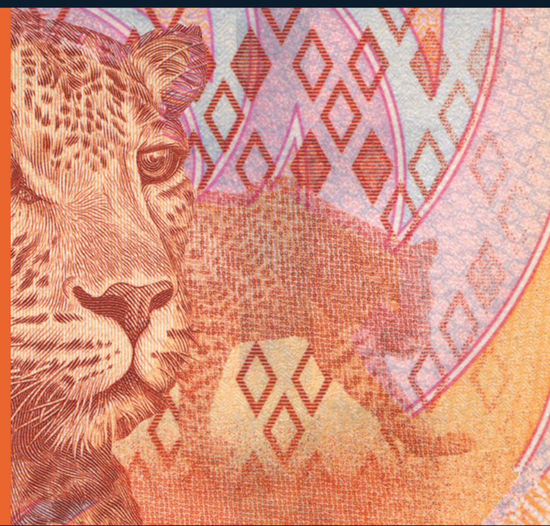
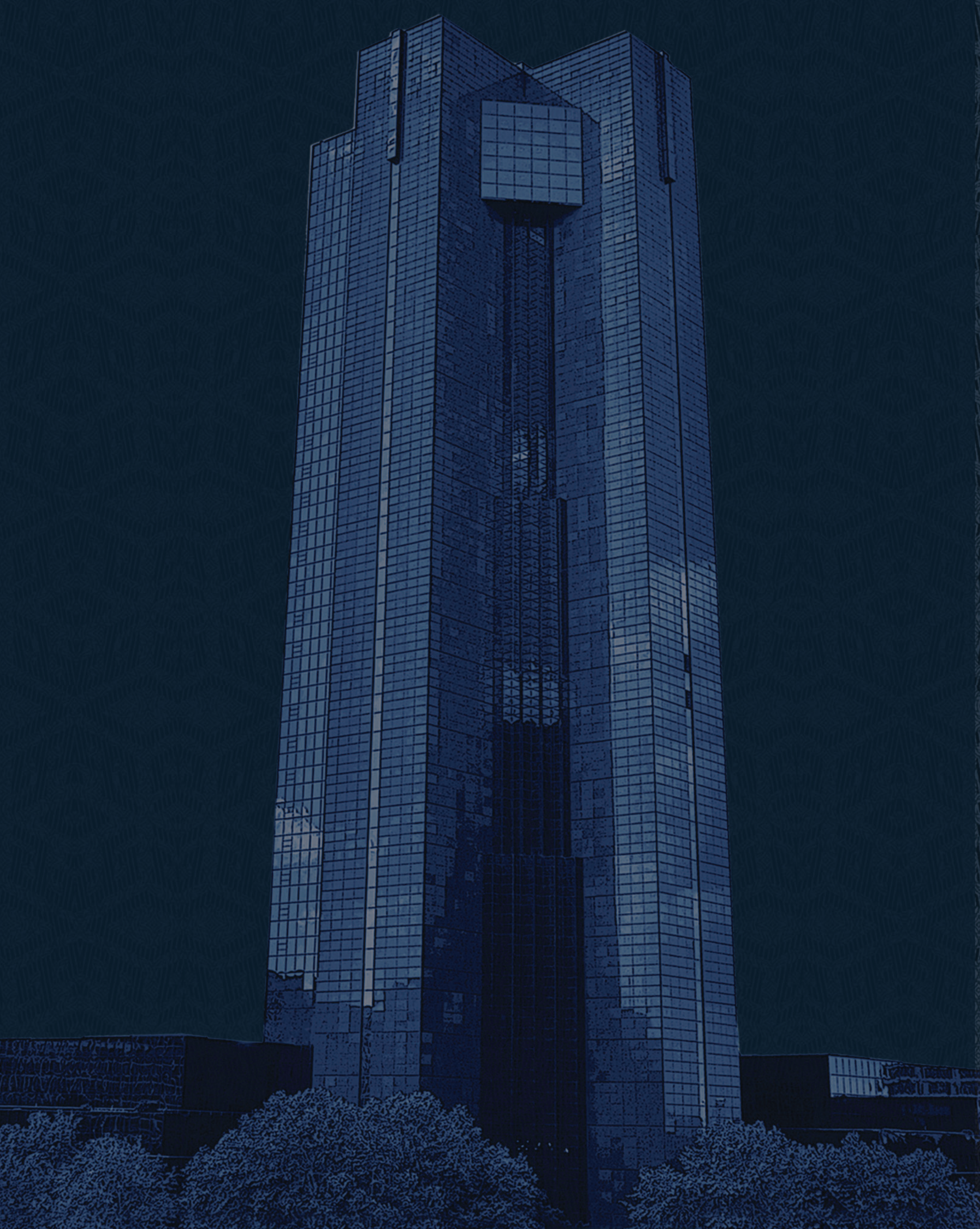
Quarterly Bulletin

September 2013





South African Reserve Bank

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Introduction

Global economic growth improved somewhat in the second quarter of 2013 and was significantly higher than the disappointing rates of increase in output registered in the four preceding quarters. The improvement was visible in both the advanced and the emerging economies, and in part reflected sustained policy efforts directed at generating greater traction in the economic recovery. While in some parts of the world governments continued with programmes to reduce fiscal stimulus, monetary policy in the main advanced economies remained highly expansionary in the first half of 2013 through both low policy interest rate settings and quantitative easing measures.

In May 2013 the chairman of the Federal Reserve in the United States (US) signalled plans to start tapering off the quantitative easing programme. Despite the inevitability of such a course eventually being pursued, this announcement triggered a strong reaction in financial markets worldwide, with bond yields rising, share prices declining and some emerging-market currencies depreciating significantly. International prices of a range of commodities declined in the second quarter of 2013, not least due to an expected lower growth trajectory in China. However, the price of crude oil remained resilient and was bolstered by events in the Middle East, particularly the conflicts in Egypt and Syria and their political ramifications.

South Africa's real growth rate picked up to an annualised rate of 3 per cent in the second quarter of 2013, recovering from the disappointing performance registered in the first quarter of the year. The biggest contribution came from the manufacturing sector, where production rebounded following the first-quarter setback related to a fire at a steel mill, maintenance of refineries and other mainly temporary forces. The electricity and construction sectors also registered improved growth rates in the second quarter. Growth in tertiary production broadly maintained its previous momentum, with the finance and trade sectors registering firm rates of expansion, whereas growth in the production of government services slackened mainly due to a high base in the previous quarter when employees were temporarily appointed to assist with by-elections. However, in the primary sector real output contracted in the second quarter of the year. The real value added by the agricultural sector declined as dry weather conditions in most maize-producing areas of South Africa in the opening months of 2013 led to lower field-crop production. Mining production also receded as platinum output was hampered by escalating cost pressures, unstable ground formations, safety stoppages and sporadic labour disruptions, while diamond production was held back in the wake of severe flooding early in the year at one of the country's largest opencast mines.

Domestic final demand maintained brisk growth momentum in the second quarter of 2013. Overall real final consumption expenditure by households expanded at a slightly firmer pace than in the preceding quarter, as did the real disposable income of the household sector. Households' spending on goods – particularly on durable and semi-durable goods – registered a notable acceleration over the period, led by purchases of motor vehicles, as well as computers and related equipment. Expenditure on motor vehicles was supported by rising income, low interest rates and other incentives offered to customers, the introduction of technologically advanced models, and pre-emptive buying in anticipation of price increases related to the depreciation in the exchange value of the rand. Household debt relative to disposable income inched higher in the second quarter of 2013, while the ratio of household net wealth to disposable income also edged higher despite setbacks to share and bond prices. The pace of increase in the general government's real consumption expenditure slackened marginally in the quarter under review.

Growth in real fixed capital formation accelerated in the second quarter of 2013, led by the private sector. Producers in the agricultural, mining and manufacturing sectors were especially active in this regard. Accordingly, purchases of agricultural machinery picked up. The mining subsectors extracting coal, gold and iron ore recorded higher capital expenditure, while in manufacturing the food, paper products, fuel and motor vehicle subsectors contributed most forcefully to the acceleration in capital spending. Capital formation by general government maintained a firm rate of expansion in the second quarter, with the local authorities in particular stepping up their expenditure. However, capital spending by public corporations contracted moderately in the second quarter, albeit off a high base.

As the economy expanded, inventories continued to accumulate in the quarter under review, with the most significant build-up recorded in the manufacturing and commerce sectors. Agricultural stocks-in-trade were boosted by the relatively early harvesting of a large part of the latest maize crop.

Having inched lower in the preceding two quarters, the deficit on South Africa's current account with the rest of the world widened in the second quarter of 2013 to 6,5 per cent of gross domestic product. The terms of trade deteriorated notably on account of lower international commodity prices, but export revenues were also held back by lacklustre growth in the volume of non-gold exports, notwithstanding a significant depreciation in the exchange value of the rand over the period under review. Manufacturing export volumes contracted somewhat, particularly in the subcategory for vehicles and transport equipment, whereas the export volumes of mining and agricultural products edged higher over the period under review. The volume of merchandise imports also inched higher in the second quarter of 2013. A contraction in dividend receipts from the rest of the world simultaneously contributed to a widening of the deficit on the services, income and current transfer account.

Net capital inflows into South Africa slowed in the second quarter of 2013, congruent with a general dampening of capital flows into emerging-market debt securities in the wake of the US Federal Reserve's indications regarding the tapering of asset purchases. The inflows into South Africa in the second quarter largely took the form of loans extended to South African companies in a foreign direct investment relationship. Renewed purchases of South African equity securities by non-residents were neutralised by selling and redemptions of debt securities in the quarter under review. The net result of the larger deficit on the current account and smaller surplus on the financial account was a moderate deficit on the overall balance of payments, which was mirrored in a somewhat lower level of the gross gold and other foreign reserves. At the same time, the exchange value of the rand depreciated significantly amid the 'tapering' remarks of the Federal Reserve chairman, the weakening of South Africa's terms of trade, sluggish economic growth, high unemployment and ongoing labour union rivalry.

The pass-through from the depreciation in the exchange rate of the rand to domestic inflation remained muted in the first half of 2013, partly on account of substantial surplus capacity in the economy. Nevertheless, in July 2013 consumer price inflation accelerated, driven by food and in particular petrol price inflation, to exceed the upper limit of the target range for the first time since April 2012. At just below 8 per cent, average wage settlement rates in collective bargaining agreements were slightly higher in the first half of 2013 than in 2012, while working days lost due to industrial action were relatively high in the first half of this year. Overall employment in the South African economy nevertheless made modest gains in the first half of 2013, although a brisk expansion in the labour force resulted in the unemployment rate rising somewhat further over this period.

The twelve-month pace of increase in both the broadly defined M3 money supply and the banks' loans and advances to the domestic private sector fluctuated in high single-digit territory in the first seven months of 2013, broadly aligned with the rate of growth in nominal gross domestic product and expenditure. While mortgage lending remained very slow, growth in instalment sale credit remained brisk, consistent with the lively spending on durable goods in the economy. General loans to households lost momentum over the past year as lenders became more cautious in the area of unsecured lending.

The South African Reserve Bank (the Bank) has kept its policy rate unchanged at its current growth-supportive level since July 2012. However, in the second quarter of 2013 long-term interest rates rose considerably and market expectations of future short-term interest rates also moved notably higher following the US Federal Reserve's comments on scaling down asset purchases, the sharp depreciation in the exchange value of the rand, the weakening of the international prices of key South African export commodities and the intensification of domestic labour strife. The environment was characterised by increased uncertainty, with analysts and traders often holding divergent views. South African share prices were supported by the depreciation of the exchange rate of the rand and despite setbacks to resources share prices, the overall share-price index reached record highs in the second quarter of the year and remained in high territory in the subsequent two months. House prices continued rising at a moderate pace during the period under review.

The public sector continued providing support to the economic recovery in the second quarter of 2013, recording a public-sector borrowing requirement equal to 5,1 per cent of gross domestic product. Non-financial public enterprises and corporations registered a significantly higher cash shortfall than a year earlier as they continued with their infrastructure drive. National government recorded a slightly smaller borrowing requirement as rising expenditure was matched by brisk collections of especially taxes on property, customs duty, personal income tax and value-added tax. During the quarter under review government redeemed a euro-denominated foreign bond and financed its cash shortfall by issuing domestic government bonds and Treasury bills, raising its total gross loan debt to 43,7 per cent of gross domestic product at the end of June 2013.

In August 2013 the Bank announced changes to its money-market management strategy, aimed at gradually raising the money-market shortage and thereby the banks' dependence on the central bank for the refinancing of their liquidity shortfalls. Going forward, the trend growth in the money-market shortage would broadly reflect the movements in the stock of notes and coin in circulation outside the Bank and in the banks' required cash reserve deposits with the Bank.

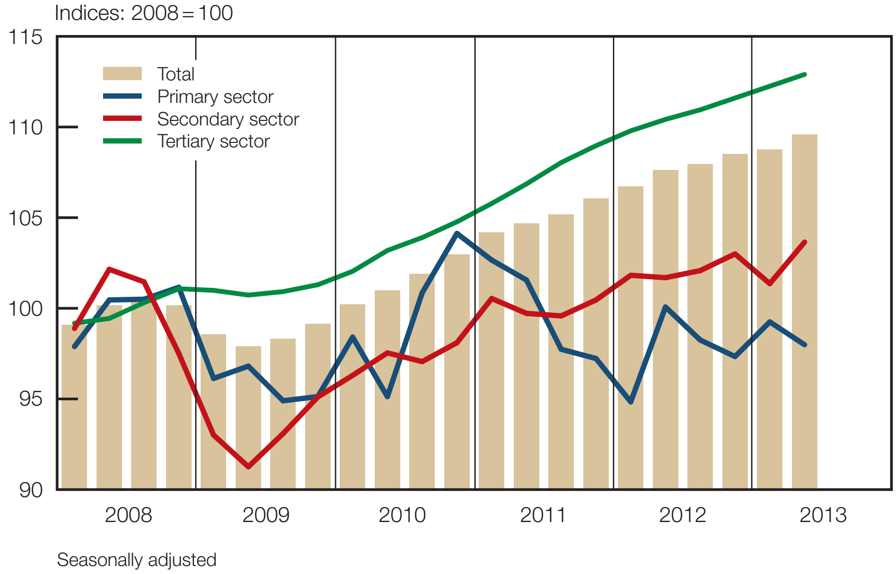
Domestic economic developments

Domestic output[1]

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

Real economic activity in South Africa picked up notably in the second quarter of 2013. Following an annualised growth rate of 0,9 per cent in the first quarter of 2013, the pace of expansion in *real gross domestic product* accelerated to 3 per cent in the second quarter, boosted primarily by the improved performance of the secondary sector. This enhanced performance could in part be attributed to base effects and to a lesser extent to a turn for the better in the fortunes of the manufacturing sector. Real output in the primary sector contracted, while growth in the tertiary sector slowed marginally. Despite this firm uptick in economic activity, aggregate real gross domestic product in the second quarter of 2013 was only 2 per cent higher than in the corresponding period of 2012.

Real gross domestic product by sector



The real value added by the *primary sector* contracted at an annualised rate of 5 per cent in the second quarter of 2013 as output declined in both the mining and agricultural sectors.

In the *agricultural sector* real output contracted at a lower rate of 3,7 per cent in the second quarter of 2013, following a decline of 4,9 per cent in the preceding quarter. A decrease in field crop production due to dry weather conditions in most maize-producing areas in South Africa in the opening months of the year was only partly offset by a sustained increase in livestock and horticultural production over the period. Indications are that the maize crop for the 2012/13 production season could be roughly 5 per cent lower than in the 2011/12 production season.

Mining production continued to be fairly erratic on a quarter-to-quarter basis. Having increased at an annualised rate of 14,6 per cent in the first quarter of 2013, the real value added by the mining sector declined by 5,6 per cent in the second quarter. Pronounced declines were registered in the production of platinum and diamonds. By contrast, the production of coal and other mining products held up well during the period under review.

Platinum production was hampered by escalating cost pressures, increased safety stoppages and sporadic labour disruptions that emerged during the second quarter of 2013. In addition to infrastructure challenges faced by the industry, production was also negatively affected by unstable ground formations that hindered activity at certain platinum mines in the period under review. As far as diamond production is concerned, production levels at one of South Africa's largest opencast diamond mines have not yet normalised after severe flooding experienced at the beginning of the year. Coal production, on the contrary, benefited from continual improvements in operational efficiencies at mines.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2012					2013	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	-9,5	24,0	-7,1	-3,7	-2,2	8,1	-5,0
Agriculture	4,8	9,3	7,4	10,0	2,3	-4,9	-3,7
Mining	-15,1	30,9	-12,7	-9,3	-4,0	14,6	-5,6
Secondary sector	5,5	-0,5	1,5	3,6	2,1	-6,2	9,3
Manufacturing	6,4	-0,8	1,2	5,0	2,4	-7,9	11,5
Tertiary sector	3,1	2,3	1,9	2,4	3,0	2,4	2,3
Non-primary sector	*3,7*	*1,6*	*1,8*	*2,7*	*2,8*	*0,2*	*4,0*
Total	**2,5**	**3,4**	**1,2**	**2,1**	**2,5**	**0,9**	**3,0**

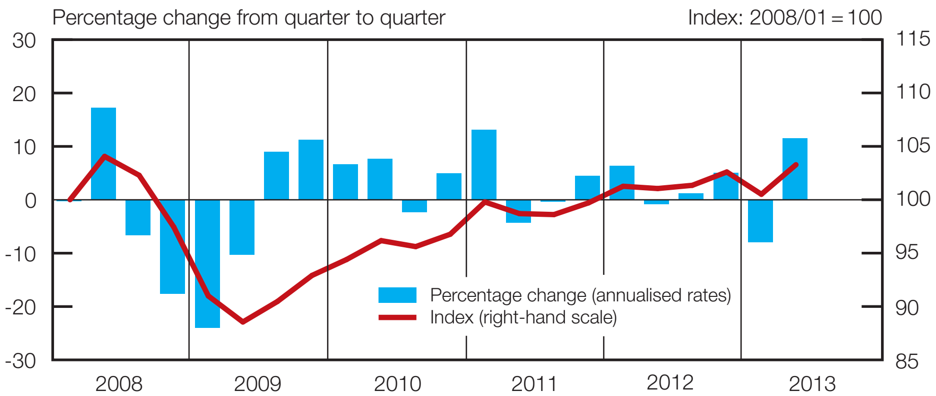
Subsequent to a decline of 6,2 per cent in the first quarter of 2013, the real value added by the *secondary sector* expanded at an annualised rate of 9,3 per cent in the second quarter of 2013 on account of increased production in both the manufacturing, and electricity, gas and water sectors. Growth in the real value added by the construction sector inched marginally higher over the period.

The real output of the *manufacturing sector* rose firmly at an annualised rate of 11,5 per cent in the second quarter of 2013, taking production in the sector to its highest level since the second quarter of 2008. In part this reflected the normalisation of output, following setbacks in the first quarter of 2013 when a fire at a steel mill, refinery maintenance and industrial action temporarily weighed on production. The expansion in manufacturing output in the second quarter was also in keeping with an increase in real gross domestic final demand and more stable global economic conditions. Moreover, domestic producers probably also benefited from the greater competitiveness provided by the lower exchange value of the rand. Pronounced increases were recorded in the production of basic iron and steel, non-ferrous metal products and machinery; motor vehicles, parts and accessories and other transport equipment; and textiles, clothing, leather and footwear. At the other extreme, production of petroleum, chemical products, rubber and plastic products continued to decline over the period. Consistent with the higher level of manufacturing production, the utilisation of production capacity in the manufacturing sector increased from 80,9 index points in the first quarter of 2013 to 81,3 index points in the second quarter.

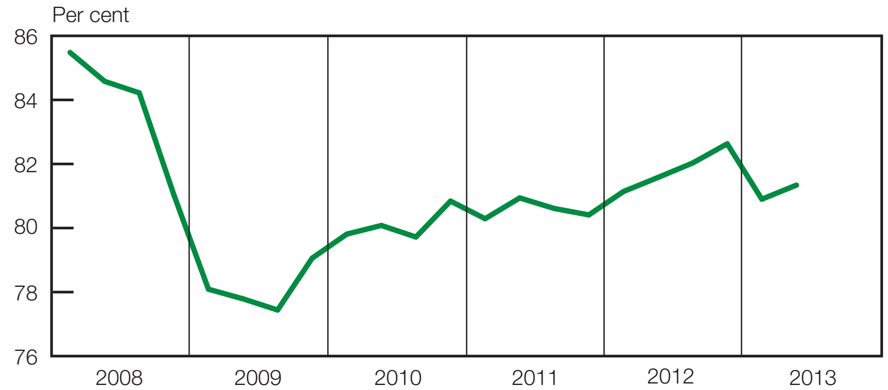
After declining for two consecutive quarters, the real value added by the sector supplying *electricity, gas and water* rose at an annualised rate of 5,3 per cent in the second quarter of 2013. This improvement reflected higher activity levels in the manufacturing sector and in some parts of the mining industry. In particular, smelters consumed substantially more electricity in June 2013 following the termination of buy-back agreements between Eskom and large industrial users of electricity in May 2013. The domestic supply of electricity was further augmented by higher electricity imports as the flood-damaged transmission line at Cahora Bassa in Mozambique returned to service during the second quarter.

The real value added by the *construction sector* increased at an annualised rate of 1,2 per cent in the second quarter of 2013, slightly higher than the rate of increase of 0,9 per cent in the preceding quarter. Activity strengthened in the residential and non-residential building segments of the construction sector, while the civil construction sector maintained its underlying upward momentum.

Real output of manufacturing



Utilisation of production capacity



Seasonally adjusted

The annualised pace of increase in real value added by the *tertiary sector* moderated somewhat from 2,4 per cent in the first quarter of 2013 to 2,3 per cent in the second quarter. The real value added by all the subsectors constituting the services sector increased over the period.

Consistent with the uptick in consumer demand and improved consumer confidence levels in the second quarter of 2013, annualised growth in the real value added by the *trade sector* accelerated from 1,9 per cent in the first quarter of 2013 to 3,2 per cent in the second quarter. Activity in the retail, wholesale and motor trade subsectors remained buoyant and increased further in the second quarter of 2013. Retailers and wholesalers continued to benefit from firm consumer demand and a moderate increase in both disposable income and credit extension over the period. The real value added by the motor trade subsector advanced strongly, underpinned by firm consumer demand in the low-interest rate environment.

Growth in the real value added by the *transport, storage and communication sector* lost some momentum in the second quarter of 2013, moderating from an annualised rate of 2,2 per cent in the first quarter of 2013 to 1,6 per cent in the second quarter. Growth in passenger transportation slowed as a result of the adverse impact of industrial action affecting these services during the period. Growth in the communication subsector, however, continued to benefit from an increased number of subscribers to mobile internet connections and firm demand for data on mobile phones. Sales of mobile handsets continued to rise as smartphones and data packages became more affordable.

Activity in the *finance, insurance, real-estate and business services sector* increased at an annualised rate of 3,5 per cent in the second quarter of 2013, following an increase of 3,3 per cent in the preceding quarter. The somewhat stronger performance could be explained by an increase in trading activity in the domestic securities market. In addition, the real output of the banking sector inched higher underpinned by, *inter alia*, an increase in fees and charges emanating from the growing use of mobile banking applications.

A marginal decrease in employment levels in the second quarter of 2013 mainly accounted for the moderation in the pace of growth in real value added by *general government* from 1,9 per cent in the first quarter of 2013 to 0,3 per cent in the second quarter.

Real gross domestic expenditure

In contrast to the acceleration observed in the growth rate of domestic production in the second quarter of 2013, growth in *real gross domestic expenditure* tapered off from an annualised rate of 3,5 per cent in the first quarter of 2013 to 2,7 per cent in the second quarter. This moderation resulted in part from slower growth in real final consumption expenditure by general government alongside a slower accumulation of real inventories. Compared with the corresponding quarter in the preceding year, total expenditure also lost some momentum in the second quarter of 2013, consistent with a moderation in the final consumption expenditure by households and capital investment over the period.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Component	2012					2013	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure							
Households	4,0	3,2	2,7	2,4	3,5	2,3	2,5
General government	1,9	3,7	8,3	-0,7	4,2	3,0	2,1
Gross fixed capital formation	4,6	5,4	5,6	4,3	5,7	2,5	2,7
Domestic final demand	**3,7**	**3,7**	**4,3**	**2,1**	**4,0**	**2,5**	**2,5**
Change in inventories (R billions)*	5,9	6,3	5,1	-4,1	3,3	4,0	2,7
Gross domestic expenditure	**4,4**	**4,4**	**4,1**	**-0,9**	**4,1**	**3,5**	**2,7**

* At constant 2005 prices

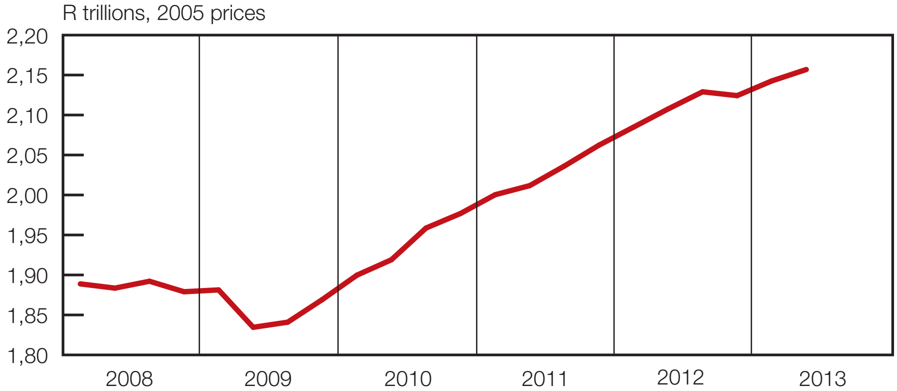
Consistent with the improvement in consumer confidence levels, growth in *real final consumption expenditure by households* accelerated from an annualised rate of 2,3 per cent in the first quarter of 2013 to 2,5 per cent in the second quarter. The ratio of final consumption expenditure by households to gross domestic product consequently increased to 61 per cent in the second quarter of 2013 – the highest ratio since the third quarter of 2009. Even though expenditure by households edged higher in the second quarter of 2013, the pace of increase was still lower than the average rate of growth recorded during the past three years.

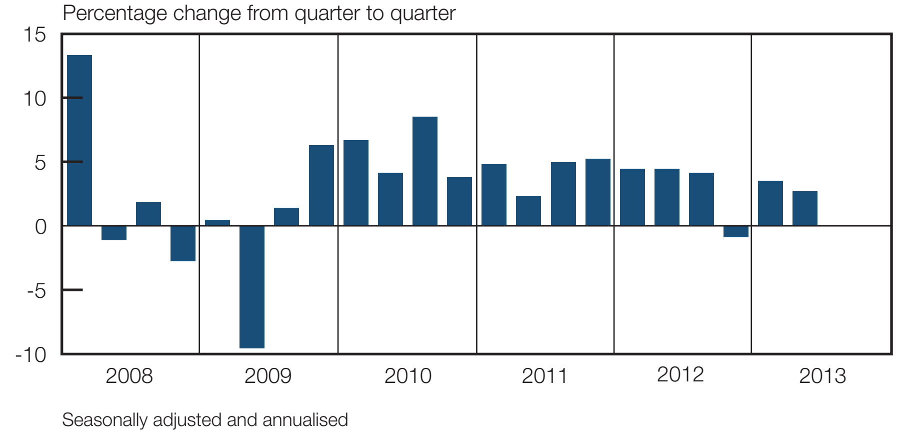
Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2012					2013	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Durable goods	8,1	8,9	7,8	6,1	11,0	5,4	11,8
Semi-durable goods	6,1	6,8	6,2	5,1	6,2	6,2	8,2
Non-durable goods	2,5	2,2	1,7	2,3	2,5	1,4	3,0
Services	3,6	1,7	1,3	0,8	1,8	1,1	-1,9
Total	4,0	3,2	2,7	2,4	3,5	2,3	2,5

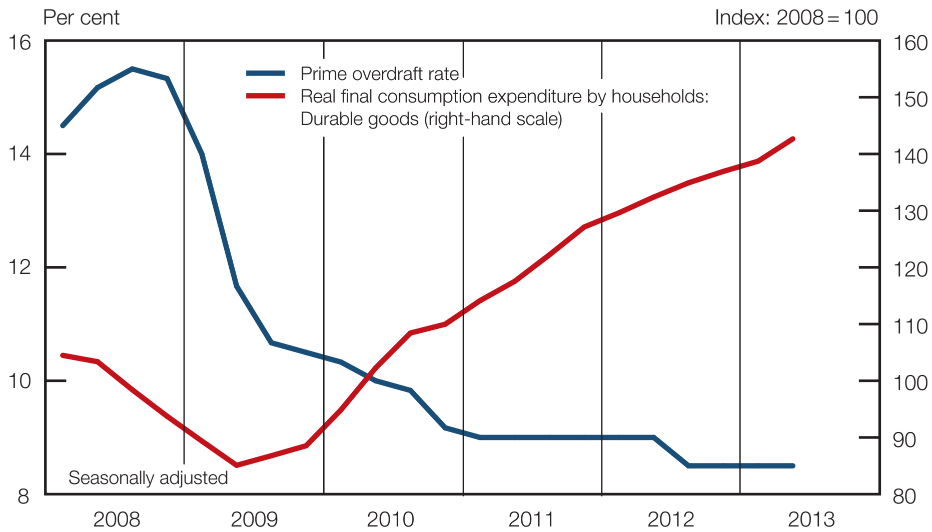
Real gross domestic expenditure





Subsequent to an annualised increase of 5,4 per cent in the first quarter of 2013, growth in real outlays on *durable goods* accelerated to 11,8 per cent in the second quarter. The surge in spending on durable goods could be attributed to increased purchases of personal transport equipment, as well as computers and related equipment. The acquisition of passenger vehicles was probably boosted by attractive incentives offered to customers, the introduction of new high-technology models, and pre-emptive buying in anticipation of possible price increases due to the depreciation in the external value of the rand. By contrast, purchases of furniture and household appliances slowed somewhat, partly as a result of higher import prices and a moderation in credit extended by in-house furniture suppliers.

Prime overdraft rate and household expenditure on durable goods



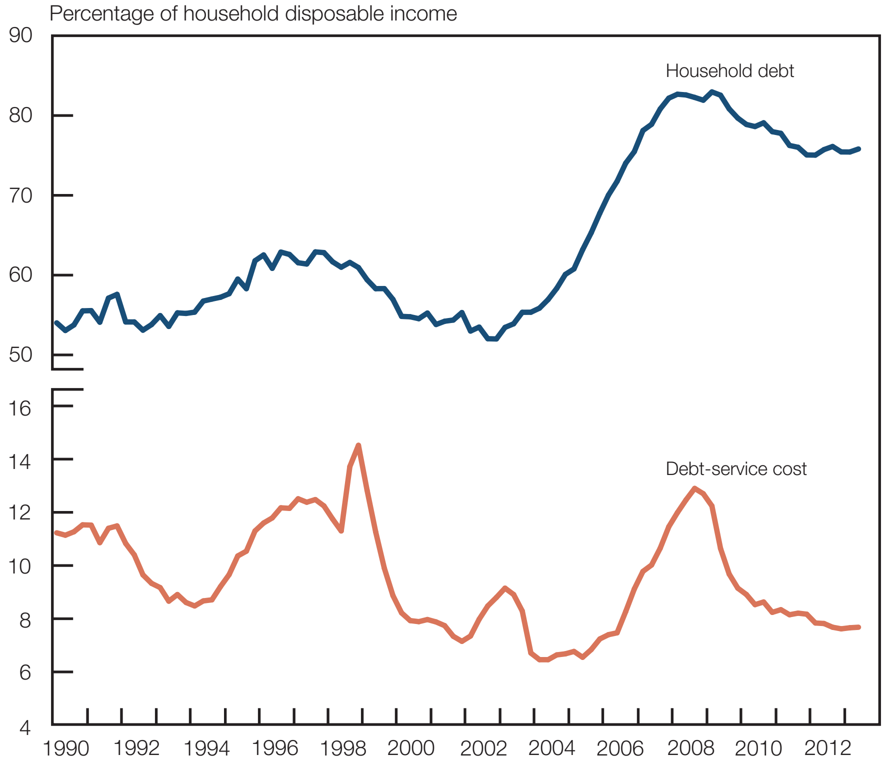
After increasing at a moderate pace in the fourth quarter of 2012, growth in spending on *semi-durable goods* accelerated in the first and second quarters of 2013, recording firm rates of 6,2 per cent and 8,2 per cent respectively. Spending on clothing and footwear – the biggest component of semi-durable goods – expanded further over the period along with increased outlays on motor vehicle parts and accessories, and miscellaneous goods.

Real spending on *non-durable goods* increased at a rate of 3 per cent in the second quarter of 2013, higher than the rate of 1,4 per cent recorded in the previous quarter. Outlays on all categories of non-durable goods increased at a marginally faster pace than in the first quarter, with the exception of spending on medical and pharmaceutical products which slowed over the period.

Real spending on *services* declined at an annualised rate of 1,9 per cent in the second quarter of 2013, following an increase of 1,1 per cent in the preceding quarter. Lower spending on miscellaneous services was partly offset by an increase in spending on all other service-related spending categories.

Having amounted to 2,2 per cent in the first quarter of 2013, annualised growth in *real disposable income* of households edged higher to 2,4 per cent in the second quarter. Concurrently, the nominal level of *household debt* rose further over the period; the ratio of unsecured lending to total household debt, however, remained around 13 per cent in both the first and the second quarters of 2013. Relative to annualised disposable income, household debt increased from 75,4 per cent in the first quarter of 2013 to 75,8 per cent in the second quarter. Consistent with the relatively low interest rate environment, the *debt-service cost* ratio remained at 7,7 per cent in the second quarter of 2013.

Household debt and debt-service ratios



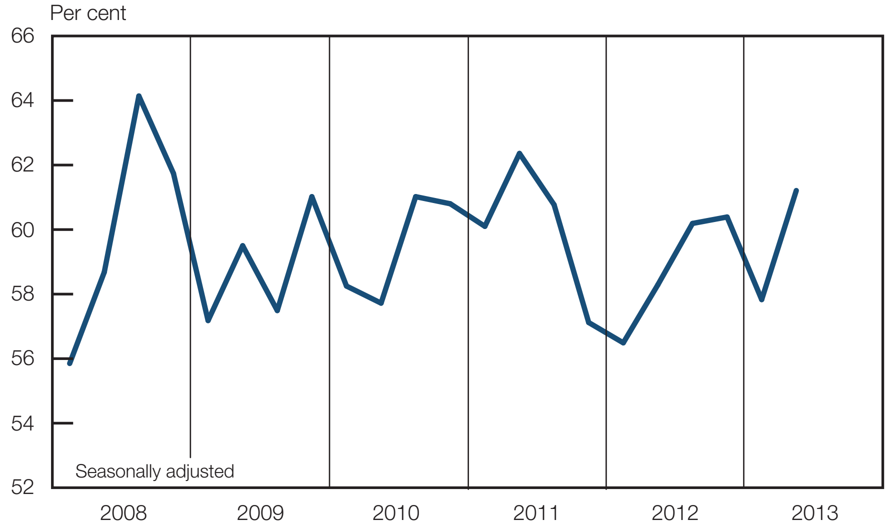
Seasonally adjusted

Growth in the *net wealth of households* tapered off in the second quarter of 2013, mainly reflecting the subdued performance of household financial assets over the period. Quarter-to-quarter increases in the value of households' financial assets lost some momentum in the second quarter partly due to a drop in share prices, whereas the non-financial assets of households continued to rise alongside a moderate upward movement in house prices. The ratio of net household wealth to annualised disposable income, however, still increased from 320 per cent in the first quarter of 2013 to 326 per cent in the second quarter.

Growth in *real final consumption expenditure by general government* slowed to 2,1 per cent in the second quarter of 2013 from 3 per cent in the first quarter. The slower pace of increase reflected the ongoing efforts by government to curb current expenditure and contain the growing public-sector wage bill. Real government consumption expenditure on non-wage goods and services increased at a slower pace in the second quarter of 2013.

Nominal compensation of public employees increased somewhat in the second quarter of 2013, mainly due to annual wage increases of around 5 per cent during the period. The ratio of final consumption expenditure by general government to gross domestic product increased from 22,1 per cent in the first quarter to 22,5 per cent in the second quarter of 2013.

Compensation of employees as a percentage of government consumption expenditure



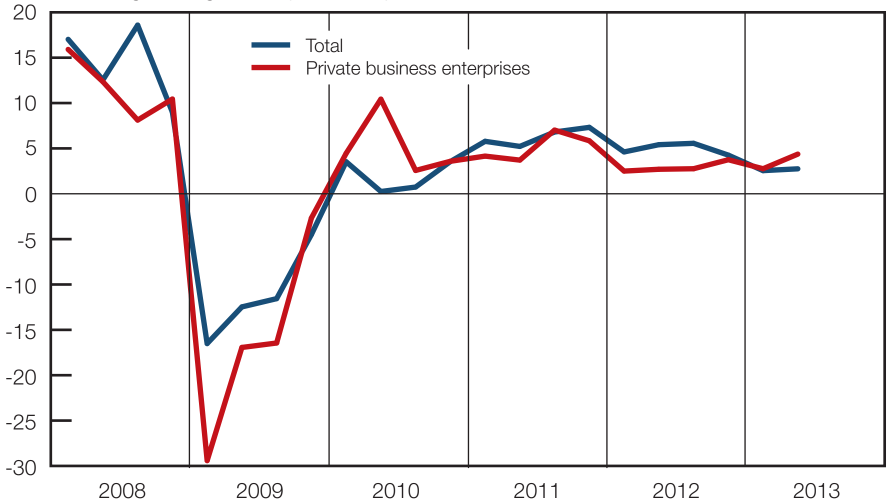
Having increased at an annualised rate of 2,5 per cent in the first quarter of 2013, growth in *real gross fixed capital formation* accelerated to 2,7 per cent in the second quarter. Capital spending by private business enterprises expanded at a faster pace, while spending by general government was sustained at a roughly similar pace than in the first quarter. Real capital spending by public corporations did, however, contract for the first time since the third quarter of 2010.

Comprising more than two-thirds of total gross fixed capital formation, real fixed capital outlays by *private business enterprises* gathered momentum from an annualised growth rate of 2,8 per cent in the first quarter of 2013 to 4,4 per cent in the second quarter. A meaningful contribution to the faster pace of growth was made by increased investment activity by the agricultural, mining and manufacturing sectors.

Capital investment in the agricultural sector was supported by strong increases in sales of agricultural machinery as a result of pre-emptive buying ahead of the possible price increases in response to the recent depreciation in the exchange value of the rand. The mining sector continued to invest in ongoing projects, with the bulk of capital spending shifting from construction works to machinery and equipment. Spending on capital assets was particularly, noticeable in the coal, gold and iron ore mining industries.

Real gross fixed capital formation

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Expenditure, particularly by the food, paper products, fuel and motor vehicle subsectors, contributed towards the faster pace of increase in capital spending by the manufacturing sector. The uptick in market sentiment in the construction sector was underpinned by the sustained increase in capital spending by the private sector in both residential and non-residential buildings. Capital investment in the trade sector was largely evidenced by the development and upgrading of non-residential buildings.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

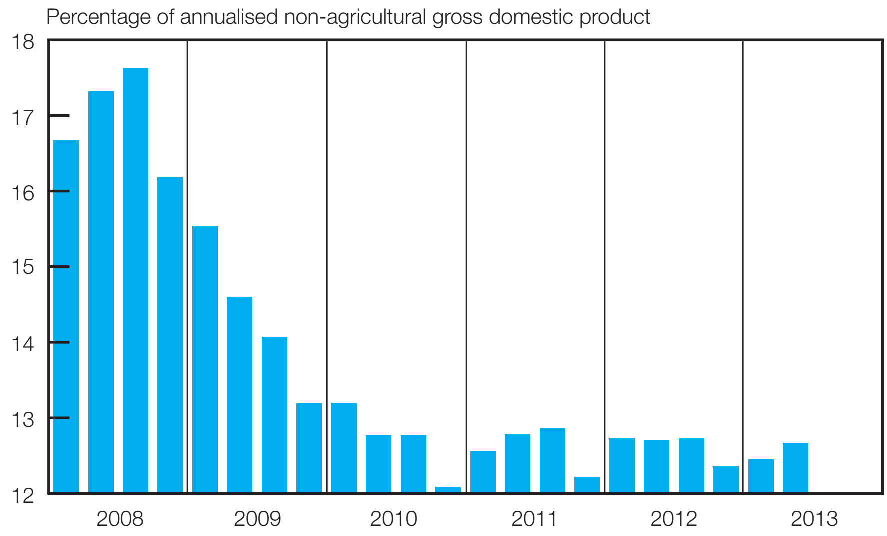
Sector	2012					2013	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Private business enterprises	2,5	2,7	2,8	3,8	3,9	2,8	4,4
Public corporations.............................	11,0	9,8	10,6	7,2	9,1	1,5	-2,0
General government	4,9	10,9	10,3	2,1	8,5	3,2	3,1
Total	**4,6**	**5,4**	**5,6**	**4,3**	**5,7**	**2,5**	**2,7**

Real fixed capital expenditure by *public corporations* contracted at an annualised rate of 2 per cent in the second quarter of 2013. The decline in capital spending by public corporations reflected a series of unplanned delays on current projects and a sluggish uptake of new projects. The level of spending was mainly curtailed by restrained growth in the transport sector as most of the leading public entities, including Transnet, SANRAL and the Trans-Caledon Tunnel Authority, lowered their capital spending. Although expenditure by Eskom picked up from the first quarter of 2013, it was not enough to increase the overall capital spending by this institutional sector.

The pace of capital spending by *general government* was roughly maintained in the second quarter of 2013. Improved capital spending by local government departments and sustained spending by provincial government departments supported the sideways movement in capital outlays by the sector. Capital spending was particularly focused on roads and transport, utilities, human settlements, education and health. The investment in both economic and social services contributed to the fulfilling of service delivery mandates.

Real inventory investment decelerated from R4 billion in the first quarter of 2013 to R2,7 billion in the second quarter, mainly on account of developments in the mining sector. The slower pace of inventory accumulation in the mining sector mainly reflected lower inventory holdings in the platinum-mining sector in the second quarter of 2013. Manufacturing inventories increased in response to heightened production levels of various manufactured products, while exports of certain categories of manufactured goods lost some momentum. Stock levels in the commerce sector rose owing to an increase in agricultural stocks-in-trade as the bulk of the latest maize crop was harvested and stored in silos during the quarter under review. Consequently, the level of industrial and commercial inventories as a percentage of non-agricultural gross domestic product increased from 12,5 per cent in the first quarter of 2013 to 12,7 per cent in the second quarter – similar to the ratio registered in the first three quarters of 2012. This ratio is significantly lower than in the period preceding the financial crisis. Possible reasons for the declining trend in the inventory ratio include the deterioration in economic growth and an increasingly competitive business environment, which necessitated the implementation of steps to curtail the cost of holding inventories. Advanced technology also made provision for more effective inventory management techniques.

Industrial and commercial inventories



Seasonally adjusted

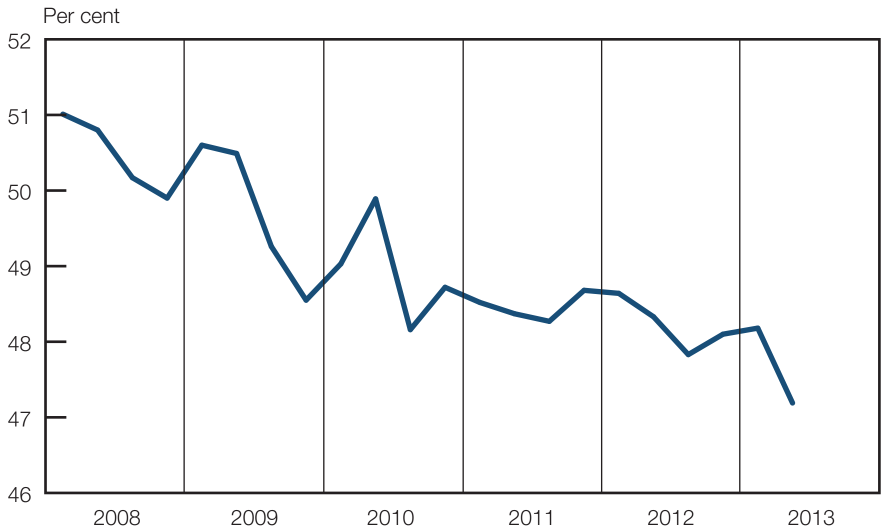
Factor income

The growth in *total nominal factor income*, measured over one year, slowed from 6,9 per cent in the first quarter of 2013 to 6,2 per cent in the second quarter. This slightly weaker growth resulted from slower growth in the operating surplus of business enterprises, while compensation of employees edged higher over the same period.

Year-on-year growth in *total compensation of employees* accelerated from 7,4 per cent in the first quarter of 2013 to a firm 8,6 per cent in the second quarter. Strong growth was registered in almost all sectors of the economy following widespread industrial wage protests in the opening months of the year. Relative to total factor income, the remuneration of employees increased from 51,8 per cent in the first quarter of 2013 to 52,8 per cent in the second quarter.

Measured over a year, growth in the total *gross operating surplus* decelerated notably from 6,2 per cent in the first quarter of 2013 to 3,8 per cent in the second quarter. This moderation in the pace of increase in the gross operating surplus of business enterprises was mainly attributable to the mining sector, where business conditions remained challenging due to ongoing labour disputes, falling commodity prices and rising production costs. Profits in the mining and manufacturing sectors were further depressed as production and exports continued to face weak global demand. Consequently, the share of the gross operating surplus in total factor income receded from 48,2 per cent in the first quarter of 2013 to 47,2 per cent in the second quarter.

Gross operating surplus as a percentage of total factor income



Seasonally adjusted

Saving

South Africa's *national saving ratio* (i.e., total gross saving as a percentage of total gross domestic product) moderated from 14 per cent in the first quarter of 2013 to 13,3 per cent in the second quarter. A deterioration in the saving performance of corporate business enterprises more than fully offset a lower rate of dissaving by general government, while the household saving ratio remained stable over the period. The foreign financing ratio increased somewhat from 29,3 per cent in the first quarter of 2013 to 32,8 per cent in the second quarter, indicating that gross capital formation was financed to a greater extent by foreign sources.

Gross saving by the *corporate sector* as a percentage of gross domestic product decreased from 14,2 per cent in the first quarter of 2013 to 13,3 per cent in the second quarter. The annual growth rate in gross operating surpluses of incorporated business enterprises slowed from 5,4 per cent in the first quarter of 2013 to 2,8 per cent in the second quarter, partly on account of weaker international commodity prices. This slowdown was partly countered by lower dividend payments in the quarter under review.

Dissaving by *general government* as a ratio of gross domestic product improved marginally from 1,9 per cent in the first quarter of 2013 to 1,7 per cent in the second quarter. Tax revenue increased at a steady annual rate of around 9 per cent in the second quarter of 2013, while government consumption expenditure rose at a slower pace, thus supporting the national saving ratio.

The gross saving rate of the *household sector* remained unchanged at 1,7 per cent in the first and second quarters of 2013. An increase in disposable income of households was matched by higher growth in household consumption expenditure in the second quarter.

Employment

Following the marginal decline in the level of formal non-agricultural employment in the fourth quarter of 2012, employment rose notably in the first quarter of 2013, despite a marked slowdown in output growth over the period. According to the *Quarterly Employment Statistics* (*QES*) survey by Statistics South Africa (Stats SA), employment increased by 2,8 per cent (seasonally adjusted

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

and annualised) in the first quarter of 2013, as both public and private-sector employment levels rose. After adjustment for seasonal variation, around 57 600 employment opportunities were created in the first quarter of 2013, advancing the level of total formal non-agricultural employment to an estimated 8,48 million at the end of the quarter.[2]

Change in enterprise-surveyed formal non-agricultural employment by sector*

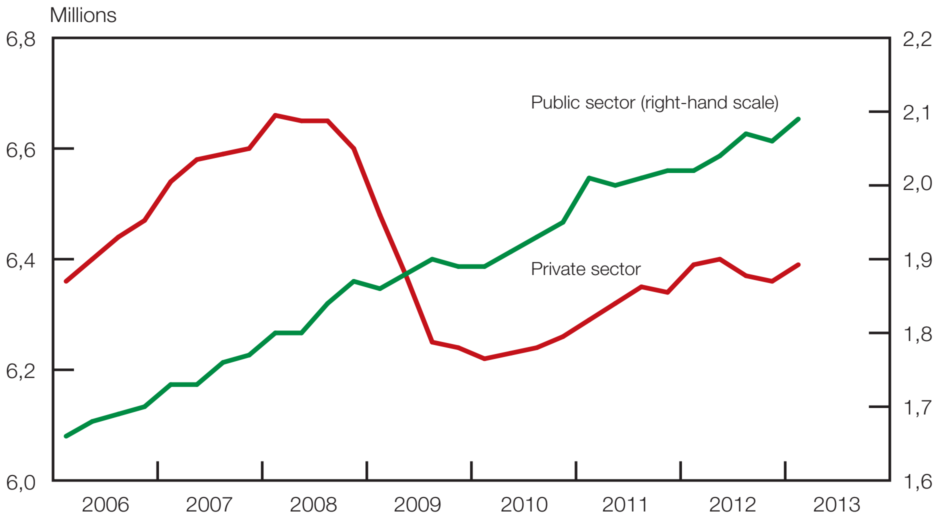
Sector	Change in 1st qr 2013		Change over four quarters to 1st qr 2013		Cumulative job losses(-) gains(+)	
	Number	Per cent	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 1st qr 2013
Finance, insurance, real-estate and business services	21 500	4,8	9 200	0,5	-163 400	97 900
Manufacturing	-3 800	-1,3	-10 600	-0,9	-118 300	-38 500
Trade, catering and accommodation services	19 600	4,8	10 600	0,6	-75 700	57 900
Construction	-1 700	-1,6	3 800	0,9	-52 100	13 500
Total mining	- 400	-0,3	-8 700	-1,7	-35 900	23 200
Gold mining	-2 200	-6,1	-4 300	-3,0	-8 900	-21 300
Other mining	1 800	1,9	-4 400	-1,2	-27 000	44 500
Electricity	- 300	-2,0	1 400	2,2	-3 300	5 900
Private transport, storage and communication services	-2 000	-3,0	-4 300	-1,6	-2 000	2 800
Community, social and personal services	-1 700	-1,6	3 200	0,8	13 400	12 300
Private sector	**31 300**	**2,0**	**4 500**	**0,1**	**-437 300**	**174 900**
Provinces	-3 200	-1,2	8 700	0,8	51 600	77 400
Local governments	- 200	-0,4	13 300	5,2	15 000	29 200
National departments	7 600	7,0	10 800	2,4	- 800	43 200
Public transport, storage and communication services	-1 100	-3,7	14 700	13,7	-4 900	18 100
Other public-sector enterprises	23 400	87,4	27 400	20,5	-7 800	32 200
Total public sector	**26 400**	**5,2**	**74 900**	**3,7**	**53 100**	**200 000**
Grand total	**57 600**	**2,8**	**79 400**	**0,9**	**-384 200**	**374 900**

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

The public sector expanded its job complement by 26 400 or by 5,2 per cent in the first quarter of 2013. The bulk of these job gains, however, consisted of temporary employment positions created by the Independent Electoral Commission to assist in a number of municipal by-elections. In addition, employment levels increased at national departments. Conversely, local governments and provinces reduced their employment numbers in the first quarter of 2013.

Following two consecutive quarterly declines, private-sector employment rose at an annualised rate of 2,0 per cent in the first quarter of 2013. Job increases were registered in the trade, catering and accommodation services sector (at an annualised rate of 4,8 per cent); the finance, insurance, real-estate and business services sector (4,8 per cent) and the non-gold mining sector (1,9 per cent). These increases were, in part, offset by employment losses in the gold-mining sector (6,1 per cent); the private transport, storage and communication sector (3,0 per cent); the electricity generation sector (2,0 per cent); the construction sector (1,6 per cent); the private community, social and personal services sector (1,6 per cent) and the manufacturing sector (1,3 per cent). In the year to the first quarter of 2013 total private-sector employment expanded by a mere 4 500 job opportunities.

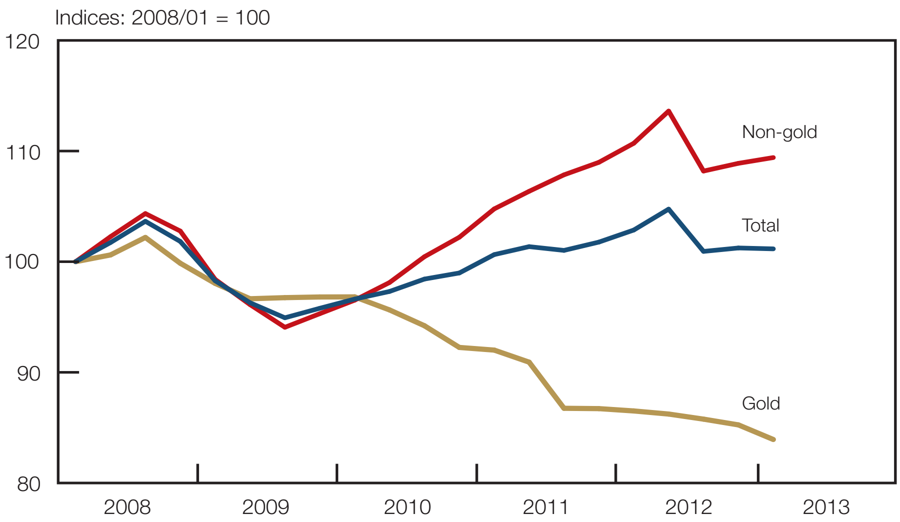
Formal non-agricultural employment



Seasonally adjusted

Overall employment in the mining sector decreased marginally in the first quarter of 2013, as job shedding in the gold-mining sector which continued apace offset further employment gains in the non-gold mining sector. Following the incidence of unprotected strike activity that pervaded the mining sector in 2012, contributing to 18 700 non-gold mining jobs being lost in the third quarter of 2012, employment in the non-gold mining sector increased by a mere 2 400 in the fourth quarter of 2012 and 1 800 in the first quarter of 2013, as some of the miners who were dismissed during the wildcat strikes were subsequently re-employed. Conversely, employment levels in the gold-mining sector disappointingly continued to contract, with the pace of labour paring accelerating for the fifth consecutive quarter to an annualised rate of 6,1 per cent in the first quarter of 2013. Job shedding in the gold-mining sector in recent quarters has been exacerbated by the notable decline in the US dollar price of gold since October 2012, which was only partially offset by the depreciation in the exchange rate of the rand. In addition to the depressed gold price and the already high extraction cost of gold, the gold-mining sector is currently engaged in a challenging round of collective bargaining wage negotiations. Should wage increases be implemented that meet the current exceptionally high wage demands of labour unions, the gold-mining sector could be susceptible to further labour paring. Besides the gold-mining sector, wage negotiations are also underway in a number of other mining subsectors facing an equally challenging operational and global economic environment.

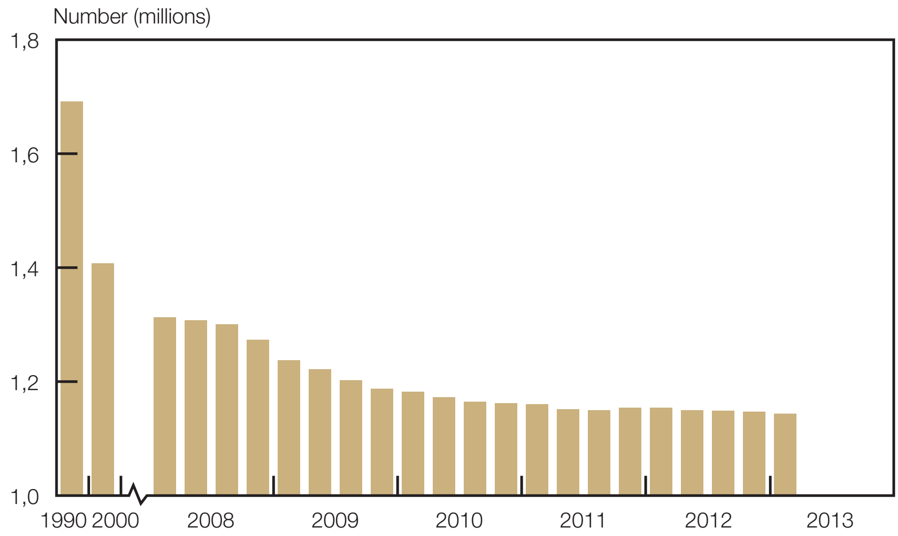
Mining-sector employment



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

Employment in the manufacturing sector has trended downwards over the past two decades, mainly for structural reasons. It decreased at an annualised rate of 1,3 per cent in the first quarter of 2013 – its fifth consecutive quarterly decline. The year-on-year pace of job shedding amounted to around 0,8 per cent in both the fourth quarter of 2012 and the first quarter of 2013. Disappointingly, recent outcomes of sentiment indicators do not support employment creation in the manufacturing sector in the short term. After remaining marginally below the neutral 50 index level in the second half of 2012, the seasonally adjusted employment sub-index of the Kagiso Purchasing Managers' Index (PMI) decreased notably in the first two quarters of 2013, amounting to an average index level of 44,7 in the second quarter of 2013. In addition, manufacturing business confidence as measured by the Bureau for Economic Research (BER) declined by eight index points to a level of 34 in the second quarter of 2013, largely undoing the improvements registered in the preceding two quarters. Manufacturers also reported the further retrenchment of labour in the second quarter of 2013, with a net majority of respondents indicating that their workforce had shrunk in the year to the second quarter of 2013. The outlook for manufacturing is likely to be negatively affected in the medium term by rising consumer price inflation, an uncertain labour market environment, and the high cost and constrained availability of electricity. Higher export earnings and improved competitiveness against imports following the depreciation in the exchange value of the rand could, however, mitigate the impact of these domestic headwinds to some extent.

Manufacturing-sector employment

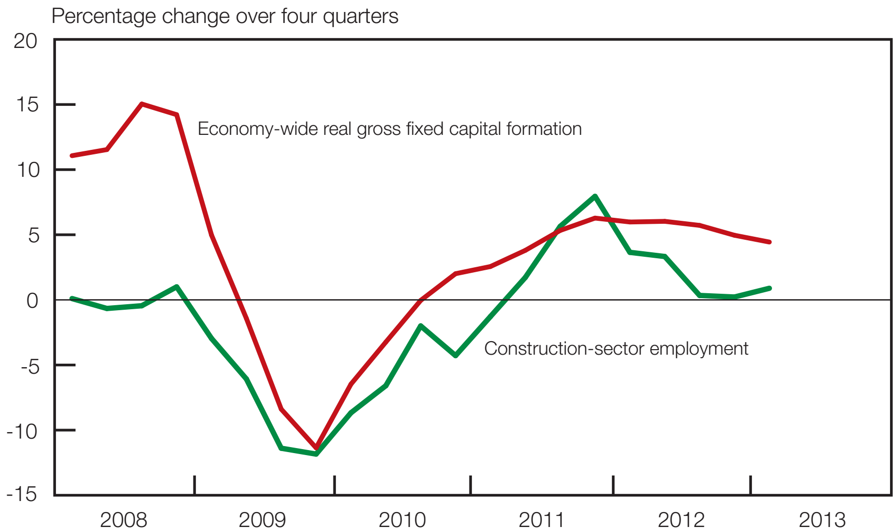


Seasonally adjusted
Source: Statistics South Africa, *Quarterly Employment Statistics* survey

Employment in the electricity generation sector decreased further at an annualised rate of 2,0 per cent in the first quarter of 2013, following labour unrest at the construction site of Eskom's new Medupi power station. These developments, accompanied by the underperformance of certain key contractors, recently compelled Eskom to announce a delay in the completion of the first unit of Medupi from December 2013 to the second half of 2014. Eskom noted that its infrastructure investment programme which commenced in 2005 resulted in roughly 35 800 people currently being employed on their project sites.

Following a marginal increase in the fourth quarter of 2012, employment in the construction sector decreased at an annualised rate of 1,6 per cent in the first quarter of 2013, resulting in the level of employment being only 0,9 per cent higher than in the first quarter of 2012. Despite the drop in employment in the first quarter of 2013, employment prospects in the construction sector continue to improve gradually. As such, the FNB/BER Building Confidence Index increased further to a level of 41 index points in the second quarter of 2013 – its highest level since the start of the global financial crisis. While still below neutral, confidence rose among both residential and non-residential contractors. Conversely, the FNB/BER Civil Construction Confidence Index declined by 6 index points in the second quarter of 2013 from a post-recession high of 51 index points in the first quarter. According to the BER, confidence edged lower largely due to a deterioration in profitability – construction activity in the public sector continued to pick up over the period. The sustained increase in construction activity and the higher level of confidence bode well for employment creation in the construction sector in coming quarters.

Gross fixed capital formation and construction-sector employment



Following a marginal increase in the fourth quarter of 2012, employment in the finance, insurance, real-estate and business services sector increased notably at an annualised rate of 4,8 per cent in the first quarter of 2013. This sector, which includes labour-broking firms, is the largest provider of employment opportunities in the formal non-agricultural sector of the economy, employing an estimated 1,8 million workers.

Despite employment in the trade, catering and accommodation services sector increasing at an annualised rate of 4,8 per cent in the first quarter of 2013, year-on-year employment gains remained lacklustre at a rate of 0,6 per cent. According to the BER, the retailer confidence level fell from 50 in the first quarter of 2013 to 41 in the second quarter as volume growth remained subdued, with challenging trading conditions prevailing in both the durable and non-durable goods sectors. In addition, the indicator measuring growth in the number of people employed deteriorated notably in the second quarter of 2013. Encouragingly, the FNB/BER Consumer Confidence Index rebounded by 8 index points to a positive level of 1 in the second quarter of 2013, signalling an improvement in consumers' willingness to spend. The continued tapering off in household consumption expenditure growth could weigh on employment creation in the trade sector.

According to the *Quarterly Labour Force Survey* (*QLFS*) conducted by Stats SA, there were approximately 13,7 million persons employed in South Africa in the second quarter of 2013, representing an increase of 274 000 people compared with the same period in 2012. Total employment increased by 100 000 job opportunities from the first to the second quarter of 2013 on a non-seasonally adjusted basis. However, the number of unemployed persons increased by 254 000 in the year to the second quarter of 2013, lifting the official unemployment rate in the South African economy to 25,6 per cent from 24,9 per cent a year earlier and 25,2 per cent in the first quarter of 2013.

Labour market statistics

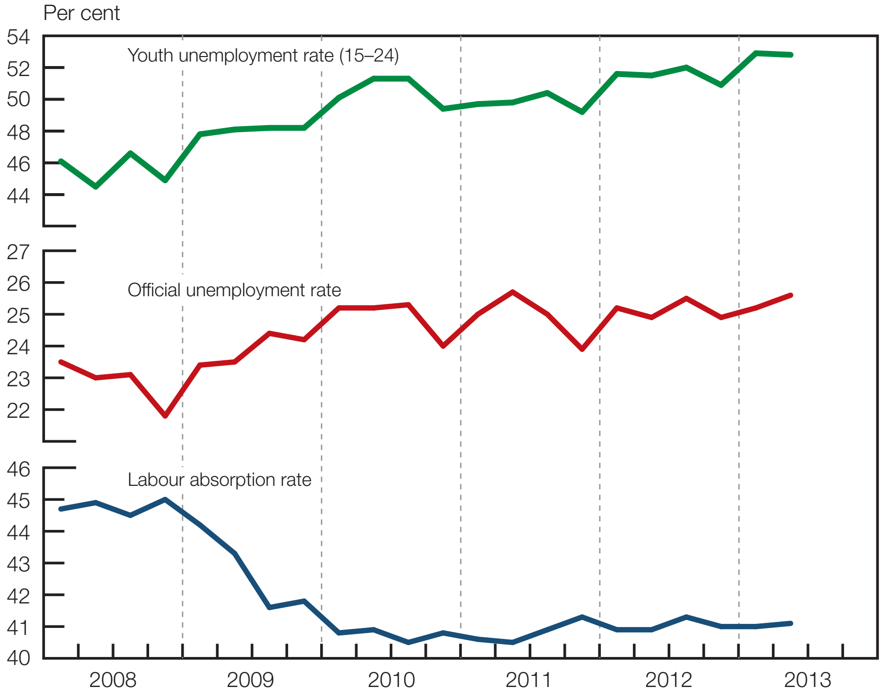
Thousands

	Jun 2012	Sep 2012	Dec 2012	Mar 2013	Jun 2013
a. Total employment	13 447	13 645	13 577	13 621	13 721
b. Total unemployment (official definition)	4 470	4 667	4 501	4 601	4 723
c. Total economically active (= a + b)	17 916	18 313	18 078	18 222	18 444
d. Total not economically active	14 987	14 705	15 050	15 017	14 908
e. Total aged 15–65 years (= c + d)	32 903	33 018	33 128	33 240	33 352
f. Official unemployment rate (= b*100/c)	24,9%	25,5%	24,9%	25,2%	25,6%

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

The higher unemployment rate could largely be explained by an expansion in the labour force. Youth unemployment remained exceptionally high and amounted to 52,8 per cent in the second quarter of 2013 – a magnitude similar to that in some of the most troubled economies in Europe. Disappointingly, the number of discouraged work-seekers increased by 54 000 in the year to the second quarter of 2013, bringing the total number of discouraged work-seekers to almost 2,4 million individuals.

Official unemployment rate, youth unemployment rate and labour absorption rate



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

Labour cost and productivity

The year-on-year pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy accelerated from 6,6 per cent in the fourth quarter of 2012 to 7,5 per cent in the first quarter of 2013. Nominal wage inflation accelerated in both the public and private sectors of the economy, the speeding up being most pronounced in the public sector where wage inflation accelerated from 6,3 per cent in the fourth quarter of 2012 to 7,8 per cent in the first quarter of 2013. In addition, the pace of increase in the real take-home pay of those gainfully employed in the formal non-agricultural sector of the economy picked up from a year-on-year rate of 1,1 per cent in the fourth quarter of 2012 to 2,3 per cent in the first quarter of 2013.

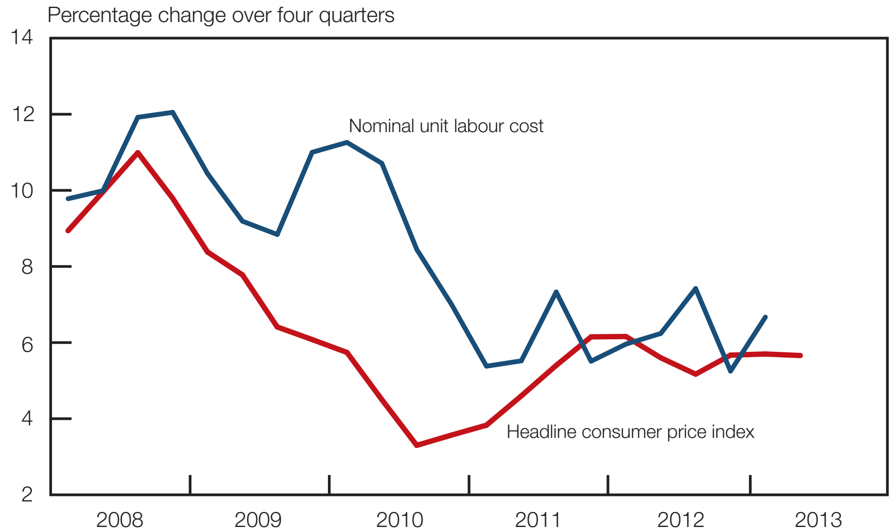
The advance in nominal remuneration per worker in the public sector in the first quarter of 2013 was most pronounced at the national and provincial level, registering a year-on-year increase of 11,8 per cent. Nominal remuneration per worker in other public-sector enterprises, excluding transport, storage and communication enterprises, however, *decreased* by 5,1 per cent in the year to the first quarter of 2013. The average remuneration per worker in this sector was likely dragged down by the appointment of a sizeable number of temporary employees by the Independent Electoral Commission for the completion of municipal by-elections.

Private-sector wage inflation accelerated marginally from 6,6 per cent in the fourth quarter of 2012 to 7,0 per cent in the first quarter of 2013. Year-on-year increases in nominal remuneration per worker remained above the inflation target range in all subsectors, with the exception of the finance, insurance, real-estate and business services sector (3,8 per cent). Remuneration per worker increased most rapidly in the non-gold mining sector (13,1 per cent), followed by the gold-mining sector (11,9 per cent); the private transport, storage and communication sector (11,7 per cent); the construction sector (8,9 per cent); the manufacturing sector (8,5 per cent); the trade, catering and accommodation services sector (8,1 per cent) and the electricity generation sector (7,8 per cent). Apart from fairly high wage settlement rates, the persistently high growth rates in remuneration per worker in some of the goods-producing sectors of the economy could probably be attributed to the replacement of lower remunerated unskilled employees with higher remunerated semi-skilled and skilled employees.

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements remained unchanged at 7,9 per cent in the first half of 2013, slightly above the average settlement rate of 7,6 per cent for 2012 as a whole. The number of working days lost due to industrial action rose from 750 000 in the first half of 2012 to 1,8 million in the first half of 2013 – the highest comparative number since 2008. With a number of multi-year wage negotiations taking place in the third quarter of this year, a further sizeable number of workdays are at risk during the remainder of 2013.

The marginal acceleration in year-on-year growth in employment in the formal non-agricultural sector of the economy in the first quarter of 2013, coupled with the notable moderation in output growth, resulted in a deceleration in labour productivity growth from 1,3 per cent in the fourth quarter of 2012 to 0,8 per cent in the first quarter of 2013. Similarly, productivity growth in the manufacturing sector decelerated to 2,3 per cent in the year to the first quarter of 2013, as output growth moderated alongside a further decline in the level of employment.

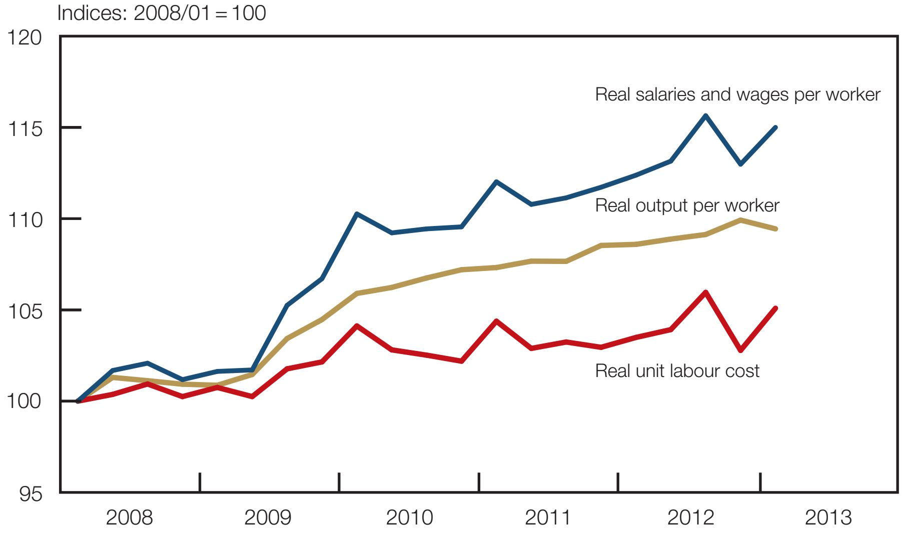
Nominal unit labour cost in the formal non-agricultural sector and consumer price inflation



Remuneration growth in the formal non-agricultural sector of the economy accelerated while real output growth slowed, resulting in year-on-year growth in nominal unit labour cost accelerating notably from 5,2 per cent in the fourth quarter of 2012 to 6,7 per cent in the first quarter of 2013. The year-on-year pace of increase in nominal unit labour cost in the manufacturing sector also accelerated from 5,1 per cent in the fourth quarter of 2012 to 6,0 per cent in the first quarter of 2013, as remuneration growth in manufacturing moderated at a slower pace than output growth. However, 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), the year-on-year pace of increase in unit labour cost decelerated from 6,8 per cent in the fourth quarter of 2012 to 5,5 per cent in the first quarter of 2013.

The accompanying graph indicates that from the first quarter of 2008, increases in real remuneration per worker in the formal non-agricultural sector occurred at a faster pace than productivity growth, particularly following the 2008–09 economic recession. As a result, real unit labour cost trended higher over this period, adding to inflationary pressures in the economy.

Real remuneration, productivity and unit labour cost in the formal non-agricultural sector



Prices

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

Against the backdrop of a relatively benign international inflation environment and subdued global and domestic output growth, domestic headline consumer price inflation remained within the inflation target range for 14 consecutive months up to June 2013, before breaching the upper limit of the target range in July.[3] Inflation nonetheless accelerated towards the upper end of the inflation target range of 3 to 6 per cent in the opening months of 2013, before moderating somewhat towards the middle of the year. Twelve-month headline consumer price inflation accelerated gradually from a recent low of 4,9 per cent in July 2012, levelling off at 5,9 per cent during the three-month period to April 2013, before moderating to 5,5 per cent in June. The acceleration in consumer price inflation could initially be attributed to higher food and petrol prices, but from the opening months of 2013 consumer services price inflation also quickened, adding to the inflationary momentum. The subsequent moderation in consumer price inflation in May and June 2013 resulted largely from a marked deceleration in petrol price inflation over the period. In July, as expected, headline consumer price inflation accelerated briskly to 6,3 per cent, largely due to a notable acceleration in petrol price inflation.

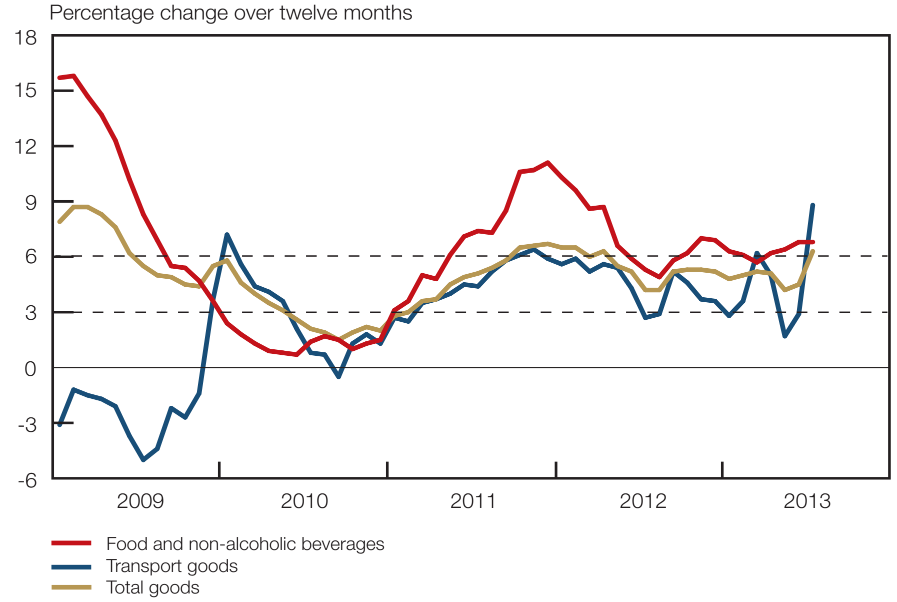
Most measures of producer price inflation accelerated in recent months, largely reflecting the inflationary impact of the depreciation in the exchange value of the rand. Following a prolonged period of moderation, twelve-month producer price inflation for final manufactured goods – the new headline producer price inflation rate – accelerated from a recent low of 4,9 per cent in May 2013 to 6,6 per cent in July. The pick-up in final manufactured producer price inflation in June and July 2013 resulted largely from a notable acceleration in price inflation of transport equipment and of coal and petroleum products, and to a lesser extent in that of food products as well as general and special purpose machinery. In addition, producer price inflation for intermediate manufactured goods accelerated further to 9,4 per cent in July 2013. Producer price inflation for mining accelerated from a recent low of 4,5 per cent in April 2013 to 7,0 per cent in June and July, as price inflation in non-ferrous metal ores, coal and gas quickened. After moderating to 0,4 per cent in March 2013, producer price inflation for agriculture, forestry and fishing products quickened to 3,2 per cent in June, before slowing to 1,4 per cent in July. Conversely, producer price inflation for electricity and water slowed notably from a recent high of 13,5 per cent in May 2013 to 5,6 per cent in July, due to a marked moderation in producer price inflation for electricity from 14,0 per cent to 6,2 per cent over the same period, reflecting the impact of the decision by Nersa to halve Eskom's electricity tariff increase from 16 per cent in 2012 to 8 per cent in 2013.

Producer and consumer prices

Despite the depreciation in the exchange rate of the rand, imported commodity price inflation slowed notably from a recent peak of 9,4 per cent in September 2012 to 1,8 per cent in May 2013, aided by lower international commodity prices. Against the generally decelerating trend in imported producer price inflation, imported agricultural producer price inflation accelerated steadily from a recent low of -3,4 per cent in March 2012 to 10,4 per cent in June 2013. However, in July 2013 imported commodity price inflation accelerated notably to 8,9 per cent, as price inflation in imported mining commodities accelerated markedly from 1,6 per cent in May 2013 to 19,5 per cent in July. Despite remaining fairly muted, imported manufacturing producer price inflation nevertheless accelerated gradually to 2,6 per cent in July 2013.

Consumer *goods* price inflation decelerated from a twelve-month rate of 5,2 per cent in March 2013 to 4,2 per cent in May, before quickening to 6,3 per cent in July as food and in particular petrol price inflation picked up. Recent variations in consumer goods price inflation were driven by movements in non-durable goods price inflation, which initially slowed from 7,5 per cent in March 2013 to 5,7 per cent in May, before accelerating to 8,7 per cent in July. Having remained in deflation for 38 consecutive months, durable goods price inflation nonetheless accelerated marginally to 0,4 per cent in July 2013. Price inflation for semi-durable goods remained fairly subdued in recent months, amounting to 3,0 per cent in July 2013. The acceleration in consumer goods price inflation in July 2013 resulted largely from higher transport goods price inflation, rising from 2,9 per cent in June 2013 to 8,8 per cent in July, mainly on account of a notable acceleration in petrol price inflation and to a lesser extent price inflation in new motor cars. Despite remaining at fairly elevated levels, price inflation in the housing and utility goods category nevertheless slowed from 9,2 per cent in January 2013 to 7,9 per cent in July.

Prices of consumer goods

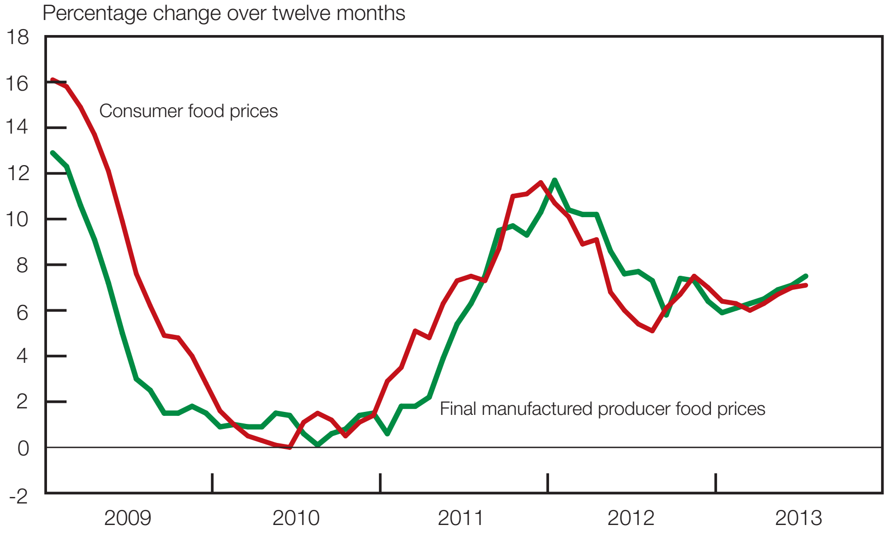


Consumer *services* price inflation quickened to 6,7 per cent in February 2013 and remained broadly at that rate up to May, before slowing to 6,2 per cent in July. A marked acceleration in health insurance price inflation was mainly responsible for the quickening in consumer services price inflation in the opening months of 2013. The subsequent moderation in services price inflation resulted largely from a notable deceleration in transport services price inflation from 12,2 per cent in May 2013 to 6,4 per cent in July, largely due to a marked slowdown in public road transportation services price inflation. In addition, price inflation for housing and utility services moderated in July 2013, as price increases in water supply and assessment rates were smaller than in July 2012.

After receding somewhat in the opening months of 2013, inflationary pressures emanating from food prices have recently re-emerged. Exacerbated by the depreciation in the exchange rate of the rand, food price pressures have been intensifying at the producer level, with final manufactured producer food price inflation accelerating steadily from a recent low of 5,9 per cent in January 2013 to 7,5 per cent in July. The acceleration was driven by notable year-on-year price increases in meat, fish, grain mill products and bakery products. Agricultural producer price inflation also accelerated in recent months, from -0,2 per cent in March 2013 to 2,8 per cent in June, mainly on account of a notable acceleration in producer price inflation of cereals and other crops. However, agricultural producer price inflation moderated to 0,5 per cent in July 2012 as producer price inflation of cereals and crops receded notably as a result of favourable base effects. Producer price inflation of fruit and vegetables has remained elevated throughout the first half of 2013, amounting to 21,4 per cent in July. Conversely, the prices of live animals *decreased* by 11,1 per cent in July 2013 compared to a year earlier, following drought conditions that led to an oversupply of livestock.

Following the acceleration in producer food price inflation, consumer food price inflation picked up from a recent low of 5,9 per cent in March 2013 to 7,1 per cent in July. The acceleration in consumer food price inflation was fairly broad-based among the various consumer food categories, with both processed and unprocessed food price inflation gaining momentum. Subsequent to moderating notably up to March 2013, price inflation in bread and cereals and to a lesser extent meat – collectively accounting for 57 per cent of the consumer food price basket – quickened to 7,3 per cent and 5,8 per cent respectively in July. In addition, vegetable price inflation remained elevated since November 2012, amounting to 13,3 per cent in July 2013, due to shortages of certain vegetables.

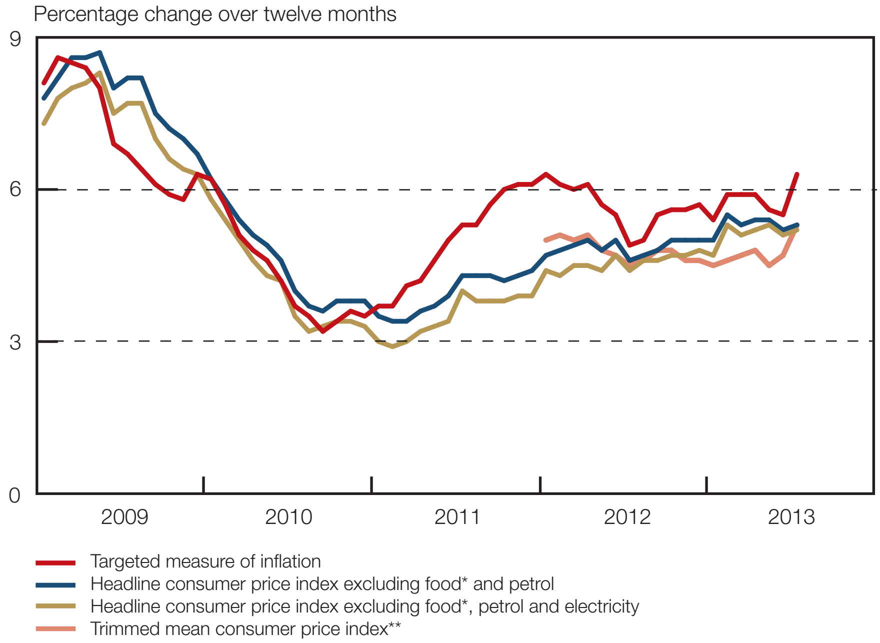
Food prices



After remaining fairly benign for more than a year, international food price inflation picked up pace in recent months, with the United Nations' Food and Agriculture Organization (FAO) international food price index accelerating from a twelve-month rate of -2,2 per cent in March 2013 to 4,8 per cent in June, before moderating notably to -3,3 per cent in July. Encouragingly, the FAO cereals price index has decreased by 13,4 per cent from its most recent peak in September 2012 to July 2013, largely due to expectations of improved international crops in 2013.

When excluding the impact of the more volatile prices of food, non-alcoholic beverages and petrol from the calculation of targeted headline consumer price inflation, underlying inflation accelerated from 4,6 per cent in July 2012 to 5,5 per cent in February 2013, before moderating to 5,3 per cent in July. Likewise, when also excluding the impact of electricity prices from the calculation, consumer price inflation displayed a similar steady pick-up throughout 2012, accelerating to 5,3 per cent in May 2013 before moderating to 5,2 per cent in July.

Underlying measures of consumer price inflation



* Food includes non-alcoholic beverages
** Trimmed mean only available from January 2012

The trimmed mean consumer price inflation rate, an alternative measure of underlying inflation, accelerated from 4,5 per cent in May 2013 to 5,3 per cent in July, aligning it more closely to the other measures of underlying inflation. Despite accelerating somewhat in the opening months of 2013, underlying inflation pressures appear to be reasonably contained.

An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories suggests a slight broadening of inflationary pressures in the economy. The twelve-month rates of change in six of the twelve categories – collectively accounting for 58 per cent of the total consumer price basket – exceeded the upper limit of the inflation target range of 6 per cent in July 2013. Of the remaining six categories, four recorded price increases which fell between 3 and 6 per cent and two categories registered rates of change below 3 per cent in July 2013.

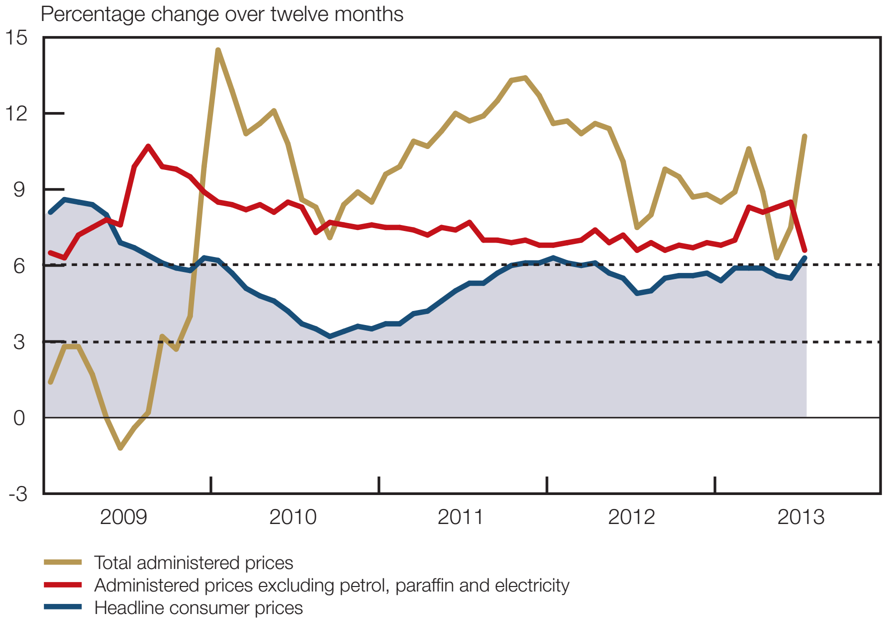
Headline CPI inflation in COICOP categories

Percentage changes over twelve months

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

Administered price inflation accelerated from 8,5 per cent in January 2013 to 10,6 per cent in March, largely on account of a marked quickening in petrol price inflation. Subsequently, administered price inflation slowed to 6,3 per cent in May 2013, as petrol price inflation moderated notably to 1,8 per cent in that month due to favourable base effects and softening international crude oil prices. However, more recently, an increase in international crude oil prices alongside a further depreciation in the exchange rate of the rand resulted in petrol price inflation accelerating markedly to 22,6 per cent in July 2013, lifting overall administered price inflation to 11,1 per cent. When excluding the effect of petrol and electricity prices from the calculation of administered prices, administered price inflation accelerated from 6,6 per cent in September 2012 to 8,5 per cent in June 2013, before slowing to 6,6 per cent in July, indicating continued strong underlying administered price pressures.

Administered prices



Average inflation expectations for 2013, as reflected in the Inflation Expectations Survey conducted by the BER in the second quarter of 2013, were broadly unchanged compared with those of the previous quarter and remained anchored around the upper limit of the inflation target range of 3 to 6 per cent. Inflation is still expected to average 6,0 per cent in 2013, before rising marginally to 6,1 per cent in both 2014 and 2015. Although financial analysts raised their inflation expectations for 2013 and 2014, their expectations nevertheless remained within the inflation target range, while business executives adjusted their expectations marginally downwards, on average. However, the inflation expectations of trade union representatives were adjusted upwards over the full three-year forecast horizon.

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2013

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2013..	5,9	6,2	6,0	6,0
2014..	5,6	6,5	6,2	6,1
2015..	5,4	6,5	6,3	6,1

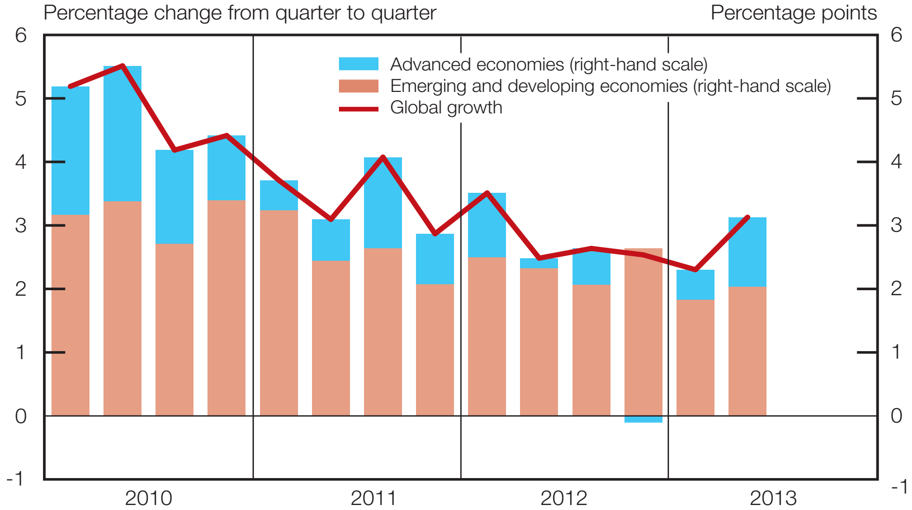
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

The pace of expansion in global economic activity picked up notably from an annualised rate of 2,2 per cent in the first quarter of 2013 to 3,4 per cent in the second quarter. The improvement in the second quarter was underpinned by stronger growth registered in both advanced and emerging economies.

Global growth and contributions from advanced economies and other emerging-market economies



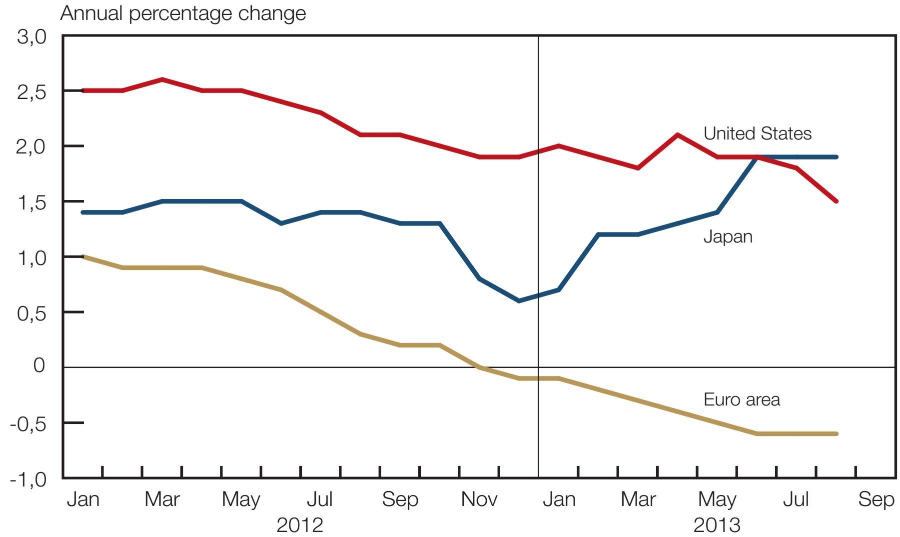
Seasonally adjusted annualised rates

Sources: National statistical offices, JPMorgan and staff calculations

4 Brazil, Russia, India, China and South Africa.

The International Monetary Fund (IMF) expects global growth to average 3,1 per cent in 2013, the same pace as in 2012. The moderate downward revision of global growth forecasts in the IMF's July 2013 *World Economic Outlook Update* (*WEO Update*) was occasioned by the persistence of the recession in the euro area and economic weakness in a number of major emerging economies, with the BRICS[4] growth projections lowered by between 0,2 and 0,9 percentage points.

Evolution of consensus forecasts for real growth for 2013



Source: Consensus Economics *Consensus Forecasts,* 12 August 2013

Despite lower growth prospects for most advanced economies, Japan's radical macroeconomic policy measures resulted in the IMF raising its forecast for 2013 to 2,0 per cent – an upward revision of 0,5 percentage points. This is consistent with the consensus forecasts and is the fastest pace of expansion among major advanced economies. Global growth is projected to reach 3,8 per cent in 2014, representing a 0,2 percentage point downward revision from the April 2013 *WEO*. The bulk of this growth is expected to originate in emerging economies.

Growth in the volume of world trade decelerated in the second quarter of 2013 to a year-on-year rate of 1,3 per cent compared with a rate of 3,8 per cent in the previous quarter. The lower growth was mainly due to a contraction in trade volumes in emerging economies. Growth in export volumes in emerging economies contracted by 2,6 per cent in the second quarter compared to 4,2 per cent in the previous quarter.

The US continued to make progress in terms of growth and employment, despite budget sequestration imposing a fiscal drag on the economy. Growth in real output accelerated from a revised 1,1 per cent in the first quarter of 2013 to 2,5 per cent in the second quarter. The economy created, on average, 188 000 new jobs a month in the second quarter, with unemployment at 7,6 per cent, falling to 7,4 per cent in July. Continuous positive economic news led the US Federal Reserve to signal plans to start tapering off the quantitative easing programme, prompting a strong reaction from financial markets worldwide. Chairman Bernanke has since clarified the Federal Reserve's exit timetable (see Box). Inflation continues to be very low, with year-on-year US consumer prices increasing by 1,8 per cent in June 2013, below the 2 per cent goal.

Box 1: The Federal Reserve's exit timetable

1. Tapering quantitative easing

The Federal Reserve currently buys US$85 billion of assets each month in an attempt to stimulate the economy. US$45 billion is spent on longer-term Treasury bonds and US$40 billion on mortgage-backed securities from government agencies. Tapering means reducing the size of these asset purchases.

Timeline: Not pinned to a threshold, but likely later in 2013.

2. Ending quantitative easing

Before the Federal Reserve starts raising rates, the asset purchases of the quantitative easing programme will end completely.

Timeline: Probably mid-2014, when the US is 'in the vicinity' of 7 per cent unemployment.

3. Raising rates

The Federal Reserve's 'Evans Rule' provides guidance as to when rates might start to rise.

Timeline: 2015, at 6,5 per cent unemployment (provided the medium-term inflation forecast is under 2,5 per cent and inflation expectations remain well-anchored). However, there is no guarantee that rates will rise at that point; the Federal Reserve has only committed not to raise rates before that, and might decide that further stimulus is warranted.

Source: Board of Governors of the Federal Reserve System, *Monetary Policy Report*, http://www.federalreserve.gov/monetarypolicy/files/20130717_mprfullreport.pdf, 17 July 2013, pp. 33–37

Economic growth in the euro area rebounded in the second quarter of 2013. Activity expanded by 1,1 per cent on a seasonally adjusted annualised basis following six quarters of negative growth. Real output growth in the region was underpinned by rebounds in Germany and France. Nonetheless, many southern European states (including Italy, Spain, Greece and Cyprus) remained in recession. Evidence from higher frequency data including purchasing managers' indices (PMIs) suggests stronger growth in the second half of the year.

Euro area consumer price inflation accelerated from 1,2 per cent in April 2013 to 1,6 per cent in July, due to higher energy and unprocessed food prices. The acceleration is, however, expected to be temporary – the European Central Bank (ECB) anticipates inflation at 1,4 per cent in 2013 and 1,3 per cent in 2014. The ECB has responded to market expectations of tighter monetary policy arising from the tapering of quantitative easing in the US by providing unprecedented forward guidance. The Governing Council recently confirmed its expectation that key ECB interest rates will remain at present or lower levels for an extended period.

Economic growth in Japan has moderated from 3,8 per cent in the first quarter of 2013 to 2,6 per cent in the second quarter. The slower-than-expected growth could mainly be attributed to negative contributions from inventories, declining private investment and higher imports. However, real output growth continued to be supported by well-balanced domestic and foreign demand. Positive contributions to growth emanated from resilient private consumption expenditure and exports. The contributions from government consumption expenditure and investment also increased as growth in both these aggregates accelerated during the quarter.

Japanese consumer price inflation remained close to zero in the second quarter of 2013, but inflation expectations (as measured by two-year breakeven inflation rates) rose sharply from 0,6 per cent in the first quarter to 1,5 per cent in the second quarter. The Bank of Japan remains committed to a radical programme of quantitative and qualitative easing, increasing the monetary base by ¥60–70 trillion annually. However, the effectiveness of these policies came into question in the second quarter as key prices started to move in unexpected directions, with Japanese government bond yields rising, while the yen appreciated.

Prime Minister Shinzo Abe, the author of Abenomics, consolidated his power in July 2013 when his Liberal Democratic Party and its coalition partner won a majority in the Upper House elections. This victory promises a period of stable leadership in Japan after years of short-lived governments, and significantly improves the chances of passing major structural reforms, the vaunted 'third arrow' of Abenomics.

Real output in the United Kingdom (UK) grew by 1,1 per cent in the first quarter of 2013 before rebounding to 2,9 per cent in the second quarter. The IMF's July *WEO Update* revised its 2013 growth projection for the UK upwards to 0,9 per cent. More evidence of a turnaround came from the manufacturing PMI, which stood at 49,2 at the end of the first quarter, climbed to 52,9 by the end of the second quarter and reached 54,6 in July 2013.

Inflation in the UK averaged 2,7 per cent in the second quarter of 2013, driven by increases in the prices of food, household utilities and clothing. The Bank of England (BOE) expects inflation to return to the 2 per cent target in 2015, which will be the seventh year since the target was last met. The BOE has announced a policy of forward guidance, promising that rates will not rise until unemployment reaches 7 per cent (down from 7,8 per cent at present), a level unlikely to be attained before 2016. The policy has three 'knock-out' clauses: that medium-term inflation does not exceed 2,5 per cent, inflation expectations remain well-anchored and monetary policy is not needed to safeguard financial stability.

Growth in China registered 6,9 per cent in the second quarter of 2013, following a rate of 6,1 per cent in the preceding quarter. The government's growth target for 2013 is 7,5 per cent, and although Chinese output growth typically exceeds the official target, this year's goal now appears to be high, prompting the adoption of a mini-stimulus package in July. Inflation in China remained comfortably below 3 per cent.

In India output growth weakened to 3,1 per cent in the second quarter, down from 5,1 per cent in the first quarter. Industrial production continued to decline, reflecting the slowdown in the manufacturing sector. Despite falling imports driven by lower purchases of gold and oil, India's trade deficit has persisted as exports also slowed. Wholesale price index inflation (which policy-makers use in preference to consumer prices) softened in the second quarter mainly due to a decline in the prices of food, fuel and power. Having started the year at 7,3 per cent, inflation as measured by this index fell to a year-on-year rate of 4,6 per cent in June 2013.

Policy responses in emerging Asia were mixed. In India, South Korea and Thailand, policy rates were reduced by 25 basis points each as central banks capitalised on modest or slowing inflation to support growth. The Bank of Indonesia, by contrast, increased its policy rate by 75 basis points to bring inflation back to within the target range, after it had accelerated in the second quarter owing to higher fuel prices and a depreciation in the exchange rate of the Indonesian rupiah.

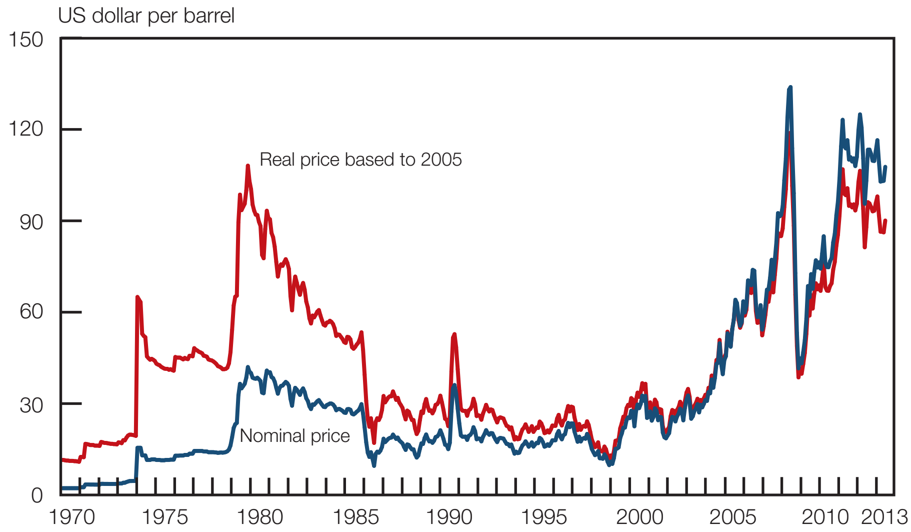
Economic activity in emerging Europe remained subdued in the second quarter of 2013. Russia, the biggest economy in the region, has experienced a sharp economic slowdown in recent quarters due to falling commodity prices. Economic growth also moderated in Turkey as a result of the euro area crisis, the loss of investor confidence following mass public protests in June and July, as well as the widening current-account deficit. Inflation in emerging Europe averaged 5,7 per cent in the second quarter of 2013, but remained above 7,0 per cent in Russia and Turkey, mainly driven by high food prices.

Growth in Latin America accelerated in the second quarter of 2013 as economic activity increased in most countries in the region. In Colombia and Brazil economic growth accelerated in the second quarter. The Central Bank of Brazil has responded to above-target inflation by raising its policy rate by a total of 175 basis points since the beginning of the year. Peru continued to grow strongly, recording growth of 7,5 per cent in the second quarter. Venezuela experienced a sharp recession in the first quarter of 2013, but recovered some of the lost ground in the second quarter. Inflation in Venezuela reached 37,3 per cent in June 2013 and 40,7 per cent in July 2013, one of the highest levels in the world.

The forecast for real output growth in sub-Saharan African in 2013 was revised downwards by 0,4 percentage points to 5,1 per cent in the July 2013 *WEO Update* owing to labour disputes in the mining sector in South Africa, floods in Nigeria and low external demand from advanced economies, especially the US and Europe. Inflationary pressures remained fairly stable across the region, but were expected to accelerate in the second half of 2013, due to weakening currencies. A number of African countries eased monetary policy in the period under review, notably Botswana (adjusting its policy rate by -150 basis points to 8,0 per cent), Kenya (-100 basis points to 8,5 per cent), Mozambique (-75 basis points to 8,75 per cent) and Uganda (-100 basis points to 11,0 per cent). The central banks of Ghana (+100 basis points to 16,0 per cent) and Zambia (+50 basis points to 9,75 per cent), however, tightened their policies on concerns of high inflation.

International prices of a range of commodities trended lower in the second quarter of 2013, not least due to the expected weaker growth trajectory in China. Oil prices fell to below US$100 per barrel at the beginning of the second quarter of 2013, but recovered with Brent crude oil trading in a range of US$100 to US$105 per barrel from the end of April to June. Price increases were moderated by weak global demand, the US shale gas boom and higher OPEC production during the second quarter. Since mid-July 2013, however, crude oil prices have risen to levels of around US$110 per barrel. This surge in prices was mostly driven by seasonal factors as well as political events in the Middle East and Egypt. As shown in the graph on the next page, the price of oil in real terms remained in high territory, taking a four-decade view.

Brent crude oil prices



Sources: Bloomberg and staff calculations

In late August 2013 Brent crude oil futures contracts traded around US$110 per barrel for delivery in the fourth quarter of 2013 and US$107 per barrel for delivery in the first quarter of 2014.

Current account[5]

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

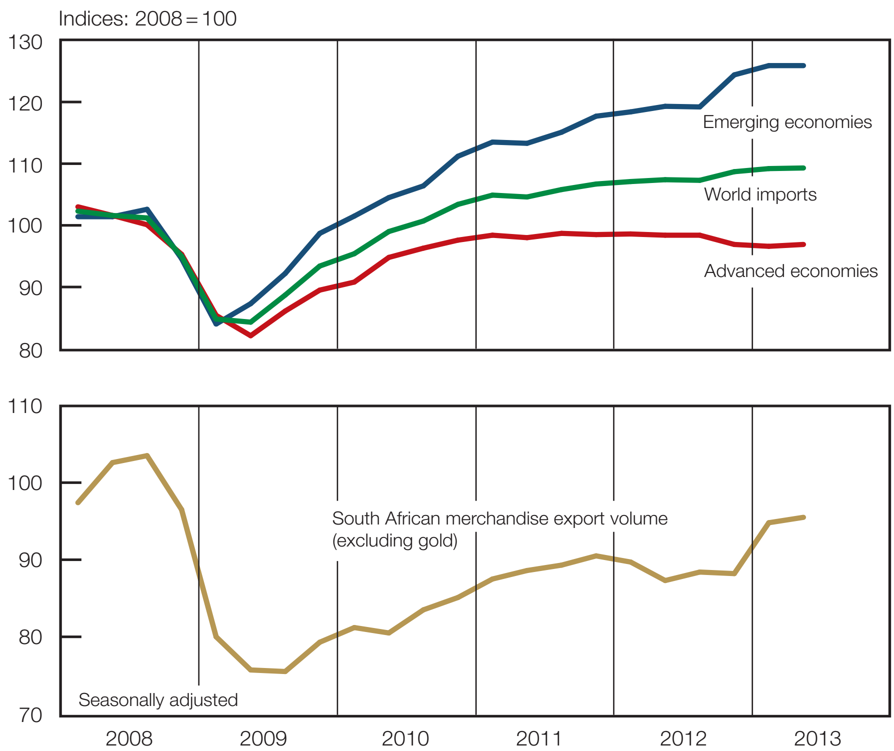
Notwithstanding the acceleration in global economic growth and a concomitant increase in world trade volumes in the second quarter of 2013, South African exporters did not benefit notably from the somewhat more favourable global economic environment. In fact, the country's trade deficit, which narrowed in both the fourth quarter of 2012 and the first quarter of 2013, widened again in the second quarter as export revenue was held back by lower international commodity prices and lacklustre growth in the physical quantity of non-gold exports. As a ratio of gross domestic product, the trade deficit consequently widened from 2,4 per cent in the first quarter of 2013 to 2,9 per cent in the second quarter. Simultaneously, the shortfall on the services, income and current transfer account also widened reflecting, *inter alia*, the base effect resulting from extraordinary high dividend receipts in the first quarter of 2013. As a result, the deficit on the current account of the balance of payments deteriorated to 6,5 per cent of South Africa's gross domestic product in the second quarter of 2013.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

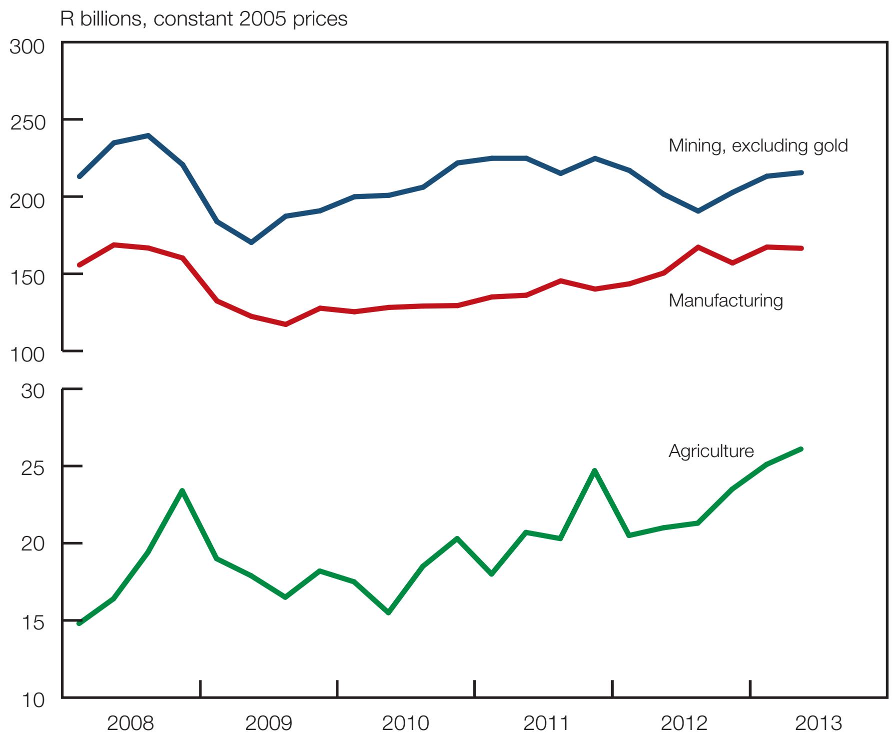
	2012				2013	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	686,1	689,1	715,0	696,2	800,1	813,2
Net gold exports	77,9	67,6	60,7	71,1	69,9	70,7
Merchandise imports	-843,9	-844,0	-861,8	-842,8	-948,2	-980,5
Trade balance	**-79,9**	**-87,3**	**-86,1**	**-75,5**	**-78,2**	**-96,6**
Net service, income and current transfer payments	-128,6	-127,7	-126,5	-122,1	-112,7	-119,6
Balance on current account	**-208,5**	**-215,0**	**-212,6**	**-197,6**	**-190,9**	**-216,2**
As a percentage of gross domestic product	*-6,7*	*-6,8*	*-6,5*	*-6,3*	*-5,8*	*-6,5*

Volumes of world imports and South African exports



The volume of South Africa's *merchandise exports* advanced by a disappointing 0,6 per cent in the second quarter of 2013 following a firm increase of 7,6 per cent in the first quarter. Manufacturing export quantities contracted in the second quarter of 2013, while mining and agricultural export volumes edged higher over the same period. In the category for manufactured exports, a marked decline was recorded in the subcategory for vehicles and transport equipment.

Volume of merchandise exports

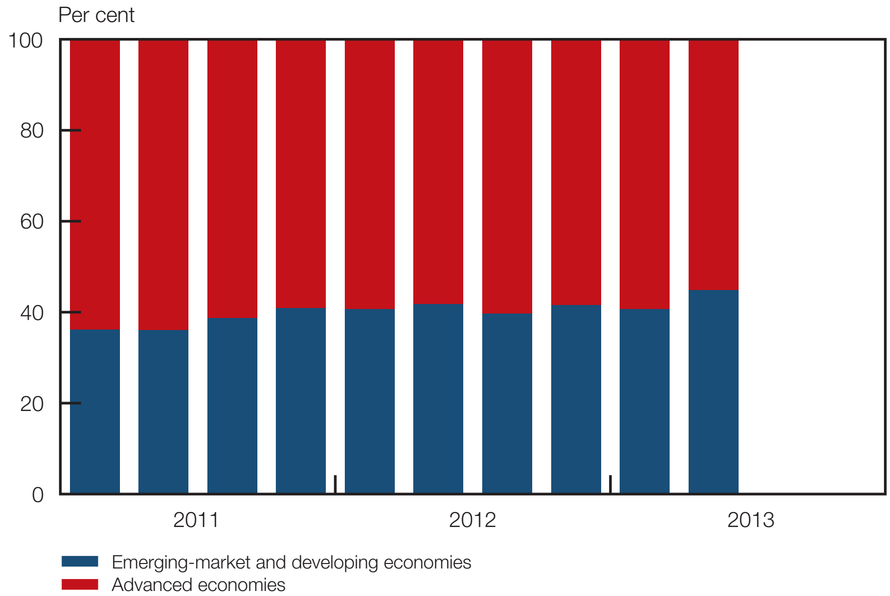


Seasonally adjusted and annualised

The export volume of agricultural products advanced firmly in the second quarter of 2013, buoyed by higher exports of maize due in part to tight maize stocks in the US – the world's largest supplier of maize. The physical quantity of non-gold mining exports advanced in the quarter under review, with increases in the export volumes of iron ore, chrome, manganese ore and nickel being partially neutralised by a contraction in the volume of coal exports following a scheduled twelve-day rail maintenance shutdown during the period under review. In addition, the exports of platinum group metals remained subdued, consistent with lower production and diminishing inventory levels.

Although a large proportion of South African-produced goods remains destined for advanced economies, exports to emerging-market economies gained notably in recent quarters. In value terms, exports to emerging-market economies advanced significantly in the second quarter of 2013, highlighting the growing importance of these economies as trading partners to South Africa.

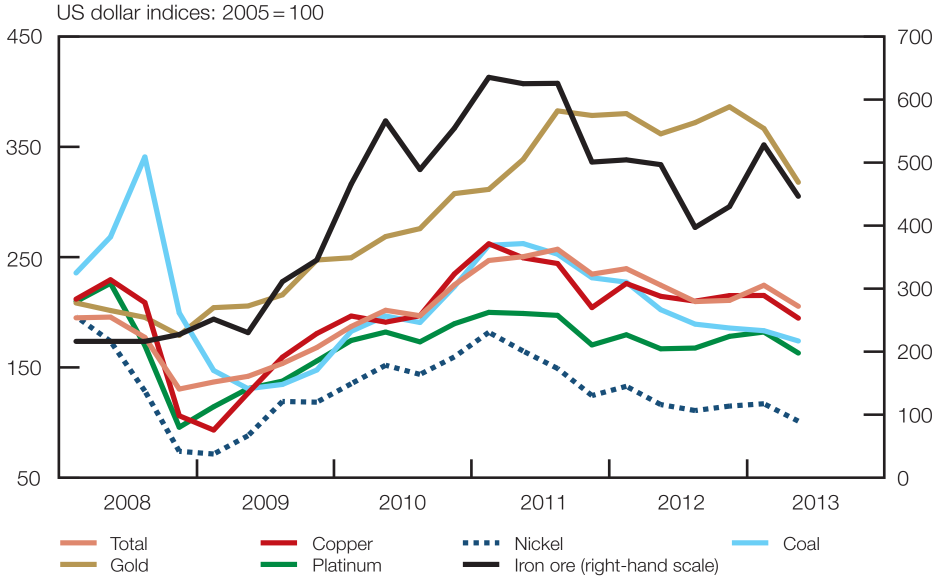
South African merchandise exports by destination



Having risen by 8,7 per cent in the first quarter of 2013, the average price in US dollar of South Africa's non-gold mining export commodities declined by 8,0 per cent in the second quarter. This was partly due to weaker demand for mining commodities from key emerging-market economies, including China. The decline in commodity prices in the second quarter of 2013 was fairly broad based with pronounced declines registered in the prices of nickel, copper, coal, platinum and iron ore. The decline in the dollar price of South African mining export commodities was, however, largely offset by the depreciation in the exchange rate of the rand, lifting the rand price of total merchandise exports during the second quarter of 2013. As a consequence, the value of merchandise exports increased by 1,6 per cent in the second quarter of 2013 following an increase of about 12 per cent in the first quarter.

The price of gold on the London market fell by 13,3 per cent from US$1 631 per fine ounce in the first quarter of 2013 to US$1 414 per fine ounce in the second quarter before declining further to US$1 286 per fine ounce in July. Even though gold exchange-traded funds (ETFs) account for a small portion of global demand for gold, they affected the price of gold over the past few months. Positive sentiment regarding the recovery in the US economy probably also encouraged investors to divest from the gold market through large withdrawals from gold ETFs. The lower price of gold in the second quarter of 2013 has nonetheless provided an opportunity to several central banks, especially those in emerging-market economies, to increase their gold holdings as part of their foreign-exchange diversification strategy. These central banks included, Azerbaijan, Kazakhstan, Nepal, Russia and Turkey.

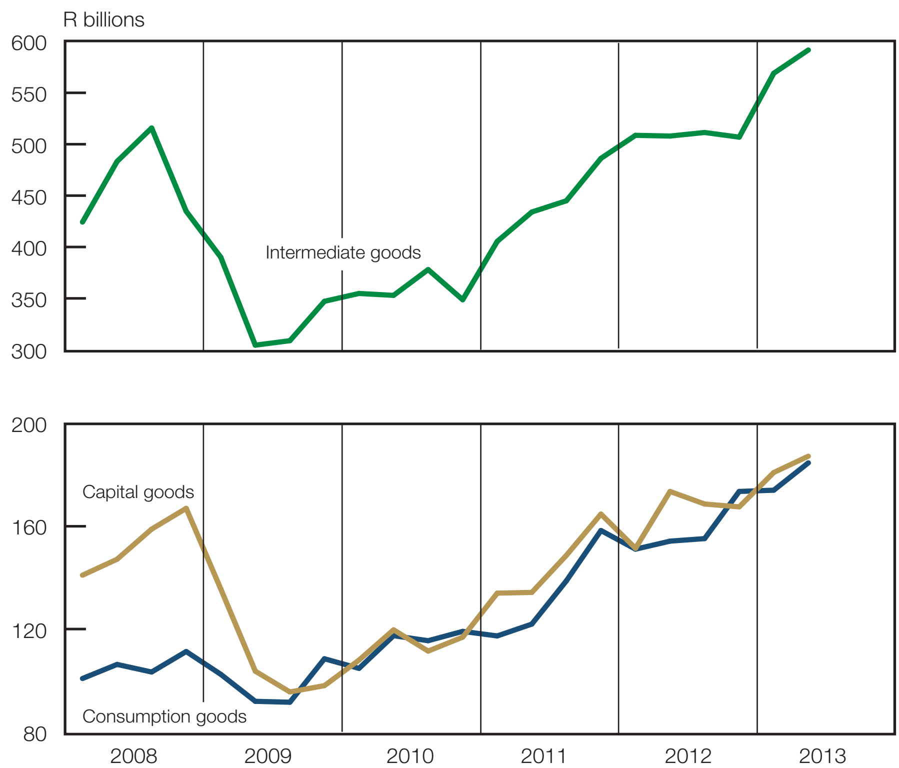
International prices of selected South African export commodities



The average realised rand price of net gold exports decreased by 6,6 per cent in the second quarter of 2013, marking a second consecutive quarterly decline. This price decline was fully offset by an increase of 8,3 per cent in the physical quantity of net gold exports. As a result, the value of net gold exports rose by 1,1 per cent over the period.

The volume of *merchandise imports*, which increased by 8,2 per cent in the first quarter of 2013, advanced by roughly 1 per cent in the second quarter. This more subdued pace of increase could be explained by slower growth in the physical quantity of imported mining products emanating, *inter alia*, from a contraction in the import volume of base metals and articles of base metal over the period.

Imports according to stage of production

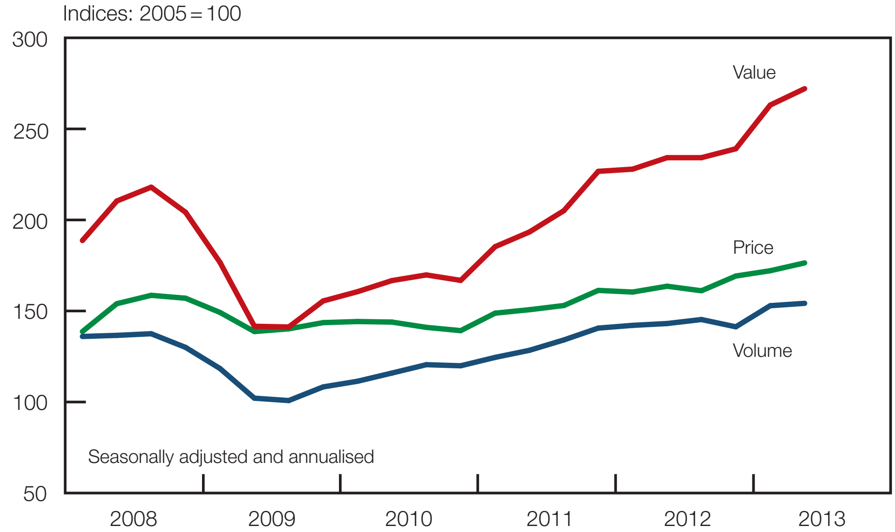


Seasonally adjusted and annualised

At the same time, the volume of manufactured imports increased for the second consecutive quarter, reflecting firm demand for foreign-produced chemical products, machinery and electrical equipment, and vehicles and transport equipment. Higher import volumes of agricultural products were also registered over the period. Relative to gross domestic expenditure, the volume of merchandise imports increased marginally from 25,7 per cent in the first quarter of 2013 to 25,8 per cent in the second quarter.

The depreciation in the external value of the rand together with higher international crude oil prices lifted the rand price of imported goods by 2,5 per cent in the second quarter of 2013. Combined with the almost 1 per cent increase in import volumes, the value of merchandise imports consequently advanced by 3,4 per cent from the first quarter to the second quarter of 2013.

Merchandise imports

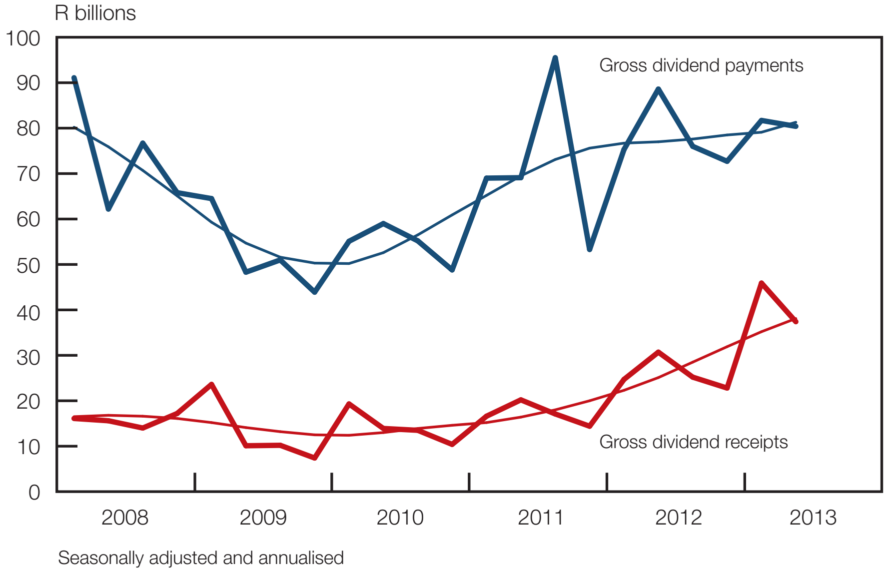


The deficit on the *services, income and current transfer account* widened from R112,7 billion in the first quarter of 2013 to R119,6 billion in the second quarter, the latter value equalling 3,6 per cent of South Africa's gross domestic product. The widening of the deficit could partly be explained by a contraction of almost 19 per cent in dividend receipts following a significant increase in dividend income in the first quarter of 2013. Even though gross dividend payments to non-resident investors contracted marginally in the second quarter of 2013, they failed to offset the contraction in gross dividend receipts over the same period.

Gross payments for 'other services' increased further during the second quarter of 2013 due to higher payments for technical services rendered by non-residents and higher transportation costs associated with the continued increase in merchandise imports. The higher gross payments for services in the second quarter of 2013 were partly cushioned by an increase in travel receipts benefiting, among other factors, from the more competitive external value of the rand. Furthermore, gross current transfer payments to non-residents advanced marginally during the second quarter of 2013, attributable to slightly higher revenue paid to members of the Southern African Customs Union (SACU).

South Africa's terms of trade deteriorated in the second quarter of 2013 as the rand price of imports accelerated at a faster pace than that of exports.

Gross dividend payments and receipts



Financial account

When the US Federal Reserve indicated in the second quarter of 2013 that it could start tapering its accommodative monetary policy measures by slowing asset purchases towards the end of the year, it negatively influenced capital flows into emerging-market debt securities. The negative sentiment among foreign investors partly arose from uncertainty regarding the pace at which monetary stimulus measures would be reduced as well as the extent to which these policy actions could weaken growth in emerging-market economies. Against this background, net capital inflows into South Africa slowed in the second quarter of 2013, its pace also dampened by lower-than-expected first-quarter economic growth data, exchange-rate volatility and a decline in commodity prices. The net inward movement of foreign capital through the financial account of the balance of payments (including unrecorded transactions) amounted to R39,4 billion in the second quarter of 2013, compared with an inflow of R55,5 billion in the first quarter. The inflow in the second quarter largely took the form of loans extended to South African companies in a foreign direct investment relationship. As a percentage of gross domestic product, the net inward movement of capital on the financial account decreased from 6,8 per cent in the first quarter of 2013 to 4,7 per cent in the second quarter.

Net financial transactions not related to reserves

R billions

	2012				2013	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	6,6	22,2	-1,4	37,6	12,9	17,4
Portfolio investment	22,7	27,5	12,5	94,7	1,4	-5,3
Other investment	19,9	7,1	38,4	65,7	23,7	-0,4
Change in assets						
Direct investment	-4,1	-9,6	-16,8	-35,8	-4,5	-8,9
Portfolio investment	-4,7	-4,7	-9,2	-40,0	-5,9	-6,4
Other investment	-16,8	19,3	15,1	40,3	-11,2	4,6
Total financial transactions*	48,0	58,6	48,8	206,2	55,5	39,4
As a percentage of gross domestic product	*6,1*	*7,3*	*6,0*	*6,5*	*6,8*	*4,7*

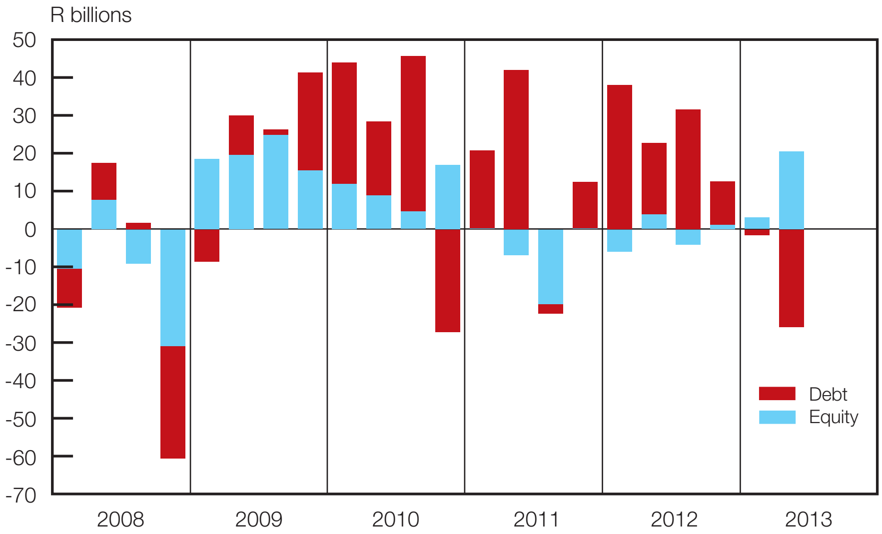
* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa amounted to R17,4 billion in the second quarter of 2013, compared with an inflow of R12,9 billion in the first quarter. This capital inflow primarily reflected a sizeable foreign loan granted by a foreign direct investment enterprise to its South African direct investor in the petro-chemical industry.

Inward foreign portfolio investment flows switched from an inflow of R1,4 billion in the first quarter of 2013 to an outflow of R5,3 billion in the second quarter – the first quarterly outflow of capital since the third quarter of 2011. In the second quarter non-residents gradually disposed of domestically issued bonds following the 'tapering' remarks by the US Federal Reserve and the accompanying change in investor sentiment and increase in bond yields. The repayment of euro-denominated international bonds by the National Treasury and non-banking private-sector companies furthermore contributed to the outflow of capital related to the sale of debt securities during the second quarter of 2013. By contrast, the revival of non-resident investors' appetite for domestic equity securities, which has become apparent since the fourth quarter of 2012, was sustained throughout the second quarter of 2013. The acquisition of domestic equity securities by foreign investors rose from net purchases of R1,1 billion in the fourth quarter of 2012 to R20,5 billion in the second quarter of 2013.

Portfolio liability flows



Other investment flows into South Africa changed from an inflow of R23,7 billion in the first quarter of 2013 to an outflow of R0,4 billion in the second quarter. The outward movement of capital in the second quarter primarily reflected the repayment of long-term loans extended to the South African banking sector. This was only partly countered by an increase in the deposit holdings of non-resident investors and in foreign loans granted to domestic parastatals.

South African-owned assets abroad

Outward direct investment totalled R8,9 billion in the second quarter of 2013 following the acquisition of foreign direct investment assets to the value of R4,5 billion in the first quarter. The larger capital outflow in the second quarter of 2013 could partly be attributed to an acceleration in asset diversification as the exchange value of the rand depreciated.

During the second quarter of 2013 the acquisition of foreign portfolio investment assets by South African institutional investors and individuals amounted to R6,4 billion, compared with an outflow of R5,9 billion in the first quarter. The consistent outflow of capital in this investment category illustrates the sustained drive towards diversification; to some extent the anticipation of further depreciation in the exchange rate of the rand could also have reinforced this behaviour by domestic institutional investors.

Other outward investment from South Africa registered an inflow of R4,6 billion in the second quarter of 2013 compared with an outflow of R11,2 billion in the first quarter. This capital inflow mainly reflected a decrease in loans granted under resale agreements by South African banks to foreign counterparties. These inflows were only partly countered by an increase in foreign deposit holdings of domestic banks.

Foreign debt

South Africa's total outstanding external debt declined moderately from US$142,3 billion at the end of December 2012 to US$140,6 billion at the end of March 2013 – the first quarterly decline in the country's external debt since the third quarter of 2011. The decline could mainly be ascribed to a decrease in the foreign-currency denominated debt, as rand-denominated debt increased marginally in the first quarter of 2013. Relative to the country's gross domestic product, the amount of outstanding debt simultaneously receded from 37,0 per cent in the fourth quarter of 2012 to 36,6 per cent in the first quarter of 2013.

Foreign debt of South Africa

US$ billions at end of period

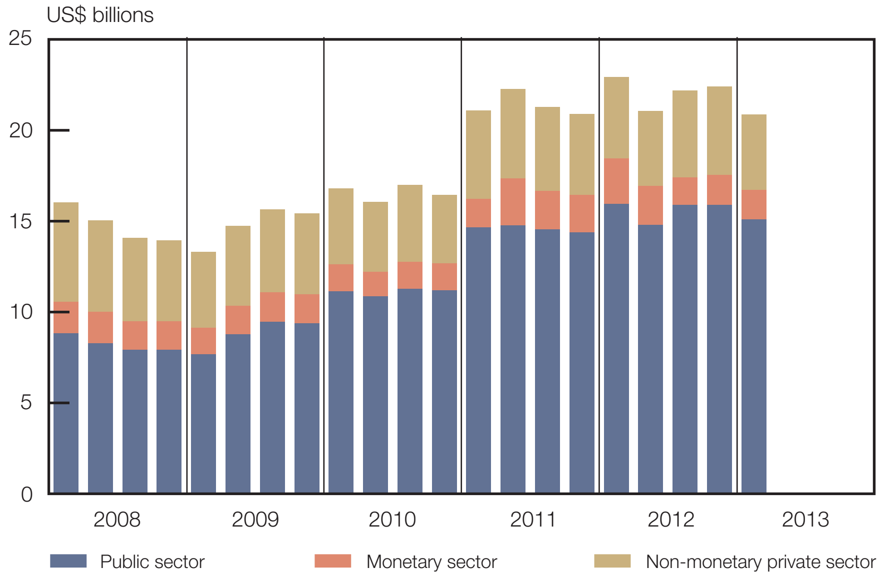
	2012				2013
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Foreign currency-denominated debt	**57,5**	**54,3**	**57,0**	**61,0**	**59,0**
Bonds	22,9	21,1	22,2	22,4	20,9
Other	34,6	33,2	34,8	38,6	38,1
Public sector	8,3	8,6	9,0	9,0	9,1
Monetary sector	11,0	9,3	9,5	13,8	12,9
Non-monetary private sector	15,3	15,3	16,3	15,8	16,1
Rand-denominated debt	**68,6**	**72,3**	**79,5**	**81,3**	**81,6**
Bonds	33,2	36,1	41,5	44,8	45,9
Other	35,4	36,2	38,0	36,5	35,7
Total foreign debt	**126,1**	**126,6**	**136,5**	**142,3**	**140,6**
As a percentage of gross domestic product	*31,6*	*31,9*	*35,5*	*37,0*	*36,6*
As a percentage of total export earnings	*102,5*	*105,5*	*116,9*	*124,3*	*121,7*

South Africa's outstanding rand-denominated debt increased from US$81,3 billion at the end of December 2012 to US$81,6 billion at the end of March 2013, mainly on account of non-residents' net purchases of domestic government bonds on the secondary market. At the end of March 2013, rand-denominated bond liabilities amounted to 56,3 per cent of total rand-denominated debt compared with a ratio of 21,0 per cent at the end of March 2008.

Foreign currency-denominated debt declined from US$61,0 billion at the end of December 2012 to US$59,0 billion at the end of March 2013 due to the redemption of short-term foreign loans and a reduction in deposit holdings of non-resident investors with the South African private-banking sector. These capital outflows more than neutralised inflows in the form of long-term loan financing over the period. In addition, international bonds also matured over the period, contributing to the reduction in the foreign currency-denominated debt.

The stock of South Africa's foreign-currency bonds in issue increased from US$14,0 billion at the end of December 2008 to US$22,4 billion at the end of December 2012, but declined to US$20,9 billion at the end of March 2013 due to the redemption of maturing bonds. In May 2013 the national government repaid a €1,3 billion bond that fell due. The public sector accounted for no less than 72,3 per cent of total outstanding foreign-currency bonds at the end of March 2013, largely due to the funding requirements of parastatals. Private-sector foreign-currency denominated bond issues are dominated by large retail companies; new issues are curtailed by hesitant global economic growth. Owing to the cost involved in issuing bonds, the regulatory and disclosure requirements regarding publically traded securities, and the risk preferences of investors, small to medium-sized companies often find it difficult to issue international bonds.

Stock of foreign currency-denominated bonds



Expressed in rand terms, South Africa's external debt increased from R1 208 billion at the end of the fourth quarter of 2012 to R1 301 billion at the end of the first quarter of 2013. At the end of March 2008 only 37,7 per cent of total foreign debt was denominated in rand, compared with 58 per cent at the end of March 2013.

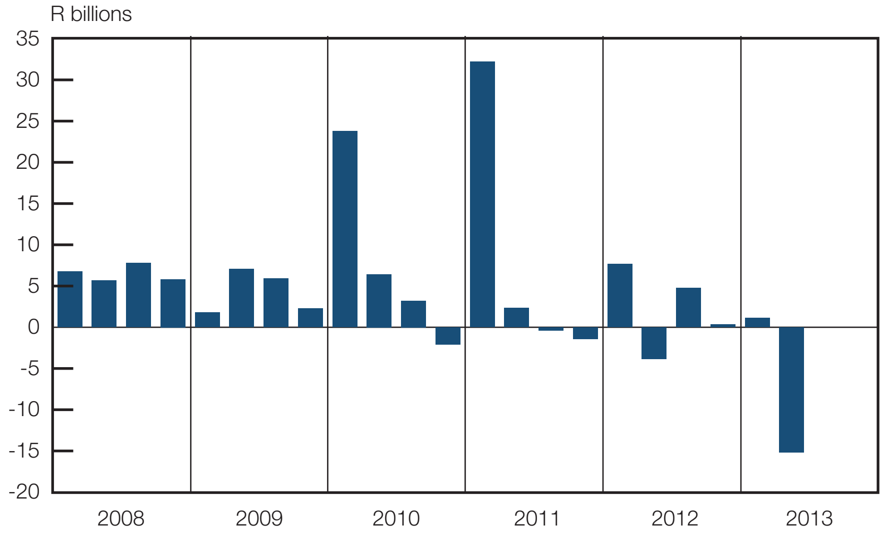
International reserves and liquidity

South Africa's overall balance-of-payments position (i.e., the change in the country's net international reserves due to balance-of-payments transactions) decreased by R15,1 billion in the second quarter of 2013 following an increase of R1,2 billion in the first quarter. This decrease could mainly be attributed to the partial withdrawal of the National Treasury's foreign currency-denominated deposit with the Bank for the repayment of a euro-denominated international bond.

Measured in US dollar terms, 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$50,0 billion at the end of March 2013 to US$47,0 billion at the end of June, before increasing to US$47,3 billion at the end of July 2013. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods, services and income) receded further from 19,5 weeks at the end of March 2013 to 19,3 weeks at the end of June.

The international liquidity position declined from US$46,1 billion at the end of March 2013 to R44,6 billion at the end of June before increasing to US$45,2 billion at the end of July.

Change in net foreign reserves



Exchange rates

The South African rand was among the emerging-market currencies that were negatively impacted by the ‘tapering’ remarks of the US Federal Reserve in May 2013. This weighed down the performance of the domestic currency during the second quarter of 2013, together with the decline in the international prices of key South African export commodities, the sizeable fiscal and current-account deficits, weak economic growth, persistent high unemployment levels and ongoing labour union rivalry. The nominal effective exchange rate of the rand consequently declined by 6,8 per cent from the end of March 2013 to the end of June; this represented the fifth consecutive quarterly decline, with the most significant depreciation recorded in May 2013.

Exchange rates of the rand

Percentage change

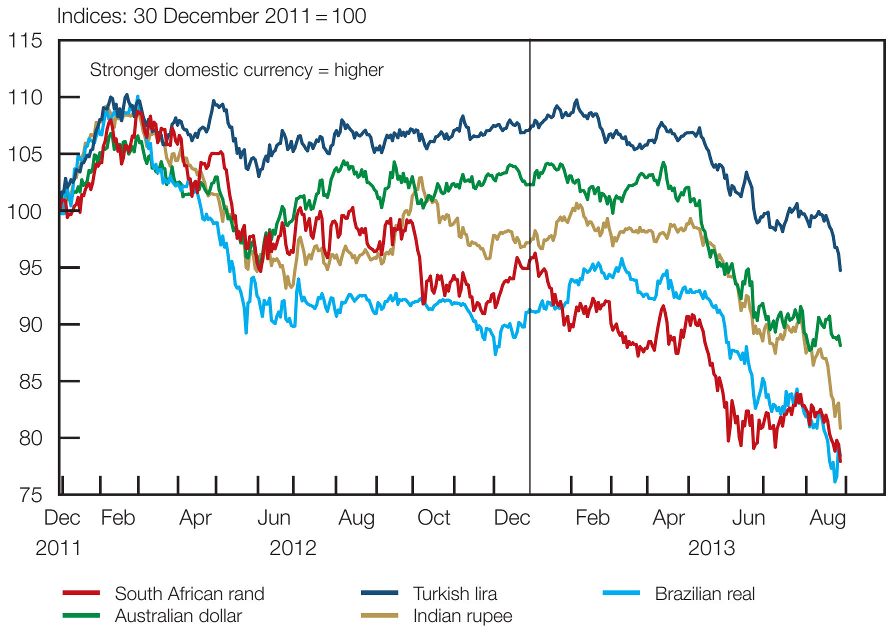
	30 Sep 2012 to 31 Dec 2012	31 Dec 2012 to 31 Mar 2013	31 Mar 2013 to 30 Jun 2013	30 Jun 2013 to 31 Aug 2013
Weighted average*	-2,8	-5,7	-6,8	-4,1
Euro	-5,0	-5,5	-8,9	-5,0
US dollar	-3,1	-8,3	-7,2	-3,6
Chinese yuan	-3,9	-8,5	-8,3	-3,8
British pound	-2,7	-2,3	-7,6	-5,2
Japanese yen	7,6	0,3	-2,5	-4,4

* Against a basket of 15 currencies

The exchange rate of the rand stabilised in July 2013 following clarifying comments by the US Federal Reserve Open Market Committee concerning the tapering off in quantitative easing and as concerns about the size of and prospects for South Africa’s current-account deficit subsided with the release of a smaller current-account deficit in the first quarter of 2013. However, during August 2013 emerging-market currencies depreciated sharply as concerns about capital outflows from these countries intensified.

The graph on the next page illustrates the recent performance of the rand and a selection of other emerging-market and commodity-producing currencies. All these currencies were adversely affected by the deterioration of the growth outlook for China as well as political unrest in Brazil, Turkey and Egypt.

Selected exchange rates against US dollar



The real effective exchange rate of the rand declined by 11,9 per cent from June 2012 to June 2013, further improving the external price competitiveness of South African exporters in international markets. In the first half of 2013, the real effective exchange rate was 8,8 per cent lower than in the corresponding period of 2012.

The average net daily turnover in the domestic market for foreign exchange increased by 12,2 per cent from US$19,5 billion in the first quarter of 2013 to US$21,9 billion in the second quarter. While both spot and forward transactions increased over this period, the increase can largely be explained by non-residents' participation in the swap market, which increased from an average of US$6,8 billion per day to US$7,6 billion per day over the period. This partly reflected foreign investors in the South African bond market hedging themselves against currency risk.

Monetary developments, interest rates and financial markets

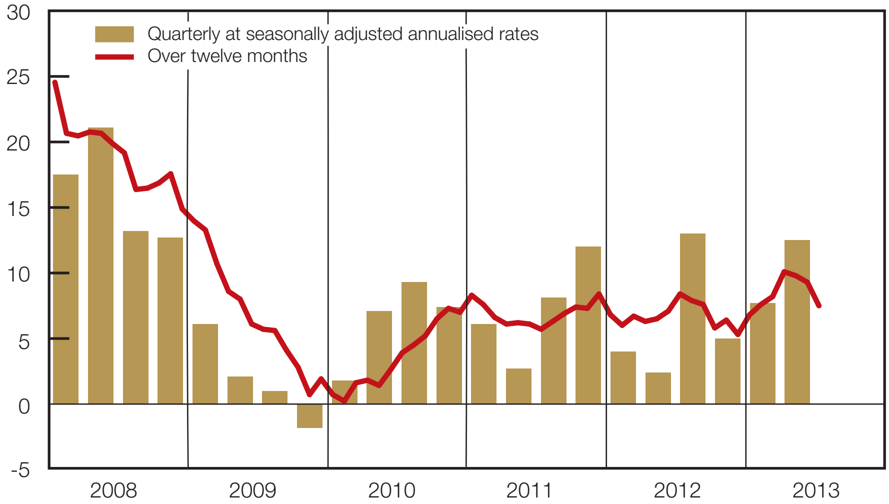
Money supply

Growth in money supply accelerated in the second quarter of 2013, partly as a reflection of the improvement in real economic activity over the period. The quarter-to-quarter[6] growth rate in the broadly defined money supply (M3) reached 12,5 per cent in the second quarter of 2013, significantly higher than the rate of 7,7 per cent recorded in the first quarter. Measured over twelve months, growth in M3 accelerated from a recent low of 5,2 per cent in December 2012 to a post-recession high of 10,0 per cent in April 2013, but moderated somewhat to 7,4 per cent in July.

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

Growth in M3

Percentage change



The above-inflation growth in M3 deposits in recent months was underpinned by growth in the deposit holdings of both the household and corporate sectors. This not only reflected a moderate improvement in income levels, but also positive wealth effects and a preference for liquid and low-risk deposits due to turbulent conditions in the financial markets. The quarterly growth in the deposit holdings of financial companies accelerated from negative growth in the fourth quarter of 2012 to 14,0 per cent and 15,8 per cent in the first two quarters of 2013 respectively, partly boosted by inflows resulting from the redemption of the R189 government bond in April 2013. By contrast, the deposit holdings of the non-financial corporate sector grew at more subdued rates, but these nonetheless increased from 1,9 per cent in the first quarter of 2013 to 9,0 per cent in the second quarter. Similarly, the pace of growth in the deposit holdings of the household sector accelerated from 4,6 per cent to 11,9 per cent over the same period.

Long-term deposits lost some momentum during the second quarter of 2013, while all the other deposit categories recorded relatively upbeat rates of growth. Over the past year cheque and transmission deposits remained a highly favoured deposit category and grew at the expense of the savings deposit category, which forms part of other short- and medium-term deposits.

The overall increase in M3 amounted to R83,4 billion for the first two quarters of 2013, a significant reversal from the decline of R6,2 billion recorded over the same period a year earlier. The increase in M3 deposits in the first half of 2013 was mainly concentrated in deposit holdings of the financial corporate sector but with firm support from deposits of the household sector. The deposit holdings of financial institutions rebounded significantly during the second quarter of 2013, possibly fuelled by precautionary and speculative motives in the wake of volatile financial markets and by cash inflows resulting from the redemption of the R189 government bond.

Maturity analysis of growth in M3

Per cent at seasonally adjusted annualised rates

	2012		2013	
	3rd qr	4th qr	1st qr	2nd qr
Notes and coin	15,6	3,1	-0,1	25,3
Cheque and transmission deposits	16,7	24,2	10,2	17,7
Call and overnight deposits	21,7	6,4	-5,5	11,9
Other short- and medium-term deposits*	0,9	-5,3	0,9	12,3
Long-term deposits**	25,7	19,2	19,1	6,2
M3	13,0	5,0	7,7	12,5

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

The rebound in the deposit holdings of financial companies brought the twelve-month growth rate in their deposits to a recent high of 11,5 per cent in May 2013, after recording subdued growth rates throughout 2012. Subsequently, growth moderated to 5,9 per cent in July. By contrast, non-financial companies drew down on their deposit holdings during the second quarter of 2013, almost completely offsetting the gains recorded in the first quarter. On a year-on-year basis, growth in deposit holdings of non-financial companies nonetheless remained buoyant as it increased from 4,9 per cent in December 2012 to 9,9 per cent in April 2013, with some moderation to 9,2 per cent in July.

M3 holdings of households and companies

	Quarterly change (R billions)			Percentage holdings of total M3 deposits		
	2012	2013		2012	2013	
	4th qr	1st qr	2nd qr	4th qr	1st qr	2nd qr
Households	8,6	10,0	19,7	28,8	28,8	29,0
Companies	20,8	20,8	33,0	71,2	71,2	71,0
Of which: Financial	-8,7	9,4	41,7	41,1	41,0	41,8
Non-financial	29,5	11,4	-8,7	30,1	30,2	29,2
Total M3 deposits	29,4	30,7	52,7	100,0	100,0	100,0

Growth over twelve months in M3 deposit holdings of the household sector moderated from an average of just below 12 per cent in 2012 to 9,2 per cent in April 2013 and further to 7,7 per cent in July. These rates were broadly consistent with the pace of increase in household disposable income and consumption expenditure over the period.

Statistical counterparts of change in M3

R billions

	2012		2013	
	3rd qr	4th qr	1st qr	2nd qr
Net foreign assets	18,1	-35,0	51,5	45,2
Net claims on government sector	34,5	6,2	-22,4	-6,0
Claims on private sector	74,4	62,7	30,4	37,5
Net other assets and liabilities	-33,6	-4,6	-28,9	-23,9
Total change in M3	93,5	29,4	30,7	52,7

The statistical counterparts to the change in M3 during the second quarter of 2013 broadly emulated the movements recorded during the first quarter. Significant increases in the net foreign assets of the monetary sector, together with growth in claims on the private sector, were the main contributors to the increase recorded in M3. These increases were partly neutralised by declines in both net claims on the government sector and net other assets and liabilities. The increase in net foreign assets mostly resulted from valuation gains in derivative instruments issued by the foreign sector, due to the depreciation in the exchange value of the rand. The depreciation also supported an increase in the gold and foreign-exchange assets held by the monetary sector. Claims on the private sector continued to record firm increases during the first half of 2013, supported by the demand for credit in the low interest rate environment. The decline in net other assets and liabilities was underpinned by an increase in the other liabilities of the Bank, coupled with an increase in liabilities in respect of derivative agreements held by the non-financial corporate sector.

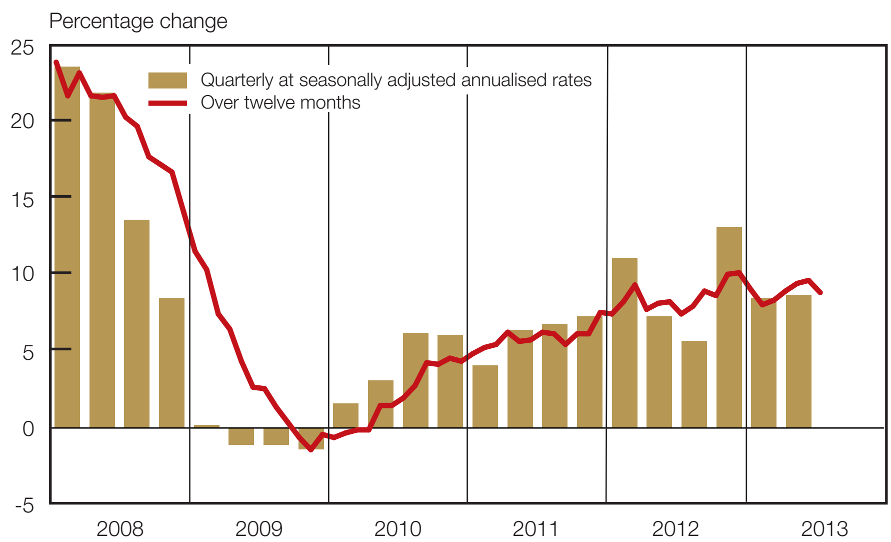
The income velocity of circulation of M3 receded from a recent high of 1,40 in the fourth quarter of 2012 to 1,38 in the first quarter of 2013 and 1,35 in the second quarter, since growth in money supply exceeded that of nominal gross domestic product. Fluctuations in the income velocity have remained relatively subdued during the past two years, suggesting that growth in money supply generally kept pace with growth in nominal gross domestic product.

Credit extension

Having gradually gained some momentum over the past four years, banks' total loans and advances to the private sector registered moderate quarter-to-quarter[7] growth rates of 8,5 per cent in the first quarter of 2013 and 8,7 per cent in the second quarter. Growth in private-sector credit extension was affected by a variety of factors during the first half of 2013, including the uncertain global and domestic growth prospects, weak labour market conditions and the already high level of personal debt. Twelve-month growth in total loans and advances decelerated from a post-recession peak of 10,0 per cent in December 2012 to 7,9 per cent in February 2013, whereafter it again recovered to 8,7 per cent in July. The rate of credit expansion was constrained by a stepwise moderation in credit extension to the household sector. Conversely, the corporate sector's appetite for bank credit remained fairly buoyant as interest rates remained low, although the operating environment for companies remained challenging given the effects of rising input costs, sluggish demand and lower commodity prices. The household sector accounted for 53 per cent of the overall increase in total loans and advances in the second quarter of 2013 and the corporate sector for 47 per cent.

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

Total loans and advances to private sector



Households registered six consecutive months of slowing growth in their utilisation of bank credit facilities. Twelve-month growth in loans and advances to the household sector moderated gradually from 9,9 per cent in January 2013 to 8,7 per cent in July. General loans to individuals, which primarily consist of unsecured lending, was at the forefront of the moderation in household credit. Growth in general loans to households continued to slow during the first half of 2013, albeit off a high base.

Composition of total loans and advances by type of credit

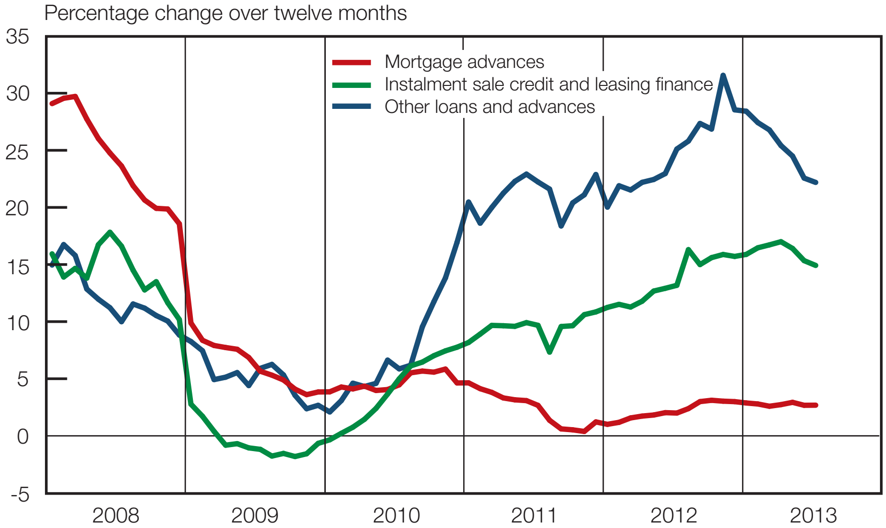
Type of credit	Quarterly change (R billions)			Percentage of total loans and advances*
	2012	2013		2013
	4th qr	1st qr	2nd qr	2nd qr
Household sector				
Instalment sale credit and leasing finance....	9,3	7,7	4,8	9,2
Mortgage advances....................................	4,2	6,4	5,4	34,0
Other loans and advances..........................	26,0	11,9	5,5	13,2
Overdrafts	*1,3*	*2,9*	*-0,6*	*1,4*
General loans	*13,0*	*7,1*	*3,3*	*8,4*
Credit card advances	*11,7*	*2,0*	*2,8*	*3,5*
Total loans and advances to household sector..	39,5	26,1	15,8	56,4
Corporate sector				
Instalment sale credit and leasing finance....	0,7	1,6	5,2	3,9
Mortgage advances....................................	2,2	-4,9	1,5	12,5
Other loans and advances..........................	31,9	16,0	7,1	27,1
Overdrafts	*-1,4*	*0,8*	*3,1*	*4,8*
General loans	*33,4*	*14,5*	*3,8*	*22,2*
Credit cards advances	*-0,0*	*0,6*	*0,2*	*0,2*
Total loans and advances to corporate sector...	34,8	12,7	13,8	43,6
Total loans and advances to private sector	**74,3**	**38,7**	**29,6**	**100,0**

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

In June 2013 banks' general loans to households rose by a mere R0,5 billion, substantially lower than the monthly increases in excess of R4 billion recorded during the last four months of 2012. Measured over twelve months, growth in general loans slowed from 35,4 per cent in September 2012 to 20,2 per cent in July 2013, the lowest annual rate of growth since August 2010. This reflected a combination of forces, including greater caution on the part of lenders in an attempt to limit credit impairments and improve risk profiles; increased regulatory scrutiny of this type of lending; continued financial pressure experienced by highly indebted households amid constrained income growth and – in instances of strike activity – loss of income; and weak employment prospects.

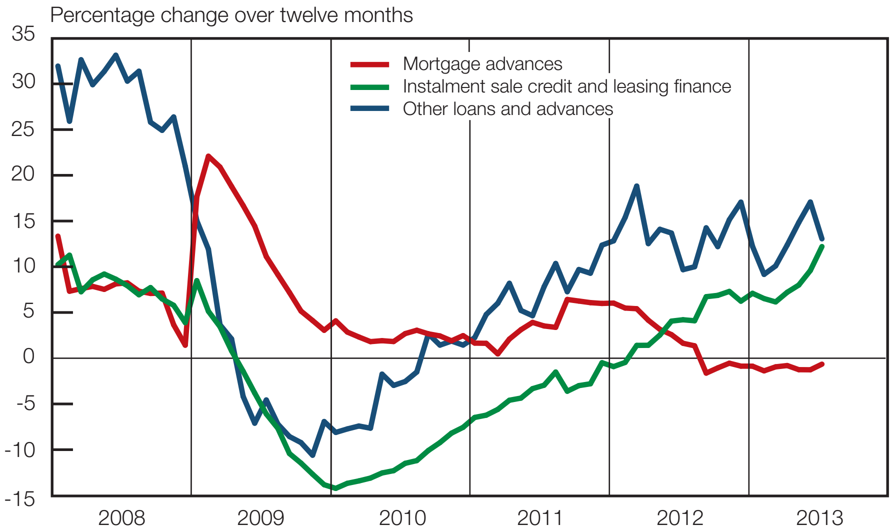
Twelve-month growth in mortgage advances to the household sector continued to record rates of just below 3 per cent, in line with the relatively low volume growth in the housing market. Despite a comparatively favourable interest rate environment, high deposit requirements, combined with elevated debt levels and poor consumer creditworthiness, remained some of the key obstacles to incremental growth in mortgage credit. Instalment sale credit to the household sector remained robust and recorded twelve-month rates of growth of 17,6 per cent in June and 17,1 per cent in July 2013, reflecting the high level of durable goods sales and vehicle sales in particular.

Total loans and advances extended to household sector



Loans and advances to the corporate sector rose by 8,6 per cent over the twelve months to July 2013, down from a recent high of 10,5 per cent in June. Negative growth in mortgage advances on commercial property was offset by resilient growth in instalment sale credit and other loans and advances to the corporate sector.

Total loans and advances extended to corporate sector

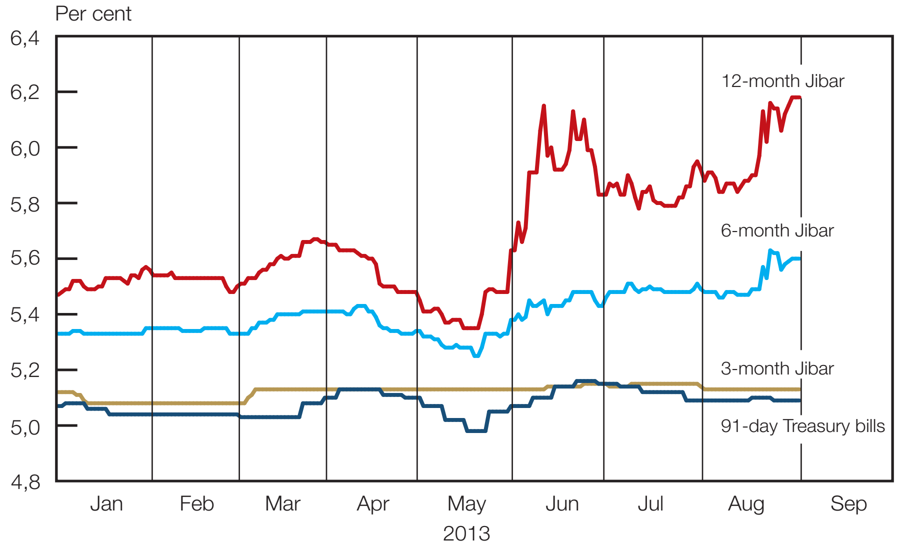


Twelve-month growth in mortgage advances to the corporate sector has been hovering around minus 1 per cent since October 2012. The weak growth in mortgage advances to the corporate sector was exacerbated by substantial capital repayments on commercial property made by non-financial companies in recent months. Year-on-year growth in general loans and advances to companies surpassed its previous high of 21,3 per cent registered in December 2012, picking up to 23,8 per cent in June 2013 before moderating to 18,0 per cent in July. Companies also utilised their overdraft facilities in order to facilitate tax payments in the second quarter of 2013. Instalment sale credit to the corporate sector improved materially in the second quarter of the year, reverting to double-digit growth of 11,4 per cent in June and 14,0 per cent in July 2013. While growth in loans and advances to the corporate sector may continue to show some resilience given the prevailing low interest rate environment, an uncertain economic outlook as well as weak business confidence may temper the uptake of credit by private-sector companies over the short term.

Interest rates and yields

Having reduced the repurchase rate by 50 basis points in July 2012 to a three-decade low level of 5 per cent per annum, the Monetary Policy Committee (MPC) kept the policy rate unchanged at this growth-supportive level at each of its six subsequent meetings. The MPC continued to balance the need to support the fragile economic recovery against the risk of surging inflation. In its deliberations in July 2013 the MPC took note of the recent sharp decline in the exchange value of the rand and was mindful of the upside risk to inflation that it posed, although the pass-through to inflation had been relatively muted, particularly when compared with previous episodes of currency weakness. Despite the upside risks to inflation, there were no strong signs of excess demand pressures. Inflation was expected to breach the upper end of the target range in the third quarter of 2013 followed by a return to within the target range by the final quarter of the year. The MPC statement discussing developments underlying the most recent monetary policy decision is reproduced in full from page 67 of this *Quarterly Bulletin*.

Money-market rates



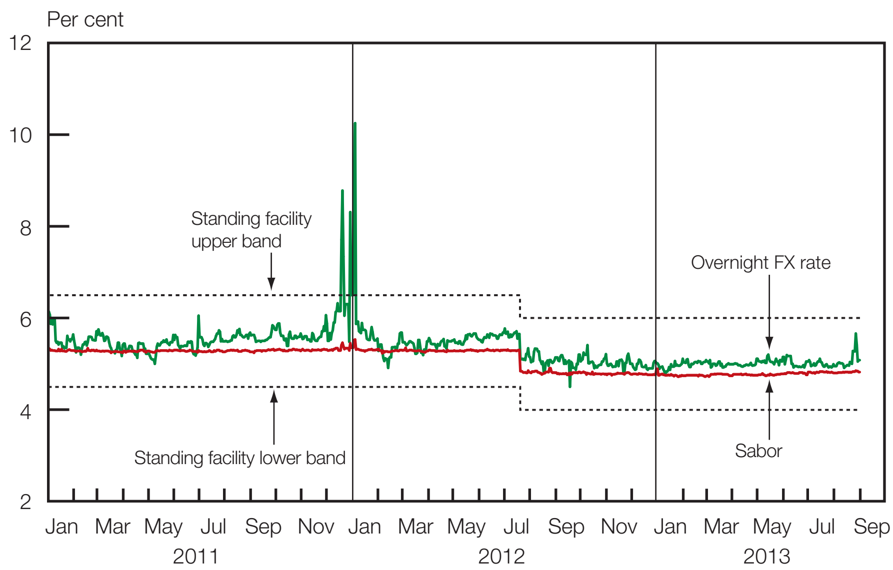
Short-term money-market rates mainly tracked the sideways movement in the repurchase rate during the first eight months of 2013, while longer-dated instruments started discounting the possibility of policy tightening when the exchange value of the rand depreciated. At the end of May 2013, slightly longer-term and forward-looking money-market rates rose sharply in response to a deterioration in inflation expectations emanating from the steep depreciation of the rand amid renewed global uncertainties. The benchmark three-month Johannesburg Interbank Average Rate (Jibar) trended mostly sideways during the first eight months of 2013 and stood at 5,13 per cent at the end of August. The tender rate on 91-day Treasury bills also displayed only a limited upward bias as it fluctuated higher from a recent low of 4,98 per cent on 17 May 2013 to 5,08 per cent at the end of August 2013. By contrast the twelve-month Jibar increased by 83 basis points from 5,35 per cent in mid-May 2013 to a high of 6,18 per cent on 29 August alongside fluctuations in the exchange rate of the rand.

Rates on forward rate agreements (FRAs) initially trended moderately upwards from mid-May 2013 when the market increasingly priced out any likelihood of further monetary policy easing. This was followed by a sharp rise in especially longer-dated forward rates from the end of May 2013 when the rand depreciated further. The increase was notably more pronounced at the long end of the curve with the 9x12-month FRA rising by 158 basis points from 4,96 per cent on 28 May 2013 to 6,54 per cent on 11 June, the largest adjustment in rates since May 2011, as uncertainty abounded with traders and analysts often holding divergent views. Short-term FRA rates rose at a more subdued pace but remained sensitive to fluctuations in the exchange rate of the rand.

Forward rate agreements

Consistent with the orderly conditions that prevailed in the interbank lending market, the South African Benchmark Overnight Rate (Sabor) on deposits and the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) remained relatively stable although the overnight FX rate showed a short-term reaction when the Bank announced changes to the money-market liquidity management strategy on 21 August 2013. The Sabor and overnight FX rates stood at 4,82 per cent and 5,08 per cent respectively at the end of August 2013.

Benchmark overnight rates



The prime lending rate and the predominant rate on mortgage loans have been maintained at 8,50 per cent since the 50 basis point reduction effected in July 2012. Other deposit and lending rates offered by banks have also remained fairly closely aligned with the unchanged policy rate.

Following its decline from 6,59 per cent on 22 March 2013 to an all-time low of 5,78 per cent on 13 May, the daily average *yield on the R208 government bond* (maturing in 2021) soared to 8,05 per cent on 29 August. This was triggered by the announcement by the US Federal Reserve

8 The differential between the South African government bond yield on rand-denominated debt issued in the domestic market and the yield on South African government US dollar-denominated bonds issued in the US, both in the seven-to-eight-year maturity range.

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

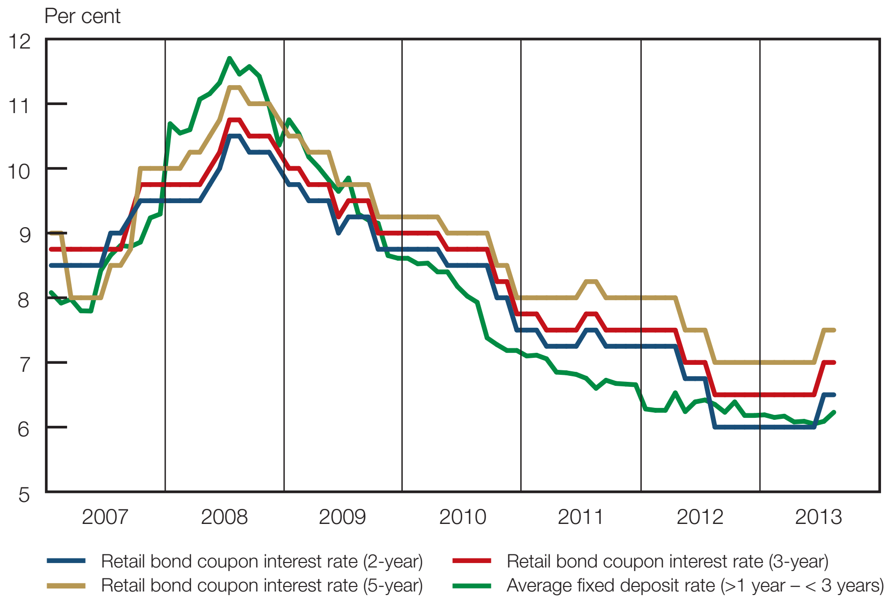
of the possible phasing out of stimulus measures – which gave rise to higher bond yields across international bond markets – the depreciation in the exchange value of the rand, inflation concerns and the selling of domestic bonds by non-residents. Given the general upward trend in domestic bond yields during 2013, the *currency risk premium*[8] on South African government bonds widened from 315 basis points in February 2013 to 348 basis points in July, as yields on rand-denominated bonds increased more pronouncedly than yields on dollar-denominated bonds.

With the exception of the extreme short end of the *yield curve,* which remained broadly anchored to the unchanged repurchase rate, the level of the yield curve moved generally higher across the rest of the maturity spectrum from May 2013. The *yield gap*, measured as the difference between yields at the extreme long and short ends of the curve, therefore widened from 274 basis points on 2 May 2013 to 452 basis points on 29 August.

The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[9] yield spread above US government bonds fluctuated wider from 259 basis points in January 2013 to 338 basis points in July, as the volatility in global financial markets led to a risk-averse stance of investors. Similarly, the *sovereign risk premium* on South African government US dollar-denominated bonds in the seven-year maturity range widened from 85 basis points in January 2013 to 150 basis points in July.

Priced off the yield curve for South African government bonds, interest rates on RSA fixed-rate *retail bonds* rose by 50 basis points in July 2013 after having been unchanged for eleven months. This increase brought the interest rate on the 2-year bond to 6,50 per cent, the 3-year bond to 7,00 per cent and the 5-year bond to 7,50 per cent. As could be expected, the downward trend in the average deposit rate with banks on one-to-three-year fixed deposits over the past five years also slowed somewhat, as shown in the accompanying graph.

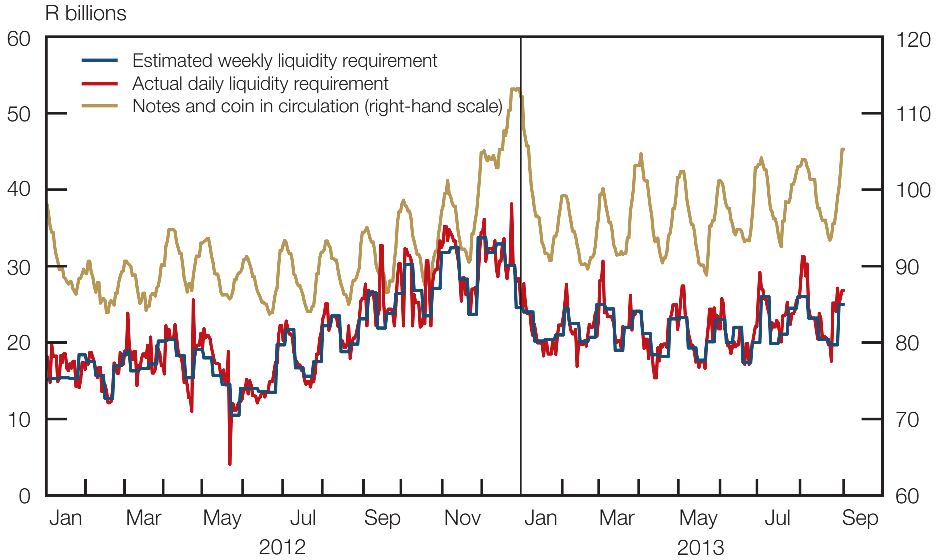
Retail bond interest rates and deposit rate



Money market

Money-market liquidity fluctuated during the second quarter of 2013, largely in line with movements in the Bank's note and coin liability. The actual daily liquidity requirement of the private-sector banks varied within a broad range of between R15,4 billion and R27,4 billion, slightly wider than the estimated liquidity requirement, which oscillated between R17,4 billion and R24,1 billion.

Liquidity requirement



During the second quarter of 2013, the net result of the money-market liquidity flows was an injection of liquidity to the value of R4,1 billion. A decrease in notes and coin in circulation and foreign-exchange transactions by the Bank served to expand the market by R4,5 billion. While government deposits with the Bank declined on account of the repayment of a foreign loan amounting to €1 250 million, this had no direct impact on the domestic money market. The excess liquidity was partly drained by, among other things, a rise in the cash reserve deposits by private-sector banks and the use of liquidity management instruments.

Money-market liquidity flows

R billions (easing + tightening –)

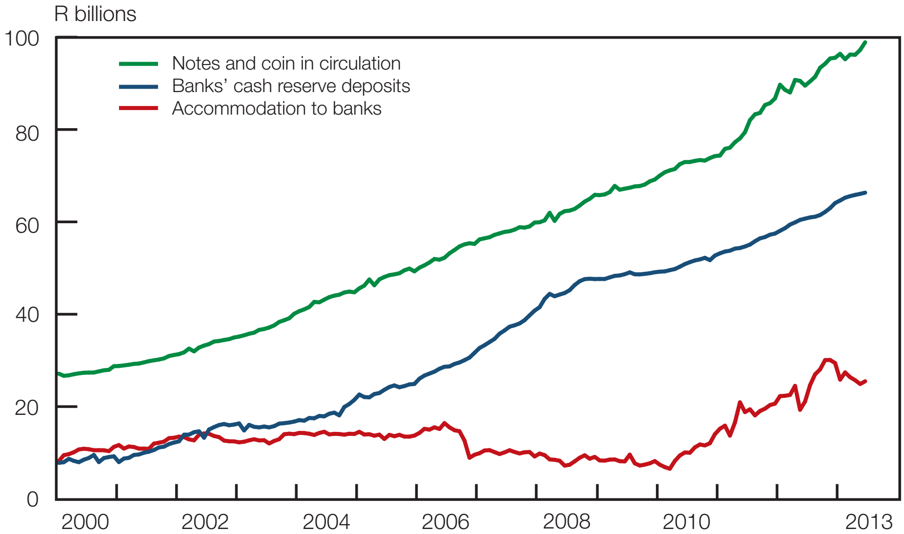
	2013	
	Jan–Mar	Apr–Jun
Notes and coin in circulation	9,0	0,3
Required cash reserve deposits	-4,9	0,9
Money-market effect of SARB* foreign-exchange transactions	0,5	4,2
Government deposits with SARB*	0,0	0,0
Use of liquidity management instruments	-4,0	-1,2
Reverse repurchase transactions	-1,5	-0,7
SARB* debentures	-2,5	-0,5
Other items net	-0,1	-0,1
Banks' liquidity requirement (decrease + increase –)	0,5	4,1

* South African Reserve Bank

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R47,2 billion were effected from the government tax and loan accounts during the second quarter of 2013.

On 21 August 2013 the Bank announced changes to its money-market management strategy. In the liquidity-deficit framework for the implementation of monetary policy that the Bank has adopted, it is deemed important to maintain a money-market shortage of an adequate size in order to ensure that banks have a measure of dependency on the central bank for the refinancing of their liquidity requirements – such refinancing being done at the repurchase rate, which is then reflected in lending and deposit rates more generally. However, it was noted that over time the money-market shortage had declined relative to the stock of notes and coin in the economy (see the accompanying graph) and relative to total assets of the commercial banks. If taken too far, this could undermine the transmission mechanism of monetary policy. To improve further the effectiveness of the monetary-policy implementation framework and to enhance the Bank's control of money-market liquidity and short-term money-market rates, the Bank therefore deemed it necessary to increase the level of the money-market shortage to a more appropriate level over time. The Bank has accordingly decided that, going forward, the trend growth in the money-market shortage will broadly reflect developments in the stock of notes and coin in circulation outside the Bank as well as in the banks' required cash reserve balances deposited with the central bank.

Selected money-market indicators



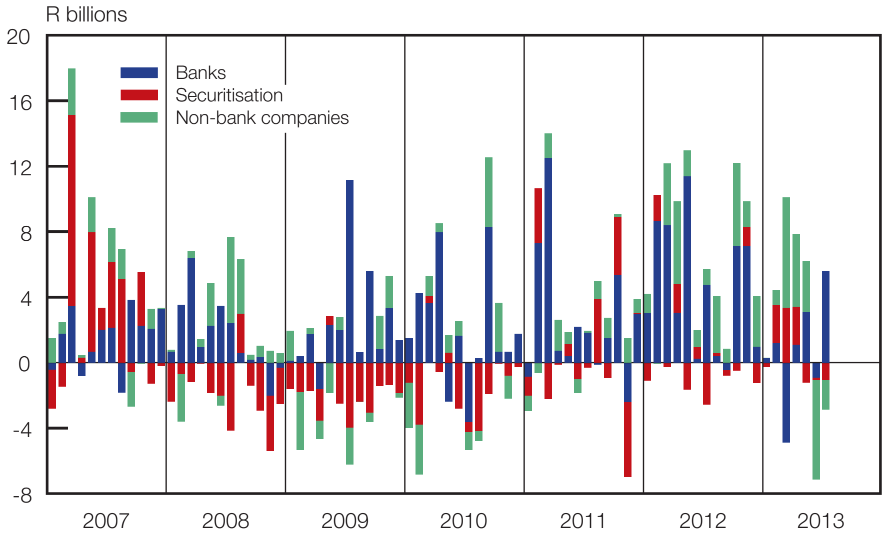
Seasonally adjusted

Bond market

Bond issuances by the public sector in the primary bond market remained strong during 2013, consistent with the sector's elevated funding needs. Total net bond issues by the public sector amounted to R96,0 billion in the first seven months of 2013, slightly lower when compared with the net issues of R114 billion recorded over the same period of 2012. National government issued the bulk of this debt. National Treasury issued two new government bonds in July 2013 – a fixed-income bond, namely the R2037 bond with a maturity date of 31 January 2037, and an inflation-linked bond, namely the I2046 bond with a maturity date of 31 March 2046. The new issues were in line with announcements in the *Budget Review 2013*.

Net bond issuances by the private sector progressed at a slower pace in the first seven months of 2013, mostly dragged lower by subdued issuances by banks. The net issues of R18,1 billion made by the private sector in the first seven months of 2013 were considerably less than the net issues of R51,5 billion recorded in the corresponding period of 2012. The total outstanding nominal value of debt securities listed on the JSE increased by R114 billion in the first seven months of 2013 to reach R1,8 trillion at the end of July.

Net issues by private sector in primary bond market



Turnover of R6,6 trillion in the domestic secondary bond market in the second quarter of 2013 was above the R5,4 trillion traded in the first quarter, following higher volumes traded. This contributed to turnover of R14,1 trillion in the first seven months of 2013, which was still 7 per cent lower than the value traded in the corresponding period of 2012. After recording a gain of 16 per cent in 2012 and reaching an all-time high in April 2013, the All-Bond Index reflected the slump in the bond market from May with a loss of 2 per cent thus far in 2013.

Non-resident issuer interest in rand-denominated bonds was more prominent in the *European bond markets* in 2013. The value of rand-denominated bond issues in these markets during the first seven months of 2013 was far more than the issuances in the *Japanese Uridashi bond market*. Net issues of rand-denominated bonds in the European bond markets amounted to R8,8 billion in the first seven months of 2013, compared with net issues of only R0,3 billion recorded in the entire 2012. In the Uridashi bond market, on the contrary, redemptions of rand-denominated bonds exceeded issues by R5,6 billion in the first seven months of 2013, compared with net issues of R1,9 billion registered in the corresponding period of 2012. This resulted in total net issues of R3,1 billion in both markets over the seven months to July 2013, as indicated in the accompanying table.

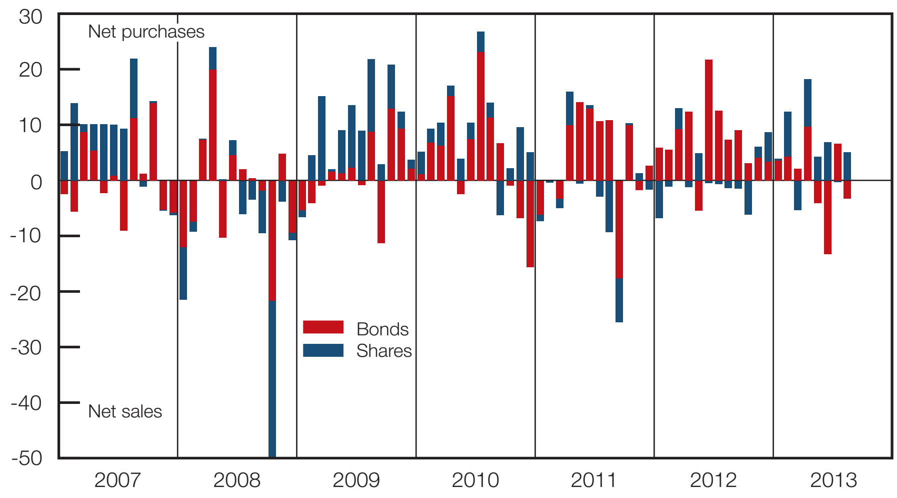
Rand-denominated bonds issued in international bond markets, January to July

R millions

	Eurorand		Uridashi		Total	
	2012	2013	2012	2013	2012	2013
Issues	5 511	12 529	7 892	6 683	13 403	19 212
Redemptions	6 775	3 760	6 017	12 316	12 792	16 076
Net	-1 264	8 769	1 875	-5 633	611	3 136

After recording net sales of R17,4 billion in May and June 2013, *non-residents* once more increased their holdings of domestic bonds by R6,6 billion in July. The resurgence in net purchases occurred alongside a general stabilisation in bond markets. In the first seven months of 2013 non-residents, on balance, recorded net purchases of local bonds to the value of R8,8 billion, which were much lower than the net purchases of R61,7 billion recorded over the same period of 2012.

Non-resident net transactions in local securities

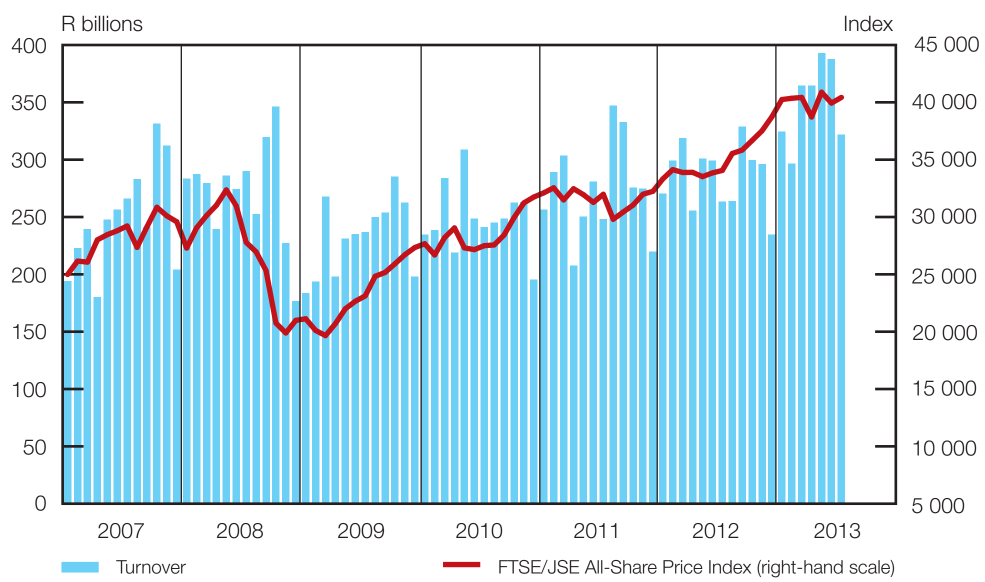


Share market

Equity capital raised by companies listed on the JSE in the domestic and international primary share markets amounted to R54,4 billion in the first seven months of 2013. This was 18 per cent higher than the amount raised in the corresponding period of 2012, despite the declining business confidence recorded, but along with stronger domestic economic growth. The 15 company delistings thus far in 2013 overshadowed the 4 new listings on the JSE. Companies with primary listings on the JSE contributed 82 per cent of the total capital-raising activity in the first seven months of 2013, while the financial sector raised 67 per cent of the total capital raised over the same period.

Despite the numerous delistings on Alt^{X}, its *turnover* was 29 per cent higher in the seven months to July 2013 when compared with the value traded in the corresponding period of 2012, mainly on account of higher volumes traded. This pattern filtered through to total turnover in the secondary share market of the JSE, boosted by record-high share prices. Turnover of

Turnover and share prices in secondary share market

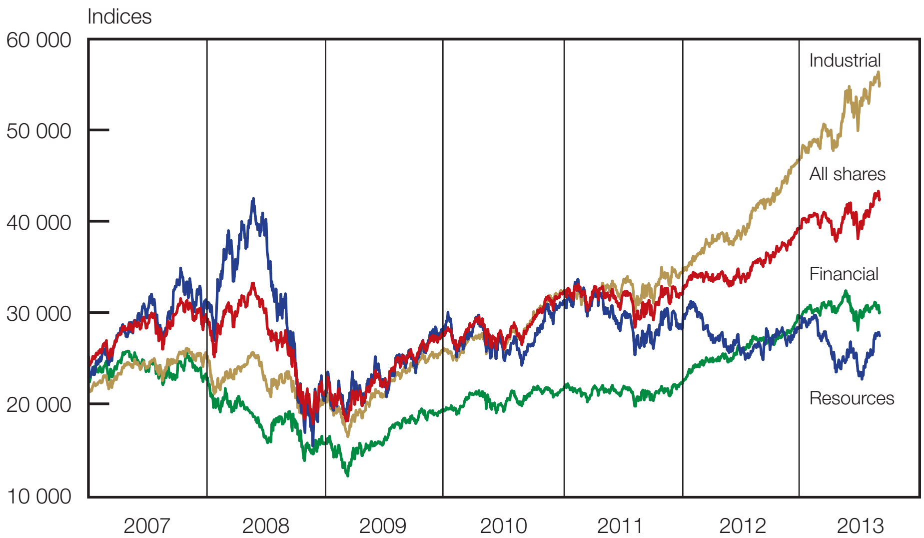


R2,5 trillion thus far in 2013 was 22 per cent higher than the value traded over the same period in 2012. The total market capitalisation of the JSE of R9,0 trillion in July 2013 was only a fraction below its all-time high reached in May 2013, in line with robust share prices.

Following net purchases of local shares amounting to R3,0 billion in the first quarter of 2013, strong appetite by *non-residents* was evident in net purchases of R19,7 billion in the second quarter. Such robust net purchases by non-residents was last observed in the third quarter of 2009 when they recorded net purchases of R24,8 billion. Despite the net sales of R0,3 billion in July 2013, net purchases of local shares by non-residents of R22,4 billion were recorded in the seven months to July 2013, compared with net sales of R1,5 billion recorded in the corresponding period of 2012.

The *FTSE/JSE All-Share Price Index* (Alsi) increased by 52 per cent from a recent low of 28 391 index points on 8 August 2011 to a new all-time high of 43 291 index points on 26 August 2013. This was largely a result of positive global market sentiment and the depreciation in the exchange value of the rand which boosted the resources and industrial companies, whose earnings are sensitive to foreign-currency movements. The gain in the resources index was, however, hampered by unrest and strikes in the mining sector and the prolonged decline in international commodity prices until the end of June 2013. Subsequently, the Alsi decreased by 2 per cent to 42 429 index points on 29 August. Exchange rate movements have an important bearing on share price outcomes: In US dollar terms, the Alsi increased slightly by 0,4 per cent from 8 August 2011 to 29 August 2013, whereas the Standard & Poor's (S&P) 500 Composite Index and the Euro Stoxx 50 Index rose strongly by 46 per cent and 21 per cent respectively over the same period.

FTSE/JSE share price indices



Market for exchange-traded derivatives

The 1,7 million *commodity futures and options contracts* traded on the Commodity Derivatives Market of the JSE during the first seven months of 2013 were 4 per cent lower than the trading activity recorded during the corresponding period of 2012. This was on account of generally lower domestic agricultural derivatives prices which were largely influenced by lower international grain prices. Fluctuating export demand, adverse weather conditions and the volatility in the exchange value of the rand contributed to a mixed trend in price movements during 2013. In June 2013, the National Agricultural Marketing Council (NAMC) released the first official domestic grain supply and demand estimates report, covering information on intended imports and exports of grains and oilseeds, as well as the official supply and demand figures for the major domestic grain crops. Local supply projections of most grains came in somewhat lower for the 2013/14 marketing season.

The buoyancy in trading activity in the *interest rate and currency derivatives markets* of the JSE continued in 2013. The 22,2 million contracts traded during the first seven months of 2013 represented a 117 per cent increase in trading volumes when compared with the corresponding period of 2012. Thus far in 2013 trade in currency derivatives constituted 89 per cent of the total trading volumes in these markets. The brisk activity in the currency derivatives market is due to the persistent introduction of new products which are continuously modified to mirror the flexible over-the-counter products. Turnover in derivatives traded on the JSE during the first seven months of 2013 is indicated in the table below.

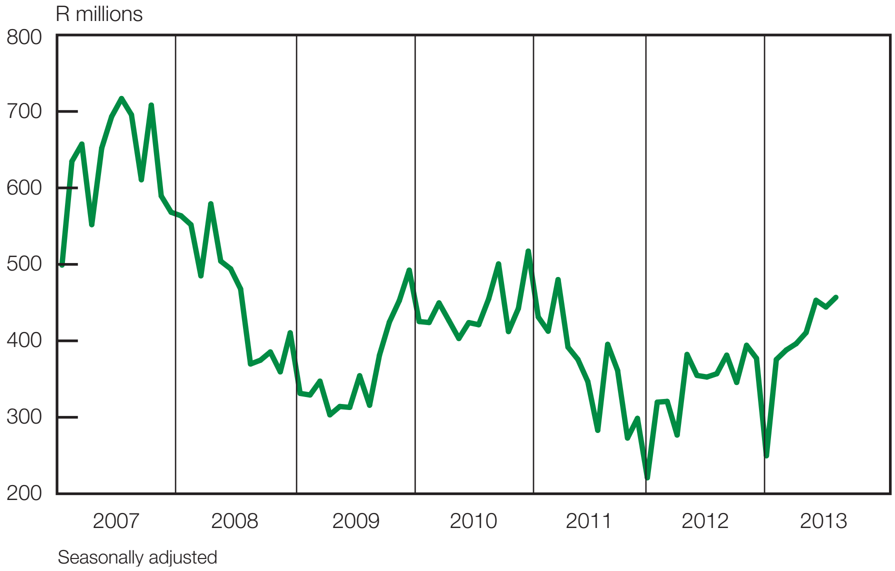
Derivatives turnover on the JSE, January to July 2013

Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity	2 815	19
Warrants	0,3	-17
Commodity	303	6
Interest rate	366	74
Currency	192	134

Real-estate market

The year-on-year rate of increase in nominal house prices across the various house price barometers varied between 7 and 10 per cent in July 2013. The drivers of property prices in recent months seem to be diverse, including the low interest rate environment and circumstances which differ across various market segments. According to FNB's *Estate Agent Survey,* over the past few quarters more estate agents have begun citing shortages of sellable property as an issue as opposed to oversupplies. This suggests that over time demand is steadily making gains on residential property supply.

Transfer duty collected in real-estate market



The average time residential properties remained on the market was broadly unchanged at 17,2 weeks in the first quarter of 2013 and 17,1 weeks in the second quarter. Despite this extended time on the market, the seasonally adjusted value of turnover in the real-estate market, proxied by transfer duty collected, increased noticeably in 2013. In the first seven months of

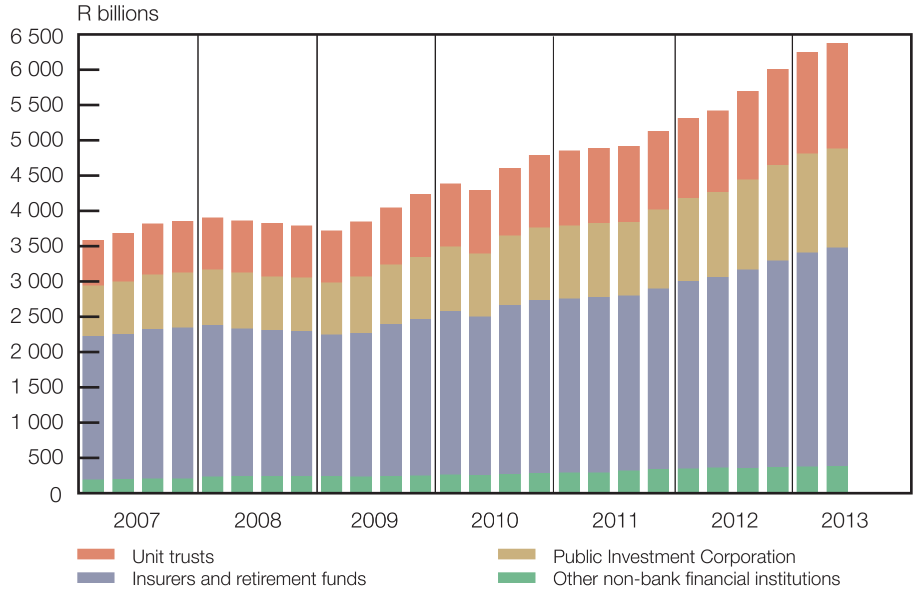
2013 transfer duty collected was 24 per cent higher when compared with the same period of 2012, indicative of higher prices in the residential property market, while the number of property transfers remained lacklustre.

Non-bank financial intermediaries

The consolidated total assets of non-bank financial institutions[10] rose from R6,0 trillion in the final quarter of 2012 to R6,3 trillion in the first quarter of 2013, amid the increase in equity prices, before reaching R6,4 trillion in the second quarter. Overall holdings of shares as a percentage of total assets fell slightly from the first quarter of 2013 to a level of 53 per cent in the second quarter, alongside the temporary decline in prices in the domestic equity market. Higher global equity prices and the depreciation in the exchange value of the rand nevertheless boosted holdings of foreign shares, which increased from 12 per cent of the total share portfolio in the first quarter to 14 per cent in the second quarter of 2013.

10 Consisting of unit trusts, the Public Investment Corporation, long- and short-term insurance companies, public and private pension funds, participation bond schemes, finance companies and non-monetary public financial corporations.

Total assets of non-bank financial institutions



The rotation of funds out of cash and near-cash instruments to fixed-interest securities and other high-yielding asset classes reversed somewhat in the first and second quarters of 2013. Both retail and institutional investors invested about R21 billion in money-market instruments in the first half of 2013, while their equity exposure declined against the backdrop of increased volatility in financial market conditions over the same period. Holdings of cash and near-cash instruments remained at 7 per cent of total assets in the first and second quarters of 2013, while the share of fixed-interest securities fell from 29 per cent to 28 per cent over the same period.

Reflecting the deterioration in households' disposable income and generally difficult economic conditions, the balance sheets of insurers and retirement funds grew at a somewhat slower pace in the first half of 2013, with the net acquisition of financial assets by these intermediaries amounting to about R108 billion over this period.

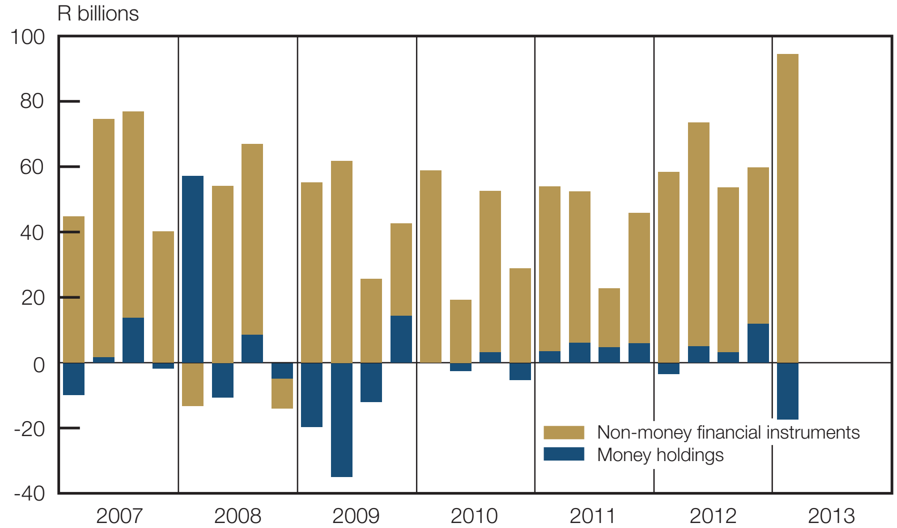
Consistent with ongoing regulatory changes to enhance supervision in the insurance industry, the Financial Services Board released a discussion paper on third-party cell captive insurance and similar arrangements in June 2013. The paper evaluates prudential and market conduct risks for insurers using captive arrangements and for policyholders that may arise from such structures and business models. Among other things, the paper proposes that cell captive insurance business be conducted under a dedicated insurance licence and not be combined with other insurance businesses.

National Treasury released the last technical discussion paper entitled *Charges in South African Retirement* in July 2013 for public comment. The document discusses charges and costs in the retirement industry and attempts to benchmark them against those of other countries. Some of the main findings outlined in the paper are that structural factors, such as the large number of retirement funds in South Africa and the low rate of pension benefit preservation, are the main drivers of costs in the system. Similarly, preference for active management, particularly on the part of consumers and intermediaries, may also have contributed to increased investment-related costs for retirement funds. Proposed policy options to reduce costs include encouraging the consolidation of funds in the industry, improving governance and strengthening fund regulation.

Flow of funds

The *non-resident sector*'s net investment flows into the domestic economy amounted to R54 billion in the first quarter of 2013, somewhat higher than the R48 billion recorded in the fourth quarter of 2012. Non-resident units mainly financed the domestic economy by acquiring domestic equities amounting to R4,8 billion and extended loans of R42 billion to the domestic sector. These investments were partially countered by a reduction of R17 billion in non-residents' deposits with the domestic banking sector. Non-residents generally hold more non-money financial instruments in their South African investment portfolio than money holdings. Within the non-money category, more interest has recently been shown in domestic equities than in government bonds, as positive global market sentiment and the depreciation in the exchange value of the rand bolstered domestic share prices.

Non-residents' acquisition of financial instruments by type



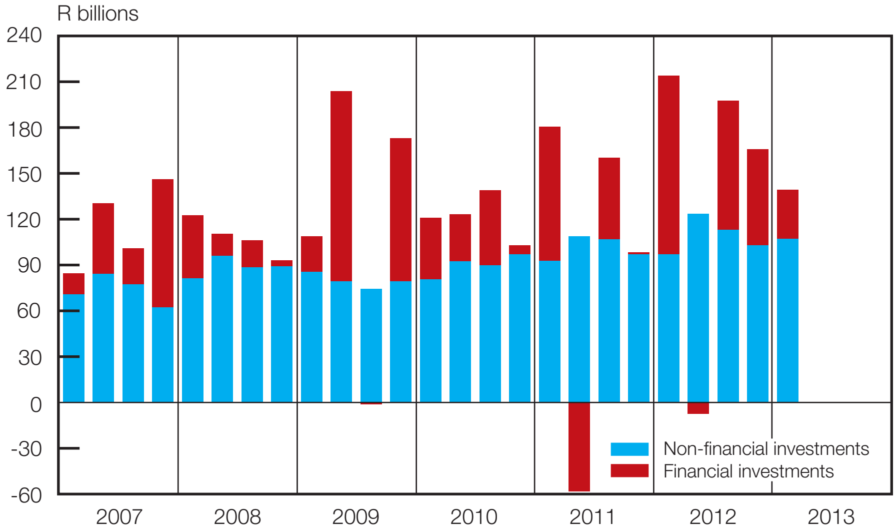
The total net flows of *financial intermediaries* amounted to R218 billion in the first quarter of 2013, with bank intermediation accounting for 31 per cent of this amount. The main contributors to bank deposits of R47 billion were general government at R37 billion (a further R2 billion was deposited at the Corporation for Public Deposits) and other non-bank financial institutions at R26 billion. Financial intermediaries recorded an increase of R46 billion in loans issued, despite a contraction of R1 billion in mortgage loans, as low margins on this type of business continued to put a strain on mortgage advances. The holdings of equities by financial intermediaries also moderated during the period under review.

The *general government sector's* deficit amounted to R34 billion in the first quarter of 2013 as expenditure continued to exceed revenue. Long-term government bonds amounting to R38 billion were issued during the review period to close the deficit. The Public Investment

Corporation, other non-bank financial institutions and non-residents collectively took up 87 per cent of these issuances. The developed and liquid domestic financial market continued to be supportive of government's funding activities.

The *corporate business enterprises* recorded a financial shortfall of R13 billion in the first quarter of 2013 – 33 per cent lower than that recorded in the fourth quarter of 2012. The deficit was largely on account of capital expenditure, especially by public enterprises. However, capital expenditure by corporates was slower in the electricity sector due to industrial action and other stoppages, while quite brisk activity was observed for roads, freight rail and port terminal capacity expansion projects. Corporate business enterprises invested R107 billion in non-money investments and R32 billion in money investments during the first quarter of 2013.

Corporate business enterprises' financial and non-financial investment flows



Households recorded a deficit position of R25 billion in the first quarter of 2013 as their incurrence of financial liabilities increased by R30 billion, mainly in the form of loans and advances. However, high levels of household debt and lacklustre employment and income prospects dampened this fund-sourcing activity. On the other side of their balance sheet, households' bank deposits and interest in retirement and life funds rose by a combined R29 billion over the same period.

11 Unless stated otherwise, year-on-year rates of increase compare fiscal 2013/14 to fiscal 2012/13.

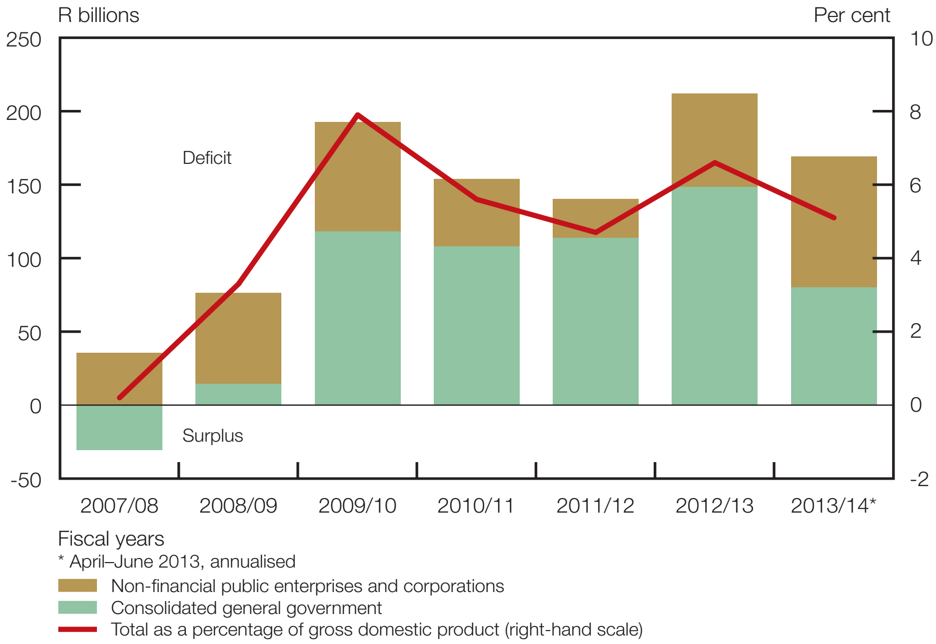
12 Calculated as the cash deficit/surplus of the consolidated central government, provincial and local governments, and non-financial public enterprises and corporations. Data are subject to revision.

Public finance[11]

Non-financial public-sector borrowing requirement[12]

In the April–June quarter of fiscal 2013/14, the non-financial public-sector borrowing requirement amounted to R42,3 billion – some R9,1 billion higher than in the same period of the preceding year. The widening of the borrowing requirement stemmed mainly from higher deficits recorded by local government and non-financial public enterprises and corporations.

Non-financial public-sector borrowing requirement



As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to 5,1 per cent in April–June 2013, higher than the ratio of 4,2 per cent recorded a year earlier. The table below summarises the financial activities of the non-financial public sector at various levels of government.

Non-financial public-sector borrowing requirement

R billions

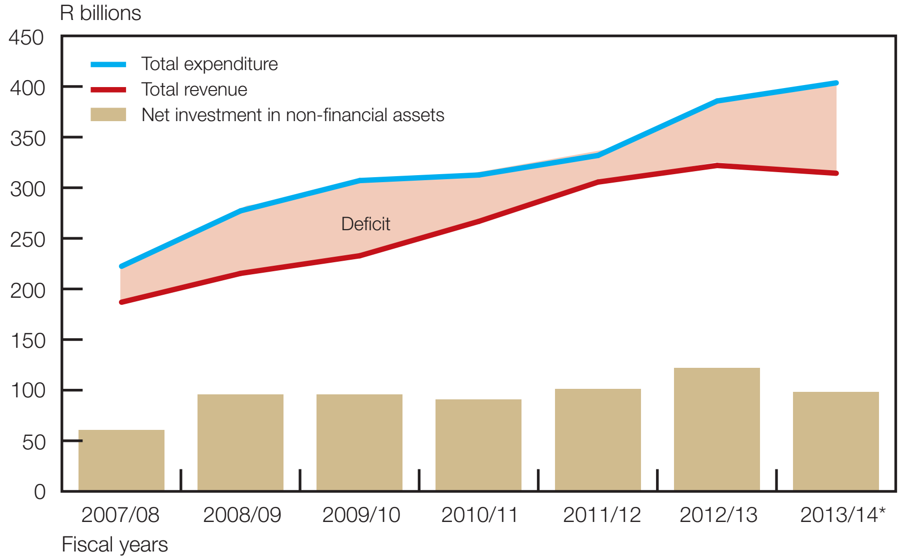
Level of government	Apr–Jun 2012*	Apr–Jun 2013*
Consolidated general government	20,0	20,0
National government	30,1	27,2
Extra-budgetary institutions	-0,9	-2,2
Social security funds	-4,6	-4,3
Provincial governments	-8,6	-7,7
Local governments	4,1	7,0
Non-financial public enterprises and corporations	13,2	22,3
Total**	33,2**	42,3**
As a percentage of gross domestic product	*4,2*	*5,1*

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

The financial activities of the *non-financial public enterprises and corporations* resulted in an estimated borrowing requirement of R22,3 billion in the first three months of fiscal 2013/14. This was R9,1 billion more than the borrowing requirement recorded in the same period a year earlier. The cash deficit widened owing to prominent growth in total expenditure which outpaced the moderate growth in total receipts. The *Budget Review 2013* projected that state-owned companies would record a deficit of R57,9 billion in fiscal 2013/14 as a whole.

Net investment in non-financial assets amounted to R24,5 billion in the first quarter of fiscal 2013/14, or 7,4 per cent more than in the same period of the previous fiscal year. The infrastructure programmes of Eskom and Transnet contributed largely to this increase. As a share of gross domestic product, net investment in non-financial assets equalled 2,9 per cent during April–June 2013, similar to the ratio recorded in April–June 2012. The Minister of Finance announced in his 2013 Budget Speech that public-sector infrastructure spending would remain high and was expected to reach R827 billion over the medium term. Financing the capital spending would be supported by higher cash flows, thereby limiting the need for increased debt issuance.

Finances of non-financial public enterprises and corporations



* April–June 2013, annualised

An analysis of *national government* finance statistics indicates that net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R27,2 billion in April–June 2013, some R3,0 billion lower than the cash deficit recorded in the previous fiscal year. Total cash receipts from operating activities amounted to R213 billion in the first quarter of fiscal 2013/14, an increase of 9,7 per cent compared with the same period of fiscal 2012/13. In relation to the first quarter of fiscal 2012/13, sluggish tax receipts from companies and other enterprises resulted in the slower growth in total cash receipts from operating activities.

Cash payments for operating activities increased by 7,4 per cent year on year and totalled R239 billion in the quarter under review. Compensation of employees recorded an increase of 13,8 per cent, which mainly stemmed from cost-of-living adjustments. In the previous fiscal year these adjustments were effected in the second quarter. As a ratio of total national government cash payments for operating activities, grants paid to other levels of government accounted for 55,7 per cent in the first quarter of fiscal 2013/14.

For the period under review, *provincial governments'* financial activities resulted in a cash surplus of R7,7 billion. This was lower than the cash surplus of R8,6 billion recorded in the same period of the preceding fiscal year. The *Provincial Revenue Fund Statement* originally projected that provincial governments would record a cash surplus of R8,1 billion in fiscal 2013/14 as a whole.

Total provincial revenue, primarily driven by grants from national government, amounted to R106 billion in the first quarter of fiscal 2013/14 – some R7,0 billion more than in the same period a year ago. Provincial grants, including equitable share transfers and conditional grants allocated for specific purposes, accounted for 97,2 per cent of total provincial revenue and amounted to R103 billion in the period under review. These grants increased at a year-on-year rate of 7,1 per cent.

Provincial government expenditure amounted to R98,1 billion in the April–June quarter of fiscal 2013/14, or 8,8 per cent more than in the same period of the previous fiscal year. Pronounced growth in provincial expenditure was driven by personnel costs which amounted to R62,7 billion. Spending in this category was 14,7 per cent higher when compared with the April–June quarter of 2012. On 31 July 2012, bargaining councils and the state signed a three-year pay settlement agreement stipulating that public servants would annually receive an increase equal to consumer price inflation plus 1 per cent. Thus, on 1 April 2013 public servants received an increase of 5,6 per cent.

Provincial governments' deposits with the Corporation for Public Deposits more than doubled, increasing from R7,4 billion at the end of March 2013 to R16,7 billion at the end of June 2013. At the same time, their deposits with private banks decreased by R2,0 billion to R13,0 billion, while their overall indebtedness to banks remained almost unchanged at R1,9 billion over the same period.

Preliminary *local government* statistics indicate that local authorities recorded a net operating surplus of R6,0 billion in April–June 2013. This outcome, together with the net investment in non-financial assets, resulted in a cash deficit of R7,0 billion compared with a cash deficit of R4,1 billion recorded in the same period of the preceding year.

The deterioration in the cash deficit was on account of an increase in total expenditure, which far outpaced the marginal increase in total revenue. Total receipts of local governments recorded a negligible year-on-year rate of increase of 0,8 per cent to amount to R49,3 billion in the period under review. The increase in municipal revenue mainly related to the collection of own funds, while the equitable share transfers and conditional grants allocated for specific purposes from national and provincial governments would only be paid in July 2013 – the start of the financial year for municipalities. Municipal own revenue increased significantly and accounted for 98,7 per cent of total revenue in April–June 2013. This increase was driven by proceeds from sales of water and electricity, as well as municipal property rates.

In the period under review, total municipal expenditure amounted to R56,2 billion – some R3,3 billion more than in the April–June quarter of 2012. This increase was mainly driven by the cost of electricity and water purchases. At the same time, net investment in non-financial assets increased by 28,5 per cent to amount to R13,0 billion; this category constituted almost a quarter of total expenditure.

In the first three months of fiscal 2013/14, local authorities and in particular metropolitan cities continued to increase their presence in the bond market. Bonds to the value of R2,1 billion and R8,0 billion were issued by the City of Tshwane and Ekurhuleni metropolitan municipalities respectively, whereas the City of Johannesburg redeemed an 8-year bond to the value of R0,7 billion. These transactions brought the value of the total outstanding marketable bonds of local governments to R16,3 billion at the end of June 2013.

Preliminary estimates suggest that the *extra-budgetary institutions* recorded a cash surplus of R2,2 billion in April–June 2013, significantly higher than the cash surplus recorded in the same period in 2012. At the same time, preliminary estimates indicate that the financial position of *social security funds* deteriorated slightly since these funds recorded a cash surplus of R4,3 billion in the period under review, compared with a cash surplus of R4,6 billion recorded in the same period a year earlier.

Budget comparable analysis of national government finance

In the 2013 Budget government indicated that it was committed to remaining within its expenditure ceiling. Real non-interest expenditure was projected to grow at an average annual rate of 2,3 per cent over the medium term.

Spending by national government amounted to R235 billion in the first quarter of fiscal 2013/14, or 10,3 per cent more than in the same period a year earlier. The originally budgeted projections indicated that national government expenditure would increase by 9,4 per cent to total R1 052 billion in fiscal 2013/14 as a whole. As a ratio of gross domestic product, national government expenditure amounted to 28,1 per cent in the April–June quarter of 2013, higher than the 27,2 per cent recorded a year earlier.

Voted expenditure contributed 54,2 per cent to total national government spending and was mainly driven by current payments, along with transfers and subsidies. Higher current payments were mainly incurred by the Justice, Crime Prevention and Security Cluster, driven by the Departments of Defence and Military Veterans, as well as Police.

Increases in transfers and subsidies mainly related to the National Treasury and departments responsible for education, health, social development and transport. Education transfers were meant to improve the quality of learning in schools and to provide financial support to universities and other higher-learning institutions. Transfers and subsidies by the Department of Social Development showed a strong increase and were aimed at the rising number of social grant beneficiaries. The Department of Transport paid subsidies to provinces and municipalities to help them improve their road networks. In addition, transfers and subsidies by National Treasury were directed at supplementing provincial and municipal capital expenditure budgets.

In April–June 2013 interest payments on national government debt increased moderately year on year, amounting to R19,4 billion. As a ratio of net tax revenue, interest payments amounted to 10,1 per cent. This ratio measures the burden of the debt service in relation to the country's tax revenues, and shows the extent to which debt service hampers the country in the use of its financial resources. Interest payments were originally budgeted to increase by 13,1 per cent in fiscal 2013/14 as a whole, to an amount of R99,6 billion.

Equitable share transfers to provinces amounted to R84,4 billion, recording a year-on-year rate of increase of 9,2 per cent in the first quarter of fiscal 2013/14. These transfers to provinces were expected to average over a third of total national government expenditure and represent the major source of provincial revenue.

An amount of R9,6 billion was budgeted to be defrayed from the National Revenue Fund and transferred to metropolitan municipalities as their share of the general fuel levy in fiscal 2013/14.

Other statutory payments increased substantially, as transfers to the National Skills Fund and Sector Education and Training Authorities (SETAs) almost doubled in the first quarter of the current fiscal year. These transfers were meant to enhance training and development of the economy's workforce and are funded through the Skills Development Levy receipts.

Over the next year, a tax review will assess whether the present tax policy is appropriate to support government's objectives of inclusive growth, employment, development and fiscal sustainability. For the first quarter of fiscal 2013/14 national government revenue recorded a firm increase, resulting from improved collections.

Total national government revenue increased by 8,1 per cent year on year to amount to R199 billion in April–June 2013. Original budget projections indicated that national government receipts would increase at a rate of 10,9 per cent in the current fiscal year and amount to R873 billion. As a ratio of gross domestic product, national government revenue amounted to 23,8 per cent in the first quarter of fiscal 2013/14, much higher than the 20,7 per cent recorded during the same quarter in fiscal 2009/10, when the global economic crisis reached South African shores.

Taxes on income, profits and capital gains increased moderately and contributed 62,2 per cent to total revenue. This increase resulted from higher personal income tax and corporate income tax collections. The early implementation of general salary increases for civil servants in April this year contributed significantly to the increase in personal income tax. In the previous fiscal year, the implementation of salary increases for public servants was in August. Receipts from companies were driven by higher-than-expected provisional payments by long-term insurers and the metal and retail trade sectors.

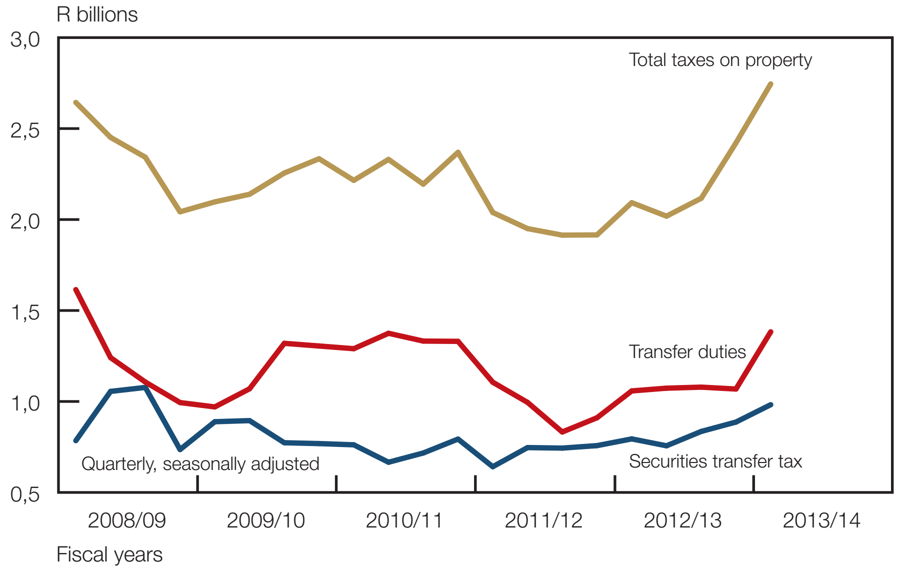
National government revenue in fiscal 2013/14

Revenue source	Originally budgeted		Actual Apr–Jun 2013	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	501,4	9,6	123,5	5,6
Income tax on individuals	*307,2*	*11,0*	*71,1*	*13,1*
Income tax on companies	*171,2*	*6,4*	*47,4*	*7,1*
Payroll taxes	12,4	9,0	2,8	8,6
Taxes on property	9,1	4,9	2,7	31,2
Taxes on goods and services	333,1	12,0	66,7	8,7
Value-added tax	*243,0*	*12,6*	*47,1*	*9,3*
Taxes on international trade and transactions	41,8	8,0	8,2	25,6
Other revenue	18,5	19,0	5,6	17,3
Less: SACU** payments	43,4	2,9	10,8	2,9
Total revenue	873,0	10,9	198,7	8,1

* Fiscal 2012/13 to fiscal 2013/14
** Southern African Customs Union

Taxes on property recorded a significant increase owing to strong collections of transfer duties and securities transfer tax, tentatively suggesting a recovery in the real-estate and capital markets during the period under review.

Taxes on property



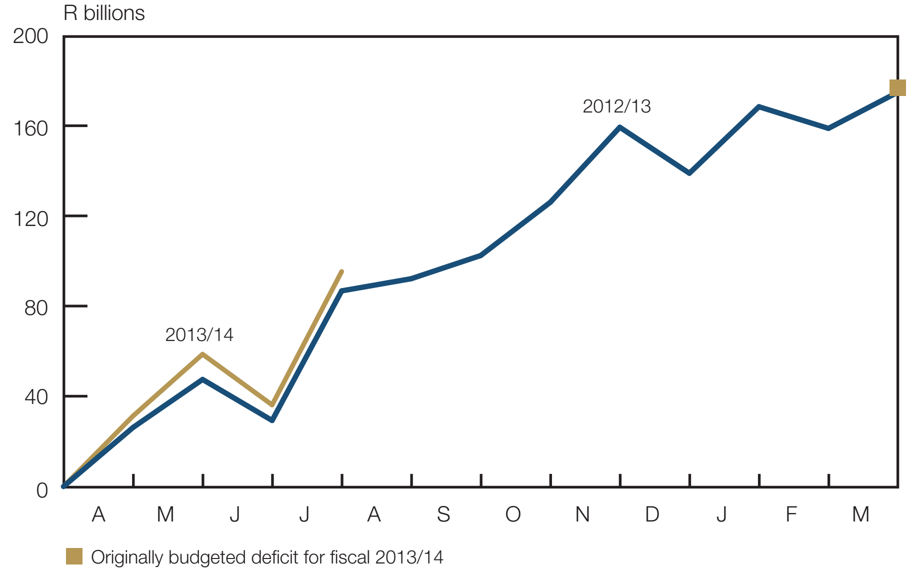
Taxes on goods and services increased strongly in the first quarter of the current fiscal year, boosted by higher increases in value-added tax (VAT) and fuel levy proceeds. Domestic VAT collections recorded a year-on-year rate of increase of 7,0 per cent, owing to high consumer indebtedness, low real-income growth, and low business and consumer confidence. Import VAT increased substantially due to higher import volumes of machinery, vehicles and parts for the Automotive Production and Development Programme (APDP).

Strong collections of customs duties in April–June 2013 contributed to higher taxes on international trade and transactions, resulting from higher imports of especially clothing, beverages and tobacco products.

Collections from non-tax revenue amounted to R5,6 billion and increased by 17,1 per cent, owing to an increase in land rent, specifically mineral and petroleum royalties.

Netting national government expenditure and revenue resulted in a cash-book deficit before borrowing and debt repayment of R36,2 billion in the first quarter of fiscal 2013/14. This deficit was R6,9 billion higher than the cash-book deficit recorded in the same quarter a year earlier. The higher deficit was on account of higher national government spending, which outpaced the increase in revenue. The cash-book deficit was originally budgeted to amount to R179 billion in the full fiscal year 2013/14, slightly higher than the actual deficit outcome of R175 billion recorded in the previous fiscal year.

Cumulative deficit of national government



As a ratio of gross domestic product, the cash-book deficit of national government amounted to 4,3 per cent in the first quarter of fiscal 2013/14, higher than in the same period a year earlier.

The primary balance[13] is a good indicator of the current fiscal effort and fiscal sustainability of a country. In the first quarter of fiscal 2013/14, the primary deficit of national government amounted to R16,8 billion – or 2,0 per cent of gross domestic product. This could be compared with a primary deficit of R10,8 billion, or a deficit ratio of 1,4 per cent recorded in April–June 2012.

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

The cash-flow deficit of national government totalled R63,5 billion or 7,6 per cent of gross domestic product in the first quarter of fiscal 2013/14. This deficit was considerably higher than the cash-flow deficit recorded in the same period of the previous fiscal year. During the period under review, the large difference between the cash-book deficit and the cash-flow deficit resulted from outstanding transfers to the value of R19,1 billion recorded only in government's cash book. Included in extraordinary receipts were penalties on retail bonds, revaluation profits on foreign-currency transactions and the liquidation of the SASRIA investment. After taking into account extraordinary transactions and the cost on revaluation of foreign debt at maturity, the net borrowing requirement of national government amounted to R64,4 billion – more than double the net borrowing requirement recorded in the preceding fiscal year.

National government financing in fiscal 2013/14

R billions

Item or instrument	Originally budgeted 2013/14[1]	Actual Apr–Jun 2013	Actual Apr–Jun 2012
Deficit	**179,2**	**63,5[2]**	**23,9[2]**
Plus: Extraordinary payments	0,9	0,0	1,4
Cost/profit on revaluation of foreign debt at redemption[3]	3,2	4,7	-2,9
Less: Extraordinary receipts	0,3	3,8	0,1
Net borrowing requirement	**183,1**	**64,4**	**22,2**
Treasury bills	23,0	20,2	11,4
Domestic government bonds	145,4	36,1	34,0
Foreign bonds and loans	-1,1	-11,8	-12,1
Change in available cash balances[4]	15,8	19,9	-11,0
Total net financing[5]	**183,1**	**64,4**	**22,2**

1 *Budget Review 2013*
2 Cash-flow deficit
3 Cost + profit –
4 Increase – decrease +
5 Components may not add up to totals due to rounding

In the April–June quarter of fiscal 2013/14, the net borrowing requirement was financed domestically through the issuances of Treasury bills (including short-term loans from the Corporation for Public Deposits) and government bonds. National government was able to secure funding domestically as the appetite for domestic debt instruments remained satisfactory. However, a portion of these domestic debt instruments are held by non-residents. Net issues of inflation-linked bonds amounted to R16,1 billion in the first quarter of fiscal 2013/14. Having been launched in 2000, the outstanding balance on these instruments amounted to R261 billion as at 30 June 2013. Inflation-linked bonds are particularly popular under the current economic conditions. In April–June 2013, RSA Government Retail Savings Bonds recorded net redemptions to the value of R0,5 billion. Redemptions of these instruments have exceeded the issuances thereof since August 2012.

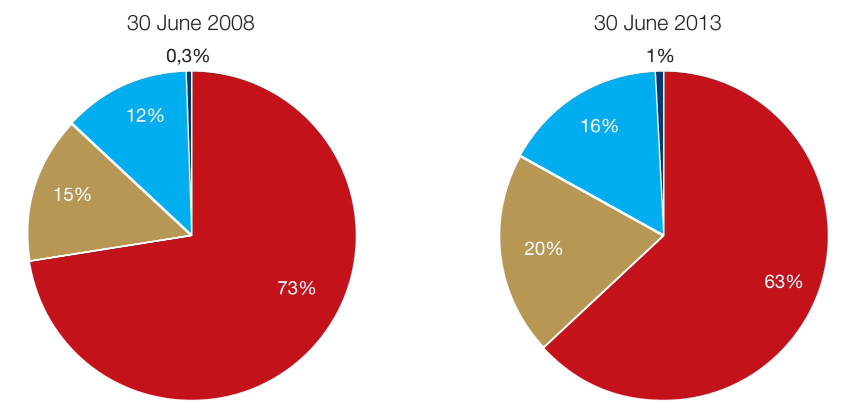
The *R201* bond was partly redeemed for R0,6 billion in May 2013 and switched to the *R186* bond with a longer-dated maturity. National Treasury launched a new fixed-income bond and an inflation-linked bond in July 2013. The *R2037* and the *I2046* bonds were named according to their year of maturity, with coupon rates of 8,5 per cent and 2,5 per cent respectively. Domestic government bonds attracted an average interest rate of 7,8 per cent per annum in April–June 2013, while short-term domestic debt instruments were issued at an average interest rate of 5,2 per cent. Between March and June 2013, the average outstanding maturity of national government domestic marketable bonds lengthened slightly from 146 months to 148 months.

Foreign bonds and loans recorded net redemptions to the value of R11,8 billion in the first quarter of fiscal 2013/14. On 16 May 2013 the TY2/81 Eurobond with a coupon rate of 5,25 per cent was redeemed for R15,0 billion. The average remaining maturity of foreign marketable bonds of national government increased from 86 months as at 31 March 2013 to 96 months at the end of June. This increase in maturity largely emanated from the redemption in May.

Funding activities of national government decreased its available cash balances by R19,9 billion in April–June 2013. As at 30 June 2013, the cash balances of national government with commercial banks and with the Bank amounted to R192 billion and R125 billion respectively.

National government: Composition of domestic debt

Percentage of total domestic debt

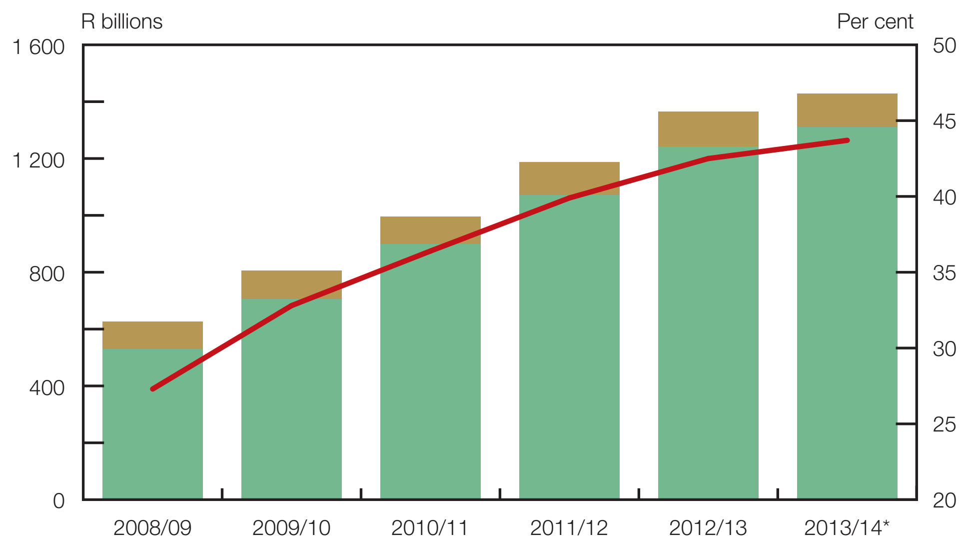


Fixed-income, floating-rate and zero-coupon bonds
Treasury bills and domestic short-term loans
Inflation-linked bonds
Retail bonds and other debt

The issuance of Treasury bills and government bonds continued to finance the deficit, which contributed to the rise in domestic debt of national government. Between March and June 2013, domestic debt increased from R1 241 billion to R1 311 billion. Government's total debt portfolio continued to consist mainly of domestic debt instruments.

Foreign debt of national government declined from R125 billion as at 31 March 2013 to R118 billion at the end of June, owing to large redemptions recorded in the first three months of the current fiscal year. These redemptions outpaced the higher revaluation effects arising from the depreciation of the rand against other major currencies.

Total gross loan debt of national government



As at 31 March of each fiscal year

* As at 30 June 2013

Foreign debt
Domestic debt
Total as a percentage of gross domestic product (right-hand scale)

Total gross loan debt of national government, comprising domestic and foreign debt, increased from R1 366 billion to R1 428 billion between March and June 2013. As a ratio of gross domestic product, total gross loan debt rose from 42,5 per cent to 43,7 per cent during the period under review. Total gross loan debt was originally budgeted to amount to R1 522 billion, or 43,2 per cent of gross domestic product, at the end of fiscal 2013/14.

Statement of the Monetary Policy Committee

18 July 2013

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

The period since the previous meeting of the Monetary Policy Committee (MPC) has been dominated by the reaction of the global financial markets to statements by the United States (US) Federal Reserve that a slowdown in quantitative easing may begin sooner than previously anticipated. The news impacted on capital flows to emerging markets, with outflows from bond markets in particular, but yields on long-term bonds of advanced economies were also affected. While some of the initial fears have been addressed by further guidance from the Fed, this episode gives some insight into the difficulties that could be faced in fine-tuning exit strategies from highly accommodative monetary policies, particularly at a time when global growth remains weak.

These events had a significant impact on the exchange rate of the rand, creating further upside risks to the inflation outlook at a time when the domestic economy has shown increased signs of vulnerability. There has consequently been no let-up in the policy dilemma faced by monetary policy: that of a widening output gap in a worsening inflation environment.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas surprised on the downside at 5,6 per cent in May 2013, having measured 5,9 per cent for the previous three consecutive months. However, this decline is likely to have been temporary as it was due in part to a 73 cent per litre decrease in the petrol price in May, which has since been reversed by an 84 cent per litre increase in July. Food price inflation increased further from 6,3 per cent in April to 6,7 per cent, and accounted for 1,0 percentage point of CPI inflation. The other main contributors to the inflation outcome were housing and utilities, and miscellaneous goods and services which contributed 1,4 and 1,1 percentage points respectively. Administered price inflation declined to 6,3 per cent from 8,9 per cent in April due to the petrol price decline. Excluding petrol, administered price inflation was unchanged at 7,8 per cent. Core inflation, which excludes food, petrol and electricity, measured 5,3 per cent, marginally up from 5,2 per cent in April. The headline producer price inflation for final manufactured goods measured 4,9 per cent in May, compared with 5,4 per cent in April.

Despite the lower starting point, the inflation forecast of the Bank has deteriorated since the previous meeting of the MPC. Inflation is now expected to average 0,1 and 0,3 percentage points higher in 2013 and 2014 at 5,9 per cent and 5,5 per cent respectively, while the forecast for 2015 has been raised from 5,0 per cent to 5,2 per cent. A temporary breach of the upper end of the target range is still expected in the third quarter of 2013, but at a higher average level of 6,3 per cent (6,1 per cent previously), followed by a return to within the target range by the final quarter of the year. The deterioration is mainly due to continued currency weakness and higher-than-expected petrol price increases.

The forecast for core inflation for 2013 is unchanged at an average of 5,3 per cent in 2013 and is now expected to peak at 5,5 per cent in the fourth quarter. This measure is then expected to moderate and to average 5,2 per cent and 5,0 per cent in the coming two years, compared with the previous forecasts of 5,0 per cent and 4,6 per cent respectively. This upward drift in the forecast in the absence of obvious excess demand pressures suggests that there may be emerging underlying pressures, possibly due to the lagged effects of the depreciation of the rand exchange rate.

Inflation expectations appear to have remained anchored around the upper end of the inflation target range. According to the survey conducted by the Bureau for Economic Research at Stellenbosch University during the second quarter of 2013, inflation expectations of all the categories of respondents remained almost unchanged compared with those of the previous quarter. Overall, the survey found that inflation is expected to average 6,0 per cent in 2013 and 6,1 per cent in the next two years, with financial analysts' expectations below those of the business executives and trade union officials over the whole forecast period and within the target range. The former category is consistent with the Reuters survey which reflects expectations of an average of 5,9 per cent in 2013, and moderating to 5,6 per cent and 5,4 per cent in the following two years respectively.

The global economic growth outlook has remained fragile due to the continuing deeper recession in the eurozone and a slowdown in a number of systemically important emerging-market economies. Several forecasters, including the International Monetary Fund (IMF), have downgraded eurozone growth forecasts against the backdrop of a slowdown in Germany, and continued risks emanating from Portugal, Italy and Spain. In its recent World Economic Outlook update, the IMF reduced its 2013 forecast for eurozone growth by 0,2 percentage points to -0,6 per cent, with a weaker recovery than previously forecast in 2014. Although the US economic recovery appears to be gaining some traction, headwinds from the fiscal contraction remain, and first quarter economic growth, at an annualised 1,8 per cent, was weaker than the initial estimate of 2,5 per cent. The sustainability of the recovery is also at risk from rising long-term bond and mortgage interest rates in response to expectations of a tapering off of asset purchases by the Fed. There are tentative signs of stronger growth in Japan, but the sustainability of the recovery remains uncertain.

The slowing growth in various emerging-market economies including China, Brazil and Russia illustrate the difficulties of decoupling from the advanced economies, with the IMF revising its forecasts for 2013 for China from 7,8 per cent to 7,5 per cent; Russia from 3,4 per cent to 2,5 per cent; and Brazil from 3,0 per cent to 2,5 per cent. The deteriorating outlook for emerging markets has been compounded by the recent capital flow reversals that impacted adversely on domestic bond and currency markets in particular. While financial markets have stabilised somewhat, the risks posed to emerging economies in general, including South Africa, by normalisation of monetary policy in the US in the future, are evident.

The combination of slower growth in China and the stronger US dollar has also impacted negatively on commodity prices, although oil prices have been underpinned by risks related to recent events in Egypt. Global inflation remains benign and monetary policy is expected to remain accommodative in the advanced economies for some time, as indicated in the forward guidance provided by the ECB, the Bank of England and the Fed, notwithstanding a possible slower pace of quantitative easing in the US. By contrast, a general tightening bias is evident in a number of emerging markets in response to recent capital flow and exchange rate developments.

Movements in the exchange rate of the rand continue to pose the main upside risk to the inflation outlook. Since the previous meeting of the MPC exchange rate volatility has increased and the rand generally traded in a range between R9,60 and R10,36 against the US dollar. Since the beginning of the year the rand has depreciated by 14,2 per cent against the US dollar and by 11,1 per cent on a trade-weighted basis. Much of the recent volatility and weakness have been in line with the reaction of a number of other emerging-market currencies to fears of US monetary policy tightening. The rand has also been negatively impacted by lower commodity prices.

Domestic bond yields increased significantly in response to capital outflows and higher bond yields in the advanced economies. The yield on the 10-year government bond, for example, increased by more than 100 basis points since the financial market turbulence in late May. Net sales of domestic government bonds by non-residents amounted to R17,4 billion in May and June. In July non-residents became net buyers again with net purchases of R3,0 billion, bringing the year-to-date net total to R5,2 billion. Having been net sellers of South African equities in both 2011 and 2012, non-residents have returned to the market, with year-to-date net purchases of R23,3 billion.

Despite a 15,5 per cent nominal effective depreciation of the rand exchange rate since January 2012, the pass-through to inflation has been relatively muted, particularly when compared with previous episodes of currency weakness. This is probably a reflection of the weak pricing power in some sectors of the economy in a low growth environment. Nevertheless, the risk remains that these pricing pressures may intensify at some stage, particularly if the exchange rate depreciates further from current levels.

Market expectations are for a moderate appreciation of the rand in the coming months, although these expectations have been tempered in recent surveys. According to the Reuters Econometer survey conducted in June, analysts on average expect a rand/dollar exchange rate of R9,70 at the end of 2013, and R9,40 at the end of 2014. There is, however, a wide dispersion between the forecasters, reflecting a high degree of uncertainty. Despite a slight narrowing of the current-account deficit in the first quarter of 2013 to 5,8 per cent of GDP, the depreciated currency reflects this deficit against a backdrop of declining terms of trade and more uncertain global capital flows.

The outlook for domestic economic growth has weakened further, following the first quarter annualised growth rate of 0,9 per cent. While more favourable outcomes can be expected in the subsequent quarters of this year, overall annual growth is likely to be lower than the 2,5 per cent growth rate recorded in 2012. The Bank's growth forecast for 2013 has again been revised down from 2,4 per cent to 2,0 per cent, and from 3,5 per cent to 3,3 per cent for 2014. Growth is expected to accelerate to 3,6 per cent in 2015, compared with 3,8 per cent previously. The risks to the outlook are still assessed to be on the downside, particularly in the face of further delays in overcoming electricity supply constraints. In line with these subdued growth prospects, the RMB/BER Business Confidence Index declined from 52 in the first quarter of 2013 to 48 in the second quarter, consistent with the continued sideways movement of the Bank's leading indicator of economic activity.

The outlook for the mining sector remains bleak following a 0,7 per cent year-on-year contraction in May. Although production showed positive month-to-month growth for the first time in four months, on a three-month-to-three-month basis the sector contracted by 1,4 per cent. There are indications that the manufacturing sector will make a positive contribution to growth in the second quarter following the annualised 7,9 per cent contraction in the first quarter. In May the sector expanded by 2,2 per cent on a year-on-year basis, and by 0,9 per cent on a three-month-to-three-month basis. This more positive trend is also indicated in the Kagiso PMI which increased by 1,2 index points to 52,6 in July.

The real value of building plans passed remains on a moderately upward trend despite a decline in May. The FNB construction confidence index reflects some improvement, having increased by 4 points to 41 in the second quarter of 2013, although the civil construction index declined somewhat over the same period.

Underlying the sluggish economic growth outlook is the low growth in real gross fixed capital formation, which moderated from an annualised 4,3 per cent in the fourth quarter of 2012 to 2,5 per cent in the first quarter of 2013. Private-sector fixed investment growth slowed from 3,8 per cent to 2,8 per cent over this period, and reflected lower outlays in all sectors apart from agriculture, construction and finance. Work stoppages at Eskom's Medupi plant also impacted negatively on investment by state-owned enterprises in the quarter. Fixed investment expenditure is likely to remain affected by low business confidence and prolonged electricity supply constraints.

Employment growth remains subdued, particularly in the private sector. In the year from March 2012 to March 2013, employment grew by 1,0 per cent, or 80 000 workers, of which 65 000 were in the public sector, although this number was inflated by temporary appointments relating to municipal by-elections in the first quarter of the year. Employment contracted in the mining and manufacturing sectors during this period. The official unemployment rate increased from 24,9 per cent in the fourth quarter of 2012 to 25,2 per cent in the first quarter of 2013. Of particular concern is the increase in the youth unemployment rate to 52,9 per cent in the first quarter.

Slower growth in real consumption expenditure by households is indicative of declining consumer confidence and the relative lack of excessive demand pressures in the economy. Household consumption expenditure growth moderated to 2,3 per cent in the first quarter of 2013, driven mainly by more subdued demand for durable goods, particularly motor vehicles. Real retail trade sales surprised on the upside in May with year-on-year growth of 6,2 per cent. Nevertheless, retail trade sales increased by 0,5 per cent in the three months ending May compared with the previous three months, suggesting a continuation of the moderate growth in sales.

Consumption expenditure is expected to be constrained by high petrol and electricity costs, high consumer debt levels and declining growth in credit extension to households. Despite a moderation in the growth of household debt in the first quarter of 2013, the ratio of household debt to disposable income was unchanged at 75,4 per cent, as growth in real disposable income also slowed.

Twelve-month growth in total loans and advances extended to the private sector increased by 9,3 per cent in May, but excluding mortgage advances the increase was 16,8 per cent. In the first five months of 2013, general loans (mainly unsecured lending) continued to account for the bulk of the increase in credit extension, but at a slower pace, particularly to households. Twelve-month growth in general loans to households declined from a recent peak of 35,4 per cent in September 2012 to 24,4 per cent in May 2013. The slowdown is more pronounced when measured over three months. In the three months to the end of May 2013, annualised growth was 11,3 per cent, compared with rates of increase in excess of 30 per cent during 2012.

One of the upside risks to inflation remains wage and salary increases. In the first quarter of 2013, a stronger upward trend was observed with growth in nominal remuneration per worker increasing from 6,6 per cent in the fourth quarter of 2012 to 7,5 per cent. With slower productivity growth, this implied an increase in unit labour cost growth from 5,2 per cent to 6,7 per cent. These increases are consistent with the overall average wage settlement rate in collective bargaining agreements published by Andrew Levy Employment Publications, which increased from 7,6 per cent in 2012 to 7,9 per cent in the first quarter of 2013.

Other upside risks to the inflation outlook emanate from food prices, which have been accelerating over the past few months following a low of 4,6 per cent in September 2012. Food price pressures are intensifying at the producer price level, with manufactured food product prices increasing by 6,9 per cent in May. Although agricultural product inflation remained subdued at 2,6 per cent, this was mainly due to the 13,0 per cent decline in live animal prices which offset the 10,4 per cent increase in cereal and other crop prices. More favourably, global food prices have declined as a result of expectations of bumper crops in some of the main grain producing countries. The FAO international cereals price index decreased by 10,1 per cent since September 2012.

Global oil prices have broken out of their recent trading range of between US$100 and US$105, mainly due to political developments in the Middle East.

However, the relatively subdued global growth outlook, particularly in China, is likely to restrain these price increases. The current under-recovery of around 36 cents per litre on the domestic petrol price is mainly due to international price developments, and indicates that a further petrol price increase can be expected in August.

The MPC continues to face conflicting policy choices relating to rising inflation and slowing growth. Inflation is expected to resume its upward trajectory following the brief respite in May. However, despite the upward trend in core inflation, there are no strong signs of excess demand pressures and the forecast for headline inflation suggests that the breach of the target may be short-lived. The main upside risk to the inflation outlook is the exchange rate and much will depend on the strength of the pass-through to inflation, which to date has been relatively muted. However, the risk remains that these pressures could be mounting, particularly if further currency weakness occurs and affects inflation expectations, which are currently anchored at the upper end of the target range. In addition, the outcome of the present round of wage bargaining will be critical in determining the extent of wage pressure on the inflation outlook.

The output gap has widened, and is only anticipated to begin to narrow during 2015, when growth is expected to be more or less in line with potential. The downside risk to growth has already resulted in the Bank being more tolerant of inflation at the upper end of the target range than would normally have been the case, an approach that is consistent with a flexible inflation-targeting framework.

While the upside risks to the inflation outlook reduce the scope for further accommodation, a tightening of the monetary policy stance does not automatically follow. This will be highly dependent on how we see the inflation trajectory unfolding in this very uncertain environment. In other words, it has become even more data dependent. At this stage a sustained breach of the inflation target is not our central forecast. However, we are concerned about the revised higher trajectory of core inflation and macroeconomic vulnerabilities that are increasingly evident. The MPC is mindful of these conflicting pressures and the challenging domestic and global environment, and will continue to monitor developments closely and act appropriately to achieve its mandate. The MPC has decided to keep the repurchase rate unchanged at 5,0 per cent per annum.