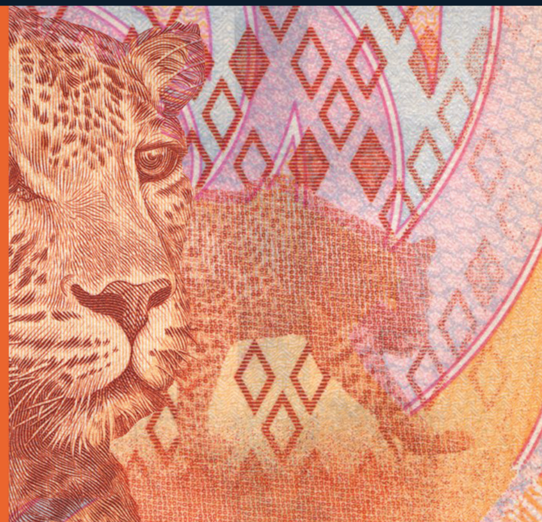
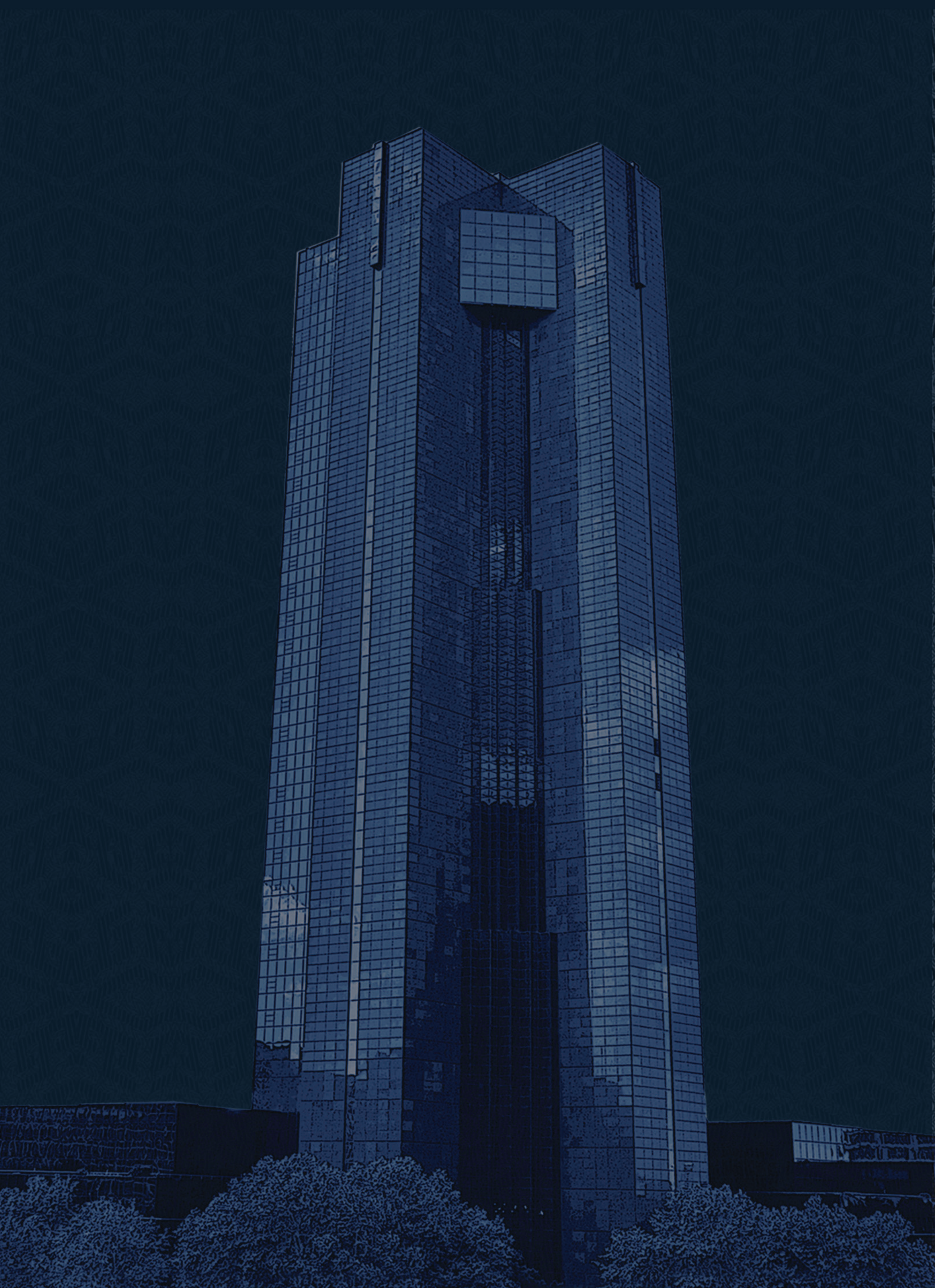
Quarterly Bulletin

March 2013





South African Reserve Bank

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Introduction

The year 2012 was disappointing as far as global economic activity is concerned, particularly in the advanced economies. Global economic growth decelerated from above 5 per cent in the first half of 2010 to around 2,5 per cent in the final quarter of 2012. Preliminary data suggest that the slowdown in world growth may have bottomed out towards the end of last year, with widespread expectations that global growth would gradually start recovering in 2013.

Output in the advanced economies declined in the fourth quarter of 2012 – the first contraction since the severe recessionary phase of the global crisis in 2008 and 2009. By contrast, the pace of economic expansion in emerging and developing markets accelerated in the final three months of last year as a result of faster growth in all regions, especially emerging Asia. Although real output growth moderated somewhat in the sub-Saharan Africa region, it still remained robust at around 4,5 per cent in 2012. The strong growth performance was underpinned by robust domestic demand, high commodity prices and rising export volumes.

International financial market conditions have improved in recent months, partly due to accommodative monetary policies by most central banks aimed at supporting economic growth. However, these easy monetary policy conditions in advanced economies in many instances resulted in depreciating exchange rates of the currencies concerned, thereby putting upward pressure on emerging-market currencies, and making the exports of the latter group of countries more expensive and less competitive.

The United States (US) avoided the so-called fiscal cliff at the beginning of 2013, but only addressed the revenue side of the fiscal problems. The US sequester (or automatic spending cuts), which became effective at the beginning of March 2013, seems set to result in a reduction of US$85 billion in federal government expenditure in the final seven months of this fiscal year, which could impact negatively on domestic demand in a fragile stage of the US recovery.

Global inflation moderated from around mid-2011 and moved broadly sideways in the second half of 2012. Despite high levels of the oil price, inflation pressures remained limited, especially in the advanced economies where large output gaps moderated price and wage behaviour. International prices of a number of food-related commodities softened somewhat in the final months of 2012.

In South Africa real economic growth picked up moderately in the final quarter of 2012 to an annualised rate of 2,1 per cent, roughly double the pace recorded in the third quarter when severe unrest in the mining sector had taken its toll. In the mining sector real value added contracted further in the fourth quarter of 2012 as a number of gold and platinum mines continued to be adversely affected by strike activity. By contrast, agricultural output rose further as livestock production held up fairly well over the period. The manufacturing sector recorded a firm increase in real output in the final quarter, supported by the expansion in activity in emerging-market economies and improved competitiveness arising from the depreciation of the external value of the rand. However, construction activity slowed in the fourth quarter of 2012, while the sector producing electricity registered a contraction in output on account of planned and unplanned shutdowns of operations at some mining and manufacturing establishments, alongside a further round of power buy-back arrangements.

In the services sectors real value added expanded at a somewhat firmer pace in the final quarter of 2012, led by an acceleration in banking and financial market activity. The transport and communication sector also registered stronger growth over the period as freight transport activity increased. By contrast, fourth-quarter retail activity was disappointing, resulting in a slowdown in real output growth in the trade sector, while real output growth of the general government sector also decelerated marginally.

The lacklustre economic growth in 2012 was accompanied by subdued job creation. While the number of workers in the public sector continued to rise, this was not always the case in the private sector, with a significant number of jobs, for instance, lost in the mining sector in the third quarter of 2012. Labour productivity continued rising at a pedestrian pace, while wage settlements averaged 7,6 per cent in 2012.

All the main domestic expenditure components weakened in the fourth quarter of 2012, culminating in a slight contraction in real gross domestic expenditure. Growth in household real final consumption expenditure slowed somewhat over the period, constrained by slower growth in disposable income and rising inflation. While moderating somewhat, the pace of increase in real spending on durable and semi-durable goods remained sturdy, led by demand for furniture, household appliances, vehicle parts and recreational goods. Real expenditure on non-durable goods and services increased at a considerably slower pace than on durables and semi-durables. Household consumption expenditure growth continued to match growth in household disposable income in the final quarter of 2012, and although household debt rose further, its pace of increase did not match that of disposable income. Accordingly, the household debt-to-income ratio edged slightly lower.

Real final consumption expenditure by general government contracted slightly in the fourth quarter of 2012 as the high level of spending on armaments in the third quarter was not repeated in the final quarter.

Real fixed capital formation rose at a notably slower pace in the fourth quarter of 2012. The rate of increase in real fixed capital spending by both general government and public corporations slowed significantly over the period. By contrast, real fixed capital formation by the private sector accelerated further in the final quarter of the year led by the mining, manufacturing and trade sectors. A number of gold and coal mines stepped up capital expenditure against the background of favourable output prices, while manufacturing firms increased their capital outlays alongside rising production and capacity utilisation.

After nine consecutive quarters in which aggregate inventory holdings increased, real inventory investment turned negative in the fourth quarter of 2012. Notable decreases in inventories were registered in the mining and manufacturing sectors, with production setbacks partly met by running down stock levels. This contributed to a broadly unchanged volume of exports in the final quarter of the year, with a recovery in mining exports – especially iron ore and coal – countered by a decline in exports of manufactured goods.

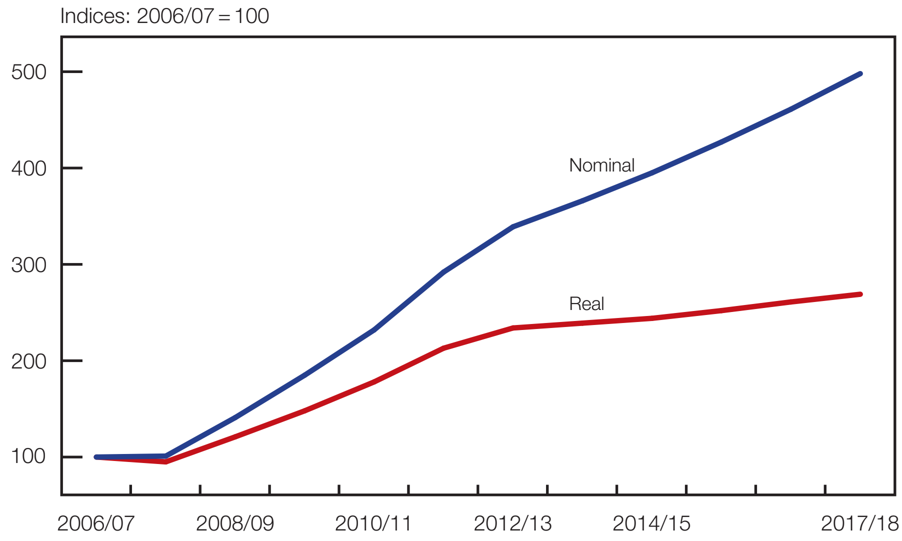
The volume of imports receded moderately in the final quarter of 2012, weighed down largely by lower imports of vehicles and transport equipment. The value of merchandise imports, however, increased over the period, predominantly owing to a significant depreciation in the external value of the rand. This also underpinned an increase in the rand value of exports. Despite a moderate deterioration in the terms of trade, these developments resulted in a slight narrowing of the deficit on the trade account from the third to the fourth quarter. Simultaneously, the deficit on the services, income and current transfer account contracted marginally, causing the deficit on current account of the balance of payments to decrease to 6,5 per cent of gross domestic product.

Financial inflows were again sufficient to finance the deficit on current account in the final quarter of 2012. The largest inflows were recorded in the form of an increase in short-term loans extended to the domestic banking sector, supplemented by an increase in non-resident deposits with South African banks. Net portfolio investment made a small positive contribution, whereas net direct investment registered an outflow of capital during the quarter concerned.

The nominal effective exchange rate of the rand on balance depreciated in the final quarter of 2012 as domestic constraints and labour unrest continued to weigh on international investor sentiment. With inflation already gradually accelerating in the second half of 2012, driven by higher prices of food and petrol, the weakening of the exchange rate of the rand imparted a further upward bias to a wide range of prices and costs. The twelve-month rate of consumer price inflation nevertheless remained below the upper limit of the inflation target range, and continued to do so in January 2013 when a rebased and reweighted consumer price index was adopted.

Underlying inflation pressures remained contained, whereas administered price inflation remained higher than headline inflation and has consistently exceeded 6 per cent over the past three years. In a step which has a bearing on administered prices and inflation expectations, the course of electricity prices was moderated in late February 2013 with the determination by the National Energy Regulator of South Africa (Nersa) that the electricity prices charged by Eskom would be increased by 8 per cent per annum over the next five years rather than the 16 per cent as requested by Eskom.

Eskom electricity price



Source: Nersa and staff calculations

The lacklustre growth in income and expenditure was reflected in a subdued pace of increase in money supply and in overall bank loans and advances to the domestic private sector in the final months of 2012. Mortgage advances displayed little increase, consistent with the directionless state of the real-estate market. Instalment sale credit and leasing finance continued to expand firmly, in pace with sales of motor vehicles and other durable goods, while other loans and advances recorded the strongest growth with both general loans to companies and unsecured lending to households posting brisk increases.

Money-market interest rates remained stable with the policy rate unchanged at 5,0 per cent since July 2012. Orderly conditions and adequate liquidity continued to prevail in the money market. In the bond market lower bond yields and rising net issuance supported turnover, while in the share market local share prices reached new record highs.

Subdued international and domestic economic activity culminated in lower-than-projected tax collections in the first ten months of fiscal 2012/13. The National Budget presented in February 2013 provided for marginally larger fiscal deficits over the next three fiscal years than earlier projections, recognising the present need for further countercyclical support to the economy, but steering towards a significantly smaller deficit and stabilisation of the ratio of government debt to gross domestic product in the outer years. To this end, expenditure plans were trimmed over the medium term. A process has started to align government's budget priorities firmly with the National Development Plan and gain traction in its implementation, building on the country's substantial strengths and tackling its weaknesses to propel development onto a vibrant trajectory.

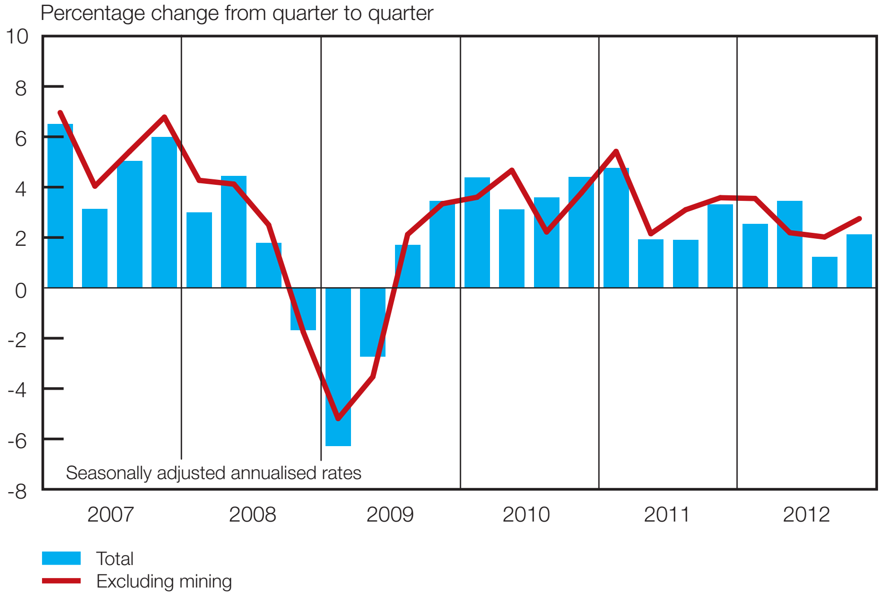
Domestic economic developments

Domestic output[1]

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

Domestic economic activity picked up moderately in the fourth quarter of 2012 following the severe labour-induced setback suffered by the mining sector in the third quarter. Growth in *real gross domestic product* edged higher from an annualised rate of 1,2 per cent in the third quarter of 2012 to 2,1 per cent in the fourth quarter. This modest acceleration reflected increased production in both the secondary and tertiary sectors. By contrast, the real value added by the primary sector contracted further in the final quarter of 2012, but at a slower pace. For the year as a whole, growth in real gross domestic product tapered off from 3,5 per cent in 2011 to 2,5 per cent in 2012.

Real gross domestic product



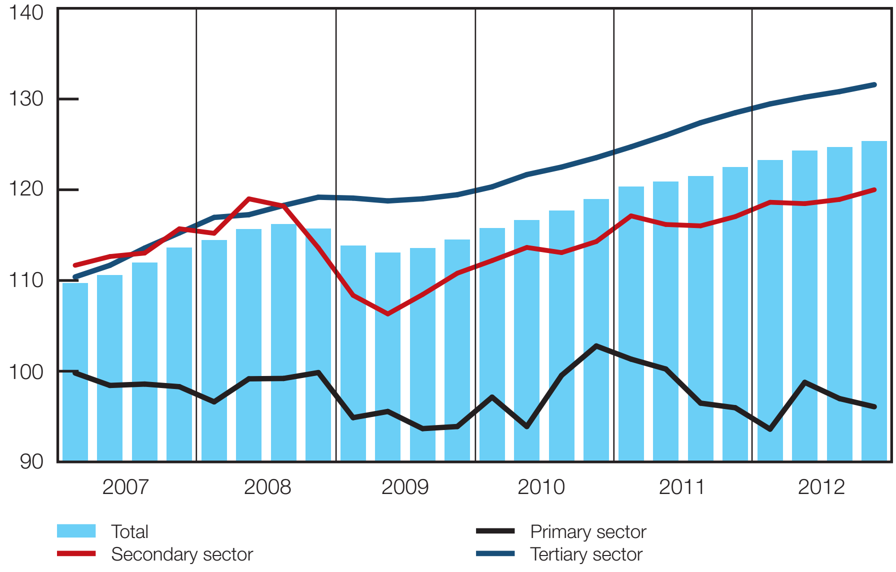
Excluding the contribution of the generally more volatile primary sector, growth in real gross domestic production picked up from an annualised rate of 1,8 per cent in the third quarter of 2012 to 2,7 per cent in the fourth quarter.

The performance of the *primary sector* continued to strain overall economic growth – the real value added by this sector contracted at an annualised rate of 3,7 per cent in the fourth quarter of 2012, following a decline of 7,1 per cent in the preceding quarter. This disappointing performance resulted from a further contraction in the real value added by the mining sector, partly neutralised by faster growth in agricultural production. The level of real production of the primary sector in the fourth quarter of 2012 was still about 4 per cent below its pre-recession level in the fourth quarter of 2008.

Real output of the *agricultural sector* increased throughout 2012 at annualised rates ranging between 4,8 per cent and 10 per cent, reaching 2,3 per cent for the year as a whole. In the final quarter of 2012, growth in the real value added by the agricultural sector accelerated to 10 per cent from a rate of 7,4 per cent in the third quarter. This increase could be explained by livestock production that held up fairly well alongside sluggish growth in field crop and horticultural production.

Real gross domestic product by sector

Indices: 2005 = 100



Seasonally adjusted

The real value added by the *mining sector* shrank at an annualised rate of 9,3 per cent in the fourth quarter of 2012 – the seventh quarterly decline in the past two years. The contraction in mining output in the fourth quarter mainly resulted from lower production volumes in the gold mining industry and slower growth in production in the platinum group metals sector: both sectors were adversely affected by strike activity in the fourth quarter. Lower grades of ore milled and safety stoppages due to the deepening and ageing of some gold mines further complicated operational conditions in the gold mining industry. By contrast, production in the coal mining sector benefited from increased demand resulting from colder winter temperatures in the northern hemisphere.

Real gross domestic product

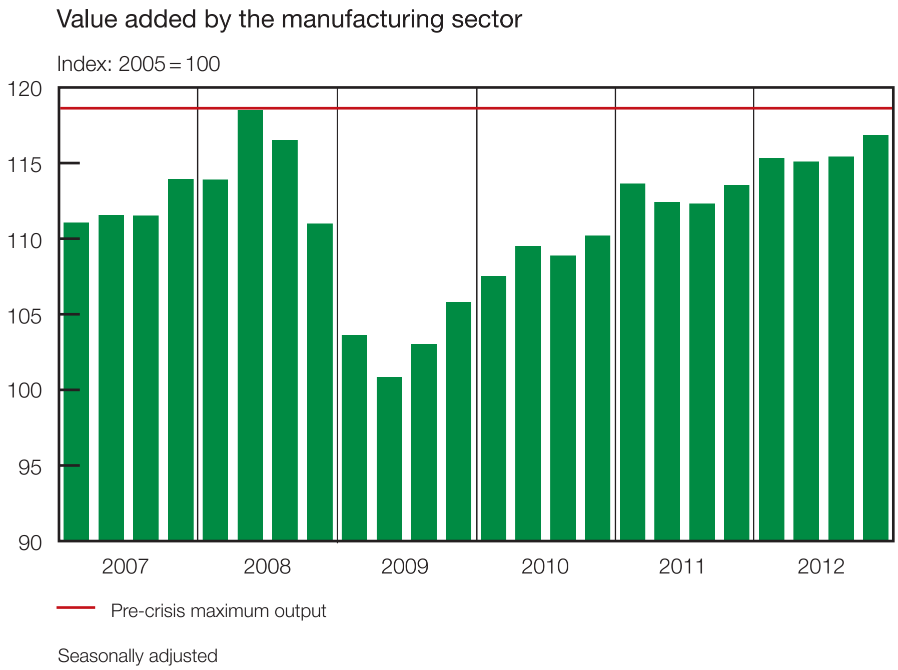
Percentage change at seasonally adjusted annualised rates

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

On an annual basis, negative considerations resulted in the real value added by the mining sector contracting by 4 per cent in 2012, following an increase of 0,3 per cent in the preceding year. Further to relatively sluggish global demand for South African-produced commodities and domestic uncertainty, mining production was weighed down during 2012 by periodic strike activity and the concomitant shut-down of operations and safety-related disruptions in especially the gold and platinum mining sectors.

Growth in the real value added by the *secondary sector* accelerated from 1,5 per cent in the third quarter of 2012 to 3,6 per cent in the fourth quarter. This stronger expansion in real value added resulted primarily from increased activity in the manufacturing sector. Real output of the sector supplying electricity, gas and water contracted, while activity in the construction sector advanced at a slower pace.

Real output growth of the *manufacturing sector* continued to firm in the final quarter of 2012, accelerating from 1,2 per cent in the third quarter of 2012 to 5 per cent in the fourth quarter, thereby adding 0,8 percentage points to the overall economic growth rate in the quarter. The expansion was in keeping with somewhat stronger growth in emerging-market economies and enhanced competitiveness due to the depreciation in the external value of the rand. Production in the subsectors involved in the manufacturing of petroleum, chemical products, rubber and plastic products; glass and non-metallic mineral products; and basic iron and steel, non-ferrous metal products and machinery increased at a faster pace in the fourth quarter of 2012. Simultaneously, production in the subsectors manufacturing radio, television and communication apparatus and professional equipment; and wood and wood products, paper, publishing and printing continued to rise, albeit at a slower pace. By contrast, production decreased in the sectors producing food and beverages; textiles, clothing, leather and footwear; motor vehicles, parts and accessories and other transport equipment. Despite the steady increase in overall manufacturing production, output levels in the fourth quarter of 2012 were still below the pre-recession peak recorded in the second quarter of 2008.



The utilisation of production capacity in the manufacturing sector has showed a steady upward trend since the middle of 2011, rising from 82,2 per cent in the third quarter of 2012 to 82,8 per cent in the fourth quarter. In the final quarter of 2012 capacity utilisation advanced notably in the subsectors involved in the manufacturing of basic iron and steel, non-ferrous metal products and machinery; non-metallic minerals; and textiles, clothing, leather and footwear.

When the calendar year outcomes are compared, growth in the real value added by the manufacturing sector, however, decelerated from 3,6 per cent in 2011 to 2,4 per cent in 2012. The slower pace of increase emanated, *inter alia*, from a decline in the manufacturing of basic iron and steel products on account of weaker domestic demand from the building and construction industry. This was reinforced by the stunted global demand for manufacturing products during the course of 2012.

Having increased at an annualised rate of 1,6 per cent in the third quarter of 2012, the real value added by the sector supplying *electricity, gas and water* contracted by 2,2 per cent in the final quarter of 2012. The decline in electricity production could be attributed primarily to lower demand from the manufacturing and mining sectors, which were both adversely affected by planned and unplanned shutdowns of operations during the period. Electricity production was furthermore affected by the second round of power buy-back arrangements between Eskom and ferrochrome producers which started in the closing months of 2012. For 2012 as a whole, the real value added by the sector contracted by 1,2 per cent following an increase of 1,1 per cent in 2011.

Real output of the *construction sector* decelerated from an annualised rate of 3,3 per cent in the third quarter of 2012 to 0,2 per cent in the fourth quarter. Growth in civil construction activity by the public sector inched lower due to lower capital outlays by the electricity and transport subsectors. The pace of increase in private-sector activity, however, advanced mainly due to increased capital spending by the mining, manufacturing and trade sectors. At the same time, demand for residential and non-residential buildings remained weak during the quarter under review. Following an increase of 0,5 per cent in 2011, the real value added by the construction sector increased by 2,5 per cent in 2012. The civil construction sector maintained its underlying upward momentum, as government remained focused on infrastructure development. Demand for residential buildings increased marginally during 2012, whereas activity in the non-residential building sector remained subdued.

The real value added by the *tertiary sector* increased at a somewhat faster pace in the fourth quarter of 2012, consistent with the higher volume of transactions in services in most subsectors. Growth in the real value added by the general government subsector, however, slowed marginally.

Subsequent to an annualised increase of 1,7 per cent in the third quarter, growth in real output of the *trade* sector decelerated to 1,5 per cent in the final quarter of 2012. The slower pace of increase in the fourth quarter was consistent with a contraction in activity in the retail subsector as consumer spending was negatively affected by a pickup in inflation. At the same time, somewhat slower spending by consumers on catering and accommodation services probably restrained output in the overall trade sector in the final quarter of 2012. The real value added by the wholesale subsector increased notably, in part due to a recovery in sales volumes following the disruptive industrial strike action in the transport sector in the third quarter. In addition, the motor vehicle industry experienced stronger demand from the car rental industry in South Africa, probably partly in anticipation of an increase in prices due to the depreciation in the external value of the rand. Overall, growth in the real value added by the trade sector slowed to 3,6 per cent in 2012, compared with a rate of increase of 4,5 per cent in 2011.

The pace of increase in the real output originating in the *transport, storage and communication sector* edged higher from an annualised rate of 1,1 per cent in the third quarter of 2012 to 1,9 per cent in the fourth quarter. The increased growth can primarily be attributed to increased activity in the land transport subsector, more specifically, freight transportation. The communication subsector maintained its growth momentum throughout 2012, benefiting from more attractive electronic data transfer and call packages offered, as well as technological innovation. This was reflected in the annual growth for 2012 that amounted to 2,3 per cent.

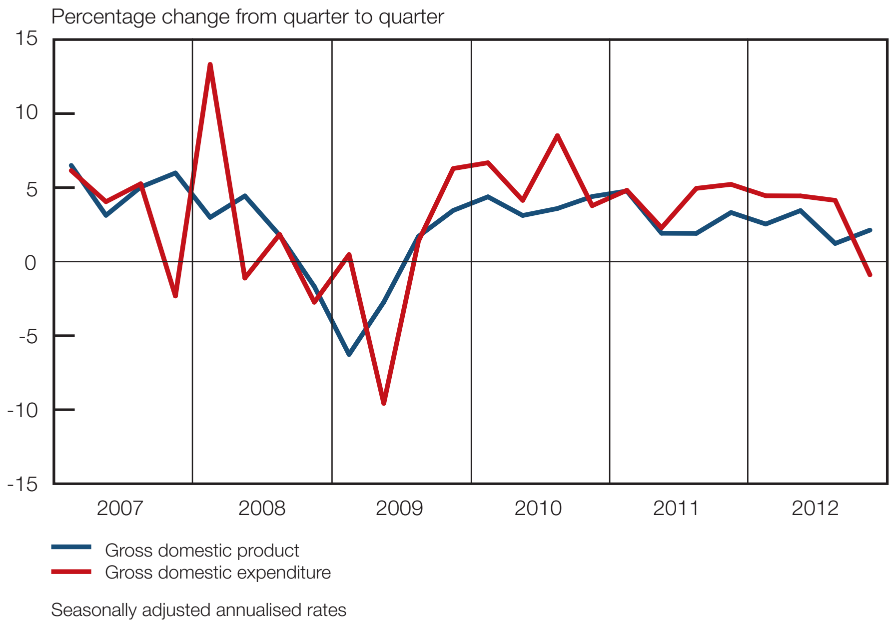
Growth in the real value added by the *finance, insurance, real-estate and business services sector* accelerated from 1,8 per cent in the third quarter of 2012 to 2,9 per cent in the fourth quarter. The stronger performance of this sector primarily reflected an increase in the real value added by the banking sector. Activity in the equity, bond and other financial markets also remained relatively firm in the period under review. Consistent with the increased growth in the financial sector, the Ernst & Young Financial Sector Confidence Index edged higher in the final quarter of 2012, exceeding the highest confidence level recorded since the onset of the global financial crisis five years ago, largely as a result of the rebound in the level of confidence in the life insurance industry. On balance, overall growth in the real value added by the finance, insurance, real-estate and business services sector moderated from a rate of 4 per cent in 2011 to 3,3 per cent in 2012.

Real output growth of the *general government sector* decelerated marginally from 2,7 per cent in the third quarter of 2012 to 2,6 per cent in the fourth quarter, as employment by general government expanded at a slower pace. Growth in real value added by the general government sector slowed from 3,9 per cent in 2011 to 3,1 per cent in 2012.

Real gross domestic expenditure

Unlike the increase in real gross domestic production, aggregate *real gross domestic expenditure* contracted at an annualised rate of 0,9 per cent in the fourth quarter of 2012 – the first quarterly contraction since the second quarter of 2009.

Real gross domestic product and expenditure



The decline in real gross domestic expenditure in the fourth quarter resulted from a decline in real final consumption expenditure by general government alongside a sharp contraction in the level of real inventories. At the same time, growth in real final consumption expenditure by households and gross fixed capital formation slowed somewhat. For the calendar year 2012 as a whole, real gross domestic expenditure increased by 4,1 per cent compared with an increase of 4,6 per cent in 2011.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

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

* At constant 2005 prices

Household consumption expenditure continued to be restrained by slower growth in disposable income of households and rising inflation. Having increased at an annualised rate of 2,7 per cent in the third quarter of 2012, *real final consumption expenditure by households* rose at a rate of 2,4 per cent in the fourth quarter – the fourth consecutive quarterly slowdown in household spending. Slower growth in spending on durable and semi-durable goods, and on services more than offset a faster pace of increase in spending on non-durable goods. As a result of the slowing quarterly pace of increase throughout the year, consumption expenditure by households advanced by 3,5 per cent in 2012, compared with an increase of 4,8 per cent in 2011.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2011	2012				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods	15,8	8,1	8,9	7,8	6,1	11,0
Semi-durable goods	5,9	6,1	6,8	6,2	5,1	6,2
Non-durable goods	3,1	2,5	2,2	1,7	2,3	2,5
Services	3,5	3,6	1,7	1,3	0,8	1,8
Total	4,8	4,0	3,2	2,7	2,4	3,5

Real outlays by households on *durable goods* decelerated from a sturdy annualised rate of 7,8 per cent in the third quarter of 2012 to 6,1 per cent in the fourth quarter. After virtually no growth was attained in consumer spending on furniture and household appliances in the first three quarters of the year, the pace of spending on this category accelerated in the final quarter of 2012. Outlays on all other categories of durable goods increased at marginally slower rates than in the preceding quarter. For the calendar year 2012 as a whole, spending on durable goods increased at a still fairly robust 11 per cent, moderately slower than the rate of increase of 15,8 per cent recorded in 2011.

Subsequent to an annualised increase of 6,2 per cent in the third quarter of 2012, real spending on *semi-durable goods* rose at a rate of 5,1 per cent in the fourth quarter. The slower pace of spending on clothing and footwear, household textiles and furnishings, was only partly offset by increased sales of motor vehicle parts and accessories, and recreational goods. Household spending on motor car tyres, parts and accessories advanced at a somewhat stronger pace, consistent with the upward trend in the household sector's total vehicle fleet and the associated need to maintain those vehicles.

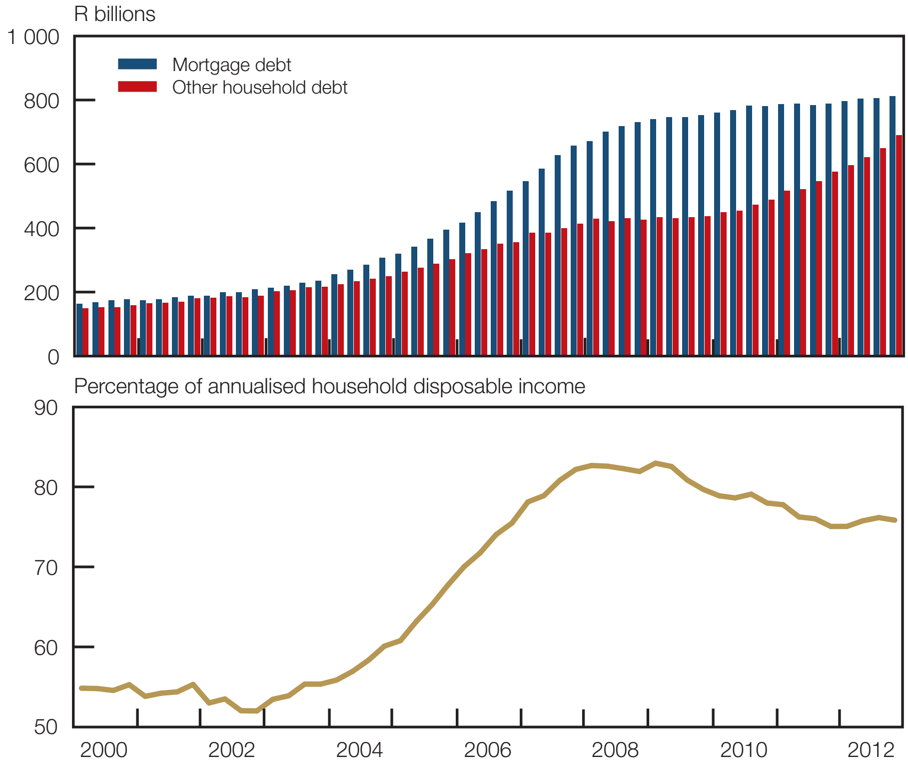
Real outlays on *non-durable goods* expanded at annualised rates of 1,7 per cent in the third quarter and 2,3 per cent in fourth quarter of 2012. Despite their often unavoidable nature, spending on household fuel and power, household consumables, and medical and pharmaceutical products registered subdued increases, probably influenced by the adverse impact of increases in the prices of these products and the further pressure on consumers arising from industrial action and job losses. Real outlays on food and beverages and on petroleum products rose somewhat despite the relatively high prices of these products; the latter probably reflecting the continued expansion in household ownership of vehicles. On an annual basis, real spending on non-durable goods increased at a more subdued rate of 2,5 per cent in 2012 compared with an increase of 3,1 per cent in 2011, in line with the slower growth in real income over the period.

Real spending by households on *services* slowed from the third to the fourth quarter of 2012. Slower spending on household services, transport and communication services as well as on recreation and entertainment services was partly offset by a decline in spending on miscellaneous services; spending on medical services increased at a faster pace over the period.

Real spending by households was well aligned with the sustained, albeit slower, rate of increase in *real household disposable income*. Having increased at an annualised rate of 2,7 per cent in the third quarter of 2012, growth in real household disposable income moderated to 2,4 per cent in the fourth quarter.

Despite the slower pace of increase in consumer spending, credit extended to the household sector edged higher in the fourth quarter of 2012. The growth in nominal disposable income of households still outpaced the growth in household debt, causing the ratio of household debt to disposable income to recede from 76,2 per cent in the third quarter of 2012 to 75,8 per cent in the fourth quarter. In line with strong growth in high interest-rate advances and slower growth in the low interest-rate advances, the ratio of debt-service cost to disposable income of the household sector remained around 6,5 per cent in both the third and the fourth quarters of 2012.

Household debt



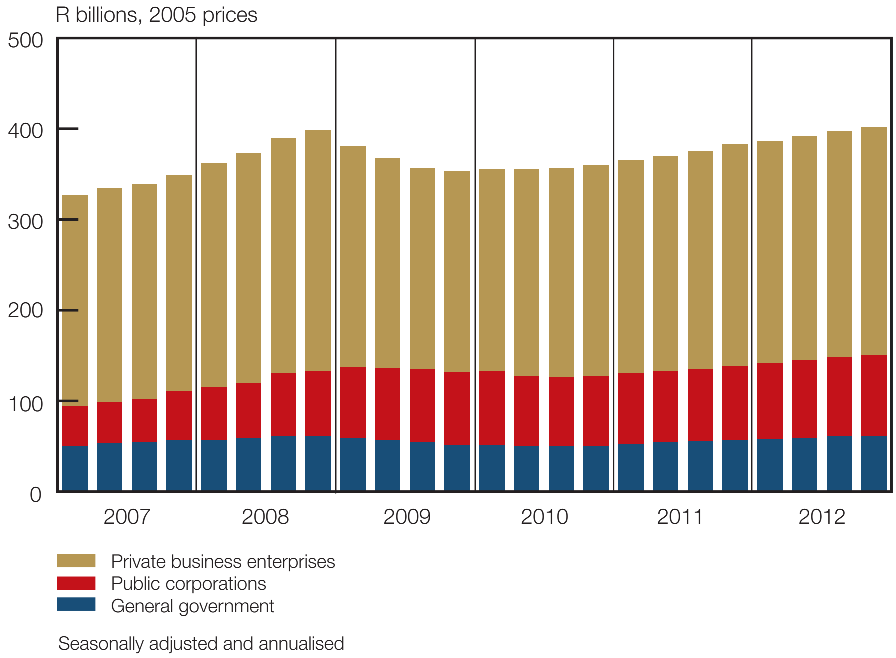
Seasonally adjusted

The sustained pace of increase in household debt in the fourth quarter of 2012 was more apparent in the "other household debt" category, as growth in mortgage advances to the household sector remained subdued. Owing to stronger quarterly growth in household assets compared with increases in household debt, the *net wealth of the household sector relative to annualised disposable income* increased from 310 per cent in the third quarter of 2012 to 313 per cent in the fourth quarter.

Real final consumption expenditure by general government contracted at an annualised rate of 0,7 per cent in the fourth quarter of 2012 following an increase of 8,3 per cent in the third quarter, as the relatively high level of spending on armaments in the third quarter was not repeated in the final quarter of the year. Excluding expenditure on armaments, growth in consumption expenditure by general government tapered off from 3,8 per cent in the third quarter of 2012 to 3,6 per cent in the fourth quarter, owing to a marginal contraction in expenditure on non-wage goods and services.

Following an annualised increase of 5,6 per cent in the third quarter of 2012, growth in real *gross fixed capital formation* slowed to 4,3 per cent in the fourth quarter. Capital outlays by public corporations and the general government increased at a notably slower pace, while spending by private business enterprises gained further momentum in the final quarter of 2012. Fairly strong quarter-to-quarter increases in aggregate capital spending during the course of 2012 resulted in an annual real increase of 5,7 per cent in 2012 compared with 4,5 per cent in 2011.

Real gross fixed capital formation by institutional sector



Growth in real capital outlays by *private business enterprises* accelerated from an annualised rate of 2,8 per cent in the third quarter of 2012 to 3,8 per cent in the fourth quarter. Higher levels of capital spending by the mining, manufacturing and trade sectors gave rise to this modestly faster pace of increase. Even though production in the mining sector was weighed down by industrial action, capital spending was pronounced in especially the gold and coal mining sectors, while expenditure on, in particular, machinery and equipment upheld the growth in capital formation by the manufacturing sector over the period. Capital spending in the communications sector was concentrated on the improvement of transmission capabilities of radio networks and the adding of additional base stations to the network. For 2012 as a whole, real gross fixed capital formation by private business enterprises slowed to 3,9 per cent following an increase of 4,6 per cent in 2011.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Sector	2011	2012				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private business enterprises	4,6	2,5	2,7	2,8	3,8	3,9
Public corporations	1,5	11,0	9,8	10,6	7,2	9,1
General government	8,6	4,9	10,9	10,3	2,1	8,5
Total	4,5	4,6	5,4	5,6	4,3	5,7

Real gross fixed capital formation by *public corporations* increased at an annualised rate of 7,2 per cent in the fourth quarter of 2012, notably slower than the rate of increase of 10,6 per cent in the third quarter. This slower rate of increase was due to lower-than-expected capital outlays by the electricity and transport sectors. Capital expenditure by Eskom on the construction of its power plants Medupi, Kusile and Ingula continued but at more moderate levels. In addition, Transnet lowered its capital spending on its freight rail acquisition project. Capital spending by the water boards, SANRAL and Trans-Caledon Tunnel Authority (TCTA) was not sufficient to maintain the upward momentum in capital expenditure by public corporations over the period. For the year as a whole, real capital outlays nevertheless advanced by 9,1 per cent in 2012, compared with an increase of 1,5 per cent in 2011.

Real capital spending by *general government* decelerated noticeably in the fourth quarter of 2012. The deceleration in growth in real gross fixed capital formation was evident at all three levels of government notwithstanding continued outlays on education, health, transport and energy. Provincial government's infrastructural spending in the fourth quarter of 2012 comprised the construction and upgrading of provincial roads, schools and hospitals. Growth in real capital expenditure by general government slowed marginally from 8,6 per cent in 2011 to 8,5 per cent in 2012.

Having risen uninterruptedly for nine consecutive quarters, the aggregate level of *real inventory holdings* declined by R4,1 billion in the fourth quarter of 2012. Consequently, the run-down in inventory levels subtracted 1,7 percentage points from the growth in real gross domestic expenditure over the period.

Real inventory holdings receded in most of the sectors of the economy with notable decreases registered in the mining and manufacturing sectors. The decline in the stock of inventories in the mining sector was the net result of a build-up in platinum inventories which was more than offset by a reduction in other mining inventories in the fourth quarter of 2012. Lower imports of crude oil due to planned maintenance shutdowns at some major refineries were in part responsible for the lower stock of inventories in the manufacturing sector in the fourth quarter of 2012. The level of real inventories at the end of 2012 was also moderately lower than a year earlier.

As a percentage of non-agricultural gross domestic product, industrial and commercial inventories (held in the trade and manufacturing sectors) declined from an average of 12,7 per cent in the first three quarters of 2012 to 12,4 per cent in the fourth quarter.

Factor income

The growth over four quarters in *total nominal factor income* accelerated from 7,2 per cent in the third quarter of 2012 to 7,6 per cent in the fourth quarter. A faster rate of increase in compensation of employees was partly neutralised by a moderation in growth of gross operating surpluses of business enterprises over the period. The rate of increase in total nominal factor income for 2012 as a whole amounted to 8,3 per cent, somewhat lower than the 8,8 per cent recorded in 2011.

Measured over a year, growth in total *compensation of employees* accelerated from 8,1 per cent in the third quarter of 2012 to 9,2 per cent in the fourth quarter. The increase in remuneration of employees could mainly be attributed to a further increase in salaries paid by general government. This was partly offset by the suspension of wage payments to striking staff and job losses in the mining and the agricultural sectors following labour market disruptions in the second half of 2012. Consequently, the ratio of total remuneration of employees to total factor income decreased from 52,2 per cent in the third quarter of 2012 to 51,9 per cent in the fourth quarter. Consistent with the moderation in average wage settlement rates in 2012, aggregate remuneration increases of employees slowed from 9,8 per cent in 2011 to 8,8 per cent in 2012.

Year-on-year growth in the total *gross operating surplus* moderated from 6,2 per cent in the third quarter of 2012 to 5,8 per cent in the fourth quarter as business activity was constrained by the uncertain domestic and global economic conditions. Slower growth in gross operating surpluses was particularly evident in the agricultural and mining sectors. Some relief in the manufacturing sector from the weaker rand was probably offset by sharp increases in input costs, including labour and electricity costs. Profit margins of business enterprises were further negatively affected by disruptions in production due to industrial action and weaker global demand.

Gross saving

Gross saving as a percentage of gross domestic product (i.e., the *national saving ratio*) advanced slightly from 12,7 per cent in the third quarter of 2012 to 12,8 per cent in the fourth quarter. The increase followed a moderation in the pace of dissaving by general government against a marginal deterioration in the savings performance of the corporate sector, while the household savings ratio remained stable. The higher savings ratio implied that South Africa's dependency on foreign capital to finance gross capital formation decreased from 34,7 per cent in the third quarter of 2012 to 33,7 per cent in the fourth quarter. However, for the year as a whole, this ratio disappointingly increased markedly from 17,4 per cent in 2011 to 32,3 per cent in 2012, emphasising the sizeable shortfall in domestic savings in financing total gross domestic investment.

The savings ratio of the *corporate sector* edged down from 14 per cent in the third quarter of 2012 to 13,8 per cent in the fourth quarter. Measured over a year, dividend payments rose by 8,5 per cent in the fourth quarter of 2012 despite growth in operating surpluses slowing over the period. Relative to gross domestic product, gross saving by the corporate sector declined from 16 per cent in 2011 to 13,9 per cent in 2012.

Gross saving by the *household sector* as a percentage of gross domestic product remained unchanged at 1,7 per cent in all four quarters of 2012, mainly due to slower growth in final consumption expenditure by households.

General government continued to dissave. The rate of dissaving by government, however, moderated from 3 per cent of gross domestic product in the third quarter of 2012 to 2,7 per cent in the fourth quarter. Lower current expenditure levels alongside higher tax income favourably influenced the level of saving by general government in the current quarter. Taxes on products, especially value-added tax (VAT) and excise duties, as well as personal tax receipts recorded strong annual growth rates. Higher government income was, however, partly offset by slower growth in taxes received from business enterprises in the fourth quarter of 2012 compared with the preceding quarter. The dissaving ratio of general government worsened considerably to 2,4 per cent in 2012 from 1,5 per cent in 2011.

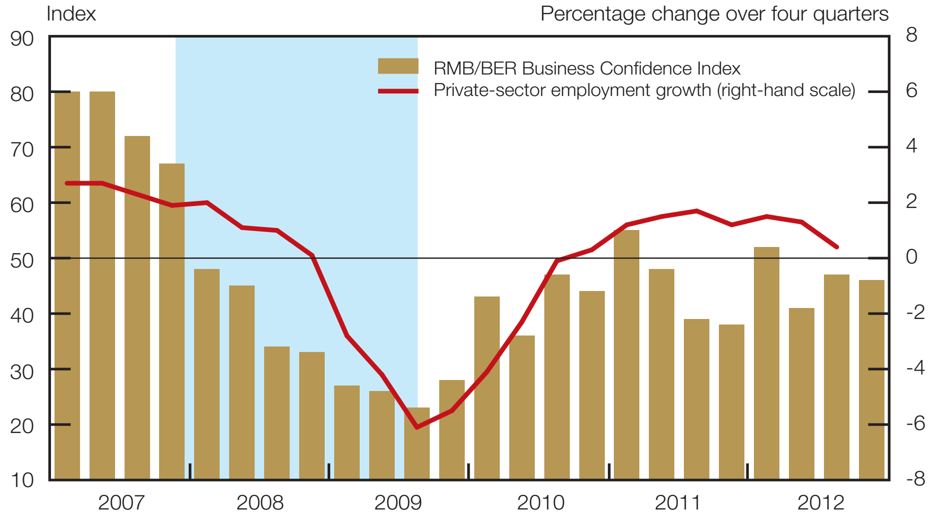
Employment

The level of employment in the formal non-agricultural sector of the economy remained broadly unchanged in the third quarter of 2012. According to the *Quarterly Employment Statistics (QES)* survey by Statistics South Africa (Stats SA), employment gains in the public sector were fully offset by job shedding in the private sector during the period, leaving the level of total formal non-agricultural employment at an estimated 8,44 million at the end of September 2012.[2]

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

The South African labour market was characterised by fairly widespread and disruptive labour unrest in the third quarter of 2012. The strike activity originated in the platinum mining sector, before spreading to other mining subsectors and subsequently to other sectors of the economy, notably the road freight transportation and agricultural sectors in the Western Cape Province. These developments contributed to the shedding of some 31 900 private-sector employment opportunities in the third quarter of 2012. Industrial action continued into the fourth quarter of 2012 and, given the violence which in some instances accompanied it, adversely affected the already fragile business and investor confidence in the domestic economy.

Formal non-agricultural private-sector employment and the RMB/BER Business Confidence Index



Shaded area indicates a downward phase in the business cycle

Sources: Statistics South Africa and Bureau for Economic Research (BER) at Stellenbosch University

On a seasonally adjusted basis, public-sector employment rose by 32 200 employees in the third quarter of 2012, representing an annualised rate of increase of 6,4 per cent.

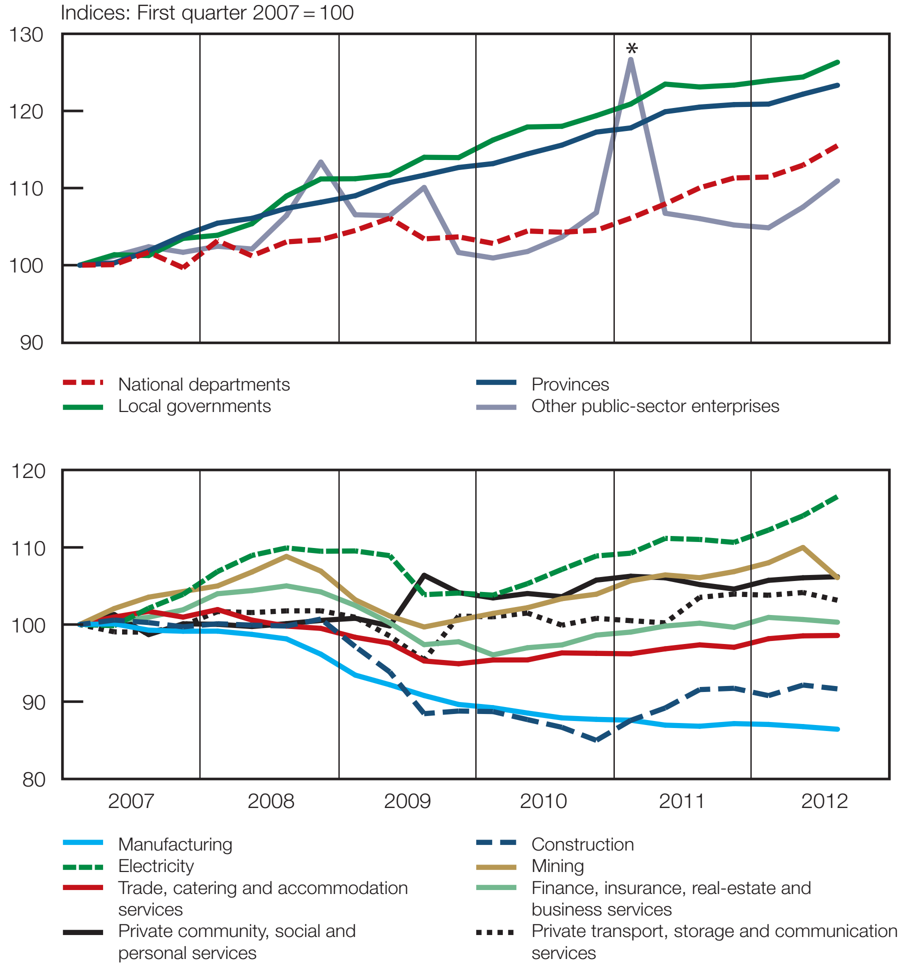
Changes in enterprise-surveyed formal non-agricultural employment*

Sector	Change over one quarter				Change over four quarters to 3rd qr 2012		Cumulative job losses (-) gains (+)	
	2011	2012						
	4th qr	1st qr	2nd qr	3rd qr	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 3rd qr 2012
Finance, insurance, real-estate and business services	-9 800	23 400	-4 800	-6 400	2 500	0,1	-163 400	77 500
Manufacturing	4 600	-1 500	-3 800	-4 500	-5 100	-0,4	-118 300	-37 000
Trade, catering and accommodation services	-5 400	19 100	6 400	900	20 900	1,2	-75 700	54 700
Construction	800	-4 500	6 400	-2 300	500	0,1	-52 100	13 900
Total mining	3 800	5 600	9 600	-19 000	0	0,0	-35 900	22 500
Gold mining	0	-400	-500	-700	-1 500	-1,1	-8 900	-18 200
Other mining	3 900	6 000	10 100	-18 300	1 600	0,4	-27 000	40 700
Electricity	- 200	900	1 000	1 300	3 000	5,0	-3 300	6 900
Private transport, storage and communication services	1 100	- 400	900	-2 500	- 900	-0,4	-2 000	5 400
Community, social and personal services	-2 300	4 600	1 300	600	4 100	1,0	13 400	11 000
Private sector	-7 400	47 200	17 000	-31 900	24 900	0,4	-437 300	155 000
Provinces	2 800	700	11 400	10 300	25 200	2,3	51 600	90 400
Local governments	500	1 200	1 000	4 000	6 600	2,6	15 000	20 900
National departments	5 100	500	6 200	10 100	21 800	5,0	- 800	50 700
Other public-sector enterprises	-4 600	-1 600	2 300	5 100	1 200	0,8	-7 800	13 000
Public transport, storage and communication services	2 700	700	3 800	2 800	10 100	9,7	-4 900	10 000
Total public sector	6 500	1 500	24 700	32 200	64 900	3,2	53 100	184 900
Grand total	- 900	48 700	41 800	300	89 800	1,1	-384 200	339 000

* Seasonally adjusted. Components may not add to totals due to rounding.

For national departments this rate of increase was as much as 9,3 per cent, for local governments 6,3 per cent and for provincial governments 3,8 per cent. In addition, employment levels in other public-sector enterprises rose further at an annualised rate of 13,2 per cent in the third quarter of 2012, following an already substantial increase of 10,6 per cent in the second quarter. In the year to the third quarter of 2012 the public sector expanded its workforce by around 65 000 employees, representing an increase of 3,2 per cent.

Formal non-agricultural employment

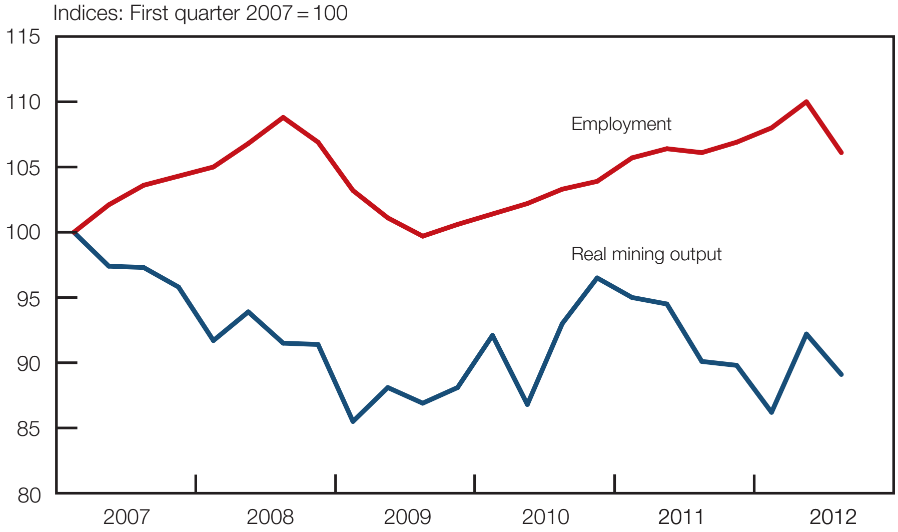


* The surge in employment by other public-sector enterprises resulted from the appointment of temporary workers by the Independent Electoral Commission to assist with the municipal elections in May 2011

Employment levels in the private sector decreased at a seasonally adjusted and annualised rate of 2,0 per cent in the third quarter of 2012. Job shedding was fairly pervasive throughout the private sector, with employment losses occurring in the non-gold mining sector (at an annualised rate of 17,4 per cent); the private transport, storage and communication sector (3,8 per cent); the construction sector (2,1 per cent); the gold-mining sector (2,0 per cent); the manufacturing sector (1,6 per cent); and the finance, insurance, real-estate and business services sector (1,4 per cent). These decreases were partly countered by employment gains in the electricity sector (9,0 per cent); the private community, social and personal services sector (0,5 per cent); and the trade, catering and accommodation services sector (0,2 per cent). Following the recent shedding of private-sector jobs in the third quarter of 2012, the number of private-sector jobs was only about 25 000 more than in the corresponding period of 2011, representing a disappointing increase of only 0,4 per cent.

Work stoppages due to unprotected and often violent strike activity severely curtailed production activity in the mining sector in the third quarter of 2012. As a result, the mining sector lost around 19 000 jobs during the quarter, of which 18 300 were in the non-gold mining sector – the first decline in employment levels in the subsector to be registered since the third quarter of 2009. In the gold-mining sector employment levels have contracted unabatedly since the first quarter of 2010, representing a cumulative loss of around 18 200 employment opportunities up to the third quarter of 2012. Continued reports of further layoffs following the illegal strike activity and unprofitable operations due to increased cost pressures and the sustained relatively weak global demand for mining commodities do not augur well for job creation in the mining sector in the near term. This follows a protracted period during which employment levels in the mining sector continued to increase despite the declining volume of mining output – an outcome that is unlikely to be sustainable over the longer run, being reflected in an adverse trend in labour productivity.

Real output and employment in the mining sector



Source: Statistics South Africa

Despite modest growth in manufacturing output in the third quarter of 2012, the pace of labour paring accelerated from a seasonally adjusted and annualised rate of 1,3 per cent in the second quarter of 2012 to 1,6 per cent in the third quarter. On a year-on-year basis, the pace of job shedding in the manufacturing sector also accelerated marginally from 0,2 per cent in the second quarter of 2012 to 0,4 per cent in the third quarter. According to the Bureau for Economic Research Manufacturing Survey for the fourth quarter of 2012, manufacturers indicated a further disappointingly deterioration in employment numbers. In addition, the percentage of manufacturers rating the general political climate as a constraint to business activity rose sharply. Apart from relatively weak global demand for manufactured goods, sentiment in the manufacturing sector, particularly regarding employment, was dented further by the violent labour unrest that occurred in other sectors of the economy during the second half of 2012. Hence, the seasonally adjusted employment sub-index of the Kagiso Purchasing Managers' Index (PMI) fell steeply to 44,7 index points in December 2012, its lowest level since August 2011.

Supported by continued capacity-enhancing infrastructure investment, employment growth in the electricity-generation sector continued apace, at annualised rates of 6,8 per cent and 9,0 per cent in the second and third quarters of 2012 respectively. Conversely, employment in the finance, insurance, real-estate and business services sector declined at rates of 1,0 per cent and 1,4 per cent over the same two periods.

Employment opportunities in the trade, catering and accommodation services sector rose by around 26 000 in the first three quarters of 2012. However, in conjunction with the slowdown in output growth in the sector, the pace of increase in employment creation moderated in each successive quarter, from annualised rates of 4,7 per cent in the first quarter of 2012 to 1,5 per cent in the second quarter and further to 0,2 per cent in the third quarter. In addition, the FNB/BER Consumer Confidence Index declined by 2 index points to a level of -3 index points in the fourth quarter of 2012. The "economic outlook" and "the time to buy durable goods" subindices of the Consumer Confidence Index both declined in the fourth quarter of 2012. The pace of employment growth in the trade, catering and accommodation services sector could remain subdued, as continued consumer price inflation erodes the purchasing power of highly indebted households.

Following a fairly substantial increase in the second quarter of 2012, employment levels in the construction sector decreased at a rate of 2,1 per cent in the third quarter, resulting in the lowering of the employment level to only 500 more than in the same period in the preceding year. Disappointingly, the FNB/BER Civil Construction Confidence Index declined from a three-year high of 42 index points in the third quarter of 2012 to 36 index points in the fourth quarter, with respondents indicating that construction activity slowed somewhat and that the pace of job losses accelerated in the survey quarter. However, the FNB/BER Building Confidence Index increased somewhat in the fourth quarter of 2012, hinting at a continuation of the hesitant recovery in the building sector. Encouragingly, building contractors indicated that employment growth was currently at its highest level since the first quarter of 2008. After bottoming out for a period of roughly three years, the real value of total building plans passed increased somewhat from the middle of 2012, suggesting a moderate pickup in building activity in the months ahead.

Labour market statistics

	2011	2012			
	Dec	March	June	Sep	Dec
	(000's)	(000's)	(000's)	(000's)	(000's)
a. Total employment	13 497	13 422	13 447	13 645	13 577
b. Total unemployment (official definition)	4 244	4 526	4 470	4 667	4 501
c. Total economically active (= a + b)	17 741	17 948	17 916	18 313	18 078
d. Total not economically active	14 929	14 838	14 987	14 705	15 050
e. Total aged 15–64 years (= c + d)	32 670	32 786	32 903	33 018	33 128
f. Official unemployment rate (= b*100/c)	23,9%	25,2%	24,9%	25,5%	24,9%

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

According to the *Quarterly Labour Force Survey (QLFS)* conducted by Stats SA, there were approximately 13,6 million persons employed in South Africa in the fourth quarter of 2012, representing an increase of 80 000 people compared to the same period in 2011. Total employment decreased by 68 000 job opportunities from the third quarter of 2012 to the fourth quarter on a non-seasonally adjusted basis – the first fourth-quarter decline since the inception of the QLFS in 2008. Disappointingly, the number of unemployed persons increased by an estimated 257 000 in the year to the fourth quarter of 2012, partially explained by an expanding labour force and probably more people actively looking for a job as there was a decrease of 58 000 in the number of discouraged work-seekers over the same period. The official unemployment rate in the South African economy consequently rose from 23,9 per cent in the fourth quarter of 2011 to 24,9 per cent in the fourth quarter of 2012.

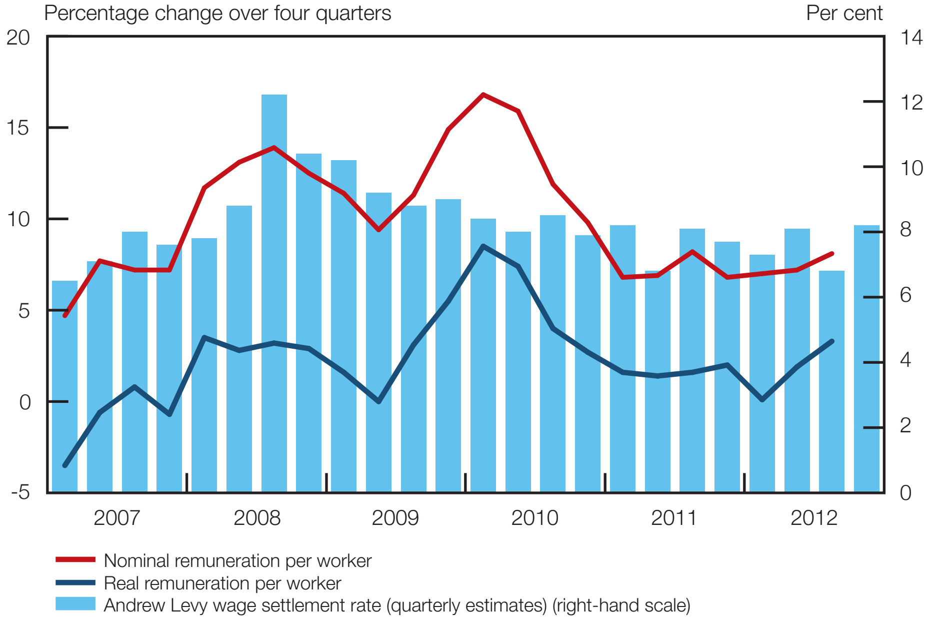
Labour cost and productivity

The year-on-year pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy accelerated to 8,1 per cent in the third quarter of 2012, after having remained fairly stable at around 7,0 per cent in the first half of the year. The acceleration in nominal wage growth occurred primarily in the public sector, where wage growth quickened from 6,0 per cent in the second quarter of 2012 to 8,7 per cent in the third quarter. By contrast, private-sector wage growth remained at around 7,5 per cent over the same period. 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 3,3 per cent in the year to the third quarter of 2012.

Despite the slight moderation in private-sector wage growth, year-on-year increases in nominal remuneration per worker remained above the inflation target range in all subsectors, with the exception of an increase of 4,8 per cent in the finance, insurance, real-estate and business services sector – the sector that employs the highest number of people. Remuneration per worker increased at the fastest pace in the construction sector (10,8 per cent), followed by the manufacturing sector (10,4 per cent); the non-gold mining sector (10,4 per cent); the private community, social and personal services sector (9,8 per cent); the electricity-generating sector (8,7 per cent); the gold-mining sector (8,1 per cent); and the trade, catering and accommodation services sector (7,4 per cent).

The acceleration in year-on-year nominal remuneration growth per worker in the public sector was most evident at provincial level (9,2 per cent); local governments (7,0 per cent); and the public transport, storage and communication sector (19,3 per cent). By contrast, the rate of increase in nominal remuneration per worker moderated to 5,3 per cent in the national departments and 6,3 per cent in the other public-sector enterprises in the third quarter of 2012.

Remuneration per worker and wage settlement rates



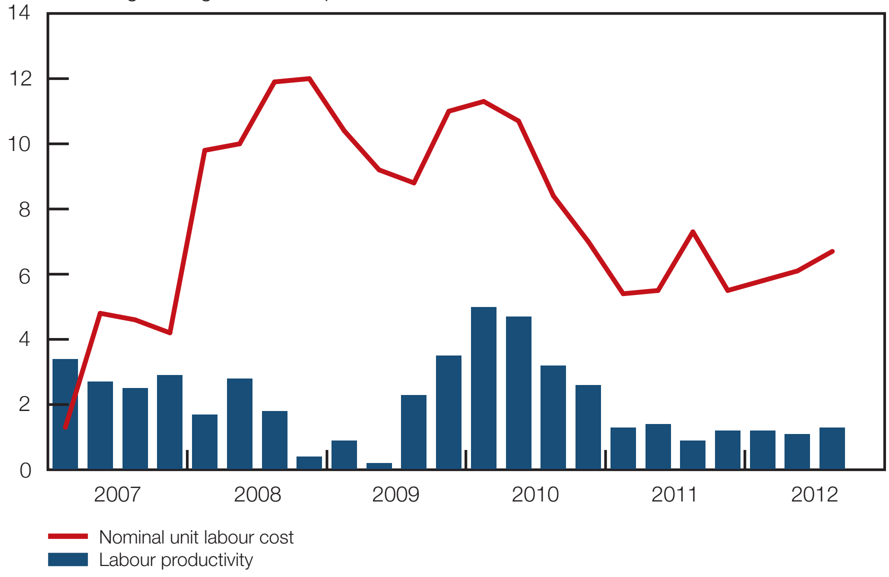
Sources: Statistics South Africa, Andrew Levy Employment Publications and South African Reserve Bank calculations

The average wage settlement rate in collective bargaining remained broadly unchanged at 7,7 per cent in 2011 and 7,6 per cent in 2012, according to Andrew Levy Employment Publications. Notwithstanding the slight decrease for the year as a whole, wage settlement rates picked up to around 8,2 per cent in the fourth quarter of 2012. Despite the fairly widespread and disruptive labour unrest that occurred during the second half of 2012, the number of working days lost due to strike action fell substantially to 3,5 million in 2012, compared with 6,2 million in 2011. A number of multi-year agreements were negotiated in 2010 and 2011, pushing up the number of working days lost due to strike action in those years and thus facilitating the decline in 2012. The major strike trigger remained wages, accounting for 96 per cent of working days lost and 78 per cent of the number of strikes in 2012.

Year-on-year growth in employment in the formal non-agricultural sector of the economy moderated at a slightly faster pace than that of output in the third quarter of 2012, resulting in labour productivity growth accelerating marginally from 1,1 per cent in the second quarter of 2012 to 1,3 per cent in the third quarter. Productivity growth in the manufacturing sector also accelerated somewhat in the third quarter of 2012, to a year-on-year rate of 2,9 per cent, as output increases picked up alongside a further decline in the level of employment.

Labour productivity and nominal unit labour cost

Percentage change over four quarters



Sources: Statistics South Africa and South African Reserve Bank calculations

The acceleration in remuneration growth in the formal non-agricultural sector of the economy, coupled with the moderation in output growth, resulted in year-on-year growth in nominal unit labour cost accelerating from 6,1 per cent in the second quarter of 2012 to 6,7 per cent in the third quarter. The year-on-year pace of increase in unit labour cost in the manufacturing sector also accelerated, from 6,6 per cent in the second quarter of 2012 to 7,3 per cent in the third quarter, as the acceleration in remuneration growth outpaced that in output growth. When assessing unit labour cost developments by applying 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 moderated somewhat to 5,5 per cent in the third quarter of 2012.

Prices

In contrast to the relatively benign inflation environment in most advanced economies, domestic headline consumer price inflation accelerated steadily from a recent low of 4,9 per cent in July 2012 to a twelve-month rate of 5,7 per cent in December, before moderating to 5,4 per cent in January 2013.[3] Although the quickening in consumer price inflation resulted primarily from higher food and fuel prices, price inflation also picked up in a number of other categories. Rising wage cost pressures and the depreciation in the exchange rate of the rand pose further upside risk to the domestic inflation outlook in the months ahead. Encouragingly, year-on-year producer price inflation for domestic output remained fairly benign, amounting to 5,2 per cent for three consecutive months up to December 2012. As a result, producer price inflation for domestic output moderated from an annual average of 8,4 per cent in 2011 to 6,2 per cent in 2012. Conversely, headline consumer price inflation accelerated somewhat from an annual average of 5,0 per cent in 2011 to 5,6 per cent in 2012.

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

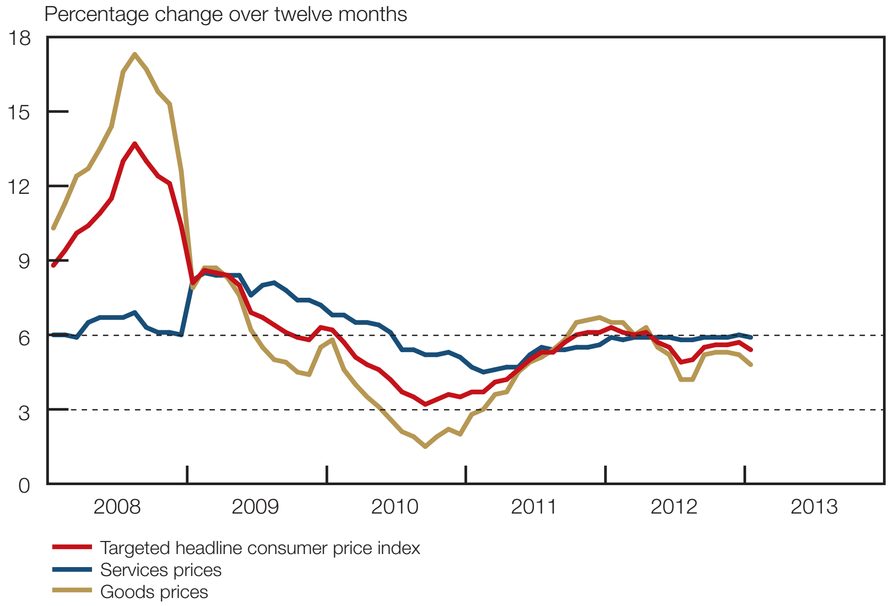
Producer price inflation moderated throughout most of 2012 to a recent low of 4,2 per cent in September, assisted by declining international commodity prices, before accelerating to a twelve-month rate of 5,2 per cent in October and remaining at that level up to December. Despite a depreciation in the exchange rate of the rand, price inflation moderated in most producer price categories throughout 2012, with the exception of producer food price inflation, which remained elevated. However, price inflation in mining and quarrying products accelerated from -0,1 per cent in September 2012 to 6,7 per cent in December, while that in petroleum and coal products picked up from 5,6 per cent in July 2012 to 8,8 per cent in December. These accelerations were counter-balanced by moderations in price inflation in basic metals, from

4 From January 2013 Stats SA applied a new methodology to calculate the producer price index.

-0,4 per cent in August 2012 to -7,3 per cent in December, and metal products, from 5,6 per cent in September 2012 to 4,4 per cent in December, keeping overall domestic producer price inflation stable in the closing months of 2012. Electricity price inflation decelerated notably throughout 2012, but nevertheless remained at double-digit rates, amounting to 12,1 per cent in December.[4]

Despite accelerating gradually to twelve-month rates of 5,7 per cent in December 2012 and 5,4 per cent in January 2013, headline consumer price inflation nevertheless remained within the inflation target range of 3 to 6 per cent for nine consecutive months. The acceleration in consumer price inflation in the second half of 2012 could largely be attributed to a quickening in price inflation of consumer goods; notably that of food and petrol. Rising unit labour cost following the recent spate of disruptive and protracted labour unrest in the mining sector and in the agricultural sector in the Western Cape Province, coupled with the lagged effect of the depreciation in the exchange rate of the rand could add to inflationary pressure in the months ahead. In February 2013 Stats SA released a reweighted and rebased headline consumer price index (CPI) for all urban areas, which was statistically linked to the previous headline CPI for all urban areas. The reweighting and rebasing of the CPI is discussed in more detail in the box on page 21.

Consumer price inflation



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

Consumer *goods* price inflation picked up pace from a twelve-month rate of 4,2 per cent in July 2012 to 5,3 per cent in November, before moderating to 4,8 per cent in January 2013. The acceleration in consumer goods price inflation resulted largely from an acceleration in price inflation in non-durable goods from 6,3 per cent in August 2012 to 7,6 per cent in December, and to a lesser extent semi-durable goods from 1,1 per cent in May 2012 to 3,3 per cent in October. Higher price inflation was recorded in a number of goods categories, notably the food and non-alcoholic beverages category which picked up from 4,9 per cent in August 2012 to 7,0 per cent in November; the transport category from 2,7 per cent in July 2012 to 5,2 per cent in September; the recreation and culture category from -3,4 per cent in May 2012 to 2,3 per cent in December; the housing and utilities category from 8,4 per cent in July 2012 to 9,1 per cent in December; the household contents, equipment and maintenance category from 0,2 per cent in August 2012 to 1,8 per cent in December; and the miscellaneous goods category from 1,0 per cent in May 2012 to 3,7 per cent in December. Non-durable and semi-durable goods price inflation registered annual average rates of 8,2 per cent and 2,0 per cent respectively, while durable goods prices actually *declined* at an annual average rate of 0,6 per cent in 2012. Within the consumer goods basket, the food and non-alcoholic beverages, the alcoholic beverages and tobacco, and the housing and utilities categories all registered annual average rates of increase in excess of the upper limit of the inflation target range of 6 per cent in 2012.

Box 1: The reweighted and rebased consumer price index

In line with international best practice, Statistics South Africa (Stats SA) periodically revises the weights and constituents of the consumer price index (CPI) basket, as well as the base period of the CPI. These interventions are necessitated by changes in the spending patterns of consumers over time, and to keep the reference period of the index appropriate and recent. The most recent revision of the CPI basket and weights by Stats SA was implemented in February 2013 and is applicable to the CPI time series from January 2013 onwards.

The primary data source used to determine the constituents of the CPI basket and their respective weights in the index is the Income and Expenditure Survey (IES). The IES is a comprehensive survey of household incomes and expenditures of which the latest was conducted from September 2010 to August 2011, and covered approximately 31 500 households. Stratified sampling was utilised to ensure a high level of representativity of the universe of South African households. The IES 2010/11 was conducted by applying a diary method combined with a recall questionnaire, and by utilising other household information. Households were required to record all their daily purchases in diaries provided by Stats SA for a period of two weeks. In addition, households were required to answer a variety of questions from a household questionnaire administered by a Stats SA official over a four-week period. These recall questionnaires captured purchases of durable and semi-durable items. Where under-counting was suspected, Stats SA augmented the IES results with available counterpart supply-side data, such as large sample surveys conducted in the retail and wholesale trade sectors, and data from industry associations and regulatory bodies.

The items in the new CPI basket will continue to be classified according to the Classification of Individual Consumption by Purpose (COICOP). The new basket of goods and services comprises 393 items, compared with 402 items in the previous basket. New items in the basket include mageu, filter coffee, mineral water, bricks, cement, doors, electrician and plumbing services, satellite dishes, and tablet computers. *Package holidays* is also included as a new item, being the only new item to be explicitly shown in the monthly Stats SA CPI statistical release due to its higher-order position in the COICOP classification system. Items now excluded from the CPI basket include samp, vienna sausages, varnish, toasters, music hi-fi centres, parking fees and swimming pool entrance fees due to the fact that they did not meet the selection criteria.

Comparison of weights for the new and previous CPI basket

COICOP categories	All urban areas		
	New CPI	Previous CPI	Difference
Food and non-alcoholic beverages	15,41	15,68	-0,27
Alcoholic beverages and tobacco	5,43	5,58	-0,15
Clothing and footwear	4,07	4,11	-0,04
Housing and utilities	24,52	22,56	+1,96
Household contents and services	4,79	5,86	-1,07
Health	1,46	1,47	-0,01
Transport	16,43	18,80	-2,37
Communication	2,63	3,22	-0,59
Recreation and culture	4,09	4,19	-0,10
Education	2,95	2,19	+0,76
Restaurants and hotels	3,50	2,78	+0,72
Miscellaneous goods and services	14,72	13,56	+1,16
Goods	49,86	54,20	-4,34
Services	50,14	45,80	+4,34
Total	100,00	100,00	0,00

Among the twelve main COICOP categories the housing and utilities, miscellaneous goods and services, education and restaurants and hotels categories registered the largest increases in weight. Conversely, the transport and the household content and services categories recorded the largest decreases in weight. At the more detailed level notable changes in weights included those for electricity (from 1,68 per cent in the previous basket to 4,13 per cent in the new basket), the purchase of motor vehicles (from 11,25 per cent to 5,98 per cent), petrol (from 3,93 per cent to 5,68 per cent) and insurance (from 7,71 per cent to 9,92 per cent).

To increase the relevance of the CPI weights, in line with international practice, Stats SA price-updated the new set of weights to the level of the CPI in December 2012 – known as the 'weights reference period'. The price-updating exercise was done to adjust the weights to account for differences in relative price movements of goods and services since the IES 2010/11 was conducted. This approach, however, does not account for behavioural changes of consumers due to those price changes.

Since changes in the CPI represent a weighted average of price changes, revisions to the weights of individual goods and services can have a significant effect on the level of and changes in the index. The introduction of a new set of CPI weights is therefore regarded as the introduction of a new CPI time series, in a technical sense. In order to obtain a continuous CPI time series it is necessary to link the previous set of indices to the new set of indices. Instead of rebasing the CPI to an average index level of 100 in a particular calendar year (previously 2008), Stats SA has now rebased the CPI to an index level of 100 in December 2012 – known as the 'price reference period'. Stats SA then linked the previous and new indices in December 2012, since the indices using the previous weights and those using the new weights all equal 100 in that month, as do all aggregations of the indices. The index levels for January 2013 were then calculated in the normal manner, that is, the sum of the lower-level indices multiplied by their weights. This method of rebasing and linking the CPI achieves the following important objectives:

– The historic rates of change in the CPI are retained
– There is a base period in which all indices equal 100 (namely December 2012)
– All monthly changes in the CPI from January 2013 reflect underlying price movements
– Additivity is maintained through all levels of aggregation.

In addition to the new set of weights, Stats SA also introduced a number of methodological changes to the compilation of the CPI, including:

– the replacement of one CPI basket per province by three CPI baskets per province, covering the province's primary urban areas (large towns or cities), its secondary urban areas (small towns) and rural areas in order to enhance the relevance of the CPI to purchasing patterns at the local level;
– the collection of food item prices in the rural areas, previously proxied by food prices in secondary areas;
– the inclusion of a 'seasonal fruit basket' in the CPI, the composition of which will change according to the changing of the seasons; and
– the introduction of quality adjustments to the prices of certain durable goods, such as vehicles, communication equipment and computers, by means of hedonic regressions, to account for quality changes impacting the effective value derived from the purchase of such goods.

Following the reweighting and rebasing of the CPI, the headline CPI for all urban areas will remain the inflation target measure for monetary policy purposes.

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Statistics South Africa. 2012. "Updating the Weights of the CPI". November. Pretoria: Statistics South Africa.

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Although consumer *services* price inflation remained very stable near the upper end of the inflation target range throughout 2012, it nonetheless accelerated marginally from 5,8 per cent in August 2012 to 6,0 per cent in December, before moderating to 5,9 per cent in January 2013. Within the consumer services basket, however, the prices of health, transport, education, as well as restaurant and hotel services increased at rates in excess of the upper limit of the inflation target range throughout 2012. By contrast, communication services prices declined at an annual average rate of 0,2 per cent in 2012.

Food price inflation

Higher food prices have been one of the main drivers of increased inflationary pressures during the past year. Producer food price inflation accelerated from a twelve-month rate of 6,3 per cent in May 2012 to 10,8 per cent in November, resulting in the annual average picking up from 5,3 per cent in 2011 to 8,5 per cent in 2012. This upward trajectory in producer food prices resulted from an acceleration in food price inflation at both the manufacturing and agricultural levels, to 11,1 per cent and 10,1 per cent respectively in November 2012. The pickup in producer food prices was initially led by a marked increase in the prices of grain and oil seeds, as the international prices of these commodities rose notably in response to adverse weather conditions in parts of the northern hemisphere. These price increases spilled over into a broader acceleration in producer food price inflation, exacerbated by the sustained depreciation in the exchange rate of the rand throughout 2012, and labour unrest in the road freight transportation sector and in the agricultural sector in the Western Cape Province. Encouragingly, largely due to improved international crop conditions, producer price inflation of grain subsequently slowed from 27,6 per cent in July 2012 to -2,9 per cent in December, assisting in the moderation of overall producer food price inflation to 8,4 per cent in December.

Producer and consumer food price inflation

Percentage change over twelve months

	Weights*	2011	2012	Jan 2013
Producer prices of agricultural food........................	3,89	4,3	6,4	-
Producer prices of manufactured food	5,87	5,9	9,7	-
Total producer food prices...................................	9,76	5,3	8,5	-
Consumer prices of unprocessed foods.................	7,42	7,1	7,1	5,9
Consumer prices of processed foods.....................	6,78	7,5	7,8	7,0
Total consumer food prices.................................	14,20	7,3	7,4	6,4

* CPI weights applicable from January 2013 onwards

Following the acceleration in producer food price inflation, consumer food price inflation quickened from 5,1 per cent in August 2012 to 7,5 per cent in November. The acceleration in consumer food price inflation resulted from a pickup in price inflation in unprocessed food from 3,9 per cent in August 2012 to 7,3 per cent in November, and in processed food from 6,0 per cent in September 2012 to 7,5 per cent in December. On an annual average basis, consumer food price inflation accelerated only marginally from 7,3 per cent in 2011 to 7,4 per cent in 2012.

Price increases of bread, cereals and meat responded quickly to the sharp rise in the producer prices of grain, peaking at rates of 8,4 per cent in October 2012 and 7,7 per cent in September 2012 respectively. However, consumer food price inflation subsequently became increasingly broad based, with price inflation in six of the nine components within the consumer food basket exceeding the upper limit of the inflation target range of 6 per cent in December 2012. On average, inflation in seven of the nine components exceeded the upper limit of the inflation target range in 2012, while only four of these components had increased at rates in excess of 6 per cent in 2011. Encouragingly, consumer food price inflation moderated to 6,4 per cent in January 2013, aided by a deceleration in meat price inflation in particular, but also in bread and cereals price inflation. In addition, international food prices decreased somewhat in recent months and prospects for the domestic maize crop currently being cultivated seem fair, which could assist in arresting the upward trend in consumer food price inflation.

Consumer food prices

Percentage change over twelve months

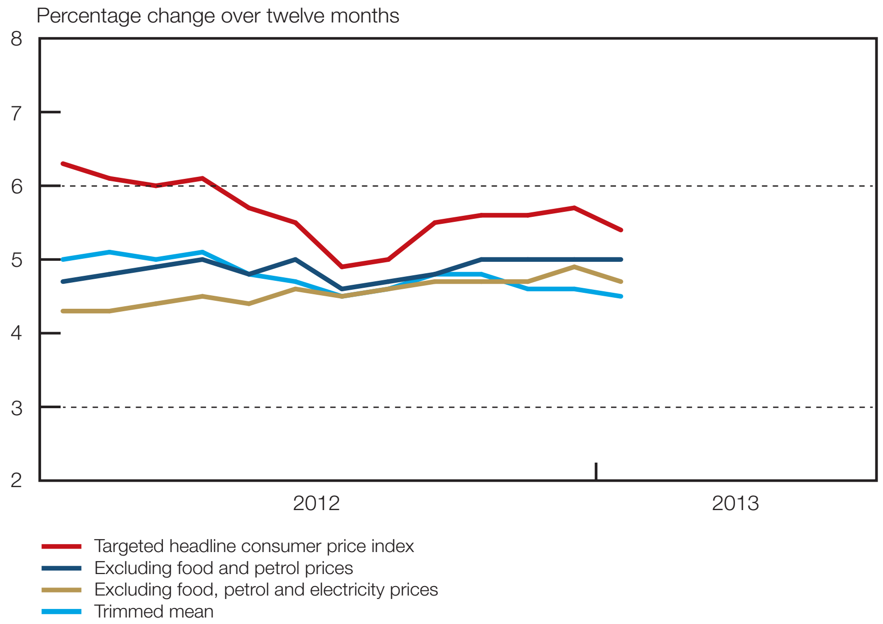
	Weights*	2011	2012	Jan 2013
Bread and cereals	3,55	6,9	8,4	7,1
Meat	4,56	10,9	7,6	3,2
Fish	0,37	2,8	8,9	7,0
Milk, cheese and eggs	1,74	0,7	7,9	9,9
Oils and fats	0,55	20,9	6,7	4,2
Fruit	0,23	6,0	4,6	0,3
Vegetables	1,61	4,1	4,2	12,3
Sugar, sweets and desserts	0,65	9,8	9,8	5,9
Other foods	0,94	5,5	7,7	8,8
All food items	14,20	7,3	7,4	6,4

* Weights applicable from January 2013 onwards

When the impact of the more volatile food, non-alcoholic beverages and petrol prices is omitted from the calculation of targeted headline consumer price inflation, underlying inflation accelerated from a twelve-month rate of 4,6 per cent in July 2012 to 5,0 per cent in October and remained at this rate up to January 2013. This measure of underlying inflation has remained fairly stable throughout 2012 but, nevertheless, picked up from an annual average rate of 3,9 per cent in 2011 to an annual average rate of 4,9 per cent in 2012. When also excluding the impact of electricity prices from the calculation, consumer price inflation accelerated gradually throughout 2012 and amounted to 4,9 per cent in December, before moderating to 4,7 per cent in January 2013. The annual average rate of change in this inflation measure for 2012 amounted to 4,6 per cent compared with 3,5 per cent in the previous year. In February 2013 Stats SA started releasing an additional measure of underlying inflation, namely the trimmed mean CPI. This measure of underlying inflation decelerated marginally from a twelve-month rate of 4,6 per cent in December 2012 to 4,5 per cent in January 2013. Despite accelerating somewhat in 2012, underlying inflation pressures remained fairly muted.

An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories confirms the view that underlying inflationary pressures remained reasonably restrained in the economy throughout 2012.

Underlying measures of consumer price inflation



The annual average rates of change in six of the twelve categories did not exceed the upper limit of the inflation target range in 2012, with three recording price increases which fluctuated between 3 to 6 per cent, and the other three registering rates of change below 3 per cent. The six categories that increased at rates in excess of 6 per cent in 2012, together accounting for 68 per cent of the consumer price basket, include food and non-alcoholic beverages; alcoholic beverages and tobacco; housing and utilities; transport; education; and restaurants and hotels. In January 2013, however, the twelve-month rates of change in only four of the twelve categories exceeded the upper limit of the inflation target range, while six categories recorded price increases within the inflation target range and two categories registered rates of change below the lower limit of the inflation target range.

Headline CPI inflation in COICOP categories

Percentage changes over twelve months

	Weights*	2011	2012	Jan 2013
Food and non-alcoholic beverages	15,41	7,1	7,2	6,2
Alcoholic beverages and tobacco	5,43	6,1	7,1	7,1
Clothing and footwear	4,07	2,3	3,6	3,2
Housing and utilities	24,52	6,6	6,2	6,0
Household content, maintenance and equipment	4,79	1,4	2,6	3,2
Health	1,46	5,8	5,3	5,5
Transport	16,43	4,9	6,1	5,1
Communication	2,63	-1,7	-0,8	0,0
Recreation and culture	4,09	-0,6	0,9	3,0
Education	2,95	8,7	8,9	8,9
Restaurants and hotels	3,50	4,9	6,1	7,3
Miscellaneous goods and services	14,72	4,1	5,4	4,9
All items headline CPI	100,00	5,0	5,6	5,4

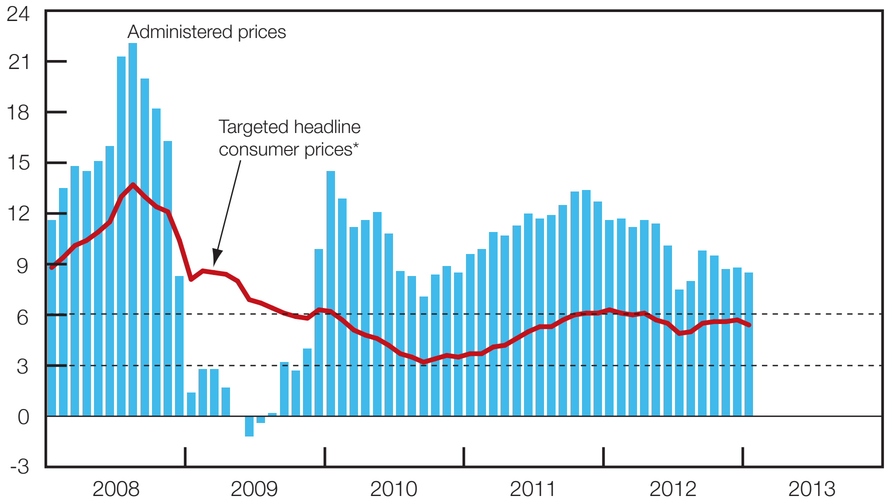
* Weights applicable from January 2013 onwards

Although administered price inflation continued to add upward pressure on domestic consumer price inflation, it nevertheless moderated somewhat from a twelve-month rate of 9,8 per cent in September 2012 to 8,5 per cent in January 2013. The recent moderation in administered price inflation occurred primarily as a result of a deceleration in petrol price inflation, from 17,6 per cent in September 2012 to a still-high 11,6 per cent in January 2013. Annual average administered price inflation remained in double digits, decelerating only marginally from 11,7 per cent in 2011 to 10,0 per cent in 2012, marking the third consecutive year that annual average administered price inflation has been above the upper limit of the inflation target range.

When excluding the effect of petrol prices from the calculation of administered prices, this rate of increase slowed from 8,9 per cent in April 2012 to 7,1 per cent in July, before quickening to 7,5 per cent in January 2013. When also excluding electricity prices from the above-mentioned calculation, administered price inflation accelerated from 6,1 per cent in February 2012 to 6,8 per cent in January 2013. The acceleration in this measure of administered price inflation resulted largely from a deceleration in electricity price inflation from 17,3 per cent in June 2012 to 10,0 per cent in January 2013. Despite Eskom's initial application for a 16 per cent increase in electricity prices in each of the five years starting in 2013, Nersa recently approved an 8 per cent increase per annum for this period, which should assist in moderating administered price inflation over this period.

Targeted inflation and administered prices

Percentage change over twelve months



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

Inflation expectations, as reflected by the Inflation Expectations Survey conducted by the BER in the fourth quarter of 2012, have increased marginally but, nevertheless, remained anchored around the upper limit of the inflation target range of 3 to 6 per cent. Inflation is expected to average 5,9 per cent in 2012, 6,1 per cent in 2013 and 6,2 per cent in 2014. The inflation expectations of financial analysts and business executives have risen over the full three-year forecast horizon since the previous quarter, while trade unions adjusted their expectations for 2013 and 2014 downwards. However, households raised their inflation expectations for the next twelve months by a significant 0,8 percentage points to 7,2 per cent – their highest expected rate in two years.

Headline consumer price inflation expectations

Per cent, as surveyed in the fourth quarter of 2012

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2012..	5,6	6,1	6,0	5,9
2013..	5,6	6,6	6,1	6,1
2014..	5,5	6,7	6,6	6,2

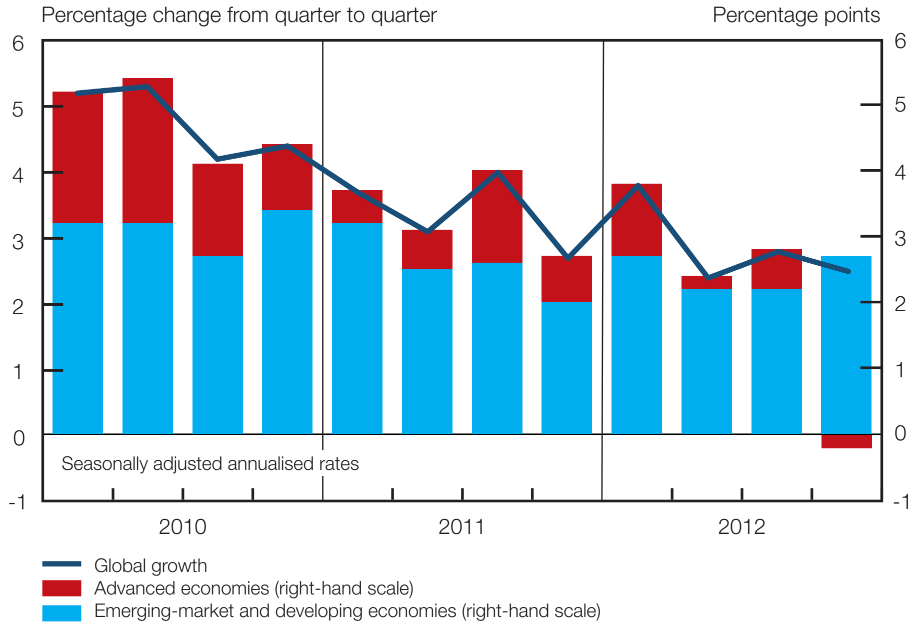
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

Global economic growth moderated slightly to an annualised rate of 2,5 per cent in the fourth quarter of 2012, after having accelerated somewhat in the third quarter. While real output in advanced economies contracted in the fourth quarter of 2012, economic growth in emerging-market and developing economies accelerated over the period, largely offsetting the negative contribution from the advanced economies.

Global growth and contributions to growth from advanced, and emerging-market and developing economies



Sources: National statistical offices, JPMorgan and staff calculations

The International Monetary Fund (IMF) in its January 2013 *World Economic Outlook Update* projected an acceleration in global economic growth in both 2013 and 2014 as factors constraining growth gradually dissipated. Global output was expected to increase by 3,5 per cent and 4,1 per cent in 2013 and 2014 respectively, from an estimated 3,2 per cent in 2012. Policy actions, specifically related to addressing the "fiscal cliff" in the US and the ongoing crisis in the euro area, have helped to ease negative tail risks to growth. Recent developments have reinforced the view that 2013 could see an improvement in market conditions.

The IMF expected economic growth in the sub-Saharan Africa region to pick up to 5,8 per cent in 2013 before moderating marginally to 5,7 per cent in 2014. Oil-exporting countries (such as Angola, Cameroon, Chad, Equatorial Guinea and Ghana) were projected to benefit from rising oil production, while new mining production in countries such as Niger and Sierra Leone would also be positive for growth. The region also seemed likely to benefit from continual strong capital investment from China.

Economic activity in advanced economies declined marginally in the final quarter of 2012 as a result of contractions registered in the United Kingdom (UK), the euro area and Japan. Real output in the US moderated significantly to 0,1 per cent in the fourth quarter of 2012 after having expanded by 3,1 per cent in the preceding quarter. Positive contributions from personal consumption, fixed investment and imports were offset by a marked contraction in government's military expenditure, with further negative contributions from inventory disinvestment and exports.

After contracting in the second and third quarter of 2012, real output in Japan continued to decline in the final quarter albeit at a slower pace of 0,4 per cent. Relations between Japan and China were strained by a dispute over sovereign rights to a number of small islands. The Japanese yen depreciated significantly in the fourth quarter of 2012, increasing speculation about possible currency wars between key currencies. However, a recovery in real growth during 2013 is anticipated, following significant increases in financial stimuli and their positive impacts on residential and infrastructural reconstruction and employment creation.

Real output in the euro area contracted at an annualised rate of 2,3 per cent in the fourth quarter of 2012. This marked the fifth consecutive quarterly decline in economic activity. Euro area growth is estimated to have bottomed out in the final quarter of 2012 with contractions in Germany and France and continued weakness in the periphery economies. Real output in Spain and Italy shrank further in the final quarter of 2012, complicating their path to fiscal sustainability. According to high-frequency data, economic growth may pick up in the region as a whole in 2013.

Real output in the UK contracted at an annualised rate of 1,0 per cent in the final quarter of 2012 following an increase of 3,9 per cent in the preceding quarter. Positive contributions from lower imports as well as increased government and consumer spending were, however, more than offset by negative contributions from declining exports and inventory disinvestment. The impetus provided to the services industries by the 2012 London Olympic Games also petered out. The Economic Sentiment Indicator moderated further in the final quarter of 2012, indicating subdued manufacturing sector production in the period ahead.

Economic growth in Asia accelerated in the fourth quarter of 2012, supported by rising exports and increased consumption expenditure in the region. Real output growth in China surpassed expectations, registering 9,4 per cent in the final quarter of 2012. An increase in retail sales and industrial production contributed to higher growth in the Chinese economy.

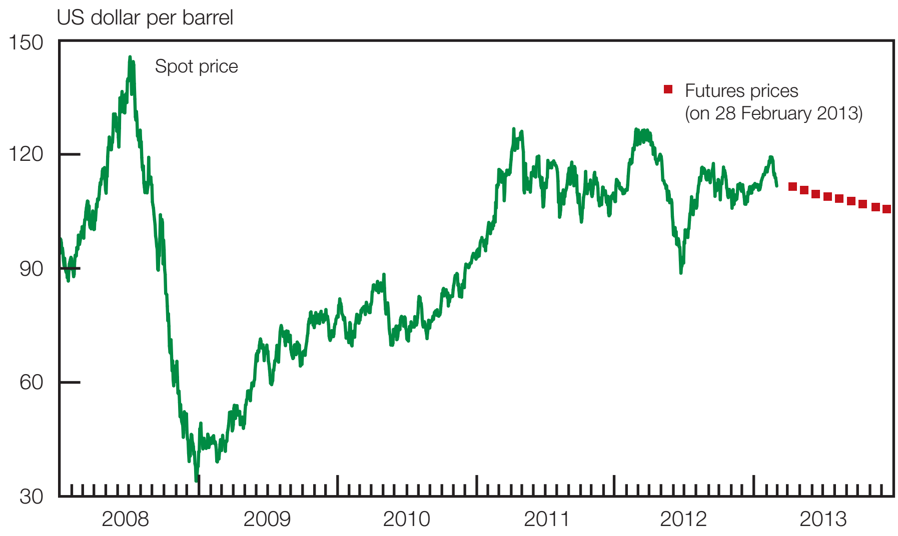
Economic activity in emerging Europe improved somewhat in the fourth quarter of 2012 but on average the pace of growth still remained fairly modest. Economic growth in Russia accelerated in the fourth quarter of 2012, while real output continued to contract in Hungary.

Real output growth in Latin America accelerated slightly in the fourth quarter of 2012. The improved economic performance was widespread among the largest economies in the region. Economic growth in Brazil, however, remained subdued compared with quarterly rates of increase recorded in 2009 and 2010. Consumer confidence levels in Brazil fell to their lowest level in eleven months in December 2012. In addition, the current-account deficit reached a ten-month high in November.

The volume of world trade expanded by 3,5 per cent on an annualised basis in the fourth quarter of 2012, after having increased by 0,6 per cent in the preceding quarter. The faster pace of increase was due to increased trade activity in emerging-market economies. Trade volumes contracted in the advanced economies during the fourth quarter. According to the CPB Netherlands Bureau for Economic Policy Analysis, growth in world trade volumes is expected to accelerate from 0,5 per cent in 2012 to 2,8 per cent in 2013.

Brent crude oil prices rose appreciably from below US$90 per barrel towards the end of June 2012 to around US$117 per barrel in mid-August. The increase in oil prices was mainly due to a European Union embargo on the purchases of Iranian crude oil that officially came into effect on 1 July 2012, and the threat to oil production posed by Hurricane Isaac in the Gulf of Mexico. Iran was also cut off from the international banking system and the decline of Iran's foreign-exchange reserves caused a collapse in the value of the country's currency in early October 2012. Brent crude oil prices thereafter remained volatile, trending lower to about US$107 per barrel in early December 2012 before edging higher to around US$118 per barrel in mid-February 2013. Rising oil prices primarily reflected seasonally stronger winter demand, geopolitical concerns about the deteriorating situation in the Middle East, signs that global economic growth was about to accelerate and lower oil production by the Organization of the Petroleum Exporting Countries (OPEC). Brent crude oil futures prices for delivery in the second quarter of 2013 traded at around US$111 per barrel in early March 2013.

International crude oil prices

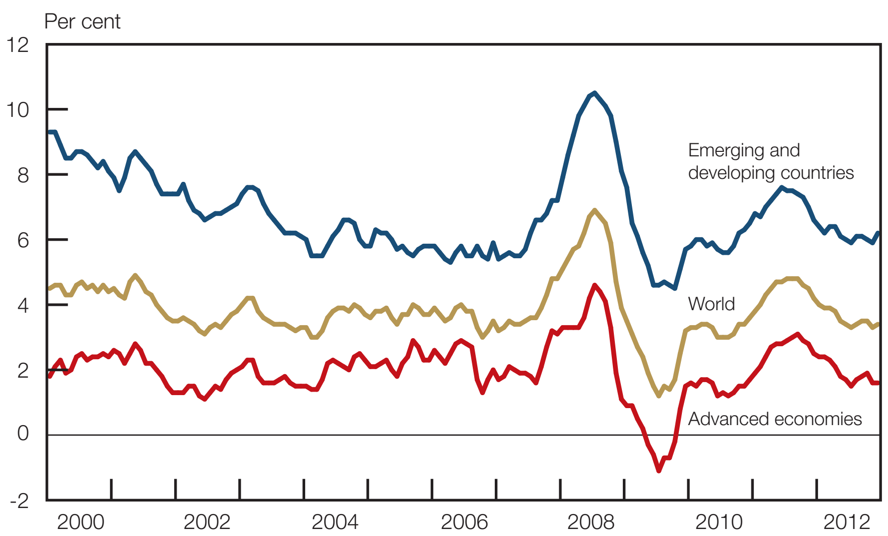


Source: Bloomberg

Global demand for crude oil has increased from 90,2 million barrels per day in the third quarter of 2012 to 91,0 million barrels per day in the fourth quarter. The demand for crude oil increased in countries such as China, Japan, India, Mexico, South Korea and Brazil, but decreased in Saudi Arabia, Canada, Russia and Iran over the period. Global oil supply increased from 90,7 million barrels per day in the third quarter of 2012 to 91,4 million barrels per day in the fourth quarter. The increase in oil supply during this period mainly reflected higher production by non-OPEC countries, while OPEC production has declined. The decline in OPEC production resulted from lower production in Saudi Arabia, Iran and Libya. Iran's oil production has declined by more than 27 per cent since the end of 2011 as sanctions became effective.

Global headline inflation moved sideways in the second half of 2012 registering 3,4 per cent in December 2012. Inflation in both advanced and emerging-market economies has trended downwards since peaking at 3,1 per cent and 7,6 per cent respectively around mid-2011. According to the January 2013 *World Economic Outlook Update*, the IMF projects inflation in advanced economies to moderate to 1,6 per cent and to remain unchanged at 6,1 per cent in emerging-market and developing countries in 2013.

Global consumer price developments



Source: IMF *International Financial Statistics*

Annual consumer price inflation in the US decelerated from 3,9 per cent in September 2011 to 1,4 per cent in mid-2012. Consumer price inflation subsequently accelerated to 2,2 per cent in October 2012 before moderating to 1,6 per cent in January 2013, which is below the Federal Open Market Committee's (FOMC) longer-run target of 2,0 per cent. Annual consumer price inflation in the euro area slowed from 2,6 per cent in September 2012 to 2,0 per cent in January 2013, mainly due to lower energy price inflation. Headline consumer price inflation in the UK moderated significantly from 5,2 per cent in September 2011 to 2,2 per cent in September 2012, before edging higher to 2,7 per cent in January 2013. Deflationary pressures diminished steadily in Japan, resulting in the rate of decline in general consumer prices to moderate from 0,4 per cent in October 2012 to 0,1 per cent in December.

In emerging Europe consumer price inflation moderated from 6,6 per cent in September 2012 to 6,0 per cent in January 2013. Consumer price inflation remained elevated in Russia and Turkey, mainly due to high food price inflation. Inflation in emerging Asia moderated from 6,8 per cent in September 2011 to 3,9 per cent in October 2012, before accelerating to 4,6 per cent in December 2012. The upward inflationary pressures in recent months could largely be attributed to inflation rising in China to 2,5 per cent in December 2012 and inflation in India accelerating to 10,6 per cent. Inflation in Latin America decelerated from 7,1 per cent in December 2011 to 6,0 per cent in December 2012. In Brazil and Argentina consumer price inflation has accelerated in recent months, while consumer price inflation decelerated in Mexico. Inflation as measured by the harmonised consumer price index for the Southern African Development Community (SADC) reached an average of 6,5 per cent in the final quarter of 2012, slightly higher than the 6,2 per cent recorded in the preceding quarter. Food price inflation moderated somewhat, but inflation was fuelled by the lagged effects of currency depreciations as well as higher energy and transportation costs.

The US Federal Reserve has kept the targeted federal funds rate unchanged since December 2008, and continued with its unorthodox policies to support growth and employment. At the December 2012 meeting, the FOMC provided further forward guidance by announcing a set of economic conditions rather than a likely timeframe that would trigger a review of its accommodative monetary policy stance. The target range for the federal funds rate of between 0 and 0,25 per cent would remain in place for at least as long as the unemployment rate remains above 6,5 per cent, inflation projected for one to two years ahead no more than half a percentage point above the committee's 2 per cent longer-run goal, and longer-term inflation expectations continued to be well anchored.

Successful policy actions in the past have allowed the European Central Bank (ECB) to leave policy rates unchanged during the fourth quarter of 2012 as financial conditions improved and inflation remained subdued. Important policy actions were taken by European policy-makers during the third quarter of 2012, including the introduction of outright monetary transactions (OMTs) by the ECB, which helped to stabilise financial markets and improve business and consumer sentiment. According to the OMT programme, the ECB will be able to purchase government bonds from struggling euro area countries to correct for fears of a euro area break-up being priced into the bonds.

In the final quarter of 2012, the Bank of Japan kept its key interest rate unchanged at between zero and 0,1 per cent. The bank, however, continued to extend its asset purchase programme and injected an additional ¥192 trillion into the economy. In January 2013, after a joint meeting between the Bank's Monetary Policy Committee and the government of Japan, an inflation target of 2 per cent was adopted and initiatives such as the price stability target and the open-ended asset purchasing programme were introduced. The unlimited programme will entail monthly increases of ¥13 trillion commencing from January 2014 with the aim of combating deflation and reviving economic growth.

The Bank of England maintained both the official Bank Rate at 0,50 per cent and the stock of asset purchases financed by the issuance of central bank reserves at £375 billion in the final quarter of 2012. The Canadian and New Zealand central banks have both kept their policy rates unchanged for more than two years. The Reserve Bank of Australia (RBA), however, reduced its policy rate in December 2012 by 25 basis points to 3,0 per cent to enhance sustainable growth in demand and realise inflation outcomes consistent with the target over time. The RBA has reduced its policy rate by a cumulative 175 basis points since late 2011.

During the fourth quarter of 2012, the monetary policy stance of most central banks in emerging Asia was to maintain interest rates at current levels. Further easing was associated with deflationary concerns at the expense of economic growth. The easing of inflationary pressures and subdued pace of economic growth in India allowed the central bank to reduce the repo rate and cash reserve requirement in January 2013 by 25 basis points to 7,75 per cent and 4,0 per cent respectively. Monetary policy changes in emerging Europe mostly favoured economic growth over inflation control in the final quarter of 2012. A number of countries in the region reduced their key policy rates on concerns of below-trend growth rates and persisting global economic instabilities. Hungary and Poland reduced their key policy rates by 125 basis points and 100 basis points respectively since the final quarter of 2012. Turkey, however, lowered its benchmark rate by only 25 basis points in December 2012. Most central banks in Latin America kept their policy rates unchanged during the fourth quarter. However, the central bank of Colombia reduced its policy rate by 25 basis points in November and December 2012 and again in January 2013, reducing its official rate to 4,0 per cent.

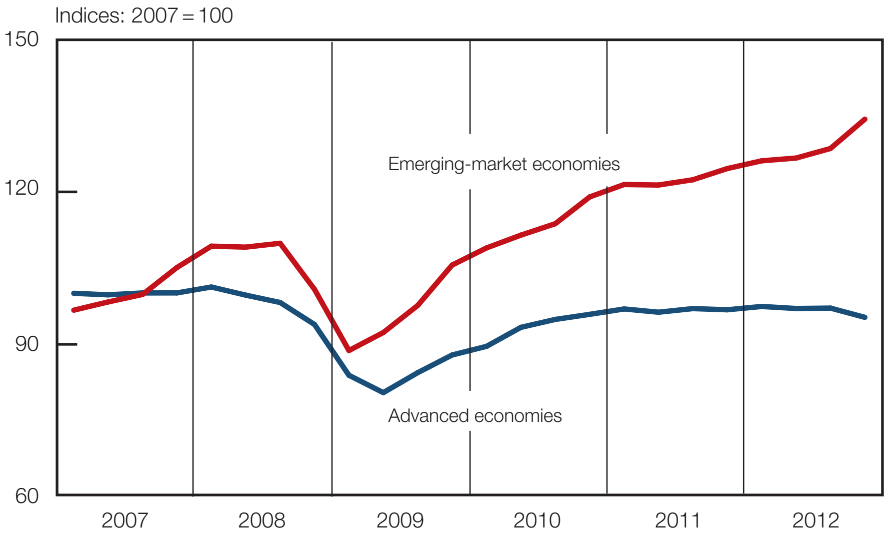
Several African economies kept their key policy rates unchanged in the final quarter of 2012. However, Malawi and Tanzania are currently experiencing double-digit inflation rates. Malawi responded by increasing its policy rate by 400 basis points to 25 per cent, while Tanzania raised reserve requirements to arrest high consumer inflation. Kenya, on the other hand, reduced its key rate by 150 basis points to 9,5 per cent in January 2013.

Current account[5]

Notwithstanding the uneven and fragile global economic recovery, growth in global trade volumes accelerated in the fourth quarter of 2012. An increase in import demand from several emerging-market economies caused South African mining exports to regain some momentum over the period, reflecting, *inter alia*, a meaningful run-down of domestic stockpiles in a somewhat more stable production environment. These developments were, however, almost fully offset by a further increase in the value of merchandise imports. As a result, the country's trade deficit narrowed marginally from R87,3 billion in the third quarter of 2012 to R86,1 billion in the fourth quarter.

5 Unless stated to the contrary, the current-account transaction flows referred to in this section are seasonally adjusted and annualised.

Volume of global merchandise imports



Source: CPB Netherlands Bureau for Economic Policy Analysis

The deficit on the services, income and current transfer account also narrowed in the final quarter of 2012 complementing the developments on the trade account, ultimately resulting in a slight narrowing of the deficit on the current account of the balance of payments. Relative to gross domestic product, the deficit on the current account shrank from 6,8 per cent in the third quarter of 2012 to 6,5 per cent in the fourth quarter. For 2012 as a whole, the deficit on the current account amounted to 6,3 per cent of gross domestic product compared with 3,4 per cent in 2011.

Balance of payments on current account

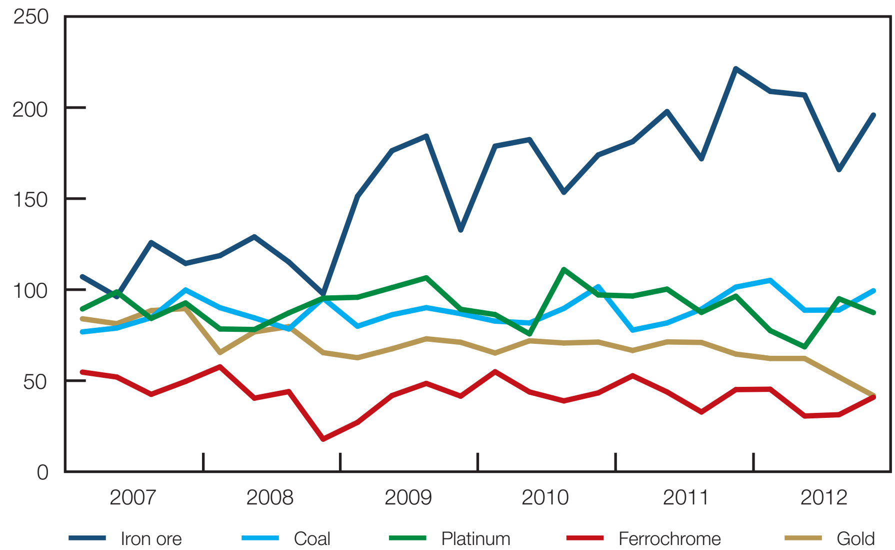
Seasonally adjusted and annualised
R billions

	2011	2012				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	671,2	694,6	686,1	689,1	715,0	696,2
Net gold exports	75,3	78,0	77,9	67,6	60,7	71,1
Merchandise imports	-730,1	-821,4	-843,9	-844,0	-861,8	-842,8
Trade balance	16,4	-48,8	-79,9	-87,3	-86,1	-75,5
Net service, income and current transfer payments	-115,2	-105,5	-128,6	-127,7	-126,5	-122,1
Balance on current account	-98,8	-154,3	-208,5	-215,0	-212,6	-197,6
As a percentage of gross domestic product	*-3,4*	*-5,0*	*-6,7*	*-6,8*	*-6,5*	*-6,3*

The volume of *merchandise exports* remained broadly unchanged in the fourth quarter of 2012 after advancing by 1,3 per cent in the third quarter, as an increase in the volume of mining and agricultural exports was countered by a decline in the volume of exported manufactured goods. Mining exports, more specifically base metals and articles of base metals and mineral products, bounced back in the final quarter of 2012 following the prolonged labour unrest that disrupted the production and distribution of mining products in the preceding quarter.

Export volumes of selected mining commodities

Indices: 2005 = 100



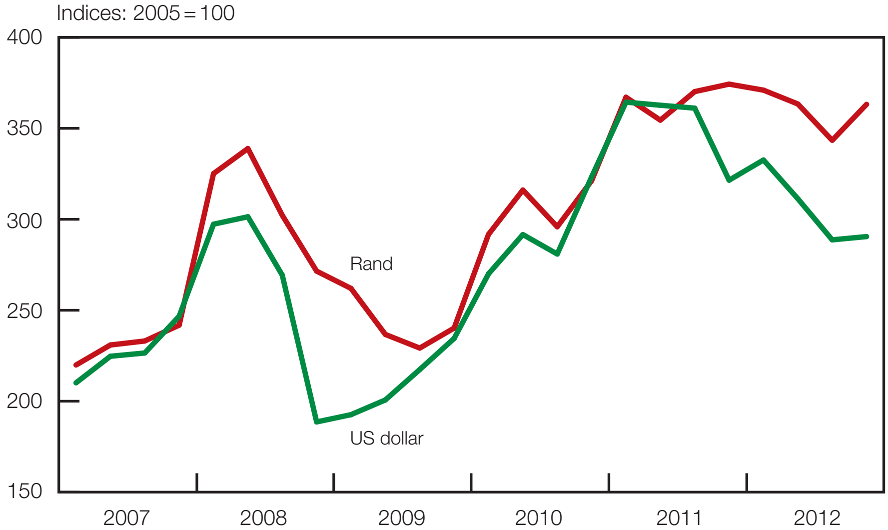
Seasonally adjusted

The volume of exported mineral products surged by 8,1 per cent in the fourth quarter of 2012, underpinned by an increase in the export of mainly iron ore and coal. The higher volume of iron ore exports buoyed by an increase in demand from China was met mainly by a reduction in stockpiles, allowing the country to become the third largest supplier of iron ore to China. Mineral exports also benefited from increased quantities of coal exported to northern hemisphere countries experiencing extremely cold winter temperatures. Hesitant growth in some of

South Africa's most important trading-partner countries in Europe, however, gave rise to a contraction in the export volume of vehicles and transport equipment as well as chemical products in the fourth quarter of 2012, reducing the overall volume of manufactured exports by 6,1 per cent over the period.

The value of merchandise exports benefited from higher international commodity prices. The international price of a basket of South African-produced non-gold export commodities advanced by 0,6 per cent in the fourth quarter of 2012, boosted by a modest improvement in global industrial demand. Pronounced increases were noted in the prices of commodities such as iron ore, nickel, copper and platinum. Owing to the depreciation in the external value of the rand, the country's export commodity price index rose in rand terms by a firm 5,8 per cent in the fourth quarter of 2012, having declined in the first three quarters of the year. Ultimately, the rand price of merchandise exports rose by 4,0 per cent in the final quarter of 2012, lifting overall export earnings by 3,8 per cent over the period. Despite the fairly fickle demand for South African products, the export earnings of domestic producers surged by 3,7 per cent from R671 billion in 2011 to R696 billion in 2012.

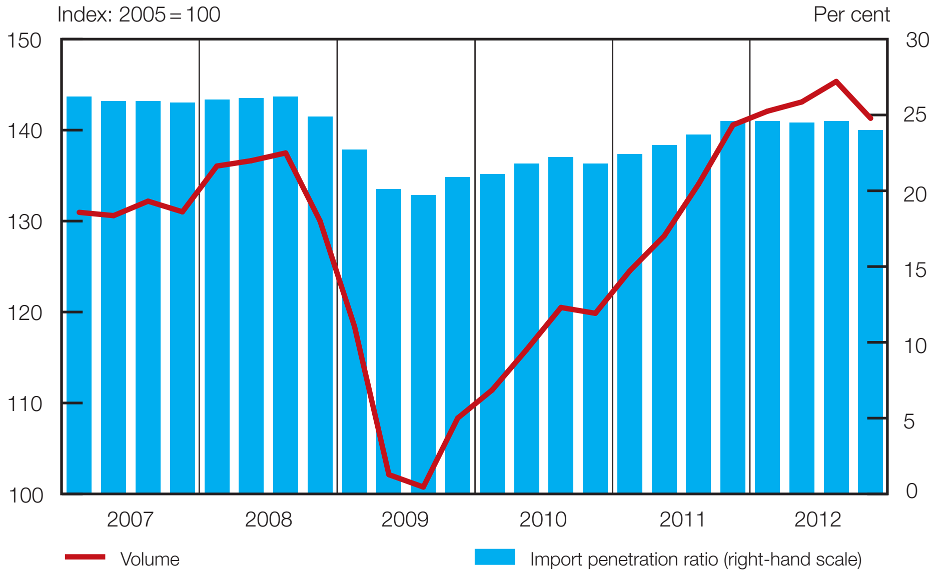
South African non-gold export commodity prices



A further decline in gold production, following prolonged industrial action in the mining sector, along with sluggish growth in the demand for jewellery from especially China and India, resulted in a notable contraction of 18,3 per cent in the volume of net gold exports in the fourth quarter of 2012. This followed in the wake of a similar contraction in the third quarter, when the volume of net *gold exports* declined by 16,4 per cent. The export earnings of South African gold producers were partly cushioned by a 9,9 per cent increase in the average realised rand price of net gold exports during the fourth quarter of 2012 as the effect of a somewhat higher dollar price of gold was amplified by a depreciation in the external value of the rand. The US dollar price of gold on the London market rose by 3,9 per cent to US$1 719 per fine ounce in the fourth quarter, while the rand price increased by 9,2 per cent over the period. The value of net gold exports accordingly fell by 10,2 per cent in the final quarter of 2012 following a decline of 13,2 per cent in the third quarter.

The volume of *merchandise imports* contracted by 2,8 per cent in the fourth quarter of 2012, having increased for seven consecutive quarters. The lower demand for foreign-produced goods corresponded with a moderation in growth in domestic final demand and was mainly evident in the categories for mining and manufactured goods. Lower quantities of crude oil imports were substituted by increased volumes of refined petroleum products in the fourth quarter of 2012. The demand for imported manufactured goods decreased over the same period, weighed down largely by a decline in the volume of imported vehicles and transport equipment. On balance, the country's import penetration ratio, which had been hovering at around 24,6 per cent in the first three quarters of 2012, dropped to 24 per cent in the fourth quarter. When measured on an annual basis, the share of domestic expenditure being met by imports was still a percentage point higher in 2012 than in 2011.

Real merchandise imports



Largely owing to the depreciation in the external value of the rand, the average rand price of merchandise imports increased by 5 per cent in the fourth quarter of 2012, more than neutralising the decline in import volumes. As a result, the value of merchandise imports rose by 2,1 per cent over the period.

The deficit on the *services, income and current transfer account* contracted marginally from the third to the fourth quarter of 2012 as higher net income payments to the rest of the world were offset by lower net payments for "other services" rendered by non-resident parties to South African entities. Net dividend payments to non-resident investors declined marginally in the fourth quarter of 2012 as gross dividend receipts from abroad decreased less than gross dividend payments to foreign investors. Net interest payments to the rest of the world, by contrast, increased further in the fourth quarter of 2012, primarily reflecting the steady upward trend in gross interest payments to foreign creditors and investors since the fourth quarter of 2011. Higher gross interest payments, despite the prevailing environment of low interest rates, are indicative of the country's rising foreign debt levels – on a full-year basis gross interest payments to the rest of the world rose from R22,4 billion in 2011 to R29,3 billion in 2012 or by 31 per cent. Lower net payments for "other services" rendered by foreign parties to domestic entities were fully neutralised by a decline in foreign travel receipts in the fourth quarter of 2012.

For the year 2012 as a whole the deficit on the services, income and current transfer account widened by 6 per cent. Expressed as a percentage of gross domestic product, the deficit remained at about 4 per cent in 2011 and 2012.

Owing to the generally faster pace of increase in the prices of merchandise imports and of services rendered by non-resident parties to South African residents, the country's terms of trade deteriorated somewhat in the fourth quarter of 2012. On an annual basis, the terms of trade was also less favourable when compared with 2011.

Financial account

Sentiment in global financial markets improved somewhat in the fourth quarter of 2012 despite the prevailing uncertainty around the US “fiscal cliff” and unresolved issues in the euro area. The net inward movement of foreign capital through the financial account of the balance of payments (including unrecorded transactions) amounted to R48,8 billion in the fourth quarter of 2012 compared with an inflow of R58,6 billion in the third quarter. An inflow of loan capital to the domestic banking sector made the largest contribution to the financing of the shortfall on the current account. Cumulatively, the net inflow of capital amounted to R206,2 billion in 2012, noticeably more than the net capital inflow of R131,3 billion in 2011. Both portfolio and other investment increased on a net basis in 2012, whereas direct investment decreased over the period.

Net financial transactions not related to reserves

R billions

	2011	2012				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	43,6	10,2	6,6	22,2	-1,4	37,6
Portfolio investment	45,9	32,0	22,7	27,5	12,5	94,7
Other investment	43,0	0,3	19,9	7,1	38,4	65,7
Change in assets						
Direct investment	1,8	-5,3	-4,1	-9,6	-16,8	-35,8
Portfolio investment	-62,2	-21,4	-4,7	-4,7	-9,2	-40,0
Other investment	-13,4	22,7	-16,8	19,3	15,1	40,3
Total financial transactions*	**131,3**	**50,8**	**48,0**	**58,6**	**48,8**	**206,2**
As a percentage of gross domestic product	*4,5*	*6,7*	*6,1*	*7,3*	*6,0*	*6,5*

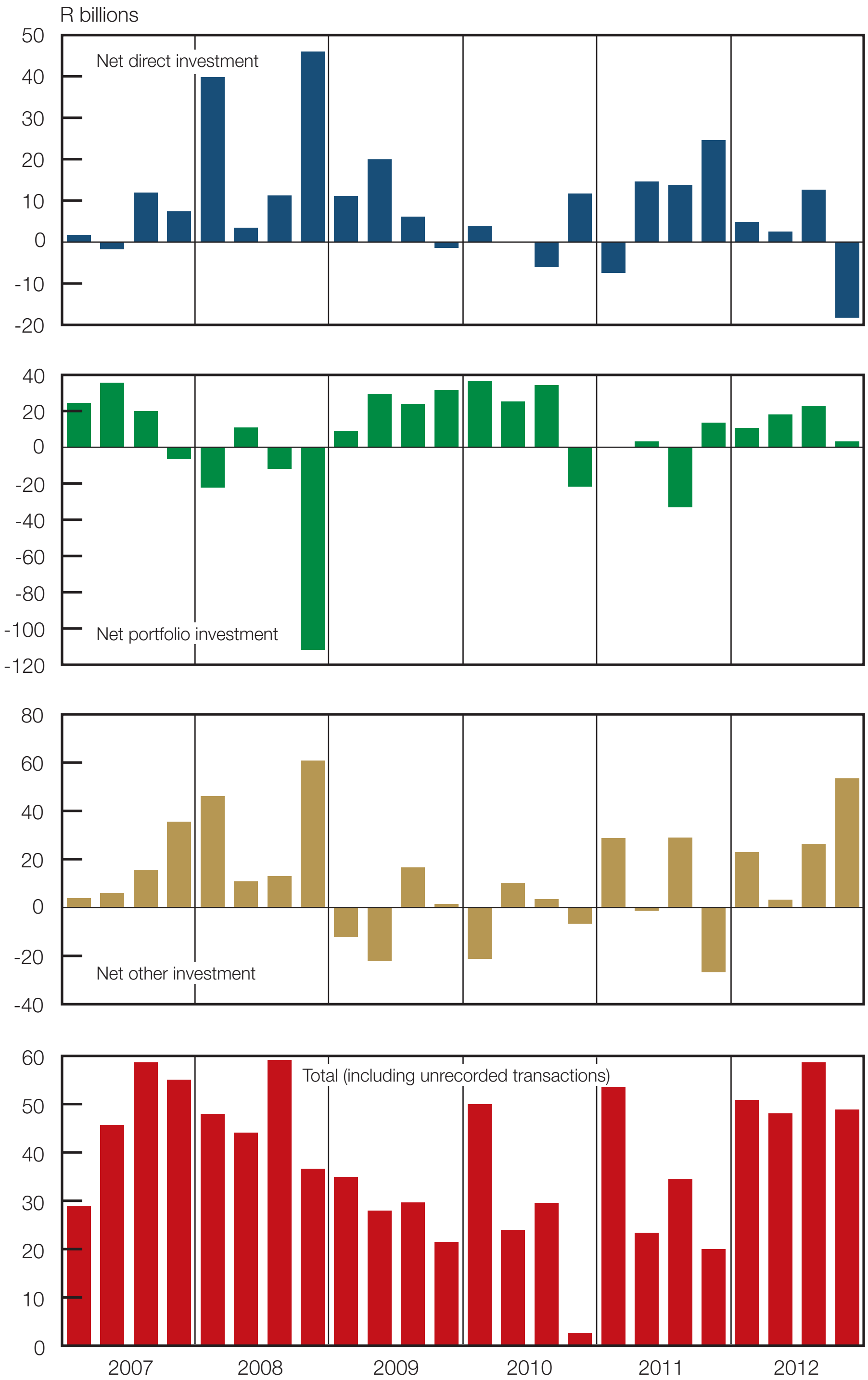
* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded an outflow of R1,4 billion in the fourth quarter of 2012 compared with an inflow of R22,2 billion in the third quarter. Capital outflows in the final quarter of 2012 were mainly related to the sale of a non-resident mining company’s equity holding in its South African subsidiary. Cumulatively, direct investment inflows amounted to R37,6 billion in 2012, marginally less than the inflow of R43,6 billion registered in 2011. According to the latest United Nations Conference on Trade and Development (UNCTAD) *Global Investment Trends Monitor,* global foreign direct investment flows declined by 18 per cent in 2012, mainly as a result of macroeconomic fragility and policy uncertainty. Foreign direct investment flows to emerging-market and developing economies declined by only 3 per cent in 2012, for the first time exceeding foreign direct investment flows to advanced economies.

Inward foreign portfolio investment declined from an inflow of R27,5 billion in the third quarter of 2012 to an inflow of R12,5 billion in the fourth quarter – the smallest quarterly inflow during 2012. Despite South Africa’s inclusion in the Citi World Government Bond Index, the acquisition of domestically issued bonds by non-resident investors contracted sharply in the fourth quarter of 2012; at the same time non-resident investors again became net purchasers of shares after having been net sellers in the third quarter. Foreign investors’ confidence in South Africa was negatively affected in the closing months of 2012 as labour unrest in the mining sector spilled over into the agricultural sector and as rating agencies announced sovereign rating downgrades of South Africa, while retaining South Africa in the investment grade category. The deterioration in investor sentiment towards South Africa was in contrast to the gradual improvement in the outlook for developed and emerging-market economies over the medium term. On balance, inward portfolio investment flows more than doubled in 2012 to R94,7 billion compared with an inflow of R45,9 billion recorded in 2011.

Balance of payments: Financial account



Other investment flows into South Africa registered a substantially larger inflow of R38,4 billion in the fourth quarter of 2012 compared with an inflow of R7,1 billion in the third quarter. The inward movement of capital in the final quarter of 2012 resulted mainly from an increase in short-term loans extended to the South African banking sector, augmented by an increase in non-resident deposits with the domestic banking sector. For 2012 as whole, other investment inflows amounted to R65,7 billion compared with an inflow of R43,0 billion in 2011.

South African-owned assets abroad

South African entities gradually regained their appetite for foreign direct investment assets during 2012. Outward direct investment showed an outflow of R16,8 billion in the fourth quarter of 2012 following an outflow of R9,6 billion in the third quarter. The outward movement of capital in the final quarter of 2012 was mainly related to the acquisition of dominant interests in offshore companies by South African mining, wholesale and healthcare companies. For 2012 as a whole, direct investment outflows amounted to R35,8 billion following an inflow of R1,8 billion in 2011.

South African institutional investors acquired foreign portfolio investment assets to the value of R9,2 billion in the fourth quarter of 2012, significantly more than the outflow of R4,7 billion registered in the third quarter. This larger outflow of capital can partly be explained by better prospects for global economic growth in 2013 along with the further diversification of investment portfolios amid the depreciation in the exchange value of the rand. On an annual basis, the acquisition of foreign portfolio assets amounted to R40 billion in 2012 compared with an outflow of R62,2 billion in 2011.

Other outward investment assets of South Africa declined by R15,1 billion in the fourth quarter of 2012 compared with an inflow of R19,3 billion in the third quarter. This capital inflow largely reflected a reduction in South African banks' deposits with, and loans extended to, foreign banks. For the year 2012 as a whole, capital inflows of R40,3 billion were recorded compared with an outflow of capital to the value of R13,4 billion in 2011.

External debt

South Africa's total outstanding external debt increased substantially from US$121,6 billion at the end of June 2012 to US$131,6 billion at the end of September – an increase of US$22,7 billion when compared with outstanding debt at the end of September 2011. Expressed as a ratio of South Africa's gross domestic product, the country's outstanding foreign debt rose from 30,7 per cent at the end of the second quarter of 2012 to 34,2 per cent at the end of the third quarter.

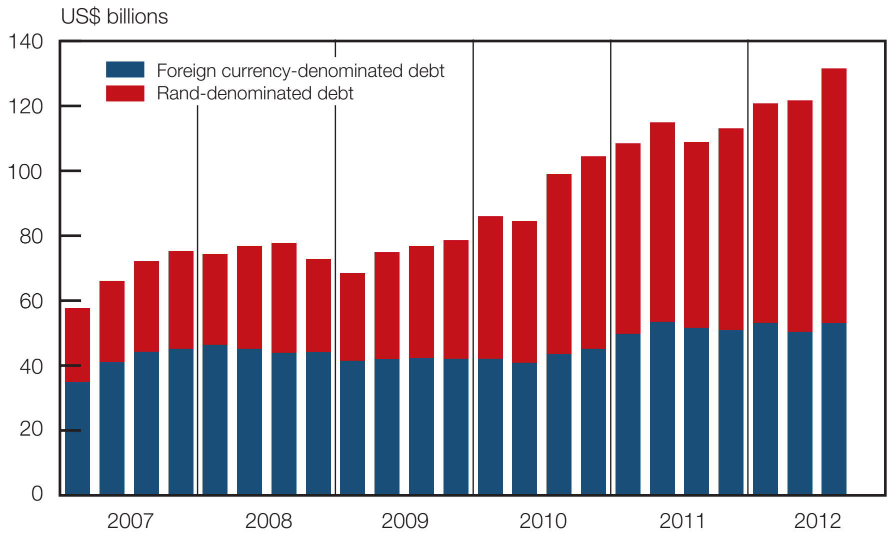
Foreign debt of South Africa

US$ billions at end of period

	2011		2012		
	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Foreign currency-denominated debt	**51,6**	**50,9**	**53,3**	**50,3**	**53,0**
Bonds	21,3	20,9	22,9	21,0	22,2
Other	30,3	30,0	30,4	29,3	30,8
Public sector	7,8	7,6	8,3	8,6	9,0
Monetary sector	10,0	9,9	11,0	9,3	9,5
Non-monetary private sector	12,5	12,5	11,1	11,4	12,3
Rand-denominated debt	**57,3**	**62,2**	**67,4**	**71,3**	**78,6**
Bonds	27,9	30,2	33,1	36,1	41,5
Other	29,4	32,0	34,3	35,2	37,1
Total foreign debt	**108,9**	**113,1**	**120,7**	**121,6**	**131,6**
As a percentage of gross domestic product	*26,5*	*28,1*	*30,2*	*30,7*	*34,2*
As a percentage of total export earnings	*89,0*	*91,9*	*98,2*	*101,3*	*112,6*

In US dollar terms, South Africa's rand-denominated debt increased markedly from US$71,3 billion at the end of June 2012 to US$78,6 billion at the end of September, mainly due to the acquisition of domestically issued marketable bonds by non-resident investors on the secondary market. Foreign direct investment companies also extended long-term loan finance to their South African direct investment subsidiaries during the third quarter of 2012. At the same time, foreign currency-denominated debt increased at a more subdued pace from US$50,3 billion to US$53,0 billion. The issuance of foreign currency-denominated international bonds by a public corporation and by the domestic banking sector more than neutralised the redemption of foreign-currency bonds by the banking sector over the period. Funding for infrastructure development also contributed to the rise in the foreign currency-denominated debt. In rand terms, total foreign debt increased from R1,011 trillion at the end of the second quarter of 2012 to R1,082 trillion at the end of the third quarter.

External debt



During January 2013 the rating agency Fitch reduced South Africa's sovereign credit rating from BBB-plus to BBB with a stable outlook. The rating agency cited rising social and political tension, the government's inability to implement reforms effectively, and the country's deteriorating economic growth performance and prospects as major reasons affecting public finances and exacerbating social and political tensions. Standard & Poor's (S&P) reduced South Africa's credit rating in October 2012 by one notch to BBB with a negative outlook, while Moody's had reduced the country's rating to Baa1 in September 2012.

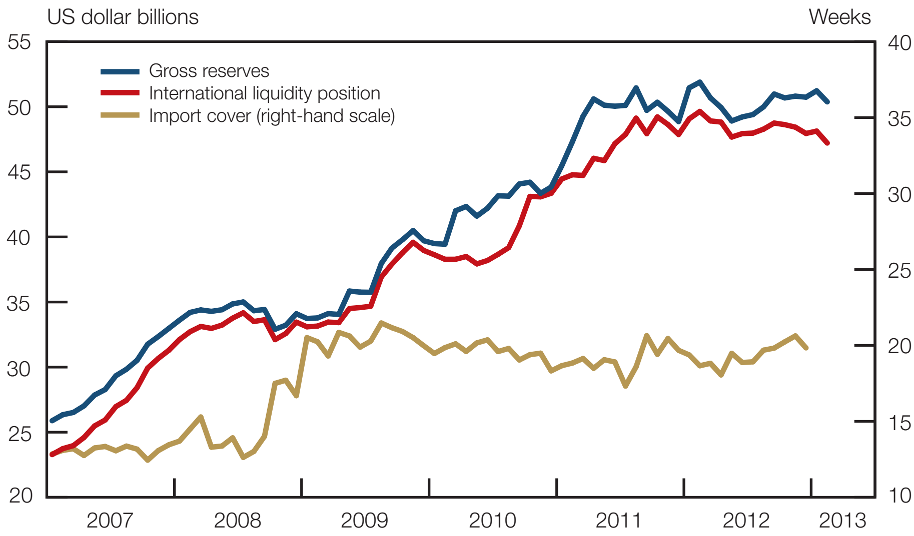
International reserves and liquidity

South Africa's overall balance-of-payments position increased by R0,3 billion in the fourth quarter of 2012 following an increase of R4,8 billion in the third quarter. The country's net international reserves advanced by R9,0 billion in 2012, following an increase of R32,7 billion in 2011.

Measured in US dollars, the value of South Africa's gross gold and other foreign reserves (i.e., the international reserves of the Bank before accounting for reserve-related liabilities) declined from US$51,0 billion at the end of September 2012 to US$50,7 billion at the end of December, before increasing to US$51,2 billion at the end of January 2013. On balance, the country's gross international reserves rose by US$5,0 billion and US$1,9 billion in 2011 and 2012, respectively. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) remained the same at 19,8 weeks at the end of December 2012 when compared to September.

The country's international liquidity position declined from US$48,7 billion at the end of September 2012 to US$47,9 billion at the end of December before increasing to US$48,1 billion at the end of January 2013. The international liquidity position rose, on balance, by only US$0,1 billion in 2012, following an increase of US$4,5 billion in 2011.

International reserves and import cover

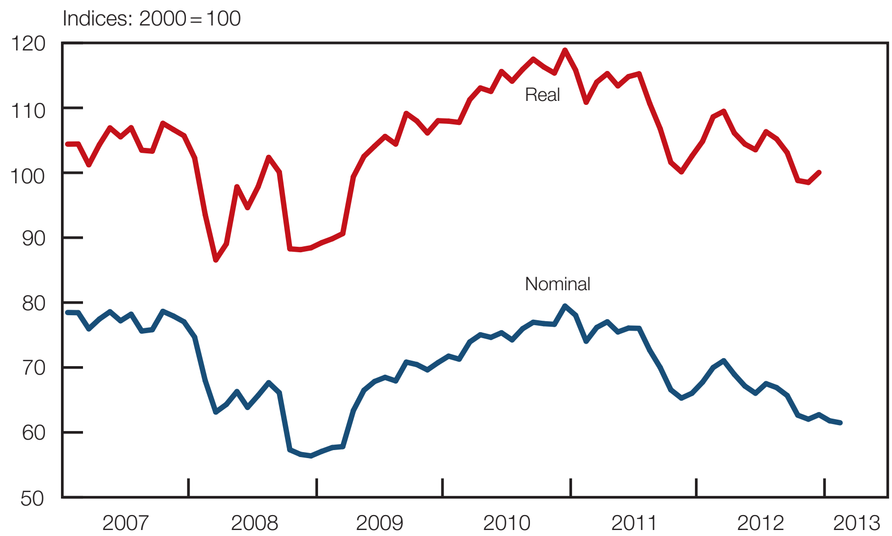


Exchange rates

The performance of the rand in the market for foreign exchange in the fourth quarter of 2012 was influenced by a combination of domestic and international developments. International investor sentiment continued to be adversely affected by domestic constraints, including the large deficit on current account and social unrest in the mining sector that spilled over to other sectors in October 2012. Further to the instability and ongoing political uncertainty in the domestic mining sector, investor capital appeared to have moved back from investment in perceived higher-risk currencies to Europe in view of the reduced threat of a collapse of the euro area. The nominal effective exchange rate of the rand declined, on balance, by 4,5 per cent and 1,4 per cent in October and November respectively, but increased by 3,2 per cent in December. Political uncertainty related to the mining sector, and to economic policy in general, was reduced significantly with the ruling political party's adoption of the National Development Plan and positions against nationalisation of mines at its conference held in December 2012.

Subsequent to the increase of 4,4 per cent in the nominal effective exchange rate of the rand in the first quarter of 2012, the weighted average exchange rate of the rand declined in all three remaining quarters of the year and recorded, on balance, an annual decline of 4,6 per cent in 2012 compared with a decline of 17,6 per cent in 2011.

Effective exchange rates of the rand



The exchange rate of the rand depreciated further in January 2013 and became the worst-performing emerging-market currency against the US dollar. The decline in the external value of the rand was largely attributable to the downgrading of South Africa's sovereign credit rating and the widening of the deficit on current account.

The real effective exchange rate of the rand declined by an estimated 2,4 per cent in the year to December 2012, marginally improving the external price competitiveness of South African exporters over the period. In November 2012 the real effective exchange value of the rand stood at its lowest level since March 2009.

Exchange rates of the rand

Percentage change

	31 Mar 2012 to 30 Jun 2012	30 Jun 2012 to 30 Sep 2012	30 Sep 2012 to 31 Dec 2012	31 Dec 2012 to 28 Feb 2013
Weighted average*	-4,8	-1,3	-2,8	-2,5
Euro	-1,9	-1,9	-5,0	-3,7
US dollar	-7,5	1,0	-3,1	-4,0
Chinese yuan	-6,7	-0,1	-3,9	-4,2
British pound	-5,3	-2,7	-2,7	2,1
Japanese yen	-10,5	-1,4	7,6	3,0

* Against a basket of 15 currencies

The average net daily turnover in the domestic market for foreign exchange decreased from US$20,1 billion in the third quarter of 2012 to US$18,7 billion in the fourth quarter, or by 6,9 per cent. This decline can be ascribed to a notable decrease in the activity of the monetary sector in the swap market, which receded from an average of US$2,6 billion per day to US$1,7 billion per day over the period.

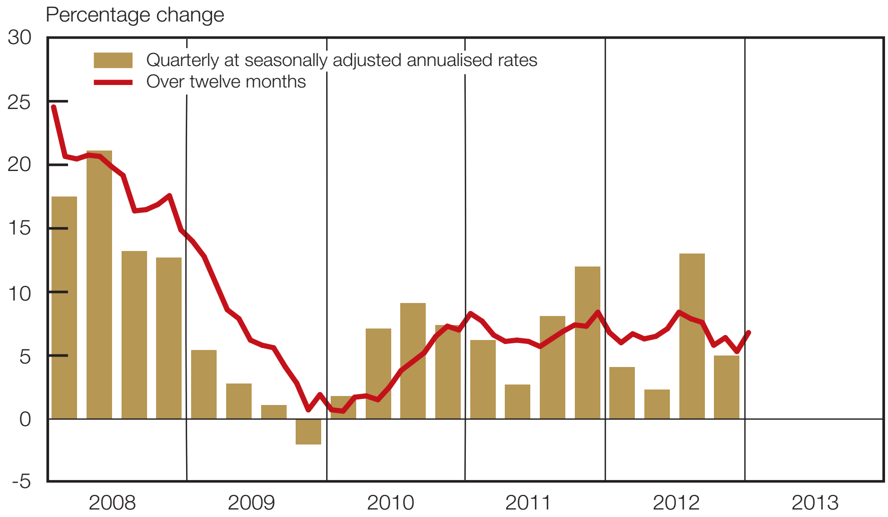
Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) continued at a moderate pace during the second half of 2012, consistent with sluggish underlying growth in real economic activity. After reaching a post-recession high of 8,3 per cent in July 2012, twelve-month growth in M3 decelerated to 5,2 per cent in December, the lowest rate of growth since September 2010. The strong growth in July was partly related to increases in the public's holdings of negotiable certificates of deposit and increases in collateral deposits with fund managers triggered by mark-to-market movements on derivative exposures following the reduction in short-term interest rates in July. Industrial action in various sectors of the economy, including the mining and agricultural sectors, dented business sentiment and constrained income growth for both households and companies, contributing to slower deposit growth in the final months of the year. In January 2013 twelve-month growth in M3 rose somewhat to 6,7 per cent. The slowdown in M3 growth was also notable in the quarter-to-quarter[6] growth rates, which fell from a high of 13,0 per cent in the third quarter to 4,9 per cent in the fourth quarter of 2012.

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

Growth in M3



Following the somewhat unanticipated reduction in interest rates in July 2012, and perhaps fuelled in part by a desire to hedge against the possibility of further monetary policy easing, depositors showed a preference for locking their deposit holdings into the potentially higher-yielding long-term deposits in the third and fourth quarters of 2012.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2012			
	1st qr	2nd qr	3rd qr	4th qr
Notes and coin	3,8	16,0	15,6	3,0
Cheque and transmission deposits	10,1	-1,8	16,7	24,2
Call and overnight deposits	3,7	-0,1	21,7	6,5
Other short- and medium-term deposits*	-1,2	7,1	0,9	-5,3
Long-term deposits**	-4,6	-1,3	25,7	19,0
M3	4,1	2,4	13,0	4,9

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

Growth in cheque and transmission deposits also increased noticeably during the fourth quarter of 2012, whereas growth in notes and coin in circulation was muted.

Overall, M3 increased by R116,6 billion in 2012, less than the increase of R172,4 billion recorded in the previous year, mostly on account of slower growth in corporate deposits. In the corporate sector, growth in the deposit holdings of financial and non-financial companies moderated during 2012. M3 deposit holdings of the household sector recorded robust twelve-month growth rates during 2012 and reached a high of 13,9 per cent in August, before slowing to 9,4 per cent in December and 10,3 per cent in January 2013. Growth in corporate sector deposits was more subdued and peaked at 6,7 per cent in July 2012, before receding to 3,6 per cent in December. In January 2013 growth in corporate sector deposits picked up to 5,4 per cent.

M3 holdings of households and companies

	Year-on-year change (R billions)			Percentage holdings of total M3 deposits		
	2010	2011	2012	2010	2011	2012
Households	13,7	59,5	58,5	27,1	27,7	28,8
Companies	121,1	112,9	58,1	72,9	72,3	71,2
Of which: Financial	110,2	40,4	28,4	44,1	42,5	41,6
Non-financial	10,9	72,5	29,7	28,8	29,8	29,6
Total M3 deposits	134,9	172,4	116,6	100,0	100,0	100,0

In a statistical sense, growth in M3 during the fourth quarter could be more than fully explained by an increase in claims on the private sector. By contrast, net foreign assets declined due to combined decreases in foreign currency loans and advances, along with loans granted under resale agreements to the foreign sector. Net claims on the government sector increased moderately in the fourth quarter when increased holdings of government securities by the banking sector exceeded the rise in government deposits.

Statistical counterparts of change in M3

R billions

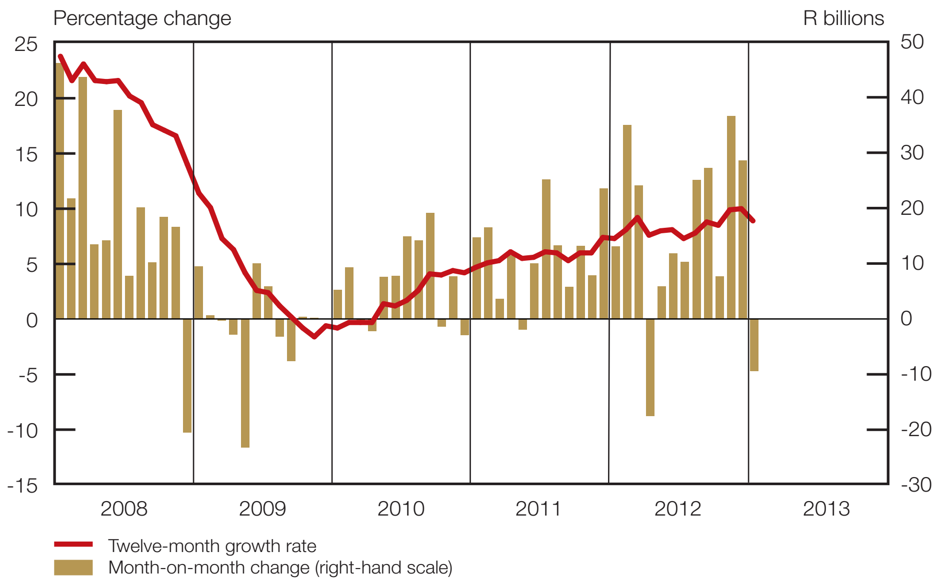
	2012				
	1st qr	2nd qr	3rd qr	4th qr	Year
Net foreign assets	-43,9	60,6	18,1	-35,5	-0,8
Net claims on the government sector	-4,8	-16,7	34,5	2,9	15,9
Claims on the private sector	73,5	12,0	74,4	63,7	223,6
Net other assets and liabilities	-56,9	-30,1	-33,5	-1,7	-122,2
Total change in M3	-32,0	25,7	93,5	29,4	116,6

The income velocity of circulation of M3 increased from 1,36 in the first quarter of 2011 to 1,39 in the second quarter of 2012 and slightly further to 1,40 in the fourth quarter. The relatively subdued changes in the income velocity during the past two years, by definition, show that growth in money supply generally kept pace with growth in nominal gross domestic product.

Credit extension

A fragile domestic private-sector investment climate – conflated with a constrained global economic outlook and a domestic economy marred by protracted periods of labour unrest – resulted in fairly subdued growth in credit extension during the first eight months of 2012. Signs of renewed vigour became evident from September 2012, largely reflecting a revival in the demand for credit by the corporate sector. In the first ten months of 2012, the year-on-year growth in banks' total loans and advances to the private sector averaged around 8 per cent. It accelerated to 9,9 per cent in November and 10,0 per cent in December, the latter being the first double-digit growth recorded since early 2009. Twelve-month growth in total loans and advances decelerated to 8,9 per cent in January 2013.

Total loans and advances to the private sector



The recovery in total loans and advances resulted in a quarterly growth rate of 13,1 per cent in the fourth quarter of 2012, up from lacklustre growth of 5,7 per cent and 7,3 per cent recorded in the third and second quarters of 2012 respectively. This marked the highest quarterly growth recorded since the third quarter of 2008 when growth amounted to 13,6 per cent.

Composition of total loans and advances by type of credit

Type of credit	Year-on-year change (R billions)			Percentage of total loans and advances*		
	2009	2011	2012	2009	2011	2012
Household sector						
Instalment sale credit and leasing finance....	-1,0	17,4	27,9	8,0	8,5	9,0
Mortgage advances....................................	26,8	9,2	23,0	39,0	36,8	34,5
Other loans and advances..........................	4,2	42,6	65,4	8,6	11,0	12,8
Overdrafts	*-1,9*	*0,8*	*3,7*	*1,4*	*1,3*	*1,3*
General loans	*9,0*	*37,4*	*43,3*	*4,4*	*6,9*	*8,2*
Credit card advances	*-3,0*	*4,5*	*18,4*	*2,8*	*2,8*	*3,4*
Total loans and advances to the household sector..	30,0	69,3	116,3	55,5	56,4	56,3
Corporate sector						
Instalment sale credit and leasing finance......	-14,1	-0,4	5,1	4,7	3,9	3,8
Mortgage advances....................................	8,2	17,0	-2,6	14,9	14,4	13,0
Other loans and advances..........................	-34,4	58,1	88,8	24,9	25,3	26,9
Overdrafts	*-7,8*	*9,9*	*0,5*	*5,4*	*5,2*	*4,7*
General loans	*-28,0*	*47,2*	*87,4*	*19,3*	*20,0*	*22,0*
Credit cards advances	*1,4*	*1,0*	*0,9*	*0,2*	*0,1*	*0,2*
Total loans and advances to the corporate sector..	-40,4	74,7	91,3	44,5	43,6	43,7
Total loans and advances to the private sector	**-10,4**	**144,0**	**207,6**	**100,0**	**100,0**	**100,0**

* Expressed as a percentage of outstanding balance of total loans and advances (excluding investments and bills discounted)

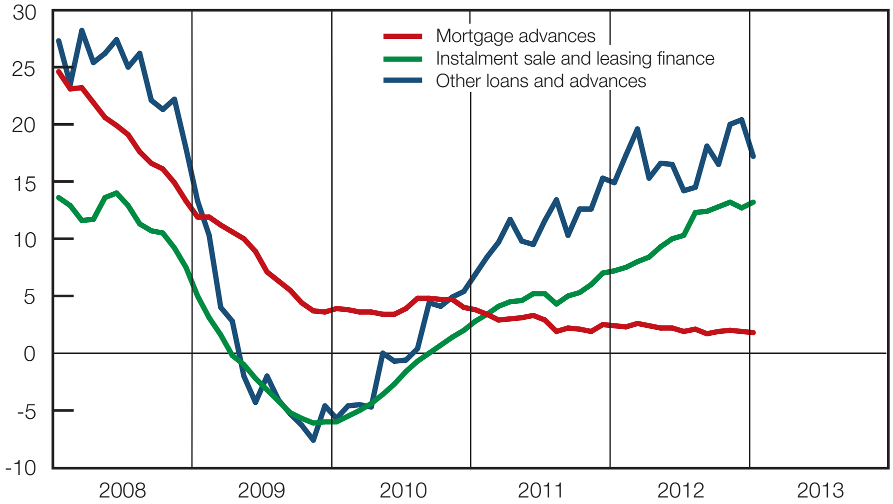
For 2012 as a whole, growth in credit extended to the household sector outperformed that to the corporate sector, with R116,3 billion being extended to the household sector out of the R207,6 billion increase in total loans and advances. In value terms this resulted from a higher take-up of credit across nearly all credit categories to the household sector.

A breakdown of the various credit categories shows a structural change in the composition of credit since the 2008–09 recession. *Mortgage advances* became less attractive for banks because of the higher risk of default and high levels of non-performing loans; increased regulatory capital requirements; low margins for banks on long-term mortgage loans; and an overhang of housing inventory. A lacklustre property market, strict affordability criteria and large deposit requirements for aspirant home buyers further dampened demand for mortgage advances.

The shorter maturities and better scope in pricing unsecured loans, among other considerations, contributed to banks progressively promoting general loans to households. Companies also increasingly opted for general loans and, as a result, the category *other loans and advances* (inclusive of general loans, credit card advances and overdrafts) became the main driver behind the overall increase in total loans and advances throughout 2011 and 2012. Whereas other loans and advances constituted 33,5 per cent of total loans and advances in 2009, the category's share rose to 39,7 per cent in 2012. By contrast, the contribution of mortgage advances to overall growth in total loans and advances waned from 2009 onwards and, as a consequence, its share of the outstanding balance of total loans and advances shrank from 53,9 per cent in 2009 to 47,5 per cent in 2012.

Credit extension to the private sector by type

Percentage change over twelve months

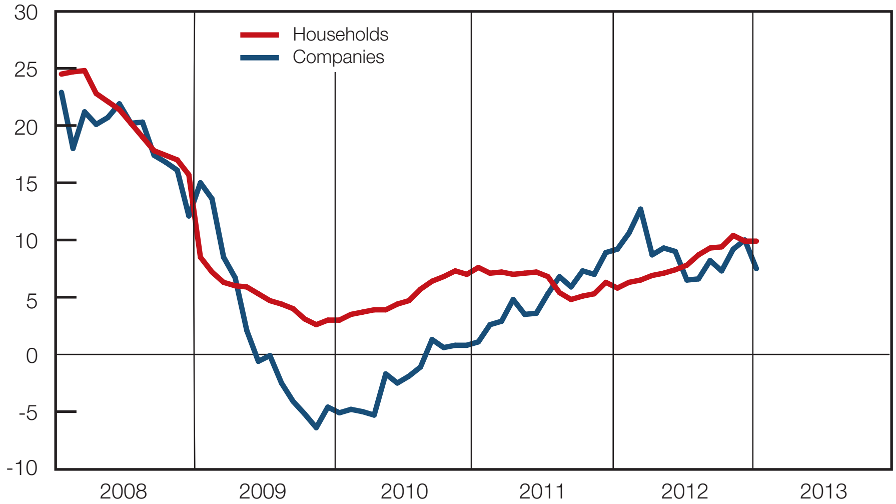


In the category of other loans and advances, twelve-month growth in *general loans* returned to pre-recession levels at 23,3 per cent in December 2012, from 19,3 per cent in October. In January 2013 growth amounted to 19,6 per cent. Twelve-month growth in *credit card advances* extended its upward trajectory during 2012 from 11,1 per cent in January to 16,1 per cent in October. In November credit card advances recorded an exceptional monthly increase when a bank acquired the store card book of a retail company. As a result, twelve-month growth in credit card advances almost doubled from November 2012 and amounted to 31,3 per cent in December and 30,9 per cent in January 2013. Excluding this transaction, growth in credit card advances would have amounted to 16,7 per cent in January 2013. Growth in overdrafts displayed an uneven trend in 2012 and receded sharply from a high of 24,5 per cent in March 2012 to 1,2 per cent in January 2013.

Instalment sale credit and leasing finance, mostly taken up by the household sector, continued to support the demand for credit in 2012, reflecting the continued favourable demand for motor vehicles and other durable goods in the current lower interest rate environment.

Total loans and advances extended to households and companies

Percentage change over twelve months



Credit extension to the household sector continued its rising trend from a twelve-month growth rate of 5,8 per cent in January 2012 to a high of 10,4 per cent in November with some moderation to 9,9 per cent in January 2013. The steady expansion in the household sector's usage of bank loans and advances in 2012 could mainly be attributed to a high demand for general loans. While growth in unsecured lending remains high, there has been a moderation in recent months, partly reflecting the diminishing borrowing capacity of some households that had already borrowed heavily and partly demonstrating less aggressive marketing and greater caution in the banks' management of their exposure to this market segment.

The recovery in corporate borrowing during 2012 mainly stemmed from a high demand for general loans. This was in part a reflection of project loans; for instance, the development of South Africa's renewable energy capacity has drawn support from local banks, some of whom have made a significant commitment towards supporting the renewable energy sector through enabling major projects in this sector.

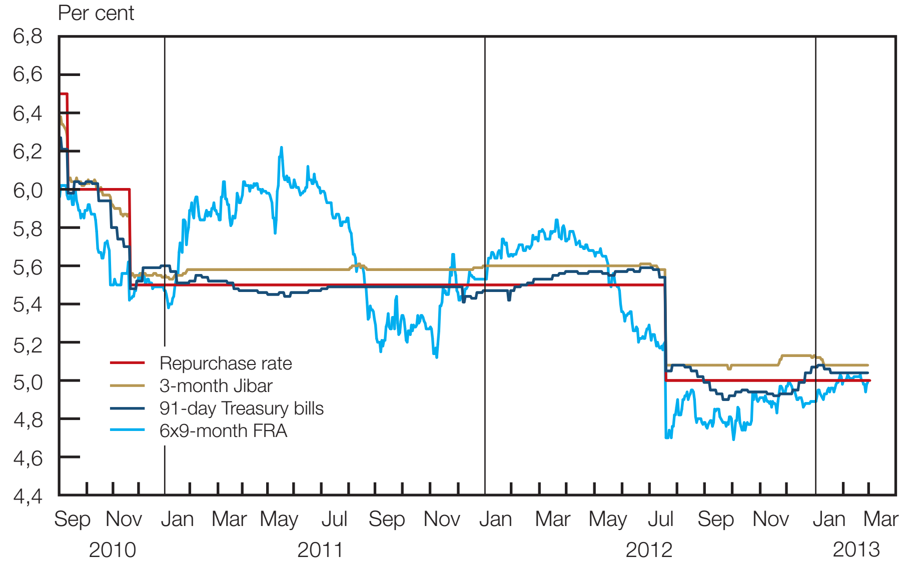
Interest rates and yields

Having reduced the repurchase rate from 5,5 per cent to 5,0 per cent in July 2012, the Monetary Policy Committee (MPC) kept the repurchase rate unchanged at its subsequent three meetings, balancing the need to support economic activity with that of containing future inflation. In its January 2013 statement the MPC assessed the balance of risks to growth to be on the downside, while the balance of risks to the inflation outlook was assessed to be on the side of overshooting. The negative output gap was expected to persist, given the uncertain outlook for the mining industry and ongoing unsettled labour relations which posed downside risks to economic growth. The depreciation of the exchange value of the rand and rising unit labour costs remained the key upside risk factors to the inflation outlook, while the likely impact of the reweighting and rebasing of the CPI were expected to be marginal, but on the upside. Although the inflation outlook for 2013 was revised higher, inflation was expected to remain within the target range over the forecast period. The MPC statement discussing developments underlying recent monetary policy decisions are reproduced in full from page 72 of this *Quarterly Bulletin*.

Consistent with the unchanged monetary policy stance, short-term money-market rates remained fairly stable during the fourth quarter of 2012 and early part of 2013. The three-month Johannesburg Interbank Agreed Rate (Jibar) initially remained anchored at 5,08 per cent from mid-July to mid-November 2012, but then inched higher to reach 5,13 per cent on 26 November. The Jibar rate remained at this level through the end of the year before again retreating to 5,08 per cent in January and February 2013. Similarly, the tender rate on 91-day Treasury bills fluctuated in a narrow band between 4,92 and 4,95 per cent during October and

November 2012, but subsequently inched higher to reach 5,08 per cent on 4 January 2013 amid low market activity during the festive season. The Treasury bill rate softened marginally when normal market activity resumed and stood at 5,04 per cent at the end of February 2013.

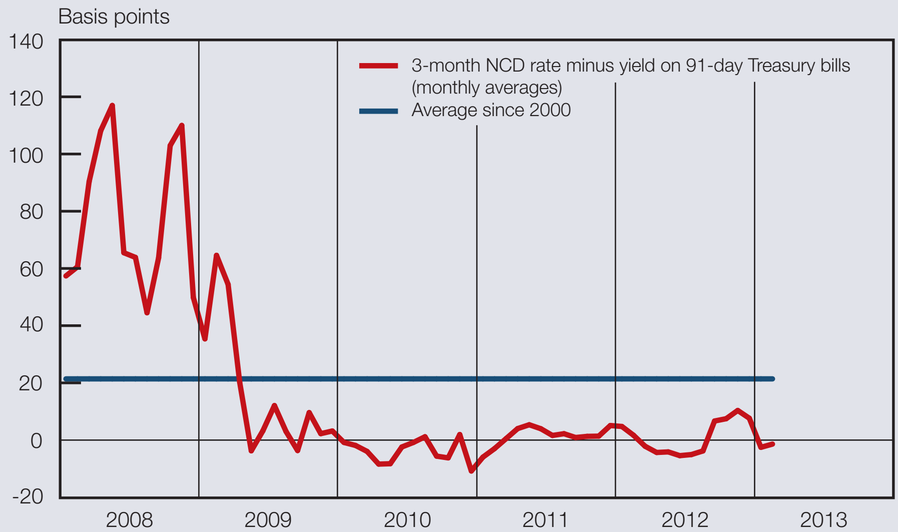
Money-market rates



Box 2: Money market: Liquidity and credit risk spread

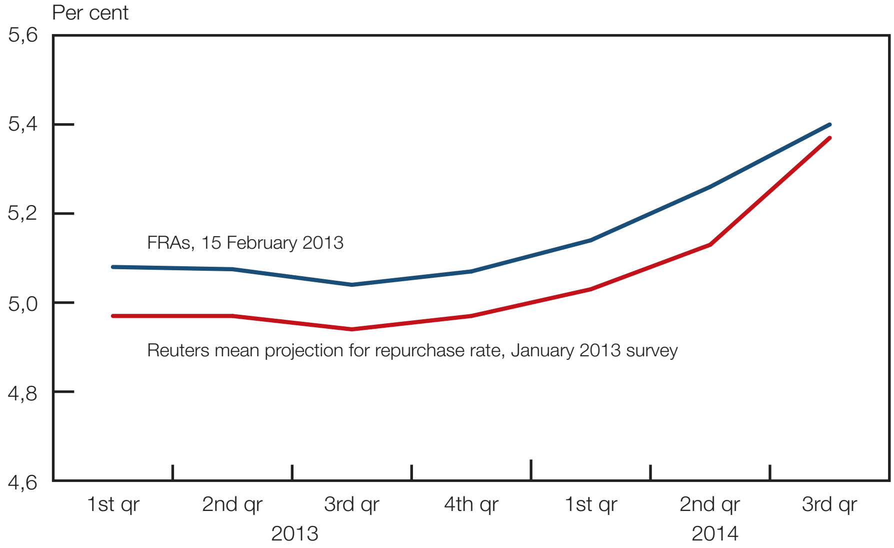
The interest rate differential between the rate on three-month negotiable certificates of deposit (NCDs) and the yield on 91-day Treasury bills is an indicator of perceived liquidity and credit risk in the banking sector. NCDs, which can be likened to term deposits that are fully negotiable before the date of maturity, tend to be held by financial intermediaries such as money-market funds, pension funds and insurance companies. The current low spread indicates that the market is liquid with no undue risk being perceived. A rising spread, as observed during the intensification of the global financial crisis in 2008, is associated with tightening credit markets and reduced liquidity, and signals a possible downturn in financial markets. The risk spread is currently low compared to historical standards, even falling below levels before the financial crisis, as yields on three-month NCDs are fluctuating close to the virtually risk-free yields on Treasury bills.

Liquidity and credit risk spread



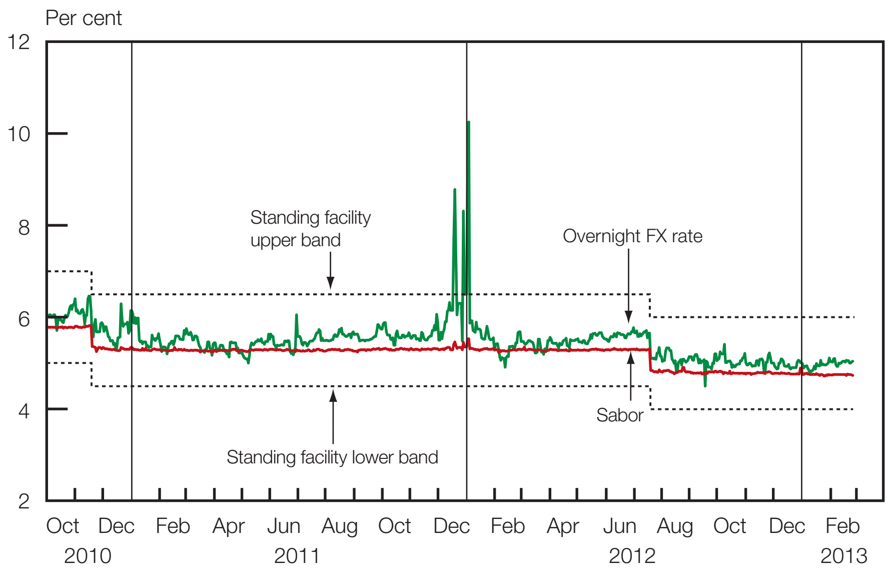
The depreciation in the exchange rate of the rand and its concomitant impact on inflation prospects contributed to rates on forward rate agreements (FRAs) fluctuating higher during the final months of 2012; For instance, the 6x9 month FRA rate, which initially discounted the possibility of further monetary policy easing, fluctuated upwards from a record low of 4,69 per cent on 3 October 2012 to end the year at 4,89 per cent. The upward trend extended into 2013 as the market increasingly priced out any likelihood of further monetary policy easing due to renewed depreciation in the exchange rate of the rand, following a further downgrading of South Africa's sovereign credit rating. Recently, FRA rates have generally converged with the prevailing policy rate and the 6x9 FRA rate measured 5,01 per cent at the end of February 2013. Interest rate projections implied by FRAs predict a relatively flat trajectory for 2013 but a modest increase in 2014. The interest rate trajectory corresponds well with other indicators of short-term interest rate expectations, such as those represented by the Reuters consensus forecast.

Interest rate expectations



In the absence of undue stress in the domestic overnight money market during the fourth quarter of 2012, as opposed to the same period in 2011, both the South African Benchmark Overnight Rate (Sabor) and the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) remained stable, fluctuating well within the standing facility limits.

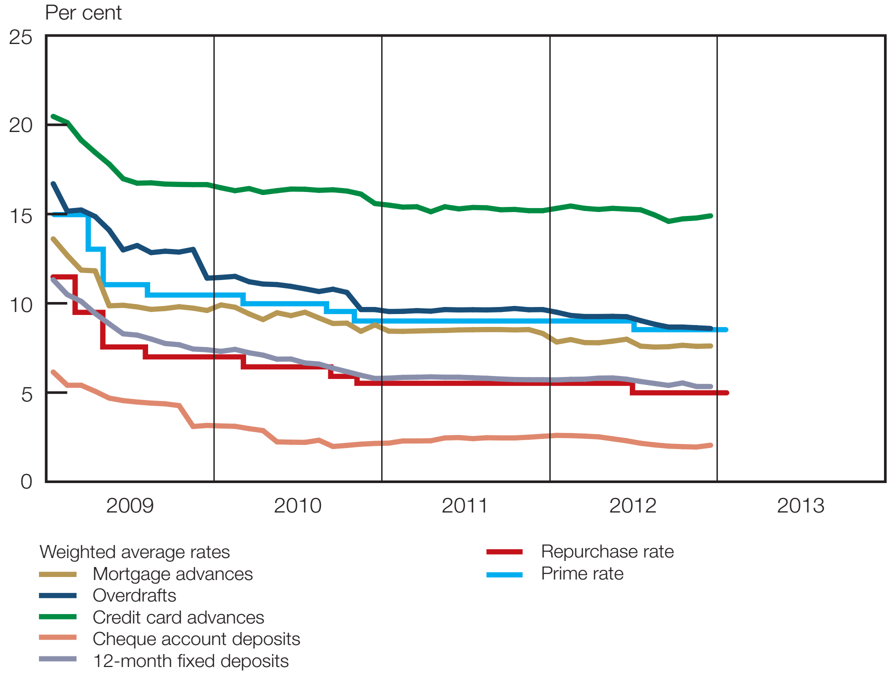
Benchmark overnight rates



Despite a short-lived increase to 4,89 per cent at the end of December 2012, Sabor fluctuated between a narrow range of 4,72 and 4,82 per cent throughout the fourth quarter and the first two months of 2013. The overnight FX rate ranged between a high of 5,41 per cent and a low of 4,81 per cent during the fourth quarter and stood at 5,08 per cent at the end of February 2013.

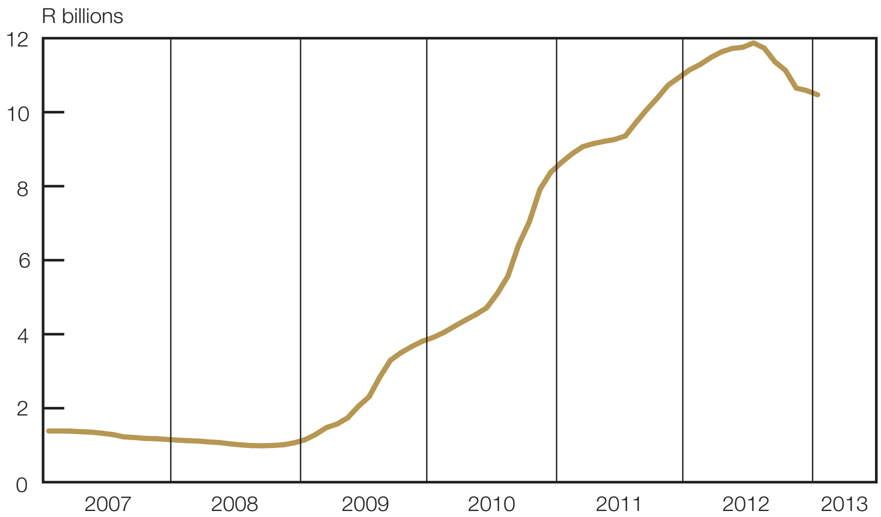
The prime lending rate and the predominant rate on mortgage loans have remained unchanged at 8,50 per cent since July 2012, while other interest rates offered by banks also remained fairly stable.

Selected bank interest rates



The rates of interest on *government fixed-rate retail bonds*, priced off the yield curve, remained unchanged after the last reduction in August 2012, which brought the 2-year bond to 6,00 per cent, the 3-year bond to 6,50 per cent and the 5-year bond to 7,00 per cent. After increasing by R4,6 billion in 2010 and R2,6 billion in 2011, the amount in issue of all retail bonds declined for the first time since 2008 by R0,4 billion in 2012. This probably followed as people of pensionable age – forming the largest investor category – remained under financial pressure given the low interest rate environment.

Amount in issue of South African retail bonds

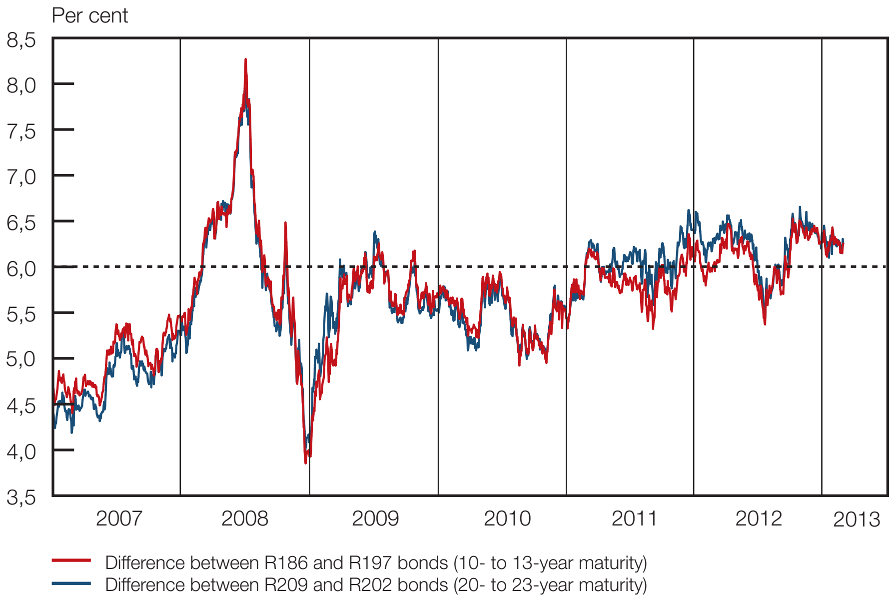


The daily average *yield on the R157 government bond* (maturing in 2014/15/16) declined noticeably from 6,92 per cent on 22 March 2012 to 5,34 per cent on 20 July, in response to firm demand for local bonds by non-residents, lower inflation and the low interest rate environment. Thereafter, the yield fluctuated broadly sideways, reaching 5,27 per cent on 28 February 2013, in line with the depreciation in the exchange value of the rand, the deteriorating inflation outlook, the sovereign rating downgrades by rating agencies as well as a slowdown in net purchases of local bonds by non-residents. The daily closing yield on the *US 5-year government bond* followed a similar trend, decreasing to a low of 0,55 per cent on 25 July 2012, before edging slightly higher to 0,77 per cent on 28 February 2013. As rand-denominated government bond yields remained generally at the same level, the *currency risk premium*[7] on South African government bonds narrowed from 444 basis points in December 2012 to 386 basis points in February 2013, following the increase in the US dollar-denominated South African government bond yield.

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

Break-even inflation rates, as approximated by the differential between nominal yields on conventional government bonds and real yields on inflation-linked government bonds, fluctuated higher across most maturities from July 2012 breaching the 6 per cent level around September and October. This measure of expected inflation rose along with the weaker exchange value of the rand, as a broadly sideways movement in yields on conventional government bonds was registered while real yields on inflation-linked bonds declined somewhat.

Break-even inflation rates



The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[8] yield spread above US government bonds narrowed from 419 basis points in May 2012 to 276 basis points in February 2013 as investors' sentiment towards debt instruments of emerging markets continued to improve. The *sovereign risk premium* on South African government US dollar-denominated bonds in the one-year maturity range trading in international markets also narrowed from 116 basis points in March 2012 to 93 basis points in February 2013.

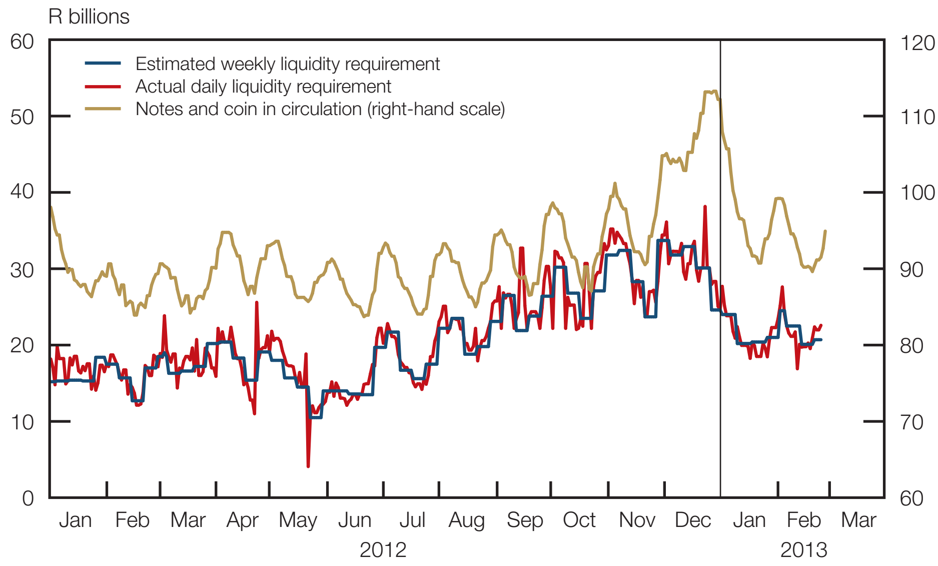
8 EMBI+ measures total returns on US dollar-denominated debt instruments of emerging-market economies.

Money market

The daily liquidity requirement of private-sector banks grew quite strongly during the second half of 2012, coinciding with the heightened level of cash reserves that private-sector banks were required to hold with the South African Reserve Bank. During the fourth quarter of 2012, the daily liquidity requirement varied between a record high of R38,2 billion and a low of R22,0 billion, up from a lower range of between R12,1 billion and R23,8 billion recorded in the first quarter. In the first two months of 2013 the liquidity requirement ranged between

R16,9 billion and R27,7 billion. The rise in the liquidity requirement reflected the efforts of the monetary authority to keep the money-market shortage aligned with the structural liquidity requirement in order to support the transmission of monetary policy decisions into the economy.

Liquidity requirement



During the final quarter of 2012, the money market, on balance, experienced a net injection of liquidity amounting to R1,8 billion. A seasonal rise in notes and coin in circulation outside the Bank to the value of R15,2 billion contributed to tight conditions in the money market during this period. The required cash reserve deposits of banks served to drain a further R2,0 billion from the money market. The tight conditions that prevailed were mainly neutralised by allowing SARB debentures to mature and, together with reverse repurchase transactions, jointly injected liquidity amounting to R16,4 billion into the money market. Liquidity in the amount of R2,0 billion, resulting from the Bank's operations in the foreign-exchange market, was completely sterilised by the R2,9 billion increase in government deposits with the Bank.

Money-market liquidity flows

R billions (easing + tightening –)

	2012		
	Apr–Jun	Jul–Sep	Oct–Dec
Notes and coin in circulation	-1,9	-5,1	-15,2
Required cash reserve deposits	-1,7	-0,9	-2,0
Money-market effect of SARB* foreign-exchange transactions	6,2	4,9	2,0
Government deposits with the SARB*	5,8	-3,9	-2,9
Use of liquidity management instruments	-1,6	-6,4	16,4
Reverse repurchase transactions	-2,0	-1,9	1,9
SARB debentures	0,4	-4,5	14,5
Other items net	-6,3	4,7	3,4
Banks' liquidity requirement (decrease + increase –)	**0,5**	**-6,7**	**1,8**

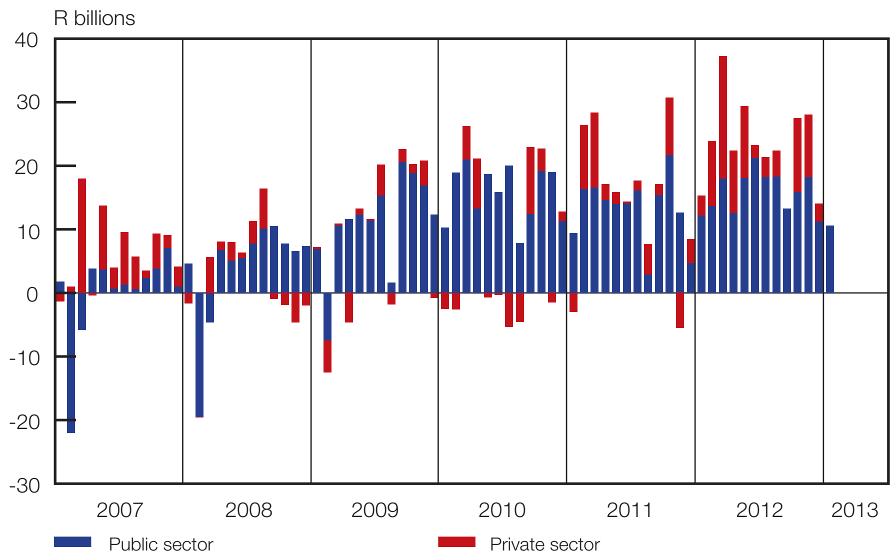
* SARB: South African Reserve Bank

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R23,1 billion were effected from the government tax and loan account during the fourth quarter of 2012. Only R0,1 billion of this amount accrued to the Bank's own bond portfolio.

Bond market

Net issues of fixed-interest securities in the *primary bond market* of R276 billion in 2012 exceeded net issues of R199 billion recorded in 2011 by 38 per cent. Although the public sector raised the bulk of the funding, its contribution to net issues declined from 79 per cent in 2011 to 69 per cent in 2012, as funding by the private sector gained momentum. Net issues by the private sector of R87,3 billion in 2012 were more than double the net issues of R39,2 billion recorded in 2011, with issuance activity by banks accounting for 62 per cent of the total private-sector net bond issuances in 2012. The total outstanding nominal value of debt securities listed on the JSE Limited (JSE) increased further by R10,6 billion in the first month of 2013 to reach R1,7 trillion at the end of January 2013.

Net issuances in the primary bond market



Lower bond yields and high trading activity in the *secondary bond market* boosted turnover in 2012. The record-high annual turnover of R25,3 trillion in 2012 was 10 per cent more than the value traded in 2011, with the average value traded per day of R91 billion in 2011 increasing to an average of R101 billion in 2012. The liquidity ratio[9] in the bond market reached 13,7 in 2012, down from 15,1 in 2011, as the nominal value of bonds listed increased more pronouncedly. Following a gain of 9 per cent in 2011, the All-Bond Index (ALBI) returned 16 per cent in 2012, boosted by, among other things, consistent demand for local bonds by non-residents. In the first two months of 2013 daily average turnover amounted to R90 billion.

9 Measured as the nominal value of bonds traded relative to the nominal value of bonds listed.

Issuances of rand-denominated bonds by non-residents in the *European and Japanese Uridashi bond markets* dwindled in 2012 compared with 2011, as indicated in the accompanying table. Issuances of rand-denominated bonds in these markets during 2012 were adversely affected by concerns over the global economic recovery, in particular the European debt crisis, and the downgrading of sovereign debt credit ratings domestically. Net issuances of rand-denominated bonds in both markets amounted to R0,1 billion in 2012, which was far below the R20,0 billion net issues recorded in 2011. Net issues of R3,5 billion were recorded in both markets in the first two months of 2013.

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

R millions

	Eurorand		Uridashi		Total	
	2011	2012	2011	2012	2011	2012
Issues	16 842	9 305	19 027	10 622	35 868	19 926
Redemptions	6 680	8 975	9 146	10 811	15 826	19 786
Net	10 162	330	9 880	-190	20 042	140

Non-residents continued to be net buyers of local bonds in the last quarter of 2012, albeit at a slower pace following, among other things, the downgrades of South Africa's sovereign credit rating by rating agencies. After increasing their holdings of domestic bonds by R28,8 billion in the third quarter of 2012, non-residents' net purchases amounted to R10,6 billion in the fourth quarter. Total net purchases of local bonds by non-residents reached an all-time annual high of R88,6 billion in 2012, which was more than double the net purchases of R42,0 billion recorded in 2011. Non-residents increased their bond portfolios by a further R7,8 billion in the two months to February 2013.

Share market

The *capital raised* by companies listed on the JSE in the domestic and international primary share markets was testimony to the current economic climate as the R78,1 billion raised in 2012 was 11 per cent lower than the amount raised in 2011. The number of companies listed on the JSE also decreased as delistings exceeded new listings for the fourth consecutive year in 2012. Total listings on the main board came to 332 at the end of 2012, while 63 companies were listed on Alt^{X}, and 5 companies on the development and venture capital boards. The most prominent method of raising capital in 2012 was the waiver of pre-emptive rights where shares were issued for cash to the general market or specific investors.

Contrary to the primary market, elevated share prices contributed to record-high turnover and market capitalisation in the *secondary share market* in 2012. While turnover increased by 4 per cent in 2012, market capitalisation increased by a marked 21 per cent over the same period. This led to a decline in market liquidity[10] from 48 per cent in 2011 to 41 per cent in 2012. The total market capitalisation amounted to R8,6 trillion in February 2013 – somewhat lower than the all-time high of R8,7 trillion reached in January 2013 – and turnover amounted to R621 billion in the first two months of 2013.

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

Although *non-residents* traded more local shares, thus fuelling share prices in 2012 compared with 2011, they continued to be sellers on a net basis. Their total net sales of R3,4 billion in 2012 were, however, far lower than the net sales of R17,2 billion recorded in 2011. Non-residents increased their holdings of South African shares by R7,3 billion in the last two months of 2012, with further net purchases of R8,4 billion in January and February 2013. Non-residents' participation in the local share market increased marginally from 14 per cent in 2011 to 15 per cent in 2012.

The strong performance displayed by the domestic share market in 2012 continued in early 2013 as local share prices reached new record highs. The *FTSE/JSE All-Share Price Index* (Alsi) breached the 40 000 level in 2013, increasing by 44 per cent from a recent low of 28 391 index points on 8 August 2011 to an all-time high of 40 893 index points on 8 February 2013. Factors that seem to be responsible for this include the higher international equity prices, positive global market sentiment and the depreciation in the exchange value of the rand. While the industrial and financial sectors recorded gains of 37 and 32 per cent respectively in 2012, the resources sector ended 2012, on balance, broadly at the same level as in 2011. After the all-time high reached in early February 2013, the Alsi declined marginally by 3 per cent to 39 710 index points on 28 February. In US dollar terms, the Alsi increased by 10 per cent from 8 August 2011 to 28 February 2013 while the S&P 500 Composite Index rose strongly by 35 per cent during the same period.

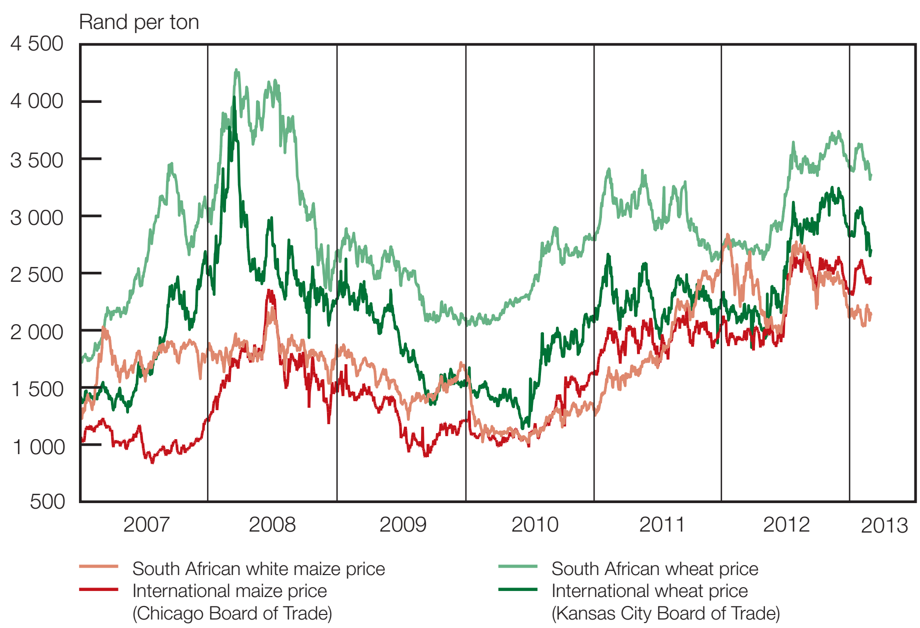
FTSE/JSE share price indices

Market for exchange-traded derivatives

Safcom, South Africa's clearing house for exchange-traded derivatives, achieved a global standard for risk management and qualified for Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO) compliance in December 2012. Safcom's certification of compliance will potentially facilitate growth in the derivatives market, enhance liquidity and uplift the credibility of the local market system as a foreign investment destination. Adherence to CPSS-IOSCO standards fosters investor protection, promotes transparency and assists in reducing systemic risk.

Some 3,0 million *commodity futures and options contracts* were traded on the Commodity Derivatives Division (CDD) of the JSE in 2012, compared with 2,6 million contracts traded in 2011. This was alongside higher local grain prices emulating higher international grain prices and responding to the depreciation in the exchange value of the rand.

Agricultural commodity prices



The CDD of the JSE announced its intentions to expand its commodity derivatives product range to include Zambian grain derivative contracts, to be traded and cleared in US dollar. Aimed to be introduced by the end of March 2013, the offering is envisaged to promote price risk management, improve price discovery, and increase South Africa's reputation as Africa's investment hub.

The total number of contracts traded on the *Interest Rate and Currency Derivatives Markets* of the JSE during 2012 came to 19,4 million compared with 15,1 million contracts traded in 2011, alongside brisk activity in the flexible currency derivatives market. A further 4,7 million contracts were booked for trade during the first two months of 2013. Turnover in all derivatives traded on the JSE during the first two months of 2013 is indicated in the table below.

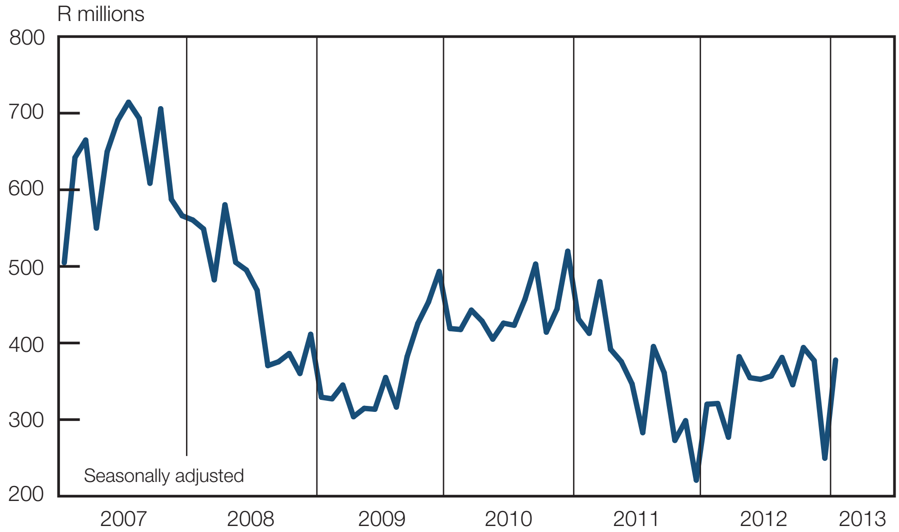
Derivatives turnover on the JSE, January and February 2013

Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity derivatives	561	17
Warrants	0,1	-41
Commodity derivatives	83	15
Interest rate derivatives	154	170
Currency derivatives	33	146

Real-estate market

Inflation in nominal house prices remained subdued in 2012. These subdued price movements reflected the sluggish economic growth, ongoing financial pressure for many households amid rises in municipal rates and utility tariffs, and the generally conservative criteria used by banks to approve mortgages. According to Ooba, a bond originator, the effective mortgage approval rate averaged 65 per cent in 2012, lower than the 76 per cent recorded in 2007. Even though the overall seasonally adjusted value of turnover in the real-estate market, proxied by transfer duty collected, generally increased in the first ten months of 2012, it was 4 per cent lower in 2012 as a whole when compared with the amount paid in 2011. This accompanied lower transfer volumes in the residential real-estate market.

Transfer duty collected in the real-estate market



Non-bank financial intermediaries

The real gross inflows[11] to non-bank financial intermediaries[12] reached a record high in 2012 despite the sluggish economic activity. Growth in real inflows of 14 per cent from 2011 to 2012 was a reflection of both new inflows and higher investment income received in the same period. Investment income probably benefited from the strong equity market, while new inflows were supported by low interest rates and a moderate improvement in the level of household disposable income. Gross inflows as a ratio of gross domestic product increased from 11 per cent in the final quarter of 2011 to 13 per cent in the final quarter of 2012.

11 Consisting of investment income, contributions and premiums received and sales of unit trusts adjusted for the consumer price index.

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

Non-bank financial intermediaries' financial flows

Real inflows into the unit trust industry surged by a marked 15 per cent from 2011 to 2012, following an improvement in both retail and institutional investors' confidence. Unit trusts real inflows were largely channelled to domestic multi-asset portfolios, as investors continued to balance risk and return considerations. Similarly, real inflows to longer-term saving vehicles[13] increased by almost 13 per cent to R649 billion during the same period, amid higher premiums received by insurers.

13 Insurers and pension and provident funds.

Real gross outflows[14] registered by these intermediaries rose by 13 per cent from 2011 to 2012, following an increase in the repurchases of units by unit trusts and higher insurance policies surrendered. Similarly, benefits paid by pension and provident funds remained high in the same period.

14 Consisting of benefits and claims paid, surrenders, repurchases of units and administrative expenses adjusted for inflation using the consumer price index.

Real net inflows[15] to the non-bank financial intermediaries rose by 25 per cent from 2011 to R175 billion in 2012 – the highest since 2010. Cash inflows were largely invested in equities and other higher-yielding assets. The net purchases of bonds and shares by these intermediaries amounted to R103 billion in the first three quarters of 2012. Net inflows will probably continue to be supported by an improvement in economic conditions and a further rise in equity market prices, given the direction of the global economy and markets.

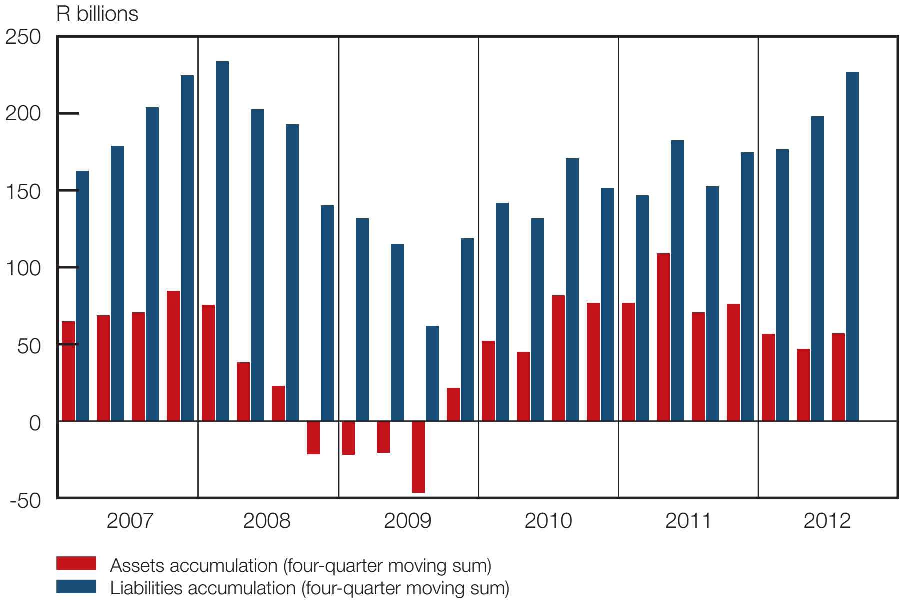
15 Measured as the difference between real gross inflows and outflows.

The asset allocation of these institutions showed that holdings of ordinary shares and fixed-interest securities increased by 2 per cent and 1 per cent of the total assets in 2012, while cash and cash equivalent instruments declined by 2 per cent.

Flow of funds

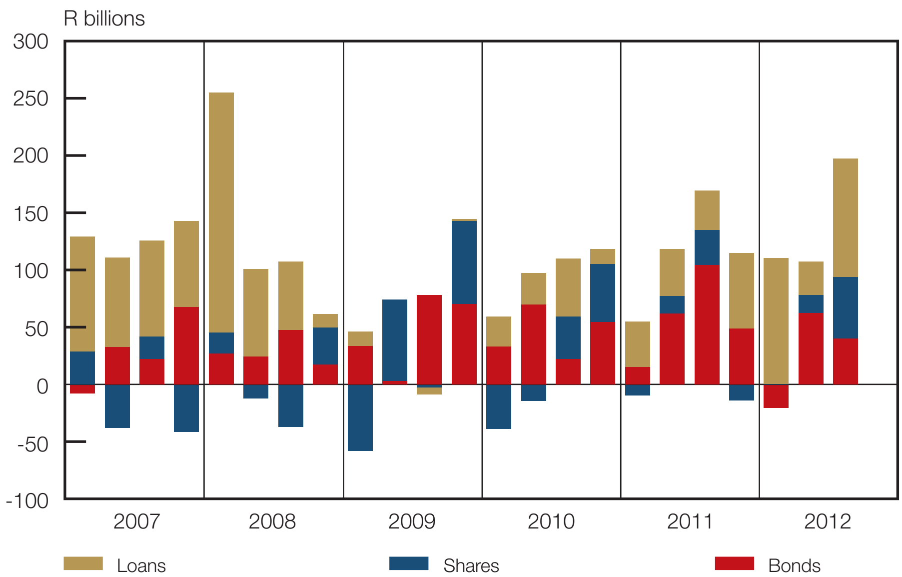
The local economy's indebtedness to the *foreign sector* increased further in the third quarter of 2012 as non-residents' investment in domestic financial instruments amounted to R51,8 billion. Non-residents purchased shares and bonds, and issued loans to domestic sectors. On the other hand, local economic agents' assets held by non-residents declined by R2,0 billion, in line with lacklustre domestic income growth levels during the third quarter of 2012.

Domestic assets and liabilities accumulation with non-residents



In spite of the sluggish economic conditions, *financial intermediaries*' flows increased during the third quarter of 2012, partly due to loans amounting to R103 billion. However, this credit was not sufficient to stimulate demand and thus could not boost the level of economic activity satisfactorily. Intermediation through bond purchases amounted to R39,7 billion while shares amounted to R54,1 billion. The non-financial private and household sectors, which are vital role-players for real economic activity, collectively received R69,7 billion through loans, R20,1 billion from bond issuances and R59,7 billion from shares in the third quarter of 2012.

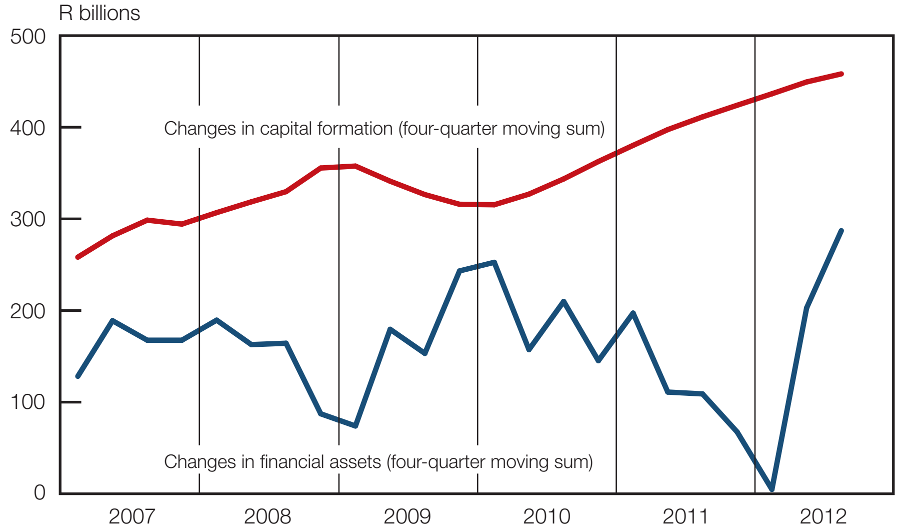
Financial intermediation by main instrument



The *general government sector* continued to raise capital in the bond market in the third quarter of 2012. Funds raised were largely used to finance capital spending, which continued to grow at a strong pace during the review period. In particular, central and provincial governments constructed new road networks and maintained existing ones. A total amount of R12,6 billion was spent as the government also engaged in community development projects. At the same time, a significant portion of the R12,5 billion capital expenditure by local governments was made on the construction and upgrading of housing and water infrastructure for communities. Consequently, the general government sector's accumulation of financial assets declined as the sector depleted its cash and deposits balances. The decline in financial assets accumulation represented 32 per cent of the sector's total flows during the period under review.

Capital spending by the *non-financial corporate business enterprises sector* was maintained at a robust pace during the third quarter of 2012. The acquisition of capital goods by public non-financial businesses amounting to R34,1 billion mainly consisted of Eskom's power station projects, fleet expansion by Transnet and the roll-out of road networks by the South African National Road Agency Limited. Capital formation by private non-financial business enterprises amounted to R79,0 billion in the third quarter of 2012, driven by the acquisition of information systems, computer equipment and machinery in the finance and construction subsectors. As a share of total non-financial corporate business enterprises' flows, changes in capital formation accounted for 46 per cent and financial assets 54 per cent.

Acquisition of assets by non-financial corporate business enterprises



Household-sector flows were lower along with weaker economic activity and the sector recorded capital formation of R15,9 billion during the third quarter of 2012. Nonetheless, this enabled the sector to improve its net worth by R13,5 billion during the third quarter of 2012, thus strengthening its capacity to spend in future.

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

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

Public finance[16]

Non-financial public-sector borrowing requirement[17]

The *non-financial public-sector borrowing requirement* amounted to R147 billion in the first three quarters of fiscal 2012/13 – some R5,3 billion higher than the deficit recorded in the same period of the preceding fiscal year. The higher borrowing requirement stemmed mainly from a higher deficit recorded by national government, due to higher grant transfers. All other levels of government recorded surpluses, with the exception of non-financial public enterprises and corporations, which recorded a smaller deficit, owing to faster growth in revenue and a reduction in net investment.

As a ratio of gross domestic product, the non-financial public-sector borrowing requirement reached 6,2 per cent in the first three quarters of fiscal 2012/13 – lower than the ratio of 6,4 per cent recorded in the same period of the previous fiscal year. Financial activities at various levels of the non-financial public sector are summarised in the accompanying table.

Non-financial public-sector borrowing requirement

R billions

Level of government	Apr–Dec 2011*	Apr–Dec 2012*
Consolidated general government	101,9	109,6
National government	117,2	136,7
Extra-budgetary institutions	-1,4	-4,8
Social security funds	-9,7	-12,0
Provincial governments	-6,5	-8,0
Local governments	2,3	-2,2
Non-financial public enterprises and corporations	39,6	37,3
Total**	**141,5****	**146,9****
As a percentage of gross domestic product	*6,4*	*6,2*

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

The borrowing requirement of the *consolidated general government* amounted to R110 billion in the first nine months of fiscal 2012/13, or R7,6 billion more than in the corresponding period of fiscal 2011/12. As a ratio of gross domestic product, the consolidated general government borrowing requirement amounted to 5,0 per cent, relative to 4,6 per cent recorded a year earlier.

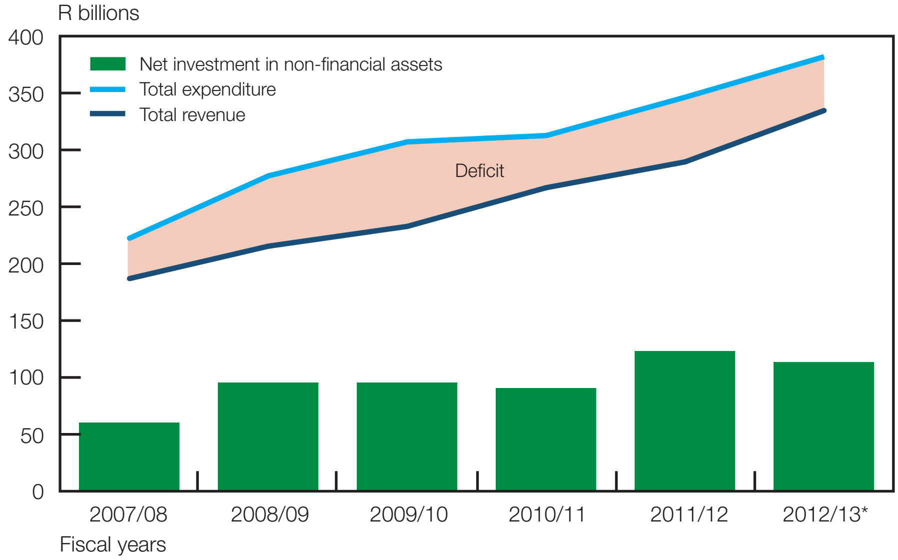
18 A legal entity that is created by government in order to participate in commercial activities on the government's behalf. A state-owned enterprise (SOE) can be either wholly or partially owned by government and is typically ear-marked to participate in commercial activities. Examples are Eskom, Sanral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

In the first nine months of fiscal 2012/13, *non-financial public enterprises and corporations*, including major State Owned Enterprises[18] (SOEs), recorded a preliminary cash deficit of R37,3 billion, some R2,3 billion lower than the cash deficit recorded in the same period of the preceding fiscal year. The improvement in the borrowing requirement resulted from faster growth in cash receipts which outperformed the slower growth in expenditure by these entities.

Net investment in non-financial assets by the non-financial public enterprises and corporations decreased by R7,2 billion to amount to R85,7 billion during the three-quarter period under review. The *Budget Review 2012* indicated that R137 billion in infrastructure investment would be undertaken by the non-financial public enterprises and corporations in fiscal 2012/13 as a whole. South Africa's infrastructure spending had been increasing since fiscal 2003/04, reaching a peak in 2010 with the hosting of the FIFA 2010 World Cup™. Government's countercyclical fiscal policy supported the acceleration of the public-sector investment programme, signalling a new impetus in public-sector investment as the foundation for long-term growth, employment and development. The building of infrastructure was, however, characterised by serious challenges and delays.

In the 2012 State of the Nation Address and Budget speech, government committed to expand infrastructure investment. Government intended broadening the infrastructure boom that gained momentum in the years leading up to the FIFA 2010 World Cup™, together with the implementation of the Gautrain project, in order to accelerate national economic growth and development. Over the medium term, R845 billion had been approved in the budget for public-sector projects in total, with some R300 billion allocated to the energy sector, and R262 billion allocated to transport and logistics projects. Infrastructure spending would largely be funded by national government guarantees and borrowing by non-financial public enterprises and corporations.

Finances of non-financial public enterprises and corporations



* April–December 2012

In the first three quarters of fiscal 2012/13, an analysis of *national government* finance statistics indicated that cash receipts from operating activities of national government amounted to R597 billion, representing a year-on-year growth rate of 9,5 per cent. Cash payments for operating activities increased by 10,7 per cent year on year to amount to R726 billion, mainly as a result of grants paid to other levels of government. Grants paid by national government to other levels of general government amounted to R426 billion, of which provincial governments received 68,5 per cent. Net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R137 billion in April–December 2012. This deficit was significantly higher than the cash deficit of R117 billion recorded in the corresponding period a year earlier.

Between April and December 2012, *provincial governments*' financial activities resulted in a cash surplus of R8,0 billion, somewhat higher than the cash surplus of R6,5 billion recorded in the same period of the preceding fiscal year. The *Budget Review 2012* provided for a full-year provincial cash surplus of R7,4 billion in fiscal 2012/13.

Total provincial revenue, primarily driven by grants received from national government, amounted to R300 billion during April to December 2012. Of this amount, provincial grants, which included equitable share transfers and conditional grants allocated for specific purposes, amounted to R291 billion in the period under review, representing a year-on-year rate of increase of 7,9 per cent.

Provincial government expenditure amounted to R292 billion between April and December 2012, or 7,7 per cent more than in the same period of the previous fiscal year. Compensation of government employees accounted for the bulk of provincial government expenditure, amounting to R176 billion in the first three quarters of fiscal 2012/13. Spending in this category was 7,7 per cent higher when compared with April–December 2011.

Net investment in non-financial assets by provincial governments amounted to R19,7 billion, a slight increase from the R19,3 billion recorded in the same period of fiscal 2011/12. Higher spending in this category was mainly for the construction of new schools, the upgrading of facilities in the public sector, and for the expansion of health infrastructure.

The provincial cash surplus resulted in an increase in provincial governments' deposits with the Corporation for Public Deposits, up from R6,4 billion at the end of March 2012 to R13,0 billion at the end of December. At the same time, their deposits with private banks decreased by R2,8 billion, while their overall indebtedness to banks increased from R1,1 billion to R2,0 billion.

Financial activities of the consolidated *local government*, as presented in the *Quarterly Financial Statistics (QFS)* published by Stats SA, recorded a preliminary net operating cash surplus of R35,5 billion in the first nine months of fiscal 2012/13. This surplus, together with the net investment in non-financial assets resulted in a cash *surplus* of R2,2 billion, in contrast to a cash *deficit* of R2,3 billion recorded in the first three quarters of fiscal 2011/12. The positive turnaround in the financial results of the consolidated local government could be attributed to higher growth in cash receipts which outpaced the growth in expenditure by municipalities.

Higher growth in local government revenue was on account of a substantial increase in inter-governmental transfers and higher sales of goods and services by municipalities. Municipal own revenue increased by 12,4 per cent, amounting to R137 billion in the first three quarters of fiscal 2012/13. The increase in municipal own revenue resulted from innovation as municipalities sought new ways to increase their revenue, such as dustbin rental, network and demand-side management charges. Service fees for sewerage, sanitation and waste removal started to attract revenue recently, whereas in the past, only revenue from the provision of water and electricity as well as property taxes formed part of municipal own revenue.

Cash payments for operating activities amounted to R160 billion in the first three quarters of fiscal 2012/13, or an increase of 12,8 per cent year on year. Purchases of bulk water, electricity and gas, which accounted for the greater part of these payments increased substantially, recording an increase of 18,3 per cent during the period under review. At the same time, net investment in non-financial assets increased by 8,0 per cent to amount to R33,3 billion.

Extra-budgetary institutions recorded a cash surplus of R4,8 billion in the first nine months of fiscal 2012/13 – substantially higher than the cash surplus of R1,4 billion recorded in the same period a year earlier.

Preliminary estimates indicate that the financial position of *social security funds* improved significantly. These funds recorded a cash surplus of R12,0 billion in the first nine months of fiscal 2012/13 – higher than the cash surplus of R9,7 billion recorded in the same period of the preceding fiscal year. Spending by social security funds was projected to be lower, partly owing to weaknesses in the processing of claims by the Road Accident Fund and compensation funds.

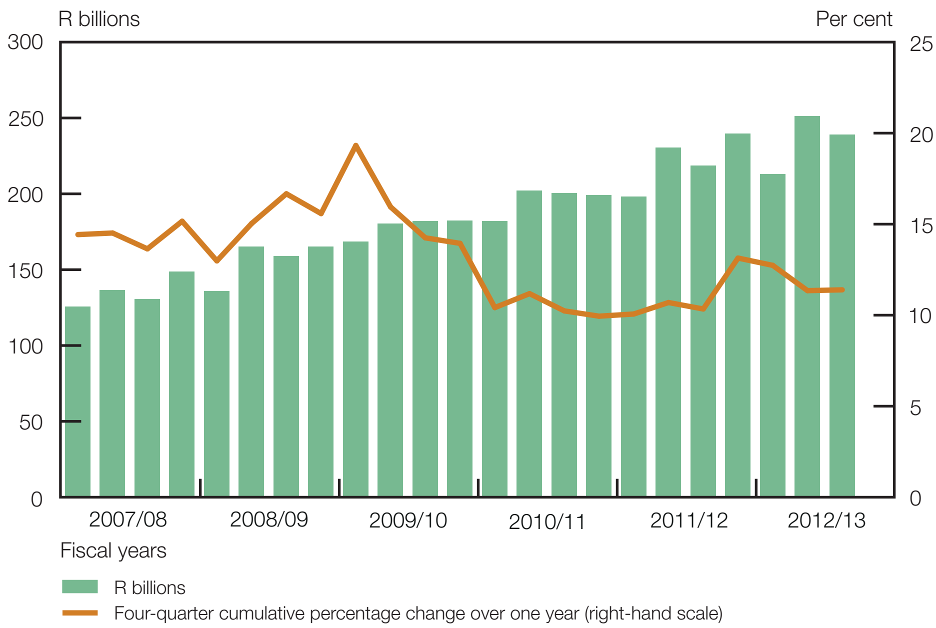
Budget comparable analysis of national government finance

In the first nine months of fiscal 2012/13, national government spending and revenue collections both increased at a marginally slower pace than the originally budgeted projections for the full year. Subdued economic activity and lower-than-expected inflation contributed to this outcome. Simultaneously the cumulative fiscal deficit in absolute terms was higher than a year earlier, broadly consistent with earlier projections.

National government expenditure totalled R703 billion in the first three quarters of fiscal 2012/13, representing a year-on-year rate of increase of 8,7 per cent. This increase was lower than the originally budgeted increase of 9,1 per cent for the fiscal year as a whole, and also lower than the increase of 9,0 per cent foreseen in the *Medium Term Budget Policy Statement* (*MTBPS*) *2012.*

As a ratio of gross domestic product, national government expenditure amounted to 29,3 per cent in April–December 2012, broadly unchanged from the same period a year earlier.

National government expenditure



Higher spending was driven by increases in all expenditure categories. The increase in current payments stemmed primarily from higher payments by the Departments of Police as well as Defence and Military Veterans. Spending by these two departments combined accounted for 77,2 per cent of the total current expenditure in the Justice, Crime Prevention and Security Cluster. Increased expenditure by the Department of Defence and Military Veterans was meant to provide and support landward defence capabilities for the defence and protection of South Africa. In addition, it enabled police stations to preserve safety and security and to provide for specialised interventions and the policing of South Africa's borders.

During April–December 2012, transfers and subsidies by the Social Services Cluster contributed the biggest share towards total national government departmental expenditure. The Departments of Education, Health and Social Development contributed most to the increase in total transfers and subsidies by this cluster. Higher transfers by the departments responsible for education were mainly to improve the quality of learning in schools and to provide financial support to universities. The Department of Social Development accounted for 57,4 per cent of total transfers and subsidies paid by the Social Services Cluster, mainly to provide income support to vulnerable groups. Increased transfers and subsidies by the Department of Health were meant to strengthen prevention programmes through the HIV/AIDS conditional grants. Further grants to provinces were aimed at building health infrastructure and to strengthen tertiary hospital services.

Although a small spending category, payments for capital assets also recorded substantial growth in April–December 2012. Spending on capital assets by the Department of Police increased at a higher rate and contributed the greater share to total payments for capital assets. The increase in spending by this department was mainly for the provision of administrative support.

Interest paid on national government debt increased by 12,7 per cent year on year, amounting to R60,5 billion in April–December 2012. Higher issuances of domestic government bonds and Treasury bills to finance the higher deficit contributed to the increase in the interest bill of government. Full-year interest payments were budgeted to amount to R89,3 billion or increase by 16,9 per cent year on year in the current fiscal year, but were revised slightly downwards in the *MTBPS 2012* to amount to R88,7 billion. Interest payments represented 2,5 per cent of gross domestic product in the first nine months of fiscal 2012/13, compared with 2,4 per cent a year earlier.

In the first nine months of fiscal 2012/13, equitable share transfers to provinces increased by 7,1 per cent year on year, much higher than the originally budgeted increase of 5,9 per cent. Higher equitable share transfers to provinces reflected government's commitment to improved service delivery in the health and education sectors.

In the *Budget Review 2012,* provision was made for R9,0 billion to be paid from the National Revenue Fund (NRF) to metropolitan municipalities as their share of the general fuel levy. The funds were meant to boost metropolitan municipalities' budgets for road and transportation infrastructure, premised on the link between fuel sales and road usage. In April–December 2012, transfers from the NRF for this purpose totalled R6,0 billion.

In the first nine months of fiscal 2012/13, national government revenue amounted to R564 billion or 7,1 per cent more than in April–December 2011. Revenue for the full year was originally budgeted to increase at a rate of 8,0 per cent and total R799 billion, but was revised downwards in the *MTBPS 2012* to amount to R794 billion, a year-on-year rate of increase of 7,3 per cent. The downward revision of revenue reflected weaker domestic economic conditions.

As a ratio of gross domestic product, national government revenue amounted to 23,5 per cent in the first nine-month period of fiscal 2012/13 when compared with 23,7 per cent recorded in April–December 2011.

Taxes on income, profits and capital gains increased at a rate of 7,8 per cent, underpinned by a strong increase in personal and corporate income taxes. Personal income tax was boosted by higher collections from pay-as-you-earn and assessment payments. The *Budget Review 2012* projected personal income tax to amount to R287 billion. Subsequently, this revenue component was revised slightly downwards in the *MTBPS 2012* to amount to R282 billion, mainly as a result of lower wage settlements and bonuses paid to public servants. Robust corporate income tax collections were recorded in the period under review, which emanated from higher provisional payments by large companies in June and September 2012 and small- and medium companies in August. However, corporate income tax collections in December were significantly lower due to lower provisional payments by the mining and banking sectors.

National government revenue in fiscal 2012/13

Revenue source	Originally budgeted for the full fiscal year		Actual Apr–Dec 2012	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	475,7	11,5	329,6	7,8
Income tax on individuals	*287,2*	*14,3*	*192,9*	*9,7*
Income tax on companies	*169,5*	*10,6*	*119,9*	*3,8*
Payroll taxes	11,1	9,4	8,6	15,6
Taxes on property	8,6	10,4	6,3	5,5
Taxes on goods and services	294,5	11,6	212,4	12,0
Value-added tax	*209,7*	*9,8*	*153,0*	*12,0*
Taxes on international trade and transactions	36,4	6,6	26,8	15,9
Other revenue	15,2	-21,2	12,3	10,1
Less: SACU** payments	42,2	93,7	31,6	93,7
Total revenue	799,3	8,0	564,4	7,1

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

Taxes on property increased by 5,5 per cent during the period under review, reflecting a slight improvement in real-estate market activity and in the financial markets. Proceeds from taxes on goods and services recorded a strong increase, boosted by strong growth in value-added tax

(VAT), the fuel levy and excise duty collections. Domestic VAT recorded a moderate increase, supported by higher-than-expected growth in small- and medium vendors, which contributed more to growth than the large business vendors. The higher import volumes of machinery, vehicles and parts for the Motor Industry Development Programme contributed to higher import VAT.

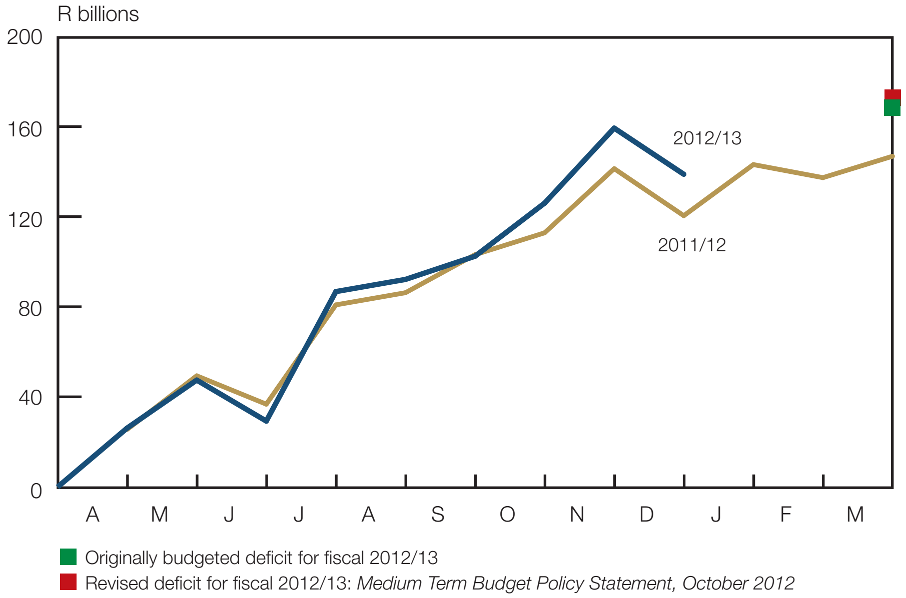
Receipts from taxes on international trade and transactions increased by 15,9 per cent year on year, mainly on account of above-budgeted collections from customs duties. Collections from customs duties increased by 6,1 per cent year on year, emanating primarily from imports of vehicles, footwear and clothing.

Collections from non-tax revenue amounted to R12,3 billion in April–December 2012, a year-on-year rate of increase of 9,9 per cent. This increase originated from a robust increase in collections from mineral and petroleum royalties.

In the first nine months of fiscal 2012/13, an amount of R31,6 billion was paid to South Africa's partners in the Southern African Customs Union, representing a year-on-year rate of increase of no less than 93,7 per cent. The brisk increase reflected the recovery in imports into the region and correspondingly higher duty collections.

Netting national government revenue and expenditure resulted in a cash-book deficit before borrowing and debt repayment of R139 billion in the first nine months of fiscal 2012/13. This deficit was R18,5 billion higher than the cash-book deficit recorded in the corresponding period of fiscal 2011/12. The wider deficit resulted from firm growth in national government expenditure, which exceeded the slower growth in revenue in April–December 2012. The full-year cash-book deficit was originally budgeted to amount to R168 billion in fiscal 2012/13, but was revised upwards to R172 billion in the *MTBPS 2012*.

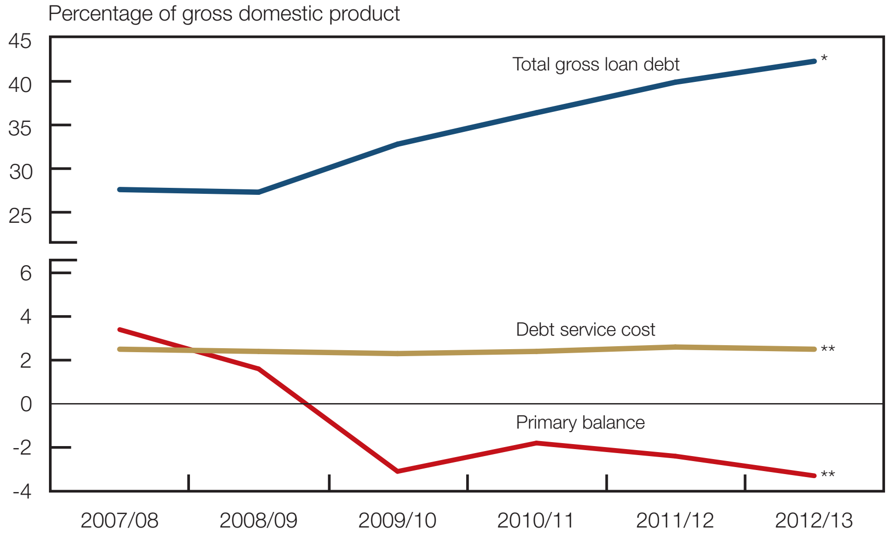
Cumulative deficit of national government



The primary balance[19] of national government amounted to a deficit of R78,4 billion in the first nine months of fiscal 2012/13, compared with a deficit of R66,8 billion recorded a year earlier. As a ratio of gross domestic product, the primary deficit reached 3,3 per cent in April–December 2012 – higher than the primary deficit ratio of 3,0 per cent recorded in the previous year.

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

National government debt sustainability indicators



* As at 31 December 2012
** April–December 2012

The cash-flow deficit of national government amounted to R129 billion after netting cash-flow revenue and expenditure in the first three quarters of fiscal 2012/13. This deficit was R8,4 billion higher than the cash-flow deficit recorded in April–December 2011. Revaluation profits on foreign currency transactions, the liquidation of the SASRIA investment and penalties on retail bonds contributed to extraordinary revenue. Extraordinary payments consisted primarily of a premium on debt portfolio restructuring to the value of R2,2 billion along with losses on the Gold and Foreign Exchange Contingency Reserve Account and revaluation losses on foreign currency transactions. After accounting for extraordinary transactions and the profit on revaluation of foreign debt at maturity, the net borrowing requirement totalled R129 billion during the period under review. This could be measured against a net borrowing requirement of R121 billion recorded in the first nine months of fiscal 2011/12.

National government financing in fiscal 2012/13

R billions

Item or instrument	Originally budgeted 2012/13	Actual Apr–Dec 2012	Actual Apr–Dec 2011
Deficit	168,4	129,4[1]	121,0[1]
Plus: Extraordinary payments	-	2,6	0,5
Cost/Profit on revaluation of foreign debt at redemption[2]	-2,3	-2,5	0,4
Less: Extraordinary receipts	-	0,7	0,9
Net borrowing requirement	166,1	128,8	121,0
Treasury bills	22,0	11,7	33,7
Domestic government bonds	119,5	113,6	99,5
Foreign bonds and loans	-9,8	-13,6	-2,1
Change in available cash balances[3]	34,3	17,2	-10,1
Total net financing[4]	166,1	128,8	121,0

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

The borrowing requirement was predominantly financed through the issuance of domestic short-term loans and government bonds. Government debt instruments continued to be appealing to investors, owing to the deep and liquid financial markets in South Africa. In the first nine months of fiscal 2012/13, net issues of inflation-linked bonds amounted to R39,8 billion, bringing the outstanding balance on these instruments to R261 billion.

In April–December 2012, the *R201* and *R206* bonds were partly redeemed for R37,4 billion and switched to bonds with maturities up to 2041. Short-term funding was acquired at an average interest rate of 5,4 per cent, while domestic government bonds attracted an average rate of 7,9 per cent per annum. Between March and December 2012, the average outstanding maturity of national government's domestic marketable bonds increased from 130 months to 140 months. The extended maturity resulted from higher issuances of government bonds and switch transactions.

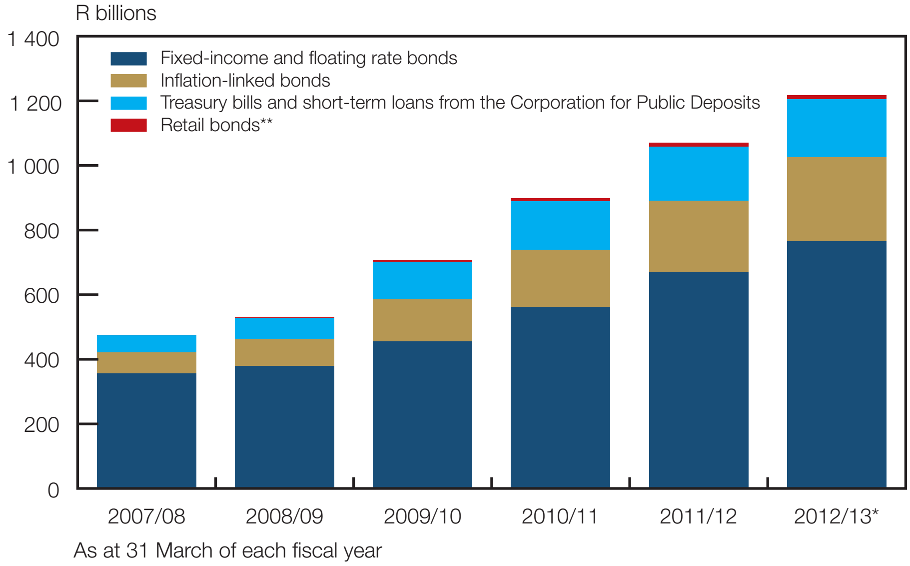
Net redemptions to the value of R13,6 billion were recorded in foreign bonds and loans of national government in April–December 2012. The average remaining maturity of foreign marketable bonds of national government narrowed slightly from 90 months at the end of March 2012 to 88 months as at 31 December.

National government decreased its available cash balances by R17,2 billion in the first nine months of the current fiscal year, bringing these balances to R188 billion at the end of December 2012. Deposits with the Bank declined by R6,4 billion between March and December 2012, amounting to R135 billion at the end of December.

Domestic debt accelerated from R1 071 billion as at 31 March 2012 to R1 217 billion at the end of December. Higher issuances of domestic short-term loans and government bonds contributed to the considerable rise in domestic debt of national government. Domestic debt continued to account for about 90 per cent of total gross loan debt, with foreign debt accounting for the balance.

Foreign debt of national government remained broadly unchanged at R117 billion between March and December 2012. The rand value of foreign debt at prevailing exchange rates was R20,4 billion higher than the rand value of foreign debt at issuance. This increase was underpinned by revaluation adjustments arising from the depreciation of the rand against major currencies included in national government's foreign debt portfolio.

Composition of domestic government debt



* As at 31 December 2012
** Including small amounts of other debt instruments

Total gross loan debt of national government, which includes domestic and foreign government debt, increased sharply from R1 188 billion at the end of March 2012 to R1 334 billion as at 31 December. During the period under review, total gross loan debt as a ratio of gross domestic product increased from 39,9 per cent to 42,3 per cent.

The Budget for fiscal 2013/14 to 2015/16

Fiscal policy stance

The National Budget was presented to Parliament on 27 February 2013 by the Minister of Finance. Tabled against the background of a new strategic framework for growth and development, it focused on national development and fiscal sustainability. Taking the National Development Plan (NDP) as its point of departure, the 2013 Budget and future budgets would ensure that the strategic plans of national departments and their medium-term expenditure plans would be aligned to realise government's objectives.

A large part of the execution of the NDP would be about proper planning, building public-sector capacity and enhanced accountability chains. The next medium-term strategic framework would identify the NDP priority objectives and actions over the next five-year term of government, which would be reflected in departmental strategic plans, with key actions outlined in annual performance plans. Executive authorities and Parliament would then hold departments and ministries accountable for meeting these objectives.

As noted in the *MTBPS 2012*, if the economic environment deteriorated, realising government's fiscal objectives would require that spending and revenue plans be reconsidered. Therefore, to ensure that the deficit narrowed and the fiscus moved towards debt stabilisation, government was trimming its medium-term spending plans by R10,4 billion. At the same time government would ensure that national development was financed in a fiscally responsible manner, so that future generations inherit a healthy, growing economy that is creating jobs and not burdened by the chains of the past.

Strong capital investment by the public sector, additional electricity-generating capacity, water supply and rail capacity upgrades, relatively stable inflation and low interest rates would support improved economic performance. More rapid growth required steps to expand employment, provide greater policy certainty, improve education and training, and accelerate infrastructure investment to strengthen regional linkages. The proposed medium-term expenditure framework took into account the prevailing fiscal constraints. The proposed disciplined spending trajectory and projected improved economic growth over the medium term would ensure sustainability of the public finances.

Economic growth was expected to accelerate from 2,5 per cent in 2012 to 3,8 per cent in 2015. In order to grow more rapidly and to address the social pressures that arise from a high degree of inequality, a long-term strategy for national development would have to be implemented effectively. Continued implementation of the national infrastructure programme was expected to result in robust public-sector fixed capital formation, which was projected to grow at an average rate of 9,0 per cent per annum over the three-year budget period. The pace of economic recovery would also be determined to a significant extent by the rate at which private investment and export growth strengthened.

Headline inflation was projected to remain near the upper limit of the 3–6 per cent target range over the medium term. Due to a relatively weak exchange rate and adjustments to the consumer price index to account for changes in household spending patterns, headline inflation would rise relative to earlier forecasts.

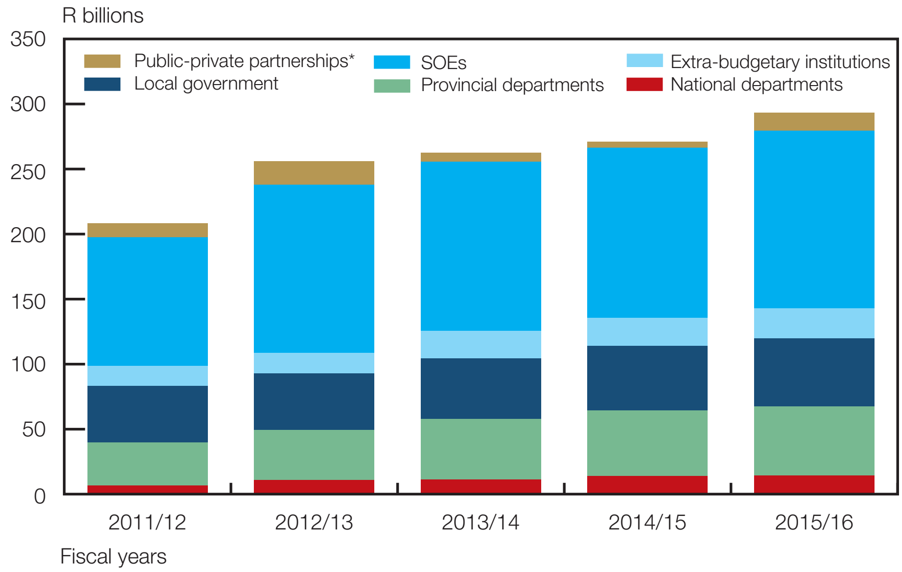
Over the past year, the slower economic growth rate resulted in lower-than-anticipated tax revenue, leading to the widening of the budget deficit. In order to protect the sustainability of the fiscus, the 2013 Budget took additional measures to control spending, thereby reducing real expenditure growth to an average of 2,3 per cent per annum over the next three years, relative to the 2,9 per cent indicated in the *MTBPS 2012*. Thus, the budget deficit was expected to decline from 5,2 per cent of gross domestic product in fiscal 2012/13 to 3,1 per cent in fiscal 2015/16. At the same time, gross debt would stabilise at around 44 per cent in fiscal 2015/16, before declining in the subsequent years. This fiscal approach would require government departments to do more with less, by paying more attention to the efficiency with which they spend public funds, and prioritising resource allocation to strengthen service delivery.

In order to meet its growth and developmental objectives, government needed a fair and equitable tax system. To this end, during 2013 the Minister of Finance would commission a review of current tax policies to ensure that public spending was supported by an appropriate revenue base. Part of this review would evaluate the current mining royalties' regime with regard to its ability to suitably serve public finance priorities.

To realise a sustained impact on growth and household services, the NDP pointed out that the country would need higher levels of capital spending. Gross fixed capital formation would need to reach about 30 per cent of gross domestic product by 2030, with public-sector investment reaching 10 per cent of gross domestic product. Subsequent to estimated spending of R642 billion over the past three years, planned spending on infrastructure projects by the public sector would total R827 billion over the next three years. A large portion of this infrastructure spending was earmarked for projects in the energy and transport sectors, most of which were multi-year projects that were initiated well before the current three-year budget period. While a substantial number of projects were already in progress or about to get under way, weaknesses in planning and capacity continued to delay implementation of other projects.

The value of major infrastructure projects in progress or under consideration in the public sector totalled R3 592 billion. There were also several private-sector projects identified in the strategic integrated projects of the Presidential Infrastructure Coordinating Commission (PICC), bringing the total value of projects being considered to over R4 000 billion. Government would improve its capacity to plan, procure, manage and monitor projects, thereby working more closely with the private sector at various stages of the project development cycle. Building technical capacity in the public sector was a multi-year effort, and initiatives to strengthen these functions were expanded. The PICC had concentrated its efforts over the past year on improved planning and decision processes.

Public-sector infrastructure expenditure by area of responsibility



* Including project funds, capital contribution and unitary payments

Source: *Budget Review 2013*

Nationally raised revenue was projected to increase by 10,9 per cent to amount to R873 billion in fiscal 2013/14. Receipts by national government would increase at an average annual rate of 11,0 per cent over the three-year budget period, and amount to R1 071 billion in fiscal 2015/16. As a ratio of gross domestic product, national government revenue was estimated to average 24,9 per cent per annum over the medium term.

Fiscal projections: National government

Fiscal years	Revised estimate		Medium-term estimates					
	2012/13		2013/14		2014/15		2015/16	
	R billions	Annual change (per cent)	R billions	Annual change (per cent)	R billions	Annual change (per cent)	R billions	Annual change (per cent)
Expenditure	967,0	8,8	1 055,1	9,1	1 138,0	7,9	1 225,7	7,7
State debt cost[1]	88,3	15,5	99,7	12,9	108,7	9,0	118,2	8,7
Current payments	161,2	11,0	171,9	6,6	182,4	6,1	191,7	5,1
Transfers and subsidies	702,9	7,5	762,2	8,4	819,5	7,5	885,3	8,0
Payments for capital assets	13,0	8,3	14,3	9,3	17,6	23,4	17,5	-0,4
Payments for financial assets[2]	1,5	-	2,9	-	3,3	-	3,0	-
Contingency reserve and unallocated funds	-	-	4,0	-	6,5	-	10,0	-
Expenditure as a ratio of GDP	*30,1%*		*30,0%*		*29,3%*		*28,7%*	
Revenue	782,5	5,7	873,0	11,6	967,9	10,9	1 070,7	10,6
Revenue as a ratio of GDP	*24,4%*		*24,8%*		*24,9%*		*25,1%*	
Budget balance[3] before borrowing and debt repayment	-184,5		-182,1		-170,1		-155,0	
Balance as a ratio of GDP.	*-5,7%*		*-5,2%*		*-4,4%*		*-3,6%*	
Balance as a ratio of GDP: October 2012 MTBPS[4]	*-5,3%*		*-4,9 %*		*-4,2%*		*-3,5%*	

1 Includes interest, management cost and the cost of raising loans
2 Consists mainly of lending to public corporations or making equity investments in them for policy purposes. Previously included in transfers and subsidies
3 Deficit – surplus +
4 *Medium Term Budget Policy Statement 2012*

Tax proposals in the *Budget Review 2013* included personal income tax relief and tax relief for small business, reforms to the tax treatment of contributions to retirement savings, and an employment tax incentive to support young workers and those employed in special economic zones. Foreign businesses, who are selling digital goods in South Africa, would have to register as VAT vendors. Furthermore, the budget made provision for the alignment of the proposed carbon tax, energy-efficiency savings tax incentives, the electricity levy and increases in fuel and excise taxes.

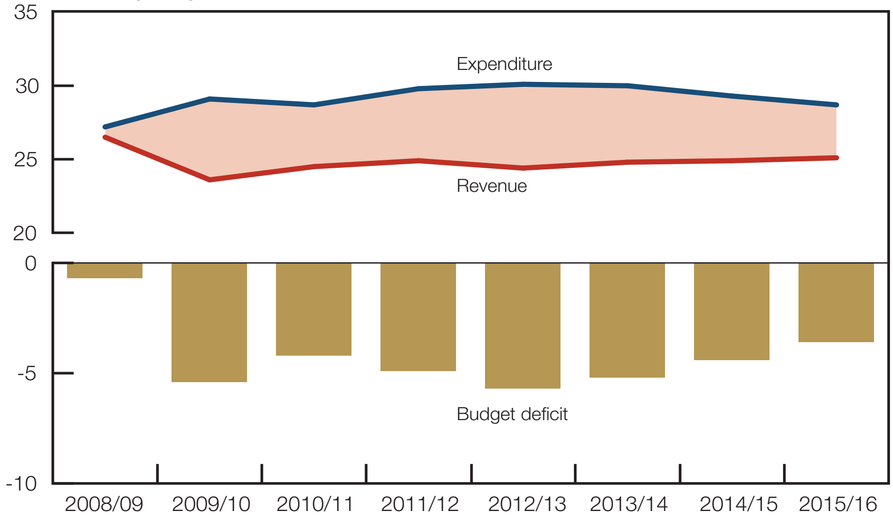
The net result of national government revenue and expenditure would be an estimated cash-book deficit of R184 billion in fiscal 2012/13 – some R14,5 billion higher than the originally budgeted deficit. This deficit would be R37,6 billion higher than the deficit recorded in fiscal 2011/12. The higher deficit stemmed from a combination of weaker-than-expected economic growth, supply disruptions in the mining sector and slightly lower-than-projected inflation, which resulted in a downward adjustment in revenue estimates. As a ratio of gross domestic product, the cash-book deficit of national government was projected to amount to 5,7 per cent in fiscal 2012/13 before decreasing to an average ratio of 4,4 per cent over the medium term.

In fiscal 2012/13, the primary balance[20] was estimated to reach a deficit of 3,0 per cent of gross domestic product, thereafter narrowing to average 1,6 per cent of gross domestic product over the medium term.

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

National government finances

Percentage of gross domestic product



Fiscal years

Source: *Budget Review 2013*

The net borrowing requirement of national government would be financed through loans incurred in the domestic and global markets and by using surplus cash. Domestic short-term loans, consisting of Treasury bills and short-term loans from the Corporation for Public Deposits, were estimated to record net issues of R22,0 billion in fiscal 2012/13. Over the medium term, Treasury bill net issuance was expected to average R24,0 billion per year.

Government planned to continue issuing bonds with maturity split over three years – and to introduce new bonds along the existing curve in order to manage the refinancing risk and improve liquidity. In recent times government made use of the bond-switch programme, which also mitigated the refinancing risk by switching short-term debt for longer-term debt.

National government financing

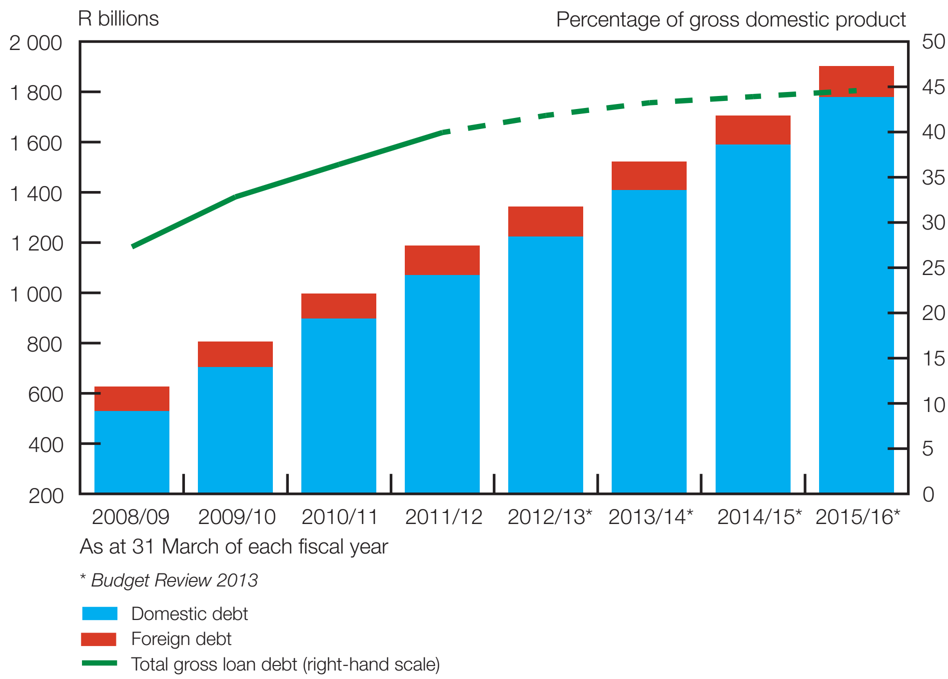
R billions

Item or instrument	Revised estimate	Medium-term estimates		
	2012/13	2013/14	2014/15	2015/16
Deficit	184,5	182,1	170,1	155,0
Plus: Extraordinary payments	2,6	0,9	-	-
Less: Extraordinary receipts	10,8	5,0	2,9	3,1
Net borrowing requirement	176,3	178,0	167,2	151,9
Treasury bills	22,0	23,0	24,0	24,0
Domestic government bonds issued	126,4	143,6	132,3	137,0
Foreign bonds and loans*	-7,4	-4,3	1,0	9,7
Changes in available cash balances**	35,2	15,8	9,9	-18,9
Total net financing***	176,3	178,0	167,2	151,9

* Including revaluation of foreign bonds and loans
** Increase – decrease +
*** Components may not add up to totals due to rounding

Over the medium term, government planned to borrow about US$1,5 billion per year in global markets to maintain benchmarks in major currencies and to meet part of its foreign-currency commitments. National government's cash balances were estimated to decrease by R35,2 billion in fiscal 2012/13, but to record an increase by fiscal 2015/16.

Total gross loan debt of national government



Gross loan debt of national government was projected to amount to R1 343 billion in fiscal 2012/13, or 41,8 per cent of gross domestic product. Over the medium term, gross loan debt relative to gross domestic product was expected to average 43,9 per cent, amounting to R1 904 billion as at 31 March 2016.

Consolidated government expenditure was projected to increase by 8,1 per cent per annum from R1 056 billion in fiscal 2012/13 to R1 334 billion in fiscal 2015/16. Non-interest expenditure would grow at an average annual rate of 7,9 per cent whereas state debt cost was expected to increase at an average annual rate of 10,2 per cent over the next three years. As a percentage of gross domestic product, consolidated government expenditure was revised to equal 32,9 per cent in fiscal 2012/13, easing to 31,2 per cent in fiscal 2015/16.

The social assistance programme was government's most direct means of combating poverty, with a significant part of government spending allocated to the social wage. As economic growth outpaced growth in grant recipients, total spending on social grants was projected to decline as a percentage of gross domestic product from 3,4 per cent in fiscal 2012/13 to 3,2 per cent in fiscal 2015/16. At the end of fiscal 2012/13, nearly 16,1 million people were beneficiaries of social grants, having increased from 2,5 million in 1998. Access to social grants had been broadened in recent years by raising the means test income thresholds. The number of *child support grant* beneficiaries had risen from 5,7 million in fiscal 2004/05 to about 11,4 million as a result of the expansion of the eligibility criteria.

The main budget deficit was offset by surpluses by provincial governments and social security funds. Provinces have budgeted for surpluses to compensate for previous unauthorised expenditure. Spending by social security funds was projected to be lower, owing to weaknesses in the processing of claims by the Road Accident Fund and compensation funds. The delayed rollout of decentralisation and lower projected benefit payments by the Unemployment Insurance Fund and compensation funds contributed to their surpluses over the medium term.

Public-sector borrowing requirement*

R millions

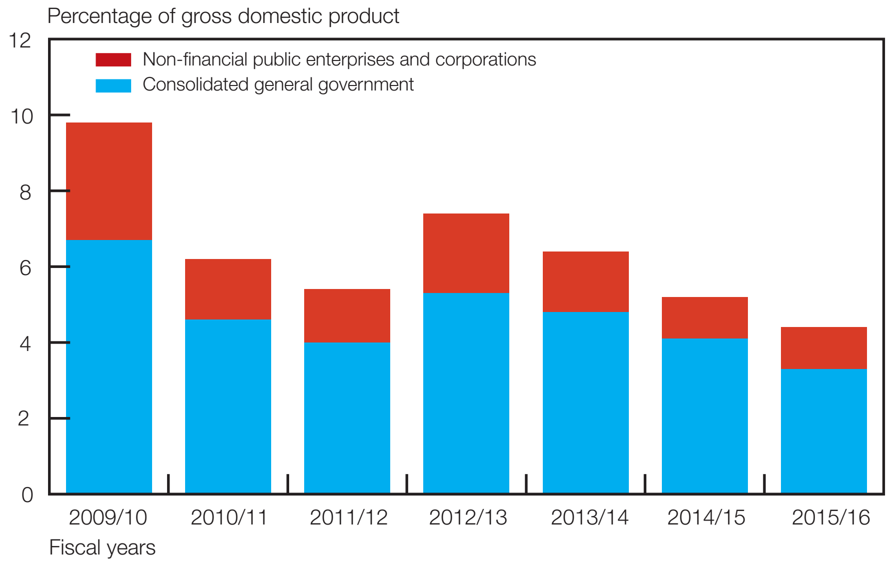
Level of government	Revised estimate	Medium-term estimates		
	2012/13	2013/14	2014/15	2015/16
National government	176 297	178 047	167 158	151 900
Public entities (Extra-budgetary institutions)	-300	800	2 500	2 100
Social security funds	-15 600	-14 200	-12 400	-13 200
Provincial governments	-600	-5 000	-6 900	-9 500
Local authorities	9 600	8 300	9 300	9 800
General government borrowing**	169 397	167 947	159 658	141 100
Percentage of gross domestic product	*5,3%*	*4,8%*	*4,2%*	*3,3%*
State-owned companies***	68 500	57 900	43 600	46 000
Public-sector borrowing requirement**	237 897	225 847	203 258	187 100
Percentage of gross domestic product	*7,5%*	*6,5%*	*5,3%*	*4,4%*
Estimated gross domestic product	3 209 142	3 520 268	3 880 406	4 270 848

* Deficit + surplus –
** Calculations may not add up to totals due to rounding
*** South African Roads Agency Limited and Trans-Caledon Tunnel Authority are included in consolidated government borrowing

Local government borrowing as a ratio of gross domestic product would stabilise over the medium term. Government would provide R7,9 billion to recapitalise the Development Bank of Southern Africa over the medium term to support the financing of municipal infrastructure.

The public-sector borrowing requirement was forecasted to decline from 7,4 per cent of gross domestic product in fiscal 2012/13 to 4,4 per cent in fiscal 2015/16. The higher borrowing requirement resulted from wider budget deficits recorded at various levels of government. The borrowing requirement of non-financial public institutions was set to decline from 2,1 per cent of gross domestic product in fiscal 2012/13 to 1,1 per cent by the end of the medium term. The largest contribution to this borrowing requirement would come from the capital infrastructure programmes of Eskom and Transnet. While their capital spending was expected to grow significantly over the next decade, financing would be supported by higher cash flows.

Public-sector borrowing requirement



Source: *Budget Review 2013*

Statement of the Monetary Policy Committee

24 January 2013

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) there has been some improvement in global financial market sentiment, but economic growth prospects in a number of the major advanced economies or regions remain constrained. Downside risks to the outlook persist as the structural problems in many countries, and in the eurozone, in particular, are still unresolved. Monetary policy in most countries is likely to remain accommodative in the absence of clear evidence of a sustained recovery, particularly against the backdrop of a relatively benign global inflation environment.

Despite a generally positive reaction to the ANC elective conference, ongoing labour conflict, the proposed scaling down of mining operations and ratings agency downgrades are symptomatic of the challenging domestic outlook. In the absence of coherent and consistent structural policy initiatives domestic economic growth is expected to continue to be well below both what is possible and required to make significant inroads into unemployment. In contrast to the situation in most advanced economies, the risks to the inflation outlook remain on the upside, due, in large part, to continued exchange rate and wage cost pressures.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas was 5,7 per cent in December 2012, up from 5,6 per cent in November. The categories of food and non-alcoholic beverages, housing and utilities, and transport together accounted for 3,5 percentage points of the inflation outcome. Food price inflation moderated from 7,5 per cent in November to 7,0 per cent, mainly as a result of lower meat and grain price increases. Core inflation, as measured by the exclusion of food, petrol and electricity from CPI, which had been unchanged at 4,7 per cent since September, increased to 4,9 per cent in December, mainly as a result of increases in services price inflation and in line with the Bank's forecast. Administered prices increased by 8,8 per cent, and by 7,6 per cent excluding petrol.

Having reached a recent low of 4,2 per cent in September 2012, year-on-year producer price inflation increased to 5,2 per cent in both October and November. This reversal of the previous downward trend was mainly due to price increases in mining and quarrying, agricultural products and manufactured food. Agricultural prices increased at year-on-year rates of 6,3 per cent and 5,9 per cent in October and November respectively, while manufactured food prices increased at rates of 10,9 per cent and 11,1 per cent in these months respectively.

The inflation forecast of the Bank reflects a further deterioration in the inflation outlook for 2013 compared with the previous forecast. The forecasts do not yet incorporate the new CPI weights and rebasing recently announced by Statistics South Africa, but these changes will be incorporated formally into the Bank's next forecast. The impact on the inflation trajectory is likely to be marginal. Having averaged 5,6 per cent in 2012, inflation is now expected to average 5,8 per cent in 2013 and 5,2 per cent in 2014, compared with the previous forecasts of 5,5 per cent and 5,0 per cent for the respective years. Inflation is expected to peak at 6,1 per cent in the third quarter of 2013 and then to moderate gradually to 5,1 per cent in the final two quarters of 2014. This deterioration is largely due to higher expected food price inflation, the lagged effects of the depreciation of the rand and higher expected unit labour costs.

The forecast of core inflation is more or less unchanged, indicating the continued absence of significant demand pressures. This measure is expected to peak at 5,0 per cent in the first two quarters of 2013, and to average 4,9 per cent and 4,5 per cent in 2013 and 2014 respectively.

Inflation expectations remain anchored at around the upper end of the inflation target range. According to the Survey of Inflation Expectations conducted by the Bureau for Economic Research (BER) in the fourth quarter of 2012, inflation is expected to average 6,1 per cent in 2013 and 6,2 per cent in 2014. This represents a marginal increase of 0,1 percentage point for 2013 compared with the previous survey, while the forecast for 2014 is unchanged. Business executives are the most pessimistic about inflation, having raised expected inflation rates to 6,6 per cent and 6,7 per cent in 2013 and 2014, while trade union respondents reduced their forecasts to 6,1 per cent and 6,6 per cent respectively for these years. The forecasts of financial analysts increased marginally, but remain within the target range for the forecast period. For the past four quarters expectations for the next five years have remained unchanged at 6,2 per cent.

The global growth outlook remains challenging, notwithstanding improved sentiment in global financial markets following the interim deal related to the fiscal cliff in the US. The fiscal issues have not been fully resolved, with decisions on expenditure cuts and the debt ceiling delayed till later this year. While the worst-case fiscal scenario has been avoided, the uncertain fiscal outlook is likely to contribute to continued sub-trend US growth. On the positive side, there are continued signs of a recovery in the US housing market and improved corporate profitability.

Although sovereign debt risks in the eurozone have subsided for now and bond spreads on peripheral European debt have narrowed significantly, the region is likely to remain in recession for much of the year, as fiscal tightening and balance-sheet repair by banks and households continue. The unemployment rate has now reached 11,8 per cent, with youth unemployment at 24 per cent. The outlook for Germany, the main growth driver in the region, has also deteriorated. Growth prospects in the UK remain relatively weak, while the outlook for Japan is uncertain despite the announcement of substantial fiscal and monetary policy stimuli.

The outlook for emerging markets, particularly those in Asia, is more positive. The Chinese economy appears to have stabilised following concerns about a possible hard landing, and consensus forecasts suggest some growth acceleration in 2013 in both China and India. Growth in Africa is expected to be sustained at rates in excess of 5 per cent, while Latin American growth is expected to be more restrained, but an improvement on 2012.

The rand exchange rate continues to pose an upside risk to the inflation outlook. The exchange rate has been impacted by the widening deficit on the current account of the balance of payments during 2012 and changing global and domestic risk perceptions, particularly relating to the adverse developments in the South African labour market, and the downgrades by the various ratings agencies. Since the previous meeting of the MPC, the rand has been fairly volatile, having appreciated initially from R8,94 to the US dollar, to R8,45 at the end of the year, but subsequently depreciated to current levels of around R9,00. Since the beginning of the year, the rand has depreciated by 6,1 per cent on a trade-weighted basis and by about 6,6 per cent against the US dollar.

While the rand is expected to remain sensitive to domestic and global developments and continued volatility can be expected, most analysts do not expect significant further sustained depreciation in the coming months. The depreciation of the rand is expected to help moderate the current-account imbalance, although platinum export growth may be undermined to some extent by possible shaft closures. However, financing of the deficit may be more challenging despite relatively high domestic nominal bond yields, as sentiment towards South Africa has deteriorated, and non-residents already hold over one-third of the stock of outstanding government bonds.

Non-resident net purchases of domestic bonds totalled R88,6 billion during 2012, due in part to South Africa's inclusion in the Citibank World Government Bond Index. However, the pace of inflows declined substantially in the final quarter of the year, when net purchases amounted to R10,6 billion. Since the beginning of 2013, net purchases by non-residents have amounted to R4,3 billion. While non-residents were net sellers of equities during 2012 to the value of R3,4 billion, they were net buyers to the value of R7,3 billion in November and December. Year to date, however, the negative trend regarding equities has continued with net sales of R2,3 billion as growth prospects remain weak.

Domestic economic growth remains fragile and below potential following an annualised growth rate of 1,2 per cent in the third quarter of 2012, and an estimated growth rate of around 2,5 per cent for the year. A similar outcome is expected in 2013 with growth of 2,6 per cent forecast, revised down from 2,9 per cent in the previous forecast. A more favourable outcome of 3,8 per cent is forecast for 2014, compared with 3,6 per cent previously, driven in part by a more favourable global outlook. However, the risks to these forecasts are assessed to be on the downside, given uncertainties and instability in parts of the mining and agricultural sectors in particular. Constraints to growth are both external and internal. To achieve a higher internally-generated growth rate would require a serious commitment to implementing a range of structural reforms and making the necessary trade-offs as outlined in the National Development Plan.

The outlook for parts of the mining sector is bleak, following continued labour disputes and announcements of possible closures of shafts and mines, a consequence of increased cost pressures, weak global demand and prices. Although mining output increased on a month-to-month basis in November, on a three-month-to-three-month basis a contraction of 10,4 per cent was recorded.

There are mixed signals pertaining to the outlook for the manufacturing sector. The real volume of manufacturing production increased by 2,3 per cent in November, its highest month-on-month rate in 4 years, due in part to a rebound from widespread strike activity in previous months, and growth in the fourth quarter is estimated to have been relatively robust. Capacity utilisation has also increased. However, the Kagiso PMI declined to below the 50 index point level to 47,4 in December, indicating an expectation of some contraction in the sector.

The negative business sentiment evident in the confidence indicators is also reflected in the continued weakness in private-sector gross fixed capital formation. Recent developments in the mining sector are likely to reinforce this weakness as plans are scaled back. Investment expenditure is likely to remain underpinned by the government and state-owned enterprises. In the third quarter of 2012, gross fixed capital formation grew at an annualised rate of 7,2 per cent, but private-sector capital formation, which accounts for just under two thirds of the total, only grew at a rate of 2,8 per cent.

Growth in consumption expenditure by households moderated as expected in the third quarter of 2012 when it increased by 2,6 per cent. The main driver of the moderation was the decline in expenditure growth on services and non-durable goods. However, there are also signs of moderation in the growth of expenditure on durable and semi-durable goods, and the depreciated exchange rate is likely to sustain this trend. Growth in motor vehicle sales has slowed in recent months, and there was a marked decline in the confidence of new vehicle traders reported by the BER. Despite the higher-than-expected increase in retail trade sales in November, the quarterly rates suggest further moderation in growth. The FNB/BER Consumer Confidence Index declined by 2 index points to -3 index points in the final quarter of 2012.

On balance, the MPC does not assess growth in household consumption expenditure to be excessive or to pose significant inflationary risks, and further moderation is possible. Factors that affect the outlook for consumption expenditure, both positively and negatively, include concerns regarding employment, wage settlements, credit extension particularly unsecured lending, and administered price increases which impact on discretionary spending.

The upward momentum of banks' total loans and advances to the private sector has continued, with twelve-month growth of 9,9 per cent recorded in November, the highest growth rate since February 2009. Excluding mortgage advances, which remain subdued, the increase in November was 18,3 per cent. Bank credit extension to the household sector increased by 10,4 per cent. General loans to households, which is mainly unsecured lending, while still exhibiting rates of growth in excess of 30 per cent, shows some signs of moderation amid reports that banks are becoming more cautious in extending new loans in this category. Access to new loans may also be constrained by the increased size of outstanding debt. However, despite rising debt levels, household debt to disposable income appears to have stabilised at around 76 per cent.

The MPC remains concerned about the potential impact of the higher level of wage settlements on employment and inflation. There are indications that wage increases are trending higher, with growth in nominal remuneration per worker increasing from 7,2 per cent in the second quarter of 2012 to 8,1 per cent in the third quarter. Once productivity increases are accounted for, this translates into unit labour cost increases of 6,1 per cent and 6,7 per cent in these respective quarters. According to Andrew Levy Employment Publications, the overall average wage settlement rate in collective bargaining agreements amounted to 7,4 per cent in the first nine months of 2012.

The MPC is mindful of the danger of a possible wage-price spiral and further employment losses should unaffordable real wage demands be granted while economic growth remains constrained. The risks to inflation should this scenario play itself out are significant in the absence of productivity gains.

The subdued pace of employment creation in the private sector has been further undermined by the fractious nature of recent wage negotiations and the announcement of further possible restructuring in the mining sector, which would involve the closure or mothballing of mines or shafts. According to the Quarterly Employment Statistics survey of Statistics South Africa, non-agricultural formal sector employment grew by 1,0 per cent or 82 000 employees in the year to September 2012. Almost two-thirds of this increase was accounted for by the public sector, while net job losses over this period were experienced in the manufacturing and construction sectors, with employment in the mining sector unchanged. However, in the third quarter of 2012, 15 000 jobs were shed in the mining sector and there are fears that this trend could continue. Employment in the agricultural sector, which is not covered by the survey, is also at risk.

Food prices continue to pose a significant near-term risk to the inflation outlook, although there are signs that these price pressures may moderate during the year as a result of favourable base effects, as well as the recent moderation in global and domestic wheat and maize prices. The price of these commodities will also be influenced by developments in the exchange rate of the rand and unpredictable weather patterns.

Administered prices remain on average well in excess of the upper end of the target range, and there is as yet no clarity about the new Eskom tariffs to be implemented later this year. At this stage a 16 per cent tariff increase is assumed in the forecast. International oil prices have remained relatively stable for the past few months and are more or less unchanged from the previous meeting of the MPC. Futures prices reflect an expectation of some moderation in coming months, but some volatility can be expected. The domestic price of petrol, which is also impacted by the exchange rate, declined by a cumulative 34 cents per litre since early November, but much of this decline is likely to be reversed in February.

The MPC continues to assess the balance of risks to the inflation outlook to be on the upside. While the risks to the forecast emanating from food prices may have diminished somewhat, particularly over the medium term, the exchange rate and wage settlements remain the key upside risk factors. While the reweighting and rebasing of the CPI is still to be finalised, the impact is likely to be marginal, but on the upside. Core inflation trends indicate that demand pressures are relatively contained, and household consumption expenditure has continued to moderate.

Risks to economic growth are assessed to be on the downside, particularly given the uncertain outlook for the mining industry and ongoing unsettled labour relations. The negative output gap is therefore expected to persist. The MPC remains concerned about the possibility of a wage-price spiral and its potential to exacerbate the high level of unemployment in the economy. As we noted in the previous MPC statement, concerted action is needed on the part of all the parties involved. We need cohesion of policy and decision-making to provide the necessary certainty for sustainable economic growth and development.

The monetary policy stance remains accommodative and appropriate, with the real policy rate remaining slightly negative, notwithstanding the expected temporary breach of the inflation target. However, further accommodation at this stage is constrained by the upside risks to the inflation outlook. The MPC 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.

1 These are typically companies such as vehicle finance companies and retail trade finance companies.

Note on recent developments in the finance companies[1] industry

D Mosime

In this *Quarterly Bulletin* statistical tables showing the assets and liabilities of finance companies are launched. This note introduces these companies and highlights key dimensions of their activities.

Finance companies obtain funds in various forms with the objective of lending or investing these funds in the form of instalment sale credit, mortgage loans and other loans. The harnessing of surplus funds from savers and the disbursement of such funds to borrowers is the core business of finance companies. As the financial system became broader, some domestic finance companies have increasingly become important lenders, especially to households.

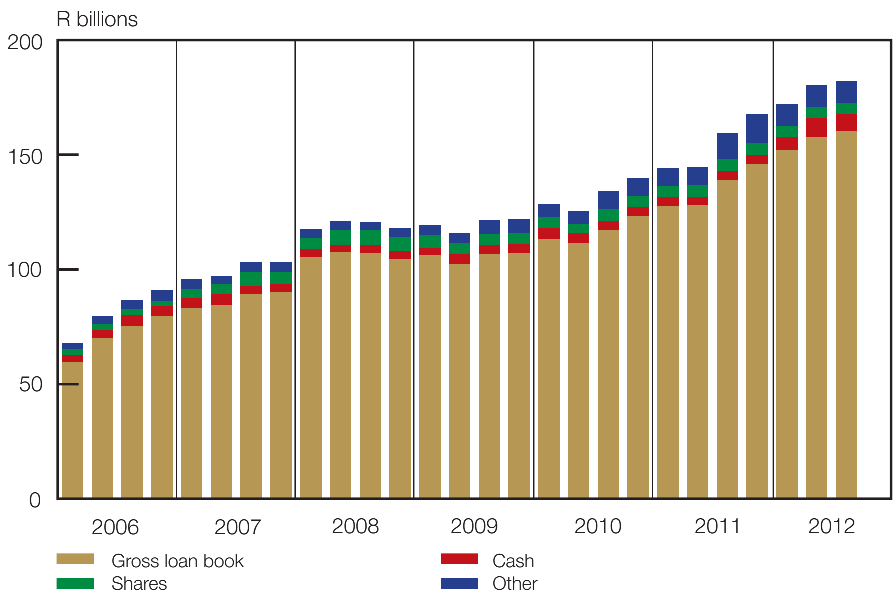
Unlike banks, finance companies are not deposit-taking institutions. Nevertheless, finance companies play an important role similar to that of banks by intermediating credit to households and companies, often to fund consumption expenditure and fixed capital formation. Finance companies had total assets of R182 billion at the end of September 2012. While this is a large amount, it is overshadowed by the banking sector's total assets of R3 583 billion at the time.

2 Consistent data covering the significant industry players were included in the survey from 2006.

The total assets of finance companies rose by 172 per cent from 2006[2] to R182 billion in the third quarter of 2012. In the period from 2006 to 2007 annual average growth in the industry's total assets amounted to 14 per cent per annum, while in the recessionary period 2008–09 this decelerated to 3 per cent. In the subsequent period, 2010 to September 2012, growth in total assets recovered to 9 per cent per annum. However, as a percentage of gross domestic product, assets remained broadly unchanged at 5 per cent from 2006–10, before increasing to 6 per cent in 2011 and September 2012. The growth in the balance sheet of this industry was buoyed by the loan book which increased by 170 per cent from 2006 to R160 billion at the end of September 2012. This was a reflection of several factors, including the ongoing improvement in household disposable income, lower interest rates, innovative financing and rising motor vehicle sales, while banks also exercised greater caution before extending loans.

The gross loan book accounted for 88 per cent of the finance companies' total assets in the third quarter of 2012. Their holdings of cash and cash equivalent instruments constituted a further 4 per cent, with shares and other assets representing the remainder.

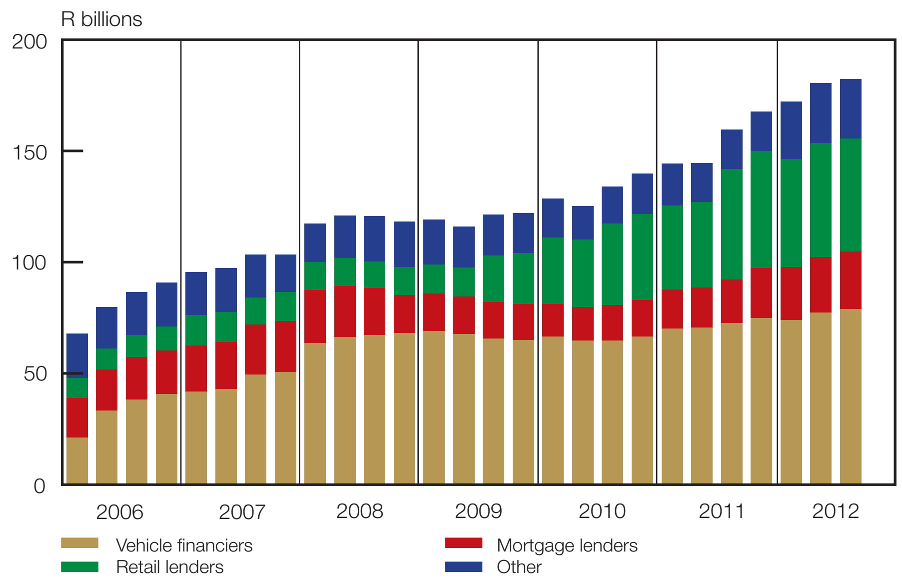
Asset composition of finance companies



The source of funding for finance companies includes loans from banks and parent companies, loans from other institutions, and funds raised in the capital market. Although some banks have strategic partnerships and relationships with finance companies or with parent companies and have, in some instances, direct shareholding, loans received from banks averaged only 29 per cent of total funding obtained by finance companies over the period from 2006–12, dipping below this average during 2007–09.

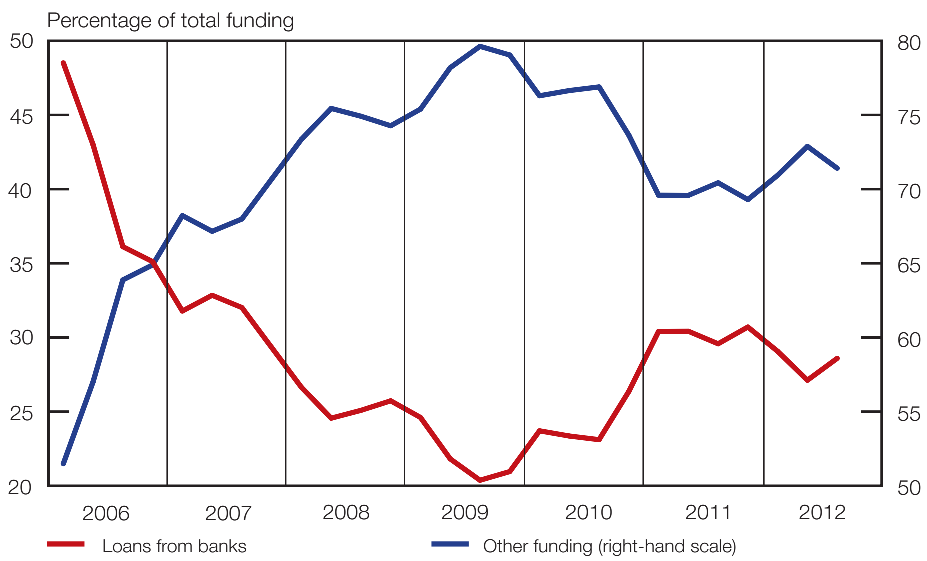
Where finance companies raise funds in the capital market it is usually in the form of debt securities, and mostly through commercial paper and bond programmes that are backed and guaranteed by parent companies. External sources of funding were augmented by internal financing from reserves and retained income, which averaged 13 per cent of total liabilities over the period 2006–12. The diversified funding base made it possible for finance companies to extend credit during the recent financial crisis – as was evident in the vehicle financiers.

Asset holdings by type of lender



Vehicle financiers accounted for 43 per cent of total assets in the finance companies sector in the third quarter of 2012, thereby constituting the largest segment of the market. Retail lenders accounted for 28 per cent and mortgage lenders for a further 14 per cent of total assets, while other sectors accounted for 15 per cent in the same period.

Source of funding by type



3 Gross loans extended minus loans from banks.

The net credit extended[3] by the industry rose by 250 per cent from the first quarter of 2006 to R122 billion in the third quarter of 2012. The growth in net credit extended has supported household consumption and the overall retail and motor trade sector, as well as their supporting industries.

While the finance companies' aggregate credit extension remains much smaller than that of banks, the availability of the former group's data makes it possible to undertake a more comprehensive analysis of credit extension trends in the economy on a regular basis.

Notes to tables

Participation bond schemes: Funds received and invested – Table S–43

Information on participation bond schemes were previously presented in two subtables. These have been collapsed into a single table, retaining the most important series.

Trust companies: Assets and liabilities – Table S–43

A new table with balance sheet information of trust companies has been added.

Finance companies: Assets and liabilities – Table S–44

Finance companies are non-bank companies that obtain funds in various forms with the objective of lending or investing such funds in the form of instalment sale credit, mortgage advances and other loans. A new table presenting these companies' assets and liabilities has been added.

Non-bank financial institutions: Assets and liabilities – Table S–45

Non-bank financial institutions include public and private pension funds, long- and short-term insurers, unit trusts, the Public Investment Corporation, participating mortgage bonds schemes, finance companies and non-monetary public financial corporations. This new table presents consolidated assets and liabilities of these institutions.

National financial account – Tables S–46 to S–47

The national financial accounts tables, previously on pages S–44 and S–45, have been moved to pages S–46 and S–47.