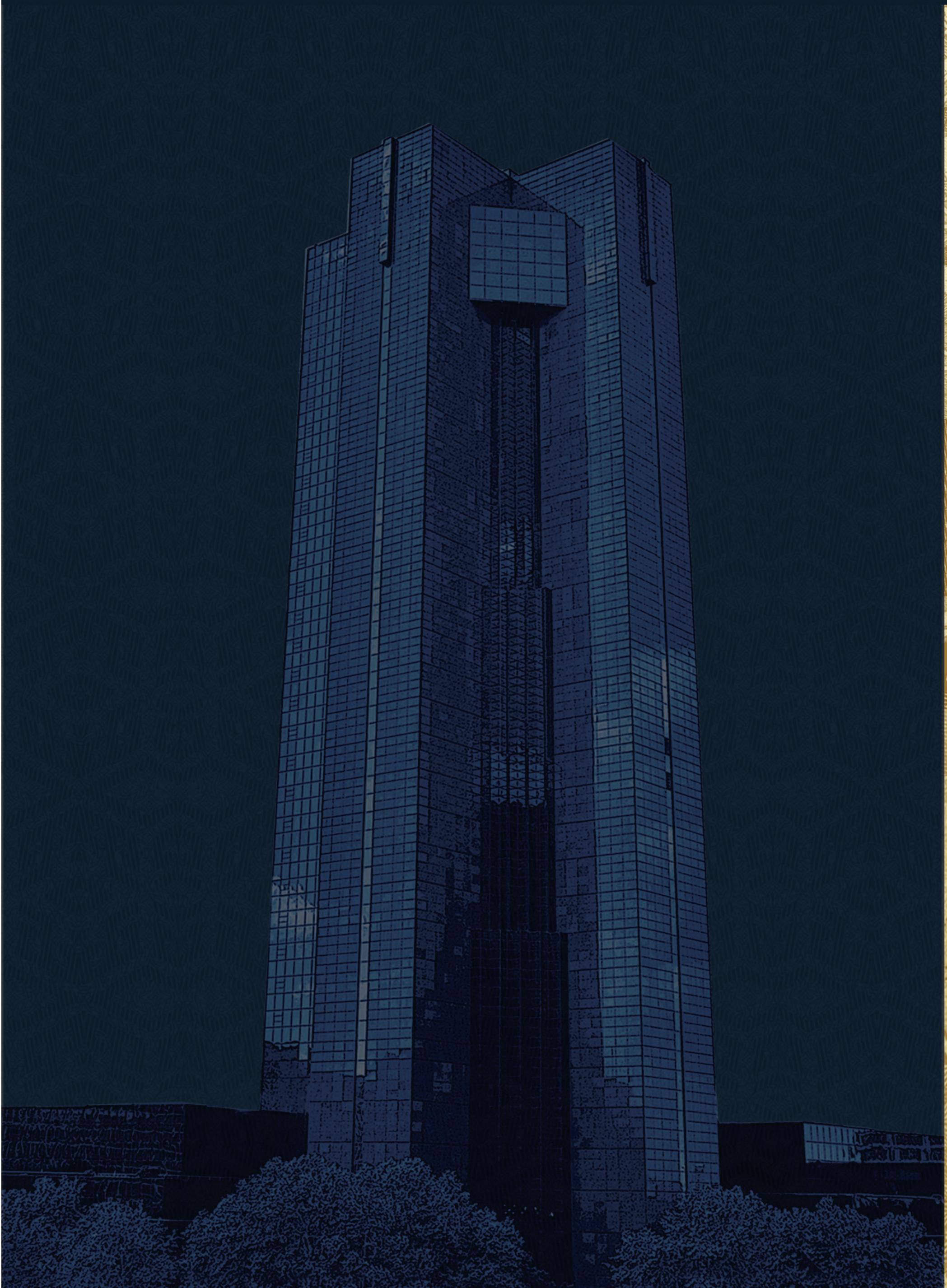
Quarterly Bulletin

December 2014



South African Reserve Bank

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Introduction

Global economic growth accelerated marginally in the third quarter of 2014, largely due to the improved growth momentum in some of the advanced economies. However, growth outcomes and prospects remained uneven, resulting in different monetary policy stances being adopted. Facing headwinds, policymakers in the euro area and Japan for instance added further monetary stimulus, whereas in the United States (US) the sustained improvement in economic activity enabled the Federal Reserve to bring its stimulatory programme of asset purchases to an end. Among emerging-market economies growth outcomes and inflation pressures were mixed, leading to divergent central bank policy decisions.

The sustained slack in the world economy continued to weigh on international commodity prices, reinforced by indications of excess capacity in the Chinese manufacturing sector. With global oil demand lacking vigour and oil supply remaining robust, augmented by shale gas, the price of Brent crude oil receded to five-year lows of less than US$70 per barrel towards the end of November 2014. This contributed to a reduction in actual and projected inflation in most parts of the world, while also impacting negatively on the external and fiscal balances of, and growth prospects for, oil-producing countries. In sub-Saharan Africa, which includes several oil producers such as Nigeria, Ghana and Angola, the near-term growth outlook was scaled down accordingly.

In South Africa, the annualised real economic growth rate picked up to 1,4 per cent in the third quarter of 2014 as the frictions related to the five-month-long platinum strike in the first half of the year started to dissipate, but were replaced by industrial action in the steel and engineering subsector of manufacturing. This lasted one month, involved 220 000 employees, and contributed to the manufacturing sector registering a third successive quarter of negative real growth. It also spilled over to the real output of the electricity-producing sector, which contracted for a second successive quarter. Taking account of the direct and indirect effects, it is estimated that in the absence of the industrial action in the manufacturing sector, the growth rate of the overall economy in the third quarter would have been 3,1 per cent.

In the third quarter agricultural sector output was bolstered by a near-record maize crop. Mining output rose marginally over the period, while activity in the construction sector continued to expand, albeit at a moderate pace.

The steady performance of the tertiary sector was sustained in the third quarter with the trade and finance sectors recording higher growth, whereas some momentum was lost in the transport and communication sector due to the Post Office strike and in the general government sector, where temporary employment related to the elections held in May 2014 was discontinued.

Real gross domestic expenditure regained some momentum in the third quarter of 2014. Growth in real final consumption expenditure by households inched higher over the period, aligned with a slight acceleration in real disposable income. Purchases of durable goods picked up in the third quarter, led by spending on personal transport equipment which benefited from the introduction of new passenger vehicle models. Expenditure on semi-durable goods also registered a firm increase, whereas spending on non-durable goods and services was subdued. Given muted home-loan activity, the ratio of household debt to disposable income declined somewhat further in the third quarter of 2014. Simultaneously, the household sector's net wealth ratio also declined marginally, consistent with the lacklustre performance of the equity market.

The general government's real final consumption expenditure registered moderately lower growth in the quarter under review as temporary employment related to the national and provincial elections held in May 2014 was discontinued.

Real fixed capital formation registered a contraction in the first half of 2014 as a number of projects started to wind down and were not replaced by others given the slack in the economy, the infrastructure-related constraints and the additional caution brought about by extended industrial action. In the third quarter of 2014 capital spending turned around and inched higher. While moderate increases in capital expenditure were registered by private businesses in the agricultural, mining, manufacturing and transport and communication sectors, the most significant boost came from a recovery in real outlays by Eskom and Transnet.

A moderate build-up of inventories was recorded in the third quarter of the year following destocking in each of the preceding three quarters.

Real net exports declined somewhat in the third quarter of 2014, subtracting from overall expenditure on gross domestic product. Export volumes rose by less than import volumes over the period, with exports of gold and iron ore registering contractions as short-term frictions inhibited delivery to external markets and global demand for commodities softened. However, with the price of crude oil declining more steeply than the prices of South African export commodities, the terms of trade improved. In value terms, the deficit on the trade account narrowed somewhat in the third quarter of 2014. This was partly offset by a widening in the deficit on the services, income and current transfer account, reflecting higher net interest payments to non-residents and higher net payments for transport-related services.

The smaller trade deficit but larger services and income shortfall culminated in a slightly narrower deficit on the current account; it edged lower from 6,3 per cent of gross domestic product in the second quarter to 6,0 per cent in the third quarter. The third-quarter deficit was fully financed by net portfolio and net other investment flows. Non-resident investors acquired domestic equity and debt securities in roughly equal proportions during the quarter concerned, and supported the South African government when it issued three international bonds. In the other investment category, loans extended to the South African banking sector rose significantly. By contrast, net direct investment recorded a sizeable outflow of capital over the same period, with a substantial part involving a food and beverage retail investment by a South African entity.

South Africa's international reserves increased in the third quarter of 2014, aided by proceeds from the government's international bond issues. While the nominal effective exchange rate of the rand depreciated further in early 2014, adding additional risk to the inflation outlook, it subsequently recovered much of the lost ground and thereafter fluctuated broadly sideways in the remainder of the year to date.

Employment trends reflected the generally subdued growth in economic activity, with the unemployment rate as estimated by household surveys remaining marginally above 25 per cent in the third quarter of 2014. Enterprise-surveyed employment in the formal non-agricultural sector rose somewhat over the most recently available four quarters to the second quarter of 2014, but with most of the job creation taking place in the public sector and a significant part thereof being temporary employment related to the elections held in May.

Average wage settlements increased moderately over the past year, but allowing for advances in productivity, the underlying pace of increase in unit labour cost remained reconcilable with the inflation target range. The number of workdays lost due to industrial action stood at high levels in each of the first three quarters of 2014, adding friction and hidden costs to the economy.

Consumer price inflation, which moved above the inflation target range from April 2014, returned to within the target range from September. While most measures of underlying inflation also seem to have stabilised more recently, the inflation expectations of business and trade union representatives have continued to exceed 6 per cent, although by a fairly slight margin.

In the first eleven months of 2014, orderly conditions and adequate liquidity continued to characterise the domestic financial markets, with no contagion spreading to the system when a relatively small banking institution was placed under curatorship by the authorities in August. Growth in bank advances to the private sector remained in single-digit territory, with credit extended to the corporate sector rising briskly, but advances to the household sector displaying lethargic growth. General advances to the household sector (or unsecured lending) was particularly weak as lenders and borrowers alike seemed to become more risk-averse. As a main balance-sheet counterpart to banks' credit extension, growth in the broad money supply also lacked vigour.

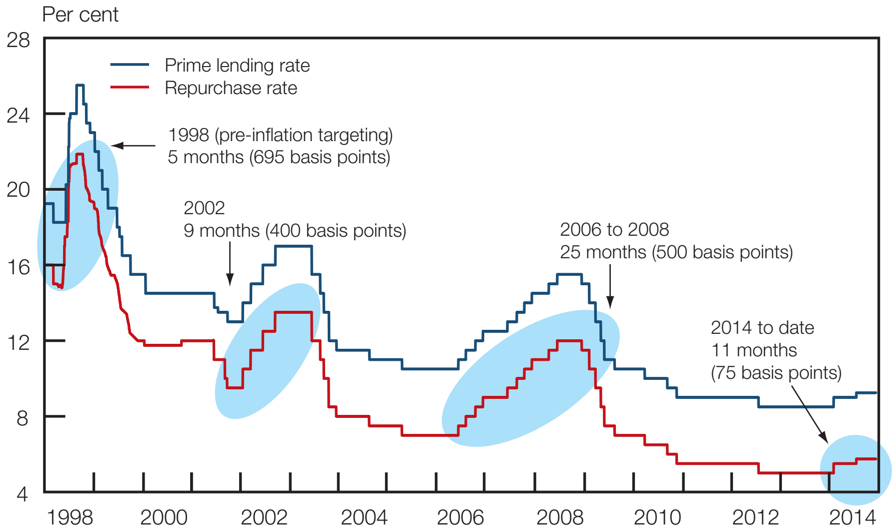
The continued sluggish economic growth bodes ill for the trajectory of government tax revenue, the fiscal deficit and government debt. As further setbacks to growth resulted in the projected trajectories of these variables worsening further, the Minister of Finance announced a shift in fiscal policy in the October 2014 *Medium Term Budget Policy Statement* to arrest the deterioration, re-establish a sustainable foundation for the public finances and build a platform for investment-led growth. The key ingredients of the fiscal package included a reduction in growth in government spending, and an increase in tax revenue brought about by adjusting tax policy and administration through proposals to be introduced in the 2015 Budget.

In close alignment with international bond yields, South African bond yields trended lower from early 2014. The shift in fiscal policy as already mentioned was favourably received in the bond market, helping to support the trend in yields. Domestic share prices came under downward pressure from the end of July 2014 along with international share prices, but started recovering from mid-October.

In the real-estate market, turnover and house prices rose somewhat in 2014 to date, and the average time properties remained on the market before being sold shortened somewhat. Growth in mortgage advances also inched higher.

Earlier in 2014 as inflation outcomes and the outlook for inflation deteriorated, the Monetary Policy Committee (MPC) increased the repurchase rate twice – from 5,00 per cent to 5,50 per cent in January, and further to 5,75 per cent in July. With the international prices of oil and food – previously drivers of accelerating inflation – reversing course, the most recent inflation outcomes receded to within the target band and the outlook for inflation also improved significantly. This prompted the MPC to indicate at its November 2014 meeting that it viewed the risks to inflation to be more or less evenly balanced between the upside and the downside, and the repurchase rate to be at an appropriate level for the time being. As seen in the accompanying graph, the trajectory followed by the repurchase rate in the present upward cycle in interest rates is very gradual compared to preceding cycles. This is consistent with the measured approach followed by the MPC in which the need to vigilantly keep inflation under control is balanced against the need to avoid unnecessary policy tightening in an environment of fragile economic growth.

Repurchase rate and prime lending rate



Source: South African Reserve Bank

Domestic economic developments

Domestic output[1, 2]

1 The analysis in this section of the review is based on a revised set of national accounts estimates. These revisions are based on more detailed or more appropriate data that have become available. In addition, the national accounts estimates at constant prices have been rebased from 2005 prices to 2010 prices. The current revisions also incorporated conceptual, methodological and classification changes to South Africa's national accounts statistics following the partial implementation of the latest edition of the *System of National Accounts* (2008 SNA). The revisions are introduced in a note in this edition of the *Quarterly Bulletin*.

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

Economic activity in South Africa expanded at a faster pace in the third quarter of 2014. Having recorded negative growth in the first quarter of 2014, growth in *real gross domestic product* accelerated from 0,5 per cent in the second quarter of 2014 to 1,4 per cent in the third quarter. This moderate acceleration in growth could be attributed to increases in the real value added by both the primary and tertiary sectors. By contrast, the real value added by the secondary sector declined further over the period. Following the somewhat improved growth performance in the third quarter of 2014, the level of real gross domestic production in the first three quarters of 2014 was 1,5 per cent higher than in the corresponding period of 2013. This was in line with the revised outlook for growth projected for the country by both the recent *Medium Term Budget Policy Statement* for 2014 (MTBPS) and the latest *World Economic Outlook* of the International Monetary Fund (IMF).

Real gross domestic product

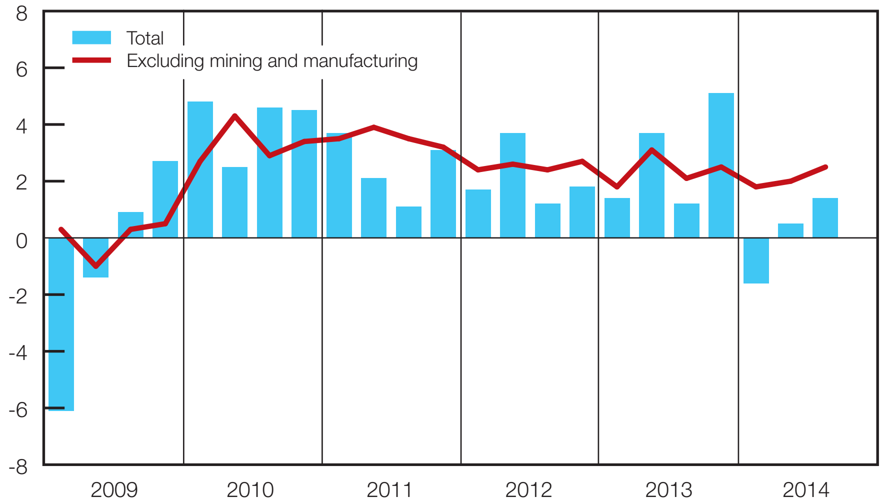
Percentage change at seasonally adjusted annualised rates

Sector	2013					2014		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	10,1	-3,7	10,2	14,8	**3,4**	-17,7	-1,2	3,1
Agriculture	-2,9	-1,1	3,6	6,8	**1,5**	3,3	5,3	8,2
Mining	14,3	-4,5	12,3	17,2	**4,0**	-23,0	-3,1	1,6
Secondary sector	-6,1	9,3	-4,3	8,2	**0,9**	-3,8	-2,5	-2,0
Manufacturing	-7,8	11,7	-6,6	12,3	**0,7**	-6,4	-4,0	-3,4
Tertiary sector	2,4	3,2	2,1	2,7	**2,5**	1,7	1,9	2,4
Excluding mining and manufacturing	*1,8*	*3,1*	*2,1*	*2,5*	**2,4**	*1,8*	*2,0*	*2,5*
Total	1,4	3,7	1,2	5,1	**2,2**	-1,6	0,5	1,4

Excluding the contribution of the strike-affected mining and manufacturing sectors, growth in the real gross domestic product accelerated from an annualised rate of 2,0 per cent in the second quarter of 2014 to 2,5 per cent in the third quarter.

Real gross domestic product

Percentage change from quarter to quarter

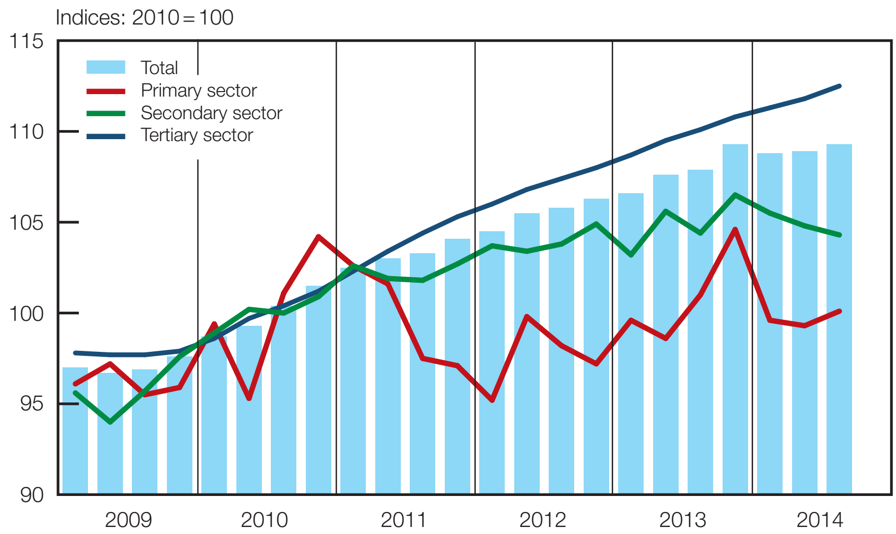


Seasonally adjusted annualised rates

Subsequent to a contraction of 1,2 per cent in the second quarter of 2014, the real value added by the *primary sector* increased at a rate of 3,1 per cent in the third quarter. Growth in the real output of the agricultural sector gained further momentum alongside an increase in mining production, following declines in the preceding two quarters.

Growth in the real output of the *agricultural sector* accelerated for the second consecutive quarter, increasing at an annualised rate of 8,2 per cent in the third quarter of 2014 compared with a growth rate of 5,3 per cent in the preceding quarter. This further expansion mainly reflected improved field crop, horticultural and animal production over the period. The maize crop for the 2013/14 production season amounted to 14,3 million tons as opposed to 11,8 million tons in the previous season. Owing to lower prices anticipated for the forthcoming season, producers are expected to plant 2,6 million hectares of maize in the 2014/15 production season – 3,3 per cent less than what was planted in the previous year.

Real gross domestic product by sector



Seasonally adjusted

Following the resolution of the five-month strike in the platinum-mining sector at the end of June 2014, production in the *mining sector* increased in the third quarter of 2014. Real output of the mining sector advanced by 1,6 per cent over the period, underpinned by higher production of iron ore, manganese ore, diamonds, chromium ore and other metallic minerals. At the same time, the pace of decline in the production of platinum group metals slowed significantly as mines started to ramp up production following the longest and most destructive period of industrial action in the history of the industry. The real output of the mining sector subsequently contributed 0,1 percentage point to aggregate growth in gross domestic product in the third quarter of 2014 after having subtracted 0,2 percentage points in the second quarter of 2014.

The production of iron ore remained resilient as iron ore mines improved their efficiency alongside enhanced waste control programmes, while more efficient underground operations gave rise to an increase in diamond production. The lower level of coal production in the third quarter of 2014 partly reflected the lower domestic demand for coal. Gold-mining production decreased following the temporary shutdown of operations at a major gold mine due to an earthquake. In general, declining commodity prices, low confidence levels, electricity-supply and infrastructure constraints and rising input costs continued to adversely affect mining operations in South Africa.

The real value added by the *secondary sector* contracted at an annualised rate of 2,0 per cent in the third quarter of 2014 following a decline of 2,5 per cent in the second quarter. This was mainly on account of a further drop in the real output of the manufacturing sector. Growth in the real value added by the construction sector edged higher, while the real value added by the sector supplying electricity, gas and water continued to decline.

Following a quarter-to-quarter annualised decline of 4,0 per cent in the second quarter of 2014, *manufacturing production* contracted at a rate of 3,4 per cent in the third quarter, subtracting 0,4 of a percentage point from the overall rate of growth in the quarter. The further decrease in manufacturing production in the third quarter of 2014 was largely evident in the subsectors producing wood and wood products; petroleum, chemical products, rubber and plastic products; basic iron and steel, non-ferrous metal products and machinery; electrical machinery; and radio and television equipment. On the contrary, production volumes advanced in the subsectors producing food and beverages; textiles, clothing, leather and footwear; motor vehicles, parts and accessories and other transport equipment; and glass and non-metallic mineral products.

Box 1 Impact of the recent industrial action in the steel and engineering industry

Following an impasse in negotiations between the National Union of Metalworkers of South Africa (Numsa) and the Steel and Engineering Federation of South Africa (SEIFSA), a national strike by the Union was declared which commenced on 1 July 2014. The industrial action involved around 220 000 of the Union's claimed membership of 340 000, and was marred by reports of violence, with many people being arrested for vandalising businesses and intimidating non-striking workers. The union, however, claimed that these acts of violence were perpetrated by non-union members under the guise of belonging to the union.

Labour demands preceding the commencement of industrial action comprised a salary increase of 15 per cent along with a R1 000 housing allowance and other non-wage related demands such as the banning of labour brokers, while the employer body offered an increase of between 7 per cent and 8 per cent. The wage demand by the Union was subsequently lowered to an effective 10 per cent increase annually during the full duration of the three-year agreement. The final three-year wage agreement reached between the two parties towards the end of July 2014 comprised increases of between 8 and 10 per cent in the first year; 7,5 and 10 per cent in the second year; and 7 and 10 per cent in the third year. The agreement moreover stipulates that section 37 of the Metal and Engineering Industry Bargaining Council Collective Agreement will remain unchanged, with a provision that existing company-level agreements stay in force. As part of the agreement, labour brokers will not be banned as requested by Numsa, but a number of regulatory instruments will be introduced – such as compliance officers to act on complaints of alleged abuse and non-compliance.

The National Employers Association of South Africa (Neasa) represents mainly small and medium-sized businesses and was not party to this agreement. Neasa was expected to also implement the agreement within the centralised bargaining system, despite having indicated that the agreement was unaffordable and jeopardised the continued existence of its members. Neasa subsequently embarked on legal action to have the agreement set aside for its members.

In early December 2014, the Labour Court dismissed the attempt by Neasa to prevent the wage agreement from being extended to the rest of the metals and engineering sector. Following the judgment, Neasa, however, lodged an appeal because according to its interpretation, the judge had erred and premised the judgment on incorrect information.

According to industry sources the direct cost of the strike to the economy amounted to around R300 million per day or 0,4 per cent of gross domestic product for the full duration of the month-long strike. With the metals and engineering sector being strategically linked within the supply chain to other important industries in the economy such as the mining, construction and auto-manufacturing industries, the impact of the strike was greatly amplified. The metals and engineering sector represents around 34 per cent of manufacturing production with a total annual turnover of around R335 billion.

The damaging impact of the strike on the economy was underscored by a seasonally adjusted decline of 6 per cent in manufacturing production in July 2014, contributing to an annualised decline of 6,6 per cent in manufacturing production in the third quarter of 2014.

Preliminary estimates from consolidated data emanating from SEIFSA's members and other sources, covering 10 200 companies, indicate that employment in the steel and engineering industry has contracted by around 2 per cent from July to October 2014, with around 7 000 employees having been made redundant during that period.

South African Reserve Bank (the Bank) staff calculations show that the impact of the strike in the third quarter of 2014 equates with a decrease of 0,25 per cent in real gross domestic product, or 1,0 per cent at an annualised rate. However, secondary effects such as the decrease in household consumption expenditure due to no-work-no-pay contractions in salaries and wages should also be taken into account. Estimates based on simulation exercises done with the Bank's core econometric model indicate that annualised real economic growth in the third quarter of 2014 would have been higher by 1,7 percentage points (1,0 per cent due to direct effects and 0,7 per cent due to secondary effects) if industrial action in the steel and engineering sector had not occurred during that period. Annualised growth in real gross domestic product in the third quarter of 2014 could therefore have been closer to 3,1 per cent had industrial action not taken place, in contrast to the increase of 1,4 per cent which materialised. Unfortunately, the consequences of strikes and lockouts extend far beyond mere measurables, also tarnishing the image of the country as a preferred investment destination.

Estimated impact of industrial action on gross domestic product

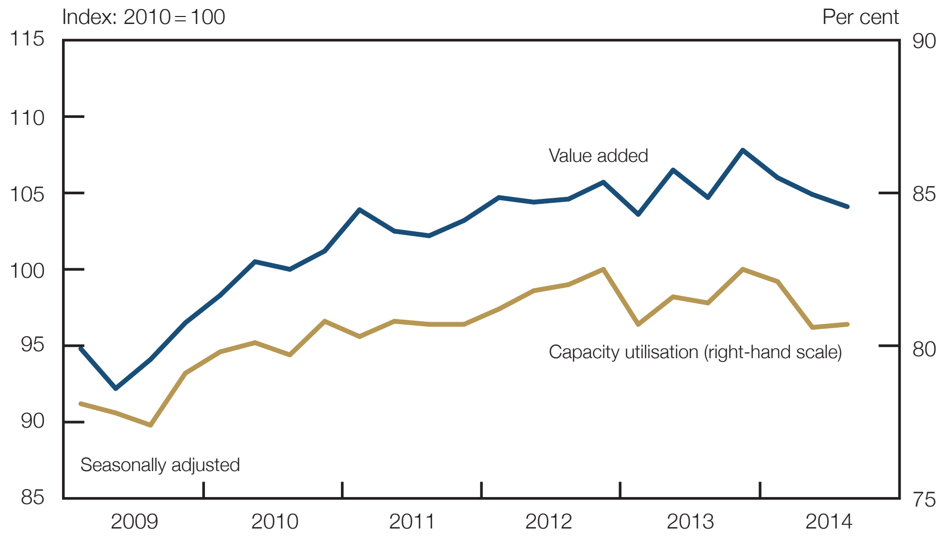
Per cent

	3rd qr 2014	
	Actual	Normal
Growth in real gross domestic product *	1,4	3,1

* Seasonally adjusted and annualised

Production in the manufacturing sector subsided from the beginning of 2014, weighed down by, among other factors, the prolonged strike in the platinum-mining industry in the first half of the year and the four-week-long strike in the steel and engineering industry in July 2014. The latter affected the subsector manufacturing basic iron and steel, non-ferrous metal products and machinery in particular. Apart from a decline in international demand, in particular from China, activity in the domestic manufacturing sector also continued to be adversely affected by rising labour costs, electricity constraints, above-inflation increases in electricity tariffs, skills shortages, rail and port inefficiencies, and subdued domestic demand.

Manufacturing: Real gross value added and capacity utilisation



Consistent with the lower production levels in a number of subsectors, the utilisation of production capacity in the manufacturing sector remained broadly unchanged at 80,7 per cent in the third quarter of 2014. Real manufacturing output in the first three quarters of 2014 was only 0,2 per cent lower than in the corresponding period of 2013.

The real value added by the sector supplying *electricity, gas and water* continued to decline from an annualised rate of 0,5 per cent in the second quarter of 2014 to 1,1 per cent in the third quarter. The decline could in part, be attributed to the reduced demand for electricity following the closure of a large aluminium smelter during the period. Exports of electricity to Botswana, however, picked up over the same period.

Activity in the *construction sector* which had moderated from 3,7 per cent in the first quarter of 2014 to an annualised rate of 2,1 per cent in the second quarter, inched higher to 2,2 per cent in the third quarter. Growth in civil construction activity by private business enterprises moderated due to the completion of certain projects in accordance with the Independent Power Producer Procurement Programme. In addition, activity in the residential and non-residential buildings sector remained subdued affected by, inter alia, disruptions in the supply of essential building materials such as reinforcing steel.

The steady performance of the *tertiary sector* was sustained in the third quarter of 2014. Growth in real value added by the sector accelerated from an annualised rate of 1,9 per cent in the second quarter of 2014 to 2,4 per cent in the third quarter, essentially reflecting increased activity in the trade and the finance, insurance, real-estate and business services sectors. Growth in the real value added by the transport, storage and communication, and the general government services sectors slowed over the period.

Consistent with a marginal uptick in consumer demand in the third quarter of 2014, quarter-to-quarter growth in the real value added by the *commerce sector* accelerated from -0,2 per cent in the second quarter of 2014 to 3,4 per cent in the third quarter as activity in the retail and motor-trade subsectors regained some momentum. The value added by the wholesale subsector declined at a slower pace, in part due to the normalisation in sale volumes following the industrial action in the steel and engineering industry. The retail sector benefited from increased demand for durable and semi-durable goods, partly aided by the normalisation in the payment of salaries and wages of those workers affected by the strike in the platinum-mining subsector and metal industries. In addition, the motor-trade subsector benefited from higher domestic vehicle sales as well as exports. Investment demand by the car rental industry in South Africa remained high.

Growth in the real output of the *transport, storage and communication sector* slowed from an annualised rate of 3,9 per cent in the second quarter of 2014 to a rate of 2,2 per cent in the third quarter. Slower growth in the land transport subsector, more particularly freight transportation, partly explained the slower pace of increase in the transport subsector. Activity in the communications subsector slowed marginally in the third quarter mainly due to the strike in the postal services industry.

Growth in the real value added by the *finance, insurance, real-estate and business services sector* accelerated from 1,2 per cent in the second quarter of 2014 to an annualised rate of 2,4 per cent in the third quarter. The stronger performance of this sector primarily reflected an increase in trading activity in the equity, bond and other financial markets. The real output of the banking sector, however, contracted over the period.

Growth in the real value added by *general government* moderated to an annualised rate of 2,2 per cent in the third quarter of 2014 following an increase of 3,9 per cent in the preceding quarter. The output by general government in the second quarter was raised significantly by services rendered by additional workers temporarily employed to assist with the national and provincial elections in May 2014; third-quarter growth reflected the discontinuation of such temporary services.

Real gross domestic expenditure

Following an increase of 0,5 per cent in the second quarter of 2014, growth in *real gross domestic expenditure* accelerated to an annualised rate of 2,6 per cent in the third quarter. An acceleration in growth in real final consumption expenditure by households, along with positive growth in real gross fixed capital formation and in inventory holdings, more than neutralised slower growth in expenditure by general government over the period. The level of real gross domestic expenditure in the first three quarters of 2014 was only 0,4 per cent higher than in the corresponding period of 2013.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

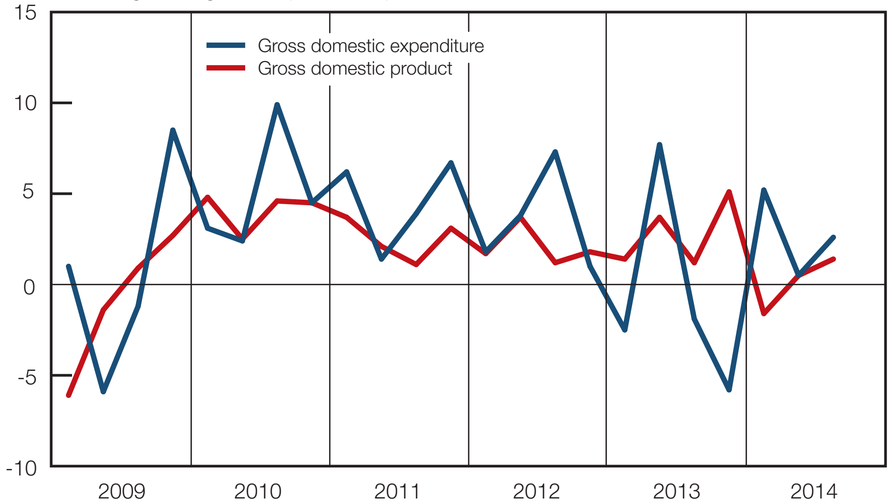
Component	2013					2014		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure								
Households	1,7	1,8	1,7	1,4	2,9	0,5	1,1	1,3
General government	3,1	1,0	0,7	3,5	3,3	1,6	2,1	1,4
Gross fixed capital formation	9,2	9,8	9,7	4,8	7,6	-9,5	-5,4	2,1
Domestic final demand	3,5	3,2	3,1	2,5	3,9	-1,4	0,0	1,5
Change in inventories (R billions)*	1,3	35,7	5,9	-35,3	1,9	-4,3	-2,2	1,1
Gross domestic expenditure	-2,5	7,7	-1,9	-5,8	1,4	5,2	0,5	2,6

* At constant 2010 prices

The largest contribution to growth in real gross domestic product in the third quarter of 2014 emanated from the three components of final demand, which added 1,4 percentage points, whereas net exports subtracted 1,1 percentage points.

Real gross domestic product and expenditure

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Contribution of expenditure components to growth in real gross domestic product

Percentage points

Component	2013					2014		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure								
Households	1,1	1,1	1,0	0,9	1,8	0,3	0,7	0,8
General government	0,6	0,2	0,1	0,7	0,7	0,3	0,4	0,3
Gross fixed capital formation	1,8	2,0	2,0	1,0	1,5	-2,1	-1,2	0,4
Change in inventories	-2,2	4,8	-4,0	-5,7	-1,2	4,1	0,3	0,5
Net exports	4,0	-4,0	3,2	11,3	0,7	-6,7	0,0	-1,1
Residual	-3,9	-0,4	-1,1	-3,1	-1,3	2,4	0,3	0,6
Gross domestic product	1,4	3,7	1,2	5,1	2,2	-1,6	0,5	1,4

Having lost some momentum since the first quarter of 2013, *real final consumption expenditure by households* picked up slightly in the second and third quarters of 2014, as did real disposable income. Growth in real expenditure by households accelerated from an annualised rate of 1,1 per cent in the second quarter of 2014 to 1,3 per cent in the third quarter, due to higher real outlays on all four components of spending. Although consumer confidence retreated somewhat in the third quarter of 2014, it still remained marginally above the low levels recorded in the second half of 2013. Following the somewhat stronger performance in the third quarter of 2014, the level of real final consumption expenditure by households in the first three quarters of 2014 was 1,2 per cent higher than in the corresponding period of 2013. The ratio of final consumption expenditure by households to gross domestic product, however, decreased somewhat from 61,0 per cent in the second quarter of 2014 to 60,7 per cent in the third quarter.

Despite the slower pace of increase in credit extension to the household sector in recent months, growth in households' real spending on *durable goods* accelerated from 5,1 per cent in the second quarter of 2014 to 6,2 per cent in the third quarter. Spending on all durable categories increased over the period, with growth in spending on personal transport equipment – the biggest component of durable goods – accelerating robustly in the third quarter of 2014. Spending on this category was probably boosted by the release of a number of new passenger vehicle models, attractive packages on offer, and pre-emptive buying in anticipation of possible price increases in the remainder of the year. Purchases of computers and communication equipment also benefited from new technology and attractive prices.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Category	2013					2014		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods	5,3	6,0	5,8	4,5	9,0	3,5	5,1	6,2
Semi-durable goods	4,9	5,3	5,4	4,6	5,3	2,4	2,3	2,4
Non-durable goods	2,1	1,9	0,0	1,4	1,5	1,2	0,6	0,5
Services	-0,1	0,1	1,4	0,1	2,2	-1,2	0,4	0,6
Total	1,7	1,8	1,7	1,4	2,9	0,5	1,1	1,3

Following growth of 2,3 per cent in the second quarter of 2014, real spending on *semi-durable goods* broadly maintained its momentum, rising at an annualised rate of 2,4 per cent in the third quarter. Although higher spending was evident in all semi-durable goods categories, the largest contribution over the period emanated from spending on clothing and footwear.

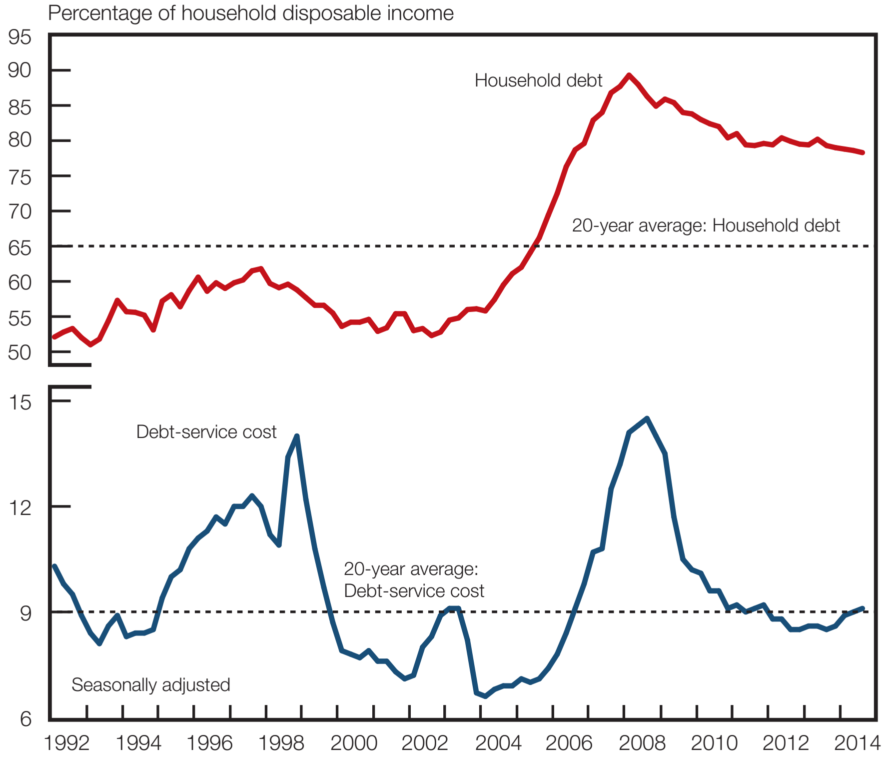
Growth in real outlays on *non-durable goods* remained subdued. Subsequent to an increase of 0,6 per cent in the second quarter of 2014, such consumer outlays grew at a rate of 0,5 per cent in the third quarter of 2014. The slower rate of increase could be attributed to a decline in spending on household fuel and power and on petroleum products, which was partly countered by higher spending on other types of non-durable goods.

Real spending on *services* increased marginally from an annualised rate of 0,4 per cent in the second quarter of 2014 to 0,6 per cent in the third quarter. The slightly faster pace of increase essentially reflected increased spending on rent, household services, medical services, and transport and communication services, which was partly neutralised by a decline in spending on recreational, entertainment and miscellaneous services.

Growth in *real disposable income* of the household sector accelerated from an annualised rate of 1,6 per cent in the second quarter of 2014 to 1,8 per cent in the third quarter. Compensation of employees increased in the third quarter, partly reflecting the normalisation in the payment of salaries and wages of those workers affected by the action in the platinum-mining subsector, although compensation in the metal industries was impaired by the industrial action in July. Households continued to incur debt over the period but at a slower pace than growth in disposable income; the ratio of debt to disposable income subsequently edged lower from 78,6 per cent in the second quarter of 2014 to 78,3 per cent in the third quarter. The cost of servicing debt as a ratio of disposable income increased slightly from 9,0 per cent in the second quarter of 2014 to 9,1 per cent in the third quarter.

Growth in the value of household assets slowed from the second to the third quarter of 2014, partially reflecting the lacklustre performance of the equity market as well as the slower pace of increase in house prices. With the value of household assets increasing at a slower pace than financial liabilities, growth in total net wealth moderated, registering the slowest rate of increase since the second quarter of 2013. As growth in disposable income exceeded that of total net wealth, the ratio of net wealth to annualised disposable income moderated to 355 per cent in the third quarter of 2014 from 359 per cent in the preceding quarter.

Household debt and debt-service ratios



Having increased at an annualised rate of 2,1 per cent in the second quarter of 2014, growth in *real final consumption expenditure by general government* moderated to a rate of 1,4 per cent in the third quarter. The slower pace of increase followed the high base set by increased spending on the national and provincial elections in the second quarter of 2014. Although at a more subdued pace of increase, spending by government in the third quarter of 2014 reflected improvements in the health and education sectors, specifically spending by provincial governments. The level of real spending by general government in the first three quarters of 2014 was 2,0 per cent higher than in the corresponding period of 2013. As a percentage of gross domestic product, final consumption expenditure by general government increased marginally from 20,5 per cent in the second quarter of 2014 to 20,6 per cent in the third quarter.

Following declines in both the first and second quarters of the year, *real gross fixed capital formation* picked up at an annualised rate of 2,1 per cent in the third quarter of 2014 as capital outlays by all three institutional sectors increased. Capital investment by private business enterprises and public corporations switched around and recorded positive growth in the third quarter, while capital spending by general government slowed somewhat over the period. Consequently, the level of capital investment in the first three quarters of 2014 was 0,3 per cent higher than in the corresponding period of 2013.

Real gross fixed capital formation by *private business enterprises* increased at an annualised rate of 0,7 per cent in the third quarter of 2014 following notable declines in the preceding two quarters. This turnaround resulted from an increase in capital outlays by the agricultural, mining, manufacturing, and transport and communication sectors, mainly on machinery and equipment. Higher capital spending in the mining sector was most pronounced in coal and metal ore mines, while capital investment in the platinum-mining sector picked up moderately. In manufacturing, real capital expenditure was particularly stepped up in the food, paper products and basic chemicals subsectors as well as in the subsectors manufacturing insulated wire and cables, and motor vehicles, parts and accessories.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

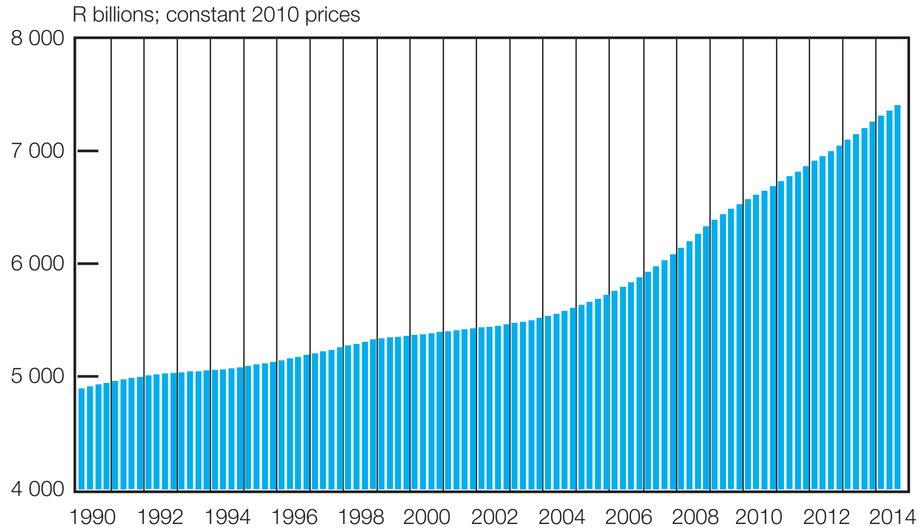
Sector	2013					2014		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Private business enterprises	11,1	12,7	12,7	0,4	8,1	-15,9	-9,3	0,7
Public corporations	-11,4	18,2	3,5	2,4	3,1	-0,5	-4,6	2,9
General government	32,4	-10,1	4,6	29,6	11,6	8,7	9,6	6,4
Total	**9,2**	**9,8**	**9,7**	**4,8**	**7,6**	**-9,5**	**-5,4**	**2,1**

Following a decline of 4,6 per cent in the second quarter of 2014, real fixed capital spending by *public corporations* increased at an annualised rate of 2,9 per cent in the third quarter. Even though most public corporations stepped up capital expenditure programmes, capital outlays by Eskom and Transnet in particular increased firmly over the period. Eskom stepped up real gross fixed capital formation on construction works and on machinery and equipment related to its Medupi, Kusile and Ingula power stations. Capital spending by Transnet was mainly focused on the renewal and maintenance of its fleet to create capacity to enhance the efficient transportation of goods, in particular coal and iron ore.

Sustained increases in real gross fixed capital expenditure by *general government* were upheld in the third quarter of 2014, albeit at a moderately slower pace. The bulk of capital outlays by general government was concentrated on building and construction works, non-residential buildings, and machinery and equipment. Higher capital spending by local government departments was focused on water, sewerage and sanitation infrastructure; roads, streets and bridges; and electricity.

The *fixed capital stock* consists of residential and non-residential buildings; construction works; information, computer and telecommunications equipment; machinery and equipment; transport equipment; and commercial livestock – key assets in the measurement of national wealth and productive capacity. Total fixed capital stock valued at constant 2010 prices increased at an annualised rate of 0,9 per cent between the first quarter of 1990 and the fourth quarter of 2004 and at a much faster pace of 2,9 per cent between the first quarter of 2005 and the third quarter of 2014. The increase in the latter period resulted from increased activity in fixed capital outlays primarily to address supply constraints in the economy.

Fixed capital stock



Having declined by R2,2 billion (annualised and at constant 2010 prices) in the second quarter of 2014, *real inventory holdings* increased by R1,1 billion in the third quarter. The build-up of inventories was mainly evident in the commerce sector. The level of industrial and commercial inventories as a percentage of non-agricultural gross domestic product edged higher from 14,1 per cent in the second quarter of 2014 to 14,2 per cent in the third quarter.

Factor income

Growth over four quarters in *total nominal factor income* accelerated from 6,6 per cent in the second quarter of 2014 to 7,0 per cent in the third quarter. Both the compensation of employees and the gross operating surpluses of business enterprises gained momentum over the period.

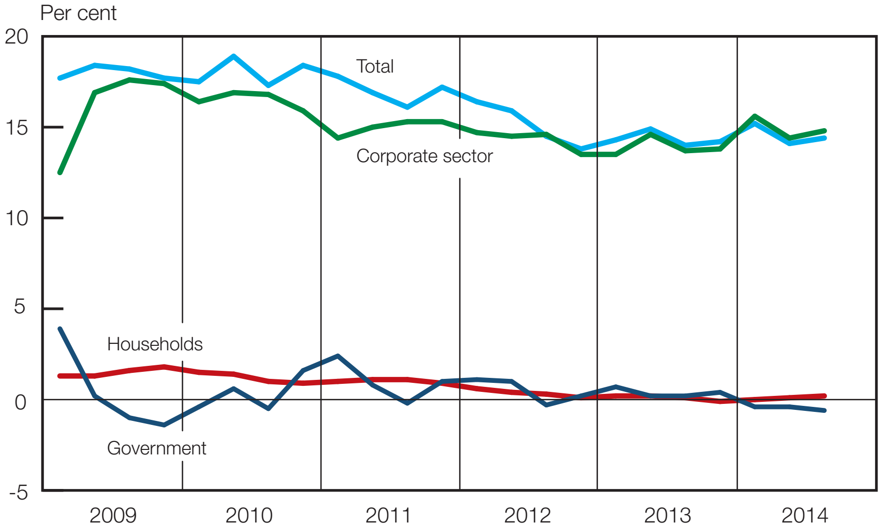
Measured over four quarters, growth in *compensation of employees* edged higher from 7,3 per cent in the second quarter of 2014 to 7,6 per cent in the third quarter. All sectors registered firm growth in compensation of employees, reflecting in part annual increases in excess of the rate of inflation. Total compensation in the platinum-mining sector was pulled down by the suspension of wage payments in the first half of the year due to prolonged industrial action, but rose in the third quarter following the resolution of the strike. Nevertheless, strike action in other sectors continued to weigh on salaries and wages. On balance, the ratio of compensation of employees to total factor income increased from 51,6 per cent in the second quarter of 2014 to 52,1 per cent in the third quarter. The *Wage Settlement Survey* released by Andrew Levy Employment Publications furthermore indicated that the average wage settlement rate for the first three quarters of 2014 inched higher and amounted to 8,0 per cent compared with the average rate of 7,9 per cent for the same period in 2013.

Measured over a year, growth of 6,5 per cent was recorded in the *total gross operating surplus* in the third quarter of 2014, higher than the rate of 5,9 per cent registered in the preceding quarter. Although increases were registered in almost all sectors of the economy, it was most notable in the finance, insurance, real-estate and business services sector. By contrast, growth in the gross operating surplus of the mining sector receded over the period, reflecting increased labour and input costs alongside muted levels of production and sales in the wake of labour-related production distortions. Consequently, the share of the gross operating surplus in total factor income decreased from 48,4 per cent in the second quarter of 2014 to 47,9 per cent in the third quarter.

Gross saving

The *national saving ratio* measured as gross domestic saving as a percentage of gross domestic product increased from 14,1 per cent in the second quarter of 2014 to 14,4 per cent in the third quarter. Gross saving by the corporate sector and by households increased alongside marginally weaker saving by general government over the period. The overall level of gross saving increased by an annualised R25,3 billion, thereby lowering South Africa's dependency on foreign capital to finance gross capital formation from 30,9 per cent in the second quarter of 2014 to 29,5 per cent in the third quarter.

Gross saving as a percentage of gross domestic product



Seasonally adjusted

Gross saving by the *corporate sector* increased from 14,4 per cent of gross domestic product in the second quarter of 2014 to 14,8 per cent in the third quarter. The higher value of the gross operating surplus of business enterprises and a significant decrease in tax payments contributed to an increase of R27,7 billion in gross corporate saving.

Gross dissaving by *general government* as a ratio of gross domestic product rose from 0,4 per cent in the second quarter of 2014 to 0,6 per cent in the third quarter. Lower levels of government income, especially on account of a slowdown in tax revenue, could not be neutralised by a simultaneous slower rate of increase in government expenditure over the period.

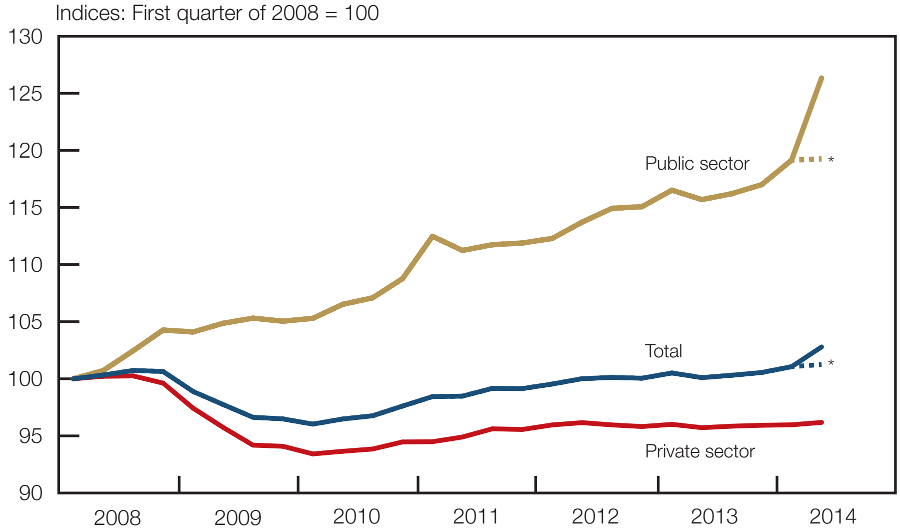
The *household* saving ratio inched slightly higher from 0,1 per cent in the second quarter of 2014 to 0,2 per cent in the third quarter. Increased spending by households was accompanied by somewhat higher growth in disposable income of households over the period.

Employment

Despite fairly weak output growth in the domestic economy in the second quarter of 2014, growth in formal non-agricultural employment accelerated over the period, largely due to employment gains in the public sector. According to the *Quarterly Employment Statistics* (QES) survey released by Statistics South Africa (Stats SA), the number of people formally employed in the non-agricultural sector of the economy increased by 7,1 per cent on a seasonally adjusted and annualised basis in the second quarter of 2014. An additional 147 000 job opportunities were created in the quarter, raising the level of formal non-agricultural employment to almost 8,67 million in the second quarter of 2014 – the highest number on record.[3]

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

Formal non-agricultural employment



* Adjusted for temporary workers employed by the Independent Electoral Commission

Similar to the first quarter of 2014, the increase in formal non-agricultural employment in the second quarter resulted from a surge in public-sector employment; public-sector employment expanded at an annualised rate of 26,4 per cent, as an additional 133 000 public-sector jobs were created in the quarter. However, 130 000 of these jobs represented temporary employment opportunities created by the Independent Electoral Commission (IEC) to assist in conducting the general elections held countrywide in June 2014. As such, the large increase in public-sector employment in the second quarter of 2014 is expected to be reversed in the third quarter. Apart from a marginal decrease in employment by local governments, all other public-sector tiers recorded moderate employment gains in the second quarter of 2014.

Despite accelerating somewhat, private-sector employment growth remained fairly pedestrian as only 13 500 new employment opportunities were created in the private sector in the second quarter of 2014. Private-sector employment levels increased in the second quarter, primarily due to employment gains in the construction sector (recording the highest rate of increase); the private community, social and personal services sector; the trade, catering and accommodation services sector; and the finance, real-estate and business services sector. However, further job losses were recorded in the private transport, storage and communication sector (registering the fastest rate of decline); the manufacturing sector; and the non-gold mining sector.

Following the 2008/09 economic recession, employment growth has been more pronounced in the domestic public sector than in the private sector. The accompanying table indicates that since the trough in the employment cycle in the first quarter of 2010, the public sector created

389 500 new employment opportunities up to the second quarter of 2014. Excluding the 130 000 temporary jobs created by the IEC in the second quarter of 2014, public-sector employment increased by 13,3 per cent from the second quarter of 2010 to the second quarter of 2014. However, the fairly rapid pace of public-sector job creation observed in recent years will, in all likelihood, not be sustained in coming years as the Minister of Finance announced a freeze on government employee headcounts in his *Medium Term Budget Policy Statement* in October 2014.

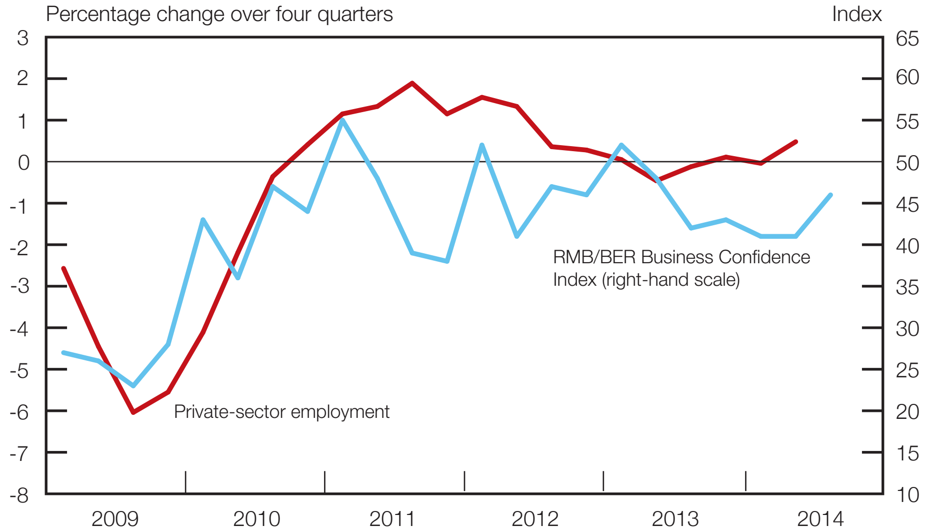
Change in enterprise-surveyed formal non-agricultural employment by sector*

Sector	Change over one quarter at annualised rate 2nd qr 2014		Change over four quarters to 2nd qr 2014		Cumulative job losses (-) gains (+)	
	Number	Per cent	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 2nd qr 2014
Finance, insurance, real-estate and business services	2 100	0,4	15 600	0,8	-182 200	116 600
Manufacturing	-5 900	-2,0	-7 200	-0,6	-113 000	-50 000
Trade, catering and accommodation services	12 200	2,9	25 600	1,5	-76 300	80 100
Construction	5 100	4,9	3 200	0,7	-48 300	12 400
Total mining	-1 200	-1,0	-20 600	-4,0	-40 700	-600
Gold mining	-	-	-16 000	-11,9	-9 600	-41 100
Other mining	-1 300	-1,3	-4 600	-1,2	-31 100	40 400
Private transport, storage and communication services	-2 400	-3,8	-7 600	-3,0	-2 000	-6 300
Community, social and personal services	3 600	3,3	20 900	5,0	13 400	29 100
Total private sector	**13 500**	**0,9**	**30 000**	**0,5**	**-449 100**	**181 200**
Provinces	2 300	0,8	25 600	2,3	51 600	112 000
Local governments	- 700	-0,9	38 400	14,1	15 200	71 200
National departments	1 600	1,4	3 400	0,8	-2 500	45 700
Public transport, storage and communication services	-1 500	-4,9	1 100	0,9	-4 900	16 2000
Other public-sector enterprises	131 400	651,5	128 500	63,2	-6 900	144 400
Total public sector	**133 100**	**26,4**	**197 000**	**9,2**	**52 500**	**389 500**
Grand total	**146 600**	**7,1**	**227 000**	**2,7**	**-396 600**	**570 700**

* Seasonally adjusted. Components may not add up due to rounding
Source: Statistics South Africa, *Quarterly Employment Statistics* (QES) survey

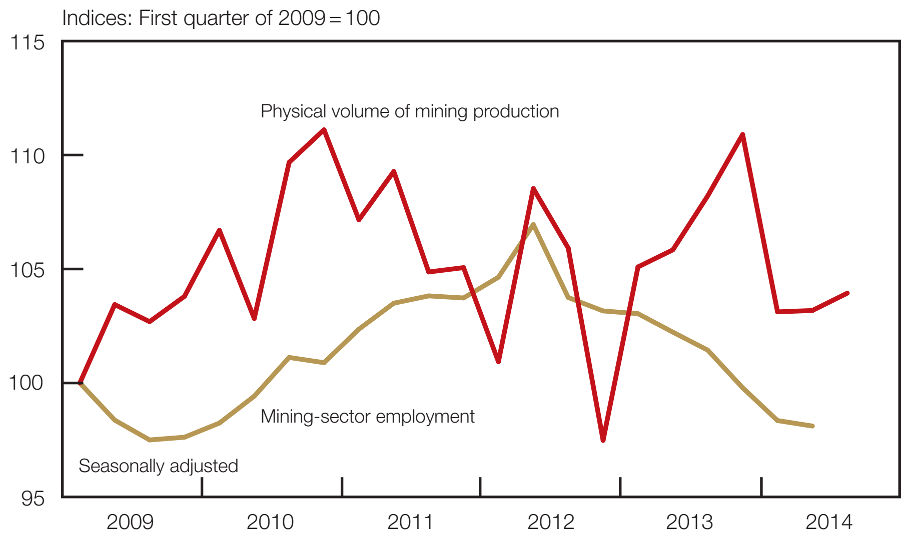
Disappointingly, only 181 200 private-sector jobs were created from the second quarter of 2010 to the second quarter of 2014, representing an increase of only 2,9 per cent. The weak private-sector employment growth in the current upward phase of the business cycle can be attributed to a combination of cyclical and structural factors. These include weak domestic and international demand, low business and investor confidence, high electricity cost and supply constraints, a loss in competitiveness, a shortage of skilled labour, and a turbulent labour relations environment. As such, South Africa slipped to the 56th position out of 144 countries in the World Economic Forum's 2014/15 Global Competitiveness Index, from 53rd out of 148 countries the previous year. The accompanying graph shows the relationship between weak private-sector employment growth and low business confidence throughout the current upward phase in the business cycle.

Private-sector employment growth and business confidence



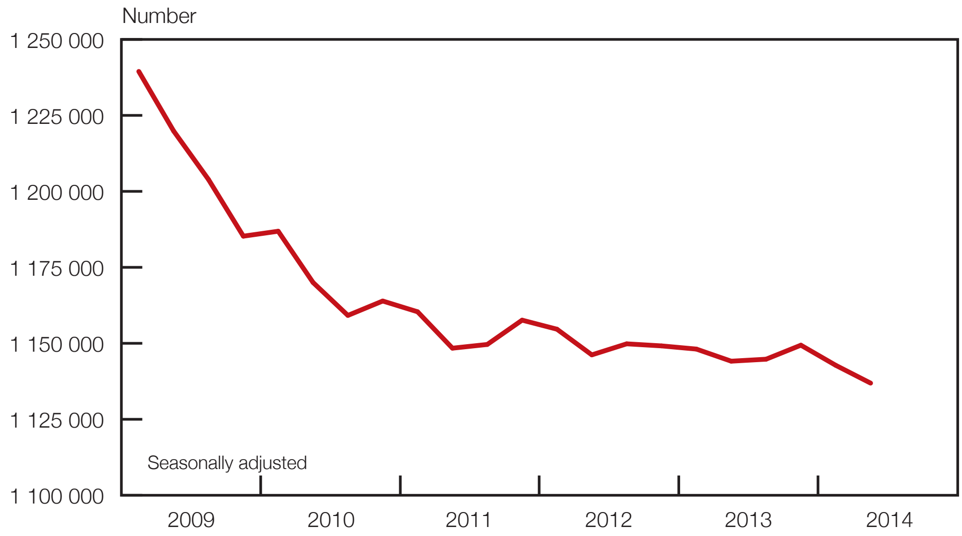
The mining sector shed a further 1 200 employment opportunities in the second quarter of 2014. Employment levels in the gold-mining sector remained broadly unchanged from the first to the second quarter of 2014, while employment in the non-gold mining sector decreased for a third successive quarter. Initially, the ramp-up to full production at all major platinum mines following the resolution of the protracted strike in June 2014 was only expected to be achieved towards the end of 2014 or early in 2015. Encouragingly, these expectations appear to have been exceeded, with most platinum-mining companies indicating that full production capacity had already been achieved. In addition to the troubled labour relations environment, investment and employment in the domestic mining sector have been hampered by rising operating costs, legislative uncertainty, weak international demand and falling commodity prices. The accompanying graph illustrates that mining output has struggled in recent years to reach the level attained in the fourth quarter of 2010, exacerbated by intermittent labour market disruptions, which adversely affected employment levels in the sector.

Mining production volumes and employment



Following moderate job creation in the second half of 2013, the manufacturing sector shed a cumulative 12 500 job opportunities in the first half of 2014, thereby continuing the steady decline in manufacturing-sector employment levels following the 2008/09 economic recession. Apart from high input costs and relatively weak domestic and global demand, the manufacturing sector was adversely affected by the prolonged industrial action in the platinum-mining sector in the second quarter of 2014, which disrupted the supply-chain performance of many manufacturers. Manufacturing output and confidence were dented further by the month-long labour strike in the metals and engineering sector in July 2014. According to the *Manufacturing Survey* published by the Bureau for Economic Research (BER), manufacturing business confidence increased only marginally from a five-year low of 25 index points in the second quarter of 2014 to 28 in the third quarter, with operating conditions remaining tough. The BER noted a further deterioration in employment indicators in the third quarter of 2014 amid continued slack in the manufacturing sector, suggesting poor employment prospects in the sector in the short run.

Manufacturing-sector employment



Encouragingly, employment in the construction sector expanded at a fairly satisfactory pace for a second successive quarter in the second quarter of 2014, with a cumulative 12 300 new construction employment opportunities being created in the first half of the year. Following a cumulative decrease of 22 index points during the first half of 2014, the First National Bank/Bureau for Economic Research (FNB/BER) Civil Confidence Index advanced by 4 index points to 48 in the third quarter of 2014, despite a notable decrease in construction activity. According to FNB, third-quarter confidence rose partly due to expectations of increased construction activity in the fourth quarter of 2014. After receding by 11 index points in the second quarter of 2014, building confidence, as measured by the FNB/BER Building Confidence Index, rose by 4 index points to 45 in the third quarter. Although the rise in confidence was fairly broad-based, the confidence levels of retailers of building materials increased markedly, led by a notable rise in residential building activity in the third quarter of 2014.

Employment in the finance, insurance, real-estate and business services sector increased for a fifth successive quarter in the second quarter of 2014, albeit at a more moderate pace than in the first quarter. Conversely, employment growth in the trade, catering and accommodation services sector accelerated somewhat in the second quarter of 2014 – the fourth consecutive quarterly increase in this sector's labour absorption. Encouragingly, the BER's *Retail Survey* for the third quarter of 2014 indicates that business confidence among both retailers and wholesalers improved markedly. Confidence levels among new vehicle traders, however, declined notably on account of lower sales volumes, while the FNB/BER Consumer Confidence Index declined from 1 index point in the second quarter of 2014 to -4 in the third quarter. Nevertheless, with the strikes in the platinum-mining and the metal and engineering sectors having been brought to an end, accompanied by above-inflation wage settlements, prospects for consumer spending and some further job creation in the trade sector improved in the second half of 2014.

According to the *Quarterly Labour Force Survey* (QLFS) conducted by Stats SA, the number of persons employed in South Africa increased by only 22 000 from the second to the third quarter of 2014, raising the total level of employment to roughly 15,12 million. Total employment increased by 81 000 in the year to the third quarter of 2014, markedly less than the 403 000 new employment opportunities created in the year to the second quarter. In addition, the year-on-year growth rate slowed for a third successive quarter, from 4,5 per cent in the fourth quarter of 2013 to 0,5 per cent in the third quarter of 2014. On a year-on-year basis, employment opportunities were created in the formal non-agricultural sector of the economy and in the informal sector, recording increases of 134 000 and 85 000 respectively in the third quarter of 2014. Conversely, private households and the agriculture, hunting, forestry and fishing sector shed 83 000 and 54 000 employment opportunities respectively over the same period.

The number of unemployed persons decreased by 3 000 from the second quarter of 2014 to the third quarter, but increased notably by 271 000 over four quarters, keeping the total number of unemployed South Africans at around 5,15 million. Disconcertingly, however, the number of discouraged job seekers increased notably by 95 000 from the second to the third quarter of 2014 and by 217 000 in the year to the third quarter, bringing the total number of discouraged job seekers in South Africa to 2,51 million – the highest number since the inception of the QLFS in the first quarter of 2008. Against this background, the official unemployment rate fell marginally to 25,4 per cent in the third quarter of 2014 from 25,5 per cent in the preceding quarter, but rose notably compared with a rate of 24,5 per cent recorded a year earlier. The seasonally adjusted unemployment rate rose marginally from 25,1 per cent in the second quarter of 2014 to 25,2 per cent in the third quarter. Although still remaining at an unacceptably high level, the youth unemployment rate receded from 51,8 per cent in the second quarter of 2014 to 51,3 per cent in the third quarter. This rate was, however, still higher than the 50,3 per cent recorded in the third quarter of 2013.

Key labour market statistics

Thousands

	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014
a. Total employment	15 036	15 177	15 055	15 094	15 117
b. Total unemployment (official definition)	4 880	4 830	5 067	5 154	5 151
c. Total economically active (= a + b)	19 916	20 007	20 122	20 248	20 268
d. Total not economically active	14 952	15 015	15 055	15 084	15 221
e. Total aged 15–65 years (= c + d)	34 868	35 022	35 177	35 33	35 489
f. Official unemployment rate (= b*100/c)	24,5%	24,1%	25,2%	25,5%	25,4%

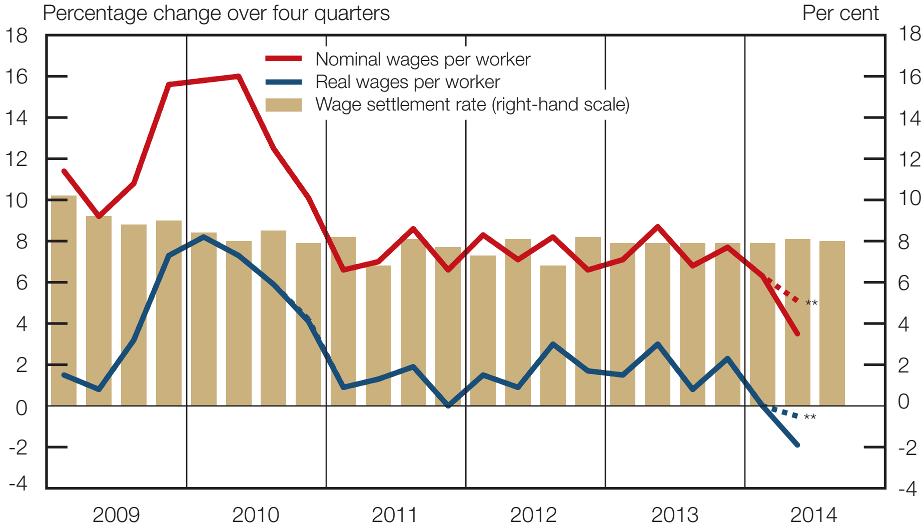
Source: Statistics South Africa, *Quarterly Labour Force Survey*

Labour cost and productivity

The pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy decelerated markedly from a year-on-year rate of 6,3 per cent in the first quarter of 2014 to 3,5 per cent in the second quarter, as remuneration growth moderated in both the public and private sectors of the economy. In fact, the real salaries and wages per worker in the formal non-agricultural sector of the economy contracted by 1,9 per cent in the year to the second quarter of 2014.

Nominal wage growth per worker in the public sector slowed notably from a year-on-year rate of 5,6 per cent in the first quarter of 2014 to a year-on-year decrease of 1,1 per cent in the second quarter. The sharp moderation in public-sector wages per worker in the second quarter resulted largely from the high number of temporary workers employed by the IEC during the general elections, which significantly lowered the average remuneration per public-sector worker in the quarter. Nevertheless, nominal wage growth remained fairly restrained at all public-sector tiers, with annual salaries and wages per worker increasing by 5,3 per cent, 3,7 per cent and -0,1 per cent at provinces, national departments and local governments respectively in the second quarter of 2014.

Remuneration growth and wage settlement rates*

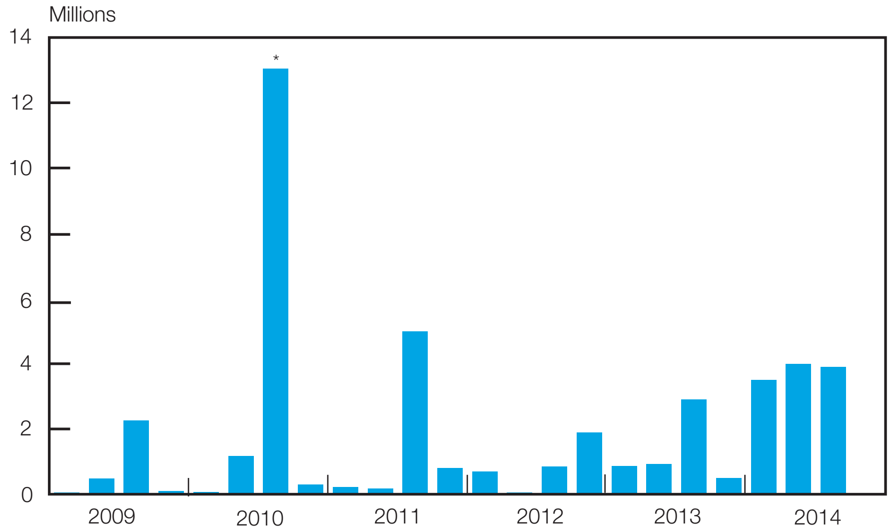


* Quarterly estimates based on cumulative data provided by Andrew Levy Employment Publications
** Adjusted for temporary workers employed by the IEC

Growth in private-sector remuneration per worker moderated for a second successive quarter, from a year-on-year rate of 6,4 per cent in the first quarter of 2014 to 5,0 per cent in the year to the second quarter, as wage growth slowed across a wide range of subsectors. However, the slowdown in private-sector remuneration growth was exacerbated by a year-on-year decrease of 4,6 per cent in salaries and wages per worker paid in the non-gold mining sector on account of most employees in the platinum-mining sector earning no income during the prolonged labour strike. In addition, remuneration growth per worker slowed to 7,9 per cent in the trade, catering and accommodation services sector; 7,1 per cent in the gold-mining sector; 6,6 per cent in the manufacturing sector; 4,7 per cent in the finance, insurance, real-estate and business services sector; and 2,7 per cent in the private community, social and personal services sector. Conversely, wage growth per worker accelerated to 7,4 per cent in the private transport, storage and communication sector and to 5,8 per cent in the construction sector.

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements amounted to 8,0 per cent in the first nine months of 2014, marginally up from 7,9 per cent for the corresponding period in 2013. The number of workdays lost due to industrial action rose notably to 11,6 million in the first nine months of 2014, compared with 4,7 million in the first nine months of 2013. The increase resulted mainly from the prolonged strike in the platinum-mining sector in the first half of the year, as well as the month-long strike in the steel and engineering industry in July 2014. Disappointingly, the accompanying graph shows that the number of workdays lost due to strike action totalled nearly 4 million during each of the first three quarters of 2014.

Number of workdays lost due to industrial action

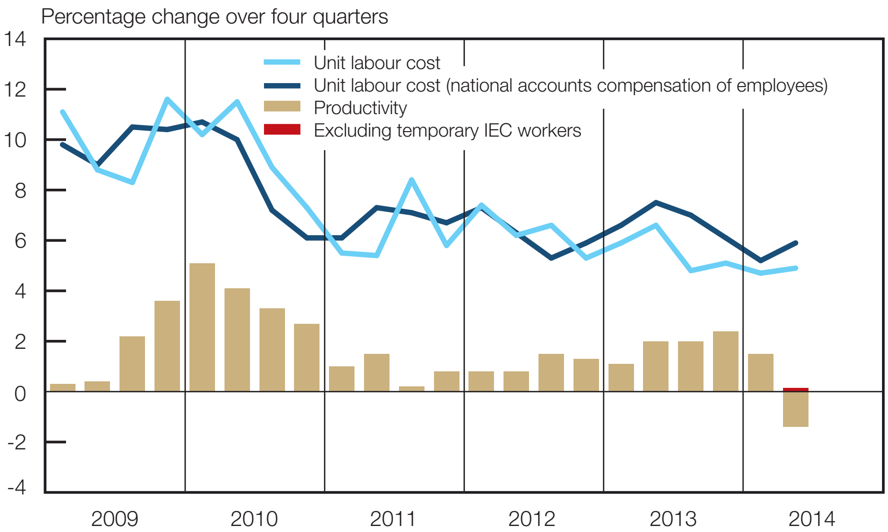


* Public-sector strike

Source: Andrew Levy Employment Publications

Real output per worker *decreased* by 1,4 per cent in the year to the second quarter of 2014, decelerating from a year-on-year growth rate of 1,5 per cent in the first quarter of the year. The decrease in this measure of labour productivity resulted largely from the marked increase in public-sector employment (due to temporary workers employed by the IEC), coupled with the notable slowdown in year-on-year output growth in the non-agricultural sector of the economy. Similarly, labour productivity growth in the manufacturing sector slowed from 1,0 per cent in the first quarter of 2014 to 0,1 per cent in the second quarter, as output growth slowed more than employment growth. With year-on-year output growth decelerating more than growth in salaries and wages in the second quarter of 2014, growth in nominal unit labour cost in the formal non-agricultural sector of the economy accelerated marginally from 4,7 per cent in the first quarter of 2014 to 5,0 per cent in the second quarter, remaining comfortably within the inflation target range.

Formal non-agricultural labour productivity and nominal unit labour cost

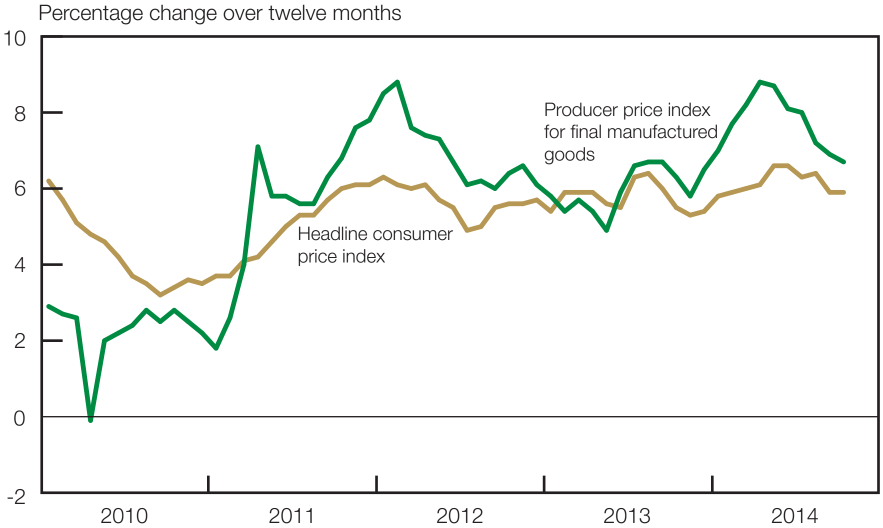


Prices

Despite an increase in global geopolitical tensions and instability in a number of regions, the international price of crude oil has declined notably in recent months, partly on account of subdued global demand. Lower crude oil prices, coupled with continued deflation in global food prices and a somewhat more stable exchange rate of the rand in recent months, contributed to a slightly more benign domestic inflationary outcome than initially expected. Headline consumer price inflation accelerated throughout the opening months of 2014, breaching the 6,0 per cent upper limit of the inflation target range in April and peaking at 6,6 per cent in June, before moderating to 5,9 per cent in both September and October as food and petrol price inflation decelerated.[4]

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

Producer and consumer price inflation



Following a notable build-up of inflationary pressures at the producer level during the opening months of 2014, these pressures eased somewhat in the second half of the year as most measures of producer price inflation began to moderate. Twelve-month producer price inflation for final manufactured goods slowed from a recent peak of 8,8 per cent in April 2014 to 6,7 per cent in October in response to the deceleration in producer price inflation for intermediate manufactured goods, which moderated from 10,5 per cent in February 2014 to 6,2 per cent in October. The moderation in manufactured producer goods price inflation was fairly pervasive over a number of product categories. The main contributors to the moderation in intermediate manufactured producer goods price inflation were the textile and leather goods; the chemicals, rubber and plastic products; and the basic and fabricated metals categories. Among the final manufactured producer goods categories, moderations in price inflation occurred in the textiles, clothing and footwear; the coal, petroleum, chemical, rubber and plastic products; the electrical machinery and apparatus; and in the transport equipment categories.

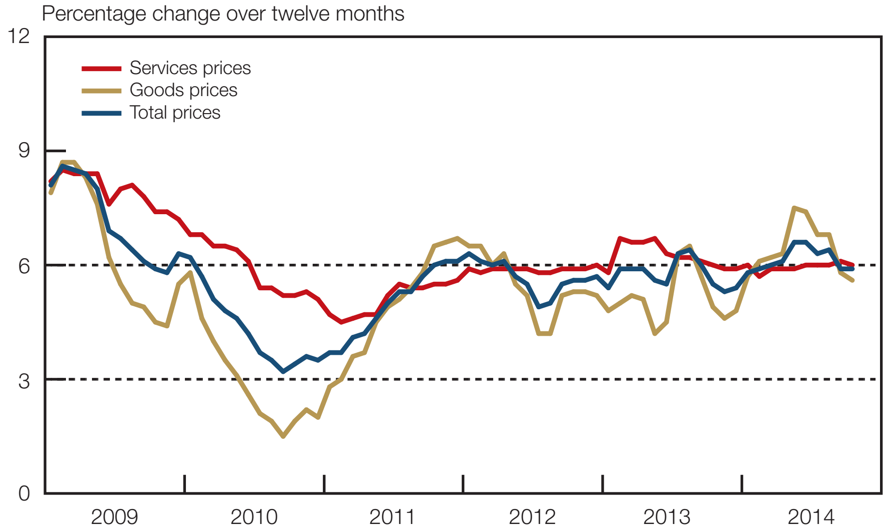
Producer price inflation for mining products quickened to 7,8 per cent in July 2014, as non-ferrous metal ore prices in particular increased notably. Following a substantial fall in international commodity prices, producer price inflation for mining products subsequently moderated notably to 2,5 per cent in October 2014. Producer price inflation for agriculture, forestry and fishing products moderated from a recent high of 11,7 per cent in March 2014 to 3,0 per cent in October, consistent with a marked slowdown in international agricultural food price inflation. Similarly, producer price inflation for electricity and water slowed from 14,6 per cent in March 2014 to 8,0 per cent in October due to a moderation in both electricity and water price inflation.

The twelve-month rate of increase in the unit value index for imported commodities[5] remained at an elevated level of around 21,0 per cent for a period of eight months up to June 2014 in response to the notable depreciation in the exchange rate of the rand throughout 2013. Price increases for imported commodities were fairly pervasive among the various subcategories during the first half of 2014. However, following the fairly stable rand exchange rate in recent months, imported commodity price inflation moderated to 12,5 per cent in September 2014, as price inflation slowed in all the main subcategories.

5 The year-on-year percentage change in the unit value index for imported commodities is calculated on a five-month moving average of the index, which could result in turning points occurring with a slight lag.

Following the moderation in producer price inflation, headline consumer price inflation decelerated from a recent peak of 6,6 per cent in May and June 2014 to 5,9 per cent in October, entirely due to a slowdown in consumer goods price inflation from 7,5 per cent in May 2014 to 5,6 per cent in October. In turn, the moderation in consumer goods price inflation could largely be attributed to a marked deceleration in non-durable goods price inflation, from 8,6 per cent to 6,3 per cent over the same period, as petrol price inflation in particular slowed notably. Semi-durable and durable goods price inflation remained well contained in the first ten months of 2014, registering twelve-month rates falling between 3 and 6 per cent throughout the period.

Targeted consumer price inflation

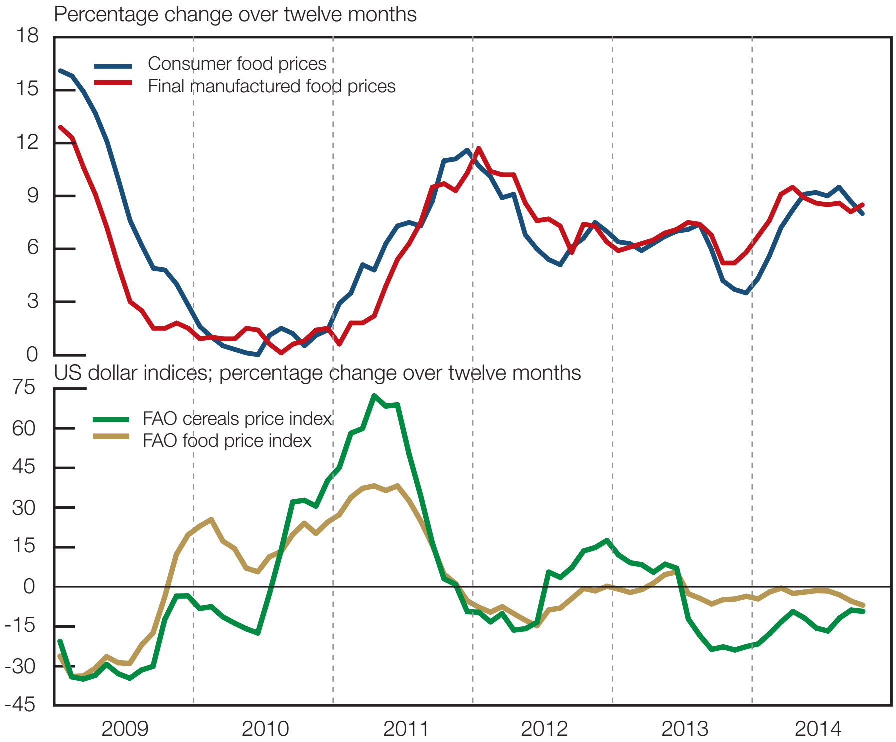


Consumer services price inflation has trended close to the upper limit of the inflation target range for a prolonged period, accelerating steadily from 5,7 per cent in February 2014 to 6,0 per cent in October. The marginal pick-up in consumer services inflation in recent months resulted primarily from a quickening in price inflation of transport, restaurant and hotel services, while inflation moderated somewhat in most other consumer services categories.

Against the backdrop of a prolonged period of fairly benign international food price inflation, domestic food price pressures have increased throughout the first half of 2014 before easing marginally in recent months. The most notable indication of subsiding food price pressures has been the marked deceleration in agricultural producer price inflation which moderated from 13,3 per cent in March 2014 to 2,5 per cent in October, largely due to the sharp slowdown in price inflation of crop and horticultural products as successive crop estimates confirmed expectations of a bumper domestic maize harvest. However, price inflation of live animals, milk and eggs has remained elevated in recent months. Producer food price inflation at the manufactured level responded to the slowdown in agricultural producer food price inflation, albeit not to the same extent; manufactured producer food price inflation decelerated somewhat from 9,5 per cent in April 2014 to 8,5 per cent in October, led by moderations in price inflation for grain mill products, fish and fish products, and sugar.

Despite the moderation in producer food price inflation, consumer food price inflation remained elevated up to the third quarter of 2014, accelerating from 3,5 per cent in December 2013 to 9,5 per cent in August 2014 as price inflation quickened among a broad range of consumer food categories. Encouragingly, consumer food price inflation then slowed to 8,0 per cent in October 2014, losing momentum in seven of the nine consumer food price categories. However, the moderation in consumer food price inflation was largely driven by a notable slowdown in bread and cereals price inflation in response to lower producer prices of crops and cereals. Although price inflation for meat and vegetables – with a combined weight of almost 44 per cent in the consumer food price basket – also moderated in September and October 2014, it nevertheless remained at fairly high levels.

Domestic and international food price inflation

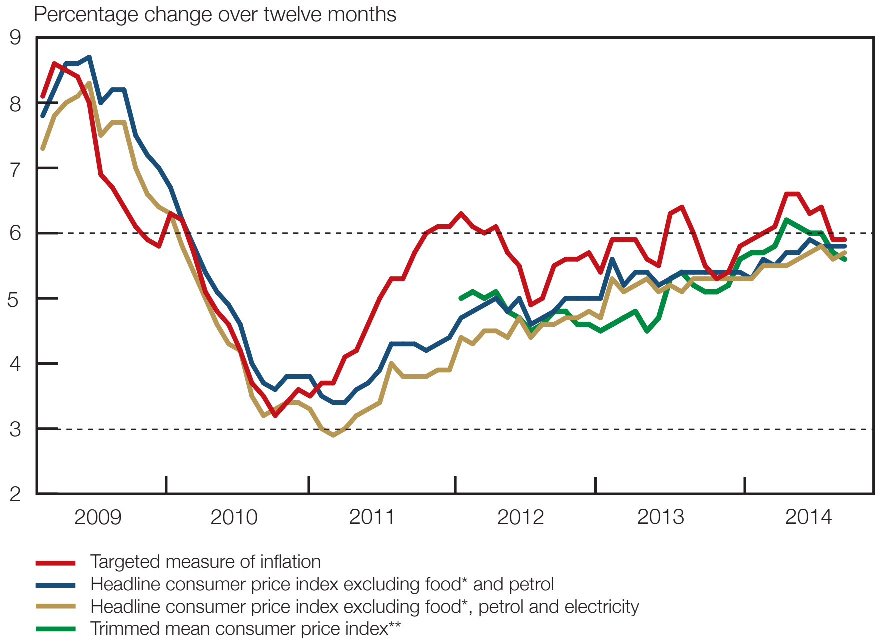


Source: United Nations Food and Agriculture Organization (FAO)

The international food price index of the Food and Agriculture Organization (FAO) (denominated in US dollar) receded for a seventh consecutive month in October 2014 as the prices of all food commodities declined, with the exception of meat prices. As a result, international food prices were 6,9 per cent lower in October 2014 than a year earlier, marking the longest period of continuous year-on-year declines in the value of the index since the late 1990s. In addition, the FAO noted that the US dollar's appreciation in recent months continued to weigh on all international food commodity prices. The international cereals price index decreased for a fifth successive month in September 2014, as maize and wheat prices continued to fall on account of high global production and ready availability for the export market. Despite international cereals prices firming slightly in October 2014, they remained 9,3 per cent below their level twelve months earlier, suggesting muted international food price pressure on domestic food price inflation in the months ahead.

Following a gradual escalation in underlying inflationary pressures during the first half of 2014, most measures of underlying inflation appear to have stabilised more recently. Subtracting the impact of the more volatile food, non-alcoholic beverages and petrol prices from the calculation of targeted headline consumer price inflation, underlying inflation quickened gradually to 5,9 per cent in July 2014 before moderating to 5,8 per cent in August, September and October. Similarly, when further excluding the impact of electricity prices from the calculation of targeted headline consumer price inflation, the resultant underlying measure of inflation accelerated steadily to 5,8 per cent in August 2014, before slowing to 5,7 per cent in October. In addition, trimmed mean consumer price inflation accelerated from 5,1 per cent in November 2013 to 6,2 per cent in May 2014, before receding to 5,6 per cent in October. The slight moderation in underlying inflationary pressures in recent months is probably indicative of fairly limited domestic pricing power due to sluggish consumer demand.

Underlying measures of consumer price inflation



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

An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories suggests a slight dissipation in inflationary pressures in recent months. Over the two months to October 2014, consumer price inflation accelerated in four of the twelve COICOP categories, moderated in seven categories and remained unchanged in one. The twelve-month rates of increase in five of the COICOP categories exceeded the 6 per cent upper limit of the inflation target range in October 2014, while four categories recorded price increases within the inflation target range and three categories registered rates of change below the lower limit of 3 per cent of the inflation target range, as shown in the table on the next page.

Recent outcomes of administered price inflation continued to be driven largely by changes in domestic petrol prices. Following an acceleration to 14,3 per cent in May 2014, petrol price inflation moderated notably to only 2,4 per cent in October on account of year-on-year declines in international oil prices, coupled with a fairly stable rand exchange rate over the period. As such, following an acceleration to 8,9 per cent in May 2014, administered price inflation moderated to 5,1 per cent in October. Aided by a relatively more stable rand/US dollar exchange rate and a further decline in international crude oil prices, the inland price of 95-octane petrol was lowered by 45 and 69 cents per litre in November and December 2014 respectively, which should assist in containing petrol price inflation and thus administered price inflation in the short run.

Headline consumer price inflation in COICOP categories

Percentage change over twelve months

	Weights	2014		
		Aug	Sep	Oct
Restaurants and hotels	3,50	8,5	8,8	8,9
Education	2,95	8,7	8,7	8,7
Food and non-alcoholic beverages	15,41	9,4	8,5	7,8
Miscellaneous goods and services	14,72	7,1	6,9	6,9
Alcoholic beverages and tobacco	5,43	6,1	6,0	6,7
Health	1,46	5,5	5,7	6,0
Housing and utilities	24,52	5,9	5,8	5,8
Clothing and footwear	4,07	5,3	5,5	5,8
Transport	16,43	6,1	4,2	4,8
Recreation and culture	4,09	3,2	2,7	2,7
Household content, maintenance and equipment	4,79	3,6	2,9	2,4
Communication	2,63	-1,5	-1,3	-1,9
All items headline consumer price index	100,00	6,4	5,9	5,9

On 3 October 2014, the National Energy Regulator of South Africa (Nersa) announced its decision to allow Eskom to increase its tariffs by 12,69 per cent, instead of the 8,0 per cent increase initially approved, pertaining to the 2015/16 financial year specifically. Apart from its impact on administered price inflation, the additional increase in electricity tariffs stands to increase headline consumer price inflation by approximately 0,3 percentage points in 2015, all other things being equal.

Although headline consumer price inflation breached the upper limit of the inflation target range during the middle months of 2014, inflation expectations, as reflected in the *Inflation Expectations Survey* conducted by the BER, have remained anchored at the upper end of the target range. As such, the average inflation expectations of financial analysts, business representatives and trade union representatives for 2014 and 2015 have remained largely unchanged for the seventh consecutive quarter in the third quarter of 2014. Financial analysts expected inflation to moderate from 6,2 per cent in 2014 to 5,7 per cent in 2015 and further to 5,4 per cent in 2016, exactly the same as their expectations in the second quarter. Conversely, business representatives expected inflation to accelerate from 6,2 per cent in 2014 to 6,4 per cent in 2015 and 2016. Trade union representatives adjusted their expectations upwards from the second to the third quarter of 2014; they now expect inflation to remain unchanged at around 6,2 per cent over the forecast period. Over a five-year horizon, financial analysts and business representatives kept their inflation expectations unchanged at 5,4 per cent and 6,5 per cent per annum respectively.

Administered price inflation

Percentage change over twelve months

	Weights	2014 Aug	2014 Sep	2014 Oct
Assessment rates	1,30	7,4	7,4	7,4
Water	1,55	9,3	9,3	9,3
Electricity	4,13	7,2	7,2	7,2
Paraffin	0,05	2,2	3,2	2,4
Petrol	5,68	5,8	1,1	2,4
Public transport: Trains	0,08	10,6	10,6	10,6
Motor registration	0,32	5,6	5,2	5,2
Telephone fees	0,48	2,9	2,9	1,1
Postage	0,01	6,3	6,3	6,3
Cell calls	1,81	-2,1	-1,7	-2,1
Television licences	0,06	6,0	0,0	0,0
Primary school fees	0,98	8,6	8,6	8,6
Secondary school fees	0,74	7,7	7,7	7,7
University, technikon and college fees	1,23	9,4	9,4	9,4
University boarding fees	0,06	9,7	9,7	9,7
Total administered price index	18,48	6,2	4,7	5,1

However, labour union representatives lowered their five-year forecast notably from 6,5 per cent to 5,9 per cent, bringing the average inflation expectations for the next five years down from 6,1 per cent in the second quarter of 2014 to 5,9 per cent in the third quarter. The BER cautioned that the five-year expectations of trade unions have fluctuated considerably between consecutive quarters over the three years that the five-year expectations have been surveyed. Following two consecutive quarters of decline, household inflation expectations for the next twelve months remained unchanged at 6,3 per cent in the third quarter of 2014.

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2014

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2014	6,2	6,2	6,2	6,2
2015	5,7	6,4	6,2	6,1
2016	5,4	6,4	6,2	6,0

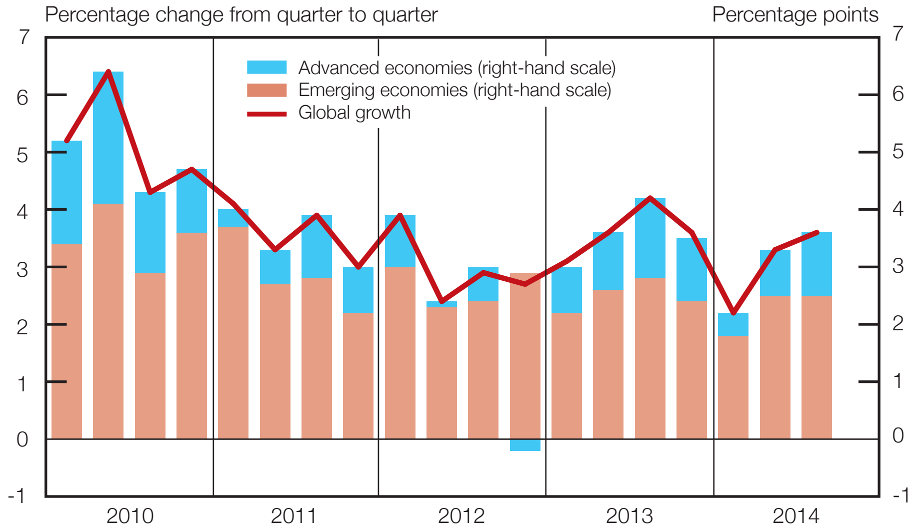
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

Global economic growth accelerated marginally from an annualised rate of 3,3 per cent in the second quarter of 2014 to 3,6 per cent in the third quarter due to the improved growth momentum in advanced economies following the slowdown in the rate of decline in the Japanese economy. The pace of economic growth in emerging economies remained essentially unchanged at 5,0 per cent in the third quarter of 2014. With advanced economies at different stages of recovery, monetary policies have started to diverge, with the United States (US) already having started to normalise monetary policy as the Federal Reserve concluded its asset purchase programme. On the contrary, the European Central Bank (ECB) only recently started to purchase assets, while the Bank of Japan (BoJ) unexpectedly expanded its asset purchase programme.

Global growth and contributions from advanced and emerging economies



Seasonally adjusted annualised rates

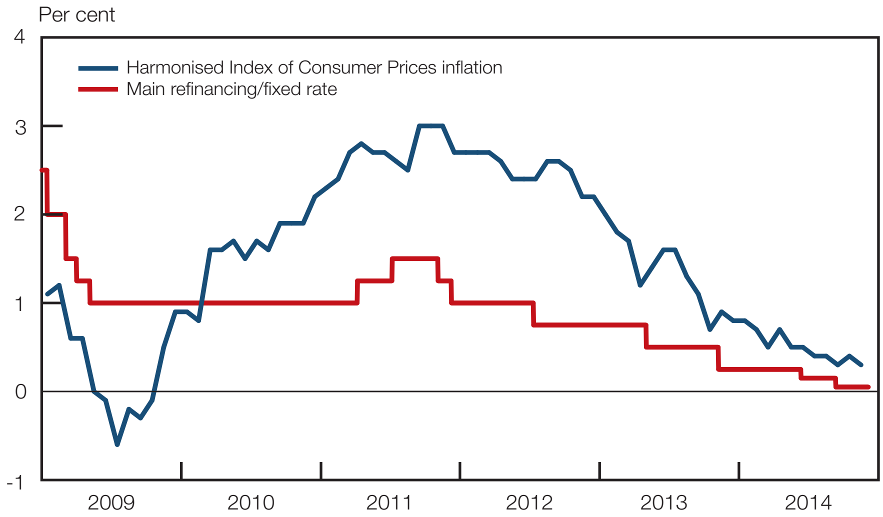
Sources: National statistical offices, JPMorgan and staff calculations

In the October 2014 *World Economic Outlook*, the International Monetary Fund (IMF) further downgraded its global growth outlook for 2014 by 0,1 percentage points to 3,3 per cent, while the 2015 forecast was lowered by 0,2 percentage points to 3,8 per cent. The risks to the global outlook remained tilted to the downside and have increased since April 2014. The growth outlook for sub-Saharan Africa for 2014 was revised downwards by 0,4 percentage points to 5,1 per cent, mainly due to the slowdown in leading regional economies, particularly South Africa's, lower-than-expected oil production in Ghana and Nigeria and the Ebola outbreak in West Africa.

Real output growth in the US exceeded expectations, amounting to 3,9 per cent in the third quarter of 2014, slightly lower than the 4,6 per cent recorded in the previous quarter. The increase in output in the third quarter was underpinned by higher personal consumption expenditure, non-residential fixed investment, federal government spending and exports, which were partly offset by a negative contribution from private inventory investment. Labour market conditions improved further with the unemployment rate declining to 5,8 per cent in October 2014. The Federal Open Market Committee (FOMC) concluded its asset purchase programme at the end of October 2014 after having purchased bonds and mortgage-backed securities amounting to US$15 billion during the month. The FOMC also reaffirmed its forward guidance policy to keep the target range for the federal funds rate at its current low levels for a 'considerable time'.

Economic growth in the euro area remained disappointing at an annualised rate of 0,6 per cent in the third quarter of 2014. Germany and France, the two largest economies in the region, struggled to expand their levels of economic activity in the third quarter. According to Eurostat's latest flash estimate, consumer price inflation decelerated marginally to 0,3 per cent in November 2014. The ECB reduced several benchmark interest rates in September 2014 and adopted additional unconventional measures, including purchases of asset-backed securities and covered bonds, to enhance the functioning of the monetary policy transmission mechanism. The ECB recently concluded its year-long comprehensive assessment of the euro area banking system, including an asset quality review and stress tests, before assuming responsibility for the supervision of all large euro area banks in early November 2014. This comprehensive assessment identified a capital shortfall of €24,6 billion across 25 banks. The aim of the exercise was to provide greater transparency and thereby rebuild confidence in the European banking system.

Euro area inflation and central bank interest rate



Sources: Bloomberg and ECB

Japan's economy unexpectedly fell into a technical recession after its gross domestic product contracted at a rate of 1,6 per cent in the third quarter of 2014. Japanese headline inflation reached 2,9 per cent in October 2014. However, excluding the direct impact of the increase in sales tax in April, year-on-year consumer price inflation was around 0,9 per cent. The BoJ implemented additional easing measures on 31 October 2014 as economic growth and inflation failed to pick up. The new measures exceeded expectations in terms of timing and scale, and included an increase in the pace of expansion of the monetary base from around ¥60–¥70 trillion to ¥80 trillion (the equivalent of US$700 billion) a year. The BoJ also significantly increased its long-term purchases of government bonds and tripled its purchases of units in exchange-traded funds and Japanese real-estate investment trusts.

Real economic activity in the United Kingdom registered an annualised increase of 2,8 per cent in the third quarter of 2014, lower than the 3,7 per cent increase in the preceding quarter. After decelerating to 1,2 per cent in September 2014, consumer price inflation edged marginally higher to 1,3 per cent in October, still well below the Bank of England's (BoE) 2,0 per cent target. The BoE has maintained its policy rate at a record low of 0,5 per cent.

Real output growth in the emerging Asian region moderated somewhat in the third quarter of 2014 due to lower growth in India. Economic activity in India expanded at a pace of 4,8 per cent in the third quarter of 2014, slower than the impressive growth rate of 6,8 per cent in the second quarter. Consumer price inflation decelerated from 6,5 per cent in September 2014 to 5,5 per cent in October, essentially reflecting lower food and energy prices. Growth in the rest of the region improved as a result of increased domestic demand and a pick-up in external demand. Real output growth in China amounted to an annualised rate of 7,9 per cent in the third quarter of 2014, unchanged when compared with the previous quarter. However, on a year-on-year basis, growth decelerated from 7,5 per cent in the second quarter of 2014 to 7,3 per cent in the third quarter – the slowest pace of increase in more than five years. Excess capacity in the manufacturing sector, a sharp slowdown in the property market and rising debt levels are the main features of China's new expected growth trend. The People's Bank of China unexpectedly reduced its benchmark interest rate by 40 basis points to 5,6 per cent in November 2014 to address the economic slowdown. The central bank has, in the previous two months, injected 770 billion yuan into the country's banks through the newly created Medium-term Lending Facility to encourage banks to lower their lending rates. The Chinese government has lifted a number of restrictions, eased credit policies in the property market and announced several infrastructure projects. Most central banks in emerging Asia held interest rates steady during the third quarter of 2014. However, the central banks of Indonesia and the Philippines increased policy rates by 25 basis points to 7,75 per cent and 4,0 per cent respectively, while the Bank of Korea lowered the base rate by 25 basis points to 2,0 per cent.

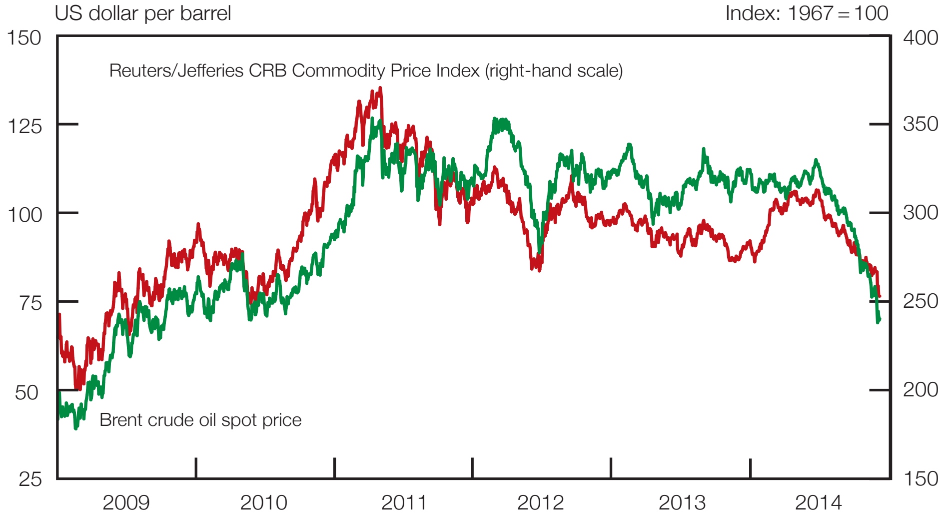
Real output growth in emerging Europe accelerated in the third quarter of 2014 after preliminary estimates suggest output growth in Turkey turned positive following negative growth in the preceding quarter. Real output growth in Poland unexpectedly accelerated to its fastest pace in more than a year in the third quarter as domestic consumption and investment rebounded. Real output growth in Russia remained subdued due to the negative impact of international sanctions and the crisis in Ukraine. Inflation in Russia reached a three-year high of 8,3 per cent in October 2014 and the country's sovereign credit rating was downgraded. In Turkey, inflation has been driven by high food prices and lagged exchange-rate effects. With the exception of Turkey and Russia, inflation in the region remains subdued as a result of imported disinflation from the rest of Europe and lower food and energy prices. Russia's central bank has raised its key interest rate by 150 basis points to 9,5 per cent as the depreciation of the rouble, together with the restrictions on the import of certain food items, resulted in higher inflation. The Polish central bank lowered its policy rate by 50 basis points to 2,0 per cent in October 2014 due to concerns about growth and deflation, but pledged in November to keep rates at record low levels for longer to support the economic recovery.

Economic activity in Latin America improved slightly in the third quarter of 2014. Brazil's growth rate turned modestly positive in the third quarter, following the contraction in economic activity in the previous quarter. The Argentine economy is expected to contract in the third quarter as the country was banished from international capital markets after defaulting in July 2014. The Brazilian central bank unexpectedly raised its benchmark interest rate by 25 basis points to 11,25 per cent in October 2014 and by 50 basis points to 11,75 per cent in November. Inflation accelerated from 5,6 per cent in January 2014 to 6,8 per cent in September, before moderating to 6,6 per cent in October. Inflation in Chile is expected to remain above the target in coming months due to temporary factors. However, medium-term inflation expectations remained anchored and the central bank of Chile decided to lower its benchmark interest rate by 25 basis points to 3,0 per cent in October 2014.

According to the CPB Netherlands Bureau for Economic Policy Analysis, the growth rate in the volume of world trade (calculated as the three-month average relative to that of the preceding three months) accelerated from 5,5 per cent in August 2014 to 8,4 per cent in September. The increase was largely underpinned by strong trade activity in emerging economies, especially emerging Asia. Advanced economies also experienced some improvement in trading activity.

The downward trend since mid-2011 in global commodity prices was interrupted in the first half of 2014 when prices started to increase, but resumed in the second half of the year. After the price of Brent crude oil reached a nine-month high of US$115 per barrel in June 2014, prices reversed notably to levels below US$70 per barrel in late November – its lowest level since October 2009. The decrease was driven by lower estimates of global demand, while supply continued to rise. The 2014 estimate for global oil demand has been revised downwards by the International Energy Agency to 92,4 million barrels per day. Global oil supply, however, increased to 94,2 million barrels per day in October due to higher production by the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries. The increase was due to the continued recovery of Libyan production as well as higher production in Iraq. Brent crude oil future contracts for delivery in the first quarter of 2015 traded at around US$70 per barrel in early December 2014.

International crude oil and commodity prices



Source: Bloomberg

Current account [6]

The significant widening of the deficit on the current account of the balance of payments from the first to the second quarter of 2014 was arrested in the third quarter. Having contracted sharply in the second quarter of 2014 as strike activity took its toll, the value of merchandise exports (excluding gold) picked up moderately in the third quarter although it continued to be impaired by industrial action. At the same time, the subdued gross domestic expenditure helped to contain growth in the value of merchandise imports, limiting the trade deficit.

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

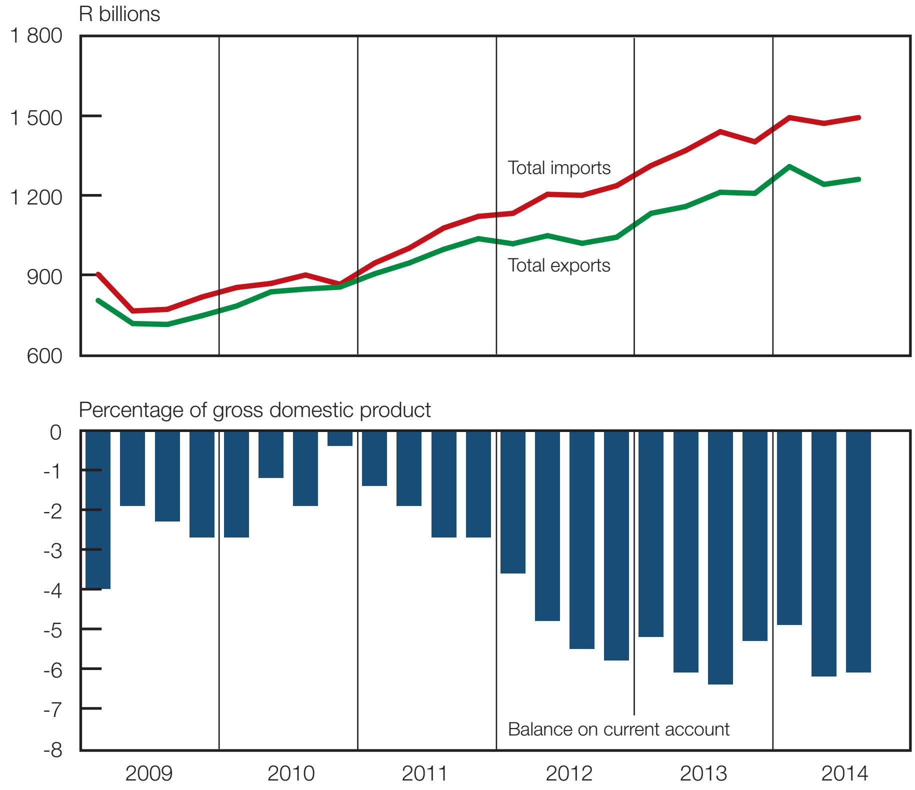
Balance of payments on current account

R billions, seasonally adjusted and annualised

	2013			2014		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	896	909	869	966	910	936
Net gold exports	63	55	64	51	55	48
Merchandise imports	-1 049	-1 010	-1 001	-1 102	-1 065	-1 077
Trade balance	**-90**	**-46**	**-68**	**-85**	**-100**	**-93**
Net service, income and current transfer payments	-139	-149	-135	-100	-134	-137
Balance on current account	**-229**	**-195**	**-204**	**-185**	**-235**	**-230**
As percentage of gross domestic product	*-6,4*	*-5,3*	*-5,8*	*-4,9*	*-6,3*	*-6,0*

The improvement in the trade balance in the third quarter of 2014 was partly offset by higher net service, income and current transfer payments to the rest of the world, resulting in a slight narrowing of the deficit on the current account of the balance of payments over the period. As a ratio of gross domestic product, the shortfall on the current account edged lower from 6,3 per cent in the second quarter of 2014 to 6,0 per cent in the third quarter.

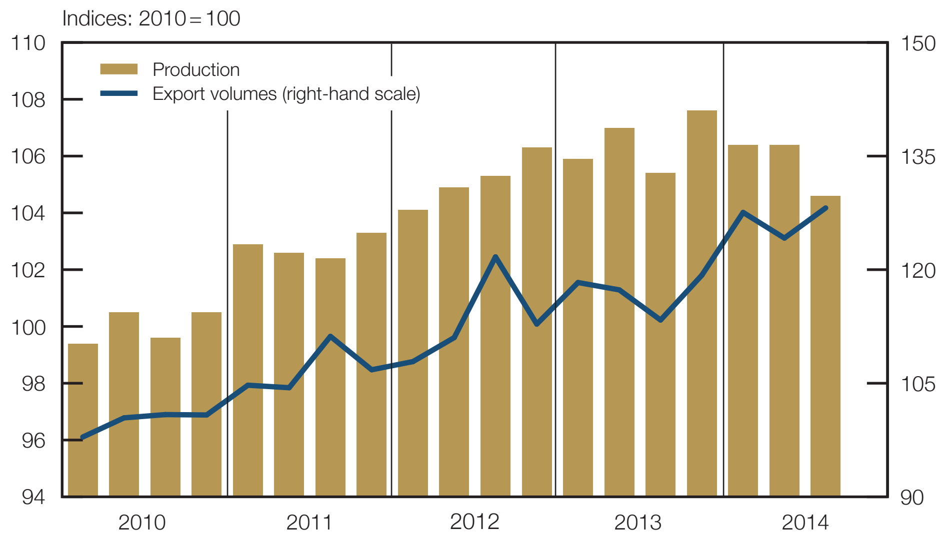
Balance of payments: Current account



The decline in the volume of *merchandise exports* in the second quarter of 2014 was reversed in the third quarter when the physical quantity of exports increased by 3,3 per cent, underpinned primarily by higher exports of manufactured and agricultural products. The physical quantity of mining exports (excluding gold) advanced moderately over the period as increases in the export volumes of diamonds, platinum group metals and coal were offset by a significant reduction in the volume of iron ore exports. Even though production in the platinum-mining sector recovered notably in the aftermath of the prolonged strike in the first half of 2014, platinum exports still remained below pre-strike levels as full normalisation had not been accomplished. Increased global demand for coal ahead of the winter season in the northern hemisphere boosted the exports of coal in the third quarter of 2014. Apart from lower demand from China, among other countries, the exports of iron ore were also adversely affected by a pre-scheduled ten-day annual maintenance shutdown of the Sishen–Saldanha railway line which is primarily used to transport iron ore.

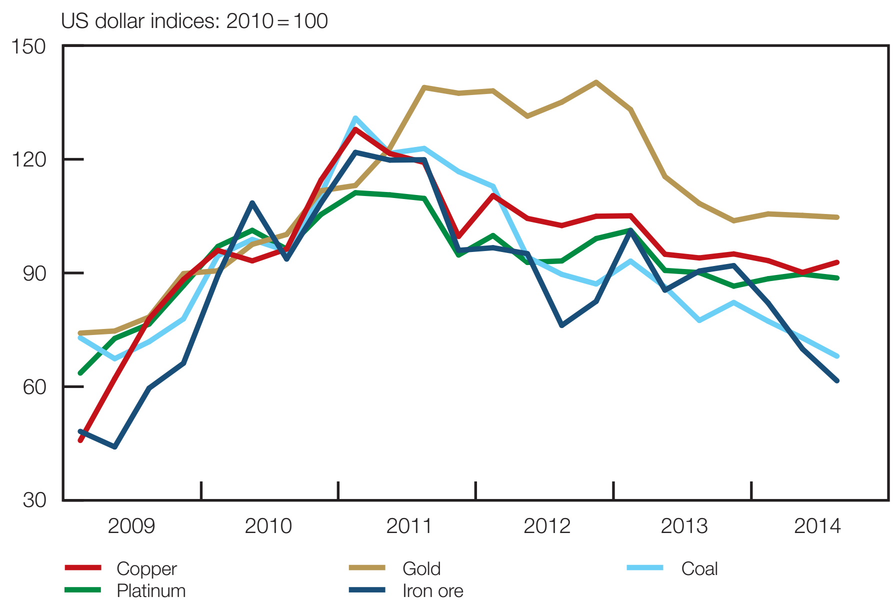
The volume of manufactured exports picked up in the third quarter of 2014 despite the month-long strike in the metal and engineering industry in July. Notable increases were registered in the subcategory for vehicles and transport equipment. Vehicle exports were buoyed, among other factors, by the exportation of a new model that recently came into production in East London. The volume of machinery and electrical equipment, however, contracted somewhat over the period. The volume of agricultural exports advanced for a third consecutive quarter due to increased shipments of citrus and maize in the third quarter of 2014.

Manufacturing: Production and export volumes



The international price in US dollar of South African-produced non-gold commodity exports decreased by 4,4 per cent in the third quarter of 2014, marking a sixth consecutive quarterly decline. As in the past, the prices of most South African export commodities displayed diverse trends over the period. Declines were registered in the prices of iron ore, coal and platinum, whereas the prices of nickel and copper increased. The international price of iron ore dropped to a five-year low in the third quarter of 2014 as global supply continued to exceed demand. By contrast, the price of copper advanced during the period, supported by the sustained expansion in manufacturing output in the US alongside supply disruptions in Indonesia.

International prices of selected South African export commodities

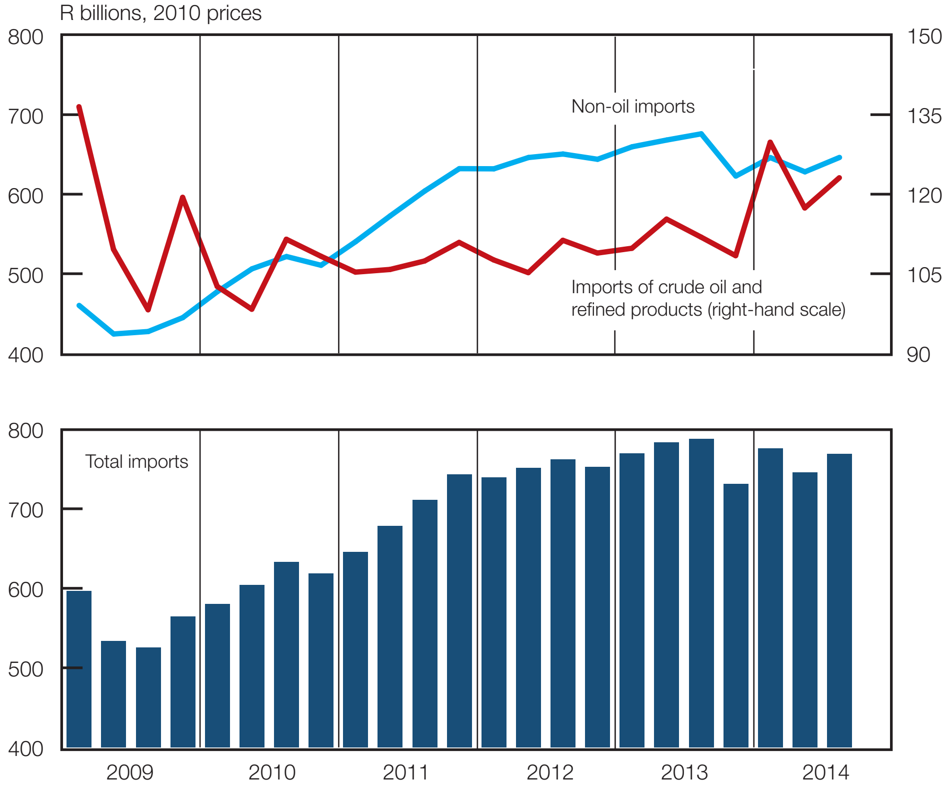


The depreciation in the external value of the rand was insufficient to offset the decline in the international prices of South African export commodities in the third quarter of 2014. As a result, the rand price of merchandise exports decreased by about 0,5 per cent in the third quarter of 2014, limiting the rise in the value of merchandise exports to 2,8 per cent.

The average fixing price of *gold* on the London market remained fairly stable in recent months, edging marginally down from US$1 289 per fine ounce in the second quarter of 2014 to US$1 283 per fine ounce in the third quarter. The price of gold has moved broadly sideways since the beginning of the year at a level roughly 23 per cent below the average of US$1 668 per fine ounce recorded in 2012. Owing to the depreciation in the external value of the rand, the average realised rand price of net gold exports, nonetheless, rose by 0,7 per cent in the third quarter of 2014. Consistent with the lower international demand for gold, the physical quantity of South African net gold exports shrank over the period. As a consequence, net gold export earnings receded by 12,2 per cent in the third quarter of 2014.

The volume of *merchandise imports* advanced by 3,2 per cent in the third quarter of 2014 after having contracted by 3,9 per cent in the second quarter. Higher imports were registered in all three main categories – mining, manufacturing and agricultural products. In particular, pronounced increases were registered in the imports of machinery and electrical equipment as well as vehicles and transport equipment, in line with the underlying firm demand for wind-powered generating sets and computers. Over the same period the volume of imported mining products rose by 3,5 per cent, despite a decrease in crude oil imports. The volume of non-oil imports advanced by 4,8 per cent over the period. Relative to real gross domestic expenditure, real merchandise imports rose from 24,7 per cent in the second quarter of 2014 to 25,3 per cent in the third quarter.

Volume of merchandise imports

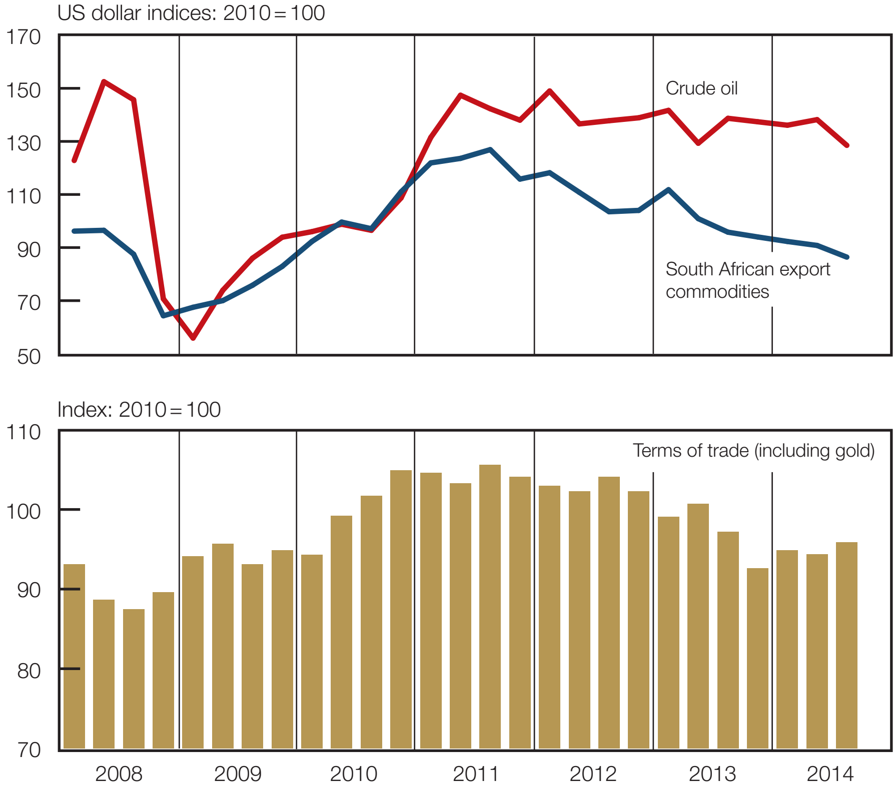


Seasonally adjusted and annualised

The decline in the international price of crude oil and other imported commodities outweighed the impact of the depreciation in the exchange rate of the rand, leading to a decrease of 2,1 per cent in the rand price of merchandise imports. The value of merchandise imports accordingly rose by 1,1 per cent in the third quarter of 2014, following a decline of 3,3 per cent in the second quarter.

South Africa's terms of trade improved slightly in the third quarter of 2014 as import prices declined at a faster pace than export prices.

International commodity prices and terms of trade



The shortfall on the services, income and current transfer account widened from R134 billion in the second quarter of 2014 to R137 billion in the third quarter. Expressed as a ratio of gross domestic product, the deficit amounted to 3,6 per cent in the third quarter of 2014.

The larger deficit in the third quarter of 2014 could mainly be attributed to an increase in net interest payments to non-resident investors and creditors as well as higher net payments for transport-related services. These higher net payments were partly offset by lower net dividend payments: the level of gross dividend payments to the rest of the world remained broadly unchanged from the second to the third quarter of 2014, while gross dividend receipts rose somewhat over the period. Gross dividend receipts in the first three quarters of 2014 were roughly 16 per cent higher than in the corresponding period of 2013.

Box 2 The impact of revisions to the services, income and current transfer account

The services, income and current transfer account is a *subaccount* of the current account of the balance of payments. This subaccount, in conjunction with the trade account (which encapsulates trade in merchandise *goods*), is collectively known as the current account of the balance of payments. The exports and imports of goods and services are therefore captured in the 'X' and 'M' of the well-known identity Y = C + I + G + X – M.

The conversion of balance-of-payments statistics from the fifth edition of the *Balance of Payments Manual* (BPM5) to the sixth edition of the *Balance of Payments and International Investment Position Manual* (BPM6), alongside annual data revisions paved the way for the disaggregation of the previously known category 'other services' in the services account into more subcategories. These categories, for which data will initially only be published on an annual basis, include manufacturing services; repairs and maintenance services; telecommunications, computer and information services; financial and insurance services; charges for the use of intellectual property; personal, cultural and recreational services; and other business and miscellaneous services (also see the note on the conversion and revision of South Africa's balance of payments statistics in this issue of the *Quarterly Bulletin*). The disaggregation of the 'other services' category, along with other revisions to previously published services categories such as transportation-related services, resulted in improved building-block data and more accurate estimates of external services payments and receipts.

According to the newly established data set, the quantitatively most important identified subcategories on the payment or debit side of the account are charges for the use of intellectual property (comprising 29 per cent of the total 'other services' payments by South Africa) and payments for telecommunications, computer and information services (comprising a further 11 per cent of the total). Concomitantly, the main subcategories on the credit side of the account are financial and insurance services, accounting for 28 per cent of the total 'other services' receipts by South Africa, and telecommunications, computer and information service receipts at 12 per cent of the total.

The accompanying table summarises the impact of the incorporation of the revisions expressed as a percentage of gross domestic product:

– On the services account, South Africa's net services deficit has been reduced compared with previous estimates as, for instance, higher receipts for transport services rendered to non-residents, are now factored in.

– As far as income payments and receipts are concerned, the situation is the reverse since 2009, with higher net income payments to the rest of the world now factored in than before the revisions. While net dividend payments remained broadly unchanged, net interest payments were revised upwards for the period 2009 to 2013. Gross interest payments to the rest of the world are now more closely aligned with the level of the country's outstanding foreign debt, in particular that of national government. Relative to total external debt, government debt rose from 26,3 per cent in 2009 to 38,2 per cent in 2013.

– Regarding current transfer payments, the changes arising from the revision exercise are fairly small.

– The overall balance on the services, income and current transfer account did not change by much since 2011 on account of the revisions. In the earlier part of the period under review, however, the revisions resulted in somewhat smaller deficits on the services, income and current transfer account.

Since trade in services is commonly regarded by the international statistical community as one of the most challenging areas to measure, the dissemination of more detailed components of the account will remain work in progress, subject to further refinement in future. Given the intangible and invisible nature of services, information to inform the estimation of transactions in international services is often scarce and scattered. South Africa is in the fortunate position that a comprehensive international transactions reporting system involving all the authorised dealers in foreign exchange is available, providing source data and guiding the identification of appropriate statistical building blocks.

Balances: Components of services, income and current transfer account

Percentage of gross domestic product

	2005	2006	2007	2008	2009	2010	2011	2012	2013	Average 2005–2013
Net services payments	-0,1	-0,4	-0,5	-1,0	-0,7	-0,9	-0,8	-0,3	-0,3	-0,6
Before revisions	*-0,3*	*-0,8*	*-0,9*	*-1,5*	*-1,0*	*-1,2*	*-1,2*	*-0,7*	*-0,6*	*-0,9*
Net income payments	-1,9	-1,9	-3,3	-3,1	-2,2	-2,1	-2,6	-2,7	-2,6	-2,6
Before revisions	*-2,0*	*-2,0*	*-3,4*	*-3,3*	*-2,2*	*-2,0*	*-2,3*	*-2,3*	*-2,1*	*-2,4*
Of which: Net dividend payments	-1,6	-1,6	-3,1	-2,6	-1,6	-1,5	-1,8	-1,7	-1,5	-1,9
Before revisions	*-1,6*	*-1,7*	*-3,2*	*-2,7*	*-1,7*	*-1,6*	*-1,9*	*-1,8*	*-1,5*	*-2,0*
Net current transfer payments	-1,0	-0,9	-0,8	-0,8	-0,9	-0,6	-0,5	-1,0	-0,9	-0,8
Before revisions	*-1,0*	*-0,9*	*-0,9*	*-0,8*	*-0,9*	*-0,6*	*-0,4*	*-1,0*	*-1,0*	*-0,8*
Overall balance	-3,0	-3,2	-4,6	-4,9	-3,8	-3,6	-3,9	-4,0	-3,8	-3,9
Before revisions	*-3,3*	*-3,7*	*-5,2*	*-5,6*	*-4,1*	*-3,8*	*-3,9*	*-4,0*	*-3,7*	*-4,1*

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

The accompanying table shows the relative share of service receipts or payments in relation to the total receipts or payments for goods and services across a number of countries. South Africa is well aligned with other emerging-market economies, both on the receipts (exports) and payments (imports) side.

Trade in services in relation to total trade in goods and services for selected countries

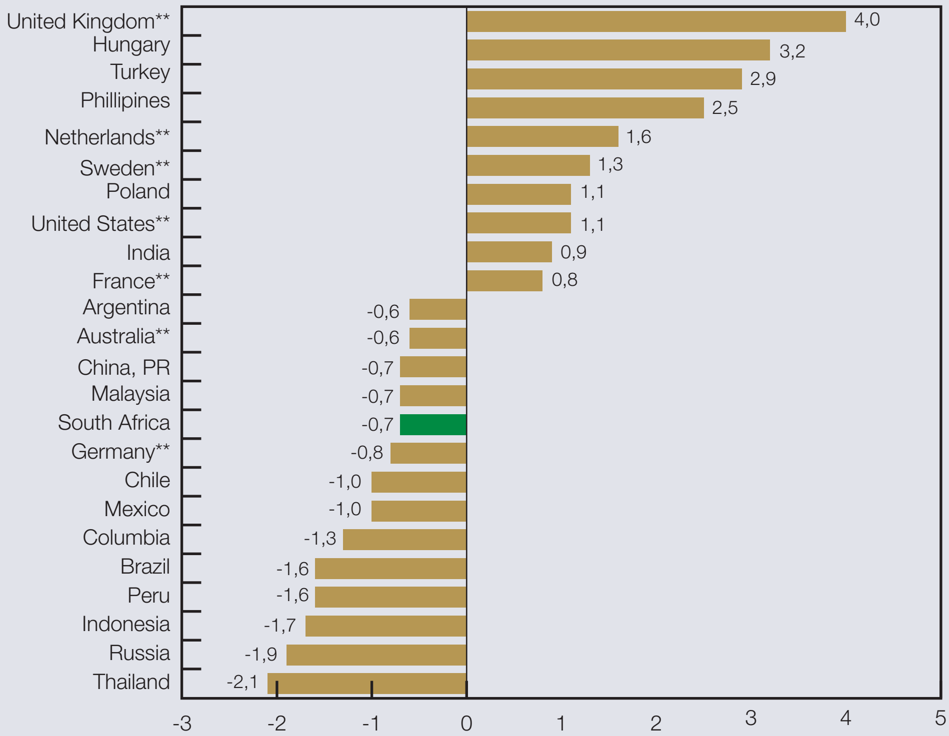
Percentage, average for the period 2008 to 2013

Receipts		Payments	
Mexico	5,0	Mexico	8,0
Colombia	8,9	Turkey	9,2
Peru	9,1	Poland	13,7
China, People's Republic of	10,2	China, People's Republic of	14,3
Indonesia	10,5	Hungary	15,8
Russia	11,3	Colombia	16,3
Chile	13,8	**South Africa**	**16,7**
Brazil	13,9	Peru	16,8
Malaysia	14,2	United States *	16,9
South Africa	**14,6**	Netherlands*	17,2
Argentina	15,5	Phillipines	17,9
Germany*	16,4	Malaysia	18,1
Poland	16,5	Chile	18,2
Thailand	17,1	Indonesia	19,2
Netherlands*	17,4	Australia*	20,2
Australia*	17,9	Germany*	20,6
Hungary	18,6	Argentina	21,3
Turkey	23,1	Thailand	21,3
Sweden*	25,0	France*	22,8
France*	27,0	United Kingdom*	23,1
United States *	30,0	India	23,5
Philippines	31,5	Russia	24,1
India	33,3	Sweden*	25,2
United Kingdom*	38,6	Brazil	25,4
Average ratio excluding advanced economies	*15,7*	*Average ratio excluding advanced economies*	*17,6*
Average ratio for advanced economies	***24,6***	***Average ratio for advanced economies***	***20,9***

* Advanced economies

The accompanying graph indicates *net* service receipts or payments relative to gross domestic product for the same countries shown in the table on the previous page, thereby differentiating between net exporters or importers of services. South Africa is a net importer of services, as are many other emerging-market economies.

Average net service* receipts for selected countries as percentage of gross domestic product for the period 2008 to 2013



* Positive sign refers to net receipts
** Advanced economies

Financial account

While mindful of the likely future direction of monetary policy in advanced economies, uncertainty still prevailed in global financial markets during the third quarter of 2014 as the IMF lowered its outlook for world economic growth and international commodity prices declined further. While these developments raised volatility in financial markets over the period, capital flows to emerging-market economies remained firm as the sustained yield premium in those markets above the low yields on offer in the euro, yen and US dollar markets enticed investors to invest in these markets. South Africa was no exception, as the country recorded net capital inflows despite industrial action in the metals industry alongside a further deterioration in the country's relative position in the global competiveness index. The financial account of the balance of payments (including reserve assets but excluding unrecorded transactions) registered a net inflow of foreign capital to the value of R58,3 billion in the third quarter of 2014. As a ratio of gross domestic product, the balance on the financial account amounted to 6,1 per cent in the third quarter of 2014, slightly more than the comparative ratio of 5,5 per cent in the second quarter.

Net financial transactions

R billions

	2013			2014		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	46,9	4,5	80,1	7,2	27,4	10,2
Portfolio investment	55,6	-9,7	69,5	12,3	27,4	50,8
Financial derivatives	-50,1	-45,5	-188,3	-48,0	-43,7	-39,6
Other investment	-5,4	31,0	50,4	38,0	5,1	49,7
Change in assets						
Direct investment	-30,1	-17,6	-64,1	-7,7	-14,4	-43,8
Portfolio investment	-5,5	6,3	-11,5	-8,9	-11,2	-3,2
Financial derivatives	51,2	46,0	195,8	54,2	48,4	40,3
Other investment	11,3	0,8	3,2	-29,4	2,9	17,2
Reserve assets	-18,7	0,0	-4,8	4,7	10,0	-23,4
Total identified financial transactions*	55,2	15,9	130,4	22,4	51,8	58,3
As percentage of gross domestic product	*6,1*	*1,7*	*3,7*	*2,4*	*5,5*	*6,1*

* Including reserve assets but excluding unrecorded transactions

Net portfolio and other investment fully accounted for the inflow of capital in the third quarter of 2014, amounting to R47,6 billion and R66,9 billion respectively. By contrast, net direct investment recorded an outflow of R33,5 billion over the same period, while inflows associated with financial derivative transactions were marginally positive over the period. Transactions in financial derivatives will from now on be reported on separately in the financial account; the accompanying box provides more detail.

Box 3 Measurement of transactions in financial derivatives

A financial derivative contract is a financial instrument that is linked to another financial instrument, indicator or commodity through which financial risks (such as interest-rate risk, foreign-exchange risk, equity and commodity price risks and credit risk) can be traded in their own right in financial markets. The value of a financial derivative contract is derived from the price of an underlying instrument, even though transactions and positions in financial derivatives are treated separately from the values of the underlying instruments to which they are linked. Financial derivative contracts are used for risk management, hedging, speculation, and arbitrage. Hedgers use financial derivatives to reduce the risk associated with the potential future price of an asset, while speculators use them to take positions on the future movements in the price of an asset. Arbitrageurs take offsetting positions in two or more instruments to lock in profits due to discrepancies between prices in two different markets.

In the case of South Africa, data on transactions in financial derivatives are only disseminated for the banking sector as the sector mainly transacts with non-resident parties in derivative instruments. Other domestic sectors transact with the banking sector in financial derivatives which, in turn, transacts with non-resident parties for hedging purposes. Financial derivatives are valued at market prices in the balance of payments and international investment position. If market price data are unavailable, other fair value methods (such as option models or present values) may be used to value these transactions.

Foreign-owned assets in South Africa

After having attracted sizeable capital inflows to the value of R27,4 billion in the second quarter of 2014, foreign direct investment flows into South Africa subsided to R10,2 billion in the third quarter. As in the preceding quarter, a large portion of these inward investment flows comprised loan finance extended by foreign parent companies to their subsidiaries in South Africa. In addition, non-resident companies also raised their equity stake in domestic companies, counteracting the sale of a significant stake in a company in the hotel and gaming industry by a non-resident investor.

Inward foreign portfolio investment almost doubled from the second quarter of 2014 to the third quarter as foreign investors acquired domestic equity and debt securities in roughly equal proportions. Portfolio inflows amounted to R50,8 billion in the third quarter of 2014, exceeding the cumulative portfolio-related inflow registered in the first half of the year. Sentiment towards emerging-market economies, including South Africa, improved notably in the third quarter of 2014 as indicated by non-resident investors' interest in three international bonds issued by the South African government. The bond issues comprised a dollar-denominated bond, a euro-denominated bond and a well over-subscribed Sukuk (Islamic) bond, the first of its kind issued by South Africa. In total, government raised more than R23 billion over the period through these issuances. Non-resident investors' net purchases of South African equities amounted to R23,6 billion in the third quarter of 2014.

Other inward investment flows amounted to R49,7 billion in the third quarter of 2014 after having registered an inflow of R5,1 billion in the second quarter. The sizeable capital inflow in the third quarter of 2014 can mainly be ascribed to an increase in foreign currency-denominated loans extended to the South African banking sector.

South African-owned assets abroad

South African entities continued to expand their business activities abroad, acquiring sizeable direct investment assets amounting to R43,8 billion in the third quarter of 2014; this was considerably more than the outflow of R14,4 billion recorded in the second quarter. A substantial part of the acquisition of direct investment assets involved the food and beverage retail industry.

Outward portfolio investment amounted to R3,2 billion in the third quarter of 2014. Investments made in foreign debt securities to the value of R7,2 billion were partly neutralised by the net sale of foreign portfolio equity assets worth R4,0 billion over the period.

In the category for other outward investment an inflow of R17,2 billion was recorded in the third quarter of 2014, primarily as the domestic banking sector reduced its foreign-currency deposit holdings. In the second quarter of 2014 a much smaller inflow of R2,9 billion was recorded.

Foreign debt

South Africa's gross external debt rose from US$138,5 billion at the end of March 2014 to US$141,8 billion at the end of June, mainly due to an increase in the value of domestic government bonds acquired by non-resident investors. The appetite of other sectors for foreign finance was fairly muted in the second quarter of 2014.

The country's outstanding foreign currency-denominated debt declined marginally to US$62,2 billion at the end of the second quarter of 2014 due to the redemption of international bonds by the private as well as the public sector. Total short-term foreign currency-denominated debt (i.e. debt with an original maturity of less than one year and other longer-term foreign currency-denominated debt maturing within the next twelve months) accounted for 42,3 per cent of total foreign currency-denominated debt at the end of June 2014; at the end of March 2014 this ratio stood at 43,8 per cent.

South Africa's rand-denominated debt, expressed in US dollars, increased from US$75,6 billion at the end of March 2014 to US$79,6 billion at the end of June. This increase could largely be explained by an increase in the foreign commitments of the public sector as non-resident investors continued to acquire interest-bearing government debt securities during the period. Relative to the country's total external debt, rand-denominated debt advanced from 54,6 per cent at the end of March 2014 to 56,1 per cent at the end of June.

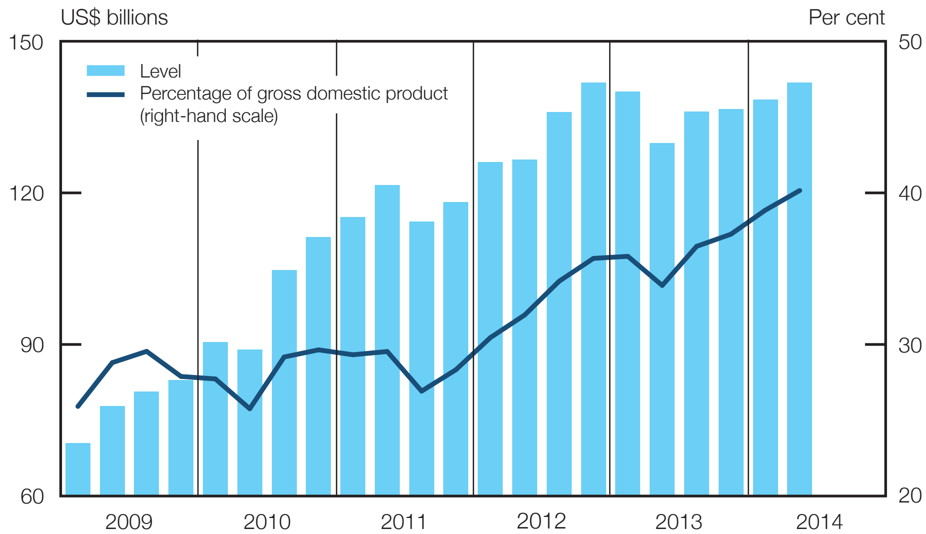
Foreign debt of South Africa

US$ billions at end of period

	2013				2014	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Foreign currency-denominated debt	58,5	57,1	60,0	61,2	62,9	62,2
Debt securities	20,4	18,5	21,6	21,8	22,0	20,1
Other	38,1	38,6	38,4	39,4	40,9	42,1
Public sector	9,1	9,4	9,6	9,0	9,1	9,1
Deposit-taking institutions	12,9	11,7	10,4	12,1	13,5	13,9
Non-monetary private sector	16,1	17,5	18,4	18,3	18,3	19,1
Rand-denominated debt	81,6	72,8	76,1	75,3	75,6	79,6
Debt securities	45,9	39,7	42,3	41,1	40,1	44,1
Other	35,7	33,1	33,8	34,2	35,5	35,5
Total foreign debt	140,1	129,9	136,1	136,5	138,5	141,8
As percentage of gross domestic product	*35,8*	*33,9*	*36,5*	*37,3*	*38,9*	*40,2*
As percentage of total export earnings	*114,6*	*107,4*	*112,9*	*113,6*	*116,5*	*120,8*

Expressed in rand terms, South Africa's external debt advanced from R1 467 billion at the end of March 2014 to R1 505 billion at the end of June. This increase raised the ratio of total external debt to annualised gross domestic product from 38,9 per cent at the end of March 2014 to 40,2 per cent at the end of June. By the same token, the ratio of external debt to annualised export proceeds rose from 116,5 per cent to 120,8 per cent over the period.

External debt



International reserves and liquidity

South Africa's international reserves increased by R23,4 billion in the third quarter of 2014, representing the first quarterly increase since the third quarter of 2013.

Measured in US dollar, 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) increased from US$48,6 billion at the end of June 2014 to US$49,1 billion at the end of September, as the proceeds from international bond issues placed with the Bank more than offset the impact of revaluation adjustments emanating from the appreciation of the US dollar and the decline in the gold price over the period. The gross reserves, however, subsequently declined to US$48,5 billion at the end of November 2014, primarily reflecting a lower gold price and other revaluation effects. The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services as well as income payments) increased from 4,4 months at the end of June 2014 to 4,7 months at the end of September.

The Bank's international liquidity position weakened from US$44,8 billion at the end of June 2014 to US$43,3 billion at the end of September, before declining further to US$42,9 billion at the end of November.

Exchange rates

Positive economic developments in the US, among other factors, caused the nominal effective exchange rate of the US dollar to increase, on balance, by about 7 per cent in the third quarter of 2014. Over the same period, the exchange rate of the euro weakened by 4 per cent, weighed down by concerns about lacklustre economic growth. Among emerging-market currencies, the oil-sensitive Russian rouble and the Argentine peso proved to be two of the worst-performing currencies thus far in 2014, while the Indian rupee and Indonesian rupiah were rated among the best-performing currencies.

Exchange rates of the rand

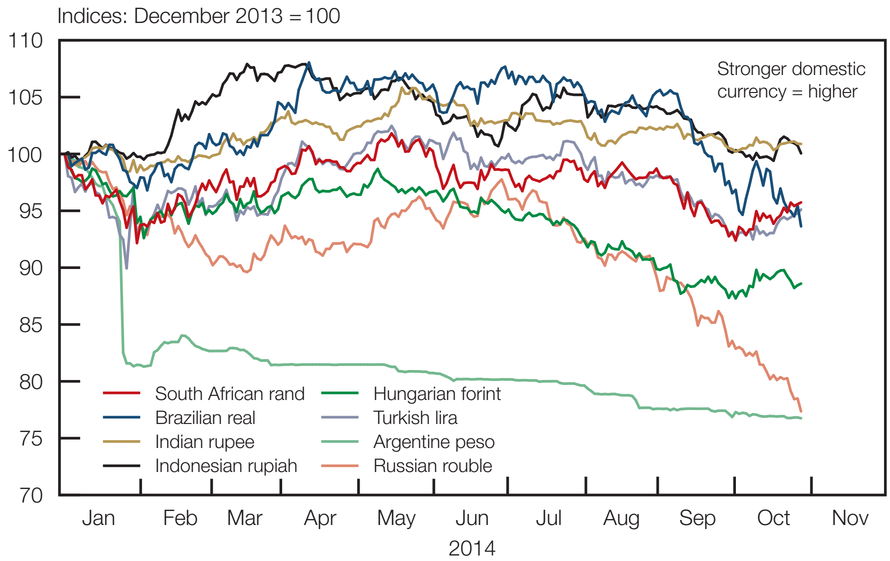
Percentage change

	31 Dec 2013 to 31 Mar 2014	31 Mar 2014 to 30 Jun 2014	30 Jun 2014 to 30 Sep 2014	30 Sep 2014 to 30 Nov 2014
Weighted average*	**-0,8**	**-0,4**	**-2,0**	**3,7**
Euro	-1,1	0,7	1,7	3,8
US dollar	-1,2	-0,2	-5,6	1,9
Chinese yuan	1,4	-0,4	-6,5	1,9
British pound	-1,9	-2,5	-1,2	5,6
Japanese yen	-3,2	-1,7	1,9	10,1

* Against a basket of 20 currencies

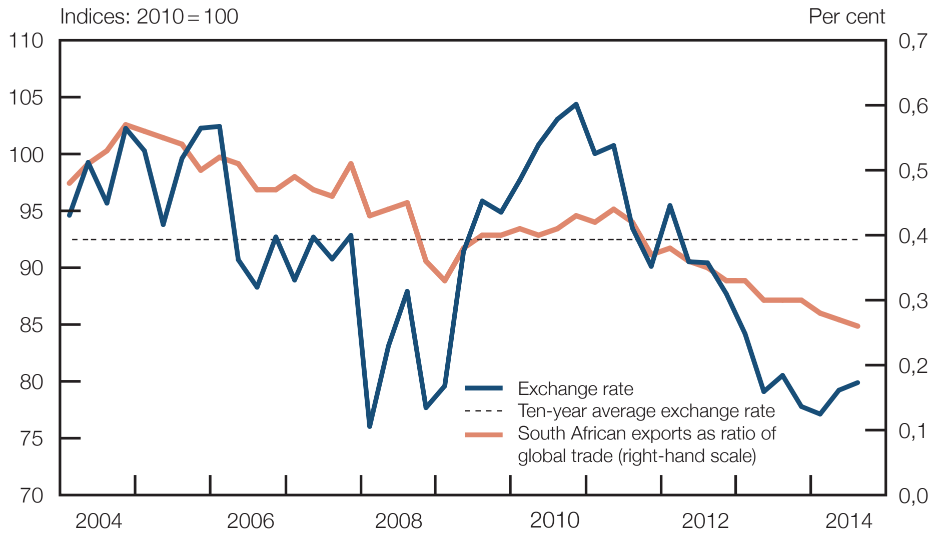
The South African rand experienced some strain in the third quarter of 2014, in line with the performance of other emerging-market currencies. Factors that weighed down on the rand included industrial strike action in the steel and engineering industry, subdued domestic economic growth, a further decline in international commodity prices as well as the country's twin deficits. On balance, the nominal effective exchange rate of the rand declined by 2,0 per cent in the third quarter of 2014 with the depreciation concentrated in September 2014, partly due to the strengthening of the US dollar. However, the nominal effective exchange rate of the rand recovered by no less than 4,0 per cent in October as the US Federal Reserve announced that monetary policy in the US would remain accommodative for longer and further stimulus injection measures were introduced by the People's Bank of China and the European Central Bank. In addition, the exchange rate of the rand also benefited from the announcement of a narrowing in the country's trade deficit for September and a prudent *Medium Term Budget Policy Statement* delivered at the end of October 2014.

Selected exchange rates: US dollar per domestic currency unit



The real effective exchange rate of the rand on balance increased by approximately 6,9 per cent from January 2014 to October 2014, but nevertheless remained below its ten-year average level. Structural factors continued to impair South Africa's ability to take full advantage of the more competitive levels of the exchange rate and step up the country's exports.

Real effective exchange rate of the rand and export penetration



The average net daily turnover in the domestic market for foreign exchange increased by 4,8 per cent from US$24,8 billion in the second quarter of 2014 to US$26,0 billion in the third quarter. Turnover in the rand market increased by 10,3 per cent from US$19,5 billion to US$21,5 billion over the same period. Higher transaction volumes in the bond and share market, among other factors, gave rise to increased transactions in the forward and swap markets.

Monetary developments, interest rates and financial markets

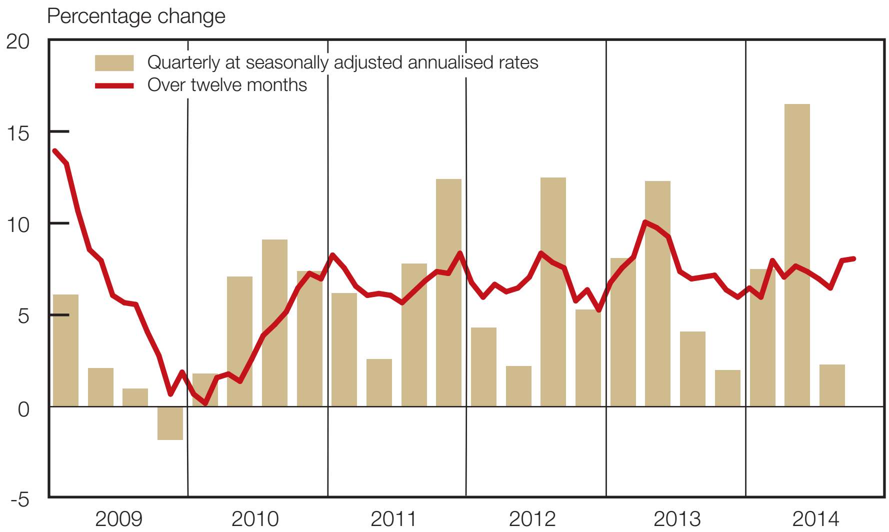
Money supply

Despite fluctuating somewhat, growth in the broadly defined money supply (M3) remained resilient in the ten months to October 2014 and extended the broadly sideways growth trend recorded over the past four years. Twelve-month growth in M3 slowed from a peak of 7,9 per cent in March 2014 to 6,4 per cent in August, before accelerating to 7,9 per cent in September and 8,0 per cent in October. While the main factor which supported sustained growth in deposit holdings in recent months was probably the rising nominal income and expenditure levels on the back of inflation, further support arose from:

– the environment of rising interest rates, raising the return on interest-bearing M3 deposits;
– a build-up in precautionary and speculative balances in the wake of a contraction in share prices;
– a rise in foreign currency-denominated deposit holdings, partly boosted by the depreciation in the exchange value of the rand; and
– large coupon payments on government bonds and the redemption of the R157 government bond during the third quarter of 2014, which temporarily boosted private-sector deposit holdings.

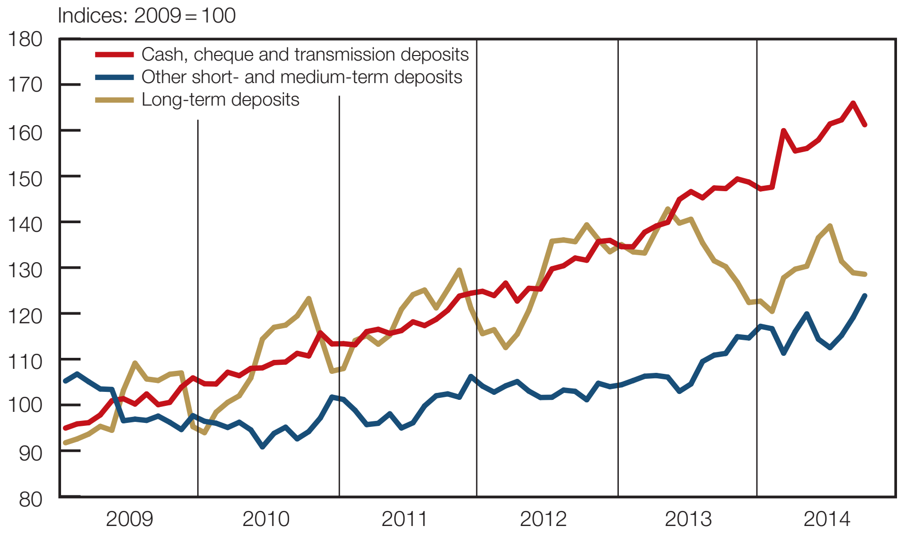
By contrast, the quarter-to-quarter growth in M3 has been quite volatile in recent quarters.

Growth in M3



Analysed by maturity, twelve-month growth in cash, cheque and demand deposits (M1) continued to exceed that of M3 during the first ten months of 2014, although it moderated from a base-induced peak of 16,1 per cent in March to 9,5 per cent in October. The preference for liquidity was furthermore evidenced by continued positive growth in the other short- and medium-term deposit category forming part of M2. Nonetheless, demand for long-term deposits showed signs of improving alongside the increases in the policy interest rate in January and July 2014. Twelve-month growth in the long-term deposit category became less negative, moving from a recent low of -9,7 per cent in February 2014 to -2,0 per cent in September. In October, growth in long-term deposits came to -1,3 per cent.

Growth in deposits by maturity



Both the corporate and household sectors held more monetary deposits in the first three quarters of 2014. Overall, M3 money supply increased by R70,3 billion in the third quarter of 2014, substantially higher than the R42,2 billion recorded in the second quarter. The deposit holdings of the corporate sector rose by R48,7 billion during the third quarter of 2014 as non-financial companies increased their deposit holdings, while financial companies drew down on their M3 holdings during this period. At the same time, the deposit holdings of the household sector increased by R21,5 billion. The uptick in deposits in the third quarter could partly be attributed to large coupon payments on government bonds and the redemption of the R157 government bond which temporarily boosted the deposit holdings of especially the corporate sector.

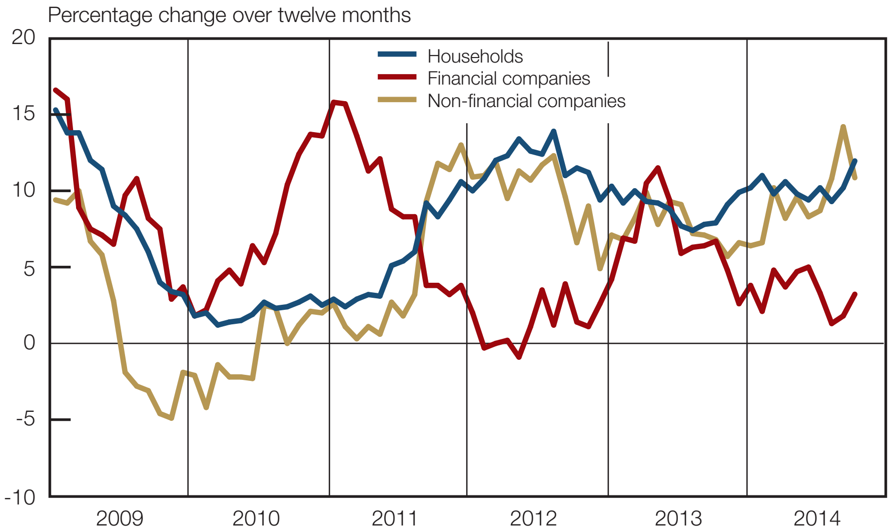
M3 holdings of households and companies

	Quarterly change (R billions)			Percentage holdings of total M3 deposits		
	2014			2014		
	1st qr	2nd qr	3rd qr	1st qr	2nd qr	3rd qr
Households	9,8	19,2	21,5	29,4	29,6	29,6
Companies	69,4	23,0	48,7	70,6	70,4	70,4
Of which: Financial	31,1	46,4	-11,8	39,8	41,0	39,4
Non-financial	38,2	-23,4	60,6	30,8	29,4	31,0
Total M3 deposits	79,2	42,2	70,3	100,0	100,0	100,0

Year-on-year growth in the deposit holdings of the household sector regained some momentum in 2014 and averaged around 10,2 per cent during the first ten months, up from average growth of 8,9 per cent recorded in 2013. In October, growth came to 12,0 per cent. Growth in deposits of the corporate sector as a whole remained fairly subdued, with year-on-year growth falling back from an average of 7,2 per cent in 2013 to 5,9 per cent in the ten months to October 2014. Growth nonetheless improved from a recent low of 3,9 per cent in February 2014 to 6,4 per cent in October.

In value terms, deposits of financial companies comprise around 40 per cent of total deposits. However, year-on-year growth in deposit holdings of financial companies remained modest, moderating from 5,0 per cent in June 2014 to 3,2 per cent in October. By contrast, growth in the deposits of non-financial corporates accelerated from 5,7 per cent in November 2013 to as high as 14,2 per cent in September 2014 and 10,9 per cent in October. Volatile cash flows and a stronger precautionary motive due to the ripple effect of protracted strike activity may have impacted on the deposit holdings of non-financial companies during this period.

M3 holdings of households and companies



In a statistical sense, the rise in M3 during the third quarter of 2014 was mainly attributable to an increase in banks' claims on the private sector which continued to be supported by growth in other loans and advances, predominantly extended to the corporate sector. Net claims on the government sector increased in the third quarter, mainly due to increased holdings of Treasury bills and government bonds. Net foreign assets decreased as the increase in banks' foreign liabilities exceeded the increase in foreign assets, while the net other assets and liabilities of the monetary sector recorded a moderate increase in the third quarter.

Statistical counterparts of change in M3

R billions

	2013	2014		
	4th qr	1st qr	2nd qr	3rd qr
Net foreign assets	-3,9	-3,3	-1,4	-7,5
Net claims on the government sector	7,6	-0,7	5,9	21,4
Claims on the private sector	35,0	96,4	38,6	53,3
Net other assets and liabilities	-33,1	-13,3	-0,9	3,0
Total change in M3	5,6	79,2	42,2	70,3

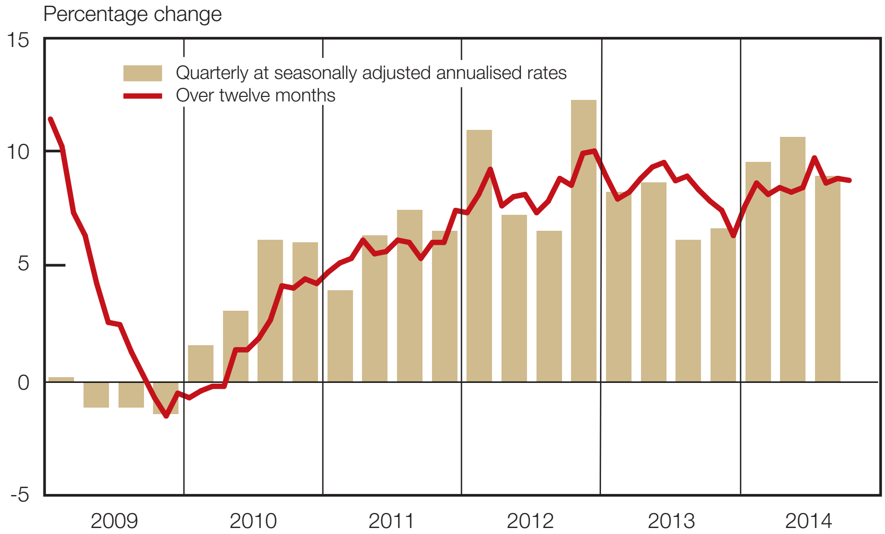
The income velocity of circulation of M3 declined from 1,47 in the first quarter of 2014 to 1,44 in the third quarter, when growth in money supply exceeded that of nominal gross domestic product. In a historical context, velocity has remained below the long-term average of 1,50 recorded since 2000, which implies relative abundance of money within a relatively constrained economic growth environment.

Credit extension

Total loans and advances extended to the private sector maintained fairly steady momentum during the first ten months of 2014. Year-on-year growth in banks' total loans and advances extended to the private sector averaged around 8,5 per cent during the first ten months of

2014, largely driven by increased demand for credit by the corporate sector, while growth in credit extension to households remained moderate. Uneven consumer spending patterns were evident in the weak uptake of credit by the household sector, which was further exacerbated by weak employment growth, the fragile economic recovery and a rising interest-rate environment. Given the prolonged period of low interest rates, the ratio of household debt to disposable income has nevertheless declined gradually.

Total loans and advances to the private sector



Total loans and advances to the private sector expanded by R175 billion in the first nine months of 2014, higher than the increase of R110 billion recorded in the same period of 2013. The quarter-to-quarter[7] growth rate in this aggregate increased from 6,7 per cent in the fourth quarter of 2013 to 10,7 per cent in the second quarter of 2014, before moderating somewhat to 9,0 per cent in the third quarter. The overall uptick in aggregate credit extension during 2014 was largely supported by the elevated usage of bank credit by the corporate sector, while credit to the household sector continued to dwindle.

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

Other loans and advances, which consist of general loans, bank overdrafts and credit-card advances, maintained its position as the dominant driver of credit extension in the first ten months of 2014, while growth in the asset-backed categories remained relatively subdued.

The quarterly growth in other loans and advances amounted to R38 billion in the third quarter of 2014, higher than the R20 billion increase recorded during the third quarter of 2013. On aggregate, other loans and advances grew by R111 billion over the first ten months of 2014, substantially higher than the R50 billion increase recorded during the same period of 2013. The corporate sector's contribution to this acceleration increased to 88 per cent in the ten months to October 2014, compared with 57 per cent over the same period a year earlier. By contrast, the contribution of the household sector plunged from 43 per cent to 12 per cent in the comparable periods of 2013 and 2014 respectively. Year-on-year growth in the category for other loans and advances rebounded from a low of 9,3 per cent in December 2013 to 15,2 per cent in October 2014.

Twelve-month growth in general loans to households decelerated sharply from a high of 30,1 per cent in January 2013 to a low of 0,2 per cent in July 2014, the lowest rate of growth since July 2003. In October 2014, growth accelerated somewhat to 2,9 per cent, albeit off a low base. The slowdown in this credit category reflects relatively tight lending conditions as lenders attempt to limit credit impairments and improve their balance-sheet risk profiles. Furthermore, household demand for credit remains constrained by weak income growth, a cost squeeze, high overall indebtedness and tenuous employment prospects.

Composition of total loans and advances by type of credit

Type of credit	Quarterly change (R billions)					Percentage of total loans and advances*
	2013		2014			2014
	3rd qr	4th qr	1st qr	2nd qr	3rd qr	3rd qr
Household sector						
Instalment sale credit and leasing finance	7,0	7,2	3,3	2,6	2,6	9,2
Mortgage advances	4,8	2,3	6,1	6,0	2,3	31,5
Other loans and advances	1,1	7,6	8,3	1,1	1,6	12,7
Overdrafts	*1,3*	*1,0*	*3,4*	*-2,1*	*-1,2*	*1,3*
General loans	*-2,6*	*3,6*	*2,6*	*0,3*	*0,8*	*7,7*
Credit card advances	*2,4*	*3,0*	*2,3*	*2,9*	*2,0*	*3,6*
Total loans and advances to the household sector	12,8	17,1	17,7	9,7	6,5	53,4
Corporate sector						
Instalment sale credit and leasing finance	3,9	2,4	2,1	2,8	2,7	4,1
Mortgage advances	6,1	-1,0	6,0	6,7	7,9	12,2
Other loans and advances	18,5	17,3	57,0	20,1	36,2	30,3
Overdrafts	*-2,0*	*4,5*	*9,0*	*8,7*	*4,4*	*5,2*
General loans	*20,4*	*11,8*	*47,8*	*10,9*	*31,5*	*24,8*
Credit cards advances	*0,1*	*1,1*	*0,2*	*0,5*	*0,3*	*0,3*
Total loans and advances to the corporate sector	28,6	18,7	65,1	29,6	46,8	46,6
Total loans and advances to the private sector	**41,4**	**35,8**	**82,9**	**39,3**	**53,3**	**100,0**

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

Mortgage advances, the largest component of total loans and advances, rose by some R40,6 billion in the ten months to October 2014, well above the R23,0 billion increase recorded over the same period in the preceding year. The gradual improvement in mortgage advances is evident from the rising trend in advances applied for, granted and paid out since April 2013. While twelve-month growth remained modest at 3,4 per cent in October 2014, it nonetheless exceeded the average growth rates of around 2 per cent recorded in the preceding two years. Elevated capital repayments on mortgage advances have partly been contributing to the moderate growth in net new mortgage advances over the past three years, but have slowed down since the interest rate increases in January and July 2014.

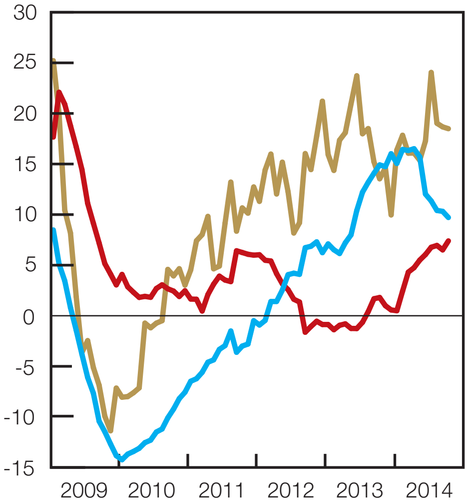
The rate of expansion in *instalment sale credit and leasing finance*, which mainly represents the financing of new and second-hand vehicles, gradually started slowing during the course of 2013 and moderated further in the first ten months of 2014. The quarterly growth in instalment sale credit and leasing finance amounted to R5,3 billion in the third quarter of 2014, roughly half the R10,8 billion recorded in the same period of 2013. Twelve-month growth declined from a recent high of 14,2 per cent in October 2013 to 7,4 per cent in October 2014 due to a reduction in especially passenger vehicle sales. New car sales had registered their first positive year-on-year growth for 2014 in September and the improvement could be attributed to a combination of factors, including attractive incentive packages, general pre-emptive buying in anticipation of further new vehicle price increases on the back of a weakening rand, relatively strong corporate purchases, replacement demand and a strong contribution by the car-rental sector.

The corporate sector's reliance on bank-intermediated funding edged higher in the first ten months of 2014, significantly outperforming credit extension to the household sector. The use of bank overdrafts by the corporate sector was particularly robust, rising by R21,8 billion in the ten months to October 2014 to dwarf the increase of R6,4 billion recorded for 2013 as a whole. Over the same period, general loans extended to both financial and non-financial companies amounted to R74,8 billion, which also exceeded the R50,6 billion extended to companies in 2013.

Bank loans and advances by type:

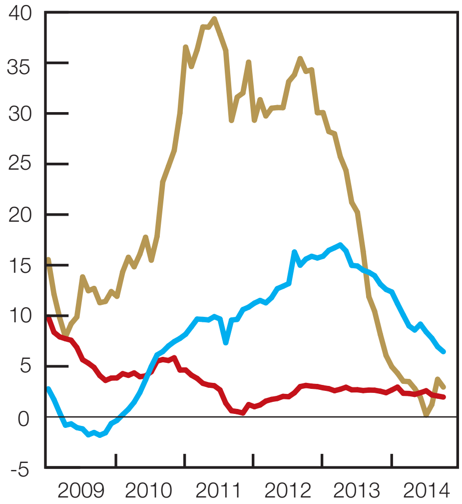
Extended to corporate sector

Percentage change over twelve months



Extended to household sector

Percentage change over twelve months



Instalment sale credit and leasing finance
Mortgage advances
Other loans and advances

The corporate sector's demand for credit accelerated from a year-on-year rate of 10,2 per cent in January 2014 to 15,3 per cent in October. The recovery in loans and advances extended to the corporate sector in 2014 was partly boosted by the renewable energy initiative of government. Growth by economic sector in credit extended in the third quarter of 2014 was dominated by wholesale and retail trade, transport, and financial intermediation services. The construction, mining and electricity sectors also raised their borrowing over the period.

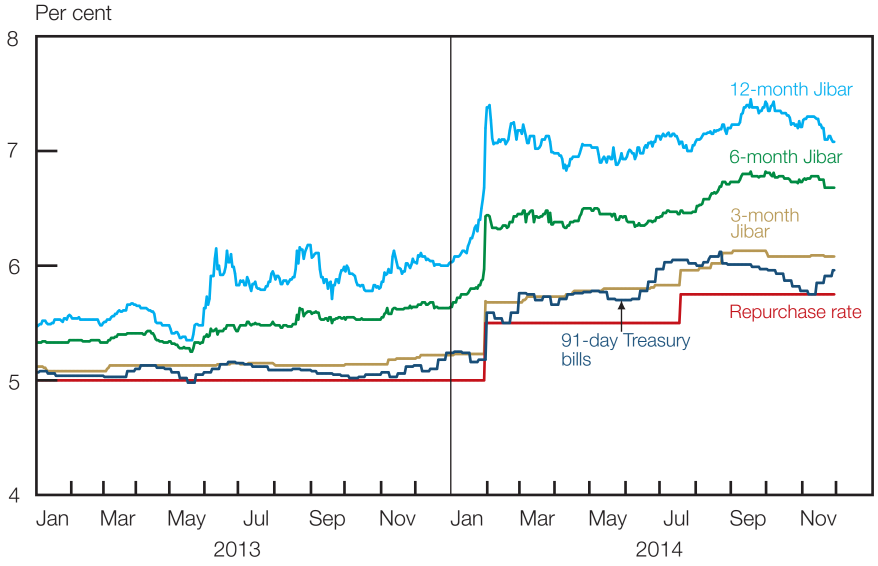
While rising growth in loans and advances to the corporate sector may suggest an improvement in economic conditions, household borrowing remains subdued. Twelve-month growth in credit extension to the household sector receded from a recent high of 10,4 per cent recorded in November 2012 to 5,5 per cent in December 2013 and even further to 3,8 per cent in September 2014. Quarterly credit extension to households halved from R12,8 billion in the third quarter of 2013 to R6,5 billion in the third quarter of 2014. The decline was largely evident in the waning of general loans, mortgage advances and instalment sale credit to the household sector. In October, growth in credit extension to the household sector amounted to 3,6 per cent.

Interest rates and yields

Owing to a slightly improved inflation outlook, stable inflation expectations and the downside risk posed by the weak growth outlook, the Monetary Policy Committee (MPC) decided to keep the repurchase rate unchanged at 5,75 per cent per annum at its September and November 2014 meetings. While the inflation trajectory remained uncomfortably close to the upper end of the target range, the combination of stubborn inflation and a sluggish growth outlook continued to pose a difficult dilemma for monetary policy. The MPC views the current stance as accommodative and supportive of the domestic economy. For the full MPC statements, see pages 78 to 87 of this *Quarterly Bulletin*.

Money-market rates moved broadly sideways during the third quarter of 2014, with more pronounced movements recorded by longer-dated instruments where expectations regarding the future course of policy rates play a bigger role. Despite the unchanged repurchase rate, the benchmark three-month Johannesburg Interbank Average Rate (Jibar) increased by 17 basis points from 5,96 per cent on 1 August 2014 to 6,13 per cent on 15 September, breaching the 6 per cent level for the first time in four years as banks competed for funds by quoting higher rates. The Jibar remained unchanged at 6,13 per cent until the end of September before declining marginally to 6,08 per cent in early October where it remained to early December.

Money-market rates



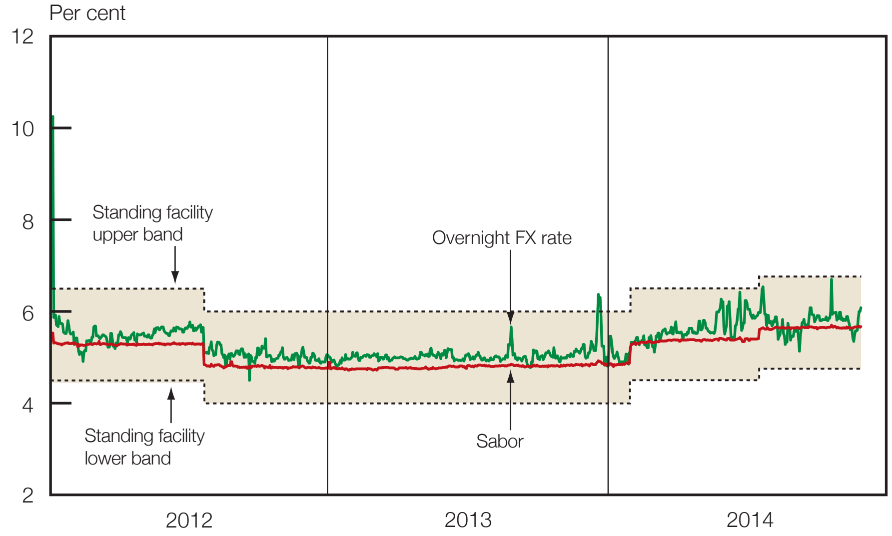
The twelve-month Jibar displayed a greater degree of variability as it emulated the movements in the exchange value of the rand. The rate rose by 35 basis points from 7,10 per cent on 1 August 2014 to a recent high of 7,45 per cent on 18 September, before fluctuating lower to 7,20 per cent on 29 October when the exchange value of the rand improved. Thereafter, the rate moved sideways with a moderate upward bias to mid-November alongside movements in the exchange rate of the rand. Subsequent to the decision to keep the policy interest rate unchanged in November, the twelve-month Jibar declined to 7,05 per cent on 1 December 2014.

The tender rate on 91-day Treasury bills displayed limited movement during the third quarter of 2014, remaining between 5,97 per cent and 6,05 per cent. The rate then started trending lower from early October, reaching 5,75 per cent on 7 November 2014. By 1 December the rate had increased to 5,96 per cent.

Both the South African Benchmark Overnight Rate on deposits (Sabor) and the implied rate on one-day rand funding in the foreign-exchange swap market (the overnight FX rate) remained fairly stable and fluctuated well within the standing facility limits between August and November 2014. The Sabor maintained its sideways trend and fluctuated in a narrow range between 5,61 per cent and 5,70 per cent during the period under review. The spread between the Sabor and the prevailing repurchase rate has been narrowing since early 2013, halving over the past 12 months. The narrowing between these rates can mainly be attributed to moderately tighter liquidity conditions in the market, partly brought about by Basel III requirements which have been forcing banks to become more competitive for cash in overnight, short- and medium-term deposits. This is evident from the higher rates that banks are willing to pay for overnight funding from their top 20 clients, which are included in the Sabor calculation.

Generally tighter liquidity conditions in the foreign-exchange market continued to affect the implied rate on one-day rand funding in the overnight FX rate. Sporadic increases in volatility saw the rate fluctuate between 5,13 per cent on 9 September 2014 and 6,70 per cent on 21 October, but always returning to values close to the repurchase rate. By 1 December, the rate had fluctuated lower to 5,73 per cent.

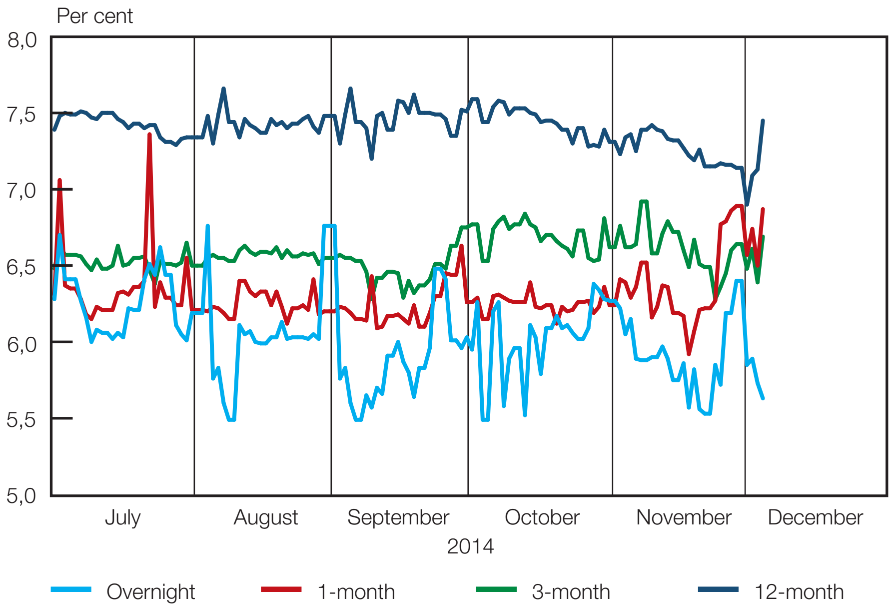
Benchmark overnight rates



Implied foreign-exchange forward rates reflect the cost of borrowing South African rand by using the raised currency (e.g. US dollars) as collateral. Intuitively, if implied rates increase, they reflect high demand for rand funding in the foreign-exchange market and vice versa. From this dynamic, the stance of liquidity conditions in this component of the money market can be observed.

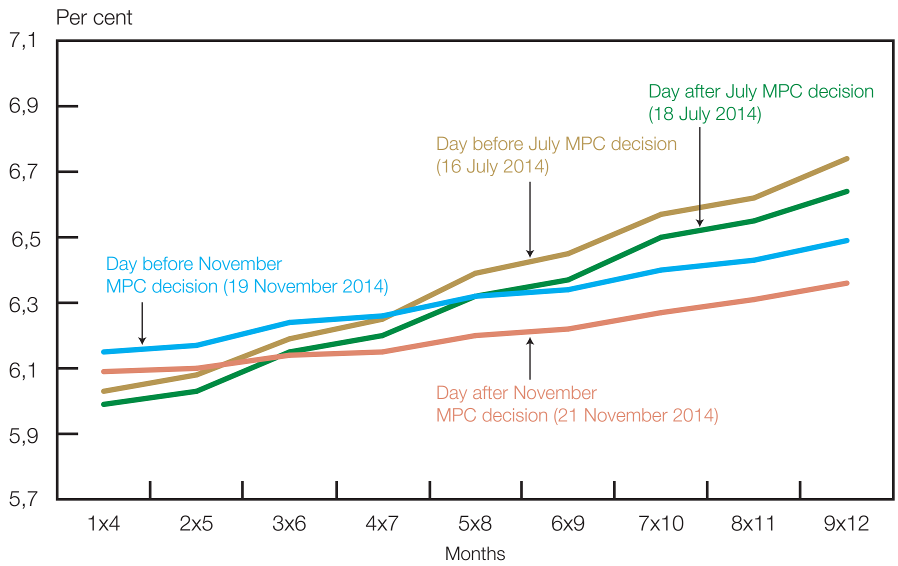
High implied rates would mean that the foreign-exchange market is short of rand and reflects a reluctance of banks' money-market desks to lend to the foreign-exchange desks. Towards month-end, implied rates normally increase, indicating a high demand for cash which settles again after the peak payment periods. During September 2014, implied rates in the three-month area of the forward curve started rising as market participants began gearing up for the expected seasonal strain on liquidity during December. The three-month implied rate registered 6,91 per cent on 3 October, reflecting an increase of 54 basis points from the 6,28 per cent recorded on 9 September 2014. During the rest of October and November, implied rates moderated when the pressure on liquidity abated.

Implied rand rates



After declining briefly from mid-July 2014 following the decision by the MPC to raise the repurchase rate, forward rate agreements (FRAs) responded to the sharp depreciation in the exchange rate of the rand by fluctuating higher in the subsequent months to early October. The increase was more pronounced at the long end of the curve, with the 9x12-month FRA rising by 52 basis points from 6,49 per cent on 27 August 2014 to 7,01 per cent on 7 October. The short-term FRA rates rose at a more subdued pace, with the 3x6-month FRA rising by 25 basis points from 6,17 per cent on 4 August 2014 to 6,42 per cent on 7 October. However, FRA rates edged lower following improved domestic inflation outcomes and a moderation in global risk sentiment, largely induced by easing expectations of a near-term rate increase in the US and China's announcement of plans to loosen some of its capital controls. By 1 December 2014, the 3x6-month and 9x12-month FRAs stood at 6,14 and 6,30 per cent respectively.

Forward rate yield curves



The prime lending rate and the predominant rate on mortgage loans remained unchanged at 9,25 per cent following the unchanged policy decision at the November 2014 MPC meeting. Rates on the different deposit and loan categories of private-sector banks broadly fluctuated in line with the unchanged policy rate.

After increasing from May 2013 to January 2014, *South African bond yields* moved generally lower to the end of November, in line with US government bond yields. This downward trend – from a high base – was fuelled not only by lower US yields and the Bank of Japan's expansion of its bond-buying programme, but also by improved inflation expectations in the wake of lower oil prices and the narrowing of the fiscal deficit provided for in the 2014 *Medium Term Budget Policy Statement* (MTBPS); these factors outweighed the impact of the net selling of local bonds by non-residents over the period. The R186 (maturing in 2025/26/27) government bond yield receded by 126 basis points from the end of January 2014 to 28 November.

The gap between the nominal yield on conventional bonds and the real yield on inflation-linked government bonds also narrowed in recent months as inflation expectations improved, regardless of the depreciation in the exchange value of the rand. The *break-even inflation rate* in the nine-year maturity range progressively moved lower from a recent high of 6,77 per cent on 18 June 2014 to 5,87 per cent on 28 November as the conventional government bond yield declined, while the real yield on inflation-linked government bonds increased.

Consistent with the recent downward trend in domestic bond yields, the *currency risk premium*[8] on South African government bonds narrowed from 401 basis points in May 2014 to 369 basis points in October, as yields on rand-denominated bonds declined more pronouncedly than yields on US dollar-denominated bonds.

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 ten-to-twelve-year maturity range.

Government bond yields

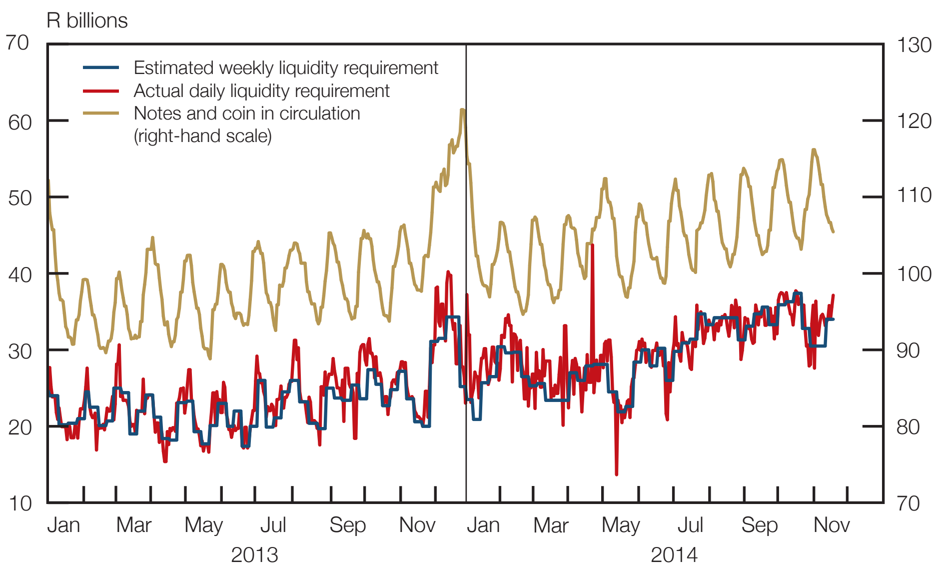
The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[9] yield spread above US government bonds fluctuated wider from 283 basis points in July 2014 to 322 basis points in October, as investor sentiment towards emerging markets turned less favourable along with the sell-off of emerging-market currencies. The *sovereign risk premium* on South African government US dollar-denominated bonds in the ten-year maturity range trading in international markets narrowed noticeably from 233 basis points in February 2014 to 169 basis points in September, before widening to 189 basis points in October.

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

Money market

Money-market liquidity varied moderately during the third quarter of 2014. From July to September 2014, the actual daily liquidity requirement of private-sector banks fluctuated between R27,4 billion and R36,5 billion. The average daily liquidity requirement of R32,8 billion during this period was R5,8 billion more than the average daily liquidity requirement recorded in the second quarter of 2014.

Liquidity requirement



During the third quarter of 2014, liquidity to the net amount of R6,5 billion was drained from the money market, slightly up from the net drainage of R5,8 billion recorded in the preceding quarter. In October, a net injection of R3,4 billion was recorded. On balance, the change in the amount of notes and coin in circulation outside the Bank and banks' required cash reserve deposits jointly tightened money-market liquidity by R10,9 billion during the third quarter and by a further R2,8 billion in October.

The Bank utilised its liquidity management instruments to partly offset the factors impacting on money-market liquidity conditions and injected R5,2 billion into the money market during the third quarter of 2104. In October, liquidity management instruments served to drain R0,3 billion from the money market.

Money-market liquidity flows

R billions (easing + tightening –)

	2014		
	Apr–Jun	Jul–Sep	Oct
Notes and coin in circulation	-1,7	-4,3	-2,8
Change in cash reserve accounts	-4,0	-6,6	6,2
Money-market effect of SARB* foreign-exchange transactions in spot market	-0,3	-0,1	-0,1
Government deposits with SARB**	-4,0	-1,3	0,0
Use of liquidity management instruments	4,1	5,2	-0,3
Reverse repurchase transactions	-0,1	2,4	0,8
SARB debentures	1,5	-2,1	0,0
Forward position (swaps)	4,0	1,3	0,0
Corporation for Public Deposits call deposits with SARB	-1,3	3,6	-1,1
Other items net	0,1	0,6	0,4
Liquidity provided to banking system	-5,8	-6,5	3,4

* SARB: South African Reserve Bank
** Change in government deposits due to the settlement of maturing foreign-exchange swaps

During the third quarter of 2014, spot sales of foreign exchange by the Bank amounted to only R0,1 billion, which had a minor contracting impact on money-market liquidity. During the same period, maturing swaps of R1,3 billion, previously entered into on behalf of National Treasury, had an expansionary impact on the money market. In order to fund these maturing swaps, government deposits were withdrawn from the tax and loan accounts at commercial banks and placed with the Bank. The table provides a summary of the outstanding balances of selected liquidity management instruments.

Liquidity management balances

R billions

	Oct 2013	Oct 2014
Longer-term reverse repurchase transactions	6,65	3,19
SARB debentures	6,01	6,81
Corporation for Public Deposits call deposits with SARB	10,70	5,04
Cash reserve accounts	69,32	69,14
Outstanding swaps	40,71	32,93
Of which: Money-market swaps	7,00	10,00
Sterilisation swaps	33,71	22,93

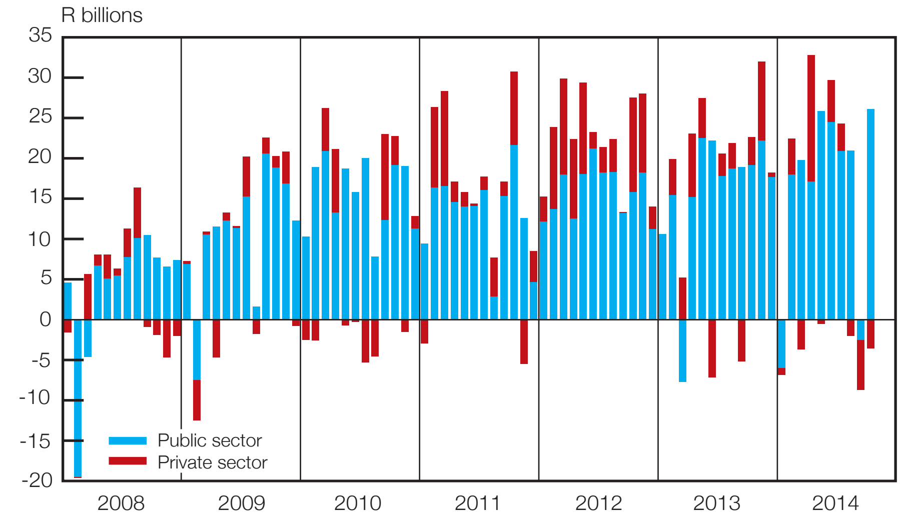
* SARB: South African Reserve Bank

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R56,2 billion were effected from the government tax and loan accounts during the third quarter of 2014, with R106,0 million of this amount accruing to the bond portfolio of the Bank.

Bond market

Debt issuances in the *primary bond market* remained brisk in the first ten months of 2014. Net issues by the public sector of R165 billion in the first ten months of 2014 were somewhat higher when compared with the net issues of R153 billion recorded in the corresponding period of 2013. The redemption of the first tranche of the R157 bond, namely the R009 bond, to the value of R24 billion occurred in September 2014. The outstanding amount in issue of the R157 bond was split on 5 September 2014 into three maturity legs. The last two legs, namely the R158 and R159 bonds, will be redeemable on 15 September 2015 and 15 September 2016 respectively.

Net bond issues in the primary bond market



The National Treasury issued a US$500 million 5,75-year Sukuk (Islamic) bond with a coupon rate of 3,90 per cent in the international capital markets in September 2014. Issuing an Islamic bond served to broaden the investor base and set a benchmark for state-owned companies in their quest for diversifying their sources of funding for infrastructure development.

With regard to private-sector bond funding, lacklustre investor appetite and dwindling issuances were evident from August 2014 following the African Bank Limited curatorship and bank credit rating downgrades. Some companies withdrew bond issuances in the wake of the above as borrowing costs were driven higher. Net issuances by the private sector of R12 billion in the first ten months of 2014 therefore fell short of the net issues of R20 billion recorded over the same period of 2013. Non-bank private companies in particular reduced their net issuances of bonds and continued with net redemptions of commercial paper, while funding through the issuance of securitised instruments has also remained out of favour so far in 2014. Despite recording net redemptions in September and October 2014, the banking sector, on the other hand, recorded higher net issuances, amounting to R21 billion in the first ten months of 2014. The total outstanding nominal value of debt securities listed on the JSE therefore increased by R178 billion in the first ten months of 2014 to reach R2,1 trillion at the end of October; at current market prices the corresponding aggregate value came to R2,2 trillion.

Although *turnover* in the secondary bond market picked up somewhat from May 2014 following lower bond yields and higher volumes traded, the average turnover of R83 billion per day in the first ten months of 2014 was still 11 per cent lower than in the corresponding period of 2013. Consequently, the annualised liquidity ratio, measured as the nominal value of bonds traded relative to the nominal amount in issue, declined from 12 times per annum in the first ten months of 2013 to 10 times thus far in 2014. Repurchase agreements and standard transactions accounted for 66 per cent and 29 per cent respectively of the total value traded in the ten months to October 2014. The All-Bond Index (Albi) generally improved during 2014, recording a gain of 9 per cent over the same period.

Offshore issuances of rand-denominated debt in the *European bond markets* grew rapidly in 2014. For investors, the attraction of Eurorand debt has been the combination of high yields and highly rated issuers. Investors have, therefore, been able to earn rand interest rates, but at lower perceived credit risk than if they had invested directly in South Africa. Eurorand debt has been extremely popular with retail investors who have been willing to accept rand exchange-rate risk but preferred the lower credit risk of an investment-grade issuer. The attraction of the Eurorand market for issuers has been the low cost of funding. Interest in rand-denominated bonds in the *Japanese Uridashi bond market*, however, continued to be subdued in 2014, with more redemptions than issues. As a result, the net issues in the Eurorand market were the key driver of the overall net issues of almost R21 billion in the first ten months of 2014 across both markets, as shown in the accompanying table.

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

R millions

	Eurorand		Uridashi		Total	
	2013	2014	2013	2014	2013	2014
Issues	17 544	25 594	9 485	1 589	27 029	27 183
Redemptions	10 260	3 478	16 293	2 998	26 553	6 476
Net	7 284	22 115	-6 809	-1 409	475	20 707

In 2014, South African bonds experienced a bout of foreign net selling last seen in 2008 during the financial crisis. In the first ten months of 2014, *non-residents*, in on-exchange transactions, reduced their holdings of domestic bonds by no less than R43 billion when compared with exchange-reported net purchases of R23 billion in the corresponding period of 2013, amid somewhat lower market liquidity. Overall demand in this market, driven by resident investors, was nevertheless strong enough to support lower bond yields over the first ten months of 2014.

Share market

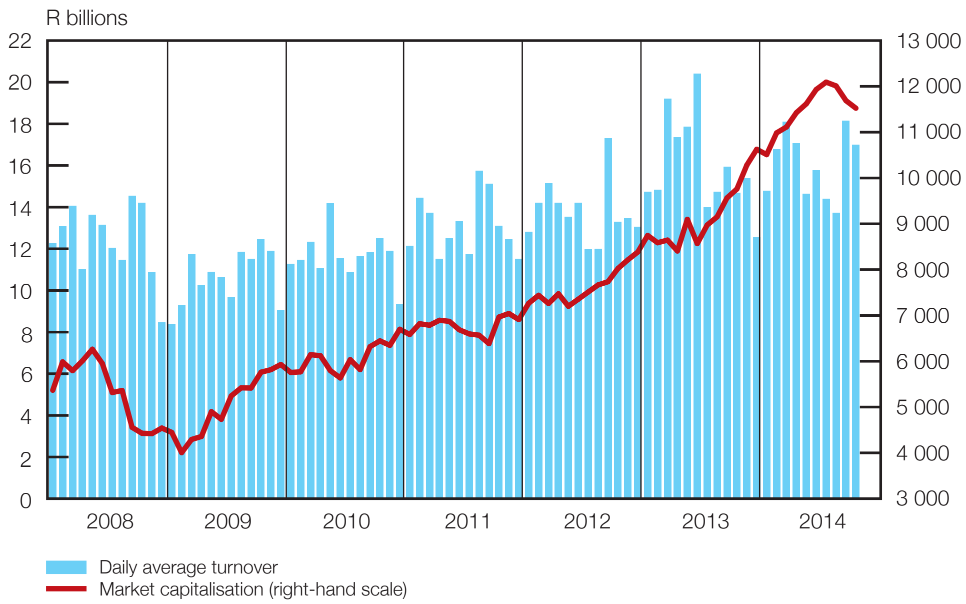
Equity funding on the JSE remains an important avenue through which listed companies obtain funds, as buoyancy in the capital-raising activity persisted in the ten months to October 2014. *Equity capital raised* by companies listed on the JSE in the domestic and international primary share markets amounted to R142 billion, which was more than double the amount raised in the corresponding period of 2013. Companies with primary listings on the JSE accounted for the bulk of the equity funding at 67 per cent of the total capital raised in the ten months to October 2014. The waiver of pre-emptive rights, where shares were issued for cash to the general market or specific investors for operational expansion purposes, continued to be the most favoured method of raising capital. The proceeds were mostly used for real-sector expansion through acquisitions. However, not all proceeds from the capital-raising activity reported by the JSE were utilised in South Africa.

Turnover in the secondary share market of the JSE, at a daily average of R16 billion in the ten months to October 2014, was 2 per cent lower when compared with the same period of 2013. This decline was registered alongside a reduction in the number of listings and lower volumes traded on the JSE. Boosted by record-high share prices, the *market capitalisation* of the JSE increased by 14 per cent from December 2013 to an all-time high of R12,1 trillion in July 2014, before subsiding to R11,5 trillion in October, along with some pullback in share prices.

Non-residents' interest in the local share market continued unabatedly in 2014, as reflected in their exchange-reported net purchases of R7,6 billion in the first quarter, rising to R8,7 billion in the second quarter and R11 billion in the third quarter. This contributed to cumulative net purchases of R33 billion in the first ten months of 2014, which surpassed the net purchases recorded in the corresponding period of 2013 by R14 billion. Non-residents demonstrated stronger participation in the domestic secondary share market in 2014 with an average participation rate[10] of 19 per cent, up from 16 per cent in the year 2013.

10 Measured as non-residents' purchases and sales as a percentage of the total value of shares traded on the JSE

Share turnover and market capitalisation



Domestic *share prices* came under some pressure from the end of July 2014, along with international share prices. For example, after increasing by 38 per cent from a recent low of 37 802 index points on 17 April 2013 to an all-time high of 52 242 index points on 29 July 2014, the FTSE/JSE All-Share Price Index (Alsi) declined by 11 per cent to a seven-month low of 46 673 index points on 15 October. This decline was a reflection of several factors, including:

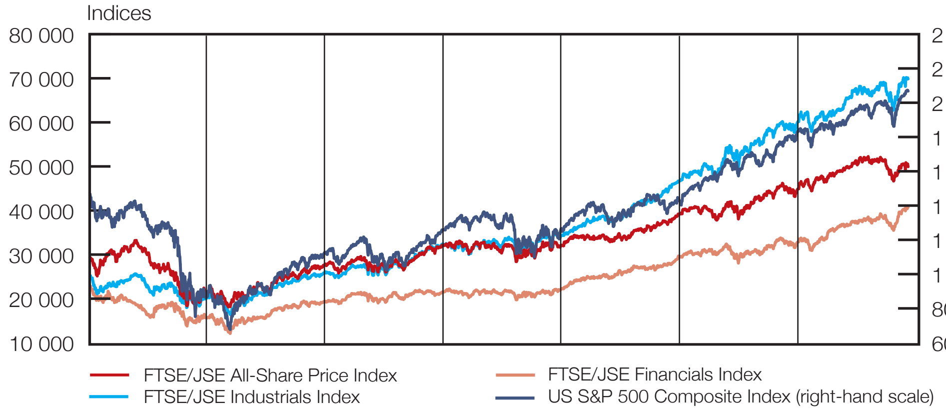
– concerns over weak global growth prospects as the IMF, for instance, revised expected global growth for 2014 downwards by 0,4 percentage points from the April 2014 baseline projection;
– uncertainties surrounding the monetary policy stance in the US, inducing financial market volatility; and
– weaker global commodity prices in the wake of somewhat slower and less commodity-intensive economic growth in China, the world's largest consumer of commodities.

Although the recent drop in domestic share prices was evident across all three major sectors, the resources sector recorded the biggest loss, consistent with lower commodity prices.

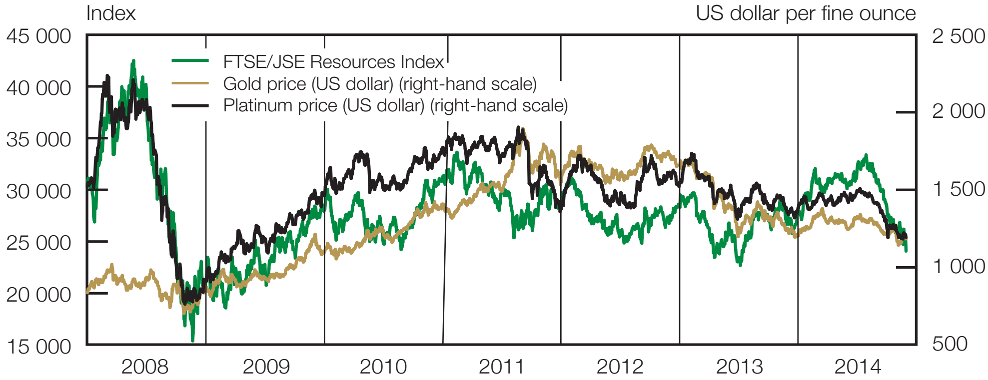
After mid-October 2014, in line with global equity markets, the Alsi increased by 7 per cent to 49 911 index points on 28 November.

The strong rise of 28 per cent in total earnings of companies listed on the JSE thus far in 2014 compressed the price-earnings ratio of all classes of shares from 20,2 in January 2014 to 16,6 in October – its lowest level since January 2013. Simultaneously, the dividend yield for JSE-listed companies increased from 2,1 per cent to 2,5 per cent, reflecting rising dividend payments.

Share prices in local currency



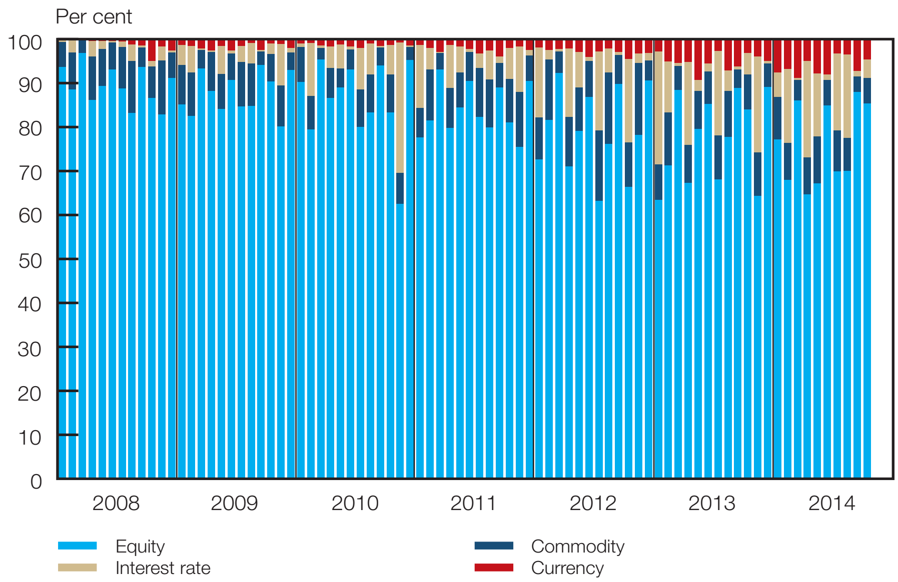
Commodity prices and the FTSE/JSE Resources Index



Market for exchange-traded derivatives

The volume of 202 million contracts traded in the *equity derivatives market* of the JSE thus far in 2014 was 15 per cent higher than in the corresponding period of 2013. This increase in the trading volume was further bolstered by an increase in the prices of the underlying shares, resulting in turnover growth of 18 per cent during this period. The equity derivatives market remained the largest derivatives market during 2014, accounting for the lion's share at 78 per cent of the total value traded in the derivatives markets during the first ten months of 2014.

Composition of derivatives turnover on the JSE



The number of *commodity futures and options contracts* traded on the commodity derivatives market of the JSE came to 2,3 million in the first ten months of 2014, virtually the same as in the corresponding period of 2013. Domestic grain prices were largely weighed down by lower international grain prices, which reflected the oversupply of grains emanating from record crop production during the 2014/15 marketing season. Further suppressed by lower international oil prices, the prices of local maize declined noticeably since reaching an all-time high on 11 March 2014.

Currency and interest rate derivatives activity on the JSE rose particularly strongly during the first ten months of 2014, as shown in the accompanying table. Furthermore, the JSE launched African currency futures contracts in October 2014. The listing of the Nigerian naira, the Kenyan shilling and the Zambian kwacha on the JSE came in as a pilot initiative aiming to afford investors, importers, exporters and travellers a hedging mechanism against adverse movements in the exchange rate. The new offerings are cash settled in South African rand.

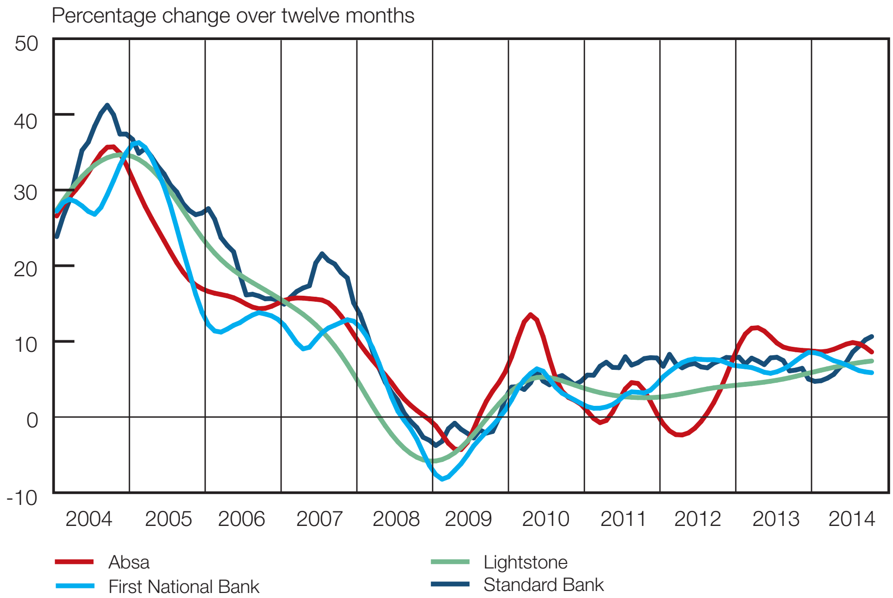
Derivatives turnover on the JSE, January to October 2014

Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity	4 857	18
Warrants	1	10
Commodity	415	2
Interest rate	510	25
Currency	410	46

Real-estate market

The year-on-year rate of increase in nominal house prices across the different barometers remained range-bound in recent months and ranged between 6 per cent and 11 per cent in October 2014, as depicted in the accompanying graph. Although tighter supply of new residential stock was a key driver, it was offset by increases in the repurchase rate, subdued income and employment growth, and relatively low consumer confidence. The average time that residential properties remained on the market declined over the past year to 11,6 weeks in the second quarter and 11,4 weeks in the third quarter of 2014.

Nominal house prices



An analysis by market segment indicates that the highest year-on-year rate of increase in residential property prices in the third quarter of 2014 was registered in the luxury market segment, followed by large middle-segment houses. It should, however, be noted that due to the relatively small size of the luxury market, price trends in this segment can be more volatile. By contrast, the year-on-year growth rate of house prices in the affordable as well as the medium-middle and small-middle segments was more subdued in the third quarter of 2014.

House price changes in different price classes

	Percentage change over four quarters		
	1st qr 2014	2nd qr 2014	3rd qr 2014
Affordable segment (40 m^2 to 79 m^2, below R545 000)	3,5	6,7	7,6
Middle segment (80 m^2 to 400 m^2, below R4 million)	8,7	9,3	9,6
Small (80 m^2 to 140 m^2, below R4 million)	5,6	10,8	7,4
Medium (141 m^2 to 220 m^2, below R4 million)	5,9	7,2	7,7
Large (221 m^2 to 400 m^2, below R4 million)	8,0	8,6	10,8
Luxury segment (between R4 million and R14,6 million)	6,4	4,7	10,9

Source: Absa

Non-bank financial intermediaries

11 Consisting of investment income, contributions and premiums received, and sales of unit trusts, adjusted using consumer price inflation

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

Real gross inflows[11] to non-bank financial institutions[12] increased by 18 per cent from the second quarter of 2014 to R605 billion in the third quarter, despite the subdued disposable income of households. Reflecting lacklustre economic activity, the real gross inflows to insurance companies and retirement funds increased by 8 per cent to R204 billion over the same period, following some moderation in pension and group life business premiums paid to insurance companies. By contrast, the real gross inflows to unit trusts increased by 24 per cent from the second quarter of 2014 to R402 billion in the third quarter. The activity in this industry was buoyed by gross inflows to both money- and non-money-market funds as investors balanced risk and return considerations.

Non-bank financial intermediaries' financial flows

Gross inflows expressed as a percentage of gross domestic product remained in high territory, increasing from 58 per cent in the second quarter of 2014 to 67 per cent in the third quarter. The gross inflows to these institutions in the third quarter of 2014 were supplemented by investment income which registered an adjusted-inflation increase of 22 per cent from the second quarter of 2014 to the third quarter.

The real gross outflows[13] recorded by these institutions increased sharply by 26 per cent from the second quarter of 2014 to R564 billion in the third quarter, representing an increase of 47 per cent from the third quarter of 2013. Gross outflows were particularly pronounced in the unit trust industry, which registered a real increase of 34 per cent to R406 billion over the same period, as investors reduced exposure to money-market funds following increased risk aversion. Benefits paid by retirement funds to members remained elevated in the second and third quarters of 2014, amid a continued increase in the withdrawal of pension benefits by members at resignation. Claims and surrenders paid by the insurance sector increased by 6 per cent from the second quarter of 2014 to the third quarter.

13 Consisting of benefits and claims paid, surrenders, repurchases of unit trusts and administrative expenses, adjusted for consumer price inflation

Net real inflows,[14] a proxy for funds available for investment, fell from R64 billion in the second quarter of 2014 to R41 billion in the third quarter. Net real inflows to these institutions in the first three quarters of the year were 32 per cent lower than those received over the same period in 2013.

14 Measured as the difference between real gross inflows and outflows

The total assets of these intermediaries remained broadly unchanged at R6,6 trillion in both the second and the third quarters of 2014. The share and cash portions both declined by 1 percentage point over the same period to 53 per cent and 12 per cent of total assets respectively, while exposure to fixed-interest securities increased by 1 percentage point to account for 24 per cent of total assets.

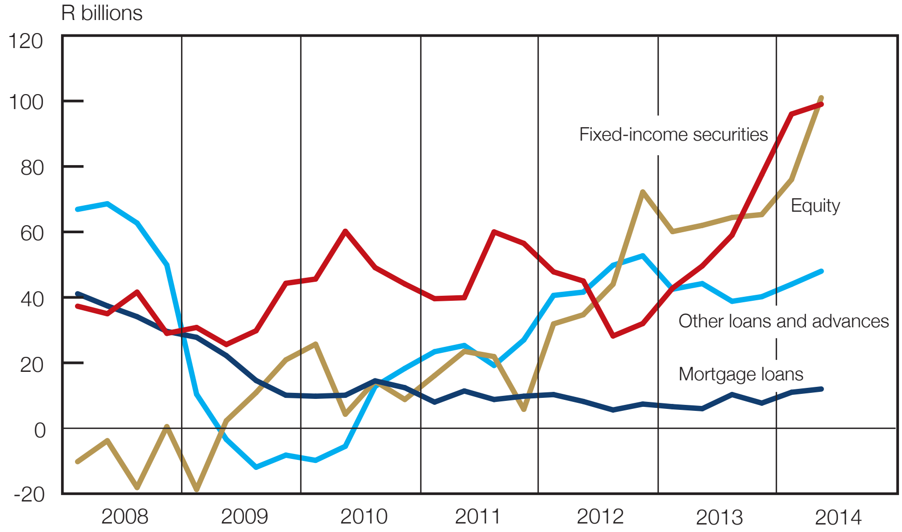
The Financial Services Board released a guidance note for the creation of a side-pocket portfolio for African Bank Investments Limited debt paper in August 2014. Accordingly, the portfolio is closed for new investors and will remain open for existing investors at the time of its creation. Redemptions will be suspended until the assets are liquid or in a position to be traded.

Flow of funds

Notwithstanding the elevated level of volatility in financial markets, especially in the foreign-exchange market, the downgrade of domestic foreign debt by credit rating agencies and the negative economic growth outlook, inflows from the *non-resident sector* into the domestic economy continued in the second quarter of 2014. Over this period, non-residents acquired net financial assets worth R17 billion in the domestic economy, led by favourable interest-rate differentials, the weaker exchange value of the rand and appetite to benefit from the surge in share prices, among other things. A large part of the inflows went into deposits, equity acquisition and long-term loans. Cumulatively, the non-resident sector's net acquisition of financial assets exceeded its net incurrence of financial liabilities over the years, as the rest of the world maintained a net lending position to the domestic economy.

The *financial intermediaries sector's* distribution of investment funds across the main asset classes continued to favour fixed-interest securities and equity in the second quarter of 2014. Having sourced most of its funds in deposits and interest in retirement and life funds, financial intermediaries invested R136 billion in equities, R93 billion in fixed-interest securities, R14 billion in other loans and advances, and R13 billion in mortgage loans. The delicate economic outlook and business confidence level kept the demand and supply conditions for loans and advances as well as mortgage loans relatively constrained, along with the low income levels of households. By contrast, the government sector's borrowing needs remained high and return on debt securities relatively encouraging, providing investors with a fairly attractive investment alternative. Similarly, return on equity remained favourable. The fixed-interest and equity asset flows jointly represented more than 90 per cent of total financial intermediaries' asset flows in the second quarter of 2014, while the total loans and advances' share was 11 per cent.

Financial intermediaries' asset portfolio (4-quarter moving average)

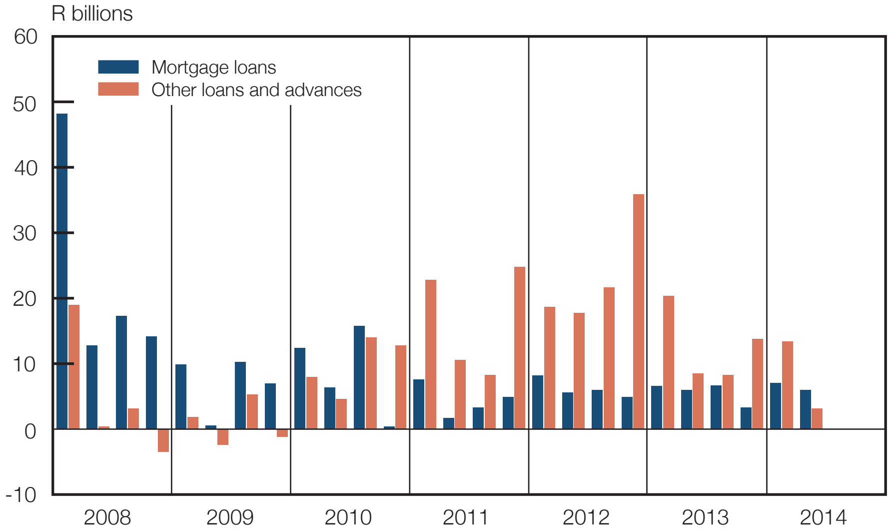


With spending commitments running higher than the revenue collection during the second quarter of 2014, the *general government sector* augmented the available funds through the issuance of paper. The main contributors to the higher spending level were transfers to the social services cluster to defray the increased cost of social grants, the improvement of basic education, and the provision of financial support to higher education institutions. The general government sector also incurred capital outlays on water treatment and supply facilities, health-care facilities and the construction of electrical substations, among other projects. This sector met the financing shortfall mainly by raising funds in the domestic financial markets – a total of R42 billion was sourced through long-term government bond issuances and R10 billion from Treasury bills. Local governments issued debt securities of R1,5 billion, with the Ekurhuleni Metropolitan Municipality returning to the market and the City of Johannesburg Metropolitan Municipality continuing to issue paper during the period under review. Furthermore, general government drew down on its cash holdings for funding purposes.

Accompanied by a rally in domestic share prices and record capital-raising activity in the second quarter of 2014, the *non-financial corporate business enterprises sector* generated R128 billion from equity sales. This sector also raised funds by incurring R28 billion in bank loans and advances, as well as R18 billion in long-term loans, and reduced its cash holdings by R26 billion as it sought to finance a deficit of R39 billion. Business enterprises increased their investment in capital projects during the second quarter of 2014, with private business enterprises spending R124 billion and public business enterprises R39 billion. Capital-expansion activity by public non-financial corporates was largely concentrated in the electricity and transport industries; it was more widespread for the private non-financial corporates.

Along with its financing surplus of R9,5 billion in the second quarter of 2014, the *household sector* increased its deposit holdings by R23 billion and interest in retirement and life funds by R16 billion. The sector's incurrence of loans moderated to R18 billion due to borrowing uneasiness stemming from high indebtedness and a fragile household income outlook. Households' mortgage borrowing amounted to R6,0 billion during the period under review.

Households' borrowing



Public finance[15]

15 Unless stated otherwise, year-on-year rates of increase compare fiscal 2014/15 to fiscal 2013/14.

16 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.

Non-financial public-sector borrowing requirement[16]

In the first six months of fiscal 2014/15, the non-financial public-sector borrowing requirement amounted to R106,2 billion, some R2,4 billion higher than in April–September 2013. The widening of the non-financial public-sector borrowing requirement resulted from cash deficits recorded by national and local governments. By contrast, social security funds, extra-budgetary institutions and provincial governments recorded higher cash surpluses. The deficit of the non-financial public enterprises and corporations narrowed during the period under review.

Non-financial public-sector borrowing requirement

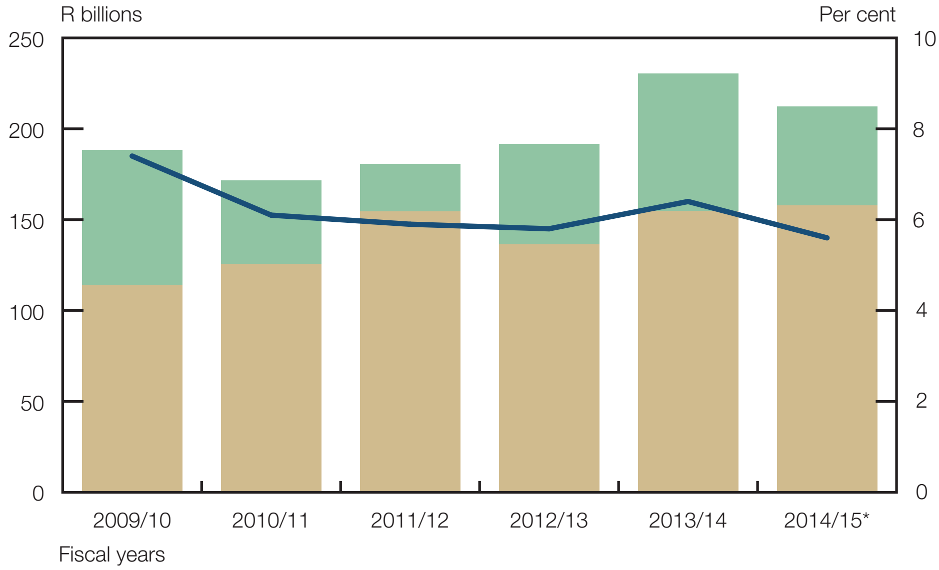
R billions

Level of government	Apr–Sep 2013*	Apr–Sep 2014*
Consolidated general government	69,4	78,9
National government	94,1	108,3
Extra-budgetary institutions	-4,1	-5,8
Social security funds	-7,9	-20,6
Provincial governments	-10,9	-11,9
Local governments	-1,8	8,9
Non-financial public enterprises and corporations	34,4	27,3
Total**	103,9**	106,2**
As percentage of gross domestic product	*5,8*	*5,6*

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

As a percentage of gross domestic product, the non-financial public-sector borrowing requirement amounted to 5,6 per cent in the first six months of fiscal 2014/15, slightly lower than the ratio of 5,8 per cent recorded in the same period a year earlier.

Non-financial public-sector borrowing requirement

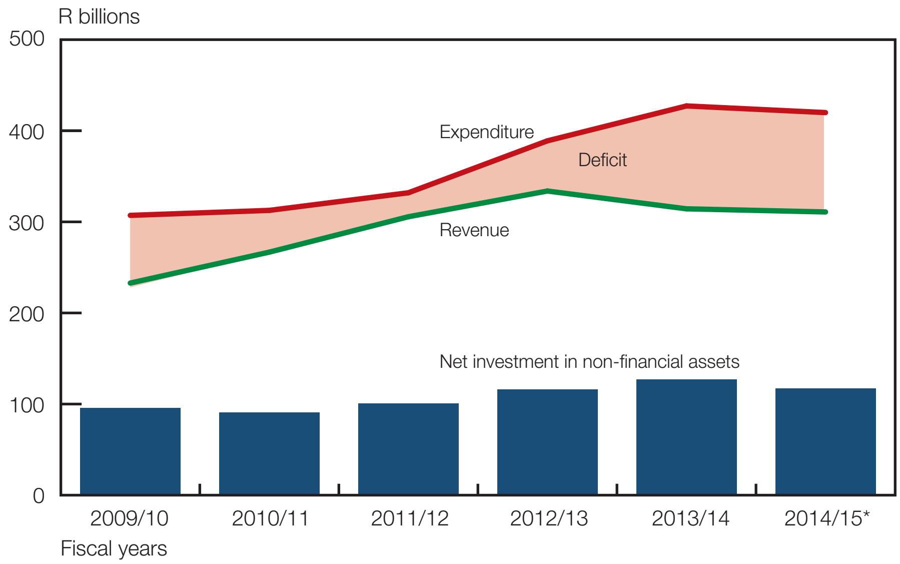


* April–September 2014, annualised

In April–September 2014, the borrowing requirement of the consolidated general government amounted to R78,9 billion, or R9,5 billion more than in the same period a year earlier. At the same time, the non-financial public enterprises and corporations recorded a preliminary cash deficit of R27,3 billion – some R7,1 billion lower when compared with the cash deficit recorded in the same period a year earlier. The narrowing of the cash deficit was on account of growth in total receipts, which outpaced growth in total expenditure. However, as large capital expenditure programmes continued, total expenditure continued to exceed total receipts by a significant margin, leading to some state-owned companies seeking recapitalisation or other forms of support from the state; these included Eskom, South African Airways and the South African Post Office. Eskom quantified its multi-year funding shortfall as R225 billion, whereas the Post Office was plagued by strikes and financial deficits.

Net investment in non-financial assets by non-financial public enterprises and corporations amounted to R58,5 billion in the first two quarters of fiscal 2014/15. This was R5,5 billion more than the amount recorded in the same period a year ago. State-owned companies continued to play an integral role in attaining government's economic and social mandate. The 2014 *Medium Term Budget Policy Statement* (MTBPS) signalled government's continued support towards achieving a sustainable expansion of public infrastructure spending. Over the medium term, financial support from the fiscus provided to state-owned companies would depend on their sound business plans and strong internal governance. However, state-owned companies would also need to borrow externally on the strength of their own balance sheets.

Finances of non-financial public enterprises and corporations



* April–September 2014, annualised

An analysis of *national government* finance statistics indicates that cash receipts from operating activities totalled R462 billion in the first half of fiscal 2014/15, some 8,6 per cent more than in April–September 2013. The increase in cash receipts resulted mainly from robust collections in taxes on income, profits and capital gains, and taxes on property.

In the first six months of the current fiscal year, national government cash payments for operating activities amounted to R566 billion, recording an increase of 9,7 per cent year on year. Higher cash payments were primarily driven by grants to other levels of government, which registered a year-on-year rate of increase of 9,8 per cent. Provincial governments received 69,3 per cent of these grants in the form of equitable share transfers and conditional grants. Net cash flow from operating activities, together with net investment in non-financial assets, resulted in a cash deficit of R108 billion in the first six months of fiscal 2014/15. This cash deficit was R14 billion more than the cash deficit recorded in the same period a year earlier.

In the first two quarters of fiscal 2014/15, provincial governments' financial activities resulted in a cash surplus of R11,9 billion. This surplus was R1,0 billion higher than the cash surplus recorded in April–September 2013. The *Budget Review 2014* projected that this level of government would record a cash surplus of R3,0 billion for the fiscal year as a whole.

Provincial governments' total cash receipts amounted to R232 billion in the first two quarters of fiscal 2014/15, representing a year-on-year rate of increase of 8,6 per cent. Grants from national government remained the main source of provincial governments' cash receipts – 97 per cent of the total – and included equitable share transfers and conditional grants earmarked for specific purposes.

In the period under review, total expenditure (cash payments for operating activities, together with net investment in non-financial assets) amounted to R220 billion, or 8,6 per cent more than in the same period of the previous fiscal year. Provincial governments' compensation of employees was the key driver of expenditure; it increased by 7,5 per cent in the first two quarters of fiscal 2014/15. Personnel spending in the health and education sectors accounted for a combined sum of 87 per cent of total personnel expenditure in the first two quarters of fiscal 2014/15.

Provincial governments' cash deposits with the Corporation for Public Deposits increased from R13,1 billion at the end of March 2014 to R24,6 billion at the end of September. At the same time, their deposits with private banks increased from R10,5 billion to R15,5 billion, while their overall indebtedness to banks decreased from R1,8 billion to R0,8 billion over the same period.

Although *local government* recorded a cash *surplus* of R3,9 billion during the July–September quarter of fiscal 2014/15, it nevertheless resulted in a cumulative cash *deficit* of R8,9 billion in the first two quarters of 2014/15, in contrast to the cash *surplus* of R1,8 billion recorded in April–September 2013. The increase in total expenditure far outpaced the increase in total revenue, resulting in a turnaround in the financial results of municipalities.

Local governments' cash receipts amounted to R144 billion in the first two quarters of fiscal 2014/15, some 6,5 per cent higher than in the same period of the previous fiscal year. Municipal own revenue continued to increase, amounting to R111 billion, with revenue from electricity being the main driver of this component. The higher revenue from electricity resulted from tariff increases implemented by most metropolitan cities from 1 July 2014. Municipalities received inter-governmental transfers from provincial and national governments amounting to R32,8 billion, of which R3,4 billion was received as part of the general fuel levy sharing with metropolitan municipalities.

Total expenditure by local government rose strongly and amounted to R153 billion in April–September of fiscal 2014/15 – some R20 billion more than in the same period a year earlier. This growth was on account of a robust increase in the purchases of goods and services by municipalities, which were mainly driven by bulk purchases of electricity and water. Net investment in non-financial assets continued to rise, recording an increase of 11,9 per cent year on year to amount to R28 billion over this period.

The *municipal human settlements capacity grant* was introduced in fiscal 2014/15, in line with the recommendation of the National Development Plan to shift the responsibility for housing from national government to the municipal level. Large metropolitan authorities continued to invest heavily in integrated public transport. The cities of Cape Town and Johannesburg began operating station depots, buses and dedicated bus lanes. Similar infrastructure projects are underway in the City of Tshwane, Mbombela, Nelson Mandela Bay, eThekwini, Rustenburg and George.

Extra-budgetary institutions recorded a preliminary cash surplus of R3,0 billion in the second quarter of fiscal 2014/15, bringing their combined cash surplus to R5,8 billion in the first half of the current fiscal year.

In September 2014, the national cabinet approved the conversion of the Property Management Trading Entity (PMTE), which constitutes approximately 75 per cent of the work and budget of the Department of Public Works, to a so-called 'Government Component' that reports directly to the Minister of Public Works and with greater flexibility in human resources matters. This action was the result of a series of negative audits over the past eight years highlighting numerous irregularities, as well as maintenance and underutilisation issues related to property owned or leased by government. While devoted to managing the property portfolio of government, ensuring the optimal use of government property, and limiting irregular and wasteful expenditure, one of the biggest challenges facing this institution was the completion of a comprehensive immovable assets register for government.

Preliminary estimates indicate that the cash surplus of *social security funds* increased significantly in the first two quarters of fiscal 2014/15. These funds recorded a cash surplus of R20,6 billion for the period under review, compared with R7,9 billion recorded in the first two quarters of fiscal 2013/14. The higher cash surplus could be attributed to an increase in social contributions.

Box 4 Social security funds

Social security funds are autonomous funds that manage and operate social security schemes. They hold their assets and liabilities separately and engage in financial transactions on their own account. Contributory social insurance funds form part of South Africa's broad social security net. Government manages these social insurance funds that pay benefits under specific circumstances; for this reason they are regarded as a subsector of central government. The four funds that constitute this subsector in South Africa are the Unemployment Insurance Fund (UIF), the Road Accident Fund (RAF), the Compensation Fund and the Compensation Commissioner for Occupational Diseases in Mines and Works.

The UIF's main function is to contribute to poverty alleviation by providing short-term unemployment insurance to all workers who qualify for unemployment-related benefits. The fund is financed by a dedicated tax on the wage bill.

The purpose of the RAF is to provide compensation for loss of earnings and support, general damage, and medical and funeral costs to victims of road accidents caused by negligent or wrongful driving of another vehicle. The RAF's primary source of revenue is a levy raised on petrol and diesel sold in South Africa that forms part of the general fuel tax regulated by government. The fuel levy per litre is set by National Treasury on an annual basis.

The Compensation Fund's main function is to provide compensation for disability, illness and death resulting from occupational injuries and diseases. The fund's main source of revenue is levies paid by employers on the basis of a fixed percentage of the annual earnings of their employees.

The main function of the Compensation Commissioner for Occupational Diseases in Mines and Works is to compensate and award benefits to miners and ex-miners suffering from occupational lung-related diseases. The fund's main source of revenue is levies collected from 249 registered mines. Levies are based on the number of hours worked by the miners multiplied by a rate which varies according to the minerals mined.

In this *Quarterly Bulletin,* the consolidated balance sheet of the social security funds is published for the first time. Included in the liabilities are provisions for outstanding claims of the UIF and the RAF. In the accounts of the RAF, a revaluation adjustment to the provisions for outstanding claims is made at the end of each fiscal year by the Auditor General in terms of claims incurred but not reported to the RAF.

Most of the financial assets of the social security funds are managed by the Public Investment Corporation (PIC), which is a public-sector financial intermediary that invests the funds placed with it in instruments such as government fixed-interest securities on behalf of the social security funds.

South Africa faces high levels of inequality and unemployment, and seeks to improve both its social security system and the effectiveness of labour market institutions. Job creation must be complemented by a well-designed social insurance framework as protection against both unemployment and income vulnerability. In this regard, the social security funds play a significant role.

Budget comparable analysis of national government finance

National government expenditure totalled R551 billion in the first half of fiscal 2014/15, representing a year-on-year rate of increase of 9,2 per cent when compared with the first two quarters of the previous fiscal year. Spending by national government was originally budgeted to increase by 9,0 per cent to total R1 139 billion for the full fiscal year. However, this was revised downwards by R6,3 billion in the 2014 MTBPS. As a ratio of gross domestic product, national government expenditure amounted to 29,0 per cent in April–September 2014, compared with 28,4 per cent recorded in the same period of the previous fiscal year.

The higher government spending by item was also reasonably aligned with the initially budgeted increases, as shown in the accompanying table. Payments for capital assets recorded the strongest increase while current payments increased at the slowest pace in the first two quarters of the current fiscal year.

National government expenditure in fiscal 2014/15

Expenditure item	Originally budgeted: Full 2014/15		Actual Apr–Sep 2014	
	R billions	Percentage change*	R billions	Percentage change*
Voted amounts	631,8	9,0	301,4	9,2
Current payments	*181,0*	*6,2*	*84,0*	*6,0*
Transfers and subsidies	*433,1*	*9,6*	*212,8*	*10,3*
Payments for capital assets	*17,7*	*26,1*	*4,6*	*21,4*
Statutory amounts**	507,2	9,1	249,4	9,2
Of which: *Interest on debt*	*114,8*	*13,6*	*56,5*	*15,0*
Total expenditure	1 139,0	9,0	550,8	9,2

* Fiscal 2013/14 to fiscal 2014/15
** Including extraordinary payments

Current payments recorded a year-on-year rate of increase of 6,0 per cent during the six-month period under review due to higher payments by the Departments of Defence and Military Veterans, and Police. Of current payments, the latter department's contribution amounted to 39,5 per cent.

Transfers and subsidies increased by a slightly higher percentage than the budgeted projections for the full fiscal year. Higher transfers and subsidies stemmed mainly from an increase in spending by the Social Services cluster. This cluster includes departments responsible for education, health and social services, and it accounted for 54,8 per cent of total transfers and subsidies. Higher spending by the Department of Social Development was to cater for the rise in the number of grant beneficiaries, apart from the annual inflation-related increases in grant amounts. The *child support* and *old age grants* are the two largest grant allocations, constituting about 75 per cent of total grant spending.

Further transfers and subsidies flowed from the Department of Transport to provinces through the provincial road maintenance grant and to the South African National Roads Agency Limited (SANRAL) for non-toll and coal haulage networks. The local government equitable share of R17,4 billion paid by the Department of Cooperative Governance and Traditional Affairs also contributed to the rise in transfers and subsidies.

During the first two quarters of the current fiscal year, equitable share transfers to provinces amounted to R181 billion – some 7,4 per cent more than in the corresponding period a year earlier. According to the *Budget Review 2014,* equitable share transfers to provinces were expected to amount to R362 billion in fiscal 2014/15. This spending category was revised slightly down to R360 billion in the 2014 MTBPS. Interest paid on national government debt reached R56,5 billion in the first half of fiscal 2014/15, some 15,0 per cent more than in

April–September 2013. Higher interest payments emanated from increasing debt levels in order to finance the budget deficit. The *Budget Review 2014* projected that spending in this category would increase by 13,6 per cent to total R115 billion in fiscal 2014/15; it was kept broadly unchanged in the 2014 MTBPS.

In the February 2014 Budget, provision was made for R10,2 billion to be paid from the National Revenue Fund to metropolitan municipalities as their share of the general fuel levy. This spending item totalled R3,4 billion in the first two quarters of fiscal 2014/15.

National government's cash-flow expenditure amounted to R542 billion in April–September 2014, after taking into account cash-flow adjustments.[17] This represented a very low year-on-year rate of increase of 1,6 per cent, caused by a high base set in 2013/14 when some expenditures flowed over from the preceding fiscal year due to the 2012/13 fiscal year-end falling over a weekend.

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

In the first six months of fiscal 2014/15, national government revenue increased by 7,3 per cent year on year, amounting to R433 billion. This increase in revenue fell below the yearly budgeted increase of 9,3 per cent projected in the *Budget Review 2014*. Relative to gross domestic product, national government revenue amounted to 22,8 per cent in the first six months of fiscal 2014/15 – broadly the same as the ratio of 22,7 per cent recorded in the same period a year earlier. National government revenue was initially expected to total R963 billion in fiscal 2014/15, but was revised downwards by R6,2 billion in the 2014 MTBPS on account of more subdued economic growth.

National government revenue in fiscal 2014/15

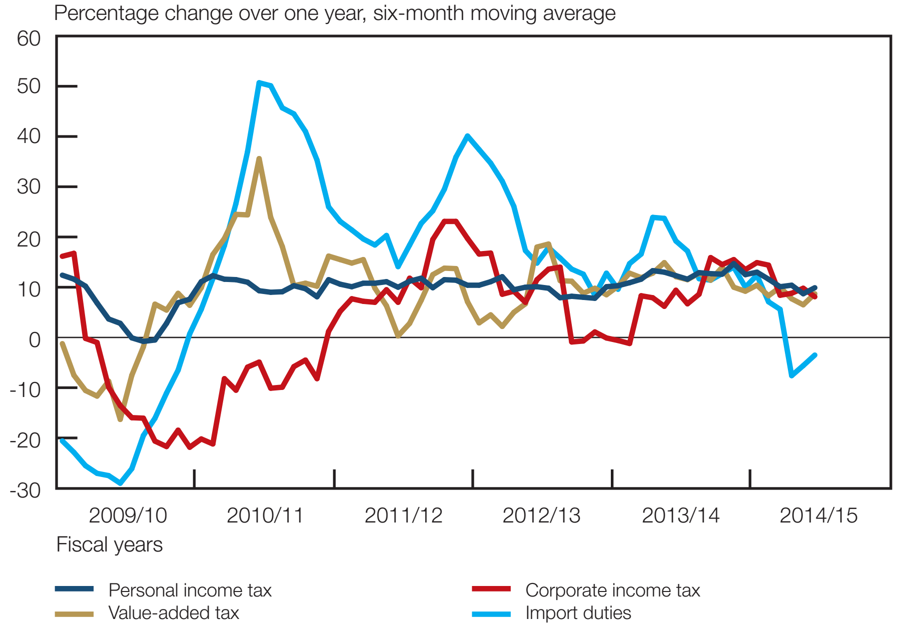
Revenue source	Originally budgeted: Full 2014/15		Actual Apr–Sep 2014	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	557,0	9,7	255,7	9,7
Income tax on individuals	*335,9*	*8,0*	*157,8*	*9,9*
Income tax on companies	*198,9*	*10,8*	*88,3*	*8,1*
Payroll taxes	13,4	7,7	6,4	8,0
Taxes on property	11,5	9,4	6,0	15,8
Taxes on goods and services	361,2	11,3	160,0	8,2
Value-added tax (VAT)	*267,2*	*12,4*	*117,3*	*8,7*
Domestic VAT	*290,9*	*10,4*	*140,3*	*10,1*
Import VAT	*151,7*	*15,7*	*58,9*	*1,2*
Taxes on international trade and transactions	50,5	12,8	18,4	-3,2
Import duties	*50,3*	*13,9*	*18,1*	*-3,5*
Other revenue**	21,0	-12,7	12,0	-13,5
Less: SACU*** payments	51,7	19,3	25,9	19,3
Total revenue	962,8	9,3	432,6	7,3

* Fiscal 2013/14 to fiscal 2014/15
** Including extraordinary receipts
*** Southern African Customs Union

In most major tax categories, national government revenue increased by more than inflation, but collections were dragged lower by a year-on-year contraction in taxes on international trade and transactions, and non-tax revenue in April–September 2014.

Taxes on income, profits and capital gains were boosted by firm collections from personal income tax and withholding tax on dividends with a slightly slower increase in corporate income tax. While the latter tax category increased year on year, the growth rate fell below budgeted projections for the year due to lower-than-expected provisional payments from the mining and trade sectors. These lower provisional payments countered the effect of higher total provisional payments and a saving on refunds. Personal income tax revenue increased due to higher pay-as-you-earn collections on bonus payments, alongside above-inflation salary increases. The substantial increase in collections from withholding tax on dividends could be attributed to some companies managing their rising cash reserves by returning these profits to shareholders through dividend payouts.

National government revenue



Proceeds from taxes on property were boosted by a significant increase in transfer duties collected, whereas securities transfer tax recorded a marginal increase. Higher collections from transfer duties mirrored the improvement in economic activity in the real-estate market and the house price inflation, which gradually increased the proportion of property transaction values subject to such duties in the absence of bracket adjustments.

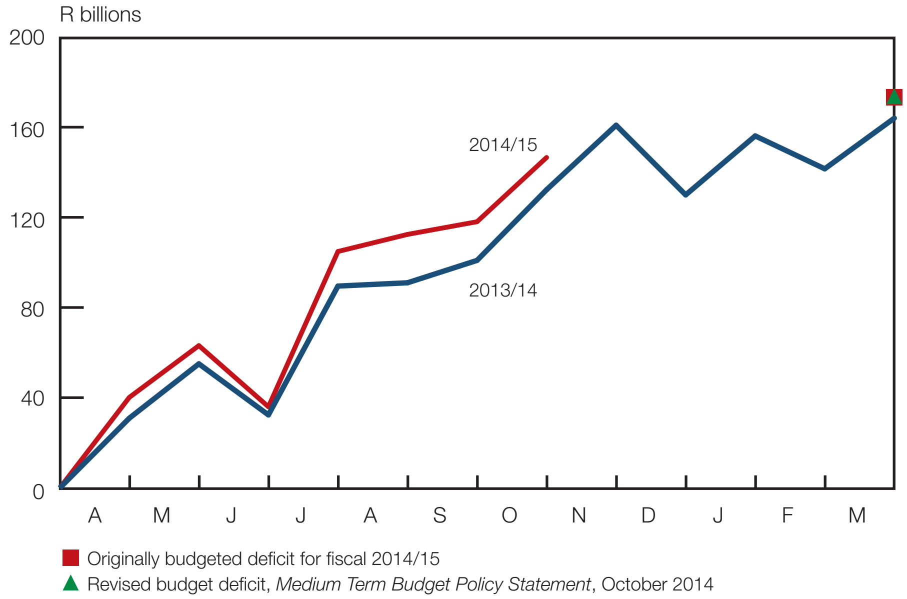
The increase in taxes on goods and services in April–September 2014 fell below the budgeted increase for the full fiscal year; nevertheless, the collections of value-added tax (VAT) and other excise duties rose by more than the contemporaneous rate of inflation. Domestic VAT was boosted by growth from the finance, wholesale and retail trade as well as the manufacturing sectors. Import VAT, however, increased very little and fell far below the yearly budgeted projections, owing mainly to a contraction in the imports of machinery, electrical machinery and vehicles.

In April–September 2014, taxes on international trade and transactions declined when compared with the first six months of the preceding fiscal year. Poor collections from this tax category resulted from a contraction in the importation of especially vehicles.

Cash-flow adjusted national government revenue amounted to R435 billion in the first six months of fiscal 2014/15, or 7,3 per cent more than in April–September 2013.

Netting national government revenue and expenditure resulted in a cash-book deficit of R118 billion in the first six months of fiscal 2014/15. This cash-book deficit was R17,2 billion more than the cash-book deficit recorded in the first six months of the previous fiscal year. Growth in national government expenditure outpaced the increase in revenue, resulting in the widening of the cash-book deficit. The *Budget Review 2014* projected that the cash-book deficit would amount to R176 billion for fiscal 2014/15 as a whole; the deficit was kept broadly unchanged in the 2014 MTBPS. As a ratio of gross domestic product, the cash-book deficit amounted to 6,2 per cent in the first six months of fiscal 2014/15 compared with a deficit ratio of 5,7 per cent recorded in the same period a year earlier.

Cumulative deficit of national government



The primary balance[18] reached a deficit of R61,6 billion in April–September 2014, or 3,2 per cent of gross domestic product. This can be measured against a primary deficit of R51,8 billion, or 2,9 per cent of gross domestic product, recorded in the corresponding period of the previous fiscal year. The primary balance is a useful indicator of current fiscal effort, since interest payments are predetermined by the size of previous deficits.

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

During the first six months of fiscal 2014/15, the cash-flow deficit of national government amounted to R107 billion – some R21 billion less than the cash-flow deficit recorded in the first six months of fiscal 2013/14. There was a considerable difference of about R11 billion between the cash-book deficit and the cash-flow deficit in the first six months of fiscal 2014/15, which stemmed from outstanding transfers of approximately R16 billion. The net borrowing requirement of national government decreased by R21 billion to R112 billion in the first two quarters of fiscal 2014/15. This was substantially lower than the borrowing requirement of R133 billion recorded in the same period a year earlier.

National government financing in fiscal 2014/15

R billions

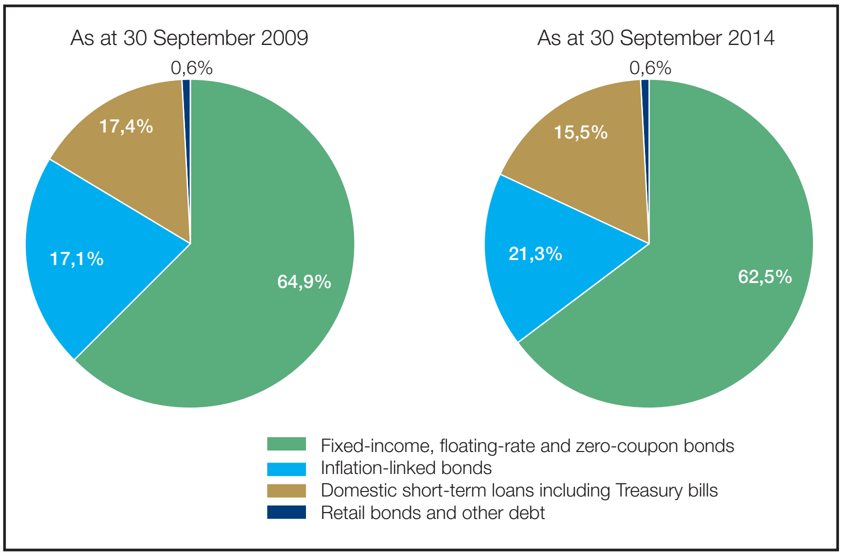
Item or instrument	Originally budgeted: Full 2014/15[1]	Actual Apr–Sep 2014	Actual Apr–Sep 2013
Deficit[2]	176,2	106,8[3]	128,1[3]
Plus: Cost/profit on revaluation of foreign debt at redemption[4]	5,9	4,8	4,9
Net borrowing requirement	182,1	111,6	133,0
Treasury bills	23,0	28,8	6,0
Domestic government bonds	128,5	62,1	80,6
Foreign bonds and loans	7,2	15,1	7,5
Change in available cash balances[5]	23,4	5,6	39,0
Total net financing[6]	182,1	111,6	133,0

1 *Budget Review 2014*
2 Including extraordinary receipts and payments
3 Cash-flow deficit
4 Cost + profit –
5 Increase – decrease +
6 Components may not add up to totals due to rounding

Higher issuance of domestic government bonds and Treasury bills, together with foreign bonds and loans, enabled government to finance the net borrowing requirement. Given South Africa's deep and liquid capital market, appetite for domestic debt instruments remained satisfactory. In the first six months of fiscal 2014/15, national government raised R34,7 billion from inflation-linked bonds. Since their inception in March 2000, the outstanding balance on inflation-linked bonds amounted to R333 billion at the end of September 2014. Net redemptions worth R0,3 billion were recorded in RSA Government Retail Savings Bonds in the first half of the current fiscal year. Redemptions of these instruments have surpassed the issuance thereof since August 2012, largely due to scheduled redemptions of such bonds.

Composition of domestic debt of national government

Per cent



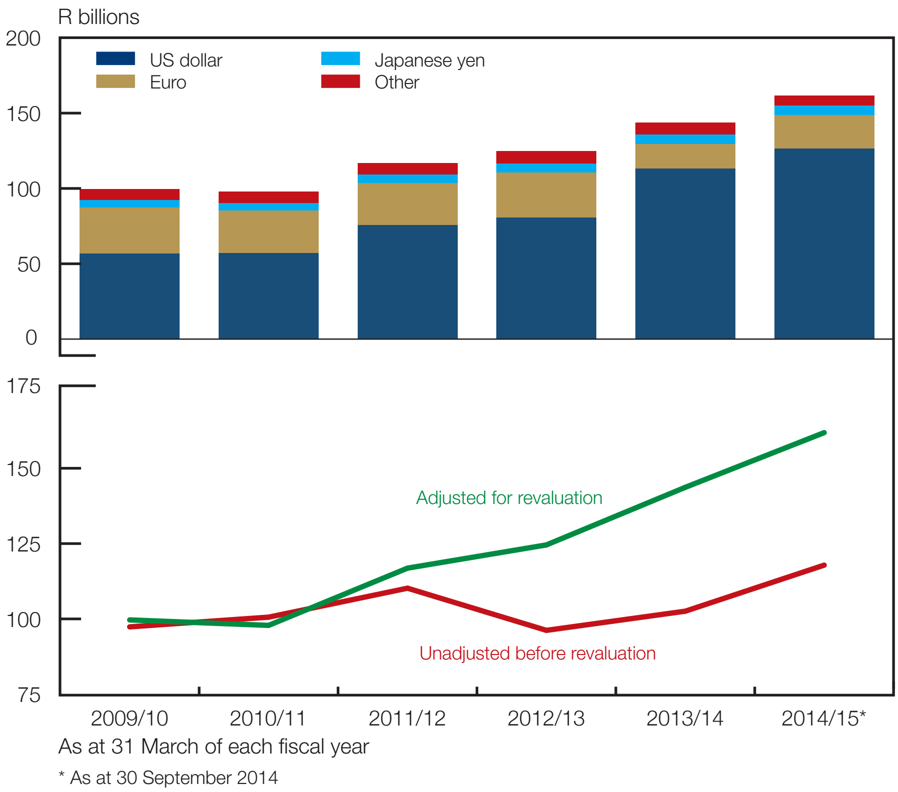
Treasury bills were issued at an average interest rate of 6,3 per cent in the first half of fiscal 2014/15, whereas long-term debt instruments were sold at an average interest rate of 8,3 per cent per annum. The average remaining maturity of national government's domestic marketable bonds increased from 154 months as at 31 March 2014 to 161 months at the end of September.

Government continued to participate in the global capital markets in order to diversify funding instruments. Net issues worth R15,1 billion were recorded in foreign bonds and loans in the first half of fiscal 2014/15. Higher foreign debt also stemmed from the debut issuance amounting to US$500 million of the new Sukuk (Islamic) bond. The decision to issue an Islamic bond was informed by a drive to broaden the investor base and to set a benchmark for state-owned companies seeking diversified sources of funding for infrastructure development. Between March and September 2014, the average outstanding maturity of national government's foreign marketable bonds lengthened from 95 months to 119 months. This increase in maturity emanated from the issuance of the new bond along with higher foreign debt valued at prevailing exchange rates, arising from the depreciation of the rand against major currencies.

National government's available cash balances declined by R5,6 billion in the first six months of fiscal 2014/15, bringing these balances to R201 billion as at 30 September 2014. Deposits with the Bank amounted to R166 billion as at 30 September 2014.

The largest share of government's debt portfolio consisted of domestic government bonds and Treasury bills. The domestic debt of national government increased markedly from R1 441 billion to R1 563 billion between March and September 2014, reflecting the higher issuance of domestic debt instruments.

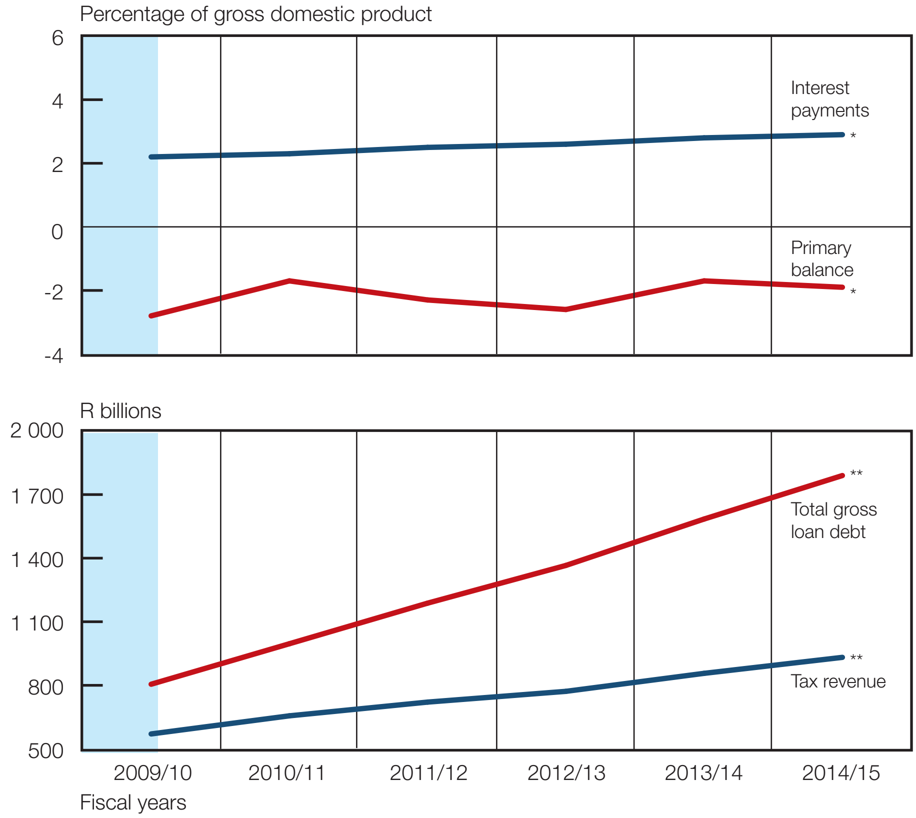
National government foreign debt



Foreign debt of national government increased from R144 billion as at 31 March 2014 to R162 billion as at 30 September 2014. The rise in foreign debt stemmed from both the issuance of new bonds and revaluation effects as the weaker exchange rate of the rand lifted the rand value of debt commitments denominated in foreign currency.

Total gross loan debt of national government, comprising domestic and foreign debt, increased from R1 585 billion to R1 725 billion between March and September 2014. Relative to gross domestic product, gross loan debt rose from 43,9 per cent to 46,2 per cent during the period under review. The *Budget Review 2014* envisaged that total gross loan debt would total R1 778 billion, or 48,2 per cent of gross domestic product at the end of fiscal 2014/15. With the level of nominal gross domestic product now more than 4 per cent higher on account of the national accounts benchmarking and rebasing exercise concluded in November 2014, the envisaged ratio of 48,2 per cent would have been restated as 46,1 per cent.

National government debt sustainability indicators



* April–September 2014
** *Medium Term Budget Policy Statement,* October 2014
Shaded area indicates downward phase of the business cycle

The 2014 *Medium Term Budget Policy Statement*

Fiscal policy stance

The 2014 *Medium Term Budget Policy Statement* (MTBPS) was tabled in Parliament by the Minister of Finance on 22 October and signalled a shift in fiscal policy: In response to a worsening debt outlook, government proposed a package of fiscal measures to re-establish a sustainable foundation for the public finances, and to build a platform for investment-led growth in the future. The series of measures proposed would narrow the deficit and stabilise debt over the medium term, and contained the following five elements:

– reducing growth in spending by lowering the 2014 Budget expenditure ceiling by R25 billion over the next two years;

– adjusting tax policy and administration to generate additional revenue of at least R27 billion over the next two years through proposals which would be introduced in the 2015 Budget;

– strengthening budget preparation by emphasising longer-term planning and efficient resource allocation within a fiscal framework that links aggregate expenditure and economic growth beyond the medium term;

– containing pressures on the compensation budget by freezing personnel headcounts over the next two years and reviewing funded vacancies; and

– lastly, adopting a deficit-neutral approach to financing state-owned companies over the next two years as government would ensure that any capitalisation required would not widen the budget deficit. Government would also explore private investment to strengthen the balance sheet of state-owned companies.

Fiscal projections

Percentage of gross domestic product

Component	2014/15		2015/16		2016/17		2017/18
	Feb*	Oct**	Feb*	Oct**	Feb*	Oct**	Oct**
National government							
Revenue	25,4	25,8	25,5	26,2	25,8	26,7	26,7
Expenditure	30,1	30,6	29,7	30,3	29,1	29,8	29,7
Budget deficit	-4,7	-4,8	-4,2	-4,1	-3,3	-3,2	-3,0
Gross loan debt	46,9	48,2	48,0	49,5	48,3	49,7	49,8
Net loan debt	41,9	42,8	43,5	44,6	44,3	45,4	45,9

* *Budget Review 2014*
** *Medium Term Budget Policy Statement,* October 2014

Government introduced the first five-year medium-term strategic framework (MTSF) for the period 2014–2019 to address the challenges of private-sector investment in the economy, and of the state's capacity to plan. The MTSF is a policy framework aligned to the *National Development Plan 2030 Vision*, aimed at improving policy coherence, alignment and co-ordination across government.

It was expected that two years of fiscal consolidation would put the public finances on a sustainable footing. However, restraining expenditure growth would not compromise essential services. All three spheres of government would need to continue identifying savings and improving the way they spend money, while protecting key social programmes. Budgets for non-essential goods and services would be frozen, resulting in substantial savings. Government would continue to roll out its capital investment programme and encourage private-sector participation in infrastructure delivery.

The main risks to the fiscal outlook were identified as the country's economic performance, the public-sector wage bill and the balance sheets of state-owned companies.

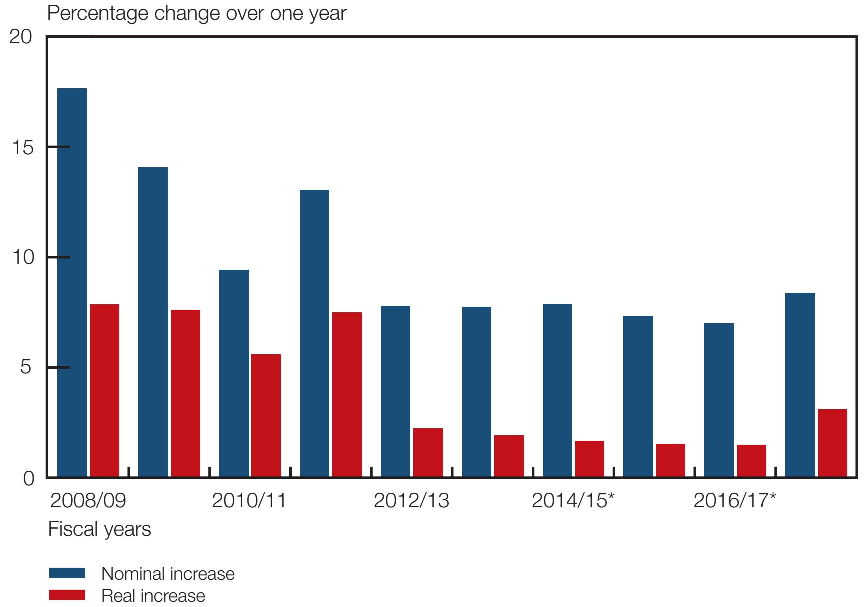
Real gross domestic product was projected to grow at 1,6 per cent in fiscal 2014/15 – much lower than the 2,9 per cent estimated in the February 2014 Budget. Short-term economic performance was affected by electricity and other infrastructure constraints, as well as low levels of business and consumer confidence along with low growth in employment and personal disposable income. In the next three years, economic growth was expected to improve to reach 3,0 per cent in 2017 as energy generation and transport infrastructure projects were completed alongside an expected recovery in export markets.

The MTBPS provided for consumer price inflation to recede from current levels and return within the target band in fiscal 2015/16. A favourable impact was expected from a moderation in global oil prices and the normalisation of electricity supply. However, further rand depreciation would pose an upside risk to the inflation outlook.

National government gross tax revenue was revised downwards by R10 billion to total R984 billion in fiscal 2014/15 as a whole. Corporate income tax, customs duties, VAT and the general fuel levy fell below budget expectations in the first half of the current fiscal year and full-year estimates have consequently been revised downwards. Above-inflation wage settlements boosted personal income tax collections, which resulted in an upward revision of R5,6 billion for this tax category. Non-tax revenue was projected to amount to R24,8 billion – some R3,9 billion higher than the February 2014 estimate.

Since the expenditure ceiling was introduced in 2012/13, government has stayed within spending targets. Government proposed to reduce this ceiling by R10 billion in fiscal 2015/16 and by R15 billion in 2016/17. Growth in spending averaged 11,1 per cent from fiscal 2008/09 to 2014/15, characterised by a substantial increase in the public-sector wage bill.

National government non-interest expenditure



* *Medium Term Budget Policy Statement*, October 2014

The ceiling on nominal non-interest spending over the next two years of the MTEF period has been reduced, with real non-interest spending projected to increase by 1,8 per cent per year on average over the three-year period.

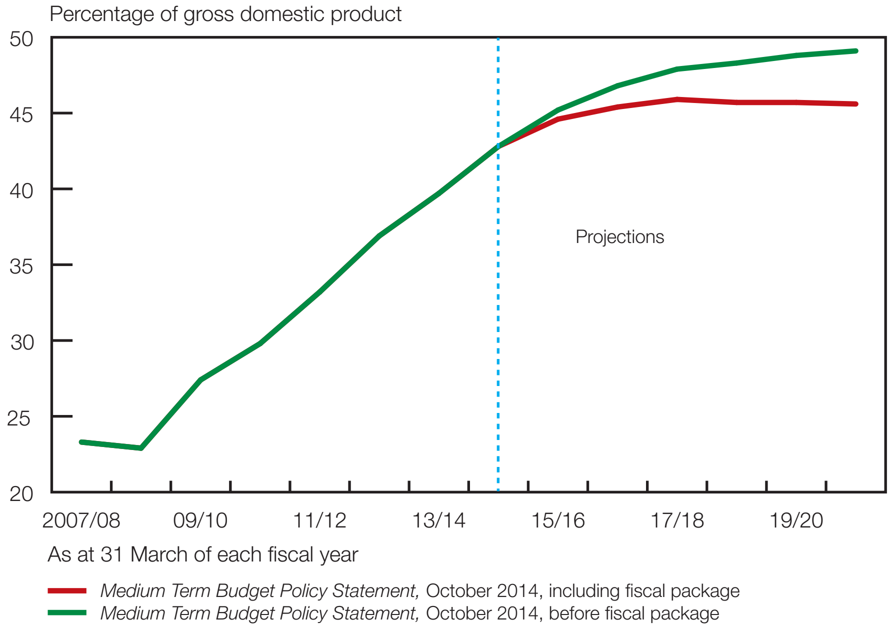
Provincial equitable share transfers would also be reduced. Reductions in provincial and local government conditional grants, which are paid by national government, would target patterns of underexpenditure. However, the local government equitable share would be protected to ensure the provision of free basic services.

Prudent levels of government borrowing play an important role in supporting the economy and protecting spending priorities. With weak economic growth having entrenched a structural imbalance between revenue and expenditure, the fiscal package referred to above would ensure the sustainability of South Africa's debt stock together with government's prudent debt management strategy. Even after taking the fiscal package into account, the projected increase in South Africa's ratio of government debt to gross domestic product between 2009 and 2019 is high among its emerging-market peers.

Government's medium-term funding strategy would focus on addressing loans maturing in 2017/18 and beyond. The strategy includes the accumulation of cash using higher borrowing in 2014/15. In addition, government would continue to exchange short-dated bonds for longer-term bonds as market conditions permitted. As cash is accumulated, short-term loans would be reduced to minimise cash balances. New bond issuance in fiscal 2014/15 was revised upwards by R20,5 billion, mainly due to the high take-up of non-competitive auctions where typically an almost-maturing existing bond is exchanged for a new bond.

Government's foreign borrowing programme would remain focused on financing foreign-currency commitments arising from interest payments and the repayment of maturing loans while continuing to manage currency risk.

Net national government debt, 2007/08–2020/21



Over the medium term, the overall gross debt stock was projected to increase by R590 billion, bringing the total debt to R2 379 billion by the end of 2017/18. Without the fiscal package's action to narrow the deficit, public debt would have continued to grow beyond the medium term.

Box 5 Impact of national accounts revisions on key fiscal ratios

On 25 November 2014, Statistics South Africa released revised estimates of gross domestic product that incorporated the results of a comprehensive benchmarking and rebasing exercise. From a previous base year of 2005, real gross domestic product was rebased to 2010 prices. The rebenchmarking exercise was aimed at facilitating a changeover to the *System of National Accounts 2008* (2008 SNA), which allows for the capitalisation of spending on research and development and on weapon systems, resulting in an addition to previously measured gross domestic product. More detailed or appropriate data that became available further raised the level of gross domestic product. This upward revision raised the level of gross domestic product at current prices compared with the previously published estimates; in 2013 this increase amounted to 4,4 per cent. Based on the new data, the ratios of the actual and projected budget deficit and gross loan debt to gross domestic product for the Medium Term Expenditure Framework (MTEF) period have been revised slightly downwards, as shown in the accompanying table.

Fiscal projections: National government

Percentage of gross domestic product

Component	2013/14	2014/15	2015/16	2016/17	2017/18
Budget deficit					
MTBPS 2014	-4,7	-4,8	-4,1	-3,2	-3,0
Revised	-4,5	-4,6	-3,9	-3,0	-2,8
Gross loan debt					
MTBPS 2014	45,9	48,2	49,5	49,7	49,8
Revised	43,9	46,1	47,3	47,5	47,6

Sources: 2014 *Medium Term Budget Policy Statement,* Statistics South Africa and South African Reserve Bank staff calculations

Statement of the Monetary Policy Committee

18 September 2014

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

Since the previous meeting of the Monetary Policy Committee (MPC), the domestic inflation forecast has improved slightly, but the inflation trajectory remains uncomfortably close to the upper end of the target range. At the same time, the domestic economic growth outlook has deteriorated further, with declining growth in both consumption expenditure and gross fixed capital formation, as confidence remains low. The combination of stubborn inflation and a sluggish growth outlook continues to pose a difficult dilemma for monetary policy.

The global environment has been characterised by increased financial market volatility following heightened speculation relating to the timing and extent of United States (US) monetary policy normalisation. This impacted on emerging-market currencies in general, and on the rand in particular. This was further illustrated after yesterday's Federal Open Market Committee (FOMC) meeting which reaffirmed the gradual pace of US monetary policy normalisation and its data-dependent nature. However, despite increased political instability and significant risks in a number of regions, the international oil price has declined along with continued weakness in global food prices, contributing to a more benign global backdrop for the domestic inflation outlook.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas surprised on the upside at 6,4 per cent in August, having measured 6,6 per cent and 6,3 per cent in June and July 2014 respectively. The higher turnout was mainly due to higher-than-expected food prices, which had been anticipated to continue their recent downward trend. Downward pressure was exerted by petrol prices which increased by 5,8 per cent, down from 8,3 per cent in July. The categories of food, housing utilities and transport together accounted for 3,8 percentage points of the inflation outcome in August, unchanged from the previous month. Core inflation, which excludes food, petrol and electricity, increased to 5,8 per cent from 5,7 per cent in July, driven mainly by the impact of the weaker exchange rate on some goods categories.

Administered price inflation excluding petrol measured 6,5 per cent, up from the 6,4 per cent measured in July. The headline producer price inflation for final manufactured goods, which reached a recent high of 8,8 per cent in April, measured 8,1 per cent and 8,0 per cent in June and July respectively, driven in part by lower agricultural product inflation.

The Bank's forecast of headline inflation is slightly more favourable than that presented at the previous meeting, mainly a result of lower expected food and petrol price pressures. Whereas for some time inflation had been forecast to peak at an average of 6,6 per cent in the fourth quarter of this year, the peak now appears to have occurred in the second quarter, at an average of 6,5 per cent. Inflation is now expected to average 6,2 per cent in 2014, compared with 6,3 per cent previously, and 5,7 per cent in 2015 (5,9 per cent previously), and to return to within the target range in the first quarter of 2015 instead of the second quarter as previously forecast. The inflation forecast for 2016 increased to 5,8 per cent from 5,6 per cent, mainly as a result of the revised electricity price assumption following the review of Eskom tariffs by the National Energy Regulator of South Africa (Nersa). The revised assumption makes provision for electricity price increases of 11,6 per cent from July 2015 and again from July 2016.

The forecast for core inflation is unchanged at an average 5,6 per cent and 5,7 per cent in 2014 and 2015 respectively, reaching a peak of 5,8 per cent in the first quarter of 2015, and moderating to 5,5 per cent in 2016. As before, the MPC sees the risks to the headline inflation forecast to be skewed to the upside, with possible renewed pressure coming from the exchange rate.

Inflation expectations, as reflected in the survey conducted by the Bureau for Economic Research (BER) at Stellenbosch University in the third quarter of 2014, have again remained more or less unchanged, and anchored at around the upper end of the target range. Inflation is expected to average 6,2 per cent in 2014 and 6,1 per cent and 6,0 per cent in 2015 and 2016 respectively. As usual, there is a fairly wide dispersion of expectations between the different categories of respondents. While business people expect inflation to average 6,4 per cent in 2015 and 2016, analysts' expectations average 5,7 per cent and 5,4 per cent. Expectations of trade unionists are for 6,2 per cent in both years, and all categories of respondents expect inflation in the current year to average 6,2 per cent. Household inflation expectations for 2014 remained unchanged at 6,3 per cent.

The global growth recovery remains asynchronous amid sustained improvements in the US and United Kingdom (UK), and deteriorating prospects in the eurozone and Japan. Although growth in the US is not expected to exceed the 2,2 per cent achieved in 2013, this is mainly a result of the contraction during the first quarter of this year. Real output growth of 4,2 per cent was recorded in the second quarter of 2014, and consensus forecasts are for growth rates of around 3 per cent in the next two quarters. Similar growth rates are expected in 2015. At the same time, the unemployment rate has been declining at a faster pace than previously anticipated. While the growth outlook for the UK remains positive, possible downside risks could emerge should Scotland vote for independence from the UK.

Growth in the eurozone has remained weak, with the German economy also under pressure following a contraction in the second quarter. Sanctions on Russia are expected to be an additional constraint affecting the eurozone's growth outlook. Although the Japanese economy appears to be recovering from the value-added tax (VAT)-induced slump in the second quarter, the recovery looks fragile.

While emerging Asia appears to be benefiting most from the US recovery, emerging markets generally are facing increasing headwinds. Signals coming out of China continue to be mixed amid a sharp slowdown in industrial production in August. Latin American economies also face a challenging outlook, particularly in Argentina, Venezuela and Brazil, which are currently experiencing a technical recession. Growth in sub-Saharan Africa is expected to remain relatively strong, although commodity producers may be adversely affected by lower commodity prices and possible spillover effects from the Ebola outbreak.

There is a continued absence of significant upside global inflation risks despite pressures experienced in some emerging markets. The various indicators of US inflation remain well contained below the 2 per cent level, while the fear of deflation in the eurozone persists. Declining international oil and food prices, along with a number of other commodity prices, are expected to reinforce the current benign global inflation environment.

The divergent growth outlooks in the advanced economies are likely to be the main drivers of monetary policy developments. The UK is expected to tighten monetary policy early next year. The stronger performance of the US labour market has led to heightened speculation that normalisation may begin earlier than previously anticipated. These expectations resulted in an appreciation of the US dollar against most currencies, as well as rising long-term US Treasury yields ahead of yesterday's FOMC meeting. At yesterday's press conference, the FOMC Chair reaffirmed the view that policy normalisation will occur gradually, but is contingent on no surprises to employment growth or inflation in either direction.

The data-dependent nature of the forward guidance means that changes in the outlook for inflation, unemployment and growth are likely to lead to bouts of global financial market uncertainty in advance of FOMC meetings in the coming months.

At the same time, however, the European Central Bank (ECB) has loosened monetary policy and has indicated its willingness to embark on some form of quantitative easing should this be necessary. Monetary policy is also expected to remain accommodative for some time in Japan. Since the previous meeting of the MPC, policy rates have been reduced in the eurozone, Israel, South Korea, Chile and Hungary, and increased in Russia and New Zealand.

Following a few weeks of relative stability, the rand exchange rate weakened in the past few days in response to US dollar strength, as well as the widening deficit on the current account of the balance of payments to 6,2 per cent of gross domestic product (GDP).

Since the previous meeting of the MPC, the rand initially traded in a range of R10,50 and R10,75 against the US dollar, but has weakened since early September, reaching a low of R11,07. On a trade-weighted basis, however, the rand depreciated by 0,4 per cent, having appreciated against the euro and the British pound. The rand is expected to remain sensitive to changes in sentiment regarding possible changes in US policy which will affect the appetite for emerging-market assets generally, as well as to possible impacts from geopolitical risks and domestic factors.

Since the previous MPC, non-residents have been net sellers of bonds to the value of R29,3 billion, but this has been offset in part by net purchases of equities to the value of R16,2 billion over the same period. In the year to date, there have been net outflows of bonds and equities to the value of R6,3 billion. These trends indicate that the financing of the current account through portfolio inflows is likely to become increasingly challenging.

The current-account deficit in the second quarter of 2014 was wider than generally expected by the markets, following the 4,5 per cent of GDP recorded in the first quarter. This widening was a result of increased dividend outflows, lower dividend inflows following a large one-off inflow during the first quarter, and weak export growth, impacted to some extent by the platinum strike. Export growth in the third quarter is expected to remain constrained by the slow return to full capacity production by the platinum mines and the strike in the steel and engineering sector in July, which had significant spillover effects on the manufacturing sector in general. The current account is anticipated to narrow gradually over time.

The domestic economic growth outlook remains weak following growth rates of -0,6 per cent and 0,6 per cent in the first and second quarters of the year respectively. These growth rates are well below potential output growth and indicative of a widening output gap. Partly as result of this outcome, as well as the expected impact of the metal workers strike in July, the Bank's forecast for GDP growth for 2014 has been revised down further to 1,5 per cent, from 1,7 per cent previously, with the risks still assessed to be on the downside. The forecasts for both 2015 and 2016 have been revised down by 0,1 percentage points to 2,8 per cent and 3,1 per cent respectively. The Bank's leading indicator of economic activity continues to trend sideways, consistent with a subdued growth outlook. Business confidence, as reflected in the Rand Merchant Bank/Bureau for Economic Research (RMB/BER) Business Confidence Index, remains negative despite a 5 index point increase to 46 in the third quarter. Adding to prevailing concerns are indications from Eskom that electricity supply constraints may be more severe and endure for longer than previously expected.

The near-term outlook for mining remains subdued, with platinum production not expected to return to full capacity before the end of the year. In July, mining production recorded a broad-based year-on-year decline of 7,7 per cent, but a 0,9 per cent increase on a month-to-month basis. Manufacturing output declined significantly in July, recording year-on-year and month-to-month contractions of 7,9 per cent and 5,4 per cent respectively, largely due to the impact of the four-week strike in the steel and engineering subsector. Capacity utilisation in the sector declined from 82,1 per cent in the first quarter of 2014 to 80,6 per cent in the second quarter. More positively, the Kagiso Purchasing Managers' Index (PMI) reflected some improvement in sentiment in August, with the index rising 3,1 index points to 49, marginally below the neutral level, while the construction sector has recorded growth rates of 5 per cent in the first two quarters of the year.

Growth prospects have been constrained by the weakening trend in gross fixed capital formation which grew at an annualised rate of 0,5 per cent in the second quarter. Real fixed capital expenditure by both the public corporations and the private sector contracted during the quarter. Of particular concern is the continued downward trend over the past three quarters in private-sector investment, despite higher capital outlays in the manufacturing sector. This has been reflected in the continued slow pace of employment creation in the private sector and the rise in the unemployment rate to 25,5 per cent in the second quarter of 2014.

Consumption expenditure by households also continued its moderating trend which began in the first quarter of 2012 amid declining real disposable income growth. Annualised growth of 1,5 per cent was recorded in the second quarter of 2014. The slowdown was particularly marked in the durable and semi-durable goods categories, probably impacted by the prolonged strikes in the mining and manufacturing sectors. Retail trade sales contracted by 0,9 per cent in June on a month-to-month basis, but increased by 1,2 per cent in July, higher than generally expected. Wholesale trade sales contracted by 5,2 per cent month-to-month in July, and by 4,6 per cent year-on-year. Domestic vehicle sales have also slowed. Given the above, somewhat surprisingly the First National Bank/Bureau for Economic Research (FNB/BER) Consumer Confidence Index increased from -6 to +4 in the second quarter.

Trends in credit extension to households are consistent with the weak growth in household consumption expenditure, showing a further divergence between credit extension to households and to the corporate sector. Growth in total loans and advances over the year measured 9,7 per cent in July, with lending to the corporate sector increasing by 17 per cent and to households by 4,1 per cent. The latter reflects continued sluggish growth in mortgage credit extension and tighter credit criteria for unsecured lending in particular. Twelve-month growth in general loans to households, which is mainly unsecured lending, reached a low of 0,2 per cent in July, while growth over three months exhibited an annualised contraction of 2,5 per cent. This decline is across all income groups, but more pronounced at the lower levels. A positive development is that household debt to disposable income moderated from 74,4 per cent in the first quarter to 73,5 per cent in the second quarter.

Growth in corporate-sector borrowing during the first half of the year was dominated by the agricultural sector, electricity supply (renewable energy projects) as well as the wholesale and retail trade sectors. The cost of bank funding appears to have increased recently as a result of changed regulatory requirements relating to the implementation of Basel III, the impact of the bail-in of certain African Bank Limited creditors and the consequent rating action by Moody's Investors Service, all of which could result in tighter funding conditions.

No new wage and unit labour cost data have been released since the previous meeting of the MPC, although settlements in the steel and engineering sector and the clothing sector have been well above current and expected inflation rates. The MPC remains concerned about the apparent delinking of wage demands and some wage settlements from underlying inflation and productivity growth trends, as well as the possible impact of forthcoming wage negotiations, including in the public sector. These concerns relate to settlements at all levels, including executive pay. Excessive wage settlements could have adverse impacts on employment, inflation, the general competitiveness of the economy, and the profitability and viability of small businesses in particular.

Notwithstanding the 9,5 per cent increase in July, food price inflation is expected to slow over the coming months. Pipeline pressures from agricultural prices continue to moderate following sharply lower maize prices since March, while manufactured food price inflation declined to 8,5 per cent in July, compared with 9,5 per cent in April. International food prices, as reflected in the Food and Agriculture Organization (FAO) international food price index, declined for the fifth consecutive month in August 2014 in response to positive maize and wheat supply conditions. These developments are expected to impact favourably on domestic consumer prices, although base effects are likely to interrupt the declining year-on-year trend in the final months of the year.

International oil prices declined in recent weeks, having traded in a range of between US$105–US$114 per barrel for the year to the end of July. Since August, the price has fallen below this range and is currently trading at around US$98 per barrel. This is despite rising tensions and instability in the Middle East and conflict in Ukraine, events that in the past would likely have resulted in an oil price spike. As a result of this lower price, the domestic petrol price was reduced by 67 cents per litre in September, having been unchanged in August. At this stage there is an average over-recovery on the petrol price due to the lower international price, but the favourable impact is being partially offset by continued rand weakness.

Despite the slight near-term improvement in the inflation outlook and the relatively stable inflation expectations, the MPC is concerned that the forecast remains uncomfortably close to the upper end of the target band. Given the upside risks to the forecast, the proximity to the upper end of the band makes the inflation outcomes highly vulnerable to changes in inflationary pressures.

A key upside risk is the exchange rate, which is vulnerable to the slow pace of adjustment to the current-account deficit, as well as to the uncertainty surrounding the future path of monetary policy in the advanced economies. At this stage it is difficult to assess the extent to which normalisation of US monetary policy is already priced in to the rate.

The MPC remains concerned about the risks of a wage-price spiral, should settlements well in excess of inflation and productivity growth become the economy-wide norm. Such developments could also undermine South Africa's international competitiveness and delay the current-account adjustment.

The deterioration in the longer-term inflation trajectory relative to the previous forecast is a result of the revised tariff increases granted to Eskom by Nersa. The view of the MPC is that such relative price adjustments should not be reacted to automatically. However, while the focus of monetary policy should be on the second-round effects of these increases, this is complicated given the multi-year nature of the adjustment.

While inflation is the primary focus of the Committee, the MPC is also mindful of the anaemic state of the domestic economy, rising unemployment and the downside risk to its growth forecast. Domestic expenditure has deteriorated further, particularly private-sector fixed capital formation and, together with continued moderation in household consumption expenditure, is indicative of the lack of demand pressures in the economy.

The MPC is still of the view that interest rates will have to normalise over time. However, given the slightly improved inflation outlook notwithstanding the upside risks, the stable inflation expectations and the downside risks to the weak growth outlook, the MPC has decided that the repurchase rate will remain unchanged at 5,75 per cent per annum.

Despite the 75 basis point increase so far this year, monetary policy remains accommodative, and will continue to be supportive of the domestic economy subject to achieving its primary inflation-targeting objective. Future decisions will, as always, be highly data-dependent.

Statement of the Monetary Policy Committee

20 November 2014

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

Since the previous meeting of the Monetary Policy Committee (MPC), the sharp decline in international oil prices has contributed to a more benign global inflation environment. This development may also ameliorate the deteriorating growth outlook in some regions by providing a boost to consumption expenditure. Lower oil prices have also had a favourable impact on domestic headline inflation, with the medium-term forecast improving relative to the previous forecast. However, the underlying inflation pressures, as reflected in core inflation, persist.

The domestic growth outlook remains challenging, but after two quarters dominated by the fall-out from extended strikes, some recovery is expected, but demand remains subdued. The coming quarters are expected to see an improved performance in the mining and manufacturing sectors, but the outlook is inhibited by domestic structural constraints, as well as by a weak global economy and the continued declining trend in non-oil commodity prices. Growth next year is expected to remain weak.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas measured 5,9 per cent in both September and October, having measured 6,4 per cent in August. Downward pressure on inflation in October came from continued moderation in food and petrol prices. Food price inflation continued its downward trend, measuring 8,0 per cent in October, down from 8,7 per cent previously, while petrol prices increased by 2,4 per cent. Core inflation, which excludes food, petrol and electricity, moderated to 5,6 per cent in September from 5,8 per cent in August, but measured 5,7 in October, reflecting primarily continued exchange-rate pass-through to some goods categories.

Administered price inflation excluding petrol measured 6,4 per cent in October, down from 6,5 per cent in September. Headline producer price inflation for final manufactured goods, which reached a recent high of 8,8 per cent in April, measured 7,2 per cent and 6,9 per cent in August and September respectively, driven in part by lower food and fuel price inflation.

The Bank's forecast of headline inflation has improved since the previous meeting of the MPC, mainly due to the impact of declining international oil prices. Having reached a peak of 6,5 per cent in the second quarter of this year, inflation is now expected to average 5,9 per cent in the final quarter of 2014, and average 6,1 per cent for the year, compared with 6,2 per cent previously. The downward trend is expected to continue into next year, with inflation forecast to reach a low of 5,1 per cent in the second quarter, and to average 5,3 per cent for the year, compared with 5,7 per cent previously. The forecast for 2016 has been revised down from 5,8 per cent to 5,5 per cent, and is expected to measure 5,4 per cent in the final quarter of the year.

The forecast for core inflation, by contrast, is more or less unchanged at an average 5,6 per cent and 5,7 per cent in 2014 and 2015 respectively, reaching a peak of 5,9 per cent in the first quarter of 2015 (previously 5,8 per cent), and moderating to 5,3 per cent in 2016, down from 5,5 per cent previously. The MPC assesses the risk to the headline inflation forecast to be broadly balanced.

The results of the fourth quarter inflation expectations survey of the Bureau for Economic Research (BER) will only be released in December. Market-based surveys, as reflected in the Reuters Econometer survey, however, show that the median CPI inflation expectation of analysts has remained unchanged over the past two months at 5,7 per cent and 5,5 per cent for 2015 and 2016 respectively. Break-even inflation rates (the yield differential between conventional government bonds and inflation-linked bonds) declined since the previous meeting and reflect expectations within the target range for 5-year maturities, and marginally above the upper limit of the inflation target range at 10-year maturities.

The United States (US) and the United Kingdom (UK) remain the main drivers of global growth although more broadly, global growth may get some impetus from lower oil and food prices, which should provide some boost to consumers. US economic growth was better than expected in the third quarter with the first advanced estimate of 3,5 per cent, and the unemployment rate declining to 5,8 per cent – the lowest level since June 2008. The UK recorded growth of 2,8 per cent in the third quarter, while the unemployment rate was unchanged at 6,0 per cent. The Japanese economy contracted for a second consecutive quarter during the third quarter, and has prompted a reconsideration of a further value-added tax (VAT) increase next year. The response to the further additional monetary stimulus announced recently remains uncertain amid a tighter fiscal policy stance. The eurozone outlook also remains bleak, including in the core countries such as France and Germany, although lower food and oil prices, coupled with further monetary easing, may have a positive impact.

The outlook for emerging markets is mixed, with emerging Asian economies expected to benefit most from the positive spillovers from the US recovery. This is expected to offset in part the adverse impact of the slowdown in China, where growth is expected to be lower than in the past few years, as the economy rebalances away from investment towards consumption. This moderation is expected to continue to impact negatively on commodity prices. The Indian economy is showing signs of sustained recovery, while the other BRICS partners, Russia and Brazil, face significant growth headwinds. Oil exporters generally are expected to face challenges from international oil price weakness.

Global inflation is expected to moderate in the face of benign food price inflation and falling international oil and other commodity prices. While this is welcome in the higher inflation regions, particularly emerging markets, it does aggravate deflationary risks in some of the advanced economies, particularly in the eurozone and Japan. Monetary policy stances are expected to remain ultra-loose in these two regions, with a significant stimulus package announced recently in Japan, and the European Central Bank (ECB) is anticipated to conduct further asset purchases. The US Federal Reserve (the Fed) has ended its programme of quantitative easing, but at this stage it is not contracting its balance sheet and proceeds from maturing assets are being reinvested. Although the general expectation is that the Fed will begin raising interest rates in mid-2015, there are also some expectations that the more benign inflation outlook could delay this. Forward guidance from both the Bank of England and the Fed is that any adjustment is likely to be gradual, and policy rates may be lower than their estimated long-run normal rates for some time despite the improved growth outlooks. Since the previous meeting of the MPC, policy rates have increased in Brazil, Russia and Indonesia, but reduced in Sweden, South Korea, Chile and Poland.

The exchange rate of the rand has been relatively volatile since the previous meeting in response to external and domestic factors, including changing expectations of the timing of the first US interest-rate increase as well as the downgrade of South Africa's credit rating by Moody's Investors Service. Although the rand initially weakened sharply against the US dollar, at one stage reaching a level of R11,36 against the US dollar, this move has since largely been reversed. Since the previous meeting of the MPC, the rand has depreciated marginally against the US dollar, but appreciated by 2,1 per cent and 3,5 per cent against the euro and sterling respectively, and by 1,8 per cent on a trade- weighted basis.

The rand is expected to remain susceptible to sudden shifts in sentiment regarding changes in monetary policy stances in the advanced economies, and the continued uncertainty regarding the extent to which US normalisation is already priced in to the exchange rate. The asynchronous nature of advanced economy monetary policies is expected to complicate the outlook and outcomes. However, the rand is likely to remain more sensitive to changes in financial conditions in the US than in Japan and the eurozone. The persistently slow adjustment of the current-account deficit also makes the rand vulnerable to swings in sentiment that raise concerns about the financing of this deficit. Although the lower oil prices should reduce the oil import bill, its positive impact on the deficit may be limited by further declines in other commodity prices.

The volatility in portfolio capital flows is indicative of fickle global investor sentiment. Net bond sales by non-residents amounted to R12,6 billion in September and R2,1 billion in October and a further R1,5 billion to date in November. In the equities market, having been marginal net sellers in September, non-residents were net buyers to the value of R5,7 billion in October but net sellers of R6,3 billion to date.

The domestic growth outlook remains subdued. Although an improved growth outcome is expected in the third quarter, following the 0,6 per cent growth in the second quarter, this is off a low base following prolonged strikes in the mining and manufacturing sectors. The Bank's forecast for gross domestic product (GDP) growth in 2014 has declined marginally from 1,5 per cent to 1,4 per cent, and forecasts for 2015 and 2016 have been revised down from 2,8 per cent and 3,1 per cent to 2,5 per cent and 2,9 per cent respectively. This restrained outlook is consistent with the Bank's composite leading indicator of economic activity which continues to trend sideways, with a slight upward move recently. The Rand Merchant Bank/Bureau for Economic Research (RMB/BER) Business Confidence Index improved in the third quarter but, at 46 index points, remains below the neutral level of 50.

The mining sector appears to be recovering to some extent from the strike-affected first half of the year, and is expected to contribute positively to third-quarter growth, following two consecutive quarters of contraction. The physical volume of mining production increased by 0,7 per cent in the third quarter compared with the second quarter, and further increases can be expected in the final quarter, as platinum output is still below pre-strike levels. By contrast, although the physical volume of manufacturing production increased in September, the month-long strike in the steel and engineering industry in July contributed to a quarter-to-quarter contraction of 1,3 per cent in the third quarter. Sentiment indicators suggest that the outlook for the sector remains bleak, with the manufacturing confidence index still at very low levels and capacity utilisation rates back at 2011 levels. More positively, the Kagiso Purchasing Managers' Index (PMI) edged above 50 index points in October for the first time since March, driven mainly by the inventory and new sales orders subindices.

The outlook for the construction sector is more positive, with the real value of building plans passed increasing for the fourth successive month in August. On a three-month-to-three-month basis, an increase of 9,8 per cent was recorded. However, while the various building confidence indices have generally improved, they remain below the neutral level.

The weak pace of economic growth is mirrored in the unemployment rate which, according to the Quarterly Labour Force Survey published by Statistics South Africa measured 25,4 per cent in the third quarter, compared with 24,5 per cent a year earlier. Total employment increased at a year-on-year rate of 0,5 per cent in the quarter. At the same time, the number of discouraged workers increased sharply, by almost 100 000, and now total 2,5 million.

Consumption expenditure by households has remained relatively subdued, but there are signs of a moderate increase in the quarterly growth rate, as the negative effects of the protracted strikes on consumption dissipate. Consumption expenditure could be positively impacted by lower petrol prices. Although retail sales growth declined by 0,8 per cent (non-annualised) in September, quarter-to-quarter growth of 0,9 per cent was recorded in the third quarter, and 2,3 per cent year on year. Similarly, wholesale trade sales contracted in the third quarter, but increased by 5,9 per cent on a year-on-year basis. Motor vehicle sales have also shown some signs of recovery, although domestic sales are expected to be lower this year than in 2013. Retail-sector confidence improved, with the BER reporting retailer confidence above the neutral level for the first time in two and a half years. Consumer confidence, however, declined significantly in the third quarter following an unexpected increase in the second quarter.

Trends in bank credit extension to the private sector have remained characterised by declining growth in advances to households, while advances to corporates have been buoyant. Total loans and advances grew at a twelve-month rate of 8,8 per cent in September, but excluding mortgages the growth rate was 13,5 per cent, compared with a recent high of 18,6 per cent in December 2012. Credit extension to the household sector grew by 3,7 per cent in September, as unsecured lending remained weak despite a reversal of the negative growth trend in the month, but credit to the corporate sector grew by 15,3 per cent. Twelve-month growth in mortgage advances to households remained at levels below 3 per cent, while instalment sale credit and leasing finance continued its downward trend with growth of 6,9 per cent. These trends are likely to constrain consumer demand in the coming months.

According to the October *Medium Term Budget Policy Statement*, government remains committed to its policy of fiscal consolidation in order to prevent an increase in the debt ratio to unsustainable levels. The fiscal deficit is expected to decline from a projected 4,7 per cent of GDP in the current fiscal year to 3,0 per cent in 2017/18.

This is expected to be achieved through adherence to a nominal expenditure growth ceiling and increased tax revenues. The ability to achieve the nominal expenditure targets will be determined to an important degree by the public-sector wage settlement.

Wage trends have remained broadly unchanged since the previous meeting of the MPC. According to Andrew Levy Employment Publications, wage settlement rates averaged 8,0 per cent in the first nine months of the year. Nominal remuneration per worker as well as productivity trends in the formal non-agricultural sector were distorted by the significant increase in temporary employees by the Independent Electoral Commission, which contributed to the decline in the year-on-year increase in remuneration from 6,3 per cent to 3,5 per cent, while productivity declined by 1,6 per cent. The net result was a marginal increase in unit labour costs of 5,2 per cent in the second quarter from 5,1 per cent previously.

Food price inflation remains a major driver of inflation, but is expected to continue to moderate in the coming months. Food price inflation appears to have peaked at 9,5 per cent in August, and has since moderated to 8,0 per cent in October as lower producer prices of crops and cereals, which declined by 6,3 per cent in September, are beginning to have an impact at the consumer price level. Restocking of herds following the drought in 2013, however, has kept meat price inflation elevated. Food price pressures also remain benign at the global level, with the Food and Agriculture Organization international food price index declining for seven consecutive months to its lowest level since August 2010.

International oil prices have declined markedly since their recent peak in June 2014 of around US$115 per barrel to current levels of below US$80 per barrel. This decline reflects a combination of factors, including increased supply coming from the US and Libya, moderating demand from China in particular, and changes in the internal dynamics within the Organization of the Petroleum Exporting Countries (OPEC) cartel. The general expectation in the market is that these lower prices could persist for some time. Although some of the advantage of lower international oil prices has been offset to some extent by a weaker rand exchange rate, domestic petrol prices have declined by a cumulative R1,17 per litre since August and, should current trends continue, a further decline of around 70 cents per litre can be expected in December.

The marked decline in international oil prices has had a significant impact on the medium-term outlook for headline inflation in the global economy and in South Africa. At this stage it is unclear whether this is a temporary shock, or if it will be sustained or decline further. As with an oil price increase, we would look through the impact effect and focus on the possible second-round effects of this decline. The possibility that oil prices are sustained at current levels introduces a degree of downside risk to the inflation forecast.

The domestic growth outlook remains challenging, and the risks to the forecast are assessed to be moderately on the downside. The MPC does not see significant signs of excess demand pressures that are impacting on the inflation outlook and household consumption expenditure is expected to remain constrained.

At the same time, despite its recent relative stability, the exchange rate remains an upside risk to the inflation outlook, vulnerable to changing perceptions of the timing of global monetary policy adjustments, and the slow pace of contraction in the current-account deficit. The extent to which policy normalisation is already priced into the exchange rate is also unclear.

A further upside risk to the inflation forecast comes from a possible increase in wage settlement rates in excess of inflation and productivity growth in the coming year.

In light of this assessment, the MPC sees the overall risk to the headline inflation forecast to be more or less balanced. However, given the elevated level of core inflation and the fact that headline inflation is expected to increase later in the forecast period as the first-round effect of the oil price decline dissipates, the Committee remains vigilant and will continue to monitor developments closely.

The Committee remains of the view that interest rates will have to normalise over time. However, given the lower trajectory of headline inflation and the continued weak state of the economy, the MPC has unanimously decided to keep the repurchase rate unchanged at 5,75 per cent per annum at this stage.

The timing of future interest-rate increases will be dependent on a range of factors, including the evolution of inflation expectations, the speed of normalisation of monetary policy in the US and the state of the domestic economy.

Note on the benchmark revisions and rebasing of South Africa's national accounts statistics

by E Botes

The author would like to express her sincere appreciation to Dr J P van den Heever and Mr S S Walters for their valuable inputs.

Introduction

The outcome of the five-yearly benchmarking and rebasing of South Africa's national accounts statistics, jointly undertaken by Statistics South Africa (Stats SA) and the South African Reserve Bank (the Bank), is disseminated in this issue of the *Quarterly Bulletin*. In addition to the comprehensive revision of national accounts aggregates and time series data, the current revisions also reflect the incorporation of conceptual, methodological and classification changes following the partial implementation of the latest edition of the *System of National Accounts* (2008 SNA). Further to making revised and comparable data covering the period 2006 up to the third quarter of 2014 available in this publication, revised national accounts estimates for the years 1946 to 2014 will be published in a supplement to the March 2015 *Quarterly Bulletin*.

Comprehensive revisions to South Africa's national accounts statistics are typically done every five years in order to incorporate new or additional information that became available, to reclassify transactions where necessary and to rebase estimates at constant prices. Market developments and the concomitant emergence of new products and services furthermore continuously necessitate changes to compilation practices. The 2008 SNA provides an international standard macroeconomic statistical framework for this purpose and replaced the 1993 version of the SNA; both publications were compiled under the auspices of the United Nations, the European Commission, the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD).

The five-yearly comprehensive revisions differ from the regular annual national accounts revisions due to the scope of the changes being made and the length of the period to which the revisions apply. The most recent set of revisions drew upon information from all relevant censuses released by Stats SA during the period 2009 to 2014, a number of sectoral surveys and technical reports, and more detailed producer and consumer price information. Most notable were the 2010/11 *Income and Expenditure Survey of Households*; the results of the *Population Census* of 2011; the 2010 *General Household Survey*; various issues of the *Annual Financial Statistics* (AFS) survey; various issues of the *Quarterly Financial Statistics* (QFS) survey; the *South African National Survey of Research and Experimental Development* produced by the Centre for Science, Technology and Innovation Indicators (CeSTII) on behalf of the Department of Science and Technology (DST); technical reports from the Department of Agriculture, Forestry and Fishing; the *Abstract of Agricultural Statistics* for various years; and information sourced from the Department of Human Settlements.

The purpose of, and background to, benchmarking and rebasing

National accounts estimates are based on a variety of data sources differing in terms of accuracy, frequency, scope and level of detail. Short-term estimates are often based on trends derived from available indicators due to the lack of detailed source data.

The purpose of benchmarking is to review high-frequency data and statistics that tracked short-term developments in the economy in the base year (2010 in this instance) and to reconcile these developments with more accurate and detailed but less frequent data to determine a revised level in the base year on which future estimates could be based. The process is done based on nominal data and therefore affects all ratios that use the gross domestic product as the denominator.

Rebasing is the process whereby the reference year for the real or constant price estimates of national accounts aggregates is changed. The further the estimates are from the previous benchmark reference year, the more scope there is for the estimates to deviate from the actual situation as the pattern of the relative prices in the base period tends to become progressively less relevant to the economic situations of the later period over time. The base period will typically be considered as a fairly 'normal' year in the economy for which the required periodic data are readily available.

National accounts data at constant prices reflect changes in the volume or quantity of goods and services produced or utilised. The statistical procedure for measuring volume changes in a macroeconomic aggregate between a chosen base period and the current period consists of revaluing the aggregate in question in the current period at the prices that prevailed in the base period, and thereafter calculating the change between these two periods. This procedure eliminates the effects of price changes from the base period to the current period by recalculating the value of aggregate output and expenditure in terms of the prices of goods and services in the base period. The prices in the selected base period are therefore a factor in determining the real values of the different goods and services that are included in the total output and expenditure in other periods.

Relative values change over time because prices generally do not change at the same pace from one period to another. Shifts in relative prices may be brought about by changes in supply and demand that in turn reflect factors such as different rates of change in productivity in different industries, changes in the quality of products, technological advances, tax changes, international price movements and exchange-rate adjustments, and changes in tastes and preferences. To ensure that relative values, and therefore weighted average volume changes, approximate the current structure of the economy as closely as possible, base periods and weights have to be changed from time to time.

The shift in the base year changes the units (rand value) in which output and expenditure volumes are measured, and the difference in the level between the previously published and revised series primarily reflects the difference in the unit of measurement. For example, rebasing from 2005 prices to 2010 prices increased the level of real gross domestic product, essentially reflecting the increase in the level of prices from 2005 to 2010. It does not indicate an increase of the same magnitude in the output or expenditure volumes.

The new constant price series, with 2010 as the base year, have been recalculated from 2006 onwards. This allows for changes in the growth rates on account of changes in the weighting structure (as a result of adjustments to nominal data and deflated by new or re-indexed deflators), while at the same time ensuring that the weights used in the measurement of changes in real national accounts aggregates between 2005 and 2010 reflect reasonably closely the relevant new price and quantity structure for this period. The previously estimated series expressed in terms of constant 2005 prices have been retained for the period up to 2006 and have been linked to the new series without being reweighted. However, due to the magnitude of some revisions, it was necessary to allow for a gradual phasing-in period prior to 2006 to accommodate the underlying revisions to certain aggregates. This implies that in those cases, the growth rates at constant prices before 2006 could change accordingly.

In order not to disturb the previously identified growth patterns in volume series up to 2006, subtotals and totals up to 2006 have been converted to 2010 prices independently of their components. Consequently, these converted subtotals and totals for periods before 2006 are not equal to the sum of their components. This means that the constant price figures do not aggregate in an accounting sense, with the difference being reflected in the residual.

Changes that will affect South Africa's national accounts statistics following the partial implementation of the 2008 SNA and other methodological changes

In the context of a set of internationally agreed concepts, definitions, classifications and accounting rules, the SNA provides a conceptual framework for compiling a coherent, consistent and integrated set of macroeconomic accounts. National accounts statistics compiled in accordance with these guidelines are used for analysing and evaluating economic performance, research and policy formulation. As indicated in the attached table, roughly 1,2 per cent of the total change of 2,8 per cent in the level of the gross domestic product in 2010 could be attributed to the partial implementation of the 2008 SNA.

Table 1 Reasons for changes to the 2010 level of nominal gross domestic product

	R billions	Percentage of 2010 GDP
Level of 2010 gross domestic product before revisions	2 673,77	100,0
Plus: Implementation of 2008 SNA		
Research and development	**16,47**	**0,6**
Gross fixed capital formation	13,33	0,5
Consumption of fixed capital	3,14	0,1
Weapon systems	**8,47**	**0,3**
Consumption of fixed capital	8,47	0,3
Livestock	**2,47**	**0,1**
Gross fixed capital formation	2,47	0,1
FISIM	**5,72**	**0,2**
Final consumption expenditure	5,72	0,2
Total, 2008 SNA implementation	33,13	1,2
Plus: Enhanced measurement of economic activity	41,11	1,6
Equals: Level of 2010 gross domestic product after revisions	2 748,01	102,8
Memo: Impact of overall revision	74,24	2,8

FISIM: Financial intermediation services indirectly measured

The revision of the SNA was a significant step forward in the modernisation of national accounts statistics and the underlying and related accounting and statistical systems, which are designed to improve measurement of an increasingly globalised economy in an integrated and consistent framework. Although the 2008 SNA retains the basic approach and statistical framework as captured by the 1993 SNA, a number of enhancements were introduced to facilitate improved measurement and analysis in a changing global economic environment. Major changes resulting from the implementation of the 2008 SNA include the following:

– Research and development

In the 1993 SNA, spending on research and development (R&D) was treated as intermediate consumption. Intermediate goods and services are used only once whereas capital assets could be used repeatedly in production processes year after year. The 2008 SNA recognises that because the output of R&D is an intellectual property product that is long-lasting, is used repeatedly in production, and provides benefits to its owners, it should therefore be included in capital formation. Investment spending on R&D as a capital asset contributed 0,5 percentage points to the total change in gross domestic product while 0,1 percentage point resulted from consumption of fixed capital on these assets.

– Information, computer and telecommunications (ICT) equipment and computer software

Capital outlays on computer hardware and software were previously included under the broader heading of 'computers and related equipment'. Outlays on these items have now been split between information, computer and telecommunications equipment and computer software, with no material impact on either total gross fixed capital formation or gross domestic product.

– Capitalisation of military weapon systems

According to the 1993 SNA, purchases of military weapon systems were treated as consumption expenditure by general government. The 2008 SNA recommends that spending on military weapon systems, such as warships, military aircraft, tanks and missile carriers be classified as fixed assets. This change recognises that weapon systems are long-lasting assets that may be used for activities that provide defence services, including deterrence and which have value on the government's balance sheet. As a result, gross domestic product was boosted by the consumption of fixed capital on weapon systems, and the acquisition of the systems has been reclassified from final consumption expenditure by general government to a number of asset categories in total gross fixed capital formation. Consumption of fixed capital on these assets contributed 0,3 percentage points to the total change in the level of gross domestic product in 2010.

– Cultivated biological resources

The aggregate amount recorded for cultivated biological resources included in total gross fixed capital formation took account of the reclassification of capital expenditure on tree, crop and plant resources yielding repeat products which were previously classified as construction works, as well as the creation of a new capital asset, namely animal resources yielding repeat products. The latter capital asset includes animals whose natural growth and regeneration are under the direct control, responsibility and management of institutional units. New data include breeding stocks of dairy cattle and sheep and contributed just more than 0,1 percentage point to the change in the 2010 level of gross domestic product.

– Financial intermediation services indirectly measured

The 2008 SNA proposes that financial intermediation services indirectly measured (FISIM) be refined to also include non-bank financial intermediaries. Previously, FISIM applied only to deposits received and loans extended by the banking sector. By expanding this calculation, roughly 0,2 percentage points were added to the level of gross domestic product in 2010.

– Other methodological changes

Other methodological changes affecting the national accounts statistics include the following:

- The capitalisation of low-cost housing has been revisited since the early 1990s. Improved estimates for these assets were accordingly incorporated into the balance sheet of the household sector. These assets will be subject to a depreciation period of 30 years.
- Total consumption of fixed capital and the capital stock were affected by the alignment of the depreciation period of residential buildings to international best practice, adopting 75 years rather than 50 years as the average lifespan.

Table 2 indicates the lifespans of the various asset classes identified in gross fixed capital formation. These have been revised in the case of residential buildings and provision has been made for the newly introduced asset classes as part of the implementation of the 2008 SNA.

Table 2 Changes in lifespans of different asset classes in gross fixed capital formation

Component	Before benchmarking revisions	After benchmarking revisions
	Years	
Residential buildings		
Low-cost housing	50	30
Other housing	50	75
Non-residential buildings	50	50
Construction works		
Government sector	80	80
Public corporations	25	25
Mining sector, not included elsewhere	30	30
Other sectors	50	50
Mineral exploration	Not included	30
Transport equipment	8	8
Machinery and equipment		
Public corporations involved in mining or electricity production	16	16
Manufacturing sector	8	8
Other sectors	10	10
Computers	5	5
Livestock	Not included	6
Research and development	Not included	10
Military weapon systems	Not included	30
Tree, crop and plant resources	25	25
Transfer cost	50	75

– Capital outlays on mineral exploration were reclassified and shown as a separate asset class in gross fixed capital formation. These expenses were previously categorised as part of construction works.

– Similar to other types of financial services, the output of non-life insurance services is also estimated as premiums earned *plus* premium supplements *less* claims. In accordance with the 1993 SNA, the recommended treatment reflected the difference between premiums paid and claims accrued – a calculation that often led to irrational volatility in the output of insurance services. The 2008 SNA instead recommends that the calculation be based on a more steady measure of adjusted claims and adjusted premium supplements incurred. As a result, the compilation method of the output of non-life insurance services, reinsurance and direct insurance services was aligned with the methodology proposed in the 2008 SNA; the treatment of reinsurance services was also brought into line.

– The implementation of the *Balance of Payments and International Investment Position Manual,* Sixth Edition (BPM6), as discussed in a further note in this *Quarterly Bulletin* has also resulted in enhanced estimates of national accounts aggregates, particularly those related to the external sector.

Changes due to comprehensive revisions

As previously mentioned, the current revision of national accounts statistics was conducted in close co-operation between Stats SA and the Bank. Stats SA focused on the re-estimation of the gross domestic product at current and constant prices using the production approach, whereas the Bank was responsible for the revision of the gross domestic expenditure at current and constant prices, as well as for the revision of South Africa's national and institutional sector accounts. In addition, the National Department of Agriculture was mainly responsible for re-estimating the output of and intermediate, capital and other expenditure incurred by the agricultural sector.

Revision of gross domestic product

The underlying contributions by kind of economic activity to total gross value added for the 2005 and 2010 benchmark estimates are presented in Table 3. Revisions, such as the incorporation of R&D and the allocation of FISIM among the various sectors of the economy, affected the relative weights of the aggregates accounting for total value added at current prices. As a result, the weights applied to extrapolate the base-year estimates of gross value added at basic prices and at constant prices in 2010 differed somewhat from the weights that were used when the base year was fixed at 2005 prices.

Table 3 Contribution of gross value added by kind of economic activity to total value added at basic prices

Per cent

Sectors	2005 base year	2010 base year
Primary sector	10,2	11,9
Agriculture	2,7	2,6
Mining	7,6	9,2
Secondary sector	23,6	20,9
Manufacturing	18,5	14,4
Electricity, gas and water	2,4	2,7
Construction	2,8	3,8
Tertiary sector	66,2	67,2
Trade, catering and accommodation	13,9	14,9
Transport, storage and communication	10,0	9,2
Financial and business services	21,1	21,0
Government	14,9	16,2
Other services	6,3	6,0
Total	100,0	100,0

* Totals may not add up due to rounding

A comparison of the contribution of the various sectors of economic activity to total gross value added at basic prices in 2005 and in 2010 shows some noteworthy differences in the relative weights of particular sectors in the two base-year periods:

– The primary sector's contribution to gross value added at current prices increased from just more than 10 per cent in 2005 to about 12 per cent in 2010, mainly due to an increase in the contribution of the mining sector which was, in turn, partly affected by a change in the weights of the different mining products when rebased to 2010.

– By contrast, the contribution of the secondary sector to total value added shrank from 23,6 per cent in 2005 to 20,9 per cent in 2010. Increases in the relative contributions of both the electricity, gas and water and the construction sectors were more than offset by a decline in the contribution of the manufacturing sector from 18,5 per cent in 2005 to just more than 14 per cent in 2010.

– The contribution of the services sector to total value added increased from 66,2 per cent in 2005 to 67,2 per cent in 2010. This was the net result of increases in the contributions of both the commerce and general government sectors which more than neutralised decreases in the contributions of the transport, storage and communications sector; the finance, insurance, real-estate and business services sector; and the other services sector. The revised increased size of the value added by the general government sector was brought about by a sharp rise in consumption of fixed capital charges on weapon systems which were capitalised according to the recommendations of the 2008 SNA.

– Table 4 presents the changes in the average annual real growth rates between 2006 and 2013 measured at 2010 prices compared with the average growth over the same period at 2005 prices. Growth in real gross domestic product was revised slightly downwards. The average annual rate of increase between 2006 and 2013 was estimated at 2,5 per cent at 2010 prices compared with a rate of 2,7 per cent estimated at 2005 prices. The real value added by the primary sector estimated at 2010 prices showed no growth compared with a rate of 0,2 per cent at 2005 prices. The real output of the agricultural sector increased, while the negative growth in mining output was maintained at a rate of 0,9 per cent measured at both 2005 and 2010 prices. Real value added by the secondary sector increased slightly faster on the new basis with its average growth rate rising from 1,6 per cent measured at 2005 prices to 1,7 per cent at 2010 prices. This essentially reflected higher growth in the real value added by the construction sector measured at 2010 prices. Growth in the real value added by the manufacturing sector registered a slower pace on the new basis, while that of electricity, gas and water remained unchanged. The pace of increase in the real value added by the tertiary sector was maintained at an annualised rate of 3,3 per cent measured at both 2005 and 2010 prices. Higher growth in the commerce and general government services sectors offset somewhat slower growth in the real value added by the transport, storage and communications, and the finance and other services sectors when measured at 2010 prices.

Table 4 Growth in real gross domestic product by kind of economic activity between 2006 and 2013

Per cent

Sectors	Compound annual rates at 2005 prices	Compound annual rates at 2010 prices
Primary sector	**0,2**	**0,0**
Agriculture	3,0	3,2
Mining	-0,9	-0,9
Secondary sector	**1,6**	**1,7**
Manufacturing	1,2	1,1
Electricity, gas and water	0,1	0,1
Construction	5,2	5,6
Tertiary sector	**3,3**	**3,3**
Trade, catering and accommodation	2,7	2,8
Transport, storage and communication	3,0	2,8
Financial and business services	4,1	3,6
Government	3,4	3,9
Other services	2,2	2,1
Total	**2,7**	**2,5**

Revisions to the components of gross domestic expenditure

Revisions to the components of gross domestic expenditure were informed by the outcome of the previously mentioned sources, a thorough analysis of certain components of households' consumption expenditure, and of the income and expenditure of general government at all levels, including audited information that became available, and the incorporation of additional information pertaining to gross fixed capital formation and the book value of inventories as outlined below.

Table 5 Contribution of expenditure components to total gross domestic product

Per cent

Components	2005 base year	2010 base year
Final consumption expenditure		
Households	63,1	59,0
General government	19,5	20,2
Gross fixed capital formation	16,8	19,3
Change in inventories	1,2	0,2
Gross domestic expenditure		
Exports of goods and services	27,4	28,6
Imports of goods and services	27,8	27,5
Residual	0,0	0,0
Gross domestic product	100,0	100,0

The revised estimates of final consumption expenditure by households were based on data obtained from, among others, the 2010/11 *Income and Expenditure Survey of Households,* the 2011 *Population Census* results; financial reports of companies; information from the National Gambling Board, Bureau of Market Research, the Federation of governing bodies of South African Schools (FEDSAS), the National Association of Automobile Manufacturers of South Africa (NAAMSA); and results of special research projects undertaken by the Bank in respect of medical aid schemes.

All subcategories of household expenditure were revised. The extent of the revisions varied from relatively insignificant to fairly substantial in the case of certain categories. Marginal changes were made to estimates in the new benchmark period by factoring in additional information regarding gambling, social protection, veterinary and other services for pets, and small tools and accessories for the house and garden, in line with the classification of individual consumption by Purpose (COICOP) reference classification.

As indicated in Table 6, the average annual rate of growth in real outlays on final consumption expenditure by households moderated from 3,1 per cent calculated at 2005 prices to 2,9 per cent measured at 2010 prices in the period between 2006 and 2013. The slower pace of increase was more pronounced in 2008 and 2009 when growth rates of 2,2 per cent and -1,6 per cent were re-estimated as 1,0 per cent and -1,8 per cent respectively. As a share of gross domestic product, final consumption expenditure by households declined from 63,1 per cent in the 2005 base year to 59,0 per cent in 2010.

Table 6 Growth in real expenditure on gross domestic product by main expenditure component, 2006 to 2013

Per cent

Components	Annualised growth rates at 2005 prices	Annualised growth rates at 2010 prices
Final consumption expenditure		
Households	3,1	2,9
General government	4,1	3,7
Gross fixed capital formation	4,7	4,5
Change in inventories (R billions)*	3,44	10,31
Gross domestic expenditure	3,2	3,1
Exports of goods and services	0,9	1,0
Imports of goods and services	3,1	2,9
Gross domestic product	2,7	2,5

* Average annual change in R billions at constant prices

Consumption expenditure by general government was revised in accordance with the latest available information on current expenditure by general government at national, provincial and local government level. A notable methodological change was incorporated in the estimation process of the compensation of general government employees on both nominal and constant price basis. Building block data in this area, such as cash payments, are quite volatile from quarter to quarter. Recognising the continuity in most government services and relative stability in government employment and underlying spending on salaries and wages, an estimation process to adjust for accrual accounting through smoothing the data was accepted. Quarterly data on nominal salaries and wages were smoothed by using a five-term Henderson filter. The deflation process to obtain a measure of the volume of services rendered by government employees was enhanced by distinguishing between the various categories of government employees and their respective average salary levels, rather than using the overall headcount only. Data were also smoothed by using a five-term Henderson filter. Special adjustments were made to factor in events such as strikes and short-term employment in the government sector related to elections and the population census.

In addition to the methodologically enhanced estimation of salaries and wages in calculating final consumption expenditure by general government, other changes affecting this component include the following:

– General government consumption expenditure on non-wage goods and services was balanced with disaggregated data as published by Stats SA for full fiscal years.
– Data for business enterprises were removed from the statistics of local government with effect from 2007 to improve the measurement of the general government services rendered by local government.
– Spending on weapon systems, previously included in non-wage goods and services, was excluded together with expenditure on R&D.
– Increases in the consumption of fixed capital followed the capitalisation of expenditure on weapon systems and R&D.
– Provision for FISIM and a portion of the output of the central bank was added to the expenditure on non-wage goods and services.

Consequently, final consumption expenditure by general government increased from 19,5 per cent of gross domestic product in the 2005 base period to 20,2 per cent in 2010, even though average growth in real aggregate final consumption expenditure by general government was revised downwards for the period between 2006 and 2013 from 4,1 per cent per annum calculated at 2005 prices to 3,7 per cent measured at 2010 prices.

The revised estimates of gross fixed capital formation originated mainly from the partial implementation of the 2008 SNA.

– R&D was added as a new asset type to each sector of economic activity. Information was compiled by using source data from the South African *Survey of Research and Development* produced by CeSTII on behalf of the DST. The distribution between the sectors was based on data obtained from the QFS and AFS published by Stats SA.
– The category animal resources yielding repeat products was added to capital expenses. Data were obtained from the Department of Agriculture, Forestry and Fishing.
– The level of capital expenditure by the finance and real-estate sector increased as the capitalisation of low-cost housing was revisited from the early 1990s.
– Capital expenditure on mineral exploration was reclassified and shown separately as gross fixed capital formation. Tree, crop and plant resources currently form part of cultivated biological resources. These outlays were previously classified as construction works.
– Capital outlays on ICT equipment and on computer software are now shown separately as individually classified capital assets.
– Spending on weapon systems, previously treated as consumption expenditure by general government, was classified as fixed assets.

Real outlays on gross fixed capital formation were revised slightly downwards. In the period 2006 to 2013, the average annual rate of increase was estimated at 4,5 per cent at 2010 prices compared with a rate of 4,7 per cent estimated at 2005 prices. Growth rates of -4,3 per cent in 2009 and -2,1 per cent in 2010 were revised to -6,7 per cent and -3,9 per cent respectively. Gross fixed capital formation as a percentage of gross domestic product increased from 16,8 per cent in 2005 to 19,3 per cent in 2010.

The incorporation of improved statistics on the book value of inventories as sourced from the AFS and QFS published by Stats SA, as well as information from financial statements of companies, resulted in somewhat higher estimates of inventory investment at current prices over the period 2006 to 2013. At constant prices, the average annual level of change in inventories at 2005 prices amounted to R3,4 billion over the period and to R10,3 billion measured at 2010 prices.

Conclusion

The main thrust of the SNA has stood the test of time, with gradual enhancement to cater for a changing world. It is trusted that the incorporation of key changes proposed in the 2008 SNA and the results of the general benchmarking, revision and rebasing of the national accounts in South Africa, as released on 25 November 2014 by Stats SA and in this issue of the *Quarterly Bulletin*, will serve the users of macroeconomic data on South Africa well.

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Note on the conversion and revision of South Africa's balance-of-payments statistics

by L Motsumi, P H Swart, Z B Jansen, M J Steenkamp and M L Chiloane

Background

In order to keep abreast of international best practice in the compilation and dissemination of balance-of-payments statistics, the South African Reserve Bank (the Bank) has aligned South Africa's balance-of-payments statistics with the guidelines provided in the Sixth Edition of the *Balance of Payments and International Investment Position Manual* (BPM6) of the International Monetary Fund (IMF). The revised statistics, including a change in the analytical presentation of the balance of payments, are disseminated in this edition of the *Quarterly Bulletin.*

Consistent with previous balance-of-payments manuals, BPM6 provides guidance to member countries of the IMF on the principles, concepts and methodological practices underlying the compilation of balance-of-payments statistics. By adhering to these guidelines, transactions between residents of different economies are recorded in accordance with internationally agreed standards.

BPM6 largely reflects changes that have occurred in the global economy since the release of BPM5 in 1993. Over the period, globalisation gave rise to a further increase in cross-border activity, ongoing financial innovation and increased financial flows. The basic framework for balance-of-payments data developed in BPM5 was maintained in BPM6. Changes proposed in BPM6 were, however, harmonised with the 2008 *System of National Accounts* (2008 SNA) and various other manuals, thereby enhancing the consistency between major macroeconomic statistical frameworks and data sets.

The revision and reclassification of balance-of-payments statistics will enable data users to compare balance-of-payments statistics internationally. To allow for consistency between balance-of-payments and national accounts statistics, the conversion to BPM6 and the partial implementation of the 2008 SNA were scheduled to coincide with the benchmarking and rebasing of the national accounts statistics at the end of 2014. The revised balance-of-payments statistics as published in this edition of the *Quarterly Bulletin* reflect the impact of the implementation of BPM6, the incorporation of new data sources as well as general revisions that are usually undertaken on an annual basis.

Detail of the revisions: Current account

Revisions related to the conversion from BPM5 to BPM6

– The reclassification of goods for processing. In BPM6 all fees received by economies for the processing of goods that have not changed ownership are to be recorded as service earnings. In BPM5 the inward and outward flows of processed goods were recorded on a gross basis in the trade account, thereby imputing a change of ownership.

– The further disaggregation of trade in services. While 'transportation' and 'travel' will continue to be reported on, the item 'other services' has been disaggregated into several subcategories aligned with BPM6. These subcategories will initially only be disseminated on an annual basis; see page S–84 (Table KB505) and page S–85 (Table KB532) of the *Quarterly Bulletin*.

The disaggregated ‘other services’ categories are:

– manufacturing services on physical inputs owned by others (*previously known as goods for processing)*;
– repairs and maintenance services on movable goods (not included elsewhere);
– telecommunications, computer and information services;
– financial and insurance services;
– charges for the use of intellectual property;
– personal, cultural and recreational services;
– other business and miscellaneous services; including inter alia:
  - legal services;
  - accounting services;
  - advertising and market research services; and
  - architectural, engineering and other technical services.

Data enhancements resulting from the incorporation of additional and/or more reliable data sources

– Trade in merchandise goods has been adjusted for the period 2006 to 2013 to fully reflect the latest available set of bilateral trade data – as released by the South African Revenue Service (SARS) – between South Africa and its neighbouring partner countries in the Southern African Customs Union (SACU), namely Botswana, Lesotho, Namibia and Swaziland. In the December 2013 edition of the *Quarterly Bulletin*, the Bank partially amended bilateral trade statistics as from 2010, thereby substituting previous estimations made by the Bank in the absence of reliable bilateral trade data between South Africa and these neighbouring countries. In addition, the Bank has also adjusted trade statistics to reflect the impact of ‘vouchers of correction’ submitted to SARS.

  A comparison of the levels of the current and the revised nominal values for merchandise exports and imports for the years 2012 and 2013 is shown in Table 1.

– International trade in services

  With regard to the trade in services, the ‘other services’ component has been disaggregated into a number of subcategories by making use of additional micro data sets. As a result, the value for international trade in services was revised. Table 1 displays the newly estimated levels for ‘net service payments’ in the services, income and current transfer account.

Table 1 Impact of migration to BPM6 and incorporation of general revisions on the current account of the balance of payments

R billions

	BPM5		BPM6 and general revisions	
	2012	2013	2012	2013
Trade account				
Merchandise exports	744	854	754	869
Net gold exports	71	64	71	64
Minus: Merchandise imports	854	991	857	1 001
Trade balance	**-40**	**-74**	**-32**	**-68**
Net service, income and current transfer account				
Net service payments	-20	-22	-9	-12
Transportation				
Passenger fares	-15	-18	-15	-18
Other	-36	-40	-25	-27
Travel	49	56	49	56
Other services	-18	-20	-18	-23
Manufacturing services on physical inputs owned by others	-	-	0	0
Repairs and maintenance services on movable goods n.i.e.	-	-	0	1
Financial and insurance services	-	-	3	4
Charges for the use of intellectual property	-	-	-15	-18
Telecommunications, computer and information services	-	-	-3	-4
Personal, cultural and recreational services	-	-	1	1
Other business and miscellaneous services	-	-	-4	-7
Net income payments	-73	-71	-88	-93
Net current transfer payments	-31	-31	-31	-31
Net service, income and current transfer balance	**-124**	**-124**	**-128**	**-136**
Balance on current account	**-165**	**-197**	**-162**	**-204**
As percentage of gross domestic product	-5,2	-5,8	-5,0	-5,8

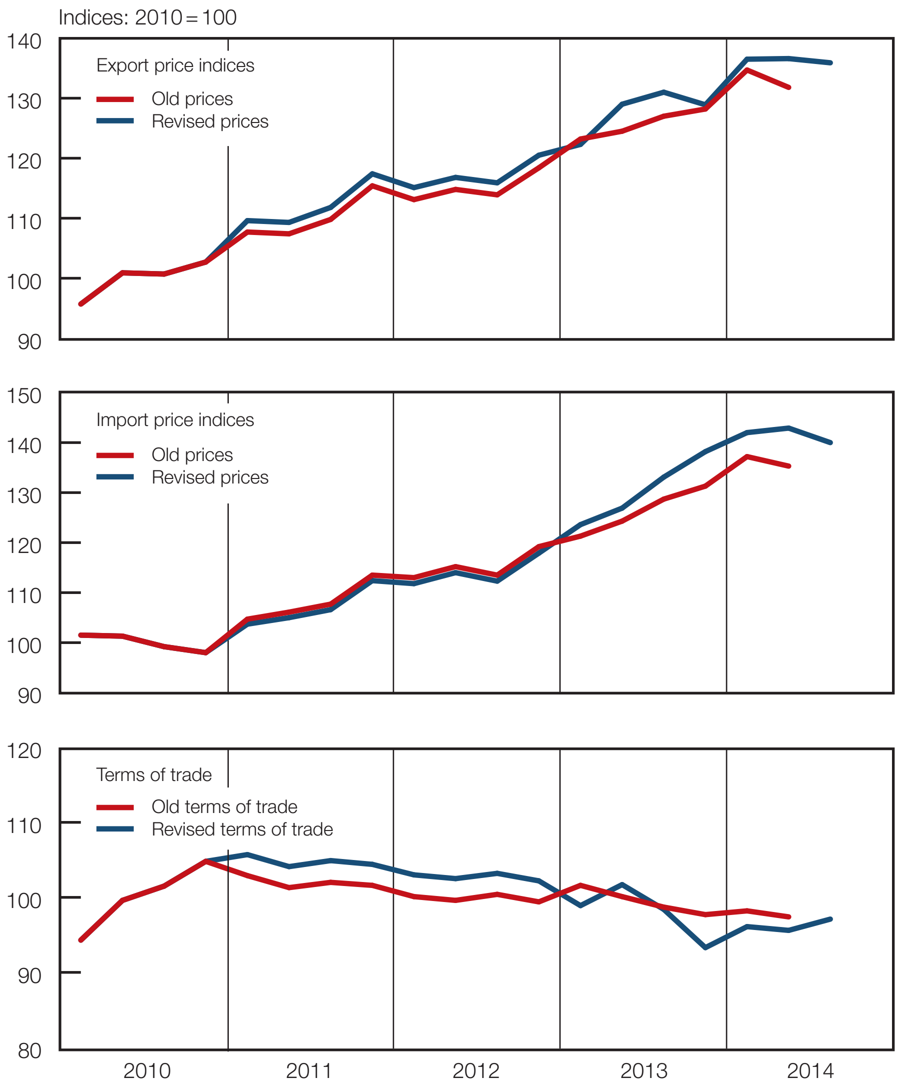
Components may not add up to totals due to rounding

– Price deflators for exports and imports

In February 2013 Statistics South Africa (Stats SA) released unit value indices (UVIs) for merchandise exports and imports from January 2010. In deriving values at constant prices for merchandise exports and imports, the Bank opted to use a combination of UVI information and realised prices of specific commodities and other products, where applicable, to derive suitable price deflators for both balance-of-payments and national-account statistics from the first quarter of 2013, as shown in the graph on the next page. Based on the newly calculated price deflators, South Africa's terms of trade for merchandise, excluding gold, seem to have deteriorated slightly more in the recent past than previously indicated.

– Data for most subcategories of the current account were revised back to 2005.

Impact of changes in merchandise export and import prices



Detail of the revisions: Financial account and international investment position

Changes related to BPM6

The adoption of BPM6 had a minimal impact on the financial account as most changes were confined to reclassifications, the refinement of definitions and layout changes. Financial account data have been revised back to 2011.

– The analytical presentation of the financial account of the balance of payments and the international investment position has been amended to incorporate additional functional categories. The previous three functional categories in the financial account of the balance of payments, namely *direct investment*, *portfolio investment* and *other investment*, were expanded to include two additional functional categories, namely *financial derivatives* and *reserve assets*. Furthermore, changes in liabilities and assets will in future be referred to as 'net incurrence of liabilities' and 'net acquisition of financial assets'. In the interest of consistency, the changes made to the layout of the financial account have also been incorporated in the country's international investment position.

- While the use of a positive and negative (+/-) sign convention used in previous editions of the *Quarterly Bulletin* was maintained, the sign convention with regard to reserve assets has been changed as a result of this category now being part of the financial account. An increase in reserve assets is accordingly indicated by a negative sign and a decrease by a positive sign.
- The allocation of special drawing rights (SDRs) is shown under the *other investment* category: *net incurrence of liabilities*, depicting the unique nature of SDRs. Previously, any allocation of SDRs was deducted from the changes in gross gold and other foreign reserves to derive the change in net international reserves or reserve assets.

Data enhancements resulting from the use of new or additional data sources and other ordinary revisions

- Balance-of-payments transactions related to financial derivatives have been included as an additional functional category in the financial account from the first quarter of 2011. The inclusion of financial derivatives as a functional category in the financial account of the balance of payments has partly reduced the magnitude of the country's unrecorded transactions in recent years.

Table 2: Transactions in financial derivatives

R billions

	Net incurrence of liabilities	Net acquisition of financial assets	Net financial derivatives
1st quarter 2011	-51,281	58,898	7,617
2nd quarter 2011	-53,075	49,377	-3,698
3rd quarter 2011	-59,150	61,435	2,285
4th quarter 2011	-81,556	88,491	6,935
2011	-245,062	258,201	13,139
1st quarter 2012	-57,605	64,948	7,343
2nd quarter 2012	-46,912	49,989	3,077
3rd quarter 2012	-44,365	51,267	6,902
4th quarter 2012	-64,987	62,043	-2,944
2012	-213,869	228,247	14,378
1st quarter 2013	-47,912	51,518	3,606
2nd quarter 2013	-44,838	47,083	2,245
3rd quarter 2013	-50,063	51,246	1,183
4th quarter 2013	-45,541	45,985	0,444
2013	-188,354	195,832	7,478
1st quarter 2014	-47,961	54,179	6,218
2nd quarter 2014	-43,713	48,354	4,641
3rd quarter 2014	-39,592	40,346	0,754

Conclusion

The adoption of BPM6 followed from South Africa's commitment to adhere to international best practice in compiling balance-of-payments statistics. A table comparing the BPM5 and BPM6 frameworks as adopted by South Africa is appended as Annexure A. With the main recommendations of BPM6 now implemented, South Africa aims to introduce the remaining (minor) recommendations gradually over the next few years.

Annexure A: Comparison of the BPM5 and BPM6 frameworks as adopted by South Africa

BPM5	BPM6
Current account	Current account
Merchandise exports	Merchandise exports
Net gold	Net gold
Minus: Merchandise imports	*Minus:* Merchandise imports
Trade balance	Trade balance
Net service payments	Net service payments
Transportation	Transportation
Passenger fares	Passenger fares
Other	Other
Travel	Travel
Other services	Other services
	Manufacturing services on physical inputs owned by others
	Repairs and maintenance services on movable goods n.i.e.
	Financial and insurance services
	Charges for the use of intellectual property
	Telecommunications, computer and information services
	Personal, cultural and recreational services
	Other business and miscellaneous services
Net income payments	Net income payments
Net current transfer payments	Net current transfer payments
Net service, income and current transfer balance	Net service, income and current transfer balance*
Current account balance	Current account balance
Capital transfer account balance	Capital transfer account balance
Financial account	Financial account
Direct investment	*Net direct investment* (Inflow (+)/outflow (-)) (1)
Liabilities	Net incurrence of liabilities
Assets	Net acquisition of financial assets
Net direct investment (1)	
Portfolio investment	*Net portfolio investment* (Inflow (+)/outflow (-)) (2)
Liabilities	Net incurrence of liabilities
	Equity securities
	Debt securities
Assets	Net acquisition of financial assets
	Equity securities
	Debt securities

Net portfolio investment (2)	
	Net financial derivatives (Inflow (+)/outflow (-)) (3)
	Net incurrence of liabilities
	Net acquisition of financial assets
Other investment	*Net other investment* (Inflow (+)/outflow (-)) (4)
Liabilities	Net incurrence of liabilities
Assets	Net acquisition of financial assets
Net other investment (3)	
	Reserve assets (Increase (-)/decrease (+)) (5)
Balance on financial account (1) + (2) + (3)	Balance on financial account (1) + (2) + (3) + (4) + (5)
	Memo item: Balance on financial account excluding reserve assets (1) + (2) + (3) + (4)
Unrecorded transactions	Unrecorded transactions (6)
Change in net gold and other foreign reserves owing to balance of payments transactions	
Change in liabilities related to reserves	
SDR allocations and valuation adjustments	
Net monetisation (+) / demonetisation (-) of gold	
Change in gross gold and other foreign reserves	
Memo item: Change in capital transfer and financial accounts including unrecorded transactions	Memo item: Balance on financial account excluding reserve assets including unrecorded transactions
	(1) + (2) + (3) + (4) + (6)

* These figures are reported on a gross basis in the annual 'services, income and current transfers' table

Notes to tables

Social security funds: Liabilities and assets
Table S–76

A table with consolidated balance-sheet information of the four social security funds has been added, improving the coverage of the public sector in the *Quarterly Bulletin*. The social security funds constitute a subsector of central government, and consist of:

- the Unemployment Insurance Fund;
- the Road Accident Fund;
- the Compensation Fund; and
- the Compensation Commissioner for Occupational Diseases in Mines and Works.

Balance of payments: Services, income and transfer receipts and payments – annual figures
Tables S–84 and S–85

The alignment of international trade in services with the guidelines of the *Balance of Payments and International Investment Position Manual* (BPM6) along with the availability of more comprehensive data resulted in the dissemination of a more detailed breakdown of the 'other services' category in the services account of the balance of payments. The additional subcategories will be updated on an annual basis.

Balance of payments: Services, income and transfer receipts and payments – quarterly figures
Tables S–86 and S–87

Quarterly estimates of services, income and transfer receipts and payments are now shown in separate tables as gross receipts and gross payments respectively.

Balance of payments and international investment position
Tables S–80, S–81 and S–88 to S–101

The layout of the balance of payments and the international investment position changed as a result of the conversion to BPM6. With the newly included financial derivatives and reserve asset categories, the financial account and the international investment position now comprise five functional categories, namely direct investment, portfolio investment, financial derivatives, other investment and reserve assets.

Gross fixed capital formation
Tables S–118 and S–119

Gross fixed capital formation by general government is no longer subdivided between such expenditure incurred by general government entities and business enterprises of general government, due to insufficient data.

Gross fixed capital formation by type of asset
Tables S–122 and S–123

Following the outcome of the five-yearly benchmarking of national accounts statistics and the implementation of key recommendations of the 2008 *System of National Accounts* (2008 SNA), a number of additional asset types have been incorporated as part of total gross fixed capital formation. Changes to the tables include the following:

- **Research and development** is now shown as a separate capital asset category.
- Capital expenditure on **information and communications technology (ICT) equipment and computer software,** previously regarded as one asset type, is now split and shown as two separate capital asset categories.
- Capital expenditure on **mineral exploration,** previously part of construction works, is now reclassified and shown as a separate asset category.
- Outlays on **cultivated biological resources,** including animal resources yielding repeat products and tree, crop and plant resources have been incorporated as an additional asset category.
- Spending on military **weapon systems** has been allocated to different asset categories.

Fixed capital stock
Table S–125

The capital stock of general government is no longer split between general government and government business enterprises.

Production, distribution and accumulation accounts of South Africa
Tables S–129 to S–134

To better inform users of the national accounts, the names of the particular subaccounts have been added to the tables. The closing balance of the one account reflects the opening balance of the subsequent account in the sequence of accounts.