.

The social services category would make up 58,2 per cent of total spending in fiscal 2012/13 of which education and health would account for 19,6 per cent and 11,5 per cent, respectively. Spending on economic infrastructure such as transport, communication, fuel and energy would constitute 7,9 per cent of total spending in fiscal 2012/13. Over the medium term, spending on economic services and environmental protection would increase by an annual average of 10,0 per cent, reaching R70,6 billion in fiscal 2014/15. Expenditure on protection services was estimated to increase to R140 billion in fiscal 2012/13.

In recent years, government had sought to accelerate public infrastructure spending, while also encouraging greater private-sector investment. Spending on economic infrastructure was estimated to increase from R83,6 billion in fiscal 2012/13 to R98,3 billion in fiscal 2014/15, rising by an annual average of 6,4 per cent. The *Budget Review 2012* stated that rail commuter transport services were severely constrained by the age and poor condition of much of the rolling stock. Accordingly in fiscal 2014/15 an additional R4 billion was allocated to the Passenger Rail Agency of South Africa to begin purchasing 233 coaches.

Public-sector borrowing requirement*

R billions

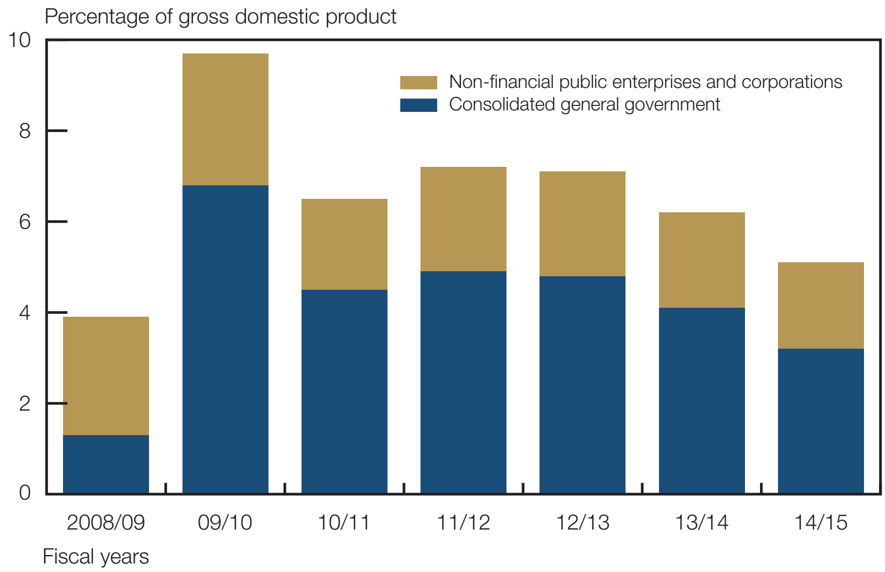
Level of government	Revised estimate	Medium-term estimates		
	2011/12	2012/13	2013/14	2014/15
National government	**152,7**	**168,8**	**158,0**	**140,9**
Extra-budgetary institutions	1,7	4,0	4,6	3,0
Social security funds	-13,5	-13,1	-13,5	-14,2
Provincial governments	-2,5	-7,4	-7,3	-9,6
Local authorities and local enterprises	7,3	5,9	6,0	6,7
General government borrowing**	**145,7**	**158,2**	**147,8**	**126,7**
Percentage of gross domestic product	*4,9%*	*4,8%*	*4,1%*	*3,2%*
Non-financial public enterprises	68,2	76,9	77,5	74,1
Public-sector borrowing requirement**	**213,9**	**235,1**	**225,3**	**200,8**
Percentage of gross domestic product	*7,1%*	*7,1%*	*6,2%*	*5,0%*
Estimated gross domestic product	2 995,5	3 301,4	3 622,2	3 997,0

* Deficit + surplus –
** Calculations may not add up to totals due to rounding

Amid a growing population, complemented by rising demand for basic services, spending on municipal infrastructure increased by 12,1 per cent a year from fiscal 2008/09 to 2011/12, and would amount to R139 billion in 2014/15. Additional funding of R1 billion was allocated to the human settlements development grant to support the upgrading of informal settlements.

The public-sector borrowing requirement was projected to decline from 7,1 per cent of gross domestic product in fiscal 2011/12 to 5,0 per cent of gross domestic product in fiscal 2014/15. The infrastructure programmes of Eskom and Transnet were expected to expand significantly over the next decade, supported by higher cash flows from operations, with the shortfalls financed by a combination of equity and debt. Taking account of social security funds, provinces, local authorities and extra-budgetary institutions, the general government borrowing requirement would decline from 4,9 per cent of gross domestic product in fiscal 2011/12, to 3,2 per cent in fiscal 2014/15.

Public-sector borrowing requirement



Source: *Budget Review 2012*

Statement of the Monetary Policy Committee

19 January 2012

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 MPC, the outlook for domestic inflation and economic growth has deteriorated, posing a serious challenge for monetary policy going forward. Inflation is now expected to remain above the upper end of the target range for a more extended period, but there is still no evidence of significant demand pressures in the economy. While economic growth in the fourth quarter was likely to have exceeded that in the previous two quarters, the forecast for growth in 2012 has been revised downwards. The primary reason for the worsening domestic growth outlook is the risk of contagion from the persistent crisis in Europe, which shows no sign of a speedy resolution.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas was 6,1 per cent in December 2011, unchanged from November. The categories of food, housing and utilities, and transport together accounted for 4,4 percentage points of the December outcome. Food price inflation accelerated further to 11,6 per cent, from 11,1 per cent in November, while petrol prices increased by 26,4 per cent. Administered price inflation excluding petrol was unchanged at 8,7 per cent. CPI inflation excluding food, petrol and electricity remained unchanged at 3,9 per cent, indicating relatively benign core inflation outcomes.

Producer price inflation moderated from a year-on-year rate of 10,6 per cent in October 2011 to 10,1 per cent in November. The impact of the depreciated rand exchange rate is evident in the 15,9 per cent increase in the price of imported commodities. Food price inflation remained elevated, with agricultural prices increasing at a year-on-year rate of 12,1 per cent in November, and manufactured food prices increasing by 8,4 per cent.

The inflation forecast of the Bank has been subject to a further upward revision. Inflation is now expected to remain outside the upper end of the target range for the whole of 2012, and to peak in the second quarter of 2012 at around 6,6 per cent before declining gradually and returning to within the target range in the first quarter of 2013. Inflation is expected to measure 5,5 per cent in the final quarter of 2013. The Bank's forecast of core inflation, which excludes food, petrol and electricity, shows a moderately rising trend, with the peak of around 5,5 per cent expected in the first two quarters of 2013. The main factor contributing to the upward revision of the forecast is the changed assumption relating to the exchange rate of the rand, which was partly offset by the downward adjustment to the global growth assumption.

Inflation expectations, as reflected in the survey conducted by the Bureau for Economic Research at Stellenbosch University in the fourth quarter of 2011, have increased moderately but have remained relatively anchored around the upper end of the inflation target range. Inflation is expected to average 6,1 per cent in 2012, compared with 5,9 per cent expected in the previous survey. Expectations for 2013 increased from 5,9 per cent to 6,0 per cent. All categories of respondents revised their forecasts moderately upwards for both years, except for business executives whose expectations for inflation in 2013 remained unchanged at 6,3 per cent.

The global outlook remains clouded by the worsening situation in the eurozone, and growth forecasts for the region have generally been revised down amid widespread sovereign ratings downgrades. It is now generally accepted that the eurozone is likely to experience a recession in 2012, but the extent and duration is still uncertain. The increasingly fragile sentiment is exacerbated by the lack of resolution of the sovereign debt crisis and the consequent increase in sovereign debt yields; further fiscal austerity measures in the region; and the impact on the real economy of higher capital requirements for banks and consequent bank deleveraging. Tightened lending standards have also had cross-border implications for a number of emerging-market economies, particularly in Eastern Europe and Latin America.

Although the OECD leading indicators and global PMIs are trending downwards, the economic growth outcomes in Japan and the United States have been more favourable than was the case in mid-2011. The unemployment rate in the US has declined, and both consumption and investment expenditure have shown some signs of recovery, although downside risks from fiscal consolidation and the continued weakness in the housing market remain.

Growth in emerging-market and developing countries, while still relatively favourable, is also expected to moderate somewhat, in part due to contagion effects from the European crisis as well as policies that have been aimed at curbing domestic demand pressures. Economic growth in China is also expected to slow, but a hard landing is not anticipated. Sub-Saharan Africa, which has become an increasingly important destination for South African exports, is expected to continue to grow at a rate in excess of 5 per cent.

Global inflation appears to be moderating, as weaker demand has contributed to declines in food and commodity prices. Oil prices, however, have been underpinned by risks to supply due to geopolitical factors.

The rand exchange rate has continued to display a relatively high degree of volatility in response to erratic changes in global risk aversion. Since the previous meeting of the MPC the rand has traded in a range of between R7,93 and R8,60 to the US dollar, but for the past month the range has generally been between R8,00 and R8,20 . Since the previous meeting, the rand has remained more or less unchanged against the dollar, and appreciated by about 6 per cent per cent against the euro, reflecting the influence of the euro/dollar exchange rate on the domestic currency. On a trade-weighted basis, the rand appreciated by almost 3 per cent over the same period.

South Africa's experience with portfolio capital flows during 2011 was similar to the general emerging-market experience of slowing bond inflows and net equity outflows. For the year as a whole non-resident purchases of bonds amounted to R42 billion, while net sales of equities to the value of R17 billion were recorded.

The outlook for the rand exchange rate remains highly dependent on global risk appetite. While the rand remains vulnerable to global developments, it has been relatively stable in the past few weeks, and consensus forecasts reflect an expectation that the current levels will be sustained for a protracted period. But this is significantly dependent on global sentiment and developments.

The outlook for domestic economic growth remains subdued. According to the Bank's forecast, the annual real growth rate in 2011 is estimated to have been in the region of 3,1 per cent, but the outlook for 2012 and 2013 has deteriorated relative to the previous forecast, mainly due to a downward revision to the global growth assumption. Growth in 2012 is expected to average 2,8 per cent compared with 3,2 per cent in the previous forecast, while the forecast for growth in 2013 has been revised down from 4,2 per cent to 3,8 per cent. This implies a further expected widening of the output gap during this period.

Despite the less favourable outlook, some improvement is expected in the mining and manufacturing sectors, which both contracted in the second and third quarters of 2011. Although mining output contracted further in October, it rebounded on a month-on-month basis in November, but the change in the three months to November compared to the previous three months showed a contraction of 0,7 per cent. The manufacturing sector experienced positive growth in October and November, with the physical volume of manufacturing output increasing at a three-month-on-three-month rate of 2,6 per cent. Nevertheless, the sector is expected to remain under pressure. Following four consecutive months of increases, the Kagiso PMI declined to below the neutral 50 level to 49,4 in December.

The construction sector also remains subdued, notwithstanding an increase in the real value of building plans passed in November, and a slight increase in the First National Bank (FNB) Building Confidence Index in the fourth quarter. On the positive side, the sector could benefit from the continued but slow improvement in the growth of gross fixed capital formation which increased at an annualised rate of 5,6 per cent in the third quarter of 2011. According to the

Rand Merchant Bank (RMB)/BER Business Confidence Index, business confidence remains relatively low, having declined marginally in the fourth quarter of 2011.

Despite the weak economic performance in the third quarter, employment growth surprised on the upside. According to the *Quarterly Employment Survey* of Statistics South Africa (Stats SA), formal non-agricultural employment increased by 47 300 in the quarter and by 207 000 year on year, with the bulk of the increases in the second and third quarters coming from the private sector. This trend is consistent with that observed in the *Quarterly Labour Force Survey*. However, the employment losses suffered during the recession have still not been recovered and future employment prospects remain uncertain given the fragile economic outlook.

Growth in consumption expenditure by households continues to be the main driver of growth in the economy but growth rates remain moderate and are not expected to pose a risk to inflation. Real final consumption expenditure by households increased at an annualised rate of 3,7 per cent in the third quarter of 2011, up from 3,3 per cent in the previous quarter, but lower than the levels recorded in previous quarters. Real retail sales grew at a year-on-year rate of 6,8 per cent in November, while on a three-month-to-three-month basis growth of 3,1 per cent was recorded. According to the FNB/BER Consumer Confidence Index, consumer confidence increased marginally in the fourth quarter of 2011.

Consumption expenditure continues to be constrained by relatively tight lending standards by banks, high levels of household debt and consistently above-average increases in a range of administered prices which reduce the amount available for household discretionary expenditure.

The gradual deleveraging by households has continued, with the ratio of household debt to disposable income declining further from 75,8 per cent in the second quarter of 2011 to 75,0 per cent in the third quarter, compared with a peak of 82,3 per cent in 2009. The decline in the ratio, however, reflects the fact that disposable income is increasing at a faster rate than debt accumulation.

Trends in credit extension have remained subdued and more or less unchanged since the previous meeting of the MPC, with year-on-year growth in banks' loans and advances to the private sector measuring 6,0 per cent in both October and November. Mortgage advances remained relatively depressed in line with the weak state of the housing market, and increased by 1,9 per cent in November. The main drivers of credit extension in November were the 6,0 per cent increase in instalment sales credit and leasing finance, reflecting improved motor vehicle sales, and other loans and advances which increased at a year-on-year rate of 12,6 per cent in both October and November. This category was driven mainly by general loans which include unsecured lending.

The main pressures on inflation continue to emanate primarily from cost-push pressures. Administered prices remain a concern in the inflation outlook. The price of electricity has been an important driver of inflation, and increases of 17,3 per cent are assumed for both 2012 and 2013. However, the current National Energy Regulator of South Africa (NERSA) determination ends in mid-2013 and subsequent price increases are yet to be determined. The case for further significant above-inflation increases is questionable. The determination of administered prices should not act as an inhibitor to growth and investment.

International oil prices have been subject to conflicting pressures. Downside pressures have emanated from the weaker global growth environment, while upside pressures emanate from geo-political factors which have raised fears of possible supply disruptions. Nevertheless, the price of Brent crude oil has been surprisingly stable and, despite some volatility, is at similar levels to those prevailing at the time of the previous MPC meeting. Domestic petrol prices have decreased by a cumulative 16 cents per litre since early November, but the current under-recovery suggests that a further increase can be expected in February.

According to Andrew Levy Employment Publications, the overall average wage settlement rate in collective bargaining agreements amounted to 7,7 per cent in the first nine months of 2011, compared with 8,2 per cent in 2010. However there are indications that the downward trend in nominal remuneration may have reversed. According to Stats SA, growth in average remuneration per worker increased by 8,6 per cent in the third quarter of 2011 compared with the same quarter in 2010, up from 6,4 per cent and 7,4 per cent in the previous two quarters respectively. Adjusting for declining labour productivity trends, this has resulted in growth in nominal unit labour costs increasing from 5,2 per cent in the first quarter to 8,3 per cent in the third quarter of 2011. These developments could pose further upside risk to the inflation outlook.

Food prices remain a major driver of inflation, influenced by both local and global factors. Domestic food prices have been negatively affected by the recent depreciation of the rand, and a smaller-than-expected maize crop which contributed to the doubling of the domestic maize price over the past year. Futures prices of maize suggest that some relief may be expected during the first half of 2012. Furthermore, global food prices have been declining, with the Food and Agriculture Organization (FAO) Food Price Index falling by 11,3 per cent in December 2011, compared to its most recent peak in February of that year. Nevertheless, domestic food price inflation at the consumer level is expected to remain relatively high for some time.

The MPC has reflected on the various risks to the inflation outlook and considers these risks to be fairly evenly balanced, notwithstanding the reality that the exchange rate remains a significant source of uncertainty. The main downside risk continues to emanate from global economic developments.

The MPC remains of the view that inflation pressures are primarily of a cost-push nature, but is concerned that a persistent upward trend in inflation and prolonged breach of the inflation target could have an adverse effect on inflation expectations which could reinforce the upward inflation dynamics. However, the MPC is also cognisant of the slowing domestic economy and feels that given the lack of demand pressures, monetary tightening at this stage would not be appropriate. At the same time, the nominal policy rate is at a long-term low and the real policy rate is slightly negative, indicating a monetary policy stance that is accommodative and supportive of the real economy.

The MPC maintains a preference for a stable interest rate environment, given the conflicting pressures on monetary policy at this stage. However, the committee will continue to monitor domestic and global economic and financial developments and the risks to the outlook, and remains ready to act appropriately to ensure the attainment of the inflation target over the medium term while being supportive of the domestic economy. The MPC has therefore decided to keep the repurchase rate unchanged at 5,5 per cent per annum.

Notes to tables

Government finance statistics of extra-budgetary institutions – Table S–65

As from fiscal 2009/10, data for *extra-budgetary institutions, non-financial and financial public enterprises and corporations* in tables S–65, S–71 and S–73 have been revised with audited annual financial statements and in accordance with the updated *Institutional Sector Classification Guide for South Africa* published in December 2011. At the macro level the revisions had no significant statistical impact on the data.

The *extra-budgetary institutions survey* has been improved and institutions such as the Armaments Corporation of South Africa (ARMSCOR), the Independent Development Trust (IDT), the South African Maritime Safety Authority (SAMSA) and others have been included in the analysis, whereas the South African Bureau of Standards (SABS) and the Council for Scientific and Industrial Research (CSIR) have been moved to the analysis of *non-financial public enterprises and corporations*.

Government finance statistics of non-financial public enterprises and corporations – Table S–71

The analysis of *non-financial public enterprises and corporations* now includes additional institutions such as the CSIR, SABS, Broadband Infrastructure Company, South African Express, State Diamond Traders, and certain water authorities, whereas institutions such as ARMSCOR, SAMSA and some other minor institutions have been removed and incorporated in the analysis of extra-budgetary institutions.

Government finance statistics of financial public enterprises and corporations – Table S–73

The *financial public enterprises and corporations* analysis now excludes data for the IDT, which was moved to *extra-budgetary institutions.* Mpumalanga Housing Finance Company was removed from the analysis as from April 2010 subsequent to the merger with the Mpumalanga Economic Growth Agency, which falls under *non-financial public enterprises and corporations*.

Selected household assets and liabilities at year-end – Table S–130

This is a new table. It presents estimates of the total assets and liabilities of the household sector and selected major items on the aggregate household balance sheet, valued at year-end. The presentation of the additional table is a further step to expand the scope of South Africa's national accounts within the framework provided by the System of National Accounts (SNA), a set of guidelines that provide a comprehensive conceptual and accounting framework for macroeconomic analysis. The estimates of household assets and liabilities are compiled by the South African Reserve Bank, and will be updated annually.

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

A series indicating the household sector's debt-service cost relative to disposable income has been added to Table S–150. The quarterly values of the ratio reflect the interest cost of servicing the household sector's debt as a percentage of household disposable income; the data are seasonally adjusted. The annual ratio is calculated as the average of the relevant four quarterly values. The debt-service cost ratio is a frequently used measure of the interest burden of the household sector.