Quarterly Bulletin

December 2012

South African Reserve Bank

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Contents

Quarterly Economic Review

Introduction

The global economy recorded lacklustre overall rates of growth in both the second and the third quarter of 2012 as firm, but marginally slower, rates of growth in the emerging economies coincided with almost stagnant output in the advanced economies. Activity in the United Kingdom (UK) nevertheless picked up following the hosting of the Olympic Games in London, and the United States (US) recorded higher growth in the third quarter, but economic activity in the euro area remained weak with peripheral economies still in deep recession and in Japan real output contracted. While progress was made with the resolution of sovereign debt concerns and strains in the euro area, important dimensions remained under negotiation. Uncertainties also continued to surround the tax-raising and expenditure-reducing efforts that the US government will decide on to address its large fiscal deficit.

Global inflation remained benign during the period under review, although marked increases in international grain prices and occasional upward pressures on the oil price had an adverse impact on the inflation trajectory. The large output gaps, contained rates of inflation and ongoing fiscal consolidation in key overindebted nations provided room for monetary policy to remain accommodative in most parts of the world.

The growth outlook for Africa south of the Sahara remained strong, supported by improved policy frameworks, modest spillovers from Europe, export diversification away from weak-growing advanced economies, and firm commodity prices.

In South Africa economic activity suffered a setback in the third quarter of 2012 as the pace of growth in real gross domestic product more than halved to an annualised rate of 1,2 per cent. This mainly reflected a pronounced contraction in the real output of the mining sector, which was severely impacted by prolonged and violent labour unrest at a major platinum mine. The unrest also spilled over to some other platinum mines, and to a number of gold, iron ore, coal and diamond mines, thereby weighing on production volumes.

The lower growth rate also reflected a modest slowdown in agricultural production. By contrast, the real value added by manufacturing expanded in the third quarter of 2012, responding to an increase in domestic final demand and stronger exports in a number of manufacturing categories. Electricity production increased somewhat over the period, supported by a number of cold spells, higher exports to neighbouring countries, and the discontinuation of power buy-back arrangements between Eskom and some of its industrial customers.

In the services sector real output growth decelerated in the third quarter as real value added lost momentum in most subsectors, impacted by factors such as a slowdown in household consumption expenditure and disruptions to road freight transport services due to industrial action. However, growth in real value added by general government and by the personal services subsector edged higher over the period.

Real gross domestic expenditure growth slackened notably in the third quarter of 2012, mainly reflecting a sharp slowdown in inventory accumulation. In turn this was largely brought about by the production disruptions noted above which resulted in producers, especially in the mining sector, having to fall back on inventories in order to satisfy demand. Growth in real domestic final demand, however, inched higher in the third quarter, led by government consumption which was temporarily boosted by the acquisition of military aircraft. Fixed capital spending also gained further momentum over the period.

Real final consumption expenditure by households continued to rise in the third quarter but at a diminishing pace when compared with preceding quarters. Expenditure on durable and semi-durable goods, while losing some momentum, continued rising at a fair pace, having benefitted from the reduction in interest rates in July 2012. While households incurred further debt during this period, their disposable income expanded at a more or less similar pace, resulting in an unchanged household debt-to-income ratio. Simultaneously, the July 2012 reduction in the repurchase rate contributed to a further decline in the household debt-service ratio.

Growth in real fixed capital expenditure accelerated somewhat in the third quarter of 2012 as the pace of capital spending by public corporations picked up further, led by Eskom and Transnet. General government maintained a brisk pace of increase in capital expenditure, with provincial governments stepping up spending on road works and local government focusing on water infrastructure, the upgrading of informal settlements and the provision of social housing. While both public corporations and general government achieved robust annualised rates of increase in real capital formation over the period, private business enterprises increased their capital expenditure at a comparatively slow pace, consistent with the surplus capacity experienced in many parts of the economy. The increase in capital spending in the private sector could mainly be attributed to the finance sector, where expenditure on business information systems and computer-related equipment drove the increase, and to the construction sector, where the focus fell on the acquisition of machinery and equipment.

Employment in the formal sector rose further in the second quarter of 2012, with an indication that this increase was sustained into the third quarter. The net job creation registered in the second quarter occurred more in the public than in the private sector, with provincial and national government departments recording sturdy increases. Wage settlements in the first three quarters of the year remained contained and were reasonably aligned with developments in inflation and labour productivity. However, looking ahead, the wage outcomes arising from the recent bouts of confrontational industrial action could present some risks in this regard.

Consumer price inflation, having registered a recent low twelve-month rate of 4,9 per cent in July 2012, regained momentum in the subsequent months, driven by the prices of petrol, electricity, education and food. Food inflation, which moderated in the first half of 2012, started accelerating again as international grain prices spiralled higher in the wake of climate-related setbacks to production.

The deficit on the current account of South Africa's balance of payments with the rest of the world moved broadly sideways from the second to the third quarter of 2012 and amounted to 6,4 per cent of gross domestic product in both quarters. Resilient gross domestic final demand was reflected in firm imports, with import volumes rising marginally in the quarter concerned as, among others, military aircraft were imported in terms of the government's arms procurement deal. The volume of merchandise exports also inched higher, reflecting higher agricultural and manufacturing exports despite a tough international trade environment. Simultaneously, the shortfall on the services, income and current transfer account narrowed somewhat, mainly on account of lower dividend payments to non-resident investors.

Net financial inflows more than fully covered the shortfall on the current account in the third quarter as South Africa attracted a combination of portfolio, direct and other investment flows. The share of government debt securities in South Africa's total foreign debt continued to rise over time as government issued more debt instruments and favourable interest rate differentials continued to attract non-resident attention. Despite the ease with which the deficit on the current account was financed and the modest increase in the country's gross gold and other foreign reserves recorded in recent months, the effective exchange rate of the rand depreciated notably in October 2012, following a moderate depreciation in the third quarter. The depreciation in October followed on the heels of severe labour unrest and the downgrading of South Africa's sovereign rating.

Growth in banks' overall loans and advances to the domestic private sector continued along a path of gradual, but somewhat hesitant, acceleration in the course of 2012, as has been the case for the past three years. Mortgage lending activity remained very slow, reflecting the subdued state of the real-estate market and caution among both lenders and borrowers to raise their exposure in this area. Growth in the other lending categories was more buoyant, with instalment sale credit, credit card advances, and general loans and advances registering double-digit rates of increase over twelve months. While the general loans and advances component extended to households (sometimes referred to as 'unsecured lending') constitutes only a moderate proportion of total credit extension, it continued to record high rates of increase.

While depository investments continued to yield low returns and the housing market remained in the doldrums, South African share prices rose to record levels in 2012 with the latest all-time high recorded in November. Bond yields trended lower, particularly from around April, with demand for bonds strengthened by factors such as lower inflation and announcements regarding the inclusion of South African government bonds in the Citi World Government Bond Index (WGBI) from 1 October 2012; some investors increased their holdings of South African government bonds in anticipation of this event. From late September 2012, however, yields increased somewhat following sovereign ratings downgrades, the release of higher-than-expected inflation data, the depreciation in the exchange value of the rand and the moderate upward revision of the expected fiscal deficit in the *Medium Term Budget Policy Statement* (*MTBPS*).

The *MTBPS* was released in October 2012 and projected a somewhat slower pace of economic growth going forward, and with that a set of marginally higher budget deficits over the period up to 2014/15 than had been foreseen in the February 2012 Budget. The size of the deficits were forecast to narrow in the outer years of the planning period, which now extended to 2015/16, and it was estimated that national government's gross loan debt would continue to rise at a moderate pace to level off at 42,7 per cent of gross domestic product from 2015. Actual national government revenue and expenditure from the beginning of the current fiscal year to October 2012 remained closely aligned with the path projected at the time of the Budget. At the same time, the non-financial public-sector borrowing requirement remained well contained and readily financed in the first half of the fiscal year.

Monetary policy was eased in July 2012 when the Monetary Policy Committee (MPC) reduced the repurchase rate from 5,5 per cent to 5,0 per cent, mindful of the deceleration in actual and projected inflation and of the considerable slack in the economy. Other short-term interest rates followed the repurchase rate downwards. At its subsequent meetings in September and November 2012, the MPC held the repurchase rate unchanged at its three-decade-low level, with considerations relating to a projected further weakening in economic growth balanced by the risks to the domestic inflation outlook arising from factors such as rising international food prices and exchange rate depreciation.

Domestic economic developments

Domestic output[1, 2]

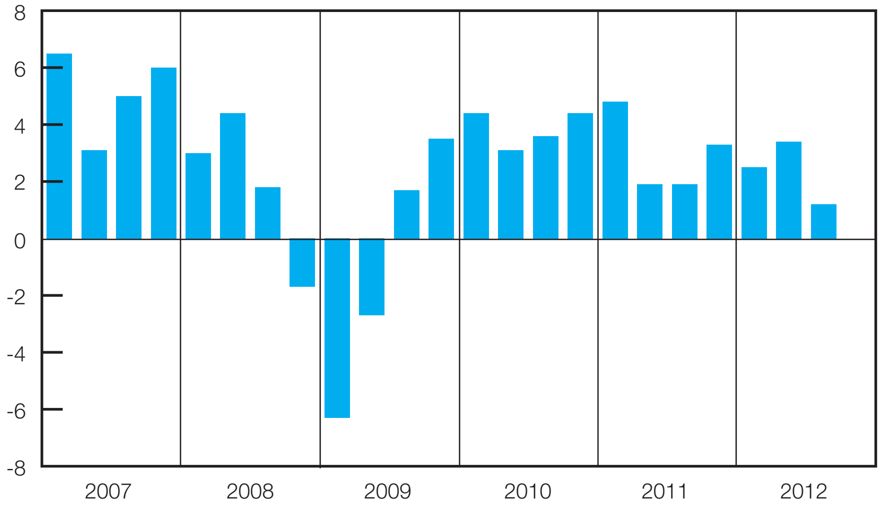
1 In accordance with normal practice in the final quarter of the year, revised national accounts data are incorporated in this issue of the *Quarterly Bulletin*. These revisions are based on more detailed or more appropriate data that became available.

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

Economic activity in South Africa slowed markedly in the third quarter of 2012, following a rebound in *real gross domestic production* in the second quarter. Real output growth more than halved from an annualised rate of 3,4 per cent in the second quarter of 2012 to 1,2 per cent in the third quarter. The slower growth in the third quarter reflected a pronounced contraction in the real output of the primary sector and slower growth recorded by the tertiary sector, which more than offset an acceleration in growth in the real value added by the secondary sector over this period. Notwithstanding the fickle performance of the South African economy in recent quarters, the level of real gross domestic production in the first three quarters of 2012 was 2,6 per cent higher than in the corresponding period in 2011. This is consistent with an expected annual rate of increase of around 2,5 per cent for 2012 as a whole.

Real gross domestic product

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Excluding the contribution of the generally more volatile primary sector, real growth in the *non-primary sector* of the economy increased from 1,6 per cent in the second quarter of 2012 to 1,8 per cent in the third quarter.

Production in the *primary sector* contracted noticeably in the third quarter of 2012 due to a fall in mining production. Quarter-to-quarter, the real value added by the primary sector declined by 7,1 per cent in the third quarter after having increased at a brisk annualised rate of 24 per cent in the second quarter of 2012 largely due to base effects.

Growth in the real value added by the *agricultural sector* lost some momentum, moderating from 9,3 per cent in the second quarter of 2012 to an annualised rate of 7,4 per cent in the third quarter. Real output of the agricultural sector was mainly affected by a much smaller part of the 2011/12 maize crop being harvested as the bulk of the crop was harvested in the second quarter.

The volatile performance of the *mining sector* continued in the third quarter of 2012. After recording an exceptionally strong quarter-to-quarter increase of 30,9 per cent in the second quarter of 2012, following the protracted labour unrest-related shutdown of operations at a major platinum mine in the first quarter of 2012, the real output of the mining sector contracted by 12,7 per cent in the third quarter. Pronounced declines were registered in the production of copper, chrome, nickel, platinum, gold and coal over the period. By contrast, production of iron ore and diamonds increased.

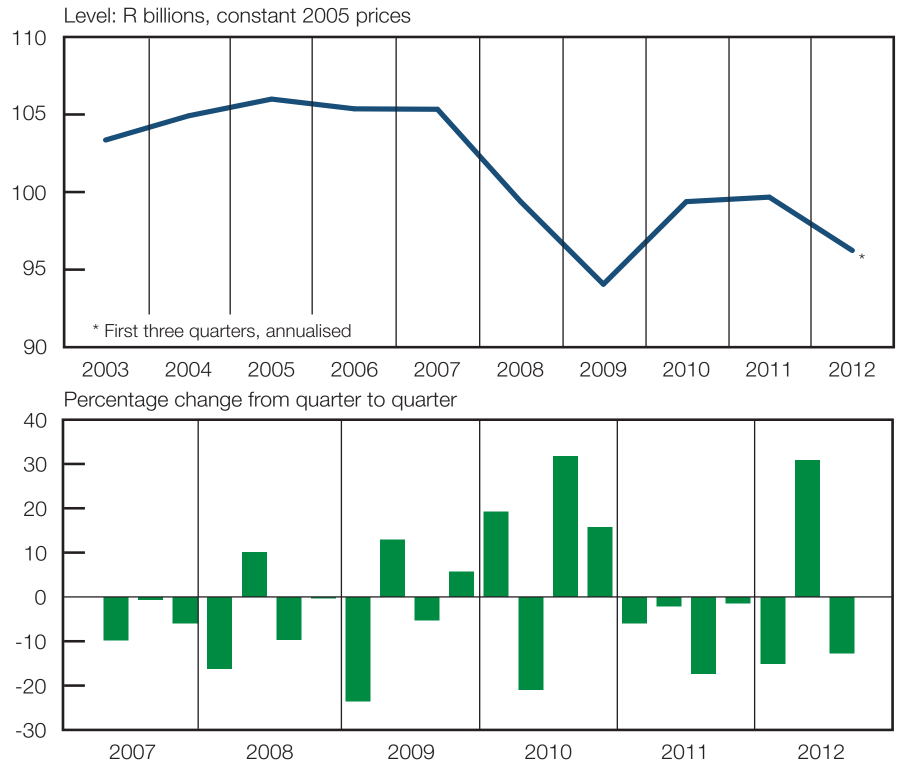
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2011					2012		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	-5,5	-4,2	-14,2	-2,1	0,2	-9,5	24,0	-7,1
Agriculture	-4,7	-9,2	-5,8	-3,7	-0,1	4,8	9,3	7,4
Mining	-5,9	-2,1	-17,4	-1,4	0,3	-15,1	30,9	-12,7
Secondary sector	10,3	-3,2	-0,5	3,6	2,9	5,5	-0,5	1,5
Manufacturing	13,1	-4,3	-0,3	4,5	3,6	6,4	-0,8	1,2
Tertiary sector	3,9	4,1	4,5	3,5	3,8	3,1	2,3	1,9
Non-primary sector	*5,5*	*2,3*	*3,2*	*3,5*	*3,6*	*3,7*	*1,6*	*1,8*
Total	**4,8**	**1,9**	**1,9**	**3,3**	**3,5**	**2,5**	**3,4**	**1,2**

Production activity in the mining sector in the third quarter of 2012 was severely curtailed by prolonged and violent labour unrest at a major platinum mine which gave rise to a complete shutdown of operations from the middle of August 2012. Towards the end of the quarter, labour unrest following the tragic event also spilled over to other platinum mines, and to a number of gold, iron ore, coal and diamond mines. In addition to the generally difficult operating conditions in the domestic mining sector, escalating cost pressures, subdued global demand and lower international commodity prices further aggravated the poor growth performance of the sector over the period. When the first three quarters of 2012 are compared with the corresponding period of 2011, the real value added by the mining sector declined by 4,2 per cent.

Real gross domestic product of the mining sector



Seasonally adjusted annualised rates

Having declined in the second quarter of 2012, the real value added by the *secondary sector* increased at an annualised rate of 1,5 per cent in the third quarter. Increased production could mainly be attributed to higher growth in the real value added by the manufacturing sector, and the sector supplying electricity, gas and water.

The real value added by the *manufacturing sector* rose at an annualised rate of 1,2 per cent in the third quarter, following a decline of 0,8 per cent in the second quarter of 2012. The acceleration in manufacturing output can be explained by a rise in real domestic final demand and somewhat stronger export demand for certain categories of manufactured goods. The quarterly expansion was evident in production volumes of several subsectors, including textiles, clothing, leather and footwear; wood and wood products, paper publishing and printing; basic iron and steel, non-ferrous metal products and machinery; and radio, television and communication apparatus and professional equipment. Slower growth was recorded in the subsectors producing petroleum, chemical products, rubber and plastic products; and motor vehicles, parts and accessories and other transport equipment, whereas production contracted in the subsectors for food and beverages; glass and non-metallic mineral products; and electrical machinery.

Real gross domestic product of the manufacturing sector

Seasonally adjusted annualised rates

Despite ailing business confidence levels and strike activity in the mining and road freight sectors, the higher demand for manufactured products gave rise to an increase in the utilisation of production capacity in the manufacturing sector from 81,3 per cent in the second quarter of 2012 to 82,3 per cent in the third quarter.

The real value added by the sector supplying *electricity, gas and water,* which contracted at an annualised rate of 4,3 per cent in the second quarter of 2012, increased by 1,6 per cent in the third quarter. Although industrial strife constrained the demand for electricity in certain mining subsectors, power buy-back arrangements with large industrial customers by Eskom, the state-owned power utility, came to an end in the second quarter of 2012 which, together with increased export volumes to neighbouring countries, boosted domestic production.

Real output growth in the *construction sector* inched marginally lower from an annualised rate of 3,4 per cent in the second quarter of 2012 to 3,3 per cent in the third quarter. The construction of both residential and non-residential buildings slowed over the period. Households' appetite for the construction of new residential buildings was probably partly suppressed by the subdued behaviour of nominal house prices and more affordable prices of existing houses when compared with new houses alongside rising building costs. Civil construction activity remained buoyant, although the pace of increase in real value added slowed somewhat when compared with the preceding quarter. This trend is consistent with the most recent movement in the Civil Construction Confidence Index which reached its highest level in more than three years in the third quarter of 2012.

Growth in the real value added by the *tertiary sector* decelerated from an annualised rate of 2,3 per cent in the second quarter of 2012 to 1,9 per cent in the third quarter. The real value added by most of the subsectors increased at a slower pace over the period.

Consistent with the moderation in consumer demand and subdued consumer confidence levels, growth in the real output of the *trade sector* slowed from an annualised rate of 2,7 per cent in the second quarter of 2012 to 1,7 per cent in the third quarter. Activity in the wholesale and motor trade subsectors moderated somewhat in the third quarter whereas growth in the real value added by the retail sector continued to accelerate over the period. Industrial action in the road freight transport industry only partly affected the real output of the wholesale sector. The retail subsector continued to benefit from relatively high real outlays on durable and semi-durable goods, supported by moderately rising levels of borrowing by households and the prevailing low interest rate environment in general.

The level of the real value added by the trade sector in the first three quarters of 2012 exceeded that of the corresponding period in 2011 by 3,9 per cent; that is somewhat slower than the rate of increase of 4,5 per cent registered for 2011 as a whole.

Growth in real value added by the *transport, storage and communication sector* slowed from an annualised rate of 2,2 per cent in the second quarter of 2012 to 1,1 per cent in the third quarter. The slower pace of increase partly reflected the adverse impact of industrial action on road freight transportation services. Conversely, growth in the communication subsector continued to benefit from an increased number of subscribers, especially in the pre-paid segment of the market and hybrid offerings by mobile telephone operators to the post-paid segment. Internet browsing also increased moderately during the quarter under review.

In contrast to an increase in financial sector confidence, growth in the real value added by the *finance, insurance, real-estate and business services sector* decelerated from an annualised rate of 2,1 per cent in the second quarter of 2012 to 1,8 per cent in the third quarter. Lower trading volumes in the securities and derivative markets and the performance of the banking sector were the main factors responsible for the slower growth in the finance sector over this period.

Growth in the real value added by *general government* accelerated from an annualised rate of 2,5 per cent in the second quarter of 2012 to 2,7 per cent in the third quarter, reflecting a modest increase in the number of employees in the sector.

Real gross domestic expenditure

Consistent with the slower growth in domestic production, *real gross domestic expenditure* lost some momentum in the third quarter of 2012, decelerating from an annualised rate of 4,9 per cent in the second quarter of 2012 to 3 per cent in the third quarter. This moderation in the pace of increase resulted mainly from slower growth in real final consumption expenditure by households alongside a slower accumulation of inventory holdings, which more than offset an acceleration in final consumption expenditure by general government and gross fixed capital formation. Real gross domestic expenditure increased by 4,4 per cent in the first nine months of 2012 compared with the corresponding period in 2011, slightly lower than the 4,6 per cent rate of increase recorded for 2011 as a whole.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

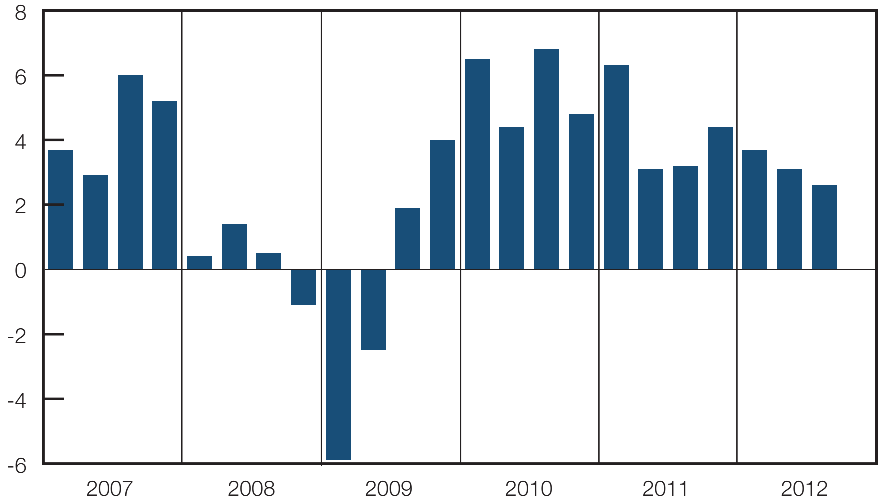
Component	2011					2012		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure								
Households	6,3	3,1	3,2	4,4	4,8	3,7	3,1	2,6
General government	9,3	-0,5	4,8	7,8	4,6	1,9	3,7	8,4
Gross fixed capital formation	5,8	5,2	6,8	7,3	4,5	5,7	7,0	7,2
Domestic final demand	6,8	2,7	4,2	5,6	4,7	3,7	4,0	4,6
Change in inventories (R billions)*	7,7	2,0	3,6	7,0	5,1	5,9	7,0	1,1
Gross domestic expenditure	4,8	2,3	4,9	5,2	4,6	4,1	4,9	3,0

* At constant 2005 prices

In the third quarter of 2012, growth in *real final consumption expenditure by households* decelerated for the third quarter in succession. Household consumption expenditure slowed to an annualised rate of 2,6 per cent in the third quarter, following a rate of increase of 3,1 per cent in the second quarter of 2012. Real outlays on all spending categories moderated over the period. Despite this moderation in spending, the level of real final consumption expenditure by households in the first three quarters of 2012 was still 3,4 per cent higher than in the corresponding period in 2011.

Final consumption expenditure by households

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

After expanding at double-digit rates throughout 2010 and 2011, the pace of increase in household consumption expenditure on *durable goods*, which typically have a high import content, moderated to annualised rates of 8,9 per cent and 7,5 per cent in the second and third quarter of 2012 respectively. The slower pace of spending on durable goods in the third quarter resulted from sustained growth in outlays on personal transport equipment and computers and equipment, which was partly neutralised by a contraction in spending on furniture and other household appliances. The decline in spending on furniture and household appliances was broadly in line with the underlying suppressed conditions in the housing market.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2011					2012		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods......................	16,0	12,6	16,9	17,1	15,8	7,3	8,9	7,5
Semi-durable goods............	6,6	6,1	4,6	7,1	5,9	5,6	6,8	6,2
Non-durable goods	4,6	2,8	2,4	3,5	3,1	2,5	2,2	1,7
Services	5,4	0,4	0,3	1,5	3,5	3,3	1,5	1,1
Total....................................	6,3	3,1	3,2	4,4	4,8	3,7	3,1	2,6

Real spending on *semi-durable goods* slowed to an annualised rate of 6,2 per cent in the third quarter of 2012 following an increase of 6,8 per cent in the preceding quarter. Outlays on a number of semi-durable goods categories slowed, while spending on household textiles and furnishings accelerated over the period. Sustained high levels of spending on clothing and footwear could probably be attributed to more competitive pricing due to cheap foreign imports.

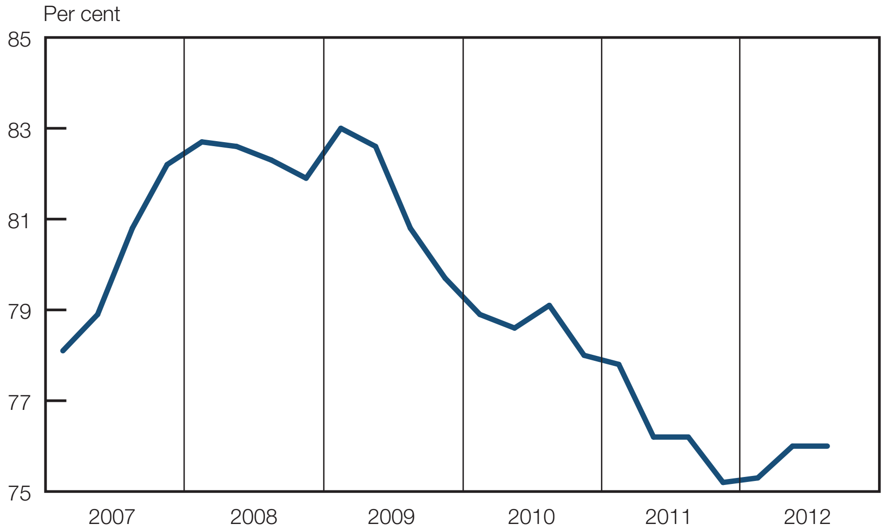
Subsequent to the annualised growth of 2,2 per cent in the second quarter of 2012, the pace of spending on *non-durable goods* moderated to 1,7 per cent in the third quarter – the slowest rate of increase since the second quarter of 2010. The slower pace of increase reflected subdued spending on food, beverages and tobacco; and household fuel and power, which could be attributed in part to persistent increases in the prices of these products, alongside a decline in spending on petroleum products. The reduction in real outlays on petroleum products followed higher-than-expected increases in the price of petrol during the period.

Spending on *services*, having moderated by 1,5 per cent in the second quarter of 2012, slowed further to 1,1 per cent in the third quarter. The sluggish growth in outlays on services was the net result of an acceleration in spending on household services and on recreational and entertainment services which was partly neutralised by a decline in expenditure on miscellaneous services.

Real spending by households was underpinned by the sustained, albeit slower, growth in real disposable income. Following an annualised increase of 3,5 per cent in the second quarter of 2012, growth in real *disposable income of households* moderated to 2,6 per cent in the third quarter reflecting, among other factors, modest employment gains during the period.

The increase in household expenditure did not translate into undue upward pressure on household debt levels as the ratio of household debt to disposable income remained unchanged at 76 per cent in both the second and third quarters of 2012. Consistent with the lower interest rate environment, the ratio of debt-service cost to disposable income decreased to 6,5 per cent in the third quarter of 2012 compared with 6,9 per cent recorded in the preceding quarter.

Household debt as a percentage of disposable income



Seasonally adjusted

Real final consumption expenditure by *general government* accelerated from an annualised rate of 3,7 per cent in the second quarter of 2012 to 8,4 per cent in the third quarter. The contribution of real final government consumption expenditure to growth in total real gross domestic expenditure consequently almost doubled from 0,7 percentage points to 1,6 percentage points over the period. The high growth in the third quarter could mainly be attributed to the acquisition of the final batch of aircraft as part of government's armaments procurement programme.

Excluding the acquisition of armaments, annualised growth in real final consumption expenditure by general government inched marginally higher from 3,7 per cent in the second quarter of 2012 to 3,9 per cent in the third quarter of 2012. This increase reflected a minor uptick in the number of government employees in the third quarter. By contrast, expenditure on non-wage goods and services declined over the period.

Growth in *real gross fixed capital formation* accelerated from an annualised rate of 7 per cent in the second quarter of 2012 to 7,2 per cent in the third quarter. Real capital outlays by private business enterprises maintained their momentum, while capital spending by public corporations and general government recorded robust growth in the third quarter of 2012. Consequently, the level of gross fixed capital formation in the first three quarters of 2012 was 6,7 per cent higher than in the corresponding period in 2011.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Component	2011					2012		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Private business enterprises ...	4,2	3,7	7,0	5,8	4,6	2,2	2,7	2,8
Public corporations................	4,2	2,5	5,5	10,0	1,5	10,7	7,9	9,3
General government.............	16,0	16,3	7,7	10,0	8,6	14,2	24,6	23,4
Total.....................................	**5,8**	**5,2**	**6,8**	**7,3**	**4,5**	**5,7**	**7,0**	**7,2**

Growth in real gross fixed capital formation by *private business enterprises* accelerated marginally to an annualised rate of 2,8 per cent in the third quarter of 2012. This increase in real capital expenditure could mainly be attributed to the finance and construction sectors; capital spending by the construction sector mainly took the form of investment in machinery and equipment. These capital outlays were corroborated by the Construction Confidence Index of First National Bank (FNB) and the Bureau for Economic Research (BER) at Stellenbosch University which rose to their highest level in three years. Growth in the finance sector accelerated on account of continued capital spending on business information systems and other computer-related equipment. Tainted by prolonged unstable conditions in the mining sector, which gradually spilled over to other sectors, and consistent with relatively weak global economic growth, mining and manufacturing companies reduced the pace of capital spending in the first three quarters of 2012.

Real gross fixed capital formation by private business enterprises

Seasonally adjusted annualised rates

Growth in real fixed capital expenditure by *public corporations* accelerated from 7,9 per cent in the second quarter to an annualised rate of 9,3 per cent in the third quarter of 2012. The sustained robust pace of expenditure by the electricity and transport sectors mainly underpinned capital outlays by public corporations. Apart from the construction of new power stations by Eskom, and the upgrade and expansion of Transnet's fleet, capital spending by most other public corporations was focused on the maintenance of current infrastructure.

Expenditure, particularly on construction works and on machinery and equipment, was undertaken by Eskom to supplement its ongoing projects related to additional power stations and power lines as part of Eskom's new build programme. Transnet focused on increasing current capacity and the upkeep of existing assets. The South African National Roads Agency Limited has maintained its momentum in spending on the South African national road network.

Growth in real gross fixed capital expenditure by *general government* was maintained at a robust pace in the third quarter of 2012. Increased activity in the areas of construction works boosted capital activity by provincial government departments. Road works in particular, dominated spending in this category, with both periodic maintenance and new roads being built to service the needs of underdeveloped communities. Increased investment by local government mainly focused on the construction and upgrading of water infrastructure, informal settlement upgrading and social housing.

The build-up of *real inventory investment* holdings decelerated from R7 billion in the second quarter of 2012 to R1,1 billion in the third quarter, due to a considerable run-down of stocks in the mining and trade sectors. Although the pace of inventory accumulation slowed, the ratio of industrial and commercial inventories as a percentage of non-agricultural gross domestic product remained at 12,7 per cent in the third quarter of 2012.

The deaccumulation of inventories in the mining sector emanated from a decline in the output of gold, platinum group metals and coal due to widespread strikes in these sectors. In the trade sector, the run-down in inventory levels was due to a slower pace of accumulation in agricultural stocks-in-trade, which more than offset an accumulation of inventories in the wholesale, retail and motor trade subsectors.

Factor income

Measured over four quarters, growth in *total nominal factor income* decreased from 9,2 per cent in the second quarter of 2012 to 7,2 per cent in the third quarter. This deceleration was due to smaller increases in both the compensation of employees and gross operating surpluses of business enterprises.

Year-on-year growth in the *compensation of employees* slowed from 8,6 per cent in the second quarter of 2012 to 8,1 per cent in the third quarter. This moderation mainly reflected slower growth in the compensation of employees in the finance, real-estate and business services sector, trade sector and the mining sector. In contrast, the share of labour in total factor income increased from 51,7 per cent in the second quarter of 2012 to 52,2 per cent in the third quarter.

In tandem with the slower growth in real economic activity, the year-on-year growth in total *gross operating surpluses* decelerated from 8,5 per cent in the second quarter of 2012 to 6,2 per cent in the third quarter. Reduced profit margins largely reflected subdued growth in the mining, manufacturing and trade sectors. The operating surpluses of business enterprises were furthermore negatively affected by volatile commodity prices, and the uncertain and unstable domestic and international economic conditions. As a percentage of total factor income, the gross operating surplus decreased from 48,3 per cent in the second quarter of 2012 to 47,8 per cent in the third quarter.

Saving

South Africa's *national savings ratio*, defined as gross saving relative to gross domestic product, remained at 13,3 per cent in the second and third quarter of 2012. Higher saving by the corporate sector was neutralised by a further deterioration in saving by the general government. Owing to the stable national savings ratio and the steady pace of increase in gross capital formation, the ratio of South Africa's total gross capital formation financed through an inflow of foreign capital decreased from 32,6 per cent in the second quarter of 2012 to 32,4 per cent in the third quarter.

Gross saving by the *corporate sector* as a percentage of gross domestic product improved from 13,5 per cent in the second quarter of 2012 to 14,6 per cent in the third quarter. The savings ratio was affected by lower tax payments and a slowdown in dividend payments during the third quarter. Gross operating surpluses of business enterprises increased at a slower pace over the period.

Dissaving by *general government* as a ratio of gross domestic product increased from 1,9 per cent in the second quarter 2012 to 3,1 per cent in the third quarter. This deterioration in the saving performance reflected a surge in government consumption expenditure which more than outpaced increased government revenue. Value-added tax (VAT) increased at an annual growth rate of 17 per cent, while transfers from government to households, of which unemployment insurance constitutes the largest component, increased at a slower pace in the third quarter of 2012. This was, however, not sufficient to outweigh the increase in government expenditure in the quarter.

Gross saving by the *household sector* as a percentage of gross domestic product has remained unchanged at 1,7 per cent since the first quarter of 2012. Marginally slower growth in both nominal disposable income and consumption expenditure by households gave rise to the stable saving performance.

Employment

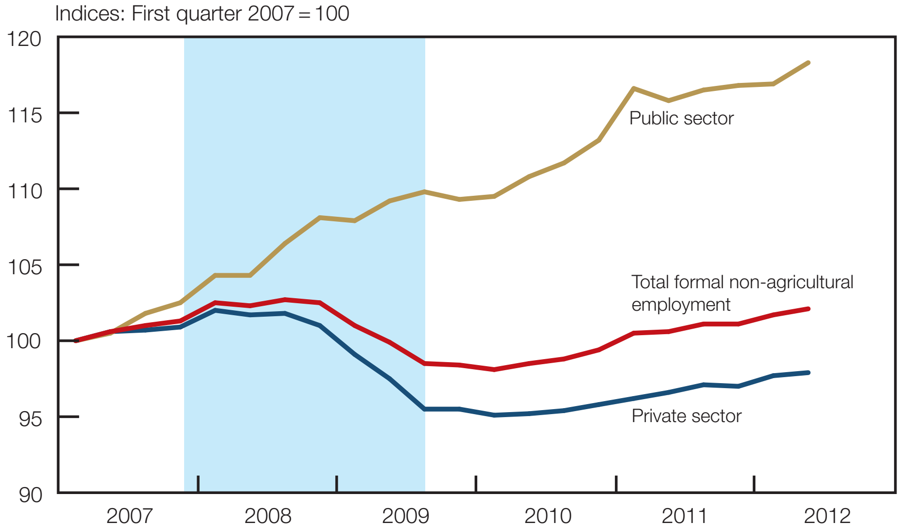
Alongside an acceleration in output growth in the domestic economy, employment in the formal non-agricultural sector of the economy increased further in the second quarter of 2012, albeit at a slower pace. According to the *Quarterly Employment Statistics* (*QES*) survey of Statistics South Africa (Stats SA), employment increased by 1,7 per cent on a seasonally adjusted and annualised basis in the second quarter of 2012, following an increase of 2,4 per cent in the first quarter. The additional 36 000 jobs created brought the level of total formal non-agricultural employment to an estimated 8,44 million at the end of June 2012 compared with 8,4 million at the end of March 2012.[3]

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

The recent spate of labour unrest that originated in the mining sector and subsequently spread to other sectors of the economy, adversely affected business and investor confidence in the domestic economy. These developments, coupled with recent downgrades of South Africa's sovereign debt rating by two credit rating agencies and weaker prospects for global growth, do not augur well for employment growth in the domestic economy over the short to medium term.

In a contracyclical fashion, employment gains in the formal non-agricultural sector of the economy in the second quarter of 2012 occurred mainly in the public sector when an additional 24 000 employees were added to its staff complement, while only 12 000 new employment opportunities were created in the private sector. Accordingly, on a seasonally adjusted and annualised basis, public-sector employment growth accelerated notably to a rate of 4,9 per cent in the second quarter of 2012 as national departments increased their staff complement by 5,7 per cent, provincial governments by 4,1 per cent and local governments by 1,1 per cent. In addition, employment levels in other public-sector enterprises increased by 10,1 per cent. In the year to the second quarter of 2012, the public sector expanded its workforce by 2,2 per cent, representing an increase of around 44 000 employees. However, the Minister of Finance recently announced in the 2012 *Medium Term Budget Policy Statement (MTBPS)* that government intended to curtail employment and wage growth in the public sector in the years ahead.

Formal non-agricultural employment



Seasonally adjusted
Shaded area indicates a downward phase in the business cycle

Source: Statistics South Africa

The formal non-agricultural sector of the economy lost some 384 000 jobs during the most recent downward phase in the employment cycle, of which 334 000 have been reclaimed from the second quarter of 2010 up to the second quarter of 2012. Notwithstanding the fact that the public sector constitutes only about 24 per cent of the total formal non-agricultural workforce, almost half of the reclaimed employment opportunities occurred in the public sector, signalling the extent of the government's contracyclical intervention during this period. Only three subsectors in the private sector were able to regain employment opportunities during the most recent upward phase in the employment cycle in excess of those lost during the downward phase in the employment cycle, that is, the non-gold mining, electricity-generation and private transport, storage and communication services sectors.

As already mentioned, employment in the private sector increased further in the second quarter of 2012, albeit at a modest annualised rate of 0,8 per cent. This increase occurred primarily due to employment gains in the non-gold mining sector (at an annualised rate of 9,4 per cent); the electricity sector (6,4 per cent); the construction sector (6,3 per cent); the private transport, storage and communication sector (2,2 per cent); and the trade, catering and accommodation services sector (0,9 per cent). These employment increases were countered by job shedding in the manufacturing sector (1,4 per cent); the finance, real-estate and business services sector (1,1 per cent); and the gold-mining sector (0,9 per cent).

Employment in the mining sector increased by around 8 300 jobs in the second quarter of 2012 as mining output rebounded notably, following a sharp contraction in output in the first quarter of 2012 due to labour unrest-related shutdowns in the platinum mining sector. All new employment opportunities were created in the non-gold mining sector (8 600), while a further decrease of 300 job opportunities occurred in the gold-mining sector in the second quarter of 2012.

Changes in enterprise-surveyed formal non-agricultural employment*

Sector	Change over one quarter 2011		Change over one quarter 2012		Change over four quarters to 2nd qr 2012		Cumulative job losses (-) gains (+)	
	3rd qr	4th qr	1st qr	2nd qr	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 2nd qr 2012
Finance, insurance, real-estate and business services	6 700	-9 800	23 400	-5 100	15 200	0,8	-163 400	83 500
Manufacturing	-1 900	4 600	-1 500	-4 100	-2 900	-0,3	-118 300	-32 900
Trade, catering and accommodation services	8 800	-5 400	19 100	3 800	26 300	1,6	-75 700	51 300
Construction	11 200	800	-4 500	6 600	14 100	3,4	-52 100	16 300
Mining	-1 800	3 800	5 600	8 300	16 000	3,1	-35 900	40 300
Gold mining	-6 900	-100	-300	-300	-7 600	-5,1	-8 900	-17 400
Other mining	5 100	3 900	6 000	8 700	23 600	6,4	-27 000	57 600
Electricity	-100	-200	900	900	1 500	2,5	-3 300	5 500
Private transport, storage and communication services	8 400	1 100	-400	1 400	10 500	4,1	-2 000	8 500
Community, social and personal services	-3 500	-2 300	4 600	200	-1 100	-0,3	13 400	9 400
Total private sector	27 700	-7 400	47 200	12 000	79 600	1,3	-437 300	181 800
Provinces	5 300	2 800	700	11 400	20 300	1,9	51 600	80 100
Local governments	-800	500	1 200	700	1 600	0,6	15 000	16 600
National departments	8 400	5 100	500	6 200	20 100	4,7	-800	40 600
Other public-sector enterprises	-1 500	-4 600	-1 600	2 300	-5 300	-3,8	-7 800	8 000
Public transport, storage and communication services	-100	2 700	700	3 800	7 200	6,9	-4 900	7 200
Total public sector	11 400	6 500	1 500	24 500	43 900	2,2	53 100	152 500
Grand total	39 100	-900	48 700	36 500	123 400	1,5	-384 200	334 300

* Seasonally adjusted

In August 2012, a renewed wave of labour unrest erupted in the South African mining sector. An illegal and violent strike at Lonmin's Marikana platinum mine resulted in a number of tragic fatalities, sparking similar unlawful wildcat strikes at many other mines and also in other sectors of the economy. The resultant work stoppages in the third quarter of 2012 seriously disrupted production in the mining sector, and numerous reports of layoffs following illegal industrial action do not augur well for further job creation in the sector in the near term. In addition, the mining sector continues to be negatively impacted by increased cost pressures and constraints in the domestic economy, notably the cost and supply of electricity, and a renewed surge in wage costs following the labour unrest. The mining sector's affliction is compounded further by relatively weak global demand for mining commodities due to lacklustre global economic growth.

Employment levels in the manufacturing sector continued to contract, with the pace of job shedding accelerating from a seasonally adjusted and annualised rate of 0,5 per cent in the first quarter of 2012 to 1,4 per cent in the second quarter. These declines followed an increase of 1,6 per cent in job opportunities in the fourth quarter of 2011, the only quarterly increase in employment levels in the manufacturing sector since the onset of the 2008/9 recession. Encouragingly, the year-on-year pace of job shedding in the manufacturing sector has moderated considerably from 7,5 per cent in the third quarter of 2009 to 0,3 per cent in the second quarter of 2012.

Employment and real output in the mining sector

Source: Statistics South Africa

Although the manufacturing sector has not been affected to the same extent as the mining sector by the recent wave of disruptive industrial action, the longer-term impact of these developments could further curtail already weak employment creation in the sector by enticing manufacturers to speed up mechanisation. In addition, relatively weak global demand and sentiment indicators suggest a fairly dim outlook for employment growth in the domestic manufacturing sector in the short term. According to the BER's Manufacturing Survey for the third quarter of 2012, general business conditions and employment indicators in the sector deteriorated further during the survey period. Furthermore, the employment sub-index of the Kagiso Purchasing Managers' Index (PMI) fell notably to 47,9 index points in September 2012, having just breached the neutral level of 50 in August.

Following a moderate increase in the first quarter of 2012, employment in the finance, insurance, real-estate and business services sector declined by 1,1 per cent in the second quarter. Conversely, employment in the electricity-generation sector increased at brisk annualised rates of 5,9 per cent and 6,4 per cent in the first and second quarters of 2012 respectively, following employment losses in the second half of 2011. Continuous capacity-enhancing expenditure by Eskom should continue to support job creation in the sector over the medium term.

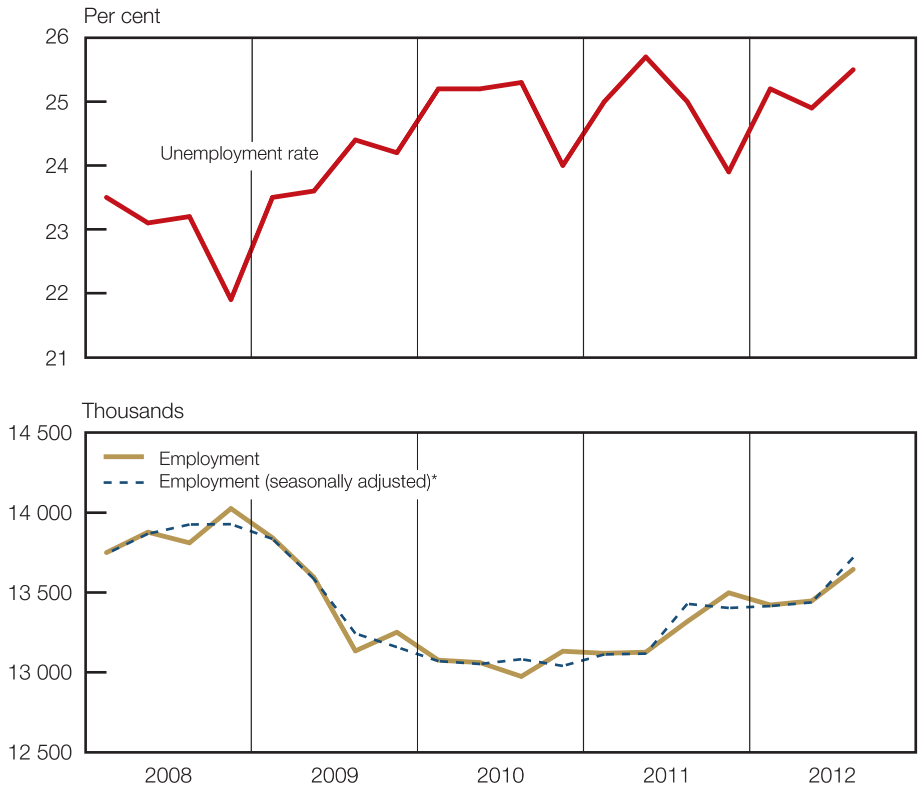
Employment opportunities in the trade, catering and accommodation services sector rose by 3 800 in the second quarter of 2012, following a notable increase of 19 100 in the first quarter. Brisk increases in new vehicle and retail trade sales assisted the continued rise in employment levels in this sector in the second quarter of 2012. The FNB/BER Consumer Confidence Index has, however, declined notably over the past year and is currently on a par with its level at the onset of the global financial crisis in the second half of 2008. In addition, anticipated higher food and energy prices are expected to erode growth in disposable income of households, which could slow the pace of job creation in the trade, catering and accommodation services sector.

Subsequent to a decrease in the first quarter of 2012, employment levels in the construction sector advanced at a brisk pace of 6,3 per cent in the year to the second quarter. This increase occurred alongside a pick-up in the real value of completed building additions and alterations, and increased sales of hardware, paint and glass in the second quarter of 2012. Employment growth in the construction sector also benefited from an increase in construction activity by the public sector during the quarter. Encouragingly, the FNB/BER Civil Construction Confidence Index rose for a fourth consecutive quarter, amounting to 42 index points in the third quarter of 2012. Prospects in the residential building sector, however, remain subdued as indicated by the FNB/BER Building Confidence Index, which receded further in the third quarter of 2012.

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

According to Stats SA's *Quarterly Labour Force Survey* (*QLFS*), South Africa's official unemployment rate increased from 25,0 per cent in the third quarter of 2011 to 25,5 per cent in the third quarter of 2012.[4] This resulted from an increase of 327 000 in the number of people employed, as well as an increase of 225 000 in the number of unemployed in the year to the third quarter of 2012. On a seasonally adjusted basis, the number of people employed (as estimated by the South African Reserve Bank) increased by 2,4 per cent from the second quarter of 2012 to the third quarter, compared to an increase of 1,5 per cent in the unadjusted number of people employed. Encouragingly, the number of discouraged work-seekers declined by 34 000 in the year to the third quarter of 2012, and by 141 000 from the second quarter of 2012 to the third quarter. The decline in the number of discouraged work-seekers could partially explain the increase in the number of unemployed persons, as more people were persuaded to search for employment in the third quarter of 2012, thereby raising the unemployment rate.

Official unemployment rate and total employment



* Seasonally adjusted by the South African Reserve Bank

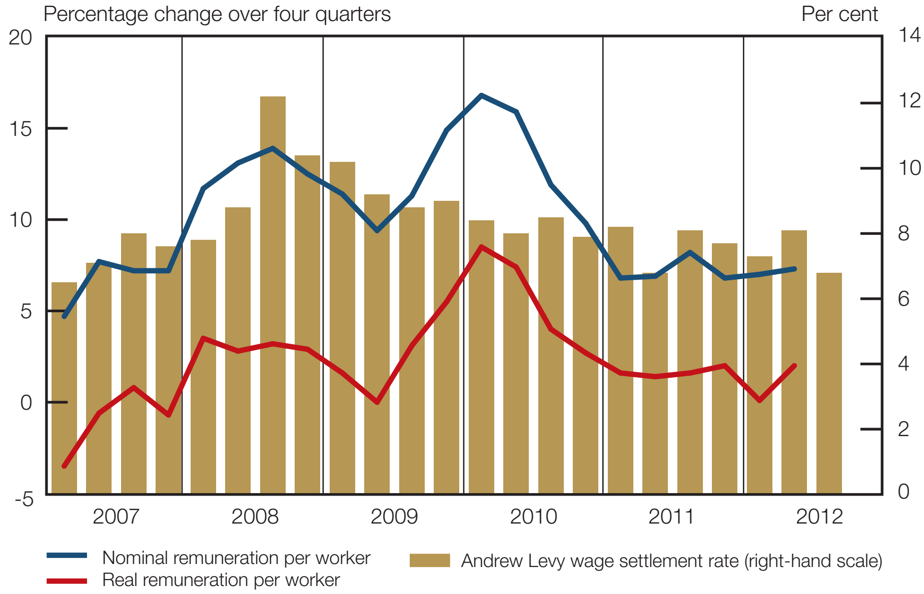
Source: Statistics South Africa, *Quarterly Labour Force Survey*

Labour cost and productivity

The year-on-year pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy remained relatively consistent at around 7,0 per cent in the first and second quarters of 2012. This consistency in aggregate wage growth, however, masked the quickening in private-sector wage growth from 6,9 per cent to 7,7 per cent over this period; at the same time, public-sector wage growth decelerated to 6,0 per cent in the second quarter. Of significance is the indication that the real take-home pay of those gainfully employed in the formal non-agricultural sector has, on average, increased by as much as 2,0 per cent in the year to the second quarter of 2012.

Although not necessarily indicative of cost pressures in the labour market, increases in private-sector nominal remuneration per worker remained above the inflation target range in the gold-mining sector (11,7 per cent); the construction sector (9,9 per cent); the non-gold mining sector (9,2 per cent); the manufacturing sector (8,8 per cent); the finance, insurance, real-estate and business services sector (8,1 per cent); the private community, social and personal services sector (6,9 per cent); and the electricity sector (6,5 per cent). The moderation in nominal remuneration growth per worker in the public sector could be ascribed to a deceleration in wages per worker paid by national departments and other public-sector enterprises, which registered year-on-year increases of 6,9 per cent and 7,8 per cent respectively. Despite the acceleration in the rate of increase in remuneration per worker at local governments, it remained fairly modest at 4,7 per cent in the year to the second quarter of 2012.

Remuneration per worker and wage settlement rates

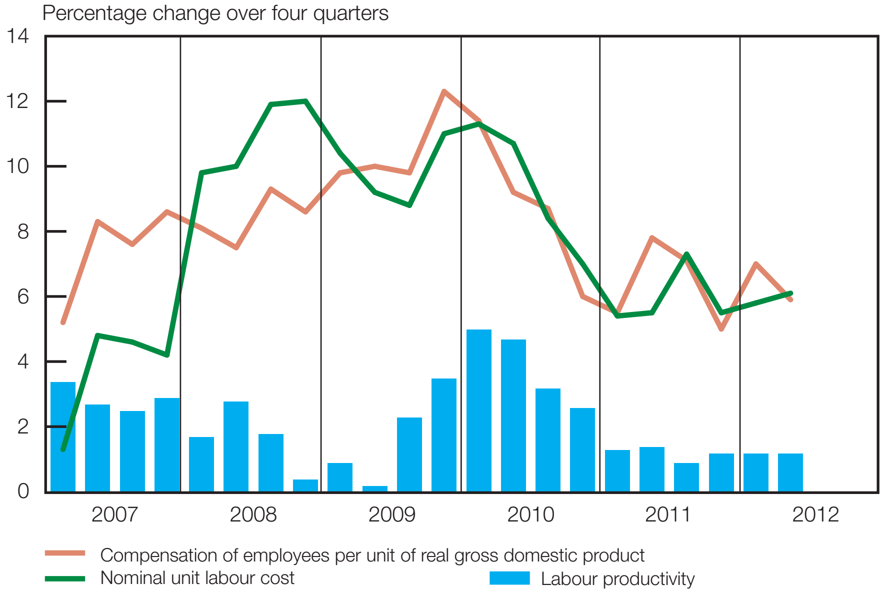


Sources: Statistics South Africa and Andrew Levy Employment Publications

Despite reports of a number of double-digit wage increases following the unprotected strike action in the mining sector, the average wage settlement rate in collective bargaining agreements decreased from 7,7 per cent in the first half of 2012 to 7,4 per cent in the first nine months of 2012, according to Andrew Levy Employment Publications. This implies wage settlements of around 6,8 per cent in the third quarter of 2012. The number of working days lost due to strike action fell to 1,6 million at the end of September 2012, compared with 5,4 million at the end of September 2011. Notwithstanding the sharp decline, a number of high-profile and disruptive strikes occurred in the mining sector, representing 86 per cent of the total number of workdays lost. The major strike trigger remained wages, accounting for 91,4 per cent of working days lost and 72,5 per cent of the number of strikes. The short-term inflationary impact of the double-digit wage increases, following the spate of industrial action, could be fairly muted as it would take some time for most of the affected workers to recoup the wages they had foregone during their illegal strike action.

Year-on-year growth in employment in the formal non-agricultural sector of the economy kept pace with that of output in the second quarter of 2012, resulting in productivity growth remaining unchanged at 1,2 per cent over the period. Productivity growth in the manufacturing sector accelerated in the second quarter of 2012, to a year-on-year rate of 2,2 per cent, as output picked up pace alongside a decline in the level of employment. The acceleration in output growth in the total non-agricultural sector of the economy lagged the acceleration in remuneration growth, resulting in growth in nominal unit labour cost accelerating from 5,8 per cent in the year to the first quarter of 2012 to 6,1 per cent in the second quarter. In the manufacturing sector, however, the year-on-year pace of increase in unit labour cost decelerated marginally from 6,5 per cent in the first quarter of 2012 to 6,4 per cent in the second quarter. When assessing unit labour cost using the broader national accounts measure of compensation of employees per unit of output (i.e., also including the agricultural sector and the informal sector), year-on-year growth in unit labour cost also moderated somewhat to 5,9 per cent in the second quarter of 2012. Given the spate of industrial action in the third quarter of 2012 which severely curtailed production volumes in especially the mining sector, productivity and unit labour cost outcomes will adversely be affected in that quarter.

Labour productivity and unit labour cost in the formal non-agricultural sector



Sources: Statistics South Africa and South African Reserve Bank calculations

Prices

Against the backdrop of relatively weak global economic growth and benign global inflation, domestic headline consumer price inflation moderated to 4,9 per cent in July 2012, before accelerating to 5,6 per cent in October.[5] The pick-up in consumer price inflation occurred mainly on account of higher food and fuel prices, partly as a consequence of the depreciation in the exchange rate of the rand in recent months. Numerous double-digit wage increases being granted in response to fairly widespread and disruptive industrial action, particularly in the mining sector, could add to inflationary pressure in the months ahead as lost wages are being recouped and income levels rise. Encouragingly, producer price inflation for domestic output decelerated from a recent high of 10,6 per cent in October 2011 to 4,2 per cent in September 2012, before accelerating to 5,2 per cent in October.

5 All rates mentioned reflect year-on-year changes, unless stated to the contrary.

Headline producer and consumer prices

Year-on-year percentage changes

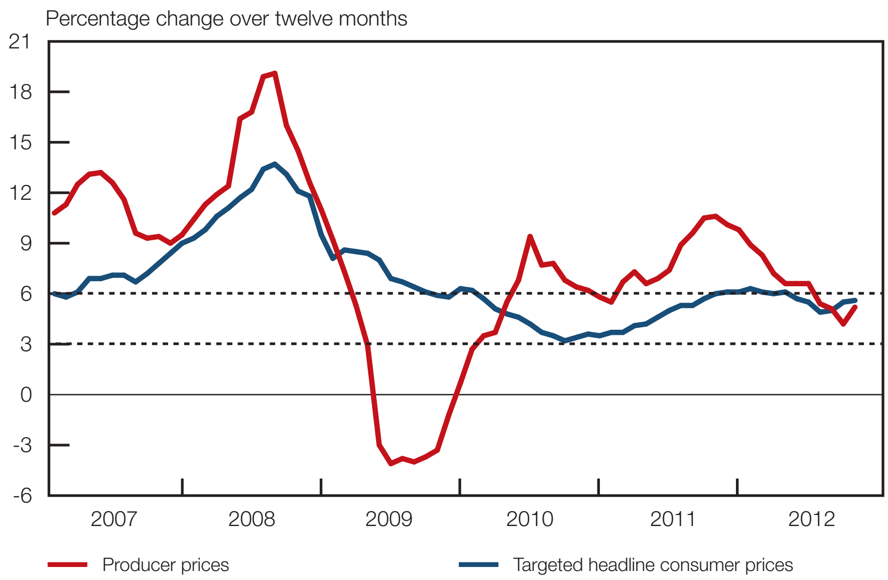
	Producer prices	Consumer prices
2012: January	8,9	6,3
February	8,3	6,1
March	7,2	6,0
April	6,6	6,1
May	6,6	5,7
June	6,6	5,5
July	5,4	4,9
August	5,1	5,0
September	4,2	5,5
October	5,2	5,6

The deceleration in domestic producer price inflation occurred despite a depreciation in the exchange rate of the rand, as deteriorating global economic growth pushed commodity prices lower. The moderation in overall headline producer price inflation was fairly well dispersed through the various price categories, that is, inflation in mining and quarrying product prices decelerated from 17,7 per cent in September 2011 to -0,1 per cent in September 2012; petroleum and coal price inflation decelerated from 33,1 per cent in November 2011 to 5,6 per cent in July 2012; and electricity price inflation decelerated from 27,6 per cent in March 2012 to 12,8 per cent in October. In addition, the prices of basic metals declined by 3,2 per cent in September 2012. The slowdown in producer price inflation was partly countered by higher inflation in producer food prices, and the prices of petroleum and coal at rates of 10,4 per cent and 10,5 per cent in October 2012 respectively.

Assisting the deceleration in overall producer price inflation, inflation in imported commodity prices moderated notably from a recent high of 16,4 per cent in December 2011 to 4,4 per cent in August 2012, aided by an appreciation in the exchange rate of the rand in the opening months of the year. However, producer price inflation of imported commodities accelerated markedly to 8,0 per cent in October 2012, as the impact of higher crude oil prices and a depreciation in the exchange rate of the rand resulted in an acceleration in imported mining and agricultural commodity price inflation to 20,8 per cent and 4,9 per cent respectively.

Headline consumer price inflation peaked at 6,3 per cent in January 2012, thereafter decelerating to 4,9 per cent in July. Subsequently, this rate of increase accelerated to 5,6 per cent in October 2012 as consumer goods price inflation picked up; notably that of food and petrol.

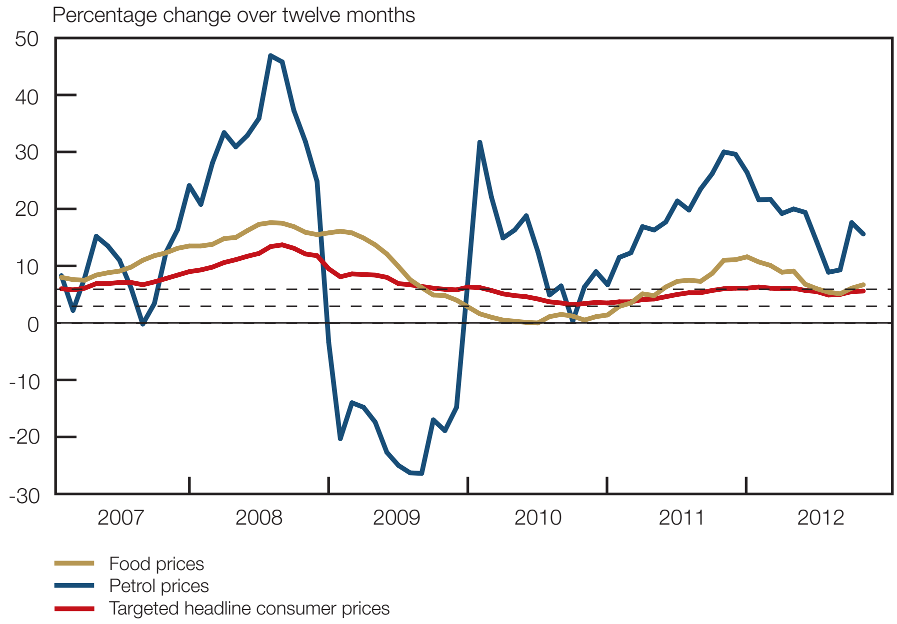
Producer and consumer prices



Consumer *goods* price inflation, after decelerating during the first half of 2012, picked up from 4,2 per cent in August 2012 to 5,3 per cent in October. The acceleration in consumer goods price inflation resulted primarily from higher price inflation in the food and non-alcoholic beverages category from 4,9 per cent in August 2012 to 6,3 per cent in October, and a doubling in transport price inflation to 5,2 per cent during the two months to September. This resulted in non-durable goods price inflation accelerating to 7,6 per cent in October 2012.

Despite accelerating to 3,3 per cent in October 2012, semi-durable goods price inflation at this rate remained within the inflation target range. The rate of deflation in durable goods prices moderated throughout 2012; extending the period of deflation to 32 months.

Consumer prices



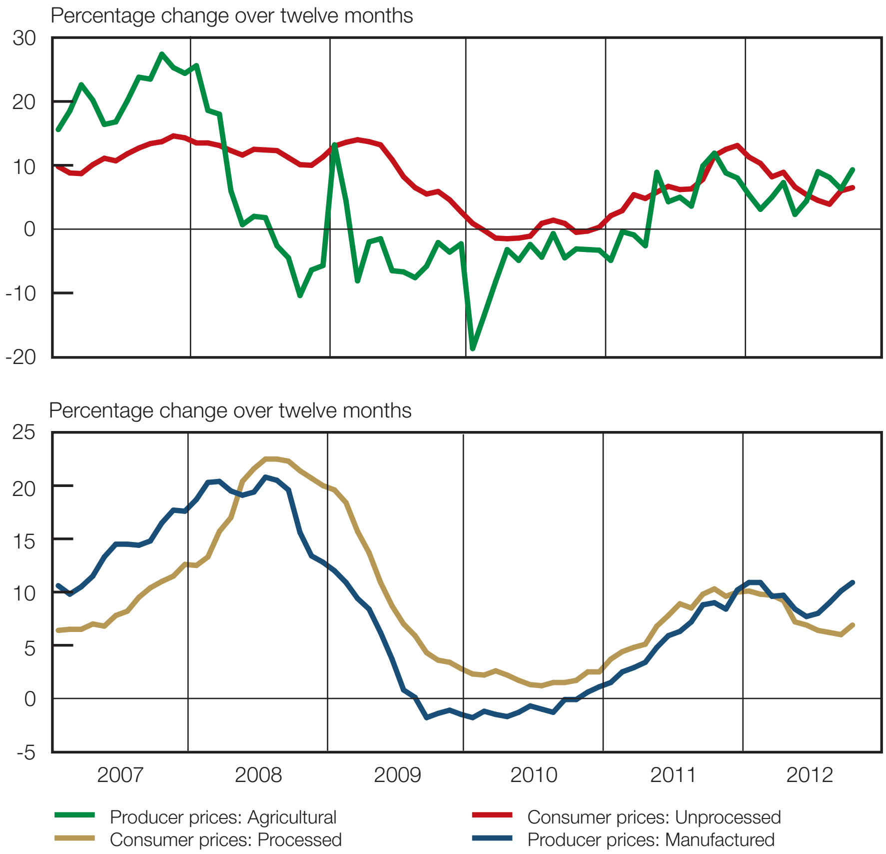
Consumer *services* price inflation accelerated to 5,9 per cent in March 2012 and remained broadly at this level up to October, marking the 28th consecutive month that consumer services costs inflation had remained within the inflation target range. Consumer services price inflation was contained by decreases in communication services costs during the twelve-month period to July 2012, increasing only marginally in the three months to October, compared with a year earlier. Conversely, the prices of transport services increased at a brisk pace of 12,3 per cent in October 2012, as the prices of public road and rail transport advanced at double-digit rates.

The slowdown in domestic inflationary pressures during the first eight months of 2012 was assisted by a notable deceleration in food price inflation over the period. Producer food price inflation moderated from a recent high of 10,0 per cent in October 2011 to 6,3 per cent in May 2012, as agricultural food price inflation slowed to 2,3 per cent in May 2012. Producer food price inflation at the manufactured level remained elevated, reflecting additional cost pressures associated with the production process such as high electricity prices and wage increases, but nevertheless moderated from a peak of 10,9 per cent in February 2012 to 7,7 per cent in June.

Similarly, consumer food price inflation more than halved to 5,1 per cent during the eight months to August 2012, as the slowdown in food price inflation at the producer level filtered through to the consumer level. The moderation in consumer food price inflation was largely driven by a notable deceleration in unprocessed food price increases, from 13,1 per cent in December 2011 to 3,9 per cent in August 2012. Consumer price inflation of processed food also moderated meaningfully from 10,3 per cent in October 2011 to 6,0 per cent in September 2012.

The downward trajectory in food price inflation appears to have been arrested in the third quarter of 2012, as producer food price inflation accelerated to 10,4 per cent in October 2012. Both agricultural and manufactured producer food price inflation picked up pace to 9,3 per cent and 10,9 per cent respectively in October 2012. The acceleration in domestic food price inflation was widely anticipated, following a spike in international grain prices in July 2012 as adverse weather conditions in the northern hemisphere reduced maize and wheat crops. Domestic producer price inflation of grain responded immediately and accelerated to 27,6 per cent in July 2012, before moderating to 11,6 per cent in October. In addition, producer prices of oil seeds increased markedly at rates of around 50 per cent in August and September 2012, before moderating somewhat to 36,6 per cent in October.

Food prices



Source: Statistics South Africa

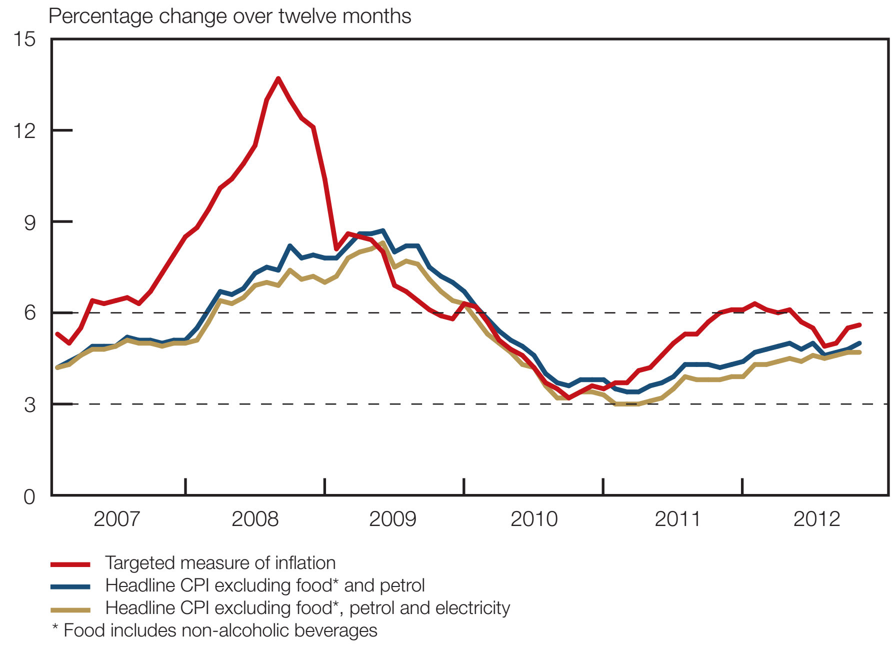
Following the quickening in producer food price inflation in recent months, consumer food price inflation picked up pace from 5,1 per cent in August 2012 to 6,7 per cent in October, due to an almost doubling in unprocessed food price inflation to 6,5 per cent over this period. The effects of the significant rise in grain prices became visible in an acceleration in price inflation of bread and cereals from 5,9 per cent in August 2012 to 8,4 per cent in October, as well as a doubling in meat price inflation (compounded by rising livestock feed costs) to 7,4 per cent in October, from three months hence. In addition to the bread, cereals and meat categories, which together account for almost 54 per cent of the consumer food basket, most other consumer food categories also experienced accelerated price inflation in October 2012.

Domestic food price inflation is expected to accelerate further in the months ahead, as a number of factors could exert additional upward pressure on these prices, notably

- the depreciation in the exchange rate of the rand in October and November 2012 following the downgrading of South Africa's sovereign debt rating by two international ratings agencies;
- international food prices remaining at elevated levels;
- the sharp rise in fuel prices between August and October 2012; an important input cost in the production and transport of food; and
- the disruptive strike action in the road freight sector in September and October 2012, which could have led to an increase in certain food items due to temporary shortages.

When the impact of the more volatile food, non-alcoholic beverages and petrol prices is excluded from the calculation of targeted headline consumer price inflation, underlying inflation accelerated from 4,2 per cent in October 2011 to 5,0 per cent in October 2012. In addition, when the impact of electricity prices is excluded from the calculation, consumer price inflation accelerated steadily from 3,0 per cent early in 2011 to 4,7 per cent in September and October 2012 – marginally above the mid-point of the inflation target range.

Underlying measures of consumer price inflation



An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories confirms that underlying inflationary pressures remained reasonably well contained in the year to October 2012.

Headline consumer prices according to COICOP categories

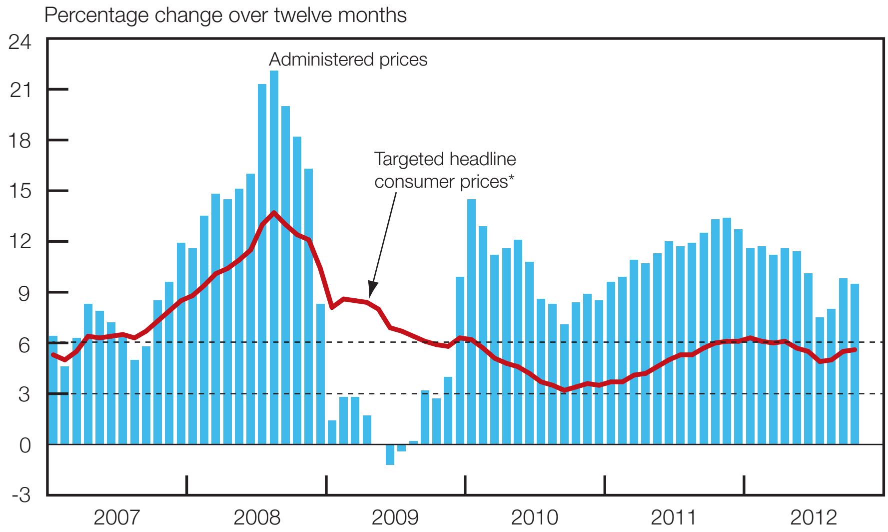
Percentage change over twelve months

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

The rate of increase in four of the twelve categories – collectively accounting for 42 per cent of the total consumer price basket – exceeded the upper limit of the inflation target range of 6 per cent in October 2012. Six categories – collectively accounting for almost 49 per cent of the total consumer price basket – recorded price increases within the inflation target range, while two categories – collectively accounting for 9 per cent of the total consumer price basket – registered rates of increase below the lower limit of the inflation target range of 3 per cent in October 2012. In addition, from September 2012 to October the rates of increase in five of the twelve COICOP categories accelerated, while the rates of change in five categories decelerated and stayed the same in the remaining two categories.

Administered price inflation accelerated from 7,5 per cent in July 2012 to 9,5 per cent in October. This acceleration can primarily be attributed to a 17,6 per cent increase in petrol prices in September 2012 when the inland price of petrol rose by a sizeable 93 cents per litre. When excluding the effect of petrol prices from the calculation of administered prices, this rate of increase still remained well above the upper limit of the inflation target range but, nevertheless, moderated somewhat from 8,9 per cent in April 2012 to 7,5 per cent for the third consecutive month in October. When electricity prices are excluded from the calculation, administered price inflation remained fairly stable during the past two years, amounting to 6,7 per cent in October 2012.

Targeted inflation and administered prices



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

Despite continuing to add to overall inflation pressures in the economy, electricity price inflation decelerated notably from 17,3 per cent in June 2012 to 10,0 per cent in October, as the annual price increase approved by the National Energy Regulator of South Africa (NERSA) in February 2012 was much lower than in the preceding year. However, Eskom recently applied for annual electricity price increases of 16 per cent for the next five years which, if approved by NERSA, would result in electricity price inflation continuing to add to overall inflationary pressures in the economy in general and administered price inflation in particular.

Average inflation expectations for 2012, according to the Survey of Inflation Expectations as conducted by the BER, were lowered to within the inflation target range at a rate of 5,8 per cent, compared with an expectation of 6,1 per cent during the second-quarter survey. These forecasts were made against the backdrop of a deceleration in headline consumer price inflation during the period April to July 2012. Financial analysts remain the most optimistic, expecting headline consumer price inflation to remain below the upper limit of the inflation target range for the entire forecast horizon. By contrast, trade union representatives expect inflation to breach the inflation target range in both 2013 and 2014. Households decreased their inflation expectations for 2012 to 6,4 per cent. Encouragingly, despite a moderately rising trend, inflation expectations remain broadly anchored around the upper limit of the inflation target range to 2014.

Headline consumer price inflation expectations

Per cent, as surveyed in the third quarter of 2012

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2012	5,5	5,9	5,8	5,8
2013	5,2	6,3	6,4	6,0
2014	5,3	6,4	6,9	6,2

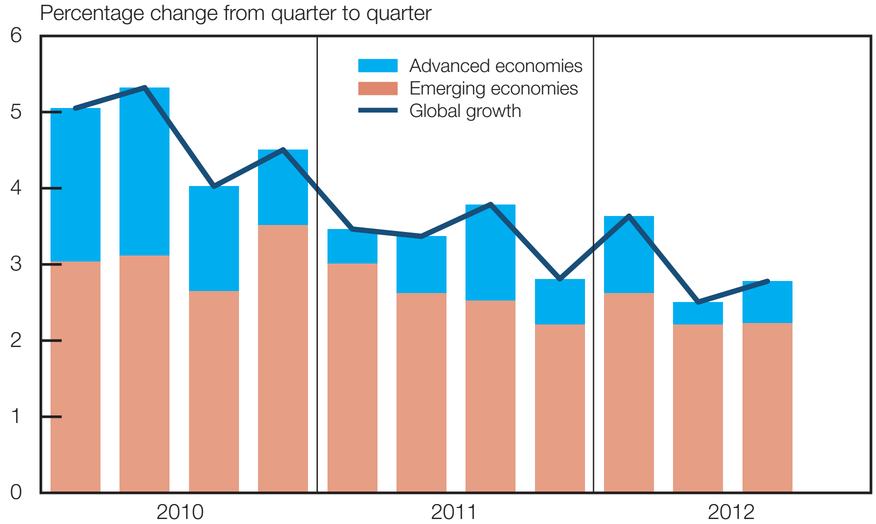
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

After having moderated in the second quarter of 2012, global economic growth edged higher to 2,8 per cent in the third quarter, nevertheless remaining subdued compared with rates of increase in the two preceding years. Growth was primarily underpinned by increased economic activity in emerging-market economies which have generally outperformed advanced economies.

Global growth and contributions to growth from advanced and emerging economies



Seasonally adjusted annualised rates

Sources: National statistical offices, JPMorgan and staff calculations

The global economic outlook has weakened further since July 2012, resulting in a further reduction of the IMF's global growth projections in the October 2012 *World Economic Outlook* to 3,3 per cent in 2012 and 3,6 per cent in 2013. These projections are based on the assumptions that European policymakers will adopt adequate policies to address financial conditions in Europe and that policymakers in the United States (US) will be able to resolve the so-called fiscal cliff, thereby avoiding a possible recession.

The IMF's projection for real output growth in the sub-Saharan African region was revised downwards by 0,1 percentage points to 5,0 per cent in 2012 but remained unchanged at 5,7 per cent in 2013. The growth outlook for the region remains strong as a result of improved policy frameworks, modest spillovers from Europe (except in the case of South Africa which has stronger ties with Europe), export diversification which reduces exposure from weak-growing advanced economies, and high commodity prices.

Real output growth in advanced economies accelerated marginally in the third quarter of 2012. Economic growth in the US rebounded to 2,7 per cent in the third quarter of 2012 after moderating in the preceding quarter. Positive contributions from personal consumption expenditure, private inventory investment, residential fixed investment, government expenditure and exports were partly offset by marginally higher imports.

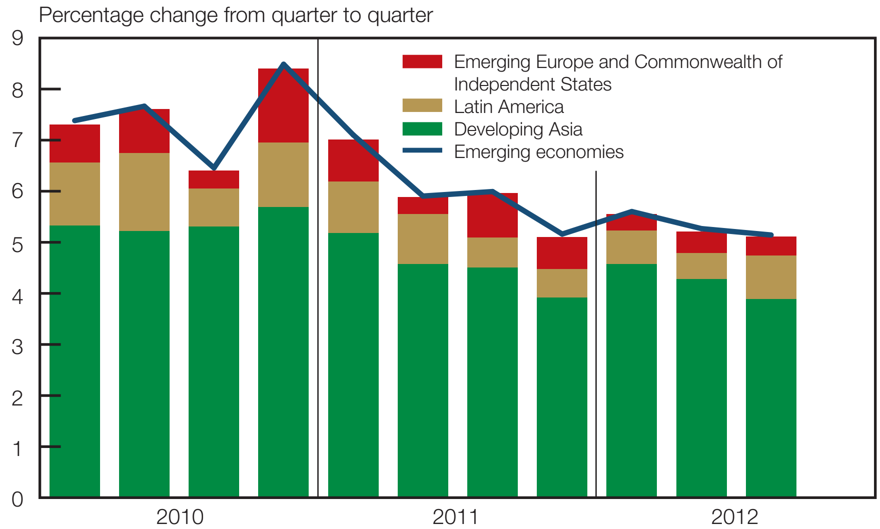
Real output in Japan contracted by 3,5 per cent in the third quarter of 2012. Economic growth was adversely affected by a rapid decline in exports due to weaker global demand and the strengthening Japanese yen. Japan's industrial production declined on an annual basis by 8,1 per cent in September 2012 – the fastest pace of contraction in 18 months. The Markit/JMMA manufacturing Purchasing Managers' Index in Japan fell to 46,9 index points in October 2012 as a territorial dispute with China spurred anti-Japanese sentiment which negatively affected Japanese exports to China.

Economic activity in the euro area declined by 0,2 per cent in the third quarter of 2012 after having contracted in the second quarter. Economic growth rebounded somewhat in France, Finland and Estonia, but remained weak in Spain, Greece and Portugal. Significant policy actions have been taken by European policymakers in recent months. The European Central Bank (ECB) introduced the *Outright Monetary Transactions* (OMT) mechanism in the secondary market for government bonds in September 2012 in order to ensure the singleness of European monetary policy and the proper transmission of policy to the real economy.

Growth in the United Kingdom (UK) rebounded strongly by 3,9 per cent in the third quarter of 2012 following a contraction of 1,5 per cent in the previous quarter. The UK economy recovered from the recent recession due to the robust performance of the services sector (e.g., hotels, restaurants, transport and communications) following the 2012 Olympic Games in London.

The growth momentum in emerging-market and developing economies slowed from around 8,5 per cent in the fourth quarter of 2010 to around 5 per cent in the third quarter of 2012. Although real output growth in emerging Asia also decelerated during this period, the region's growth performance still remains the main driver of growth in emerging-market economies as a group. Growth in emerging Asia edged higher in the third quarter of 2012, underpinned by stronger growth in China. Although China's growth accelerated to 7,7 per cent in the third quarter, it still remained well below the double-digit rates registered in 2010. The slowing growth in China has affected activity in the rest of Asia as a result of expanded linkages throughout the region.

Real output growth in emerging-market economies and regional contributions

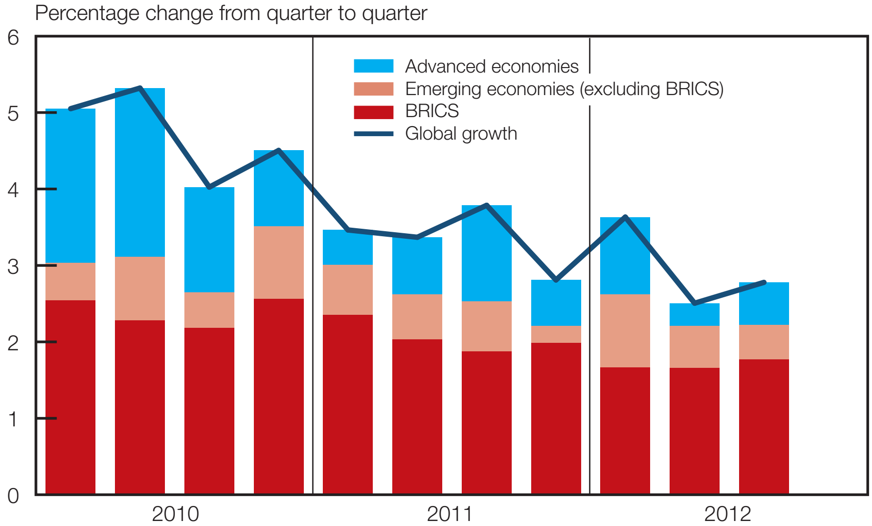


Seasonally adjusted annualised rates

Sources: National statistical offices, JPMorgan and staff calculations

Economic growth in emerging Europe is expected to accelerate somewhat in the third quarter of 2012 due to stronger growth in Russia. Economic activity in emerging Latin America (Brazil, Argentina and Venezuela) rebounded in the third quarter of 2012 as economic conditions improved in the US. Global growth in recent years has become much more dependent on the growth momentum in Brazil, Russia, India and China (the so-called BRICS countries of which South Africa also forms part) – especially on China and India (the larger and faster-growing BRICS countries).

Global growth and contributions from advanced economies, BRICS countries and other emerging-market economies



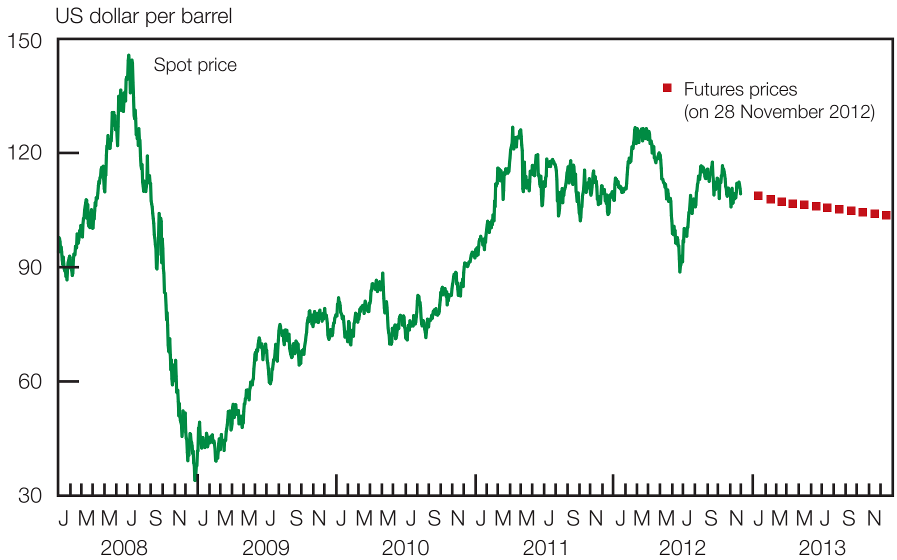
Seasonally adjusted annualised rates

Sources: National statistical offices, JPMorgan and staff calculations

World trade volumes contracted by 0,7 per cent on an annualised basis in the third quarter of 2012 after having expanded by 2,0 per cent the preceding quarter. The slowdown was mainly due to weaker growth prospects in emerging Asian economies, particularly China, and sustained weakness in advanced economies.

Having declined to below US$90 per barrel towards the end of June 2012, Brent crude oil prices rebounded sharply to about US$118 per barrel in mid-September. The higher price of crude oil was mainly due to sanctions (since 1 July 2012) imposed on Iran's oil exports (including US sanctions designed to deter countries from establishing payment mechanisms for purchasing Iranian oil that circumvent existing sanctions) and Hurricane Isaac threatening oil production in the Gulf of Mexico. Although Brent crude oil prices have since been volatile, they trended downwards to about US$110 per barrel towards the end of November 2012. Brent crude oil futures prices for delivery in the first quarter of 2013 are currently trading at around US$108 per barrel.

International crude oil prices

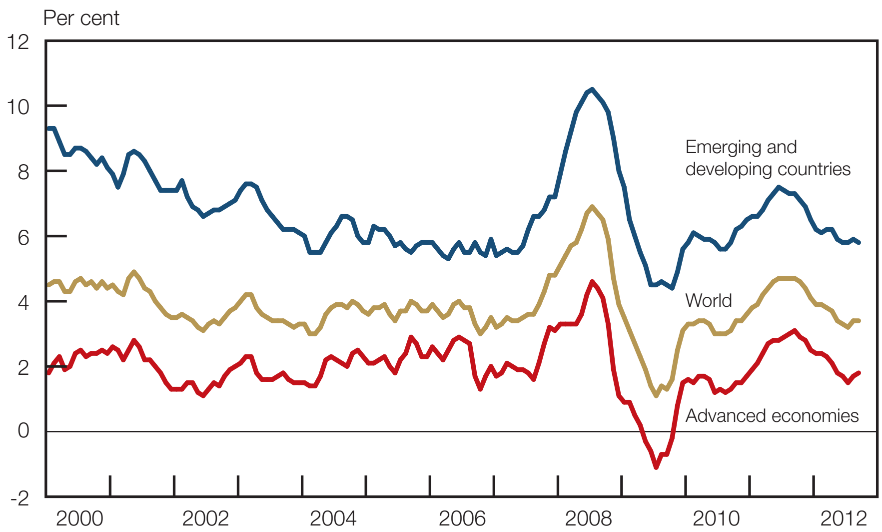


Source: Bloomberg

Global demand for crude oil rose from 89,0 million barrels per day in the second quarter of 2012 to 90,1 million barrels per day in the third quarter. Oil demand in Saudi Arabia, Russia and Japan increased in the third quarter of 2012, but decreased in Mexico, Iran and India. Crude oil production in the Organization of the Petroleum Exporting Countries (OPEC) edged lower to 31,5 million barrels per day in the third quarter of 2012 driven by lower output in Iran. Iran's oil production has declined by almost 26 per cent since the end of 2011 as sanctions began to have an effect.

Global headline inflation has been trending downwards since October 2011, reaching a recent low of 3,2 per cent in July 2012 before accelerating somewhat to 3,4 per cent in September. Average inflation in advanced economies has also decelerated during this period, but accelerated in the past two months to 1,8 per cent in September 2012. Average inflation in emerging-market economies generally trended down from 7,5 per cent in July 2011 to 5,8 per cent in September 2012.

Global consumer price developments



Source: IMF *International Financial Statistics*

Annual inflation in the US decelerated meaningfully from 3,2 per cent in 2011 to 1,4 per cent in July 2012 before accelerating to 2,2 per cent in October. Annual consumer price inflation in the euro area remained elevated at 2,5 per cent in October 2012, mainly due to higher energy prices and increases in indirect taxes. Inflationary pressures in the UK have moderated significantly from an annual headline inflation rate of 5,2 per cent in September 2011 to 2,2 per cent in September 2012, before increasing to 2,7 per cent in October. Japan's economy has unexpectedly experienced deflation when consumer prices started decreasing from June 2012. The deflationary pressures have persisted in recent months as a result of decreasing food prices and the stronger exchange rate.

Consumer price inflation in emerging Europe rose abruptly to 6,2 per cent in the third quarter of 2012. Consumer price inflation surged in Russia, Turkey and Romania due to higher food prices, reflecting grain supply shortages, especially in drought-stricken Russia. With the exception of Taiwan and the Philippines, inflation eased in emerging Asia in the third quarter. Inflation in emerging Latin America picked up marginally in the third quarter of 2012, recording an annual average rate of 6,1 per cent. Inflation was higher in Argentina, Brazil and Mexico. Inflationary pressures have moderated in the Southern African Development Community (SADC) member countries due to subdued consumer demand in the region in the third quarter of 2012. However, inflation remained elevated at double-digit rates in Tanzania, Angola and Malawi.

The US Federal Open Market Committee (FOMC) has kept the targeted federal funds rate unchanged since December 2008, but announced a third round of quantitative easing in September 2012 to boost growth and reduce unemployment. The FOMC has agreed to increase its policy accommodation by purchasing additional mortgage-backed securities (MBSs) at a pace of US$40 billion per month. The FOMC also indicated that it would continue to purchase agency MBSs, undertake additional asset purchases, and employ other tools as considered appropriate until the outlook for the labour market improves substantially in a context of price stability. The committee will also continue with the monthly purchases of long-term Treasury securities (the so-called Operation Twist) amounting to US$45 billion planned for the remainder of this year under the maturity extension programme.

The Bank of Japan has kept the uncollateralised overnight call rate unchanged at roughly 0,1 per cent since October 2010, but increased its asset purchase programme (currently its key monetary easing tool) in September 2012 by 10 trillion yen and in October 2012 by 11 trillion yen to 91 trillion yen, with the increase earmarked for purchases of government bonds and treasury discount bills.

The Bank of England has maintained the official Bank Rate at 0,50 per cent and kept the stock of asset purchases financed by the issuance of central bank reserves unchanged at £375 billion in the third quarter of 2012. The Bank, however, announced its intention to extend the stock of asset purchases in the next two months as part of its non-conventional policy measures aimed at increasing liquidity in the economy.

The central banks of Canada and New Zealand have both kept their policy rates unchanged since September 2010 and March 2011 respectively. The Reserve Bank of Australia lowered its policy rate in October 2012 by 25 basis points to 3,25 per cent due to a favourable inflationary outlook, coupled with weaker-than-expected growth. The Reserve Bank of Australia has reduced its policy rate by a cumulative 150 basis points since late 2011.

Higher inflation has made it difficult for the Reserve Bank of India (RBI) to lower its policy rates despite the need to stimulate growth. In an attempt to inject liquidity into the economy, the RBI lowered its cash reserves requirement by 25 basis points. Owing to lower rates of inflation and weaker economic prospects, the Bank of Korea reduced interest rates by 25 basis points to 2,75 per cent in October 2012. Monetary policy changes in emerging European economies mostly favoured economic growth over controlling inflation in the third quarter of 2012. Several countries in the region kept their key policy rates unchanged amid concerns about ongoing global economic uncertainties. The central banks of the Czech Republic, Hungary and Poland reduced their key policy rates in recent months. However, the central bank of Russia increased its policy rate in October 2012 by 25 basis points to 8,25 per cent. Most central banks in Latin America, including Mexico, Chile and Peru, kept their policy rates unchanged in the third quarter. The central bank of Colombia decided to reduce its policy rate by 25 basis points at meetings in July and August 2012, lowering its official rate to 4,75 per cent. The Brazilian central bank, despite a recent pick-up in inflation, continued to lower its policy rate aggressively in the third quarter to a new historic low of 7,25 per cent.

Most SADC member countries kept their key policy rates unchanged in the third quarter of 2012. However, key policy rates were reduced in Namibia and Lesotho, while Zambia increased its benchmark interest rate due to inflationary concerns.

Current account[6]

The fragile global economic recovery continued in the third quarter of 2012 amid downside risks to the growth outlook. Despite improved sentiment in financial markets in response to recent further expansionary monetary policy measures, subdued growth and uncertainty in advanced economies continued to affect emerging market and developing countries through trade and financial channels. In South Africa, domestic production furthermore suffered from widespread industrial action, thereby contributing to the country's lacklustre export performance. In contrast, the value of merchandise imports was sustained at the fairly high level recorded in the second quarter of 2012 reflecting, among other factors, the country's relatively high propensity to import. As a result, the trade deficit widened further, from R75,7 billion in the second quarter of 2012 to R82,3 billion in the third quarter.

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

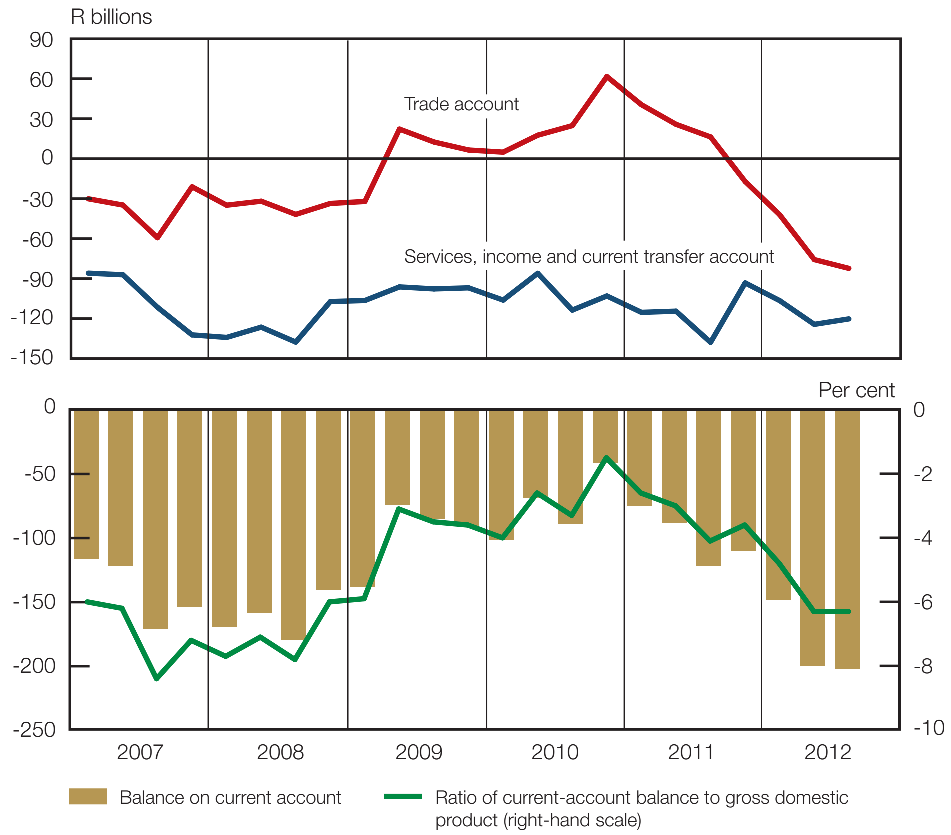
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2011			2012		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	671,8	714,8	671,2	697,7	688,6	692,7
Net gold exports	83,5	85,0	75,3	79,3	79,2	68,7
Merchandise imports	-739,0	-816,9	-730,1	-819,0	-843,5	-843,7
Trade balance	**16,3**	**-17,1**	**16,4**	**-42,0**	**-75,7**	**-82,3**
Net service, income and current transfer payments	-137,8	-93,1	-115,2	-106,6	-124,3	-120,2
Balance on current account	**-121,5**	**-110,2**	**-98,8**	**-148,6**	**-200,0**	**-202,5**
As a percentage of gross domestic product	*-4,1*	*-3,6*	*-3,4*	*-4,8*	*-6,4*	*-6,4*

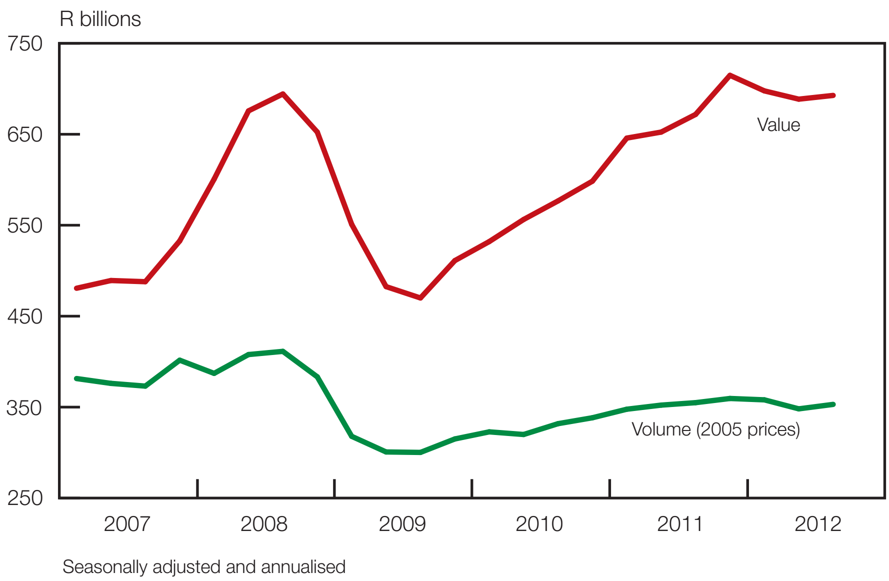
The larger shortfall on the trade account was partly countered by a smaller deficit on the services, income and current transfer account with the rest of the world. Consequently, the deficit on the current account relative to South Africa's gross domestic product remained unchanged at 6,4 per cent in the third quarter of 2012.

Balance of payments: Current account



The value of merchandise exports excluding gold increased by almost 1 per cent in the third quarter of 2012 following contractions of 2,4 per cent and 1,3 per cent in the first and second quarter respectively. The slightly higher export earnings in the third quarter of 2012 could primarily be attributed to higher export volumes as export prices decreased marginally over the period.

Merchandise exports



The volume of merchandise exports increased by 1,4 per cent in the third quarter of 2012 due to higher export volumes of agricultural and manufactured products which was only partly offset by a contraction in the volume of mining exports. It is estimated that the volume of mining exports contracted by about 5,0 per cent over the period, marking the third consecutive quarterly decline. In addition to domestic supply constraints, the decrease could be attributed to subdued foreign demand for South African-produced mineral products, and for base metals and articles of base metals, notably coal, iron ore and steel destined primarily for China, Japan and India. The exports of coal and iron ore to India were, in particular, constrained by the temporary moratorium on coal and iron ore mining activities introduced by the Indian mining authorities in response to the detection of illegal mining activities in these products. The impact of the industrial strife on platinum exports appeared not to be significant in the third quarter as the strike occurred more towards the second half of the quarter. In contrast, the volume of manufactured exports edged higher in the third quarter of 2012, buoyed by increased exports of chemical products, machinery and electrical equipment, and vehicles and transport equipment. The higher export earnings of vehicles and transport equipment could largely be ascribed to the release of new models by the domestic motor industry and a return to normality by Thailand's motor industry's operations in the aftermath of recent devastating floods in the country.

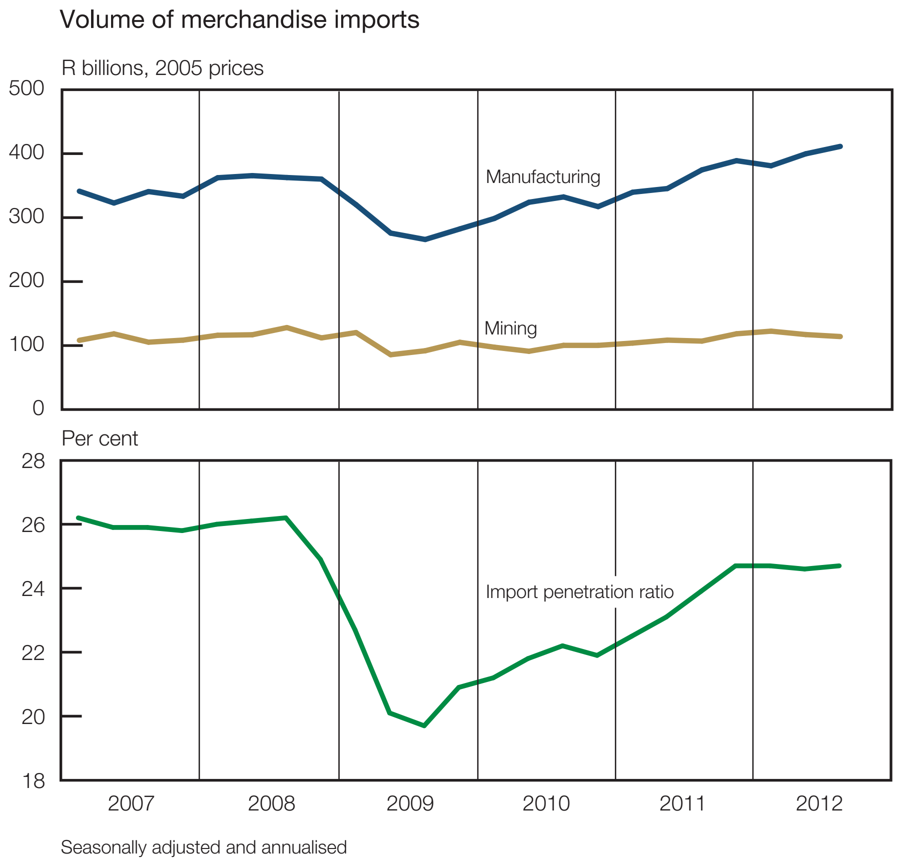
After having increased by 1,5 per cent in the second quarter of 2012, the rand price of merchandise exports declined by 0,8 per cent in the third quarter. The depreciation in the exchange value of the rand was insufficient to offset the significant reduction in the international price of a basket of South African export commodities. Following a decrease of 5,8 per cent in the second quarter of 2012, the dollar price of a basket of South African export commodities edged lower by 6,5 per cent in the third quarter. This decline occurred despite a surge in the international price of gold and platinum due to concerns about possible supply shortages amid domestic industrial strike action. Overall, the price of a basket of domestic commodities was weighed down by declines in the prices of mainly copper, iron ore, nickel and coal. Apart from mirroring the weakening trend in the global PMI, the reduced prices were also consistent with the slower demand from China and India.

South African export commodity prices and global PMI

The price of gold on the London market advanced by 2,8 per cent from an average of US$1 609 per fine ounce in the second quarter of 2012 to US$1 655 per fine ounce in the third quarter. The gold price rose as investors responded to a series of quantitative easing announcements in economies such as the European Union, the US, Japan, Australia and China. These steps taken by central banks have contributed to a shift from the safe haven status of the US dollar to gold as a hedge against losses in the purchasing power of the dollar. The higher dollar price of gold alongside the depreciation in the exchange rate of the rand raised the average realised rand price of net gold exports by 3,9 per cent in the third quarter of 2012. This increase was, however, not enough to counter the contraction in the physical quantity of net gold exports over the period. As a result, the export earnings of South African gold producers fell noticeably in the third quarter of 2012.

After increasing by 3,0 per cent in the second quarter of 2012, the value of South African merchandise imports remained broadly unchanged at around R844 billion in the third quarter – a decrease in the value of mining imports was balanced by an increase in the value of manufactured products. The value of mining imports in the third quarter of 2012 was largely weighed down by a significant decrease in the values of imported mineral products as well as pearls, precious and semi-precious stones. Simultaneously, the value of imported manufactured goods surged, reflecting pronounced increases in the values of chemical products, machinery and electrical equipment, and textiles. The increase in the import value of manufactured goods was, however, constrained by a decline in the value of vehicles and transport equipment notwithstanding the importation of four aircraft by the South African Air Force in terms of the government's arms procurement deal. The value of agricultural imports advanced marginally over the period.

The volume of merchandise imports rose by 1 per cent in the second quarter of 2012 and by 1,6 per cent in the third quarter despite a contraction in the physical quantity of mining imports. The decline in mining imports could mainly be attributed to lower non-oil imports, as crude oil imports rose notably over the period. Nonetheless, the higher volume of imported manufactured goods lifted the overall volume of non-oil imports over the period. As a result of the increased volume of merchandise imports, South Africa's import penetration ratio advanced marginally further to 24,7 per cent in the third quarter of 2012. The rand price of merchandise imports receded by about 1,5 per cent over the period on account of the lower crude oil prices and subdued inflation in South Africa's major trading partner countries. The impact of the depreciation of the exchange rate of the rand only partially countered the decline in the contractual price of crude oil imports.



The shortfall on the *services, income and current transfer account* narrowed by about 3 per cent in the third quarter of 2012, culminating in a deficit of 3,8 per cent of gross domestic product. The smaller deficit can mainly be ascribed to lower gross dividend payments to non-resident investors; net interest payments to foreign investors also declined somewhat over the period.

Following two consecutive quarterly increases, gross dividend payments to foreign shareholders contracted in the third quarter of 2012 to a level similar to that recorded in the first quarter of 2012, thereby effectively reverting the recent trend of relatively large dividend declarations despite the current restraining economic environment. Although growth in gross outward dividend payments amounted to 17,5 per cent when the first half of 2012 is compared with the first half of 2011, this rate of increase moderated to a mere 0,8 per cent when the first three quarters of 2012 are compared with the corresponding period in 2011. This moderation was not so much attributable to the contraction in dividend declarations in the third quarter of 2012 but rather a reflection of abnormally large dividend declarations in the corresponding quarter of 2011. In general, the much higher level of dividend declarations in recent years is, among other things indicative of the exceptionally sharp increase in inward portfolio investment into South African equities especially during the period 2005 to 2007.

After registering five consecutive quarterly increases, the nominal value of travel receipts from foreign tourists remained broadly unchanged in the third quarter of 2012. When the first three quarters of 2012 are compared with the corresponding period in 2011, tourism expenditure in South Africa nevertheless advanced by about 22 per cent, signalling one of the best performances in this aggregate since the early 2000's. Spending by South African residents temporarily travelling abroad picked up in the third quarter of 2012, interrupting the declining trend in outward tourist expenditure noted since the beginning of 2011. In addition, gross payments in the category "other services" rose on account of increased royalty payments to the rest of the world.

Having receded somewhat since the final quarter of 2011, South Africa's terms of trade improved marginally in the third quarter of 2012 as the prices of imported goods and services contracted at a somewhat faster pace than that of exported goods and services.

Financial account

Conditions in global financial markets remained fragile in the third quarter of 2012 in anticipation of a solution to the euro area sovereign debt crisis. Monetary policy consequently remained accommodative with the ECB, the Federal Reserve, the Bank of England and the Bank of Japan announcing measures to provide additional liquidity. As a result, the interest rate differential between advanced and emerging-market economies widened further in the third quarter of 2012, directing prospective investors' funds to emerging-market assets. In addition to inward portfolio flows, South Africa managed to attract a sizeable amount of inward foreign direct and other investment capital. In total, the country recorded net capital inflows on the financial account of the balance of payments to the value of R56,8 billion in the third quarter of 2012 following an inflow of R48,0 billion in the second quarter.

Net financial transactions not related to reserves

R billions

	2011			2012		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	2,8	20,4	43,6	10,2	6,6	22,2
Portfolio investment	-22,5	12,5	45,9	32,0	22,7	27,5
Other investment	21,4	12,0	43,0	0,3	19,9	7,1
Change in assets						
Direct investment	11,0	4,1	1,8	-5,3	-4,1	-9,6
Portfolio investment	-10,7	1,1	-62,2	-21,4	-4,7	-4,7
Other investment	7,5	-38,7	-13,4	22,7	-16,8	19,3
Total financial transactions*	34,5	19,9	131,2	49,2	48,0	56,8
Financial transactions as a ratio of gross domestic product	*4,6*	*2,6*	*4,4*	*6,5*	*6,1*	*7,1*

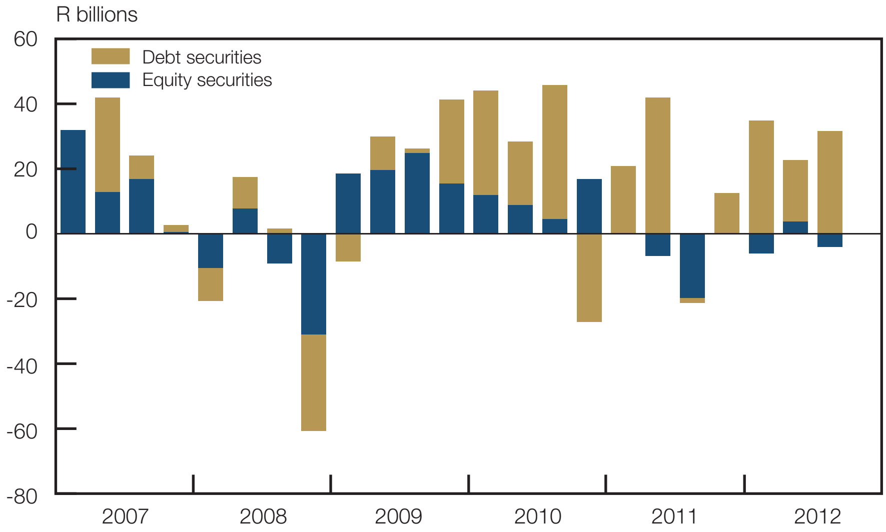
* Including unrecorded transactions

Foreign-owned assets in South Africa

Following a R6,6 billion increase in the second quarter of 2012, *inward direct investment* into South Africa increased further by R22,2 billion in the third quarter as foreign investors increased their equity stake in existing direct investment entities. In addition, these inflows also reflected loans granted by foreign parent companies to their South African subsidiaries.

The resilience of emerging-market economies in the midst of heightened risk in global financial markets has been evident in persistent flows of capital into these markets. *Foreign portfolio investment* into South Africa increased by R27,5 billion in the third quarter of 2012 following an increase of R22,7 billion in the preceding quarter. While investors continue to substitute listed equity investments for domestically issued debt securities, the issuance of an international bond by a state-owned enterprise confirms investors' interest in the country's bond market. The recent downgrade of South Africa's sovereign ratings is, however, likely to affect investor sentiments towards the country adversely.

Portfolio liabilities: Investment flows



Other investment liabilities during the third quarter of 2012 measured significantly smaller net inflows compared with the previous quarter. Third quarter net inflows of capital amounted to R7,1 billion compared with R19,9 billion recorded in the second quarter. These net inflows of capital were mainly in the form of loans advanced to non-bank private sector companies.

South African-owned assets abroad

Outward direct investment by South African companies accelerated by R9,6 billion in the third quarter of 2012 compared with R4,1 billion recorded in the second quarter. The outflow of capital was mainly on account of local direct investors increasing their equity stake in companies incorporated abroad.

South African institutional and individual investors maintained the level of outflows of outward portfolio assets invested abroad. Consequently, *foreign portfolio investment* in the third quarter of 2012 recorded a net outflow of R4,7 billion following R4,7 billion and R21,4 billion net outflows recorded in the second and first quarter respectively.

Other offshore foreign investment abroad switched from an outflow of R16,8 billion in the second quarter of 2012 to an inflow of R19,3 billion in the third quarter. The net inflow of capital could largely be attributed to a significant withdrawal of banking-sector deposits with foreign counter-parties further reflecting caution about uncertainties in the global economy.

External debt

South Africa's external debt advanced marginally from US$120,7 billion at the end of March 2012 to US$121,6 billion at the end of June as the decline in foreign currency-denominated debt almost fully countered an increase in the rand-denominated debt over the period. The contraction in the foreign currency-denominated debt during the second quarter of 2012 could mainly be ascribed to the repayment of short-term foreign currency loans by the domestic banking sector and the redemption of foreign currency-denominated international bonds by both the national government and the domestic banking sector. In contrast, the sustained acquisition of South Africa's domestically issued rand-denominated bonds by non-resident investors further raised the country's rand-denominated debt. Foreign investors' appetite for domestic bonds was further enhanced by the country's inclusion in the Citigroup's influential World Government Bond Index (WGBI). This rise was augmented by increased loan funding for infrastructural development by public corporations and an increase in non-residents' deposits with domestic banks.

Box 1: Revision of South Africa's sovereign credit ratings

After having been placed on a negative watch by the three leading rating agencies during the past nine months, two of the agencies downgraded South Africa's sovereign debt credit rating by one notch – Moody's in September and Standard & Poor's (S&P) in October 2012. Moody's has downgraded the South African government's foreign currency-denominated debt rating from A3 to Baa1, aligning their rating with that of S&P and Fitch. The alignment of the intra-agency rating was, however, reversed by the subsequent revision by S&P of its rating from BBB+ to BBB in October 2012. Furthermore, both rating agencies retained the negative outlook on the revised ratings. Concerns raised by the agencies included, among others: diminishing government's institutional strength, reduced fiscal space, negative investment climate in view of infrastructure shortfalls, relatively high labour costs despite high unemployment, and increased concerns about future political stability.

Despite the downgrading by the two rating agencies, South African sovereign bonds are still classified within the investment grade range and stand two notches above the speculative investment grade category according to Moody's and Fitch's measurements. S&P rates South Africa in the same league as Russia, Brazil, and Peru, while Moody's groups South Africa together with Thailand and Mexico.

Rating of long-term sovereign debt of emerging markets, 20 November 2012

	Moody's	Fitch	Standard & Poors
China	Aa3	A+	AA-
Chile	Aa3	A+	A+
Czech Republic	A1	A+	AA
South Korea	A1	A+	A
Botswana	A2	-	A-
Poland	A2	A-	A
Malaysia	A3	A-	A-
Taiwan	Aa3	A+	AA-
Thailand	Baa1	BBB	BBB+
Mexico	Baa1	BBB	BBB+
South Africa	**Baa1**	**BBB+**	**BBB**
Russia	Baa1	BBB	BBB
Brazil	Baa2	BBB	BBB
Peru	Baa3	BBB	BBB
India	Baa3	BBB-	BBB-
Colombia	Baa3	BBB-	BBB-
Indonesia	Baa3	BBB-	BB+
Hungary	Ba1	BB+	BB+
Philippines	Ba1	BB+	BB+
Venezuela	B2	B+	BB+
Turkey	Ba1	BB+	BB
Nigeria	B3	BB-	B+
Kenya	-	B+	B+
Egypt	B2	B+	B
Ghana	-	B+	B
Argentina	B3	B	B

Source: Bloomberg

Note: On Moody's scale, investment grade is from Baa3 and higher. On the Fitch and S&P scale, investment grade is from BBB- and higher

Expressed in rand terms, South Africa's external debt increased significantly from R927 billion at the end of March 2012 to R1 011 billion at the end of June 2012. The rise in South Africa's external debt led to a deterioration in the ratios of external debt to gross domestic product and total export earnings in the second quarter of 2012, as reflected in the accompanying table.

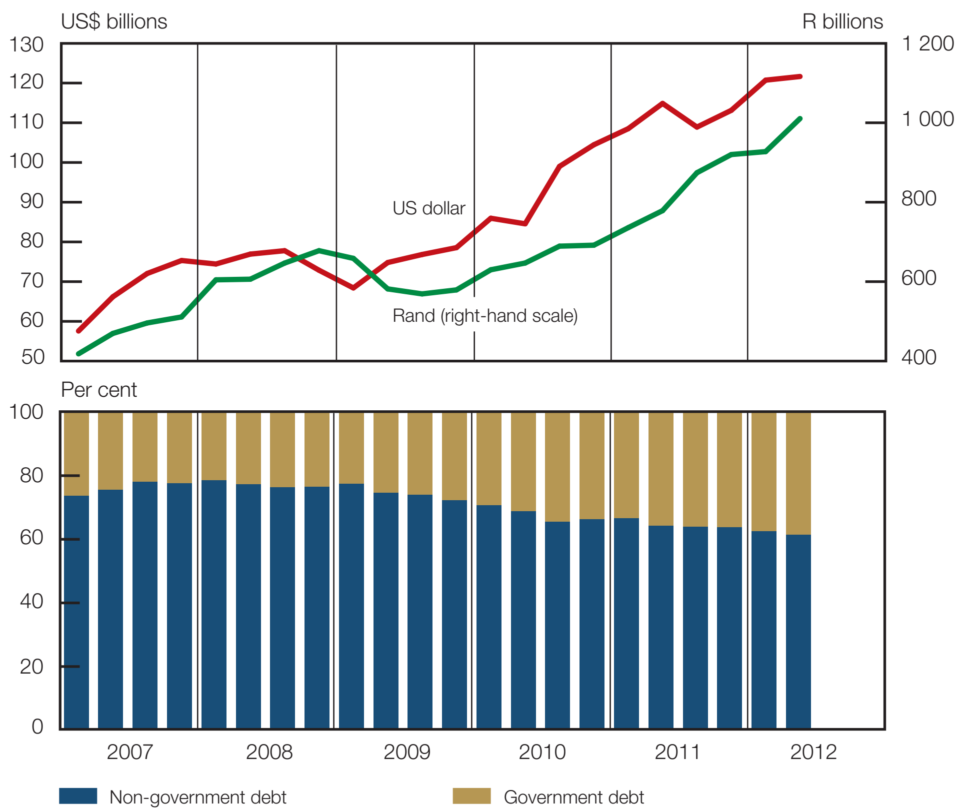
South Africa's external debt

US$ billions at end of period

	2011			2012	
	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Foreign currency-denominated debt	53,5	51,6	50,9	53,3	50,3
Bearer bonds	22,2	21,3	20,9	22,9	21,0
Other	31,3	30,3	30,0	30,4	29,3
Public sector	7,8	7,8	7,6	8,3	8,6
Monetary sector	11,0	10,0	9,9	11,0	9,3
Non-monetary private sector	12,5	12,5	12,5	11,1	11,4
Rand-denominated debt	61,4	57,3	62,2	67,4	71,3
Bonds	29,7	27,9	30,2	33,1	36,1
Other	31,7	29,4	32,0	34,3	35,2
Total foreign debt	114,9	108,9	113,1	120,7	121,6
As a percentage of gross domestic product	*28,8*	*26,5*	*28,1*	*30,2*	*30,7*
As a percentage of total export earnings	*98,5*	*89,0*	*91,9*	*98,2*	*101,5*

Non-resident investors' sustained appetite for domestic government bonds has somewhat altered the proportions of government versus non-government debt. The share of government debt in total external debt rose from 23 per cent at the end of March 2009 to 39 per cent at the end of June 2012.

External debt



International reserves and liquidity

Having decreased by R3,8 billion in the second quarter of 2012, South Africa's overall balance-of-payments position (i.e., change in the country's net international reserves resulting from balance-of-payments transactions) recorded an increase of R4,8 billion in the third quarter.

Measured in US dollars, the country's gross gold and other foreign reserves (i.e., the official international reserves of the Bank before accounting for reserves-related liabilities) rose from US$49,2 billion at the end of June 2012 to US$51,0 billion at the end of September before declining marginally to US$50,7 billion at the end of October. The Bank's international liquidity position increased, on balance, by US$0,8 billion to US$48,7 billion in the third quarter of 2012, and remained broadly at the same level at the end of October. The ratio of imports covered by gross reserves improved from 19 weeks' worth of goods and services in the second quarter of 2012 to 20 weeks in the third quarter.

Exchange rates

Subsequent to a 4,8 per cent depreciation in the second quarter of 2012, the nominal effective exchange rate of the rand declined, on balance, by a further 1,3 per cent in the third quarter. In addition to concerns about global economic growth and the persistent euro area debt crisis, the recent across-the-board weakness in the exchange rate of the rand was also aggravated by local socioeconomic factors.

Exchange rates of the rand

Percentage change

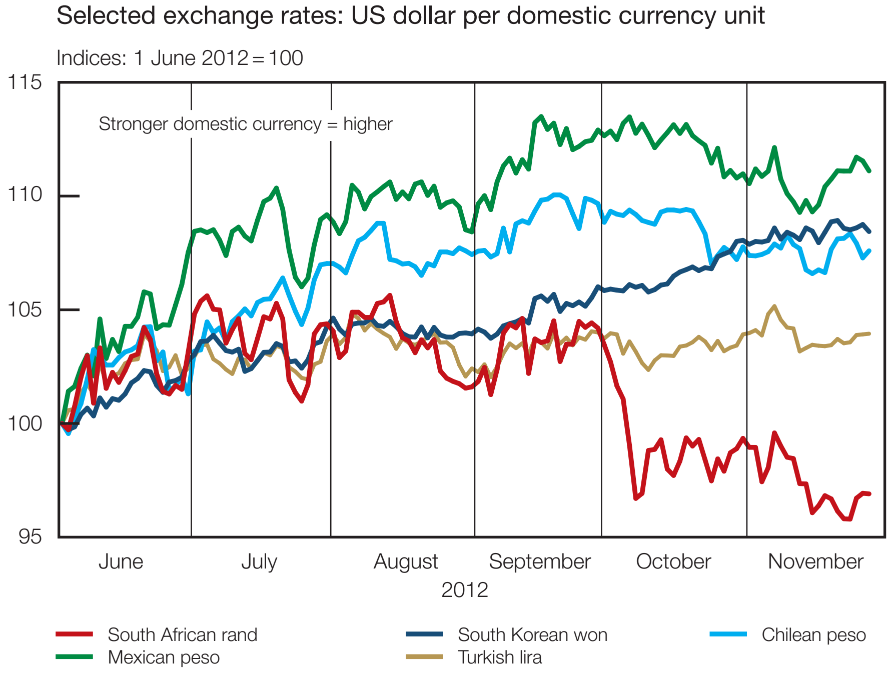
	31 Dec 2011 to 31 Mar 2012	31 Mar 2012 to 30 Jun 2012	30 Jun 2012 to 30 Sep 2012	30 Sep 2012 to 28 Nov 2012
Weighted average*	4,4	-4,8	-1,3	-6,3
Euro	2,5	-1,9	-1,9	-6,9
US dollar	5,9	-7,5	1,0	-7,0
Chinese yuan	5,9	-6,7	-0,1	-7,8
British pound	2,0	-5,3	-2,7	-5,7
Japanese yen	12,0	-10,5	-1,4	-1,9

* Against a basket of 15 currencies

The rand started off the third quarter of 2012 on a rather positive note, drawing support primarily from the local bond market and the easier monetary policy stance of other central banks which underpinned investment in emerging-market assets. Since September 2012 the rand subsequently lost ground and decoupled from the trend followed by some other emerging-market currencies. This could largely be attributed to certain developments unique to the local economy, including

– the spread of labour unrest and illegal strikes that commenced in the mining sector;
– the downgrading of the country's sovereign ratings;
– the release of economic data showing a rising trade deficit; and
– indications of a renewed pickup in inflation.

The real effective exchange rate of the rand improved by 2,7 per cent to 106,3 index points in July 2012 before declining by approximately 1 per cent and 2 per cent in August and September respectively, thereby improving the international price competitiveness of South African exports.



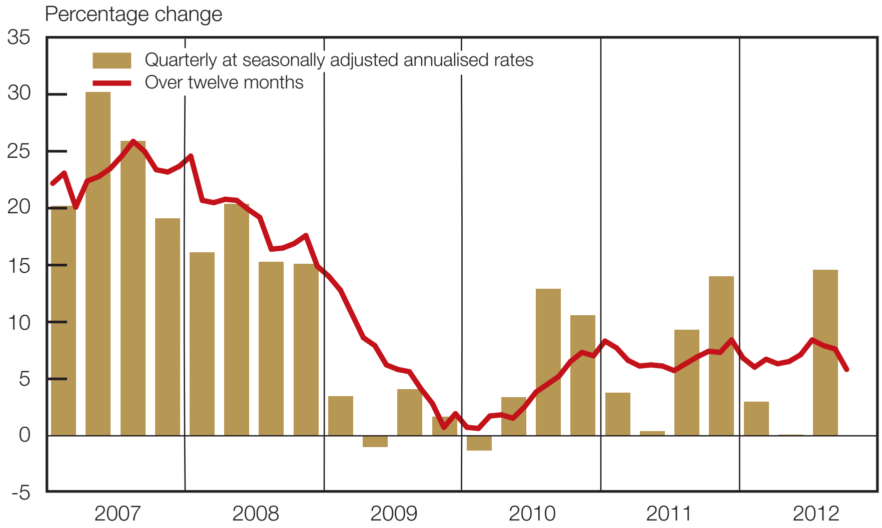
The average net daily turnover in the domestic market for foreign exchange increased from US$19,3 billion in the second quarter of 2012 to US$20,1 billion in the third quarter. The value of transactions in which non-residents participated increased from US$13,4 billion per day to US$13,5 billion per day, while that of residents and the banking sector rose by R0,3 billion and R0,4 billion respectively over the period.

Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) regained some momentum during the third quarter of 2012, after a period of lacklustre growth in the first quarter and stagnation in the second quarter of the year. Measured over twelve months, growth in M3 fluctuated just above 6 per cent in the first five months of 2012, before accelerating to a high of 8,3 per cent in July. Year-on-year growth then ebbed lower to 5,7 per cent in October. The growth trends up to September 2012 correspond with patterns observed at the start and end of 2011, when growth in M3 started with post-recession highs but only to moderate thereafter. These trends were somewhat reflective of economic growth trends which were also subjected to downward revisions.

Growth in M3



The rebound in M3 during the third quarter was fuelled by significant increases in the deposit holdings of the corporate sector, particularly that of financial companies, reflecting significant investments in negotiable certificates of deposit (NCDs) and marked increases in collateral deposits with fund managers on the back of considerable new trades and mark-to-market movements on derivative exposures, following the interest rate cut in July 2012. Non-financial public companies and local authorities also recorded hefty increases in their deposit holdings, partly due to heightened spending by national government which included a substantial equitable share transfer to local authorities. Household deposits also gathered momentum during the third quarter of 2012, supported by, among other things, the back payment of wage and salary settlements for government employees.

The quarter-to-quarter[7] growth in M3 recovered from a low of 0,1 per cent in the second quarter of 2012 to 14,6 per cent in the third quarter, when all the deposit categories increased noticeably. Long-term deposits attracted the bulk of the increase, while the other demand deposit category also improved significantly after a contraction in the preceding quarter. Cheque and transmission deposits were supported by significant growth in deposits of the household sector, while growth in notes and coin reflected a rise in the transactions demand for cash.

Overall, money supply increased by R93,5 billion in the third quarter of 2012, a considerable improvement from the increase of R25,7 billion recorded in the second quarter and the highest quarterly increase since the first quarter of 2007. Deposit holdings of the corporate sector,

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

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2011	2012		
	4th qr	1st qr	2nd qr	3rd qr
Notes and coin	14,1	1,1	15,4	18,9
Cheque and transmission deposits	18,8	10,1	-1,8	16,7
Call and overnight deposits	14,9	7,1	-4,1	21,6
Other short- and medium-term deposits*	12,8	-1,9	5,8	1,6
Long-term deposits**	22,1	-6,4	-4,4	28,2
M3	14,0	3,0	0,1	14,6

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

which grew by R74,2 billion in the third quarter, were mainly responsible for the expansion in M3, while deposits of the household sector increased by R19,3 billion. The year-on-year growth in M3 deposit holdings of the household sector grew faster than those of the corporate sector, accelerating to a high of 13,9 per cent in August 2012, before receding to 11,0 per cent in September and 11,5 per cent in October. Growth over twelve months in the deposit holdings of the corporate sector, which averaged about 4,5 per cent in the first half of 2012, briefly accelerated to 6,7 per cent in July before moderating to 3,5 per cent in October.

M3 deposit holdings of households and companies

Percentage change over twelve months

In a statistical sense, the rise in M3 during the third quarter of 2012 was underpinned by increases in both claims on the private sector and net claims on the government sector. Claims on the private sector continued to reflect the resilient growth in credit extension to households and some recovery for the corporate sector. The increase in net claims on the government sector followed a significant draw-down of deposit holdings by government partly to fund the equitable share transfer to local authorities, while significant interest payments on government bonds to the value of R21,1 billion also fell due during the period. Net other assets and liabilities continued on a declining trend during the third quarter of 2012, with growth in liabilities exceeding assets. This was brought about by combined increases in derivative instruments, debt securities and share capital. Net foreign assets, which played the leading role in the M3 expansion during the second quarter of 2012, increased only moderately in the third quarter. For a more comprehensive overview of banks' foreign and cross-border transactions see the note on South Africa's participation in the locational banking statistics later in this *Quarterly Bulletin.*

Statistical counterparts of change in M3

R billions

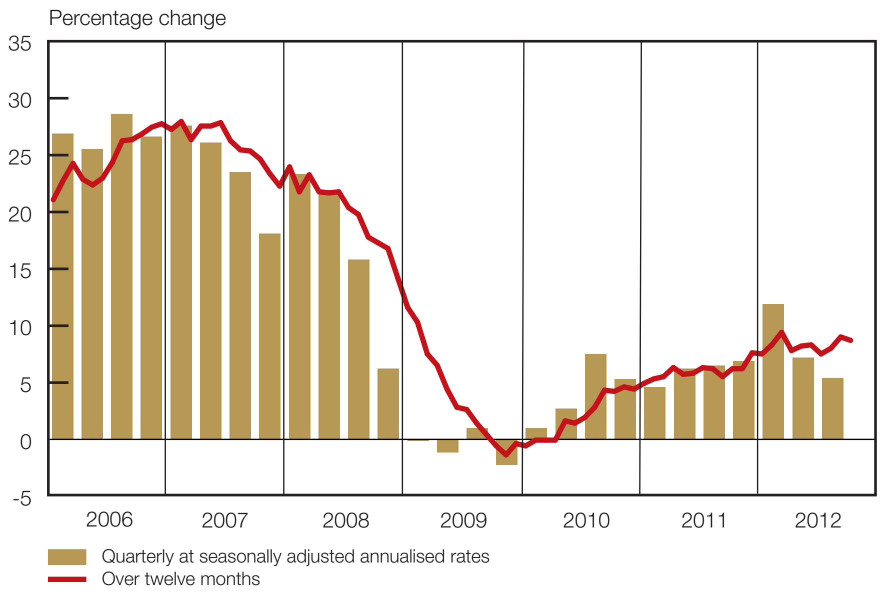
	2011	2012		
	4th qr	1st qr	2nd qr	3rd qr
Net foreign assets	25,3	-23,4	37,6	5,2
Net claims on the government sector	-12,9	-4,8	-16,7	34,5
Claims on the private sector	37,0	74,1	12,0	74,5
Net other assets and liabilities	27,4	-77,6	-7,1	-20,7
Total change in M3	76,9	-31,7	25,7	93,5

The income velocity of circulation of M3 initially moved sideways at 1,37 from the second quarter of 2011 to the first quarter of 2012, when growth in money supply kept pace with growth in nominal gross domestic product. The income velocity recorded a modest increase to 1,39 in the second quarter of 2012 but fell back to 1,37 in the third quarter when money supply grew at a faster pace than growth in nominal gross domestic product.

Credit extension

Compared with the brisk year-on-year growth rates recorded from late 2011 into the early months of 2012, growth in total loans and advances extended to the private sector weakened during the second quarter and early into the third quarter. Year-on-year growth in total loans and advances decelerated steadily from a post-recession high of 9,2 per cent in March 2012 to 7,3 per cent in July, before recovering to 8,8 per cent in September and 8,5 per cent in October. The somewhat sluggish recovery in credit extension reflected the fragile investment climate, influenced by the less-than-favourable global economic outlook and a domestic economy most recently marred by protracted periods of labour unrest.

Total loans and advances to the private sector



The quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances decelerated further to 5,4 per cent in the third quarter of 2012, down from 11,9 per cent and 7,2 per cent in the first and second quarters respectively.

Quarterly changes in banks' total loans and advances by type

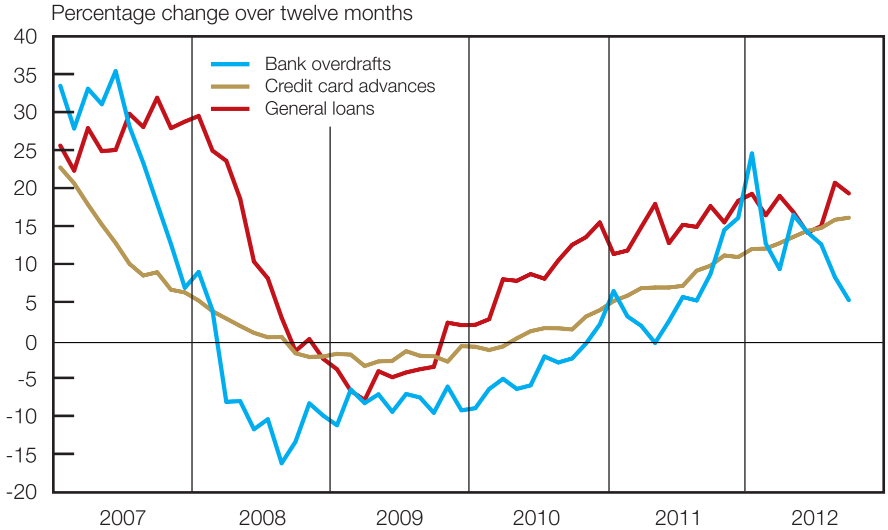
R billions

	2012			Composition, September 2012
	1st qr	2nd qr	3rd qr	Percentage of total
Household sector				
Instalment sale credit and leasing finance............	5,0	6,4	7,2	8,9
Mortgage advances..	9,2	4,4	4,5	35,6
Other loans and advances..................................	13,9	12,8	14,0	12,1
Total loans and advances	28,2	23,6	25,7	56,6
Corporate sector				
Instalment sale credit and leasing finance............	1,6	2,2	0,7	3,8
Mortgage advances..	-4,6	2,7	-2,3	13,2
Other loans and advances..................................	47,1	-28,3	38,7	26,4
Total loans and advances to corporate sector	44,1	-23,4	37,1	43,4
Total loans and advances to private sector........	**72,2**	**0,2**	**62,7**	**100,0**

As the main driver of growth in credit extension during the three preceding quarters, the category of *other loans and advances* moderated in the second quarter of 2012, but reclaimed its role as the primary source of growth in the third quarter. Similar to the first quarter of 2012, the rise in other loans and advances in the third quarter largely resulted from a strong uptake of *general loans* by the corporate sector. By contrast, *bank overdrafts* to the private sector continued to decelerate, while the usage of *credit card* advances steadily extended the rising trend. Growth in credit card advances has been improving consistently since mid-2010 and accelerated from 11,1 per cent in January 2012 to 16,1 per cent in October. On aggregate, growth in the combined category for other loans and advances receded from a recent high of 19,6 per cent in March 2012 to 14,2 per cent in July, before rebounding to 16,5 per cent in October 2012, reflecting renewed growth momentum in general loans and advances extended to both the corporate and household sectors.

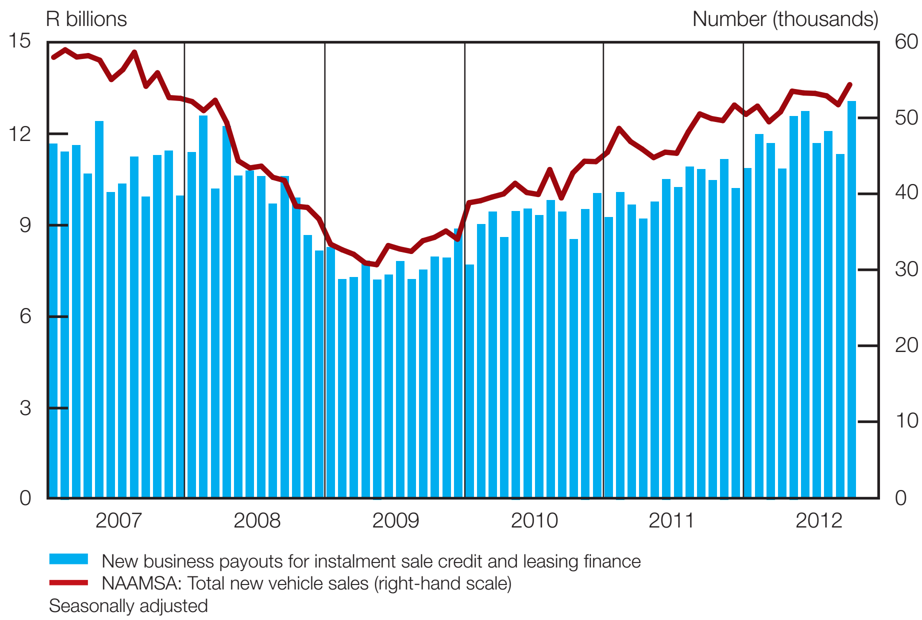
Other loans and advances

Percentage change over twelve months



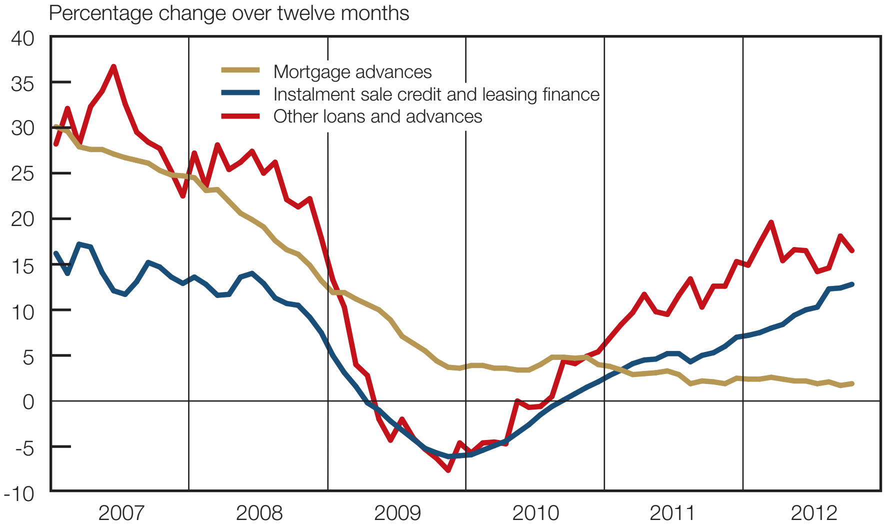
Growth in *instalment sale credit and leasing finance* continued to record new post-recession highs, supported by the favourable demand for motor vehicles and other durable goods in the current low interest rate environment. After breaching the 10 per cent mark in June 2012, year-on-year growth in instalment sale credit and leasing finance accelerated further to 12,8 per cent in October. *Instalment sale credit* continues to underpin growth in this credit category, while leasing finance has fallen out of favour since the end of 2007.

Instalment sale credit and leasing finance, and vehicle sales



Despite a further reduction in interest rates in July 2012, growth in *mortgage advances* remained relatively subdued with no visible signs of a significant recovery. The year-on-year growth in this credit category, which hovered at levels slightly above 2 per cent in the first half of the year, even dipped below these levels in July and again from September. In October, growth in mortgage advances came to 1,9 per cent. An acceleration in capital repayments brought about by declining interest rates, low margins for banks on long-term mortgage loans and an overhang of housing inventory, probably continue to contribute to the weak growth in mortgage advances.

Bank loans to the private sector by type



Despite the weak growth in mortgage advances, growth in banks' loans and advances to the household sector consistently gained momentum over the past three quarters. During this period, credit growth towards the household sector was predominantly driven by the take-up of general loans and advances, followed by instalment sale credit and leasing finance. Twelve-month growth in credit extended to the household sector reached a recent high of 9,3 per cent in October 2012, up from 6,1 per cent in January and represented the highest growth rate recorded since December 2008.

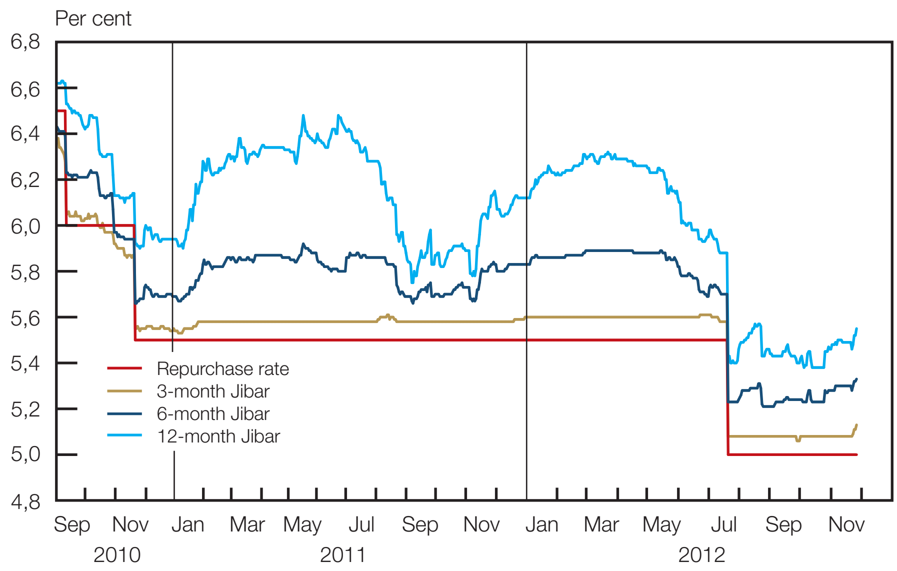
Total loans and advances extended to households and companies

After moderating in the second quarter of 2012, companies' reliance on bank-intermediated funding again edged higher in the third quarter. Year-on-year growth declined from a recent peak of 12,2 per cent in March to 6,2 per cent in July but accelerated to 8,4 per cent in September. In October growth moderated to 7,5 per cent. The slower corporate credit demand could partly be explained by the ease of access by large corporates to alternative sources of funding such as bond issuances in the capital market, encouraged by the low interest rate environment, while labour unrest, low business confidence and weak underlying economic activity also serve to dampen credit demand.

Interest rates and yields

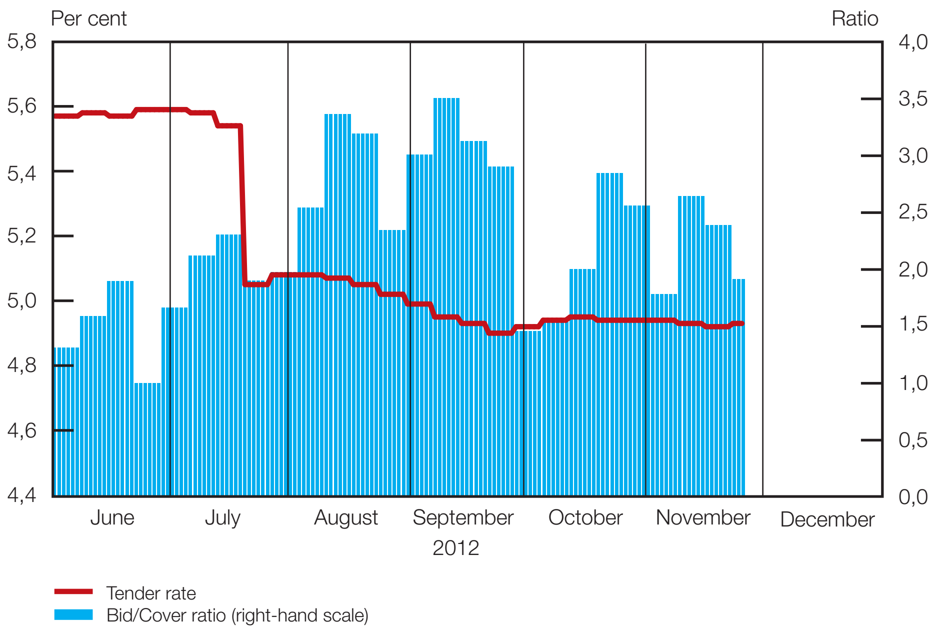
Within a relatively contained inflation environment, while mindful of the domestic economic growth prospects and the potential impact of the protracted European sovereign debt crisis on the domestic economy, the MPC decided to lower the repurchase rate to 5,0 per cent in July 2012. The policy interest rate was kept unchanged in the subsequent policy meetings of September and November. The domestic economic growth outlook remained constrained by weak global conditions and, locally, by indications of a setback to the mining sector mainly due to work stoppages and a weak performance in the manufacturing sector. Despite the fragile growth prospects, domestic inflation remained subdued and was expected to remain within the target range over the forecast period, although with some upside pressure expected from food and petrol price increases. The MPC statements discussing developments underlying recent monetary policy decisions are reproduced in full from page 72 of this *Quarterly Bulletin*.

Money-market rates



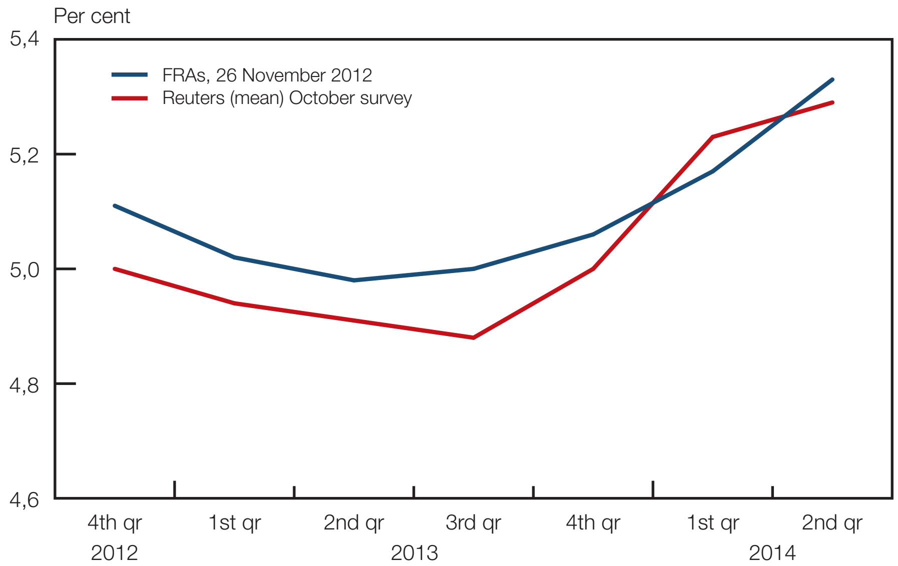
Short-term money market rates trended sideways in the aftermath of the reduction in the policy rate in July 2012 and fluctuated within a narrow range until the end of November. However, market demand-and-supply factors sporadically impacted on money-market interest rates, for example, demand for Treasury bills with a maturity of 91 days heightened when the weekly issuance of this instrument was reduced by R0,8 billion to R2,7 billion from 27 July 2012. The tender rate on 91-day Treasury bills consequently declined from 5,08 per cent on 27 July to a low of 4,90 per cent on 27 September. The downgrading of South Africa's credit ratings at the end of September and early October by two major international credit rating agencies impacted on market sentiment and the Treasury bill rate increased somewhat to 4,93 per cent towards the end of November.

Market demand for 91-day Treasury bills



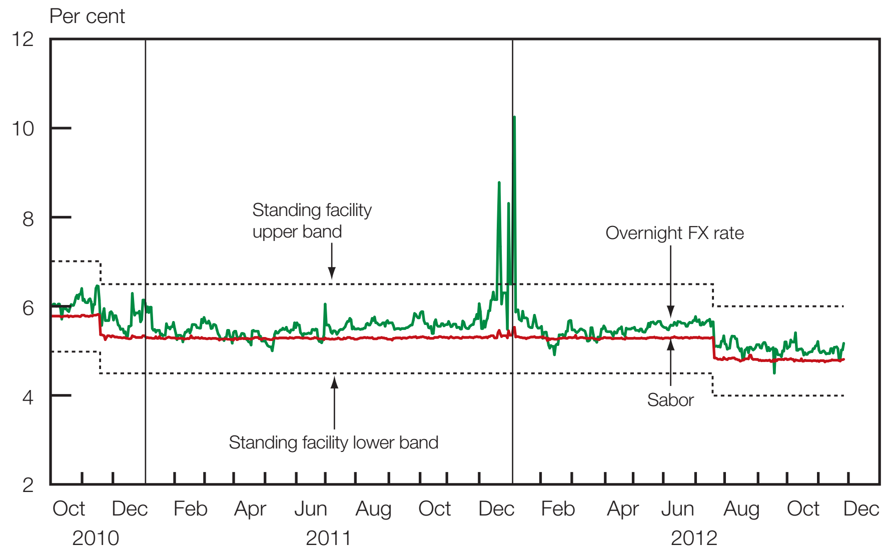
Forward rate agreements (FRAs) with maturities ranging from one to twelve months fluctuated, on average, within a narrow band of 4,79 and 5,02 per cent between August and November 2012, indicating that market players expected the monetary policy stance to remain unchanged in the near term. This reflected, to some extent, the recent favourable domestic inflation outcomes despite a weakening in the exchange value of the rand and elevated petrol and food prices during the period under review. The unchanged future trajectory of interest rates, as implied by FRAs, corresponds well with other indicators of inflation expectations such as those represented by the Reuters consensus forecast.

Interest rate expectations



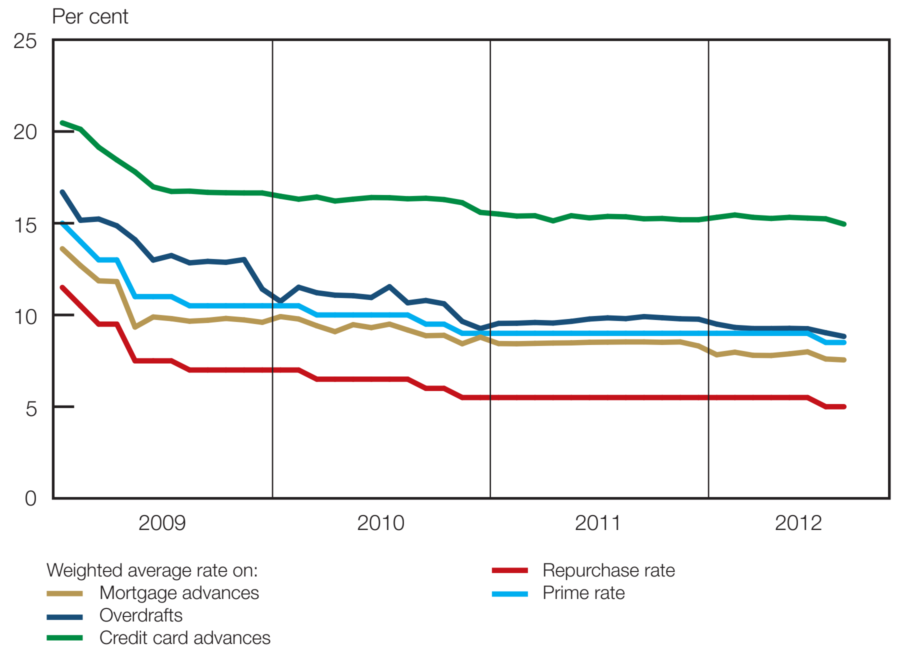
Owing to the availability of ample liquidity in the interbank market, both the South African Benchmark Overnight Rate on deposits (Sabor) and the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate), remained fairly stable and fluctuated well within the standing facility limits between August and November 2012. The Sabor maintained its sideways trend and fluctuated between a narrow range of 4,75 and 4,90 per cent during the period under review. The overnight FX rate ranged between a high of 5,41 per cent and a low of 4,50 per cent during the period and settled at 5,22 per cent towards the end of November.

Benchmark overnight rates



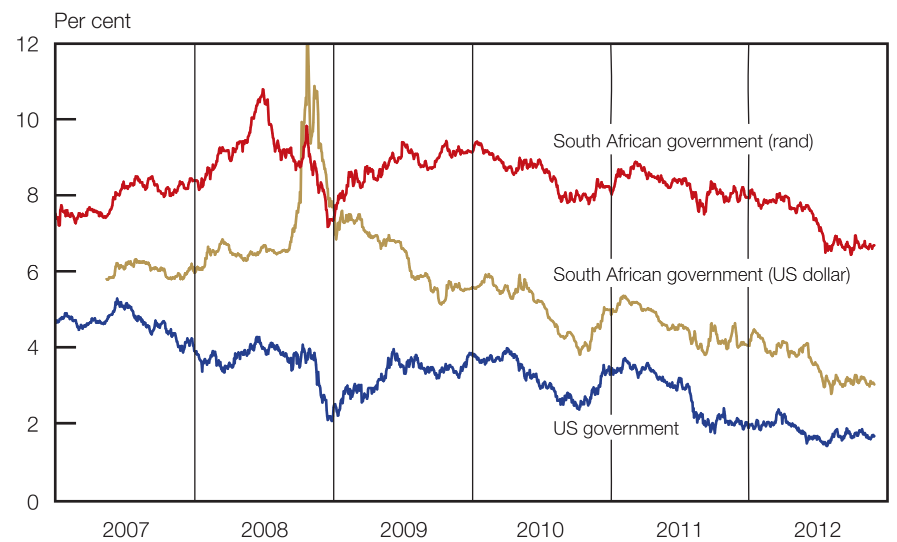
The predominant rate on mortgage loans has remained unchanged at 8,50 per cent since July 2012. Other lending rates offered by banks also remained fairly stable after following the reduction in the repurchase rate in July 2012.

Selected bank lending rates, and the repurchase rate



The daily average *yield on the R208 government bond* (maturing in 2021) declined from 8,05 per cent on 22 March 2012 to an all-time low of 6,43 per cent on 26 September. This was in response to firm demand for local bonds by non-residents, accompanied by lower inflation and interest rates. Subsequently, the bond yield increased to 6,68 per cent on 27 November following the release of higher-than-expected inflation data, the depreciation in the exchange value of the rand and the larger fiscal deficit provided for in the *MTBPS*.

Government bond yields



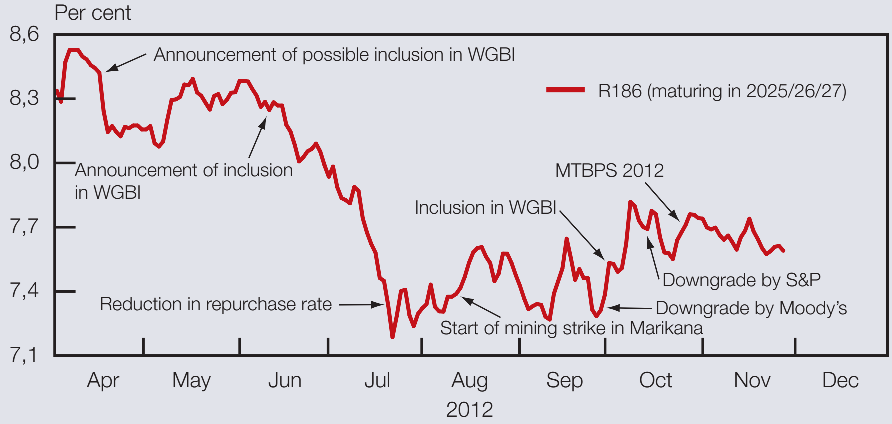
The daily closing yield on the *US 10-year government bond* followed a similar trend, decreasing from 2,36 per cent on 20 March 2012 to a low of 1,40 per cent on 25 July, before edging higher to 1,66 per cent on 27 November. As the yield on rand-denominated government bonds declined more pronouncedly than the yield on US dollar-denominated government bonds, the *currency risk premium*[8] on South African government bonds narrowed from 376 basis points in April 2012 to 345 basis points in October.

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

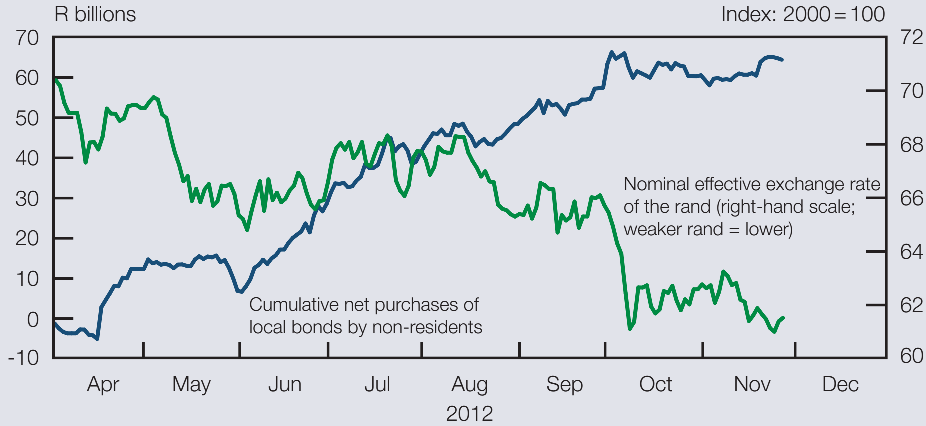
Box 2: Bond yields since the announcement of South Africa's possible WGBI inclusion

The announcement of the possible inclusion of South African government bonds in the Citi World Government Bond Index (WGBI) in April 2012 contributed to higher net purchases of local bonds by non-residents and a decline in bond yields. Thereafter, the inclusion was confirmed in June as the South African bonds had satisfied all three WGBI entry requirements, namely (i) a market capitalisation exceeding US$50 billion, (ii) an adequately strong domestic long-term credit rating, and (iii) the absence of barriers to entry. This, together with the reduction in the repurchase rate in July 2012, the release of lower-than-expected inflation data and strong demand for local bonds by non-residents – due to high levels of global liquidity, seeking higher returns – gave rise to a decline in bond yields.

Government bond yield



Non-residents' transactions in local bonds and the exchange rate



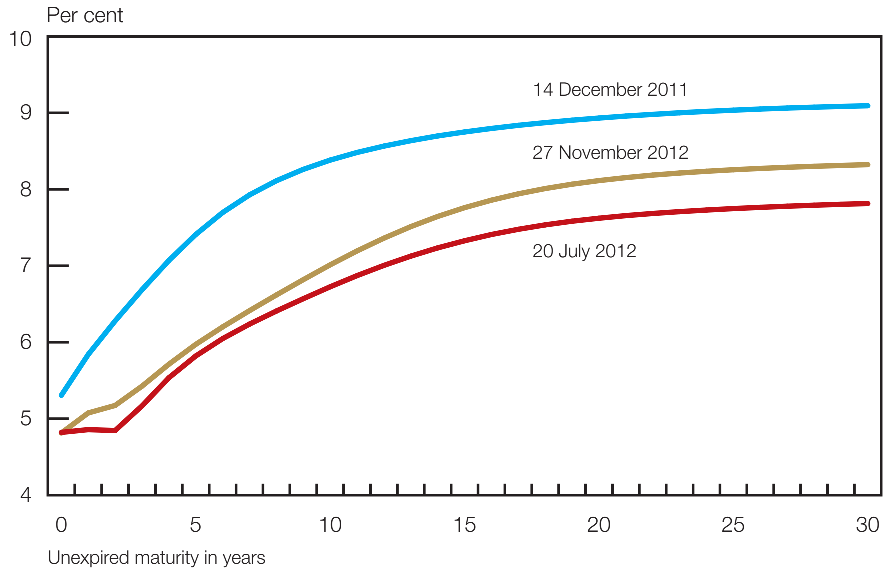
Bond yields came under some upward pressure in August 2012 as the Marikana mining strike started and the exchange value of the rand depreciated. However, as demand surged ahead of the official inclusion of South African bonds in the WGBI, bond yields again fluctuated lower. The total number of countries included in this index reached 23 after the 12 South African government bonds had been included in the WGBI on 1 October 2012. South Africa was the first African country to be included in the WGBI and accounts for 0,45 per cent of the market value of the index.

However, the inclusion of South Africa in the WGBI was overshadowed by the downgrade of the country's sovereign credit rating by Moody's Investors Service, Inc. on 27 September 2012 and by Standard and Poor's (S&P) rating agency on 12 October 2012. Subsequently, bond yields rose moderately in line with higher realised and expected consumer inflation data, the somewhat larger fiscal deficit announced in the *Medium Term Budget Policy Statement 2012*, the weaker exchange value of the rand and moderate net selling of local debt securities by non-residents. Most of the action seems to have been in front-running of the WGBI inclusion, although more lasting benefits should accrue to the South African bond market, for instance, through index-tracking investment funds.

In September 2012 National Treasury notified R157 government bond (maturing in 2014/15/16) holders of the option to split the bond into the three new bond series, namely the R009, R158 and R159 bonds.

Yields at the short end of the *yield curve* were initially broadly anchored to the unchanged repurchase rate, before moving lower in July 2012 following the decline in the repurchase rate. Although the level of the yield curve across all maturities moved lower during 2012, the yield curve steepened as the medium to long end of the yield curve fluctuated higher from August, following deteriorating inflation conditions together with the depreciation in the exchange value of the rand and concerns about possible higher government bond issuances. The *yield gap*, measured as the difference between yields at the extreme long and short ends of the curve, widened from 299 basis points on 20 July 2012 to 351 basis points on 27 November.

Yield curve



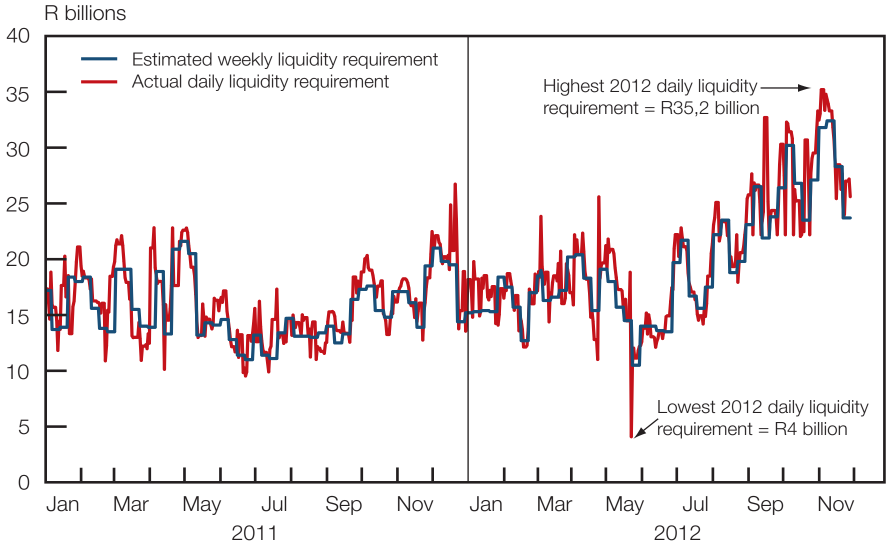
Given the financial turmoil in developed markets, investor confidence in the capital markets of emerging economies continued to improve from the second quarter of 2012 onwards. For example, the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[9] yield spread above US government bonds narrowed from 419 basis points in May 2012 to 277 basis points in October. Also broadly emulating these developments, the *sovereign risk premium* on South African government US dollar-denominated bonds in the ten-year maturity range trading in international markets decreased from an average of 210 basis points in May 2012 to 141 basis points in October. This was despite the downgrade of South Africa's sovereign rating by international credit rating agencies.

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

Money market

During the third quarter of 2012 and the ensuing months to October 2012, the actual daily liquidity requirement of the private-sector banks increased, on balance, from a low of R14,2 billion to a high of R33,3 billion. This was a considerable improvement from the relatively low liquidity requirement levels experienced during the first half of the year. The rise in the liquidity requirement reflected the effectiveness of the Bank's monetary policy operational framework which has been revised on two occasion since August 2010 to keep the money market shortage in line with conditions in the money market and thus improving the effectiveness of the transmission of monetary policy.

Liquidity requirement



During the third quarter of 2012, the net result of the money-market liquidity flows was a drainage of liquidity to the value of R6,7 billion. Notes and coin in circulation, together with cash reserve deposits by banks, drained liquidity to the value of R6,0 billion in the market. An increase in government deposits with the Bank, mainly attributable to an increase of R3,7 billion in foreign currency-denominated deposits and an increase of R0,2 billion in domestic currency-denominated deposits also served to counteract the effects of a R4,9 billion in liquidity injection through the Bank's operations in the foreign-exchange market. The remaining excess liquidity in the market was drained through the use of liquidity management instruments, such as reverse repurchase transactions and SARB debentures to the value of R1,9 billion and R4,5 billion respectively.

Money-market liquidity flows

R billions (easing + tightening –)

	2012		
	Apr–Jun	Jul–Sep	Oct
Notes and coin in circulation	-1,9	-5,1	-0,1
Required cash reserve deposits	-1,7	-0,9	-0,3
Money-market effect of SARB* foreign-exchange transactions	6,2	4,9	0,1
Government deposits with the SARB*	5,8	-3,9	-1,1
Use of liquidity management instruments	-1,6	-6,4	-0,6
Reverse repurchase transactions	-2,0	-1,9	-0,4
SARB debentures	0,4	-4,5	-0,2
Other items net	-6,3	4,7	-3,4
Banks' liquidity requirement (decrease + increase –)	0,5	-6,7	-5,4

* SARB: South African Reserve Bank

Coupon interest payments on various government bonds amounting to R15,5 billion were paid out from the government tax and loan account during the third quarter of 2012, of which R0,3 billion accrued to the Bank during this period.

Bond market

Bond issuances in the *primary bond market* remained brisk in the first ten months of 2012. At the end of October 2012 banks had the second-largest amount of debt paper in issue after the national government. As shown in the accompanying table, all other issuers, except local governments and non-residents, have recorded net issues thus far in 2012. While net issues by the public sector have continued at a steady pace so far this year, net issues by the private sector were nearly double the net issues recorded in the same period of 2011, as corporates took advantage of low yields. The total outstanding nominal value of debt securities listed on the JSE Limited (JSE) increased by R226 billion in the first ten months of 2012 to reach R1,6 trillion at the end of October.

Net issuances of bonds and commercial paper, January to October

R billions

	2011	2012	Amount in issue at the end of October 2012
National government	124	141	978
Public enterprises	11	13	203
Local governments	-1	-0,3	14
Banks	31	46	227
Private companies	4	23	89
Securitisation	6	5	81
Non-residents	2	-3	6

Turnover in the *secondary bond market* remained elevated in the first ten months of 2012, boosted by lower bond yields and higher volumes traded. The value of turnover amounted to R21,9 trillion in the first ten months of 2012, which was 12 per cent higher than the value traded in the corresponding period of 2011. The R157 government bond (maturing in 2014/15/16) was the most liquid government bond with a turnover ratio of 76,7 – measured as the nominal value of trade relative to its nominal value listed. The second most liquid bond was the R206 (maturing in 2014) with a turnover ratio of 41,1. In contrast, liquidity of the nine inflation-linked bonds in issue averaged 3,2 in the first ten months of 2012. Linkers accounted for only 4 per cent of the total value traded in government bonds over this period.

Although rand-denominated bond issuances in the *European and Japanese Uridashi bond markets* continued steadily in 2012 as issuers consistently used these instruments for investment diversification, they were more restrained when compared with the same period of 2011. This was largely due to concerns and uncertainty about the European debt crisis. Net redemptions of rand-denominated bonds were recorded in both these markets, which contributed to total net redemptions of R1,3 billion in the first ten months of 2012, compared with net issues of R14,6 billion recorded in the corresponding period of 2011, as indicated in the accompanying table.

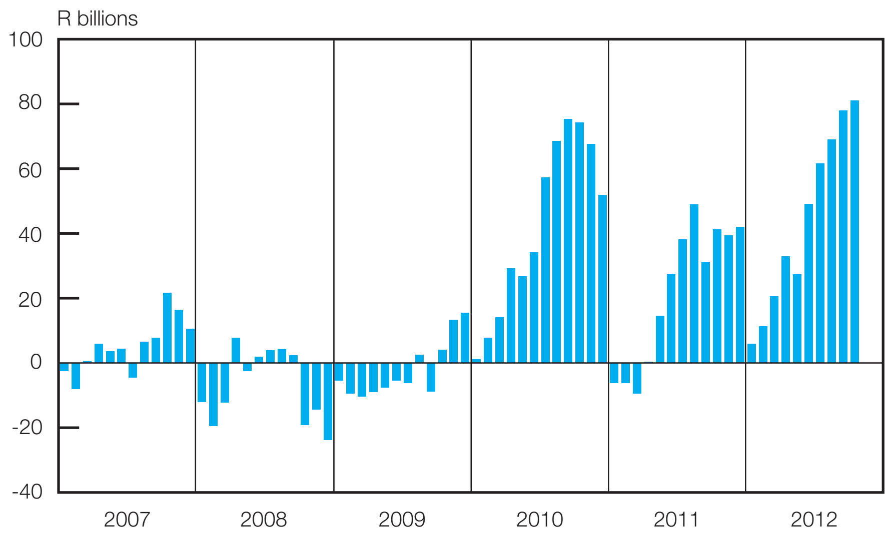
Rand-denominated bonds issued in international bond markets, January to October

R millions

	Eurorand		Uridashi		Total	
	2011	2012	2011	2012	2011	2012
Issues	15 062	8 491	13 199	8 965	28 261	17 455
Redemptions	5 680	8 975	7 990	9 753	13 670	18 728
Net	9 382	-484	5 209	-789	14 591	-1 273

Non-residents' interest in local debt securities remained strong for most of 2012, as demand for these instruments were, among others, anchored by the inclusion of South Africa's government bonds in the Citi WGBI on 1 October 2012. Non-residents increased their holdings of domestic bonds by R28,8 billion in the third quarter 2012 and by a further R3,1 billion in October. Total net purchases of local bonds by non-residents soared to a record high of R81,1 billion in the ten months to October 2012, compared with net purchases of R42,0 billion recorded in 2011 as a whole.

Annual cumulative net purchases of local debt securities by non-residents



Share market

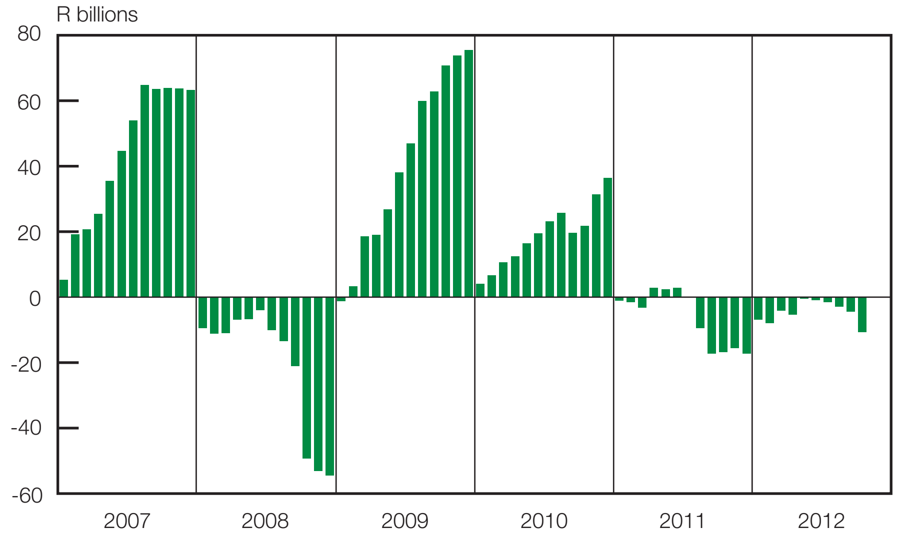
Amid lower economic growth, and constricted consumer and business confidence, the *capital raised* by companies listed on the JSE in the domestic and international primary share markets of R64,0 billion in the first ten months of 2012, was 10 per cent lower than the amount raised in the corresponding period of 2011. This was also alongside the lower number of companies listed on the JSE as delistings exceeded new listings. Companies with primary listings on the JSE accounted for the bulk of the equity funding at 68 per cent of the total capital raised over this period.

Despite lower trade volumes, *turnover* in the secondary share market remained high in the first ten months of 2012, boosted by record-high share prices. This was evident in daily average values reaching an all-time high of R17,3 billion per day in September 2012. The value of shares traded on the JSE of R2,9 trillion in the ten months to October 2012 exceeded turnover in the corresponding period of 2011 by 4 per cent. As the total *market capitalisation* soared to an all-time high of R8,0 trillion in October 2012, market liquidity[10] declined from 48 per cent in 2011 to 43 per cent thus far in 2012.

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

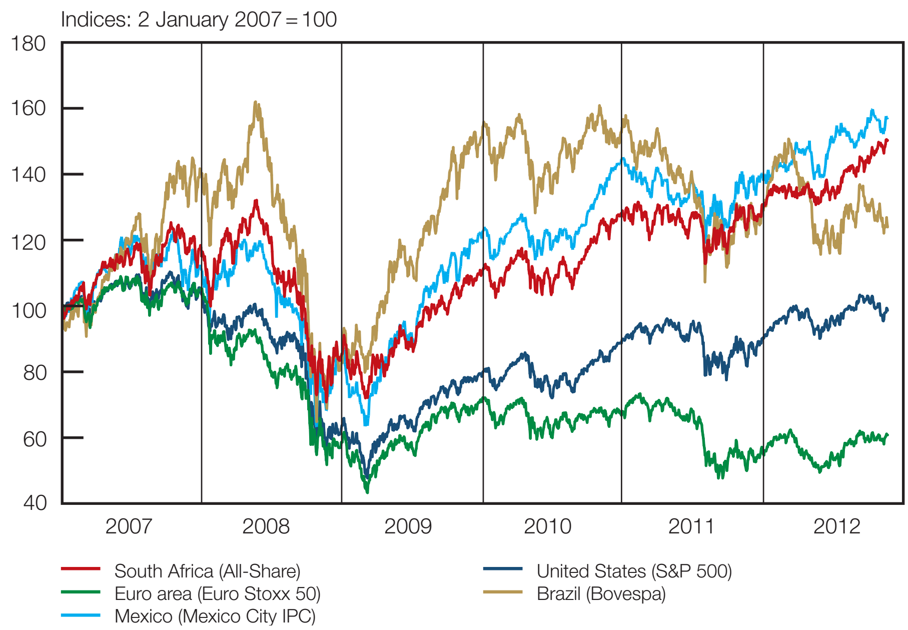
Notwithstanding the positive impetus in the domestic equity market in 2012, *non-residents* continued to be net sellers of domestic listed shares, tracking, among other things, the continuing depressed global economic performance and unrest in local mining and other sectors of the economy. Non-residents reduced their holdings of shares by R3,6 billion in the third quarter of 2012, followed by noticeable net sales of R6,2 billion in October. This contributed to total net sales of local shares by non-residents of R10,6 billion in the first ten months of 2012, compared with net sales of R16,8 billion recorded in the corresponding period of 2011.

Annual cumulative net purchases of local shares by non-residents



Despite lower economic growth, domestic share prices continued higher to reach record highs in 2012. The *FTSE/JSE All-Share Price Index* (Alsi) rose by 33 per cent from a recent low of 28 391 index points on 8 August 2011 to an all-time high of 37 866 index points on 23 November 2012. This was as a result of, among other things, higher international equity prices in developed and emerging markets, the depreciation in the exchange value of the rand and increased liquidity following the implementation of further monetary stimulus measures abroad. Subsequently, the Alsi declined marginally to 37 806 index points on 27 November.

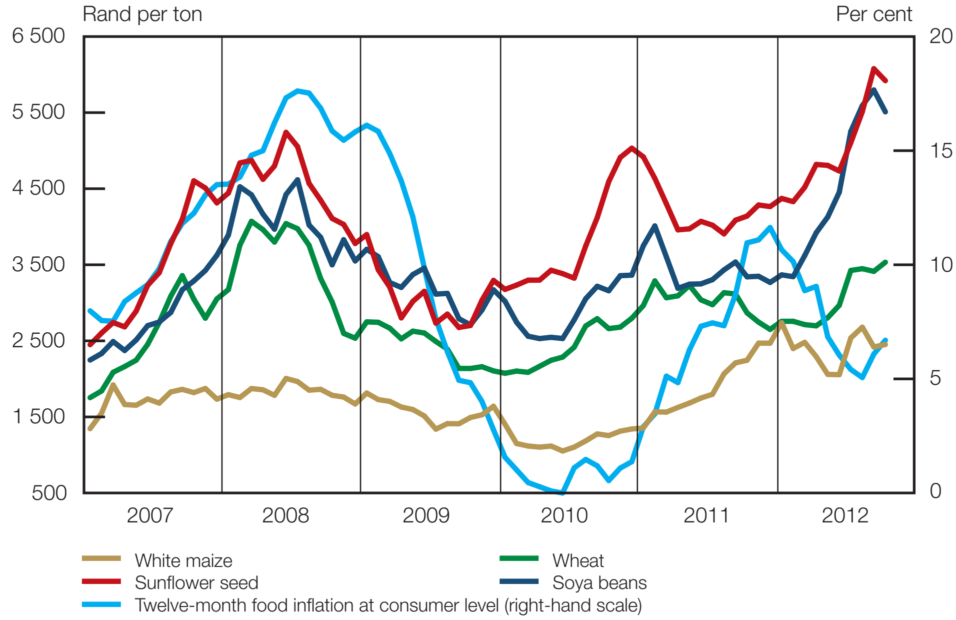
Share prices in local currency



Market for exchange-traded derivatives

Trading activity on the Commodity Derivatives Division of the JSE remained robust in the ten months to October 2012. The trading volume of 2,5 million *commodity futures and options contracts* traded during this period was 17 per cent higher than the number of contracts traded in the corresponding period of 2011. Domestic agricultural commodity prices tracked global grain prices higher, following international supply shortages emanating from adverse weather conditions. The depreciation in the exchange value of the rand also contributed to upward pressure on local agricultural commodity prices, thus giving rise to higher food inflation in recent months. The recent discovery of a deadly UG99 wheat fungus in South Africa poses yet another threat to food prices and requires very close monitoring as it could potentially reduce the quality of wheat harvested dramatically.

Agricultural commodity prices and food inflation



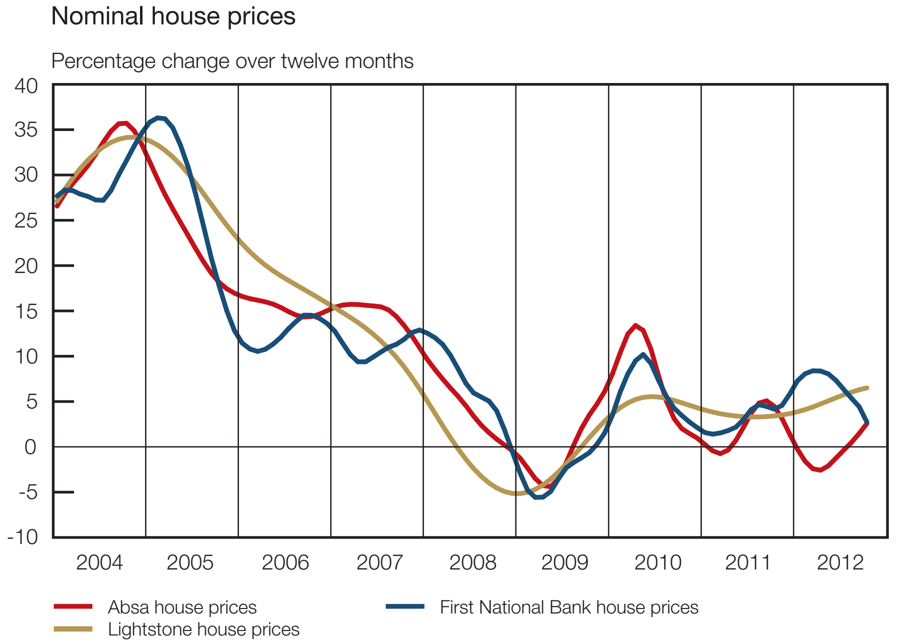
On the *Interest Rate and Currency Derivatives Markets* of the JSE some 26 per cent more contracts were traded during the ten months to October 2012 when compared with the same period of 2011, which contributed to higher turnover. The bulk of the trading activity remained concentrated in the currency derivatives market, as investors were probably lured by the option to exercise flexibility offered by the continuous introduction of new can-do options and currency any-day contracts. Turnover in all derivatives traded on the JSE during the first ten months of 2012 is indicated in the table below.

Derivatives turnover on the JSE, January to October 2012

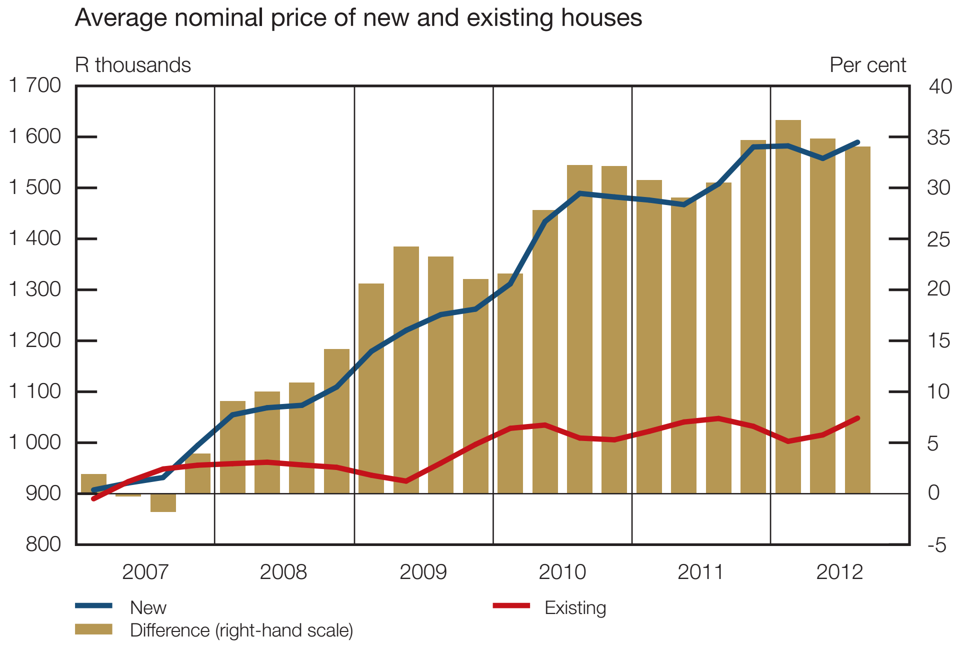
Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity derivatives	3 451	-3
Warrants	1	-45
Commodity derivatives	423	35
Interest rate derivatives	306	76
Currency derivatives	103	22

Real-estate market

Nominal house price increases remained subdued in 2012, reflecting fairly sluggish economic growth and job creation, lower transaction volumes in the residential property market and very little growth in mortgage finance against the background of households' financial pressures. This residential property environment also points to weak residential property demand relative to supply. In real terms, house prices have generally been declining since 2008.



The price differential between new and existing houses declined almost close to zero during the period from 2005 to 2007. Thereafter, between 2008 and the third quarter of 2012, existing houses were, according to Absa, on average, 25,1 per cent cheaper than new houses. This implies that existing houses have generally been below their replacement value during this period. However, the price differential has moved to 34,1 per cent in the third quarter of 2012, after reaching an all-time high of 36,6 per cent in the first quarter of 2012.



Source: Absa

A high percentage of households with impaired credit records (some 47 per cent of credit-active households), a high debt-to-income ratio, higher municipal rates and tariffs, among other things, continued to impede consumers' ability to take advantage of lower debt-service cost trends in the housing market in recent years. The *FNB Estate Agent Survey* confirmed that the percentage of households estimated to be downscaling due to financial pressure was still as high as 20 per cent in the third quarter of 2012.

Non-bank financial intermediaries

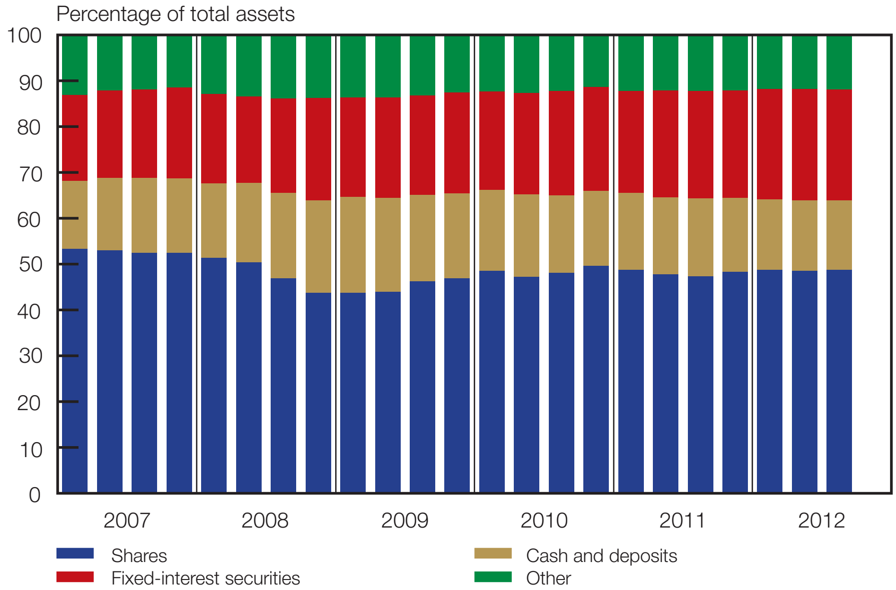
The balance sheet of non-bank financial institutions[11] grew by 6 per cent from the second quarter of 2012 to R5,2 trillion in the third quarter, representing a growth rate of 18 per cent over the same period of 2011. The longer-term contractual savings vehicles (insurers and retirement funds) accounted for 78 per cent of the total assets in the third quarter of 2012 and increased by 18 per cent on a year-on-year basis. Growth in the financial assets of these intermediaries was spurred by higher equity market revaluations, which bolstered their holdings of ordinary shares in the same period.

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

Holdings of ordinary shares to total assets moved sideways from the second quarter of 2012 to 49 per cent in the third quarter, following some deterioration in the global and domestic economic outlook. The reallocation of funds into shares is likely to be supported by improved financial market conditions and the lower interest rate environment.

Non-bank financial intermediaries' holdings of fixed-interest securities accounted for 24 per cent of total assets in the second and third quarters of 2012. Exposure to government bonds remained unchanged at 13 per cent of the total assets in the same period, alongside low bond yields. However, the continued decline in bond yields will likely have a negative impact on investment income to these institutions. Similarly, the percentage of assets allocated to public corporations' bonds have remained broadly unchanged at 4 per cent of the total assets thus far in 2012.

Asset allocation of non-bank financial institutions



Funds invested in cash and cash-equivalents accounted for 15 per cent of total assets in the second and third quarters of 2012. Investment in other assets grew slightly to 12 per cent of the balance sheet in the same period, as the combined effect of a stronger global equity market and a weaker exchange value of the rand boosted revaluation values of foreign assets.

In its endeavour to strengthen and promote savings, the National Treasury released for public comment technical discussion papers on enabling better income retirement and preservation, portability and governance for retirement funds. These papers outline policy proposals on how to encourage pre- and post-preservation of retirement income, improve retirement fund governance and reform of the retirement annuities market. The new framework for hedge funds in South Africa, released by the Financial Services Board and National Treasury, proposed that the industry be regulated within the existing Collective Investment Schemes Control Act, No. 45 of 2002 (CISCA).

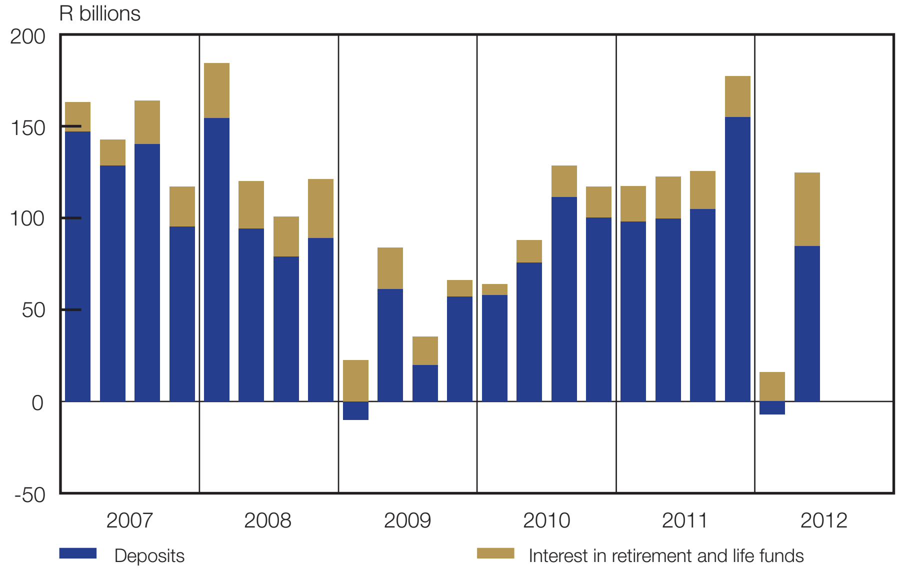
Flow of funds

The *non-resident sector* recorded a net lending position of R51,8 billion during the second quarter of 2012. Non-residents extended funds into the domestic economy mainly through the acquisition of debt securities, with loans amounting to R46,8 billion and long-term bonds to R20,3 billion. The acquisition of bonds by non-residents partly reflected the relatively competitive yields offered by the domestic debt market against the backdrop of weak global investor sentiment. However, in spite of the positive price effects evident in the domestic equity market's high share prices, non-residents' net purchases of domestic equities continued to be subdued at R2,7 billion in the second quarter of 2012.

Financial intermediaries recorded a net lending position of R22,9 billion in the second quarter of 2012. This reflected a possible increased reliance on borrowed funds by economic agents to meet their transactional needs. Most of the financial intermediation occurred through bank loans and advances, and bond and equity purchases. Long-term bond purchases by the intermediaries amounted to R24,0 billion and their accumulation of equities to R15,9 billion, while loans and advances worth R29,1 billion were extended during the second quarter of 2012. Collectively, these items represented 31 per cent of the total financial intermediation during the second quarter of 2012. The main recipients of these funds were households, general government and the private business sector.

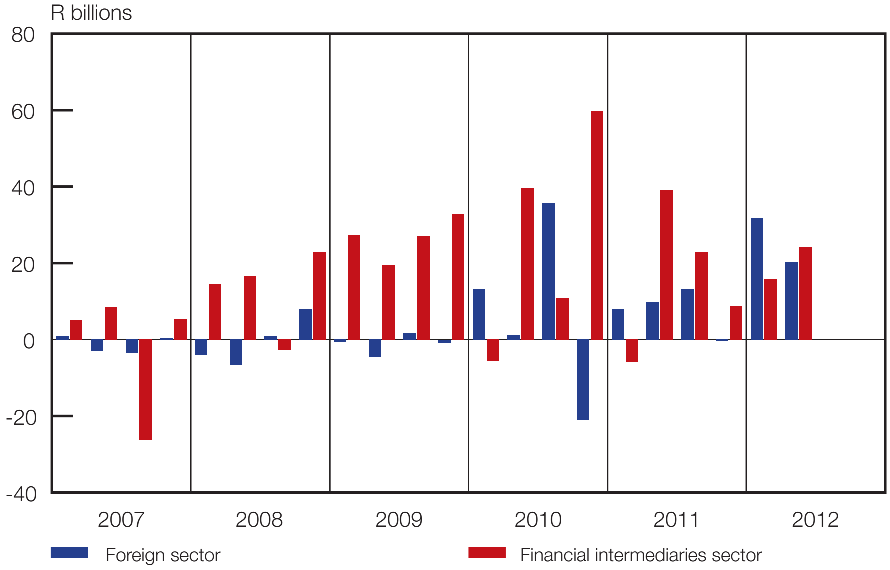
Over the same period, contractual savings and deposit flows from private business, households and the general government sectors to financial intermediaries rebounded and collectively amounted to R82,8 billion.

Financial intermediaries: Selected sources of funds



Parallel to its incurrence of a wider net borrowing position of R58,6 billion in the second quarter of 2012, the *general government sector* relied on bond issuance for financing. The borrowing position comprised R43,9 billion by the central and provincial governments and R14,6 billion by local governments. This shortfall was mainly financed by the foreign and financial intermediaries sectors, as they collectively purchased R44,4 billion's worth of long-term bonds issued. The banking and private business sectors absorbed Treasury bills worth R5,6 billion. In turn, the general government sector was able to increase its gross capital formation by R25,2 billion during the review period, as local governments invested in water and sanitation projects, and provincial governments upgraded their road infrastructure.

Long-term government bond acquisition by sector



The combined net financing position of *corporate business enterprises* amounted to a deficit of R38,5 billion in the second quarter of 2012. This comprised a deficit of R21,2 billion by public corporate businesses and R17,3 billion by private corporate businesses. The deficit position resulted from, among other things, progressive capital spending related to the construction of power stations and road networks. The total capital expenditure by public corporate businesses was R33,9 billion in the second quarter of 2012, which was 8 per cent higher than the amount reported a quarter earlier.

Capital spending by private corporate businesses also increased from the R65,6 billion recorded in the first quarter of 2012 to an increase of R87,1 billion in the second quarter, as mining businesses continued construction work and acquisition of machinery and equipment; and the telecommunications sector expanded its fibre-optic network to improve the transmission capacity and quality. This resulted in gross capital formation of R121 billion in the second quarter of 2012 for corporate business enterprises as a whole – 25 per cent more than the amount realised a quarter earlier.

During the second quarter of 2012, the *household sector's* total flows amounted to R82,3 billion, while the sector recorded a net lending position of R22,5 billion. This surplus financing balance was used to increase deposit holdings, and interest in retirement and life funds. Households acquired mortgage loans amounting to R5,5 billion, and bank loans and advances of R17,7 billion in the second quarter of 2012. Over the same period, the household sector acquired total net financial assets of R66,8 billion, which were equivalent to 81 per cent of its total flows.

12 Unless otherwise stated, year-on-year rates of increase compare fiscal 2012/13 to fiscal 2011/12.

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

Public finance[12]

Non-financial public-sector borrowing requirement[13]

Financial activities of the non-financial public sector resulted in a smaller borrowing requirement in the first half of fiscal 2012/13. The outcome was R12,5 billion lower than the R118 billion recorded in the first six months of fiscal 2011/12. The smaller borrowing requirement was due to the lower deficit recorded by non-financial public enterprises and corporations, together with surpluses recorded by provincial and local governments. The *Budget Review 2012* projected that the non-financial public-sector borrowing requirement would amount to R235 billion in fiscal 2012/13 as a whole. No firm conclusions regarding fiscal developments in the remainder of the year should be drawn from the partial outcomes, given the quarter-to-quarter volatility of the data.

As a ratio of gross domestic product, the non-financial public-sector borrowing requirement reached 6,6 per cent in the first two quarters of fiscal 2012/13, relative to the somewhat higher ratio of 8,1 per cent recorded in the same period a year earlier. The *Budget Review 2012* projected that this ratio would amount to 7,1 per cent in fiscal 2012/13 as a whole.

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

Non-financial public-sector borrowing requirement

R billions

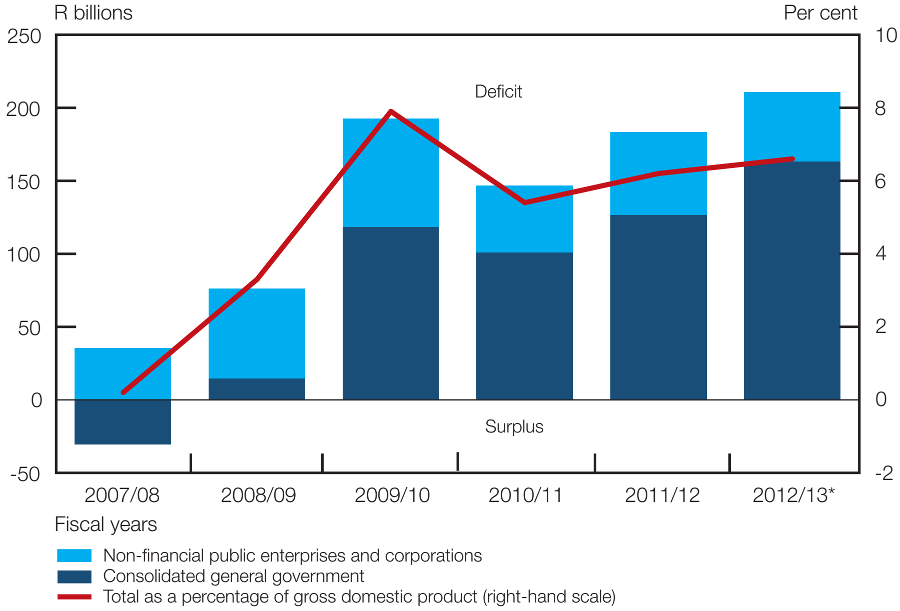
Level of government	Apr–Sep 2011*	Apr–Sep 2012*
Consolidated general government	89,9	81,6
National government	101,6	101,4
Extra-budgetary institutions	-0,2	-2,5
Social security funds	-7,2	-8,1
Provincial governments	-7,3	-9,2
Local governments	3,0	-0,1
Non-financial public enterprises and corporations	27,9	23,7
Total**	117,8**	105,3**
As a percentage of gross domestic product	*8,1*	*6,6*

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

14 A legal entity that is created by the government in order to participate in commercial activities on the government's behalf. A state-owned enterprise (SOE) can be either wholly or partially owned by government and is typically earmarked to participate in commercial activities. Examples are Transnet, Eskom and Denel.

Non-financial public enterprises and corporations, including major State Owned Enterprises[14] (SOEs) recorded a preliminary cash deficit of R23,7 billion, slightly lower than the cash deficit recorded in the first half of fiscal 2011/12. The South African National Roads Agency Limited (Sanral), which forms part of the SOEs, operates in two very distinct business areas, namely toll and non-toll operations as required by the Sanral and National Roads Act, Act 7 of 1998. In fiscal 2012/13 the toll and non-toll activities were budgeted to record deficits of R4,0 billion and R1,0 billion respectively. Sanral had incurred debt to the amount of R21 billion to finance the first phase of the Gauteng Freeway Improvement Project, of which government had guaranteed R19 billion. Tolling was due to start on 30 April 2012, but was postponed after various protests and appeals. By late September 2012, the delay had already cost Sanral about 40 per cent of its estimated revenue for 2012 as a whole.

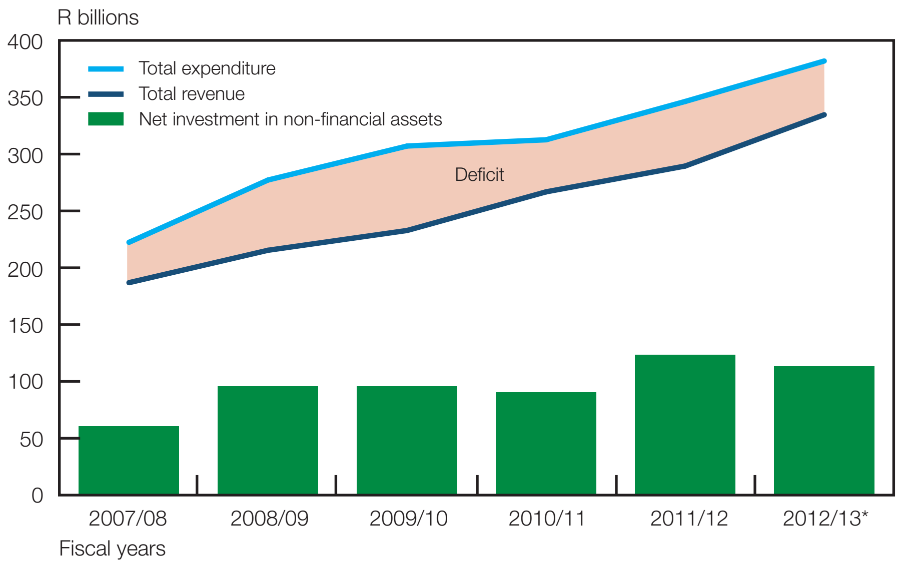
Non-financial public-sector borrowing requirement



* April–September 2012, annualised

Eskom continued with its capacity expansion programme, planning to spend approximately R320 billion on capital projects over the next five years. As a result of a late start to, and delays in, the capacity expansion programme, the supply-demand balance of electricity was expected to remain tight throughout 2012 and 2013, until the Medupi power station was fully operational. Subsequent to the announcement by the President in his State of the Nation Address to Parliament in February 2012 that Transnet would spend R300 billion in capital-expansion programmes, a multi-billion rand deal was signed with a Chinese rail company in September 2012 to supply 95 locomotives, thereby replacing a portion of Transnet's ageing fleet. Transnet was also set to create more than 220 000 jobs, thereby boosting artisan skills and logistics infrastructure as part of its R300 billion seven-year strategy. In July 2012 Transnet successfully launched a US$1 billion bond at an interest rate of 4 per cent to finance the company's capital expenditure programme. The bond was the highest amount that had ever been raised by Transnet in a single issuance and without a government guarantee.

Finances of non-financial public enterprises and corporations



* April–September 2012, annualised

During the July–September quarter of 2012, net investment in non-financial assets by the non-financial public enterprises and corporations amounted to R33,9 billion, resulting in a cumulative amount of R56,7 billion in the first six months of fiscal 2012/13. This was R5,3 billion less than the infrastructure spending recorded in the same period a year ago. The *Budget Review 2012* projected that R137 billion would be spent on infrastructure in fiscal 2012/13 as a whole.

In the first two quarters of fiscal 2012/13, cash receipts from operating activities of *national government* amounted to R384 billion, which represented a year-on-year growth rate of 13,9 per cent. Cash payments for operating activities increased by 10,4 per cent year on year to amount to R481 billion, mainly as a result of grants paid, which accounted for the major part of national government expense. Net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R101 billion in the first six months of fiscal 2012/13. This deficit was broadly the same as the cash deficit recorded in April–September 2011.

In July–September 2012, *provincial governments* recorded a cash surplus of R0,6 billion, bringing the cash surplus to R9,2 billion in the first half of fiscal 2012/13. The year-on-year increase of R1,8 billion was due to an increase in revenue which was predominantly boosted by grants from national government. These grants – equitable share and conditional grants – increased at a year-on-year rate of 8,2 per cent.

Provincial government expenditure amounted to R191 billion during April–September 2012, or a 7,7 per cent rate of increase year on year. The bulk of provincial government expenditure was on personnel costs, which amounted to R116 billion, or 60,7 per cent of total expenditure. This represented a year-on-year rate of increase of 7,6 per cent.

Provincial government's net investment in non-financial assets amounted to R13,9 billion during the first six months of fiscal 2012/13, or 16,8 per cent higher than the previous year.

The provincial cash surplus resulted in an increase in provincial governments' deposits with the Corporation for Public Deposits (CPD), up from R6,4 billion at the end of March 2012 to R14,5 billion at the end of September. At the same time their deposits with private banks increased slightly from R14,5 billion to R14,9 billion, while their overall indebtedness to banks increased from R1,1 billion to R2,0 billion over the same period.

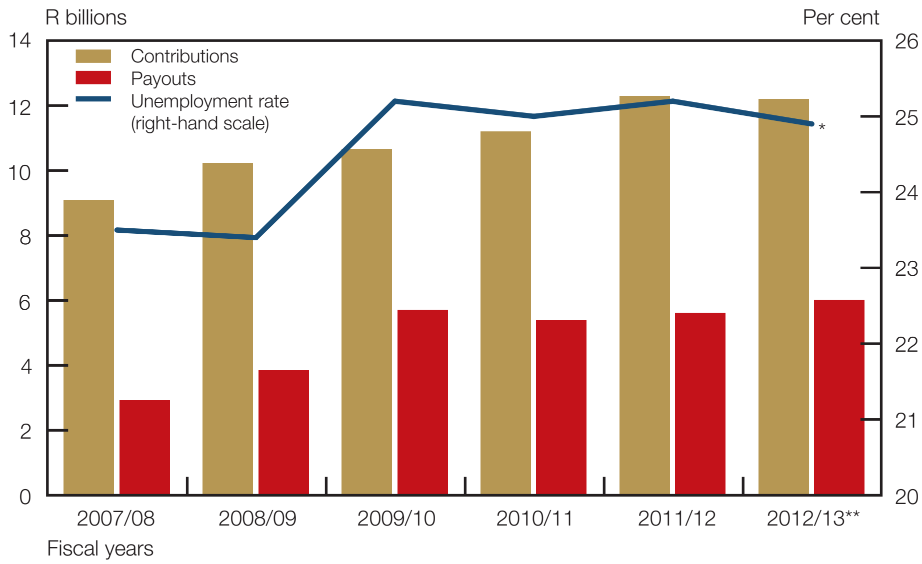
During the first six months of fiscal 2012/13, financial activities of the consolidated *local governments* resulted in a preliminary net operating cash surplus of R22,4 billion. This surplus, together with the net investment in non-financial assets resulted in a negligible *surplus*, in contrast to a cash *deficit* of R3,0 billion recorded in April–September 2011. This turnaround in local government finances was on account of strong growth in intergovernmental transfers and sales of electricity and gas.

Municipal own revenue increased by 12,3 per cent to amount to R90,7 billion in the first half of fiscal 2012/13, accounting for 73,0 per cent of total local government revenue. Sales of electricity and gas, together with property rates received, were the main sources of municipal own revenue, and rose by 10,7 per cent and 14,0 per cent respectively. National government transfers to local government were budgeted to amount to R77,3 billion in fiscal 2012/13 as a whole. The *MTBPS* made provision for local government allocations to grow faster than those for national and provincial governments over the medium term. Over the medium term, additions to the local government equitable share would compensate for the rising costs of bulk water and electricity.

Cash payments for operating activities amounted to R102 billion in the first six months of fiscal 2012/13. The bulk of these payments emanated from a moderate increase in compensation of employees as a result of inflation-linked salary adjustments during July 2012. Net investment in non-financial assets amounted to R22,2 billion – some R2,5 billion higher than in the previous year. Slow spending on the *Municipal Infrastructure Grant* resulted in the funds being reallocated to a new *interim water supply programme*, run by the Department of Water Affairs to enable the department to assist municipalities in the delivery of clean drinking water to households.

Extra-budgetary institutions recorded a cash surplus of R1,5 billion in the July–September quarter of 2012, bringing the cumulative cash surplus to R2,5 billion in the first six months of fiscal 2012/13 – significantly higher than the cash surplus recorded in the first two quarters of fiscal 2011/12. Preliminary estimates indicate that the finances of *social security funds* improved slightly, recording a cash surplus of R8,1 billion, higher than the cash surplus recorded in the same period a year earlier. The increase in the surplus position of social security funds can partly be attributed to increased employment levels, with employment rising by an estimated 327 000 in the third quarter of 2012.

Unemployment Insurance Fund contributions and payouts



* As at September 2012

** April–September 2012, annualised

Budget comparable analysis of national government finance

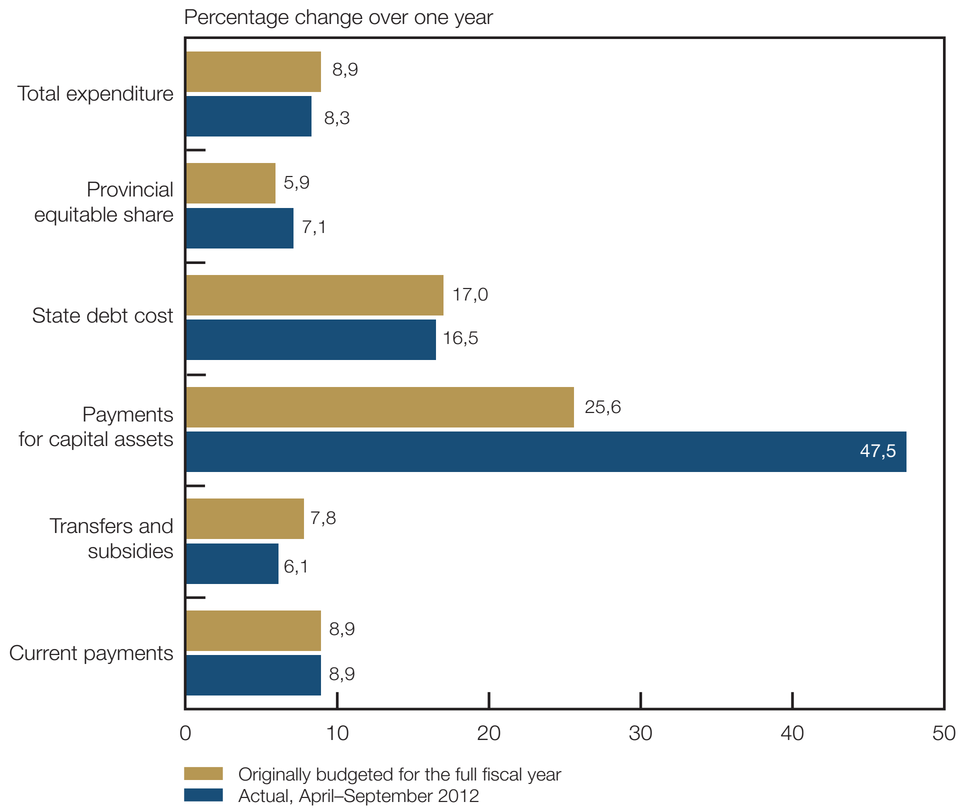
In the first half of fiscal 2012/13 overall spending by national government was contained and increased slower than the pro-rata budgetary projections. Expenditure amounted to R464 billion in April–September 2012, an increase of 8,3 per cent year on year, which accounted for 48,0 per cent of the total budgeted expenditure in fiscal 2012/13. In the February 2012 Budget national government spending was projected to amount to R968 billion, representing a year-on-year rate of increase of 9,1 per cent. Relative to gross domestic product, national government outlays amounted to 29,3 per cent, the same as the ratio recorded in the first six months of fiscal 2011/12.

At a disaggregated level, individual expenditure categories moved at multiple speeds. Higher spending was most notable in current payments, along with transfers and subsidies by various departments. The Justice, Crime Prevention and Security Cluster accounted for the major portion of current payments. The increase in current payments by this cluster was mainly driven by the Department of Police, which recorded a year-on-year rate of increase of 7,1 per cent and contributed 52,8 per cent to the above mentioned cluster. Spending by the Department of Police was meant to enable police stations to preserve safety and security, and provide for specialised interventions and the policing of South Africa's borders. The Department of Defence and Military Veterans also contributed to the increase in current payments, and recorded a year-on-year increase of 5,9 per cent, which resulted from the provision of prepared and supported landward defence capabilities for the defence and protection of South Africa.

In April–September 2012, transfers and subsidies grew by 6,1 per cent year on year, with the Social Services Cluster contributing the highest share. Spending by the departments responsible for public education, health and social services contributed significantly to the increase in expenditure. Higher transfers by the departments responsible for education were mainly to improve quality of learning in basic education schools and to provide financial support to universities. The Department of Social Development contributed 56,0 per cent to the Social Services' transfer payments, mainly to provide income support to vulnerable groups.

Interest paid on national government debt increased by 16,5 per cent year on year, amounting to R43,5 billion. Higher issuances of domestic government bonds and Treasury bills to finance the higher deficit contributed to the increase in the interest bill of government. This spending category was budgeted to amount to R89,3 billion or increase by 16,9 per cent in the current fiscal year. Interest payments represented 2,7 per cent of gross domestic product in April–September 2012, compared with 2,6 per cent in the first half of fiscal 2011/12.

National government expenditure in fiscal 2012/13



Equitable share transfers to provinces amounted to R155 billion in the first half of fiscal 2012/13, an increase of 7,1 per cent year on year. Higher equitable share transfers to provinces were meant to extend and improve service delivery outcomes in the health and education sectors. These allocations also placed provinces in a better position to help local governments implement the Municipal Finance Management Act. In the first six months of fiscal 2012/13, government had paid half of the originally budgeted amount of R309 billion to provinces as their share of nationally raised revenue. Over the same period, payments to metropolitan municipalities in terms of the general fuel levy sharing formula amounted to R3,0 billion. This expenditure item was budgeted to amount to R9,0 billion in the current fiscal year, or increase by 5,4 per cent year on year.

After taking cash-flow adjustments[15] into account, national government's cash-flow expenditure in the first six months of fiscal 2012/13 equalled R457 billion – an increase of 6,4 per cent year on year.

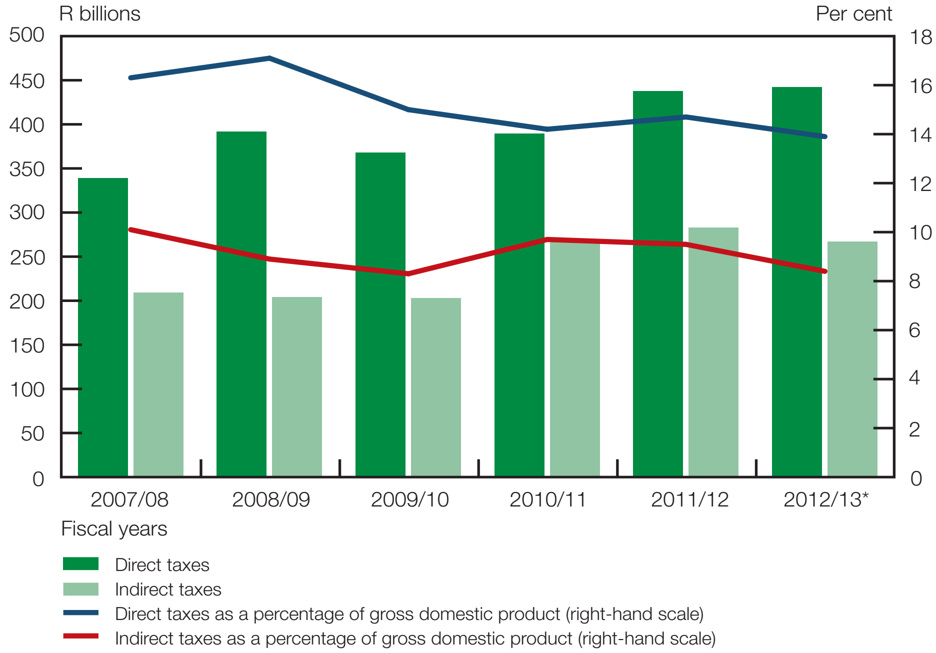
15 Transactions arising from timing differences between the recording of transactions and bank clearances, and late departmental requests for funds.

National government revenue amounted to R362 billion in the first six months of fiscal 2012/13, reflecting a year-on-year rate of increase of 11,1 per cent. At mid-year, national government receipts represented 45,3 per cent of the February 2012 budgeted revenue. National government revenue was originally budgeted to rise at a rate of 8,0 per cent and total R799 billion in fiscal 2012/13. As a ratio of gross domestic product, national government revenue amounted to 22,8 per cent in the first two quarters of fiscal 2012/13.

During the period under discussion, taxes on income, profits and capital gains grew by 11,7 per cent year on year, driven by strong growth in personal and corporate income tax collections. Personal income tax was boosted by higher collections from pay-as-you-earn and assessment payments. Corporate income tax collections increased briskly in June 2012 mainly due to higher provisional payments from large companies, and small- and medium companies in August.

Taxes on property increased lazily by 3,1 per cent during the period under review, reflecting a slight improvement in real-estate market activity and strong collections from securities transfer tax. Receipts from securities transfer taxes recorded an increase of 11,8 per cent whereas transfer duties increased by 1,7 per cent in the first six months of fiscal 2012/13.

National government tax revenue



* April–September 2012, annualised

As shown in the accompanying table, proceeds from taxes on goods and services recorded a substantial year-on-year increase, which emanated from strong value-added tax (VAT) collections and a firm increase in fuel levy and excise duties.

National government revenue in fiscal 2012/13

Revenue source	Originally budgeted		Actual Apr–Sep 2012	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	475,7	11,5	215,1	11,7
Income tax on individuals	*287,2*	*14,3*	*127,9*	*10,1*
Income tax on companies	*188,5*	*7,6*	*87,2*	*14,3*
Payroll taxes	11,1	9,4	5,5	10,1
Taxes on property	8,6	10,4	4,1	3,1
Taxes on goods and services	294,5	11,6	134,9	16,7
Value-added tax	*209,7*	*9,8*	*96,2*	*18,0*
Taxes on international trade and transactions	36,4	6,6	15,9	18,0
Other revenue	15,2	-21,2	7,5	26,5
Less: SACU** payments	42,2	93,7	21,1	93,7
Total revenue	**799,3**	**8,0**	**361,8**	**11,1**

* Fiscal 2011/12 to fiscal 2012/13
** Southern African Customs Union

Domestic VAT increased strongly due to higher domestic economic activity, supported by higher-than-expected growth from small and medium vendors, which contributed more to growth than the large business vendors. The recorded increase in import VAT was mainly due to higher volume imports of machinery, vehicles and parts for the Motor Industry Development Programme.

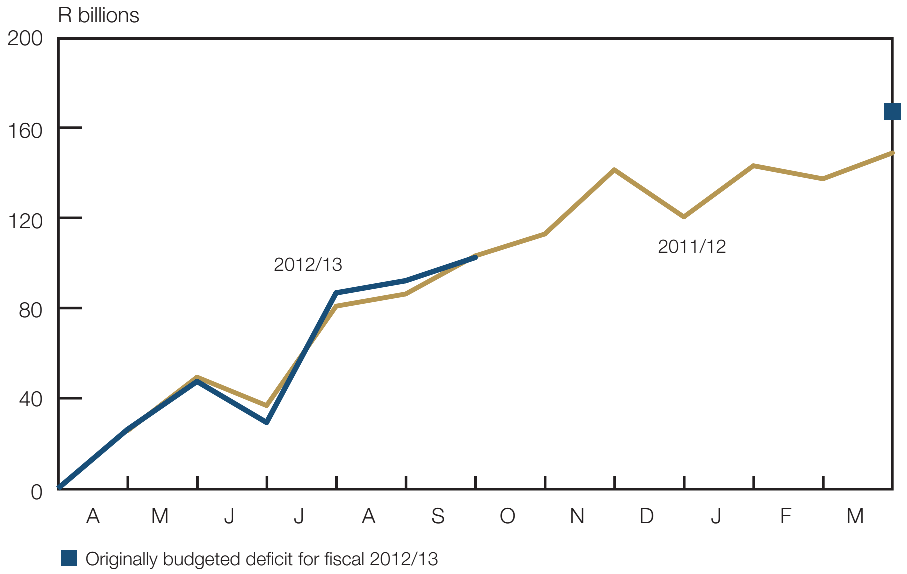
Receipts from taxes on international trade and transactions increased considerably on account of a surplus in collections from customs duties, which resulted mainly from the imports of vehicles, footwear and clothing.

Transfers to the Southern African Customs Union partners amounted to R21,1 billion in April–September 2012, almost double the amount transferred in the first six months of the previous fiscal year.

After taking cash-flow adjustments into account, national government's cash-flow revenue equalled R362 billion in April–September 2012 – some 10,9 per cent increase year on year.

Netting national government revenue and expenditure yielded a cash-book deficit before borrowing and debt repayment of R102 billion in April–September 2012. The full-year cash-book deficit was originally budgeted at R168 billion in fiscal 2012/13. As a ratio of gross domestic product, the cash-book deficit amounted to 6,5 per cent in April–September 2012 compared with 7,1 per cent recorded during the same period in the previous year.

Cumulative deficit of national government



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

In the first half of fiscal 2012/13, the primary balance[16] of national government reached a deficit of R59,0 billion, representing 3,7 per cent of gross domestic product. This could be compared with a primary deficit of R65,8 billion, or 4,5 per cent of gross domestic product in the comparable period of fiscal 2011/12. A recovery in revenue collections from all major tax categories resulted in an improvement in the primary deficit.

The net outcome of national government cash-flow revenue and expenditure was a cash-flow deficit before borrowing and debt repayment of R94,5 billion in April–September 2012 – some R8,0 billion lower than the cash-flow deficit recorded in the same period in fiscal 2011/12. Extraordinary receipts consisted of revaluation profits on foreign currency transactions, liquidation of the SASRIA investment and penalties received on retail bonds. Included in extraordinary payments was a premium on debt portfolio restructuring of R1,9 billion, losses on Gold and Foreign Exchange Contingency Reserve Account and revaluation losses on foreign currency transactions. After adjusting for extraordinary transactions and the profit on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R93,8 billion during the period under review. This could be compared with a borrowing requirement of R103 billion recorded in the first six months of fiscal 2011/12.

As indicated in the accompanying table, the bulk of the net borrowing requirement was financed in the domestic capital market through the issuance of domestic government bonds. Appetite for South African government bonds remained high, enabling government to finance the borrowing requirement adequately. Government managed to raise R21,5 billion from inflation-linked bonds in April–September 2012, bringing the outstanding balance of these instruments since inception in March 2000 to R228 billion at the end of September 2012. Net redemptions of Treasury bills and short-term loans from the CPD were recorded in the first half of fiscal 2012/13, due to a large redemption of short-term loans from the CPD in July 2012. In the first six months of fiscal 2012/13, the *R206* and *R201* bonds, maturing in 2014, were partly redeemed to the value of R31,6 billion and switched into bonds with longer maturities stretching as far as 2041.

National government financing in fiscal 2012/13

R billions

Item or instrument	Originally budgeted 2012/13	Actual Apr–Sep 2012	Actual Apr–Sep 2011
Deficit	**168,4**	**94,5**[1]	**102,5**[1]
Plus: Extraordinary payments	-	2,3	0,5
Cost/Profit on revaluation of foreign debt at redemption[2]	-2,3	-2,9	0,1
Less: Extraordinary receipts	-	0,2	0,1
Net borrowing requirement	**166,1**	**93,8**	**103,1**
Treasury bills	22,0	-4,0	17,7
Domestic government bonds	119,5	83,4	59,4
Foreign bonds and loans	-9,8	-12,5	-1,4
Change in available cash balances[3]	34,3	26,9	27,4
Total net financing[4]	**166,1**	**93,8**	**103,1**

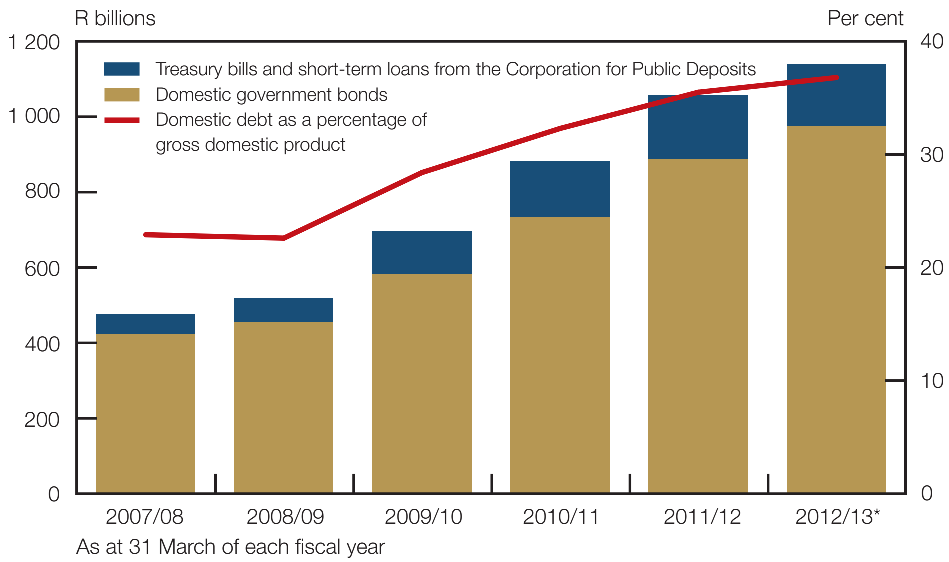
1 Cash-flow deficit
2 Cost + profit –
3 Increase – decrease +
4 Components may not add up to totals due to rounding

Treasury bills were obtained at an average interest rate of 5,5 per cent, while domestic government bonds attracted an average rate of 7,8 per cent per annum. The average remaining maturity of national government domestic marketable bonds lengthened from 130 months as at 31 March 2012 to 137 months at the end of September. This increase could be attributed to the introduction of new government bonds and the switching of bonds into bonds with longer dated maturities. The non-monetary private sector and Public Investment Corporation were the main holders of domestic marketable bonds.

National government recorded net redemptions of foreign bonds and loans worth R12,5 billion in the first half of fiscal 2012/13. Between March and September 2012, the average outstanding maturity of foreign marketable bonds of national government increased slightly from 90 months to 92 months.

In the first six months of the current fiscal year, funding activities of national government decreased the available cash balances by R26,9 billion, bringing these balances to R178 billion as at 30 September 2012. Between March and September 2012 deposits with the South African Reserve Bank decreased from R142 billion to R124 billion.

Domestic government debt

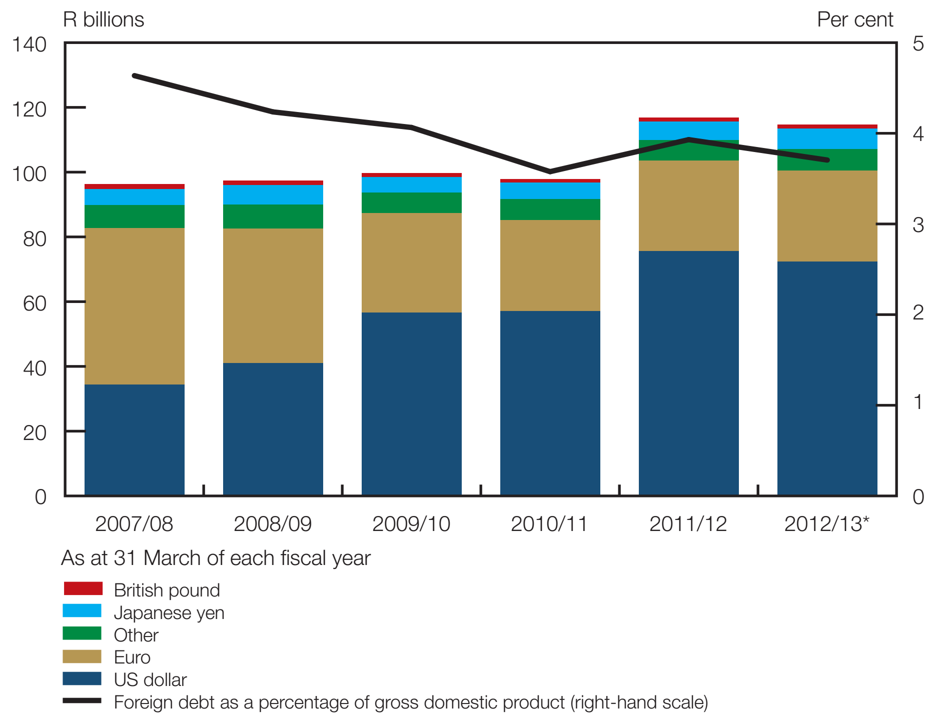


* As at 30 September 2012

Domestic debt continued on an upward trajectory, increasing from R1 057 billion as at 31 March 2012 to R1 139 billion as at the end of September. An increase in the issuance of domestic government bonds, partly because of new bonds launched earlier this year, resulted in a substantial rise in domestic debt. Funding in the domestic debt market continued to dominate foreign funding, as such, domestic debt accounted for about 90 per cent of total gross loan debt.

Foreign debt of national government decreased from R117 billion to R115 billion between March and September 2012. This decline stemmed from large redemptions, which outweighed high revaluation adjustments arising from the weaker exchange value of the domestic currency.

Currency composition of national government foreign debt



* As at 30 September 2012, annualised

Between March and September 2012, the total gross loan debt of national government, consisting of domestic and foreign government debt, increased from R1 174 billion to R1 253 billion. Total gross loan debt relative to gross domestic product increased from 39,5 per cent to 40,5 per cent during the period under discussion.

The *Medium Term Budget Policy Statement 2012*

Fiscal policy stance

The Minister of Finance tabled the *2012 MTBS* in Parliament on 25 October which presented the proposed framework for the 2013 Budget. This framework was prepared in an environment of continued economic uncertainty, with growth slowing in both advanced and developing economies. At the same time, recent domestic events had underlined the urgent need to accelerate South Africa's social transformation.

In the proposed 2013 Budget framework, the National Development Plan (NDP) would be taken as a point of departure as government ensured that choices were made within prudent fiscal limits shaped by prevailing circumstances, while laying the basis on which future budgets would be built. Government spending would be partially financed through a projected budget deficit of 4,5 per cent of gross domestic product in 2013/14. The gap would narrow to 3,1 per cent of gross domestic product in 2015/16. In line with an expected improved economic growth, this would allow government to rebuild fiscal space. Three fiscal policy objectives would still be pursued, namely ensuring moderate growth in expenditure, stabilising public debt and improving the impact of spending by shifting the balance of resource allocation towards investment in infrastructure.

The countercyclical management of revenue and expenditure was grounded in fiscal guidelines, which also promoted sustainability and intergenerational equity. Government would continue with key social economic programmes, complemented by efforts to also improve the quality of spending. As the economic context changed over the medium term, government would realign its policy stance, firmly grounded in a sustainable budget structure that would promote growth, equity and employment.

Fiscal projections

Percentage of gross domestic product

Component	2012/13		2013/14		2014/15	
	Feb*	Oct**	Feb*	Oct**	Feb*	Oct**
Consolidated government						
Revenue	27,4	27,5	27,8	27,5	28,0	27,6
Expenditure	32,1	32,3	31,7	32,0	31,0	31,3
Budget balance***	-4,6	-4,8	-4,0	-4,5	-3,0	-3,7
Gross loan debt	41,0	41,3	42,2	42,4	42,4	42,7
Net loan debt	36,0	35,7	37,8	37,7	38,5	38,8

* *Budget Review 2012*
** *Medium Term Budget Policy Statement,* October 2012
*** Deficit – surplus +

Although the South African economy showed some resilience amid a weak global economic environment, a far more rapid growth was required to absorb large numbers of unemployed South Africans into economic activity.

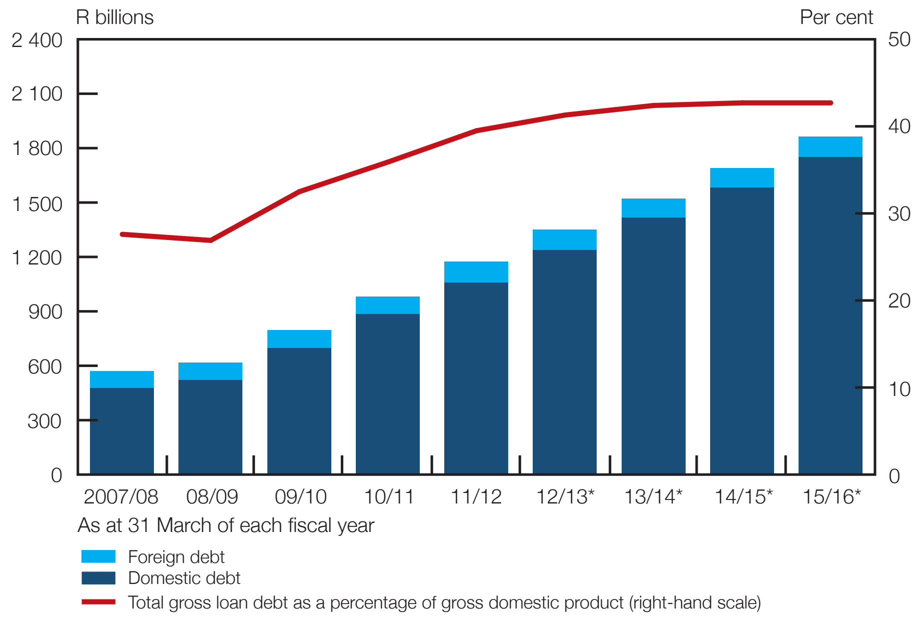
As a result of weaker economic conditions, anticipated revenue collections were revised downwards, leading to a higher-than-projected consolidated budget deficit for fiscal 2012/13. If economic conditions worsened further or mining sector output were disrupted over an extended period, further downward revision of the fiscus might be justified.

In line with performance during the first half of 2012/13, the estimated personal and corporate income tax collections and VAT for the year have been adjusted downwards, whereas customs duties have been revised upwards. Mineral and petroleum royalties have also been revised downwards due to lower commodity prices and mining strikes. Revenue from import-related taxes, such as customs duties and VAT on imports have performed strongly. Gross tax revenue collection was expected to remain subdued next year, but should improve during the outer years of the medium-term period as economic performance strengthens.

Government is committed to shifting the composition of spending from current consumption to productive investment. Within the wider public sector, municipal finances need to be strengthened and the substantial investment requirements of energy, water and transport utilities would be financed. For these shifts in the public finances to be achieved, moderation in personnel expenditure and greater efficiency in service delivery would be necessary. Higher-than-anticipated budget deficits are the result of a weakening recovery in tax revenue, rather than uncontrolled increases in non-interest spending.

The medium-term expenditure framework (MTEF) for the 2013 Budget provided for continued real growth in spending on public services. This reflected the challenging economic environment and the fiscal constraints in which government operates. National and provincial departments were further requested to reprioritise spending away from programmes that were not meeting performance requirements or that were not closely aligned to their mandates. Where possible, spending would be reduced and these funds allocated to infrastructure investment and other priorities. Allocations to the Social Services Cluster (i.e., health, social assistance, education and free basic services) would be maintained, although in these areas there was considerable scope for improved financial management and more cost-effective programmes. The emphasis on improving infrastructure, expanded public works programmes and community work programmes would continue to grow.

Total gross loan debt of national government



* *Medium Term Budget Policy Statement, October 2012*

The domestic debt market would remain the main source of funding for national government over the medium term, with foreign borrowing accounting for a small portion of government's debt portfolio. Debt issuance in the domestic market would be maintained at sustainable levels, which would be achieved by drawing on cash balances, exchanging debt maturing within the next several years for longer-dated debt and borrowing in the global capital markets to finance part of South Africa's foreign currency commitments.

Total gross loan debt was projected to increase from R1 352 billion to R1 864 billion between fiscal 2012/13 and 2015/16. As a percentage of gross domestic product, gross loan debt was projected to increase from 41,3 per cent to 42,7 per cent during the above-mentioned period.

Statement of the Monetary Policy Committee

20 September 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 Monetary Policy Committee, the global growth outlook has weakened further. However, the near-term risks to global financial markets arising from the eurozone debt crisis seem to have subsided somewhat following the announcement of the bond purchase programme by the European Central Bank. While this appears to be a positive step, significant risks still remain. At the same time, the global environment has been impacted by further monetary easing in the United States (US) and Japan.

Domestically, inflation continued to surprise on the downside, although it appears that the short-term low point could have been reached. Despite a number of upside supply-side risks, inflation is expected to remain contained within the target range over the forecast period. The growth outlook, however, has deteriorated somewhat in response to both domestic and global developments.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas was 5,0 per cent in August 2012; up from 4,9 per cent in July. The categories of food, housing and utilities, and transport together accounted for 3,0 percentage points of the inflation outcome. Food prices increased by 5,1 per cent, petrol by 9,3 per cent and electricity by 10,0 per cent. Core inflation, as measured by the exclusion of food, petrol and electricity from CPI, measured 4,6 per cent; up from 4,5 per cent in July. Administered prices excluding petrol increased at a year-on-year rate of 7,5 per cent.

Year-on-year producer price inflation moderated to 5,4 per cent in July 2012, having measured 6,6 per cent in each of the previous three months. A reversal in the downward trend in food price inflation was observed, although still at relatively low levels, with agricultural prices increasing at a year-on-year rate of 3,0 per cent in July, compared with a recent low of 1,7 per cent in May and 2,2 per cent in June. Manufactured food prices increased by 7,7 per cent and 8,0 per cent in June and July respectively.

The inflation forecast of the Bank reflects a moderate deterioration for 2013 compared with the previous forecast, and a relatively flat trajectory over the entire forecast period. Inflation is now expected to average 5,3 per cent in the final quarter of 2012, 5,2 per cent in 2013 and 5,0 per cent in 2014. The near-term deterioration is mainly due to higher expected petrol and food inflation. Core inflation appears to be well contained, with a peak of 4,9 per cent expected in the final quarter of 2012, compared with the previous forecast peak of 5,4 per cent. This measure is now expected to average 4,6 per cent in both 2013 and 2014.

Inflation expectations as reflected in the survey conducted by the Bureau for Economic Research (BER) at Stellenbosch University in the third quarter of 2012 were again virtually unchanged, particularly for 2013 and 2014, and remain anchored at around the upper end of the target range. Respondents expect inflation to average 5,8 per cent in 2012 and 6,0 per cent in 2012 and 6,2 per cent in 2014 respectively.

There is, however, a divergence of views between the respondents: while all categories of respondents expect average inflation to be within the target range in 2012, trade union officials and business executives expect it to exceed the upper end of the target range in both of the following two years. This is in contrast to financial analysts who expect inflation to average just over 5 per cent in both of these years.

The survey conducted by Reuters indicates that market analysts expect inflation to average 5,3 per cent in 2013 and 5,4 per cent in 2014. Market expectations as reflected in the break-even inflation rates initially increased after the previous meeting of the MPC, but have since declined somewhat. Expectations over the various maturities continue to reflect expectations of inflation within the target range.

The global growth outlook remains weak, notwithstanding significant policy initiatives announced by the United States Federal Reserve (the Fed), the ECB and Bank of Japan, and the initial positive reaction from global financial markets. The decision by the Fed to engage in a further round of quantitative easing was prompted by an assessment that the expected growth trajectory was not strong enough to generate a sustained improvement in the labour market. The US economy grew at an annualised rate of 1,7 per cent in the second quarter of 2012, and the outlook is clouded by the risk of a severe fiscal contraction early next year. The outcome of the US elections in November 2012 will be critical in determining the prospects for a favourable resolution of this “fiscal cliff”. In the meantime the attendant risks have had an adverse impact on investment expenditure in the US and various indicators of industrial output point to a subdued growth outlook.

In the eurozone the immediate risks posed by the continuing debt crisis appear to have abated somewhat with the announcement by the ECB of its Outright Monetary Transaction (OMT) or bond purchase programme. In addition, two important event risks were also avoided following the decision of the Federal Constitutional Court in Germany to uphold the ratification of the treaty to establish the European Stability Mechanism, although under specific conditions, and the pro-euro outcome of the Dutch election. The precise workings of the OMT, particularly the issues relating to conditionality, are still uncertain, but the initiative has bought some time to implement more permanent solutions. Despite this potential progress, the risk of a Greek exit from the eurozone remains, and growth prospects in the region have deteriorated following the overall contraction in the second quarter of this year, continued bank deleveraging and a further decline in cross-border lending. The UK economy has contracted for three consecutive quarters, while Japanese economic growth also moderated markedly in the second quarter. The impact of the US actions on the Japanese yen prompted a surprise increase of ¥10 trillion by the Bank of Japan in the size of its asset purchase programme. Although the yen depreciated in response, the impact appears to have been short-lived.

Growth momentum is also somewhat weaker in some of the systemically important emerging-market economies, particularly in China, Brazil and India, in the face of weakening external demand. A number of countries have responded by easing monetary policy and, as in the case of Brazil, by introducing measures to stimulate domestic demand and competitiveness.

Global inflation remains relatively benign, given the weak demand, but supply-side shocks in the form of higher food prices, due to droughts in the US and some parts of eastern Europe, and resilient international crude oil prices pose a risk to the outlook. Both of these shocks are not only a risk to inflation, but could also represent an additional drag on near-term growth; a combination that poses enormous challenges to monetary policy.

The rand exchange rate has fluctuated generally within a range of R8,10 and R8,50 against the US dollar since May, and continues to be affected by changing risk perceptions in global financial markets. More recently, the rand appears to have decoupled from the euro and reacted to domestic issues, including the wider-than-expected current-account deficit and developments in parts of the mining sector, following the tragic events at Marikana.

The rand has, however, been underpinned, to some extent, by continued inflows into the domestic bond markets in the lead-up to South Africa’s inclusion in the Citi World Government Bond Index (WGBI). Non-resident purchases of South African bonds have amounted to R12,1 billion since the previous meeting of the MPC, and R74,5 since the beginning of 2012. These inflows are expected to persist for some time as non-resident portfolios adjust to the WGBI inclusion. Although the rand, along with most other currencies, initially appreciated against the dollar following the announcement of further quantitative easing by the Fed, it depreciated against the euro following the positive response to the announcement of the OMT. Since the previous meeting of the MPC, the rand has depreciated by about 2,4 per cent against the dollar, by 7,5 per cent against the euro and by 5,0 per cent on a trade-weighted basis. Over this period the dollar depreciated by 5,5 per cent against the euro.

The current account of the balance of payments has emerged as a risk to the exchange rate outlook following the widening of the deficit to 6,4 per cent of GDP in the second quarter. The Bank’s forecast for the current account in 2012 is for a deficit in the order of 5¼ per cent of gross domestic product (GDP). This widening deficit is a consequence of declining commodity exports, and increased imports and service payments. The current-account deficit has been financed mainly through portfolio inflows, but could pose a risk to the exchange rate unless it moderates over the coming months.

The domestic economic growth outlook remains constrained by the weak global outlook and by recent work stoppages in the mining sector. The economy recorded a growth rate of 3,2 per cent in the second quarter of 2012, but this reflects a distortion arising from the strong contribution from the mining sector, which recovered from a deep contraction in the first quarter. Non-mining real output growth measured 1,7 per cent, due in large part to negative growth in the manufacturing sector.

The Bank's leading indicator has declined for four consecutive months, and the Bank's growth forecasts have been revised down. Real GDP growth is now expected to average 2,6 per cent in 2012 and 3,4 per cent in 2013, compared with 2,7 per cent and 3,8 per cent in the previous forecasts. Notwithstanding these downward revisions, the Bank sees further risks to the downside.

Recent high-frequency data point to a lacklustre growth performance in the third quarter. Mining output contracted by 1,5 per cent in July compared with June and the impact of the recent strikes in the mining sector is yet to be reflected in the data. The physical volume of manufacturing production contracted by 1,1 per cent on a month-on-month basis in July, while the year-on-year increase of 5,8 per cent was exaggerated by weak base effects. The Kagiso PMI, which has been moderating consistently since February, declined further in August and remains marginally above the neutral level of 50.

The First National Bank (FNB)/BER Business Confidence Index improved in the third quarter following the sharp decline in the second quarter, but remained below the neutral level. The survey reflected very negative sentiment among manufacturers and building contractors, while the vehicle trade exhibited high and rising levels of confidence, as reflected in robust vehicle sales.

The real value of building plans passed declined in June and July 2012 after a tentative recovery in the previous two months. While positive growth was observed in the non-residential sector up to June, building activity in the residential sector remains subdued, indicative of the weak housing market. By contrast, confidence in the civil construction index has improved, in line with increased civil construction activity.

Growth in gross fixed-capital formation increased to 5,7 per cent, contributing 1,2 percentage points to overall GDP growth. Private-sector investment remains weak, with annualised growth rates of 1,8 per cent, and 2,4 per cent in the first and second quarters of 2012. By contrast, fixed-capital formation by public corporations grew at an annualised rate of 9,1 per cent in the second quarter.

Formal-sector employment growth has remained weak. According to the Quarterly Employment Statistics (QES) released by Statistics South Africa, employment growth over four quarters to the second quarter of 2012 measured 1,5 per cent. This represents an increase of 123 300 jobs, one third of which were in the public sector. Although the current level of formal-sector employment is still about 60 000 less than that attained before the onset of the crisis, the trend remains positive even if too slow.

Final consumption expenditure by households was again the main contributor to GDP growth, contributing 1,9 percentage points. Nevertheless, expenditure growth moderated to 2,9 per cent in the second quarter, mainly due to the contraction in real outlays on services. Expenditure on goods, particularly durable and semi-durable goods, remained robust. Retail sales also grew at a more moderate year-on-year rate of 4,2 per cent in July 2012. Despite the decline in total new vehicle sales in August, the positive momentum in this sector seems to have been sustained, although exports to Europe are expected to remain under pressure. The FNB/BER Consumer Confidence Index increased marginally in the third quarter following a large decline in the second quarter, but remains at a low level. At these levels, consumption expenditure is not seen to pose a risk to the inflation outlook.

Following a recent high in March 2012, growth in credit extension to the private sector has moderated. Twelve-month growth in banks' total loans and advances declined from 9,2 per cent in March, to 8,1 per cent, and 7,3 per cent in June and July respectively. Credit extension to the household sector increased at a rate of 8,1 per cent in July, while credit extended to the corporate sector eased somewhat. Mortgage loans remained subdued, while instalment sale credit and leasing finance reflected the robust vehicle sales.

Growth in general loans to households, which is mainly unsecured lending, accelerated to 32,8 per cent in July, but was still below the peak growth of 39,3 per cent experienced in June 2011. Growth in unsecured lending to companies moderated to 8,3 per cent in July, from a recent high of 16,1 per cent recorded in March. The continued high rates of unsecured lending have contributed to rising household debt, with the ratio of household debt to disposable income increasing from 75,6 per cent to 76,3 per cent between the first and second quarters of 2012. There is no evidence that unsecured lending has had an adverse impact on the asset quality of the banking sector, as impaired advances as a percentage of gross loans and advances measured 4,4 per cent in July compared with 5,5 per cent a year earlier.

The trends in wage growth have been relatively benign from an inflation perspective. Measured over four quarters, nominal unit labour cost growth was 6,1 per cent in both of the first two quarters of 2012. According to Andrew Levy Employment publications, the overall wage settlement rate in collective bargaining agreements amounted to 7,7 per cent in the first half of 2012, while the public sector settled on an increase of 7,0 per cent. However, there is a risk that the recent wage settlements in the mining sector could set a precedent for wage demands more generally.

Food and petrol prices are the main upside risks to the inflation outlook. Following a sharp spike in July 2012, global grain prices stabilised and then moderated, but remain at elevated levels. Futures prices indicate an expectation that these prices may have stabilised and may subside in the medium term. Domestic spot prices of maize and wheat followed global trends, having increased by about 40 per cent and 20 per cent respectively between the beginning of June and the end of July. These increases are expected to filter through to domestic consumer prices in the coming months.

The price of Brent crude oil continued its recent upward trend, reaching around US$117 per barrel on 14 September, or US$12 per barrel higher than at the time of the previous MPC meeting. However, the Saudi Arabian government commitment to increasing the supply of oil has elicited a price response, with oil prices declining to current levels of around US$108 per barrel. How sustainable this impact will be remains to be seen, given the geo-political factors prevailing in the Middle East. The domestic price of petrol has increased significantly as a result, largely offsetting the recent price decreases. Since August, the price of petrol has increased by a cumulative R1,15 per litre, and a further increase is expected in October.

The MPC remains concerned about the risks posed to the domestic economy from the global environment. The actions of the ECB appear to have reduced immediate liquidity concerns in the region and have had a positive impact on sentiment. The continued risk of a possible Greek exit and its contagion effects are likely to hang over the markets for some time. The fundamental problems of the eurozone remain, and low or negative growth is likely to persist going forward.

Despite renewed stimulus in the US, growth is expected to remain subdued, at least until the "fiscal cliff" issue is resolved. This negative global outlook, which is reinforced by a slowdown in Asia, poses a downside risk to domestic growth prospects, particularly in the form of a weaker export performance.

The domestic outlook is also likely to be constrained by local developments, particularly in the mining sector, which have the potential to undermine the already-fragile private-sector investment sentiment despite the accommodative macroeconomic policy environment. While the Bank's forecast for growth has been revised down, the MPC assesses that further risks are somewhat on the downside.

Recent inflation outcomes have been more or less in line with the Bank's expectations, but some upside pressure is still expected from food and petrol price increases. Demand pressures are, however, expected to remain benign. The exchange rate poses a potential risk to the inflation outlook, particularly in the event of an unsustainable widening of the deficit on the current account of the balance of payments. To date, the rand has remained relatively resilient. The committee assesses the risks to the inflation forecast to be more or less balanced.

At its previous meeting the MPC assessed that conditions justified a pre-emptive loosening of the monetary policy stance. Although global and domestic growth conditions remain challenging, the MPC is of the view that a further reduction in the repurchase rate is not appropriate at this stage. The MPC has therefore decided to keep the repurchase rate unchanged at 5,0 per cent per annum. This accommodative stance is assessed to be consistent with the Bank's price stability mandate, and conducive to encouraging growth and domestic investment. Further actions going forward will be highly dependent on global and domestic developments that may change the risks to the outlook.

Statement of the Monetary Policy Committee

22 November 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 Monetary Policy Committee (MPC) the domestic growth outlook has deteriorated, while the upside risks to inflation have increased. Widespread labour market instability and work stoppages have reduced output and export volumes, with the potential for employment losses. Risks to the inflation outlook have been increased by a further depreciation of the rand exchange rate, partly in response to these developments, as well as by a possible higher trend in wage settlements and the impact of the reweighting and rebasing of the CPI basket by Statistics South Africa (Stats SA).

At the same time the global environment remains challenging with slowing growth in a number of regions, declining global industrial output, the worsening Japanese outlook, continued uncertainty regarding United States (US) fiscal policy and a resurfacing of concerns relating to the resolution of the crisis in the eurozone, which is now in recession.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas at 5,6 per cent in October 2012, and up from 5,5 per cent in September, was 0,2 percentage points above the market consensus. The categories of food and non-alcoholic beverages, housing and utilities, and transport together accounted for 3,5 percentage points of the inflation outcome. The upside surprise was mainly attributable to food prices which increased by 2,8 per cent month on month, and 6,7 per cent on a year-on-year basis. Core inflation, as measured by the exclusion of food, petrol and electricity from CPI, measured 4,7 per cent, unchanged from September. Administered prices excluding petrol increased at a year-on-year rate of 7,5 per cent.

Year-on-year producer price inflation moderated further to 4,2 per cent in September, having measured 5,1 per cent in August. This favourable trend was driven mainly by lower rates of increase in the prices of mining products. A marked acceleration was seen in the food-related categories, with agricultural prices increasing at a year-on-year rate of 5,2 per cent in September, compared with 4,3 per cent in August and a recent low of 1,7 per cent in May. Manufactured food prices increased by 9,0 per cent and 10,1 per cent in August and September respectively.

The inflation forecast of the Bank reflects a deterioration in the inflation outlook for 2013 compared with the previous forecast. Inflation is now expected to average 5,6 per cent in the final quarter of 2012, and 5,6 per cent for the year. It is expected to average 5,5 per cent in 2013 and 5,0 per cent in 2014, with a peak of 5,7 per cent expected in the first quarter of 2013. This near-term deterioration is mainly due to higher expected food price inflation and the recent depreciation of the rand. Core inflation remains contained, indicating the absence of significant demand pressures. This measure is expected to peak at 5,0 per cent in the first quarter of 2013, and to average 4,8 per cent and 4,5 per cent in 2013 and 2014 respectively.

These forecasts do not incorporate the new CPI weights and rebasing recently announced by Stats SA as the finer details of these revisions, including the introduction of new products, and the method of linking the old and new baskets, have not yet been finalised. Preliminary evidence suggests that a slight upward bias to the Bank's central projection for headline CPI inflation could occur in 2013. On the assumption that the rate of increase in price changes for most goods and services, apart from food and electricity, is more or less unchanged, the combined average upward bias would be relatively small, in the order of around 0,2 percentage points. The new weights and the rebased index will be incorporated formally into the Bank's forecast in 2013 after the revisions have been finalised by Stats SA.

Inflation forecasts of financial analysts surveyed by Reuters have also been revised upwards. Financial analysts now expect inflation to average 5,5 per cent in 2013, compared with 5,3 per cent in the previous survey. The expectation for 2014 remains unchanged at 5,4 per cent. It is unclear if these forecasts already take account of the changes to the CPI weights.

The break-even inflation rates have also exhibited a moderate upward trend since the previous MPC meeting.

The global economic outlook has deteriorated somewhat with a return to recession in the eurozone. The prospects for the region remain bleak amid procyclical fiscal austerity, continued household- and banking-sector deleveraging in a tighter regulatory environment, and renewed concerns relating to the unresolved sovereign debt crisis. The deepening recession has served to heighten the solvency risk of the peripheral countries. The recently announced Outright Monetary Transactions (OMT) programme by the European Central Bank remains yet to be activated. The Japanese economy contracted in the third quarter and leading indicators point to a possible recession. Although the United Kingdom economy experienced positive growth in the third quarter, the outlook is negative as the favourable impact from the Olympic Games dissipates.

The prognosis for the US economy remains highly dependent on progress in resolving the so-called fiscal cliff. The related uncertainty has already adversely affected investment decisions, and while some last-minute political compromise is likely, the ultimate extent of the fiscal contraction and its impact on growth are still unclear. Failure to resolve this issue could result in a recession and derail the nascent recovery in the housing market.

Prospects for emerging markets, while still positive, have also deteriorated somewhat during the past months, contributing to the downside risk to the global recovery. Trend growth rates in Asia are declining, and both China and India are expected to experience weaker growth rates, with possible implications for commodity prices.

For some time the exchange rate of the rand has been determined primarily by external developments, particularly changing global risk perceptions. More recently, domestic factors appear to have become dominant determinants of the exchange rate. These include the increased risk posed to the economic outlook by labour market developments in the mining and agricultural sectors in particular; the widening deficit on the current account of the balance of payments, which is likely to have been exacerbated by the stoppages; and the ratings downgrades by two rating agencies while also retaining a negative outlook. Since the previous meeting of the MPC, the rand has depreciated by about 6,7 per cent against the US dollar, by 5,8 per cent against the euro, and by 5,8 per cent on a trade-weighted basis.

Inflows into the domestic bond market associated with South Africa's inclusion in the World Government Bond Index of Citibank probably helped to moderate the degree of depreciation over this period. Since the beginning of the year, net purchases of South African bonds by non-residents have totalled R85,2 billion. By contrast, non-residents have been net sellers of South African equities since the beginning of the year to the value of R6,8 billion.

The rand is expected to remain sensitive to both unfolding domestic economic and political developments, in addition to global risk perceptions. The extent to which the weaker rand feeds into inflation will be dependent on the trading range of the rand going forward and the duration of these moves. Most analysts do not expect further weakening of the rand from current levels, and a number of them expect some recovery. However, the rand is expected to remain volatile and subject to overshooting, and its depreciation poses an increased upside risk to the inflation outlook.

The domestic economic growth outlook has deteriorated recently, largely as a result of the continued global slowdown and aggravated by domestic events. Mining output has declined significantly as a result of work stoppages and there are likely to be longer-term implications for output, exports and employment as the mines adjust to higher labour costs. Labour unrest in parts of the agricultural sector is also expected to affect output and prices adversely.

Recent high-frequency data indicate that third-quarter growth was well below the 3,2 per cent recorded in the second quarter. Mining output contracted at a quarter-to-quarter rate of 3,2 per cent in the third quarter and further contractions are expected in the fourth quarter. The physical volume of manufacturing production was adversely affected by the road freight transport sector strike in September when a contraction of 2,3 per cent was recorded on a month-to-month basis. For the quarter as a whole manufacturing output increased by 0,3 per cent. The outlook for the sector remains negative, with the Kagiso Purchasing Managers Index declining to a level of 47,1 in October, reflecting an expectation of contraction in the coming months.

The Bank's forecast of gross domestic product (GDP) growth has been revised downward from 2,6 per cent to 2,5 per cent in 2012. Growth in 2013 is now expected to average 2,9 per cent, compared with 3,4 per cent previously, while the growth forecast for 2014 has been revised down from 3,8 per cent to 3,6 per cent. Moreover, the risks to this forecast remain on the downside. The RMB/BER Business Confidence Index declined marginally in the fourth quarter and remains below the 50 index level.

Consumption expenditure by households appears to have lost some momentum recently following the 2,9 per cent annualised growth rate in the second quarter. Consumer confidence in the third quarter, as measured by the FNB/BER Consumer Confidence Index improved marginally, but was still at low levels that were not consistent with robust consumer spending. Nevertheless, growth in retail trade sales, which account for about half of household consumption expenditure, has been relatively resilient having grown at a quarter-to-quarter rate of 1,9 per cent in the third quarter. However, passenger vehicle sales and expenditure on services were subdued.

There is, however, still little evidence of demand pressures on inflation. The resilience of consumer demand has been attributed to a number of factors, including low interest rates, relatively low inflation, real income growth, high growth rates in unsecured lending, and until recently a relatively strong exchange rate. Some of these factors may be a constraint on expenditure going forward, especially when combined with higher administered price increases which constrain discretionary spending.

The MPC is concerned about the recent trend in wage settlements and the potential negative impact on the economy, particularly on growth and investment. These developments could also result in lower growth in employment creation or an absolute decline in employment. Although the reported headline increases granted in some of the settlements are higher than the actual average increases, there is no doubt that the increases granted are well above inflation. This has the potential to increase aggregate demand and prices with a risk of a possible wage-price spiral, which could negate the real benefits of these wage increases to workers. However, the impact will be moderated to some extent by the inevitable job losses that are likely to accompany such increases in the context of a slowing economy. The cost-push effect of these wage increases will therefore depend on the actual increase in the total wage bill and unit labour cost developments.

The most recent wage data, which do not yet incorporate these latest trends, show that in the second quarter of 2012 growth in unit labour costs was 6,1 per cent, while Andrew Levy Employment Publications reported average wage settlement rates in collective bargaining agreements of 7,4 per cent for the first nine months of 2012. Wage settlements at these levels were not assessed to pose a major risk to inflation and these trends will be closely monitored as the collective bargaining landscape has become more fractious.

It is also too early to assess the impact of recent developments on employment. According to the Quarterly Labour Force survey, total employment increased by about 200 000 in the third quarter of 2012, but the increased number of unemployed workers resulted in the unemployment rate increasing to 25,5 per cent in September. It is expected, however, that the positive employment trend in the non-gold mining sector observed during the past year is likely to have reversed or slowed down, while the negative employment trends in manufacturing and gold mining are likely to persist. The net effect of higher wages and lower employment on aggregate expenditure is therefore still unclear at this stage.

Credit extension to the private sector moderated on a quarter-to-quarter basis in the third quarter of 2012, when an annualised increase of 5,4 per cent was recorded. Twelve-month growth in total loans and advances to the private sector was 8,8 per cent in September. However, mortgage loan growth remained subdued. When this category is excluded, loans increased at a significant twelve-month rate of 16,6 per cent. The main impetus has come from the persistently strong growth in unsecured lending to households, and this has been related to real income growth particularly in the public sector. Growth in unsecured lending to households remains in excess of 30 per cent but there are some tentative signs that this growth may be moderating. Although to date this has not represented a systemic risk, as it is still a small part of total loans and advances, this is being carefully monitored by the Bank. Unsecured lending has probably helped to underpin household consumption expenditure.

The fiscal policy stance, as reflected in the *Medium Term Budget Policy Statement* (*MTBPS*) remains supportive of the economy through its contra-cyclical stance. Although the goal of fiscal consolidation is being maintained, the timing has been pushed out further, as lower expected growth is likely to result in lower revenues. Growth in expenditure is projected to remain the same as that set out in the February budget, and no large boost to aggregate demand is expected that could impact on the inflation outlook.

Food prices remain a significant risk to the inflation outlook. Global food prices, while still high, have declined from recent peaks. The impact of this shock is still to fully filter through to domestic prices. Although there is usually a lag between the impact of global food price developments on domestic prices, the impact appears to have been felt more quickly than is generally the case. The recent depreciation is also expected to exacerbate the upside risk to food prices. Futures prices, however, indicate that maize prices may be moderating following a better-than-expected domestic harvest.

International oil prices have remained relatively unchanged since the previous meeting of the MPC, although in the past few days have increased following ongoing hostilities in the Middle East. Domestic petrol prices declined in November despite the depreciation of the rand and, should the exchange rate and international product prices remain at current levels, a further moderate decline can be expected in December. However, international prices remain highly dependent on the global growth outlook and political developments in the Middle East.

Since the previous MPC meeting the domestic landscape has seen a marked change. While the global crisis remains unresolved, South Africa has seen significant developments that have impacted on the economic outlook and confidence. These domestic developments, if not addressed in a comprehensive and constructive manner, have the potential to derail the progress made to date whereby South Africa has been able to withstand the worst contagion effects of the ongoing global crisis.

While recognising that there are real issues that underlie the recent wave of wildcat strikes, the Bank is concerned about the conduct of some of the parties involved in the recent labour market instability and, in particular, the unacceptable levels of violence that have accompanied the strikes. It is critical that both employers and employees take constructive steps to address the fraught relations that appear to be prevalent in a number of areas. Employers need to better appreciate the contribution to stability that an informed, experienced, skilled and organised workforce can make, and also need to be better informed about, and sensitive to, the conditions and circumstances of their employees. An important element of this is to take measures that enable employees to be better informed about the financial situation, strategy and future plans of the companies and sectors that they work in.

At the same time employees need to ensure an end to the use of violence in labour relations. In their quest for fair and decent employment conditions, employees need to recognise the potential negative effects of unsustainable cost structures on employment levels and competitiveness in the absence of improved productivity. In the prevailing conditions there is the danger of a wage-price spiral and, inevitably, it will be the workers who bear the brunt of the fallout.

The costs are not only the direct costs in terms of lost production, but also the possible increased costs of finance. In the context of a very weak global economy, where South Africa should strive to be a destination of choice and thereby grow the economy and achieve the pursued developmental and employment goals, the ability to attract investment and improve the country's ratings must be a clear objective.

While many of the strikes appear to have been resolved, long-term resolution of the underlying causes requires ongoing, concerted action on the part of all the parties involved. We need cohesion and certainty of policy, as well as unity of purpose to build an inclusive, longer-term vision. The National Development Plan is a broad unifying framework that has been adopted by both Cabinet and Parliament, and could form the base to take the country forward, enabling South Africa to play an effective role in the continent as a favoured trading and investment partner.

The MPC assesses the balance of risks to the inflation outlook to be on the upside, given the continued pressure of food prices, uncertainty of the exchange rate movements and the reweighting and rebasing of the CPI. Furthermore, the possible impact of higher wage increases could exert further upward pressure on inflation notwithstanding the concerns that recent developments in the labour market could impact negatively on employment. The MPC considers that the demand pressures on inflation at this stage remain relatively benign, as evidenced in the contained trend of underlying inflation. There are also signs of moderation of consumption expenditure against the backdrop of a weak supply side of the economy. The negative output gap is expected to persist for some time, and the balance of risks to the growth outlook remains on the downside.

In the light of these factors, the MPC is of the view that the current accommodative stance remains appropriate and has therefore decided to keep the repurchase rate unchanged at 5,0 per cent per annum. As always, the MPC will monitor developments closely and will not hesitate to act in a manner consistent with its mandate.

Addendum to the Monetary Policy Committee statement of 22 November 2012

The Monetary Policy Committee meeting schedule for 2013 is as follows:

22–24 January 2013

18–20 March 2013

21–23 May 2013

16–18 July 2013

17–19 September 2013

19–21 November 2013

Note on South Africa's participation in the Locational Banking Statistics initiative

M van Deventer, L de Beer and D Meyer

The Bank for International Settlements (BIS) is based in Basel, Switzerland, with representative offices in Hong Kong and Mexico City. The mission of the BIS is to serve central banks in their pursuit of monetary and financial stability, to foster international co-operation in those areas and to act as a bank for central banks. Established on 17 May 1930, the BIS is the world's oldest international financial organisation. Under the Committee on the Global Financial System (CGFS), the BIS started collecting international banking statistics in the 1960s and with each subsequent financial crisis, data gaps prompted refinements. Over the years, a concerted effort was made to improve the timeliness, frequency, soundness and coverage of cross-border positions. The number of reporting countries increased and, as of the second half of 2012, the Locational Banking Statistics (LBS) initiative was covering the activities of some 7 700 banking entities from 44 countries.

Because of the regional influence and the importance of cross-border banking activity in South Africa, the BIS approached the South African Reserve Bank to participate in the LBS group of reporting countries. In September 2009 South Africa became the forty-third member country providing LBS data to the BIS. Initially, only banks with significant cross-border and foreign currency positions supplied data; but from the beginning of 2012, changes to the Regulations Relating to Banks ensured that the LBS reporting became compulsory for all resident banks located within the borders of South Africa.

One of the surveys that fulfil the need for both better measurement and transparency in the reporting of cross-border financial activity is the LBS form. This survey measures the aggregate international claims and liabilities of all banks in a specific jurisdiction. The main purpose of the LBS is to provide information on the role of banks and financial centres in the intermediation of international trade and capital flows. Data are primarily organised by country of residence of the reporting banks and their counterparties, and all positions are recorded on a gross basis, including those in respect of own affiliates. The reporting methodology is consistent with the principles underlying the compilation of national accounts, balance of payments and external debt statistics. The currency details supplied by the reporting countries allow for the approximation of capital flows and also measures lending flows in a given period.

The LBS reporting format comprises a detailed analysis of all international financial claims and liabilities of resident banks as at the end of each quarter. Banks are required to provide three main breakdowns of their total claims and liabilities: (i) a currency breakdown, (ii) a sectoral breakdown, and (iii) a full counterparty country breakdown. In view of the multidimensional nature of the data, this note includes a handful of illustrations of how the information may be used.

As depicted in the table (on page 83), the international assets and liabilities of South African-registered banks are mainly held with developed countries, with the United Kingdom, followed by Germany and the United States (US), being the major country counterparties.

The aggregate cross-border claims of South African banks expanded noticeably from June 2011 to June 2012. The two main drivers behind this expansion were increased loans granted to non-residents and increased holdings of international debt securities. Similarly, the aggregate cross-border liabilities of South African banks increased somewhat over the same period, in line with a moderate uptick in international banking activity. This increase was primarily caused by expansions in other liabilities, which mainly consist of positions in foreign derivative instruments and the issuance of debt securities in foreign countries.

Distribution of claims and liabilities of South African banks across selected regions and countries

US$ millions

Outstanding balance	Total international assets			Total international liabilities		
	Sep 2009*	Jun 2011	Jun 2012	Sep 2009*	Jun 2011	Jun 2012
Developed countries......................	47 035	40 426	43 505	35 856	27 630	30 405
Offshore centres	1 514	2 734	4 138	3 253	4 843	3 987
Developing Africa and Middle East .	2 611	2 611	4 302	4 602	4 152	4 152
Other non-resident countries	1 482	4 096	4 530	604	1 021	1 259
All non-resident countries	52 642	49 867	56 475	44 315	37 646	39 803
Residents denominated in foreign currency.............................	3 724	6 800	6 918	6 385	9 138	8 825
All countries and residents...........	56 365	56 667	63 393	50 700	46 785	48 627

* Date of inception of South Africa's participation in the LBS survey

Notwithstanding this rise, South African banks' participation in cross-border bank lending activity has remained subdued from a longer-term perspective, in line with the moderate global lending activity observed during the past few years. On aggregate, South African banks' foreign assets exceed their foreign liabilities by a significant margin.

The domestic currency exposure of both international claims and liabilities declined from September 2009 to June 2012, while the foreign currency exposure increased over the same period. The breakdown by currency shows that South African banks' exposure in both assets and liabilities are mainly in US dollar, followed by the euro. Expressed as a percentage of total foreign assets, the dollar lost some ground, but gained favour as a lending currency during the period under review.

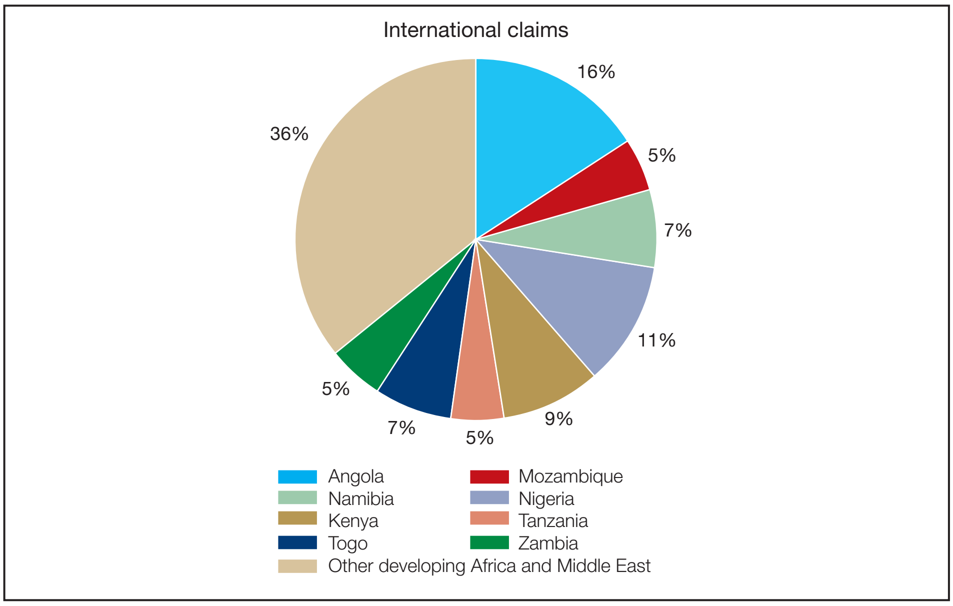
International claims and liabilities of South African banks by instrument and currency

Per cent

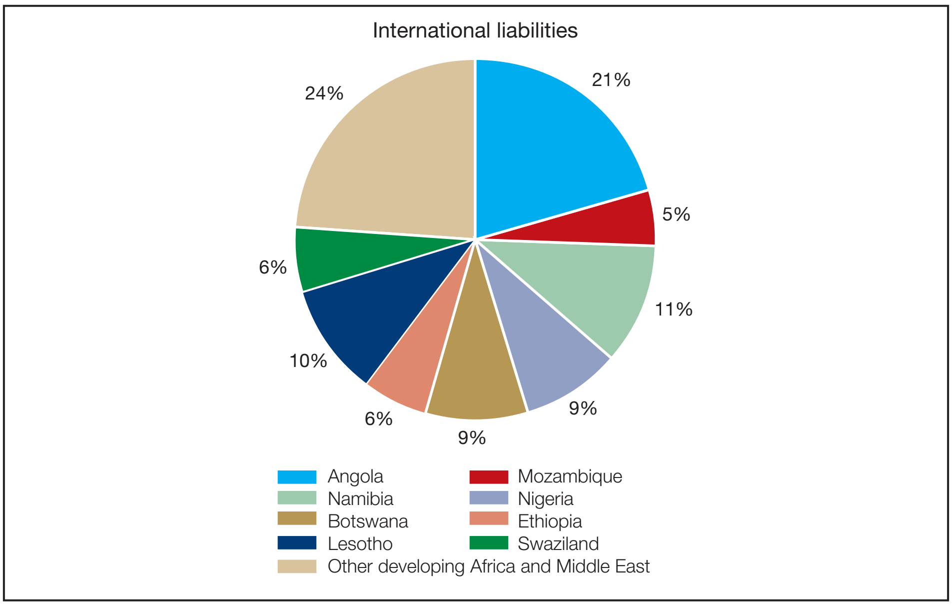
Share of components in total	Sep 2009	Jun 2011	Jun 2012
International loans	51	58	59
International holdings of debt securities..	1	8	8
Other international assets...	48	35	32
Total international claims...	100	100	100
Of which: Domestic currency...	38	28	28
Foreign currency...	62	72	72
US dollar..	*76*	*75*	*72*
Euro..	*13*	*15*	*15*
Other..	*11*	*10*	*13*
International deposits	46	58	53
International own issuance of debt securities	3	3	5
Other international liabilities	51	39	42
Total international liabilities	100	100	100
Of which: Domestic currency..	44	40	42
Foreign currency..	56	60	58
US dollar..	*74*	*72*	*75*
Euro...	*15*	*18*	*17*
Other...	*10*	*9*	*7*

The cross-border exposure of South African banks to developing Africa and Middle East investments constitutes less than 10 per cent of their total international assets and liabilities. Within this category, South African banks' exposure to a single country is dominated by Angola, although Nigeria, Namibia and Mozambique also feature prominently.

Assets: Developing Africa and the Middle East



Liabilities: Developing Africa and the Middle East



On an international basis, cross-border interbank lending worldwide stabilised in the first quarter of 2012, following the severe contraction in the previous quarter. This could be attributed partly to returning market confidence in euro area banks, following the measures undertaken by the European Central Bank (ECB) through its programme of longer-term refinancing operations (LTROs), which assisted in the reopening of wholesale bank funding markets. However, during the period from mid-June to mid-September 2012, the trajectory of global growth shifted downwards alongside renewed concerns regarding the sustainability of euro area government debt and the future of the monetary union. Such tensions in sovereign bond markets may continue to hamper the willingness of banks to provide credit, with adverse consequences for the global economy and a further deterioration in the asset quality of banks. These tensions are translated into the increase in credit default swaps of euro area banks, as well as the ongoing gradual loss of access to funding by banks in some euro area countries. To alleviate these tensions, the ECB announced a new programme of outright monetary transactions (OMTs) on 6 September 2012. The programme involves discretionary sterilised purchases of short-term sovereign bonds under specific conditions and is subject to prior request by the respective country's government for international assistance via the European Financial Stability Facility (EFS)/European Stability Mechanism (ESM).

The recent global financial crisis highlighted the need for further enhancements to the data required on major banking systems' funding and lending patterns. As a result, a working group of the Committee on the Global Financial System (CGFS) was tasked to review cross-border statistical requirements and they made a number of proposals which were approved by the CGFS for implementation from June 2012. The enhancements aim to address data issues and data gaps highlighted by the financial crisis; improve monitoring of credit exposures of national banking systems; and improve monitoring of trends in the supply of bank credit (both cross-border and domestically sourced) and banks' funding patterns. The latter will result in significant improvements in the usefulness of the international banking statistics for financial stability analysis. The enhanced surveys will be implemented in South Africa in mid-2013.

South Africa benefits from participation in LBS because it provides a benchmark vis-à-vis other countries in terms of both overall market share and categorisation provided in the data. Major lending and borrowing sectors are identified, alongside maturity and currency composition. In addition, it serves as a powerful tool for identifying economic trends that other banking statistics cannot capture. This allows for the tracking of sectors that account for build-up of risks; capturing selected channels of transmission of shocks; and early identification of large international banking flows that may require closer inspection. The balance-of-payments and external financial position data for South Africa incorporate the LBS data. Aggregated LBS data for South Africa are also included in various tables published in the BIS's *Quarterly Review* available at http://www.bis.org/publ/qtrpdf/rqt1209.htm.

At this stage, publication of a stand-alone set of LBS tables in the *Quarterly Bulletin* of the South African Reserve Bank is not envisaged, but this may be reviewed in future when more data points become available.