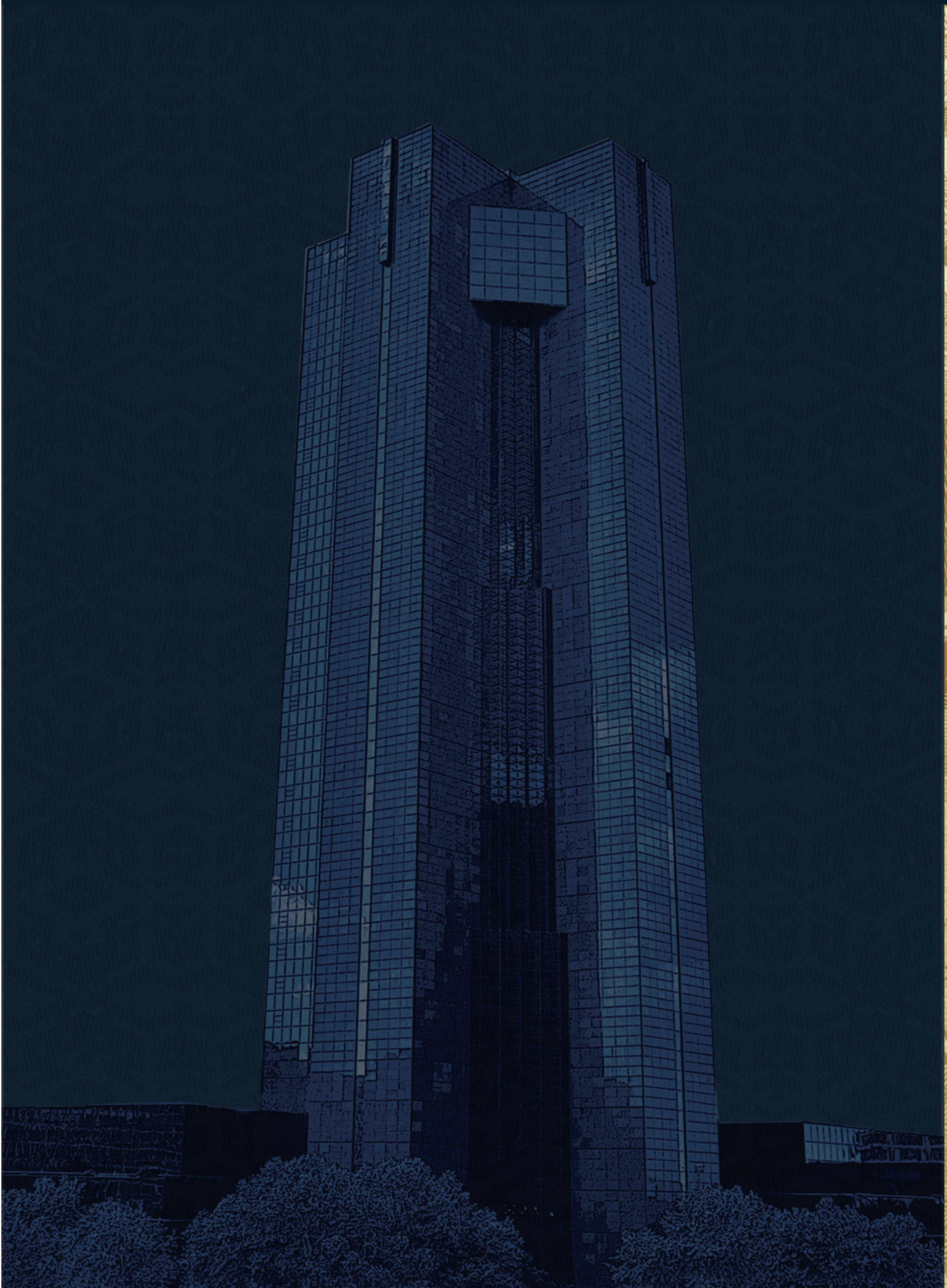
Quarterly Bulletin

March 2015



South African Reserve Bank

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Enquiries relating to this *Bulletin* should be addressed to:

Head: Research Department
South African Reserve Bank
P O Box 427
Pretoria 0001
Tel. +27 12 313-3668/3676

http://www.reservebank.co.za

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Introduction

The global economic recovery remained hesitant in 2014, with growth moderating in the final quarter of the year as activity slowed sharply in emerging-market economies. International crude oil prices, which declined considerably from the middle of 2014, continued to trend lower in the final quarter of 2014, reinforced by the stronger United States (US) dollar, weak demand and the decision by oil producers to refrain from cutting back on production. This marked decline in international crude oil prices occurred alongside a moderation in a wide range of other international commodity prices in the final quarter of 2014, thereby not only assisting in the containment of global price inflation but also raising the spectre of deflation in some economies and detracting from commodity-producing countries' export earnings. In January 2015, the price of Brent crude oil sank to a six-year low of US$45 per barrel before recovering somewhat thereafter.

In line with the lustreless global growth performance, the International Monetary Fund (IMF) lowered its forecast of world growth for both 2015 and 2016 in January 2015, weighed down largely by the weaker medium-term growth outlook for especially China, Russia, the euro area, Japan and a number of major oil-exporting countries. Under these circumstances, monetary policy remained expansionary in most parts of the world, with central banks in major advanced economies signalling that policy normalisation would not be hastened and would be gradual. A number of central banks in emerging-market economies have also eased monetary policy in recent months. The European Central Bank (ECB) in late January 2015 announced details of its long-awaited quantitative easing programme. A week earlier the Swiss National Bank after three years abandoned its policy of intervention in the market for foreign exchange to cap the external value of the Swiss franc at 1,2 franc per euro. Immediately thereafter the Swiss franc appreciated significantly.

Economic activity in South Africa expanded at a significantly firmer pace in the fourth quarter of 2014, with real gross domestic product increasing at an annualised rate of 4,1 per cent – almost double the rate of increase recorded in the preceding quarter. This acceleration largely reflected a rebound in the goods-producing sectors of the economy as conditions normalised after severe strike-induced labour disruptions earlier in 2014. Mining production, which contracted notably in the first half of 2014 due to prolonged industrial action in especially the platinum-mining sector, increased at a moderate rate in the third quarter of 2014 before picking up pace in the fourth quarter as pronounced increases in the production of platinum group metals and diamonds more than offset decreases in the production of coal and other mining commodities. At the same time, the pace of increase in the real value added by the agricultural sector slowed somewhat, mainly as a result of lower growth in field crop production.

In the manufacturing sector, growth in real value added rebounded strongly in the fourth quarter of 2014, following strike-induced contractions earlier in the year. Growth in the construction sector also picked up in the quarter concerned as civil construction activity maintained its underlying momentum, underpinned by increased activity in the residential and non-residential building subsectors. By contrast, growth in the services sector moderated following a marginal contraction in the real value added by the commerce sector, offsetting a steady pickup in the output of the transport and finance sectors.

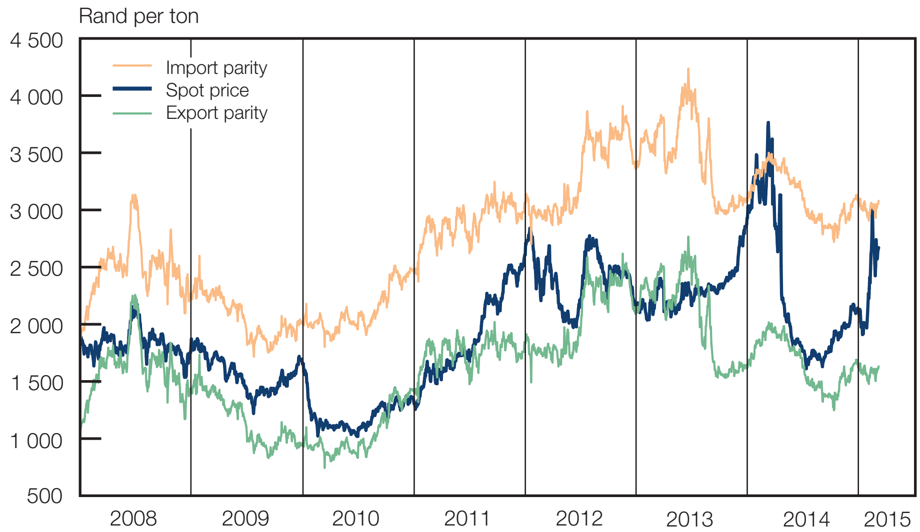
Real domestic final demand maintained its upward momentum in the final quarter of 2014, led by higher growth in both household consumption expenditure and aggregate capital spending. Growth in real final consumption expenditure by the household sector accelerated in the quarter concerned, consistent with the higher growth in household disposable income. Expenditure on durable and semi-durable goods increased notably over the period, partly encouraged by relatively favourable prices, while higher spending on non-durable goods probably partly reflected the benefit of some windfall gains following lower domestic petrol prices.

Fixed capital formation increased at a somewhat faster pace in the fourth quarter of 2014 as higher real capital outlays were recorded by all three institutional sectors. Growth in fixed capital spending by private business enterprises accelerated moderately over the period, buoyed mainly by increased spending in the mining, manufacturing, trade, and finance sectors. Simultaneously, fixed capital formation by public corporations maintained its underlying momentum, dominated by spending in the transport and electricity-generating sectors. By contrast, growth in real gross fixed capital outlays by general government slowed over the period.

Consistent with the low growth trajectory of the South African economy, enterprise-surveyed employment in the formal non-agricultural sector expanded by only 1 per cent over the four quarters to the third quarter of 2014. However, with year-on-year remuneration growth per worker accelerating briskly and output growth slowing, growth in nominal unit labour cost in the formal non-agricultural sector of the economy exceeded the upper limit of the inflation target range. The official unemployment rate was marginally higher in the fourth quarter of 2014 compared with a year earlier, with youth unemployment remaining elevated.

Inflationary pressures moderated notably from mid-2014. As a result, headline consumer price inflation slowed to around the midpoint of the inflation target range in January 2015 – its fifth consecutive month of being within the target range. The recent moderation was mainly driven by a deceleration in non-durable goods price inflation, primarily of petrol and food. Underlying consumer price inflation, however, remained sticky at just below the upper limit of the inflation target range, while the outlook for the prices of fuel and some categories of food has recently deteriorated somewhat.

Price of white maize



With real domestic expenditure increasing at a slower pace than real domestic production in the final quarter of 2014, the volume of merchandise imports advanced at a notably slower pace than the volume of merchandise exports. Export volumes benefited from the normalisation of production in the mining and manufacturing sectors, a marginal improvement in the country's terms of trade, and the more competitive exchange value of the rand. While the trade deficit with the rest of the world narrowed markedly, this was partly offset by higher net dividend payments to non-resident investors. As a result of these developments, the current-account deficit narrowed from 5,8 per cent of gross domestic product in the third quarter of 2014 to

5,1 per cent in the fourth quarter. This negative imbalance was largely financed by a net inflow of other investment capital, which consisted mainly of foreign currency-denominated loans extended to the South African banking sector.

Growth in overall bank credit extension remained pedestrian in 2014, consistent with the subdued performance of the economy. While credit extension to the household sector remained quite weak, resulting in a modest reduction in the ratio of household debt to disposable income, bank loans and advances to companies gained some momentum over the period, facilitating expansion and capital formation, providing working capital and buffering erratic cash flows. Growth in the money supply also remained in single-digit territory, broadly replicating the sideways trend observed over the preceding three years and measuring slightly below the comparable growth in nominal gross domestic product over the same period. Money-supply growth ticked moderately higher during the second half of 2014 as households and non-financial companies raised their deposit holdings.

South African bond yields moved generally lower from early 2014, in line with US bond yields. Local yields receded further in January 2015, supported by an improved inflation outlook and abundant international liquidity following the announcement of an expanded asset-purchase programme by the ECB and continued quantitative easing out of Japan. Bond yields edged higher in early March 2015 as a reversal in the oil price, the announcement of higher levies on fuel and rand depreciation impacted on inflation expectations. Most money-market interest rates have displayed little movement since the middle of 2014, remaining well-aligned with the repurchase rate of the South African Reserve Bank (the Bank) that had been held steady over this period.

Despite the subdued growth in the economy over the past year, domestic share price entered 2015 on a positive note, recovering from the losses incurred in the second half of 2014 to reach all-time-high levels in March 2015. The domestic share market benefited from sustained accommodative monetary policies in the advanced economies, while lower international oil prices and the depreciation of the rand also boosted some share prices. Corporate funding through the issuance of shares in the primary share market rose considerably in 2014, consistent with the high level of share prices and rising number of companies listed on the JSE Limited.

The residential property market continued to display signs of gradual improvement in the second half of 2014, as the rate of increase in house prices stayed slightly ahead of consumer price inflation and as sale-in-execution notices declined.

The public-sector borrowing requirement amounted to about 6 per cent of gross domestic product in the period April to December 2014, with both general government and the non-financial public corporations incurring deficits. Capital expenditure by the public sector continued to exceed the sector's borrowing requirement over this period.

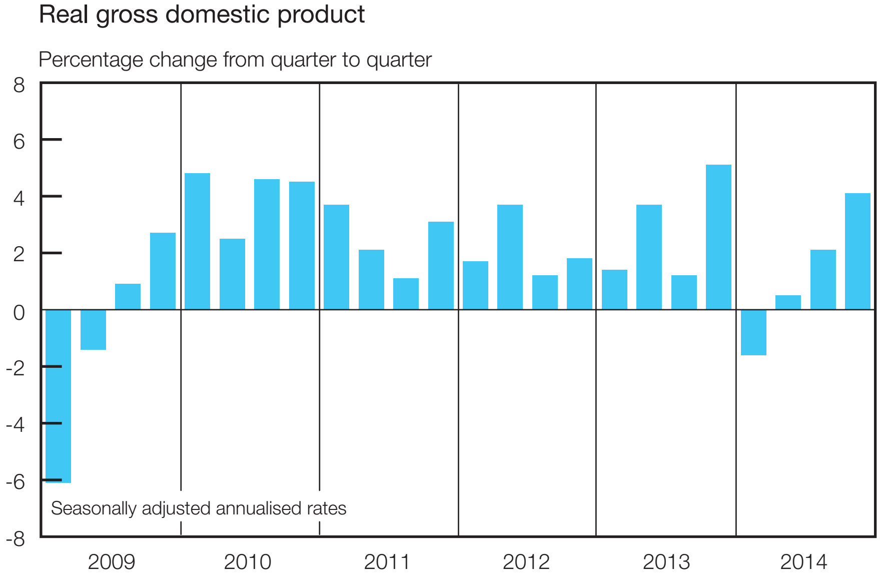
Delivered in February 2015, the Budget for fiscal 2015/16 incorporated measures to narrow the fiscal deficit and arrest the unsustainable upward trend in government's debt ratio. Government expenditure growth would be capped, while additional revenue would be raised by, inter alia, increasing the fuel levy, taxes on tobacco and alcohol, and personal income tax payable by persons in the middle- and higher-income groups. The budget pledged to address economic constraints, improve growth performance and broaden economic participation as envisaged by the National Development Plan.

Domestic economic developments

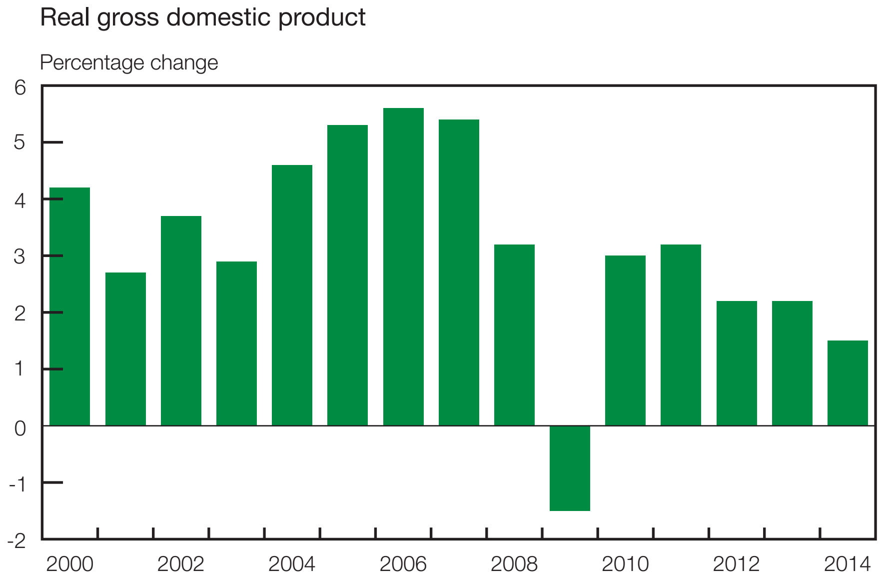
Domestic output[1]

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

Real economic activity in South Africa expanded at a significantly faster pace in the fourth quarter of 2014. Growth in *real gross domestic product* accelerated from a revised annualised rate of 2,1 per cent in the third quarter of 2014 to 4,1 per cent in the fourth quarter due to a rebound in both the primary and secondary sectors. The real value added by the tertiary sector, however, increased at a somewhat slower pace over the period.



Despite the firm acceleration in quarter-to-quarter growth in the fourth quarter of 2014, growth in real output slowed from 2,2 per cent in 2013 to a disappointing 1,5 per cent in 2014. With the exception of 2009, when gross domestic production contracted, this was the lowest annual growth recorded in the past 16 years. On average, annual growth amounted to 2,4 per cent in the five-year period from 2010 to 2014 compared with an average of 3,6 per cent in the ten years prior to 2010.



The lacklustre performance of the South African economy in 2014 can be attributed to, among other factors, the adverse impact of the five-month-long labour strike in the platinum-mining sector in the first half of 2014 and industrial action in the steel and engineering sector in July, various structural impediments in the economy including the lack of a steady supply of electricity, lower prices of key export commodities, subdued business and consumer confidence levels, and lustreless global economic growth.

Excluding the strike-affected mining and manufacturing sectors, real gross domestic product would have registered growth of 2,2 per cent for 2014.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2013	2014				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sector	3,4	-17,2	-1,0	5,2	13,3	0,0
Agriculture	1,5	4,8	5,6	9,5	7,5	5,6
Mining	4,0	-22,8	-3,0	3,9	15,2	-1,6
Secondary sector	0,9	-3,8	-2,5	-0,4	7,2	0,4
Manufacturing	0,7	-6,4	-4,0	-1,0	9,5	0,0
Tertiary sector	2,5	1,7	1,9	2,4	1,8	2,1
Total excluding mining and manufacturing	*2,4*	*1,8*	*2,0*	*2,5*	*2,0*	*2,2*
Total	2,2	-1,6	0,5	2,1	4,1	1,5

Real production of the *primary sector* increased at an annualised rate of 13,3 per cent in the fourth quarter of 2014 following growth of 5,2 per cent in the preceding quarter. The firm increase in the final quarter of 2014 mainly resulted from the brisk rate of increase in the real value added by the mining sector, while the real output of the agricultural sector increased at a slower pace over the period. In 2014 as a whole, strong growth in the agricultural sector was offset by the contraction in the real value added by the mining sector, resulting in the real output of the primary sector remaining broadly unchanged over the period.

Having increased at an annualised rate of 9,5 per cent in the third quarter of 2014, growth in the real value added by the *agricultural sector* slowed to 7,5 per cent in the fourth quarter. This marginally weaker performance was partly brought about by lower growth in field crop production. In 2014, growth in the real value added by the agricultural sector accelerated to 5,6 per cent from a rate of 1,5 per cent in 2013. Output in the agricultural sector benefited, in particular, from a bumper maize crop of 14,3 million tons harvested in the 2013/14 production season – the largest maize crop since 1981.

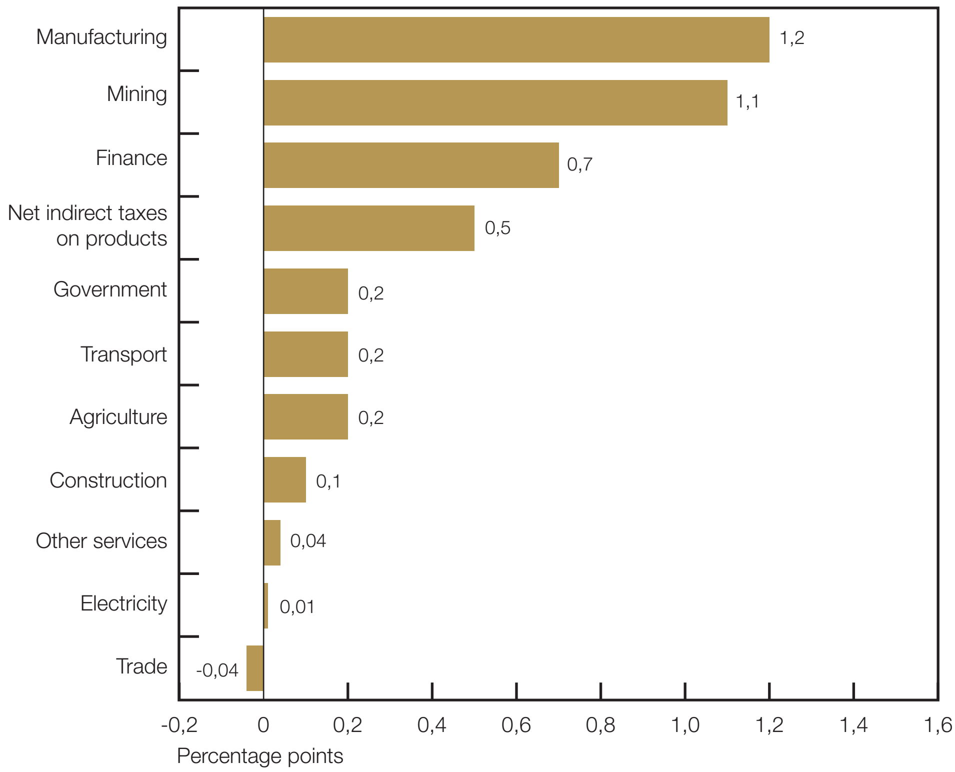
The real value added by the *mining sector* advanced at an annualised rate of 15,2 per cent in the fourth quarter of 2014, boosted by pronounced increases in the production of platinum group metals and diamonds. Platinum production benefited from an increase in production volumes, and improved productivity and cost reduction measures implemented at some platinum mines following the resolution of the protracted labour strike in the industry earlier in 2014. Diamond production, in turn, was buoyed by increased efficiency in the mining and processing of gravel, brought about by the introduction of new technologically advanced mining equipment. By contrast, production volumes decreased in the coal and other mining subsectors.

On an annual basis, the real output of the mining sector declined at a rate of 1,6 per cent in 2014 as the production of gold, diamonds, copper, coal and platinum decreased. The industry continued to be negatively affected by infrastructural constraints, policy uncertainty, ongoing labour tension, lower commodity prices alongside rising operational costs, and the fragile global recovery. Mining production subtracted 0,1 percentage point from overall economic growth in 2014, after adding 0,3 percentage points in 2013.

Growth in the real value added by the *secondary sector* picked up to an annualised rate of 7,2 per cent in the fourth quarter of 2014, following negative growth at a rate of 0,4 per cent in the third quarter. The real value added by the manufacturing and the electricity, gas and water sectors increased in the final quarter of 2014, recording positive growth alongside a solid increase in construction activity.

Subsequent to a contraction in the first three quarters of 2014, quarter-to-quarter growth in the real value added by the *manufacturing sector* rebounded to an annualised rate of 9,5 per cent in the final quarter of 2014, adding 1,2 percentage points to overall economic growth over the period. This robust increase primarily reflected the normalisation of production following the prolonged labour strikes in the mining and manufacturing industries earlier in 2014. All subsectors in the manufacturing sector, except for glass and non-metallic mineral products, contributed to higher output in the fourth quarter of 2014. Consistent with the higher level of manufacturing production, the utilisation of production capacity in the manufacturing sector increased from 80,7 per cent in the third quarter of 2014 to 81,5 per cent in the fourth quarter, with insufficient demand still cited as the main reason for the underutilisation of capacity in the sector.

Contribution to growth in real gross domestic product in the fourth quarter of 2014



Having increased by 0,7 per cent in 2013, the level of production in the manufacturing sector remained broadly unchanged in 2014 as a whole. The loss of momentum in 2014 stemmed largely from subdued demand, low confidence levels, labour instability, electricity shortages, and an increase in the price of electricity. Over the period, production nevertheless rose in the manufacturing subsectors for food and beverages; petroleum, chemical products, rubber and plastic products; radio, television and computer equipment; and motor vehicles, parts and accessories, and other transport equipment.

Owing mainly to increased activity in the manufacturing and mining sectors, the real value added by the sector supplying *electricity, gas and water* advanced by 0,3 per cent in the fourth quarter of 2014, having declined by 1,1 per cent in the preceding quarter. The cost of supplying electricity, however, remained high as open-cycle gas turbine stations had to be utilised extensively over the period. Production volumes were furthermore affected by the collapse of a coal storage silo which interrupted the supply of coal to boilers at a number of units, unforeseen technical problems at various power stations, further delays in the construction of the Medupi and Kusile power stations, depleted water reserves, and constraints in the supply of diesel needed to keep turbines running in order to cope with electricity demand.

The real value added by the *construction sector* advanced at an annualised rate of 3,5 per cent in the fourth quarter of 2014 compared with a rate of 2,2 per cent in the third quarter. Civil construction activity in the public sector maintained its underlying upward momentum, driven by general government spending on the construction and upgrading of roads, schools and hospitals. Activity in the residential and non-residential building industry also increased further over the period. For 2014 as a whole, the real value added by the construction sector rose by 2,9 per cent – well above the growth rates recorded in the other secondary sectors.

Growth in the real value added by the *tertiary sector* increased at a somewhat slower pace in the final quarter of 2014, decelerating from an annualised rate of 2,4 per cent in the third quarter to 1,8 per cent in the fourth quarter. This moderation can mainly be attributed to a decline in the real value added by the trade sector, while activity increased in the transport and communication, and the finance, insurance, real-estate and business services sectors. The real value added by the general government services sector lost some momentum over the period.

The real value added by the *commerce sector* contracted at an annualised rate of 0,3 per cent in the fourth quarter of 2014 following an increase of 3,4 per cent in the third quarter as activity in the wholesale and motor-trade subsectors declined over the period. The decline in the dollar price of commodities such as gold and platinum had a negative impact on certain subsectors within the wholesale trade subsector. However, the real value added by the retail subsectors held up well in the fourth quarter of 2014. Demand for tourist accommodation increased in the fourth quarter as the relative weakness of the rand enhanced the attractiveness of South Africa as a tourist destination. For the year as a whole, growth in the real value added by the trade sector moderated from 1,9 per cent in 2013 to 1,3 per cent in 2014. According to the National Association of Automobile Manufacturers of South Africa (NAAMSA), 2014 turned out to be a difficult year for the South African automotive industry, with domestic new vehicle sales being under pressure despite attractive incentives and strong purchases by car rental companies.

Growth in the real output of the *transport, storage and communication sector* picked up from an annualised rate of 2,2 per cent in the third quarter of 2014 to 2,9 per cent in the fourth quarter, mainly as a result of increased activity in the passenger and freight transport subsector. For the year 2014 as a whole, the real value added by the transport, storage and communication sector increased at a rate of 2,3 per cent, up from 2,0 per cent in 2013. This higher growth can be ascribed to increased activity in both the land transport and communication subsectors. The communication subsector benefited from attractive data promotions and improved network quality which overshadowed the adverse impact of labour strikes in the postal services industry during 2014.

Consistent with the acceleration in overall growth, the real value added by the *finance, insurance, real-estate and business services sector* picked up from 2,4 per cent in the third quarter of 2014 to an annualised rate of 3,5 per cent in the fourth quarter. This stronger performance primarily reflected an increase in trading activity in the domestic securities market and banking sector. Overall, growth in the real value added by the finance, insurance, real-estate and business services sector moderated from 3,0 per cent in 2013 to 2,2 per cent in 2014.

Growth in real output of *general government* slowed from 2,2 per cent in the third quarter of 2014 to an annualised rate of 1,2 per cent in the fourth quarter. On a calendar-year basis, growth in the real value added by general government slowed marginally from 2013 to 2014.

Real gross domestic expenditure

Contrary to the acceleration in growth in gross domestic production, growth in aggregate *real gross domestic expenditure* decelerated from an annualised rate of 3,2 per cent in the third quarter of 2014 to 0,3 per cent in the fourth quarter. Real final consumption expenditure by households and gross fixed capital formation increased at a faster pace in the final quarter of 2014, whereas final consumption expenditure by general government slowed over the period.

Real gross domestic expenditure

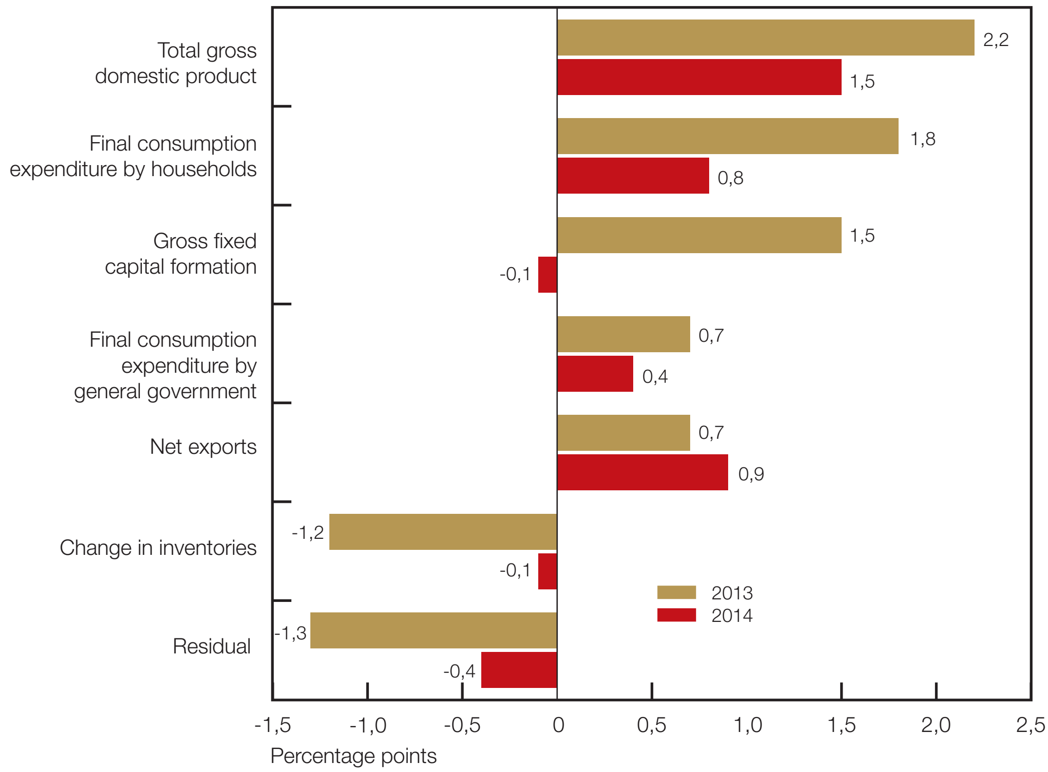
Percentage change at seasonally adjusted annualised rates

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

* At constant 2010 prices

Net exports and real final consumption expenditure by households made the largest contributions to growth in real gross domestic product in the fourth quarter of 2014, adding 3,9 and 1,0 percentage points respectively.

Contribution to growth in expenditure on real gross domestic product



Contribution of expenditure components to growth in real gross domestic product

Percentage points

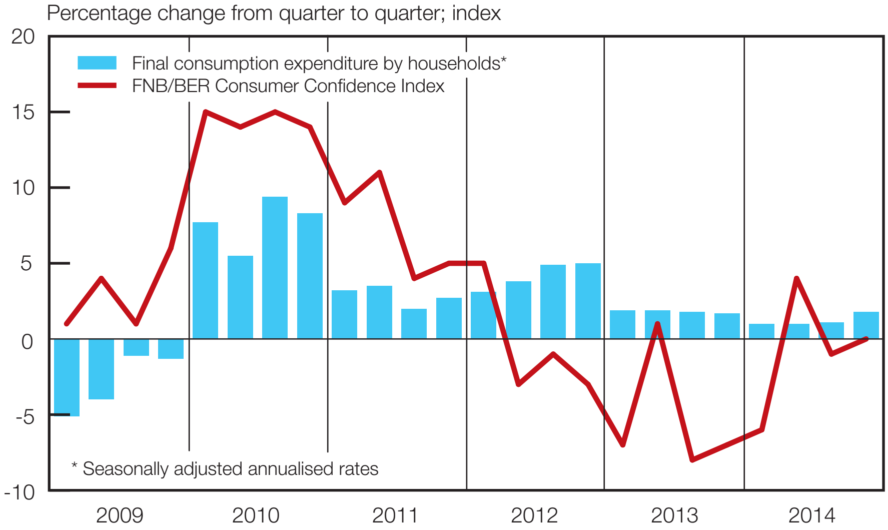
Component	2013	2014				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure						
Households	1,8	0,6	0,6	0,7	1,0	0,8
General government	0,7	0,3	0,5	0,3	0,2	0,4
Gross fixed capital formation	1,5	-2,0	-1,1	0,5	0,5	-0,1
Change in inventories	-1,2	4,1	0,4	0,5	0,1	-0,1
Net exports	0,7	-5,2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

Growth in *real final consumption expenditure by households* accelerated further from an annualised rate of 1,1 per cent in the third quarter of 2014 to 1,6 per cent in the final quarter. The higher level of spending by consumers can be ascribed to an increase in the disposable income of the household sector following a moderate rise in the compensation of employees over the period. Higher real outlays on all three goods-related categories more than offset a slower pace of increase in the expenditure on services.

Having increased at a rate of 2,9 per cent in 2013, growth in real consumption expenditure by households moderated to 1,4 per cent in 2014 – the lowest rate of increase in household spending since 2009. Spending was negatively affected by the non-payment of salaries and wages of striking workers in the mining and manufacturing sectors in particular, relatively tight lending conditions and lustreless consumer confidence as captured in the First National Bank/ Bureau for Economic Research (FNB/BER) Consumer Confidence Index, depicted in the accompanying graph.

Final consumption expenditure by households and consumer confidence

Percentage change from quarter to quarter; index



Growth in real spending by households on *durable goods* accelerated from an annualised rate of 4,0 per cent in the third quarter of 2014 to 5,3 per cent in the fourth quarter as spending on all durable goods categories increased. Higher outlays on furniture and household appliances were consistent with the upturn in residential building activity in the final quarter of 2014, whereas increased spending on recreational and entertainment goods was probably enticed by a moderation in the prices of these products. In addition, the purchases of new and used passenger vehicles increased steadily over the period. On a calendar-year basis, the pace of increase in real spending on durable goods nevertheless slowed from 9,0 per cent in 2013 to 5,3 per cent in 2014. The slower growth in expenditure can probably be attributed to subdued economic activity, higher prices of imported durable goods following the depreciation in the exchange rate of the rand, as well as marginally higher interest rates. Expenditure on all subcategories of durable goods increased at a slower pace in 2014, with growth in real spending on personal transport equipment decreasing from a double-digit figure in 2013 to just more than 5 per cent in 2014.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

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

Having increased at an annualised rate of 2,8 per cent in the third quarter of 2014, real spending on *semi-durable goods* rose by 3,3 per cent in the fourth quarter. Spending in all semi-durable categories increased at a faster pace while expenditure on clothing and footwear broadly maintained its growth momentum over the period.

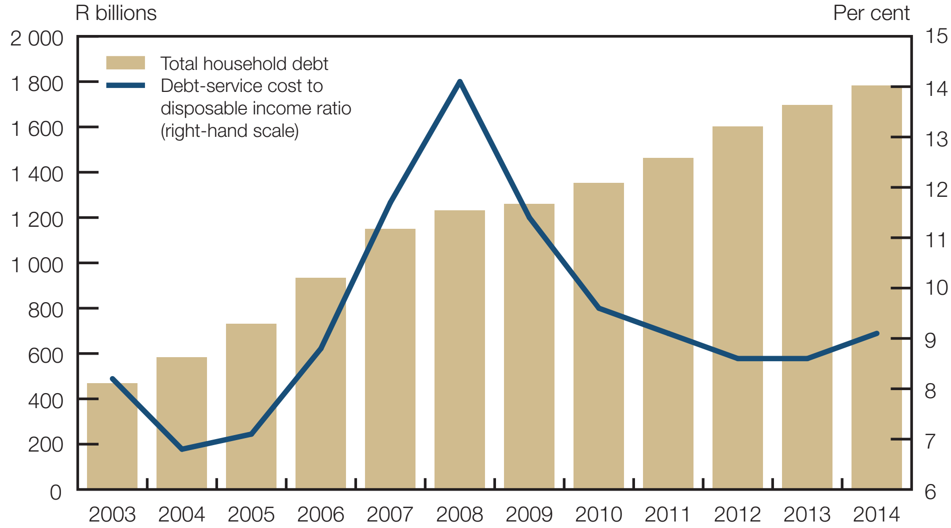
Subsequent to a decline of 0,1 per cent in the third quarter of 2014, real outlays on *non-durable goods* increased at an annualised rate of 1,5 per cent in the fourth quarter. Firm increases in expenditure on petroleum products were partly countered by lower spending on medical and pharmaceutical goods. In addition, the level of spending on recreational and entertainment goods was maintained alongside a moderation in the pace of spending on household fuel and power.

Growth in real expenditure by households on *services* slowed from an annualised rate of 1,2 per cent in the third quarter of 2014 to 0,4 per cent in the fourth quarter. A decline was registered in spending on miscellaneous services, while expenditure on all other service-related components increased. For 2014 as a whole, real spending by households on services rose by 0,5 per cent, slower than the increase of 2,2 per cent recorded in 2013.

Households continued to incur debt in the fourth quarter of 2014. However, owing to quarter-to-quarter growth in *household debt* being slower than the concurrent growth in disposable income, the ratio of debt to disposable income edged lower from 78,1 per cent in the third quarter of 2014 to 77,6 per cent in the fourth quarter. The cost of servicing debt as a ratio of disposable income rose from 9,1 per cent to 9,3 per cent over the same period; the latter value was the highest ratio since the fourth quarter of 2011.

On an annual basis, growth in household debt slowed from 5,9 per cent in 2013 to 5,1 per cent in 2014. Likewise, the ratio of household debt to disposable income edged lower from 79,5 per cent in 2013 to 78,2 per cent in 2014. However, debt-service cost as a percentage of disposable income increased from 8,6 per cent in 2013 to 9,1 per cent in 2014 as debt levels rose and interest rates increased in January and July.

Household debt and debt-service cost



While the *net wealth of households* rose somewhat further in the fourth quarter of 2014, affected mainly by an increase in share prices, this did not match the increase in disposable income. Accordingly, the ratio of net wealth to annualised disposable income of households slowed to 351 per cent in the fourth quarter of 2014 from 355 per cent in the third quarter.

Real final consumption expenditure by *general government* expanded at annualised rates of 1,4 per cent in the third quarter of 2014 and 1,0 per cent in the fourth quarter. The moderation in quarterly growth mainly reflected a slower pace of increase in real compensation of employees. Over the same period, spending on non-wage goods and services increased at a somewhat faster pace, consistent with government's drive to improve the quality of education and health services. For 2014 as a whole, growth in real final consumption expenditure by general government moderated to 1,9 per cent, notably lower than the increase of 3,3 per cent registered in 2013. Real growth in consumption expenditure by government in 2014 was also well below the long-term average of 3,9 per cent recorded for the period 2004 to 2014 as government consolidated its spending in an effort to reduce the budget deficit. Relative to the country's gross domestic product, consumption expenditure by general government remained broadly unchanged at slightly more than 20 per cent in both 2013 and 2014.

Having increased at an annualised rate of 2,4 per cent in the third quarter of 2014, growth in *real gross fixed capital formation* accelerated marginally to 2,6 per cent in the fourth quarter. Capital investment by private business enterprises and public corporations increased at a faster pace, while capital spending by general government slowed somewhat over the period. Notwithstanding increased capital spending by both the private business enterprises and public corporations in the second half of 2014 capital outlays declined in 2014 as a whole, affected by low business confidence levels, weak demand and slack in the domestic economy.

Real gross fixed capital formation by *private business enterprises* gained some momentum in the final quarter of 2014, buoyed by increased spending in the mining, manufacturing, trade, and finance sectors, mainly on machinery and equipment.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

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

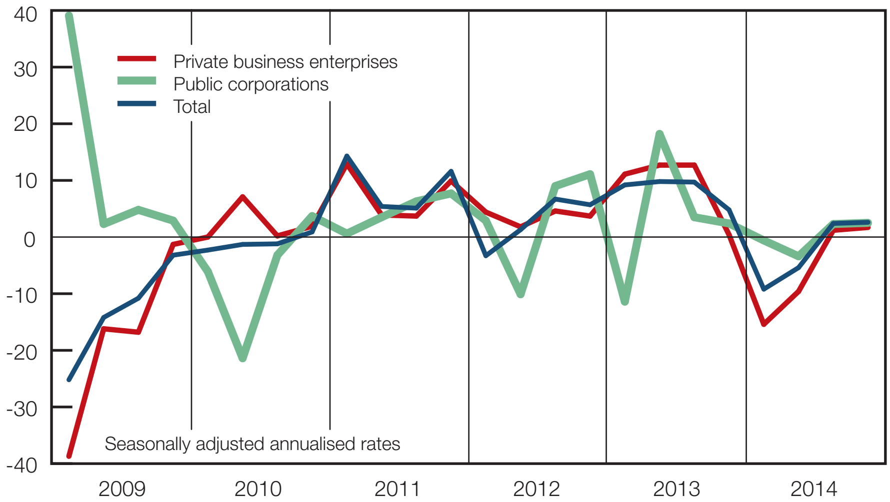
Spending on capital assets in the mining sector was mainly directed at the coal, gold, iron-ore and especially the platinum subsectors. In manufacturing, real capital spending in the fourth quarter of 2014 was noticeable in especially the food, beverages, chemicals, and motor parts and accessories subsectors. Capital outlays in the communications subsector largely reflected investment by service providers to expand their networks by adding new base stations and installing new 3G sites. In addition, growth in capital formation by the finance sector was supported by the marked increase in residential and non-residential building activity.

However, for 2014 as a whole, real gross fixed capital formation by private business enterprises declined by 3,4 per cent, dragged down by a contraction in capital spending in the first half of the year. With the lacklustre economic growth in 2014, structural bottlenecks and low business confidence levels, businesses preferred to consolidate their finances and moderate their investment in new ventures.

Real gross fixed capital expenditure by *public corporations* increased at an annualised rate of 2,5 per cent in the fourth quarter of 2014 after having advanced at a rate of 2,3 per cent in the preceding quarter. The steady pace of increase in capital investment by public corporations in the second half of 2014 reflected increased spending by the transport and electricity-generating sectors in particular. Most of the leading entities – including Transnet, the South African National Roads Agency Limited (SANRAL) and the Trans-Caledon Tunnel Authority – raised their capital investment in the final quarter of 2014. Simultaneously, the Passenger Rail Agency of South Africa (PRASA) embarked on the roll-out of its new fleet of passenger locomotives. Despite the higher capital outlays in the fourth quarter of 2014, growth in real gross fixed capital formation by public corporations amounted to only 1,6 per cent in 2014 as a whole, significantly lower than the rate of 3,1 per cent recorded in 2013.

Real gross fixed capital formation

Percentage change from quarter to quarter



Growth in real gross fixed capital outlays by *general government* remained brisk throughout 2014, registering an annualised rate of 5,9 per cent in the fourth quarter of the year due to increased spending by provincial and local government departments on education, health, transport and energy. Expenditure by the provincial governments focused on infrastructure development, including the upgrading of provincial roads, schools and hospitals.

Box 1 Trends in capital formation and the capital stock

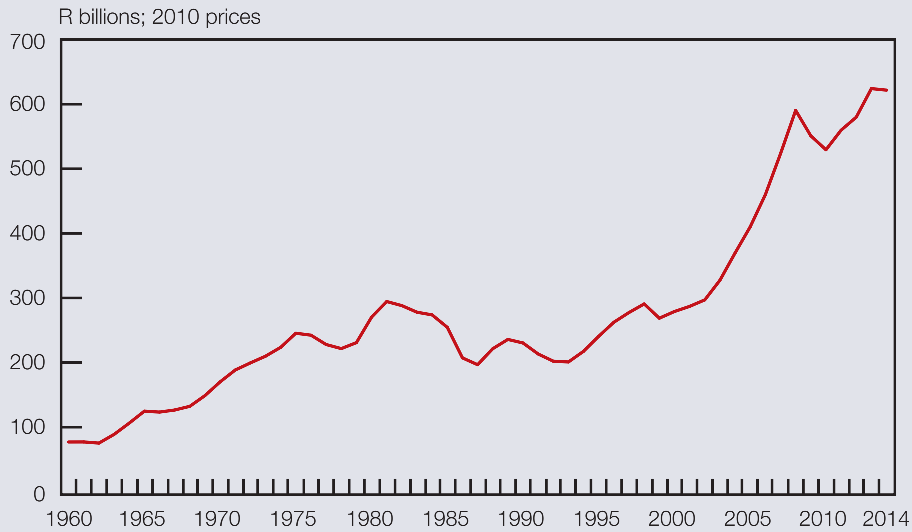
The estimation of the value of capital stock in an economy requires ample data sources and sound calculation practices such as described in the latest edition of the *System of National Accounts* (2008 SNA). This system provides a statistical framework for the calculation of a comprehensive, consistent and flexible set of macroeconomic accounts for policymaking, analysis and research. All new capital formation undertaken in a given period can be aggregated fairly easily given the availability of appropriate data sources. However, estimating the total value of a stock of assets with different characteristics and of different maturities requires more advanced estimation techniques.

The method most commonly used to derive estimates of consumption of fixed capital and the capital stock of fixed assets associates a stream of future earnings with the decline in value of a fixed asset used in the production process. It is recommended that independent estimates of consumption of fixed capital be compiled in conjunction with estimates of the capital stock. These estimates can be compiled from data on gross fixed capital formation in the past combined with estimates of the rates at which the efficiency of fixed assets decline over their service lives.

To compile estimates of the consumption of fixed capital requires estimates of the capital stock excluding the effects of price changes, even if no estimation of capital services or productivity measures is contemplated. The levels of the capital stock are typically derived by cumulating capital formation in successive periods and then subtracting the amount of capital that has been exhausted. It is not meaningful to aggregate estimates of capital formation at historical purchase prices since the effect of rising prices will overstate the amount of 'new' capital relative to 'old' capital. The preferred technique is to estimate all capital still in stock at the price of a single year and then to revalue this amount to the price prevailing at the end of the accounting period. This should be done at the most detailed level possible.

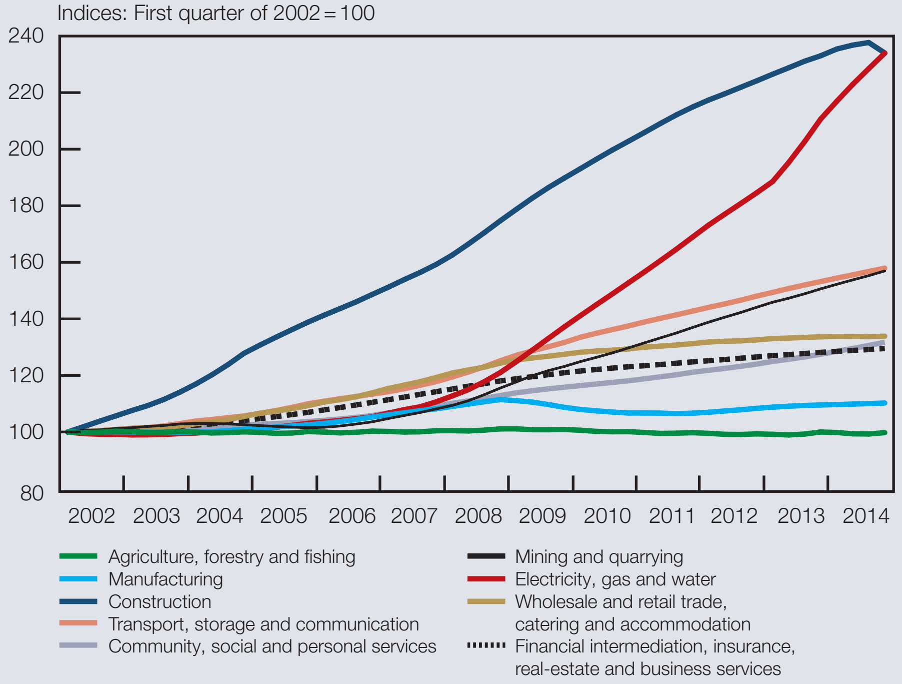
Consistent with the aforementioned estimation procedure, data published by the South African Reserve Bank indicate that real gross fixed capital formation in South Africa has more than doubled since 2000, amounting (at constant 2010 prices) to R622 billion in 2014. Real gross fixed capital formation in South Africa averaged R276 billion between 1960 and 2014, reaching an all-time high of R624 billion in 2013 and a record low of R75 billion in 1962, as indicated in Figure B1.1. A quarterly graph on this indicator is available in the national accounts rebasing and benchmarking supplement to this *Quarterly Bulletin*. In the supplement, various investment initiatives of a capital nature that were implemented over the years are being juxtaposed alongside the line indicating the evolution of fixed capital formation since 1960.

Figure B1.1: Real gross fixed capital formation



Estimates of the evolution of the real fixed capital stock in South Africa are also available for the different sectors in the economy, as indicated in Figure B1.2. Changes in the level of the capital stock differ considerably between the different sectors in the economy due to sector-specific influences impacting each sector uniquely. Gains in the real fixed capital stock in the construction sector, for instance, far outpaced that in any other sector in the economy during the period 2002 to 2014. Contrary to these gains, the level of the real fixed capital stock in the agriculture, forestry and fishing sector remained essentially constant over this period. This development does not augur well for increased agricultural output. Of similar concern is the stagnation in the level of the real fixed capital stock in the manufacturing sector since the financial crisis in 2007/08. Growth in the real fixed capital stock in the electricity-generating sector accelerated meaningfully from 2009 as Eskom engaged in massive investment of a capital nature in an effort to increase its generating capacity.

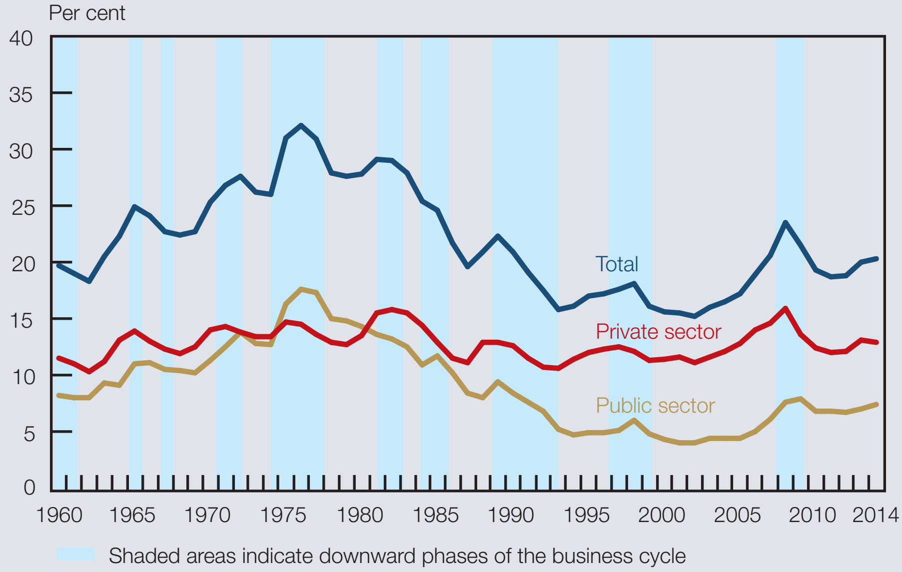
Figure B1.2: Real fixed capital stock



Real fixed capital formation by the public sector, expressed as a percentage of gross domestic product, declined significantly from around 18 per cent in 1976 to around 4 per cent in 2001. Subsequently, this contribution doubled to around 8 per cent in 2009, again declining, on balance, to 7,4 per cent in 2014. The contribution of real fixed capital formation in the private sector has historically been more constant, fluctuating between 10,3 per cent in 1962 to 15,9 per cent in 2008, and averaging 12,8 per cent during the past 50 years. The average contribution of real fixed capital formation by the public sector to gross domestic product over this period is lower at 9,1 per cent. The average ratio of total real fixed capital formation to gross domestic product during this extended period amounted to 22 per cent, with the rate being somewhat lower at 20,3 per cent in 2014. Not surprisingly, this percentage has been cyclically sensitive, almost consistently declining during downward phases of the business cycle as indicated in Figure B1.3.

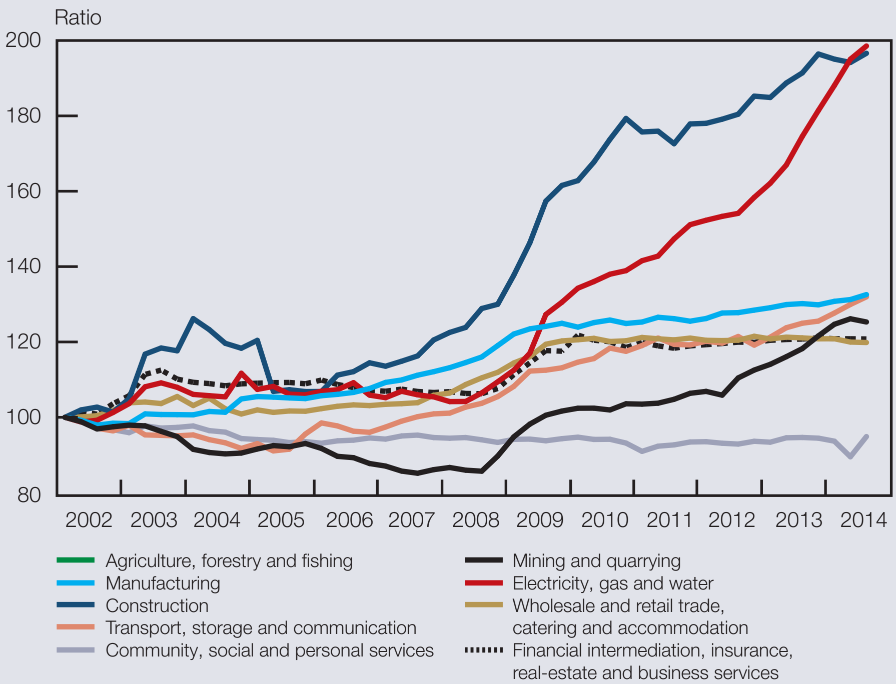
When expressing the capital-labour ratio, that is, an indicator that characterises the quantity of fixed production assets per worker employed in the production process, the uniqueness of the various sectors in the economy becomes evident. These differences between industries are the result of factors such as differences in production processes, in engineering and design features, and the different prices of fixed capital stock. Increases in the capital-labour ratio not only result from the introduction of new systems for the mechanisation and automation of production but also from the application of technology involved in the control of production processes. A rise in the capital-labour ratio is normally associated with increased labour productivity, more profitable production techniques, reduced unit costs, and an improvement in the quality of the final product that has been produced. Economic gains are maximised when labour productivity increases at a faster pace than the capital-labour ratio. Under such a scenario, the rise of the capital-labour ratio is accompanied by an increase in capital productivity.

Figure B1.3: Gross fixed capital formation as percentage of gross domestic product



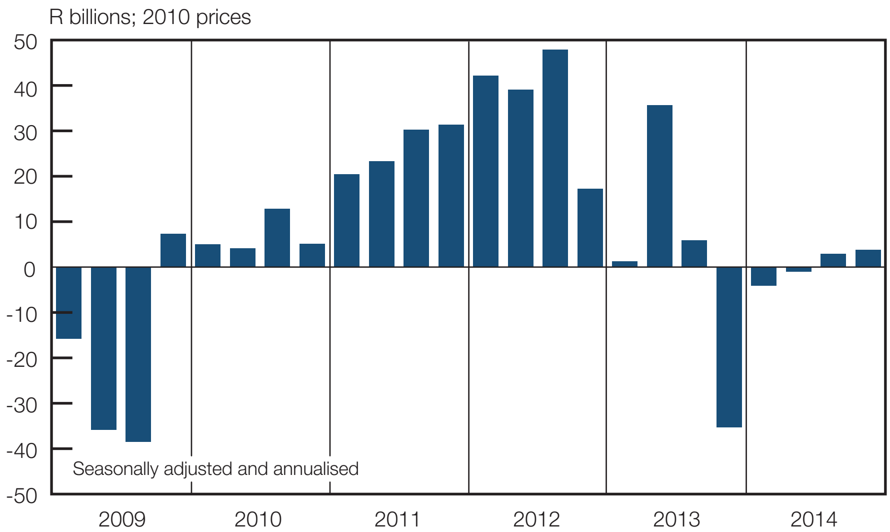
Most evident from Figure B1.4 is the pronounced rise in the capital-labour ratio in the construction sector relative to that in the other sectors. This rise in the ratio resulted from capital investment in the sector taking place at a faster pace compared with employment gains in the sector. The community, social and personal services sector on the contrary has, on balance, experienced a decline in the ratio during the past decade, as investments in capital stock in the sector lagged that in other sectors in the economy. Following massive investment of a capital nature in the electricity, gas and water sector during the past five years or so, the capital-labour ratio increased substantially. Capital productivity in this sector will, however, only benefit once the new electricity-generating capacity invested in becomes operational in coming years.

Figure B1.4: Capital-labour ratio



Having contracted in the strike-ridden first half of 2014, *real inventory holdings* increased by R2,9 billion (annualised and at constant 2010 prices) in the third quarter and by R3,8 billion in the fourth quarter. In the final quarter of the year, the level of real inventories in the mining sector increased mainly due to the stockpiling of inventories in the gold- and diamond-mining subsectors alongside a slower pace of destocking in the platinum-mining sector. The accumulation of inventories in the manufacturing sector partly reflected an increase in imports over the period. Nonetheless, industrial and commercial inventories as a percentage of non-agricultural gross domestic product edged lower from 14,2 per cent in the third quarter of 2014 to 14,0 per cent in the fourth quarter. For the year as a whole, real inventories on balance increased very little – lower than in 2013.

Change in inventories



Factor income

Growth in *total nominal factor income*, measured over one year, amounted to 6,4 per cent in the fourth quarter of 2014, lower than the rate of 7,0 per cent recorded in the third quarter. The slower pace of increase can be attributed to slower growth in the gross operating surpluses of business enterprises. For 2014 as a whole, the rate of increase in total nominal factor income decelerated to 7,2 per cent from 7,7 per cent in 2013.

As conditions normalised following industrial action earlier in 2014, year-on-year growth in *total compensation of employees* accelerated to 8,0 per cent in the fourth quarter of 2014, higher than the rate of 7,6 per cent registered in the preceding quarter. Growth in total salaries and wages accelerated across all sectors of the economy in the final quarter of 2014. For 2014 as a whole, growth in the total remuneration of employees decelerated to 7,6 per cent, notably slower than the rate of 9,3 per cent registered in 2013. By contrast, the share of labour in total factor income increased marginally from 51,7 per cent in 2013 to 51,9 per cent in 2014.

The rate of increase in the aggregate *gross operating surplus*, measured over four quarters, decelerated from 6,5 per cent in the third quarter of 2014 to 4,5 per cent in the fourth quarter. Slower growth in gross operating surpluses was mainly evident in the manufacturing sector, reflecting, among other factors, the loss of production following electricity-supply disruptions and subdued demand. As a result, the share of the operating surplus in total factor income edged lower from 47,9 per cent in the third quarter of 2014 to 47,7 per cent in the fourth quarter. For 2014 as a whole, the total gross operating surplus rose by 6,8 per cent, compared with an increase of 6,1 per cent recorded in 2013.

Gross saving

Gross saving as a percentage of gross domestic product (i.e. the *national saving ratio*) rose from 14,7 per cent in the third quarter of 2014 to 15,3 per cent in the fourth quarter. This higher saving ratio stemmed largely from a turnaround in saving by general government, from a dissaving ratio in the third quarter of 2014 to a positive saving ratio in the fourth quarter. The foreign finance ratio, measuring the country's dependency on foreign capital to finance gross capital formation, decreased from 28,5 per cent in the third quarter of 2014 to 25,0 per cent in the fourth quarter. For the year as a whole, gross saving as percentage of gross domestic product increased from 14,4 per cent in 2013 to 14,9 per cent in 2014, substantially lower than the ratio of 18 per cent attained in both 2009 and 2010.

The saving ratio of *incorporated business enterprises* weakened notably from 15,1 per cent in the third quarter of 2014 to 14,3 per cent in the fourth quarter. This decrease mainly emanated from a slowdown in gross operating surplus which could not be offset by lower corporate tax and dividend payments in the quarter under review. On an annual basis, the corporate saving ratio improved somewhat from 13,9 per cent in 2013 to 14,9 per cent in 2014, thereby accounting for more than 90 per cent of total saving.

As a ratio of gross domestic product, gross saving by *general government* improved from a dissaving ratio of 0,6 per cent in the third quarter of 2014 to a positive saving ratio of 0,8 per cent in the fourth quarter. The rise in gross saving could be attributed to tax revenue which surpassed increased government consumption expenditure. Various tax categories – such as value-added tax (VAT), personal income tax, customs levy and the fuel levy – increased at a faster pace in the fourth quarter of 2014 than in the preceding quarter. For the year as a whole, gross saving by general government deteriorated from 0,4 per cent of gross domestic product in 2013 to -0,2 per cent in 2014, the first annual dissaving ratio recorded by general government since 1998.

Gross saving by the *household sector* as percentage of gross domestic product remained at 0,2 per cent in both the third and fourth quarters of 2014.

Employment

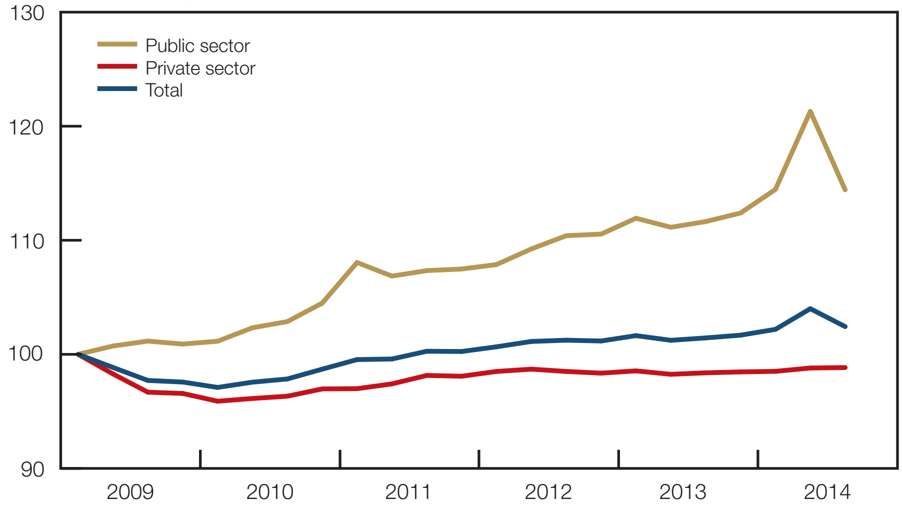
Following the abrupt increase in the level of formal non-agricultural employment in the second quarter of 2014, resulting from the employment of around 130 000 temporary workers by the Independent Electoral Commission (IEC) to assist with the general elections in May 2014, employment contracted by around the same number in the third quarter as these workers were decommissioned. 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 consequently decreased by 5,9 per cent on a seasonally adjusted and annualised basis in the third quarter of 2014, lowering the level of employment to around 8,54 million.[2]

The decrease in formal non-agricultural employment in the third quarter of 2014 can primarily be ascribed to a 20,8 per cent annualised rate of decrease in public-sector employment directly related to the decline in IEC employment numbers. In addition, employment levels decreased at all other public-sector tiers, with the exception of provinces, which increased their staff complement marginally in the third quarter of 2014.

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

Formal non-agricultural employment

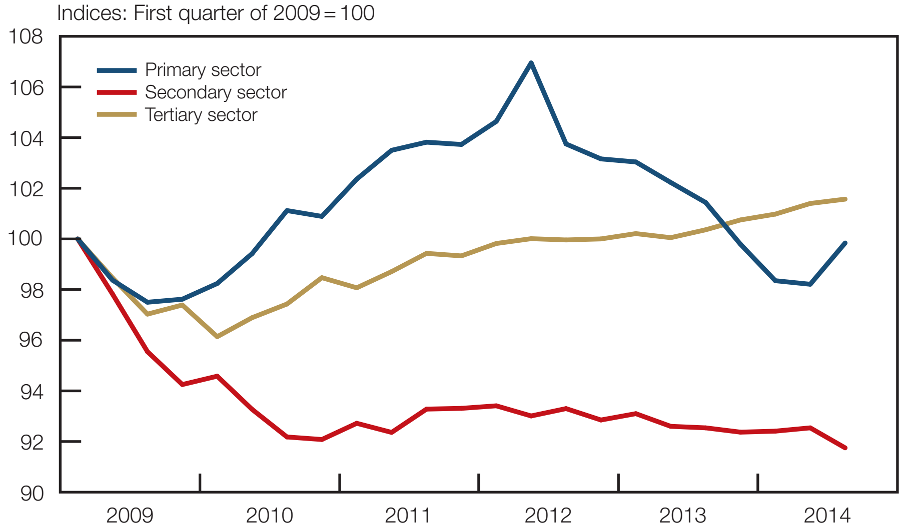
Indices: First quarter of 2009 = 100



Private-sector employment levels remained virtually unchanged: only 2 000 new employment opportunities were created in the third quarter of 2014, with the year-on-year growth rate slowing somewhat to 0,5 per cent. In the third quarter of 2014, employment gains were recorded in the non-gold mining sector (recording the highest rate of increase); the private community, social and personal services sector; the finance, insurance, real-estate and business services sector; and in the trade, catering and accommodation services sector. Conversely, job losses were recorded in the construction sector; the manufacturing sector; the private transport, storage and communication sector; and the gold-mining sector.

Formal non-agricultural private-sector employment

Indices: First quarter of 2009 = 100



The accompanying table shows that employment growth has been more pronounced in the public sector than in the private sector following the 2008/09 economic recession, as government applied contra-cyclical fiscal policy while private-sector employment struggled to gain traction. Private-sector employment growth has been stymied by a number of factors, including a deterioration in the supply of electricity, rapidly rising electricity and labour costs, a fairly hostile labour relations environment, low business confidence levels, subdued investment growth, a shortage of skilled labour and weak global demand. As illustrated by the accompanying graph, these factors have had an adverse effect on employment growth in especially the goods-producing sectors of the South African economy. However, accelerated implementation of the National Development Plan could go a long way in raising the level of private-sector employment over the medium to long term.

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

Sector	Change over one quarter at annualised rate 3rd qr 2014		Change over four quarters to 3rd qr 2014		Cumulative job losses (-) gains (+)	
	Number	Per cent	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 3rd qr 2014
Finance, insurance, real-estate and business services	5 400	1,2	19 800	1,1	-182 200	124 800
Manufacturing	-9 700	-3,4	-14 000	-1,2	-113 000	-56 200
Trade, catering and accommodation services	1 200	0,3	21 100	1,2	-76 300	81 100
Construction	-3 700	-3,4	600	0,1	-48 300	8 100
Total mining	8 100	6,8	-8 000	-1,6	-40 700	8 000
Gold mining	-200	-0,8	-10 300	-8,0	-9 600	-41 300
Other mining	8 400	9,3	2 300	0,6	-31 100	49 200
Private transport, storage and communication services	-900	-1,4	-7 300	-2,8	-2 000	-7 100
Community, social and personal services	1 500	1,3	17 300	4,0	13 400	30 100
Total private sector	**2 000**	**0,1**	**29 400**	**0,5**	**-449 100**	**188 800**
National departments	-1 100	-1,0	3 000	0,7	-2 500	44 500
Provinces	1 500	0,5	21 500	2,0	51 600	113 400
Local governments	-5 000	-6,2	29 100	10,5	15 200	64 900
Public transport, storage and communication services	-2 000	-6,4	-1 500	-1,2	-4 900	14 300
Other public-sector enterprises including electricity and the IEC	-126 000	-85,2	1 400	0,7	-6 900	18 400
Total public sector	**-132 600**	**-20,8**	**53 500**	**2,5**	**52 500**	**255 600**
Grand total	**-130 600**	**-5,9**	**82 900**	**1,0**	**-396 600**	**444 400**

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

Weak global growth and employment prospects were corroborated by the *World Employment and Social Outlook – Trends 2015* report of the International Labour Organisation's (ILO). The ILO notes that the world economy continues to expand at rates well below those that prevailed before the global financial crisis in 2008, being too low to close the significant employment and social gaps that have subsequently emerged. In addition, the report expects the global employment outlook to deteriorate over the next five years. More than 201 million people were unemployed around the world in 2014, roughly 31 million more than before the start of the global financial crisis. The ILO expects global unemployment to increase by 3 million people in 2015 and by a further 8 million in the ensuing four years. The report notes that, on balance, the employment situation improved in advanced economies while deteriorating in emerging and developing economies. The ILO highlights that the youth, especially young women, continue to be disproportionately affected by unemployment, with almost 74 million young people (aged 15–24) seeking work in 2014. The youth unemployment rate is practically three times as high as that of their counterparts aged 25 and above. Furthermore, the report notes that heightened youth unemployment is common to all regions and is occurring despite an improvement in education levels, fuelling social discontent.

Box 2 Measuring poverty and inequality in South Africa

Statistics South Africa (Stats SA) recently released a pilot study in which it employed the internationally recognised cost-of-basic-needs approach for calculating poverty lines using data from the 2010/11 Income and Expenditure Survey (IES). Three poverty lines were developed to capture different degrees of poverty, namely the food poverty line (FPL), the lower bound poverty line (LBPL) and the upper bound poverty line (UBPL). The food poverty line represents the rand value below which individuals are unable to purchase or consume enough food to supply them with the minimum per-capita-per-day energy requirement for good health (roughly 2 100 kilocalories). The LBPL and UBPL both include a non-food component. Unlike food consumption, there is no universal standard for consumption of non-food basic needs. Therefore, similar to the cost-of-basic-needs approach, Stats SA employed the methodology of Ravallion (1998) to calculate the LBPL and UBPL. Individuals at the LBPL do not have enough resources to consume or purchase both adequate food and non-food items and therefore have to sacrifice food to obtain essential non-food items. Individuals who earn between the LBPL and the UBPL are able to purchase both basic food and non-food items.

Table B2.1: South African poverty lines

	Previous poverty lines			Rebased poverty lines		
	Value per person per month	Per cent	Number of people	Value per person per month	Per cent	Number of people
Food poverty line	R321			R335		
Poverty headcount		20,2	10 185 450		21,7	10 944 089
Poverty gap		6,2			6,9	
Lower bound poverty line	R443			R501		
Poverty headcount		32,3	16 286 636		37,0	18 632 646
Poverty gap		11,8			14,5	
Upper bound poverty line	R620			R779		
Poverty headcount		45,5	22 942 475		53,8	27 117 973
Poverty gap		19,6			25,8	

Source: Statistics South Africa (2015a)

Table B2.1 shows that the share of the population living in extreme poverty (represented by the FPL) as a percentage of the total population increased marginally when moving to the rebased poverty line values. The share of those living at or below the LBPL increased from 32,3 per cent to 37,0 per cent, while the share of those at the UBPL increased notably from 45,5 per cent to 53,8 per cent. The UBPL poverty gap, which indicates how far below that poverty line the poor are on average, also increased sharply from 19,6 per cent to 25,8 per cent.

In addition, Stats SA released a separate report on poverty trends between 2006 and 2011. Although the poverty indicators in this report have not been rebased to the new poverty lines, the inequality section provides the latest Gini coefficient estimates. The Gini coefficient is an internationally recognised measure of inequality, obtained by ranking per capita household income from lowest to highest and calculating the cumulative percentage of households. The cumulative percentages are then plotted, known as the Lorenz curve. The area between the Lorenz curve and a 45-degree line (representing perfect equality) is then calculated. This area is expressed as a percentage of the total area to obtain the Gini coefficient. The coefficient ranges from 0, reflecting complete equality, to 1, reflecting complete inequality.

Table B2.2: South African Gini coefficients

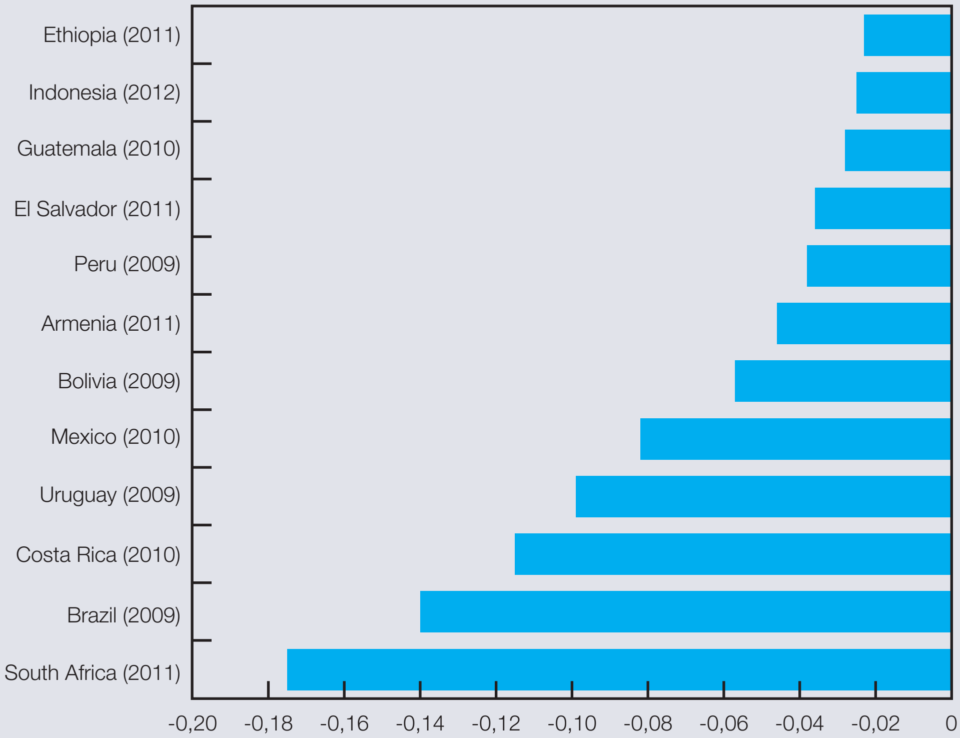
	2006	2011
Gini coefficient (income per capita from salaries and wages).........................	0,80	0,76
Gini coefficient (income per capita from salaries, wages and social grants) ...	0,72	0,69
Gini coefficient (expenditure per capita, excluding taxes).............................	0,67	0,65
Gini coefficient (income per capita from salaries, wages, social grants and free basic services, excluding taxes)	0,59*	0,596**

* Bosch et al. (2010)
** Inchauste et al. (forthcoming)

Sources: Statistics South Africa (2014a), Statistics South Africa (2008), Statistics South Africa (2012) and own calculations

Table B2.2 shows that although South Africa's Gini coefficient was fairly high in both 2006 and 2011 when including only income from salaries and wages in the calculation, it improved when supplementing income from salaries and wages with income from social grants, as well as when deducting taxes, and even further when including free basic services. However, the Gini coefficient based purely on income from salaries and wages decreased somewhat from 0,80 to 0,76 between 2006 and 2011, while it increased marginally from 0,59 to 0,596 over the same period when including income from social grants and free basic services, as well as taxes in the calculation, suggesting that the impact of fiscal policy on reducing inequality in South Africa may have reached a plateau.

Figure B2.1: Change in the Gini coefficient: Wage income only versus income, including grants and basic services, less taxes

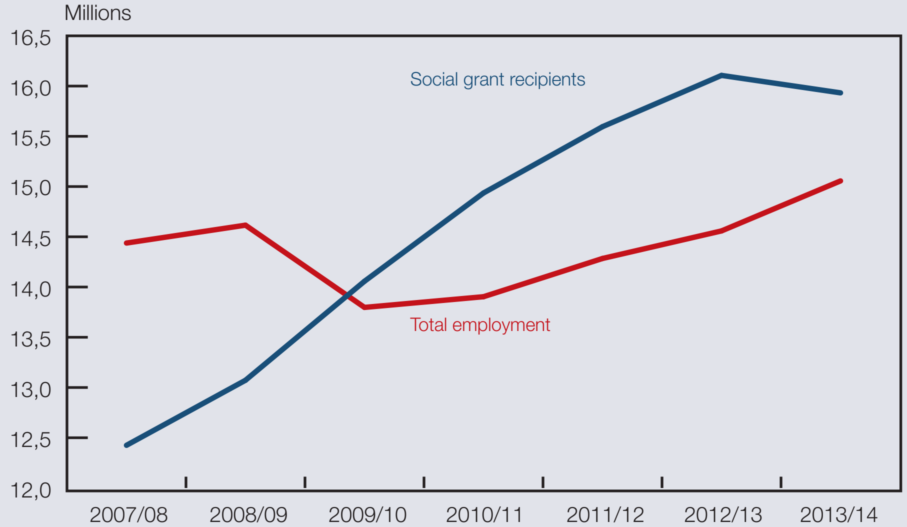


Sources: World Bank (2014a) and own calculations

The World Bank (2014a) uses the commitment to equity (CEQ) methodology to compare the effectiveness of various middle-income countries' fiscal policies in reducing poverty and inequality. Figure B2.1 illustrates that South Africa's policies to reduce inequality assisted in reducing the Gini coefficient much more than in other middle-income countries. The World Bank noted that South Africa spent more than other countries on its social programmes, with this expenditure successfully lifting around 3,6 million individuals out of poverty (based on US$2,5 a day on a purchasing power parity basis) and reducing the Gini coefficient from 0,76 to 0,596 in 2011. Taxes and social spending have succeeded in closing the gap between the rich and the poor from a situation where the richest decile earns over 1 000 times more than the poorest decile, to where the richest decile earns about 66 times more in 2011.

According to the *2013/14 Annual Report* by the South African Social Security Agency, the total number of social grant recipients has grown from 12,4 million in the 2007/08 fiscal year to 16 million in fiscal 2013/14. As shown in Figure B2.2, the number of social grant recipients has increased much faster than the total number of employed persons in South Africa, which increased from 14,4 million in March 2008 to about 15,1 million in March 2014. In addition, South African's age dependency ratio is around 52,3 (Stats SA, 2014b), implying that the share of people who are not of working age (those younger than 15 years and older than 64 years) who are dependent on those who are of working age (15 to 64 years, i.e. the labour force) is around 52,3 per cent.

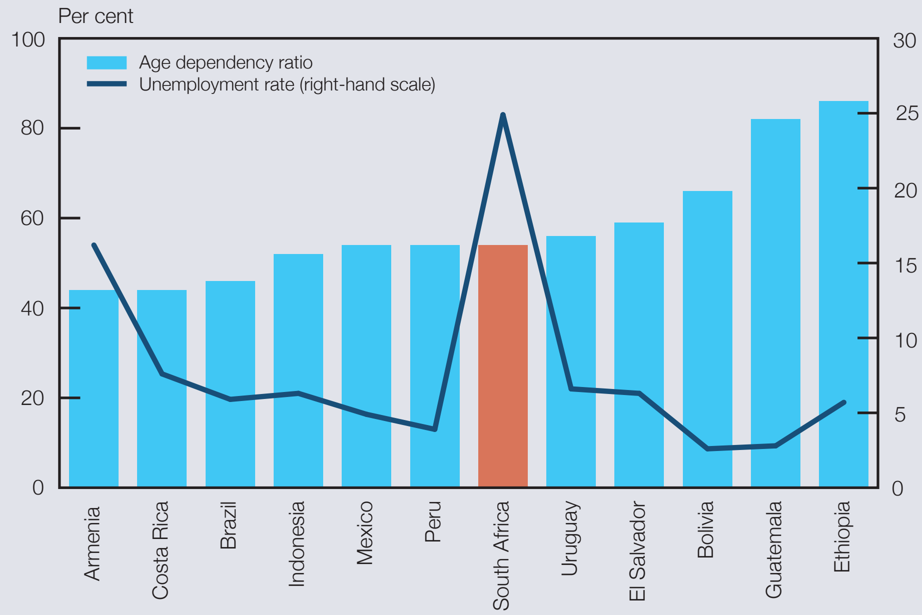
Figure B2.2: Employment and social grant recipients



Sources: South African Social Security Agency (2014), Statistics South Africa (2015b) and Quarterly Labour Force Survey

Figure B2.3 illustrates that when employing the World Bank's CEQ methodology, South Africa compares favourably with other middle-income countries such as Peru and Uruguay in terms of the age dependency ratio. However, these countries (and most of the CEQ countries) have much lower unemployment rates than South Africa, suggesting that even though a large proportion of the population is dependent on the working age in these countries, relatively more of working age are actually employed and can therefore support their dependents. Conversely, whereas a high proportion of people are similarly dependent on the working age in South Africa, a large number of the working age are unemployed.

Figure B2.3: Age dependency ratios and unemployment rates of selected middle-income countries in 2013



Source: World Bank (2014)

Although fiscal policy has succeeded in reducing poverty and inequality in South Africa, the impact of these policies may have reached a plateau, particularly considering the fiscal sustainability of such policies. In order to meaningfully reduce poverty and inequality further, in a fiscally sustainable manner, South Africa will have to implement policies that will accelerate its economic growth rate and increase its labour absorption rate.

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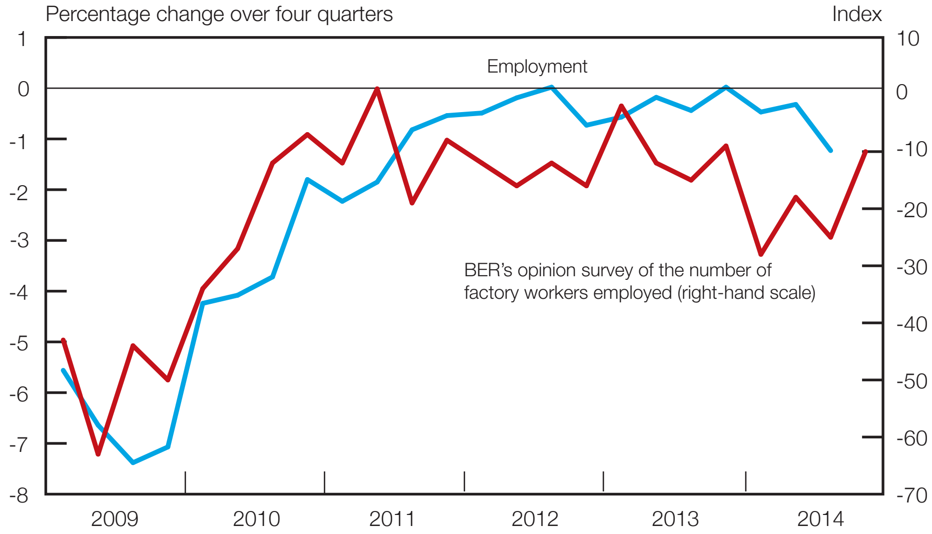
Following eight consecutive quarters of job shedding, the South African mining sector reclaimed 8 100 employment opportunities in the third quarter of 2014. In the wake of the protracted labour strike in the platinum-mining industry, all these new employment opportunities were created in the non-gold mining sector. However, employment levels in the gold-mining sector continued to trend marginally downwards in the third quarter of 2014. Notwithstanding the recent dissipation of labour disruptions, employment prospects in the mining sector were adversely affected by the decline in international commodity prices in the second half of 2014.

The pace of job shedding in the manufacturing sector accelerated in the third quarter of 2014, probably exacerbated by the industrial action in the metals and engineering industry in July. Cumulatively, the industry lost almost 18 700 formal job opportunities in the first three quarters of 2014. Encouragingly, the *Manufacturing Survey* published by the Bureau for Economic Research (BER) showed that manufacturing business confidence rose from 28 to 42 index points in the fourth quarter of 2014. During the first three quarters of 2014, key constraints to the manufacturing sector included sluggish demand, elevated competition from imports, and subdued activity in the mining and construction sectors. The survey, however, indicates a significant recovery in domestic demand and export growth during the fourth quarter of 2014. Employment prospects nevertheless remain bleak, with a net majority of respondents having indicated an expected further reduction in the number of factory workers in the fourth quarter of 2014, albeit at a slightly slower pace, as shown in the accompanying graph. In addition, the employment sub-index of the Kagiso Purchasing Managers' Index remained below the neutral 50 level, registering its tenth successive below-50 reading in January 2015.

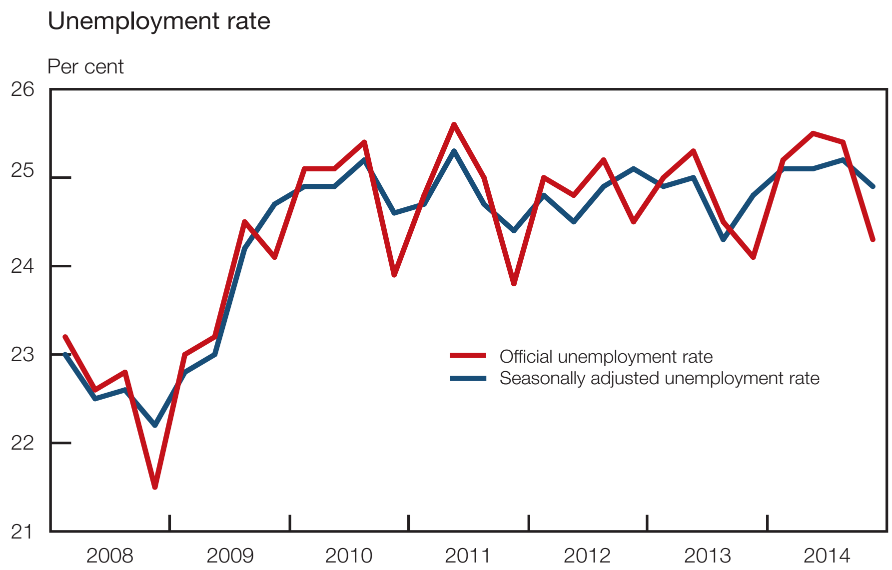
Growth in manufacturing employment



Following two consecutive quarters of fairly healthy employment gains, the construction sector shed roughly 3 700 jobs in the third quarter of 2014. However, the domestic building sector appears to be in a sustained recovery phase, led by the residential building sector. As such, the First National Bank/Bureau for Economic Research (FNB/BER) Building Confidence Index rose by 15 index points to 60 in the fourth quarter of 2014 – its highest level since the beginning of 2008. The rise in confidence was relatively broad-based, with four of the six sub-sectors constituting the index registering higher confidence levels during the fourth quarter of 2014. In particular, the BER reported that the business confidence of residential contractors rose further to a level of 69 on account of a marked improvement in building activity. Furthermore, year-on-year growth in the real value of residential building plans approved accelerated to 13 per cent in the third quarter of 2014. In addition, the FNB/BER Civil Confidence Index increased by a further 11 index points to 59 in the fourth quarter of 2014. Although respondents reported lower construction activity and profitability, confidence was likely buoyed by expectations of increased demand in 2015.

In keeping with the gradually rising trend in employment in the services sectors since 2010, employment in the finance, insurance, real-estate and business services sector increased for a sixth successive quarter in the third quarter of 2014. Likewise, employment in the trade, catering and accommodation services sector increased for a fifth consecutive quarter, albeit at a much slower pace. Encouragingly, the BER's *Retail Survey* for the fourth quarter of 2014 indicated that business confidence among both retailers and wholesalers remained elevated during the quarter. Respondents expect improved sales volumes in the first quarter of 2015, likely aided by expectations of improved consumer spending following the marked decrease in domestic petrol prices in recent months.

According to the *Quarterly Labour Force Survey* (QLFS) conducted by Stats SA, the number of persons employed in South Africa increased by 203 000 from the third to the fourth quarter of 2014, raising the total level of employment to around 15,32 million. Employment creation is usually supported by seasonal dynamics in the final quarter of every year, particularly in the trade, catering and accommodation services sector and in the agricultural sector. Thus, total employment increased by only 143 000 in the year to the fourth quarter of 2014, with the year-on-year growth rate accelerating somewhat from 0,5 per cent in the third quarter of 2014 to 0,9 per cent in the fourth quarter. Job creation took place primarily in the formal sector of the economy in the year to the fourth quarter of 2014, whereas employment opportunities were shed in the private household sector over this period.



The number of unemployed persons decreased notably by 242 000 from the third quarter of 2014 to the fourth quarter but increased by 79 000 over the four quarters of 2014, bringing the total number of unemployed South Africans to around 4,91 million. In addition, the number of discouraged job seekers decreased by 111 000 from the third to the fourth quarter of 2014 – they nevertheless increased by 203 000 in the year to the fourth quarter. Given these developments, the official unemployment rate fell notably from 25,4 per cent in the third quarter of 2014 to 24,3 per cent in the fourth quarter but rose marginally compared with a rate of 24,1 per cent recorded a year earlier. The seasonally adjusted unemployment rate decreased marginally from 25,2 per cent in the third quarter of 2014 to 24,9 per cent in the fourth quarter. Youth unemployment remained very high, registering a rate of 48,8 per cent in the fourth quarter of 2014, marginally lower than the 48,9 per cent recorded a year earlier.

Labour cost and productivity

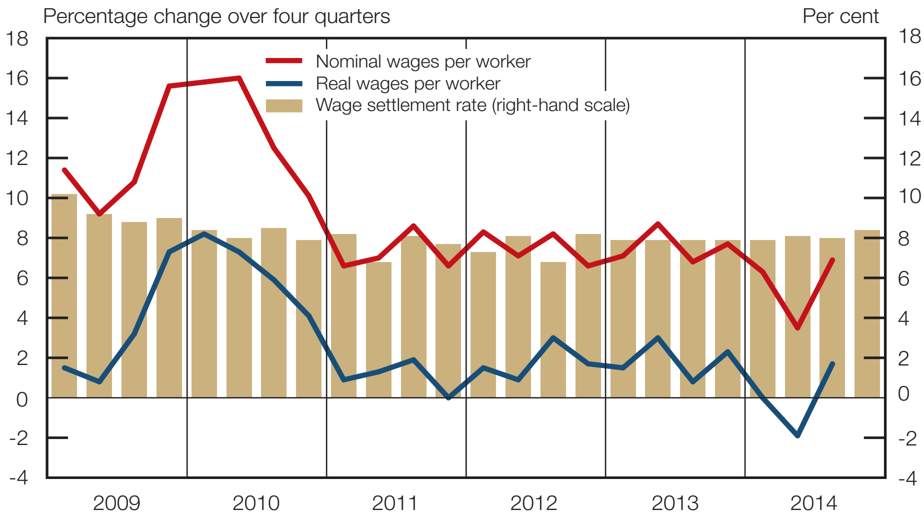
The year-on-year pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy accelerated notably from 3,5 per cent in the second quarter of 2014 to 6,9 per cent in the third quarter, as remuneration growth picked up pace in both the public and the private sectors of the economy. In addition, growth in the real salaries and wages per worker in the formal non-agricultural sector of the economy accelerated to 1,7 per cent in the year to the third quarter of 2014 from a contraction of 1,9 per cent in the year to the second quarter.

Nominal wage growth per worker in the public sector accelerated markedly from a year-on-year rate of -0,8 per cent in the second quarter of 2014 to 6,5 per cent in the third quarter. The sharp acceleration in the rate of increase in public-sector wages per worker in the third quarter of 2014 resulted largely from the termination of the high number of temporary employment opportunities by the IEC following the conclusion of the general elections, which had significantly lowered the average remuneration per public-sector worker in the second quarter of 2014. Of significance is the fact that nominal wage growth accelerated at all public-sector tiers in the third quarter of 2014.

Growth in private-sector remuneration per worker also accelerated in the third quarter of 2014, from a year-on-year rate of 4,9 per cent in the second quarter of 2014 to 6,9 per cent in the third quarter, as wage growth picked up pace in most sub-sectors. The quickening in private-sector wage growth was most pronounced in the non-gold mining sector, from -4,9 per cent in the year to the second quarter of 2014 to 10,1 per cent in the year to the third quarter, following the conclusion of the platinum-mining strike. In addition, remuneration growth accelerated in the trade, catering and accommodation services sector (to 8,4 per cent); the construction sector

(8,2 per cent); the private transport, storage and communications sector (7,6 per cent); the finance, insurance, real-estate and business services sector (6,5 per cent); and the private community, social and personal services sector (5,3 per cent). Only the manufacturing sector recorded a slowdown in remuneration growth, from 6,2 per cent in the second quarter of 2014 to 5,2 per cent in the third quarter.

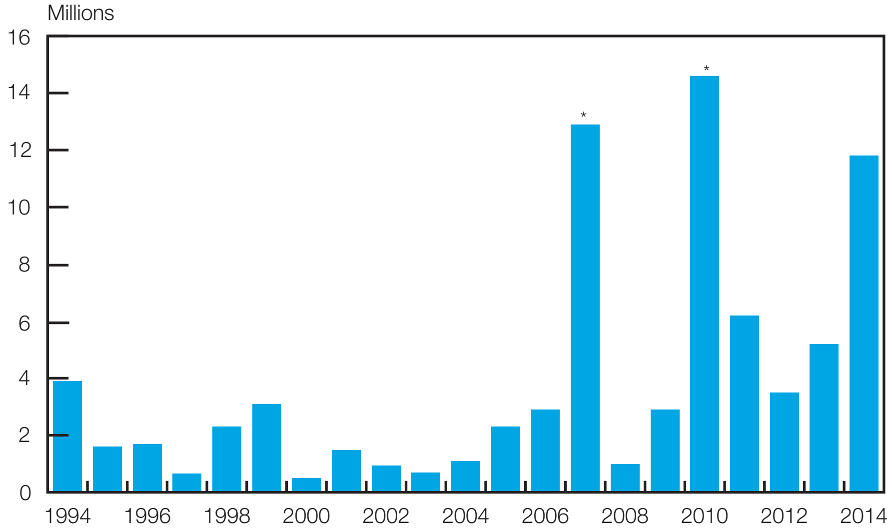
Remuneration growth and wage settlement rates*



* Quarterly estimates based on cumulative data provided by Andrew Levy Employment Publications

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements amounted to 8,1 per cent in 2014, marginally up from 7,9 per cent in 2013. However, exacerbated by the lengthy strike in the platinum-mining sector in the first half of the year and the month-long strike in the steel and engineering industry in July, the number of workdays lost due to industrial action rose notably to 11,8 million in 2014 compared with 5,2 million in 2013. The accompanying graph shows that since 1994, the third-highest annual number of workdays lost due to industrial action was recorded in 2014. The only two years in which more workdays were lost due to industrial action were 2007 and 2010, both of which experienced large public-sector strikes.

Number of workdays lost due to industrial action



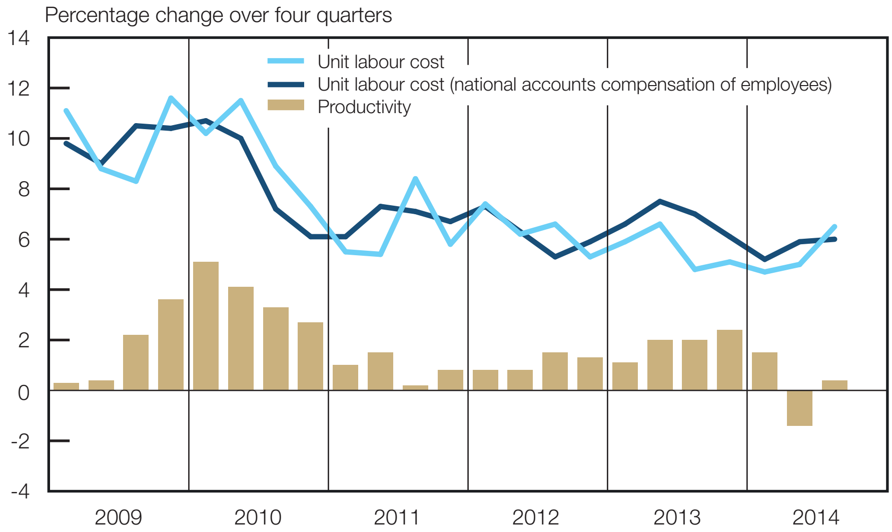
* Public-sector strikes

Source: Andrew Levy Employment Publications

Disconcertingly, however, the number of workdays lost due to industrial action has increased notably in recent years; the average annual number of workdays lost between 2008 and 2014 (excluding 2010, due to the public-sector strike) amounted to 5,1 million, compared with an annual average of only 1,8 million for the thirteen years from 1994 to 2006.

Growth in real output per worker accelerated to 0,4 per cent in the year to the third quarter of 2014 from -1,4 per cent in the year to the second quarter. The acceleration in this measure of labour productivity resulted largely from the marked decrease in public-sector employment due to the termination of a large number of temporary employment opportunities by the IEC. With year-on-year remuneration growth per worker accelerating briskly and output growth moderating marginally in the third quarter of 2014, growth in nominal unit labour cost in the formal non-agricultural sector of the economy accelerated from 5,0 per cent in the second quarter of 2014 to 6,5 per cent in the third quarter.

Formal non-agricultural labour productivity and nominal unit labour cost



Box 3 Correcting remuneration and productivity measures for temporary election-related employment

According to Statistics South Africa's *Quarterly Employment Statistics* survey, public-sector employment increased notably by around 132 000 in the second quarter of 2014. However, 130 000 of these new jobs represented temporary employment opportunities created by the Independent Electoral Commission (IEC) to assist in conducting the general elections held countrywide in June 2014. After the event, public-sector employment decreased by roughly the same number in the third quarter of 2014 as these workers were discharged. Figure B3.1 shows public-sector employment and total formal non-agricultural employment, adjusted for the outlier in the second quarter of 2014.

In addition to momentarily distorting the level of employment, the inclusion of the temporary IEC workers resulted in a somewhat misleading representation of remuneration growth per worker in the formal non-agricultural sector of the economy, and in public-sector wage growth in particular, in the second quarter of 2014. Although the inclusion of the temporary IEC workers resulted in a fairly large increase in employment in the second quarter of 2014, it did not raise the level of remuneration materially as the majority of these workers were only employed for a few days during the quarter, and earned relatively small amounts. When excluding the temporary IEC workers and their wages from the calculation, year-on-year remuneration growth per worker in the public sector amounted to 4,7 per cent in the second quarter of 2014, compared to -0,8 per cent when these workers are included. Similarly, year-on-year remuneration growth per worker in the total formal non-agricultural sector of the economy amounted to 5,0 per cent in the second quarter of 2014 when excluding the temporary IEC workers, compared to a growth rate of 3,5 per cent when including these workers. Figure B3.2 illustrates remuneration growth per worker in the public sector and in the total formal non-agricultural sector of the economy after adjusting for the temporary IEC workers and their wages.

Figure B3.1: Formal non-agricultural employment

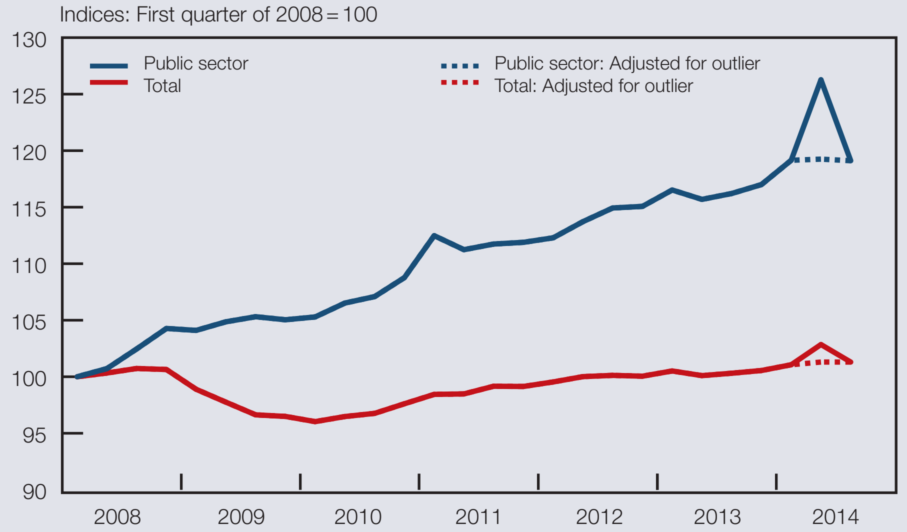
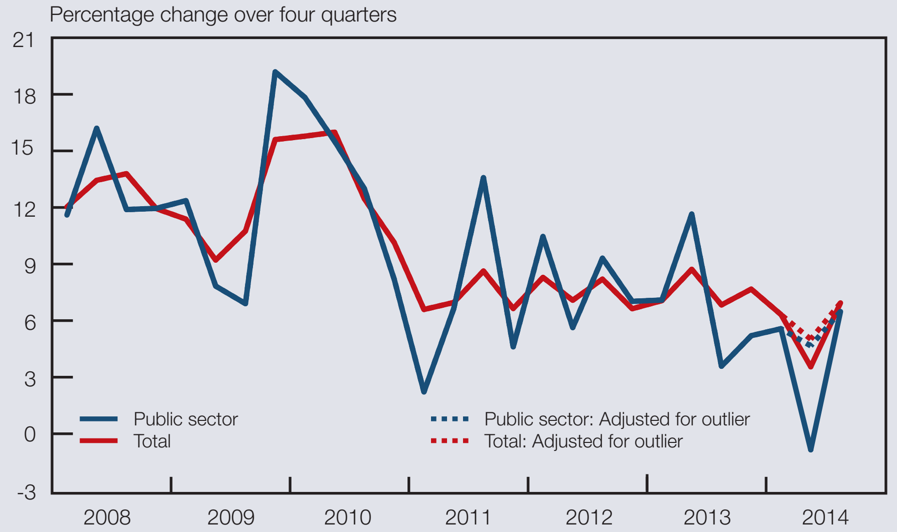
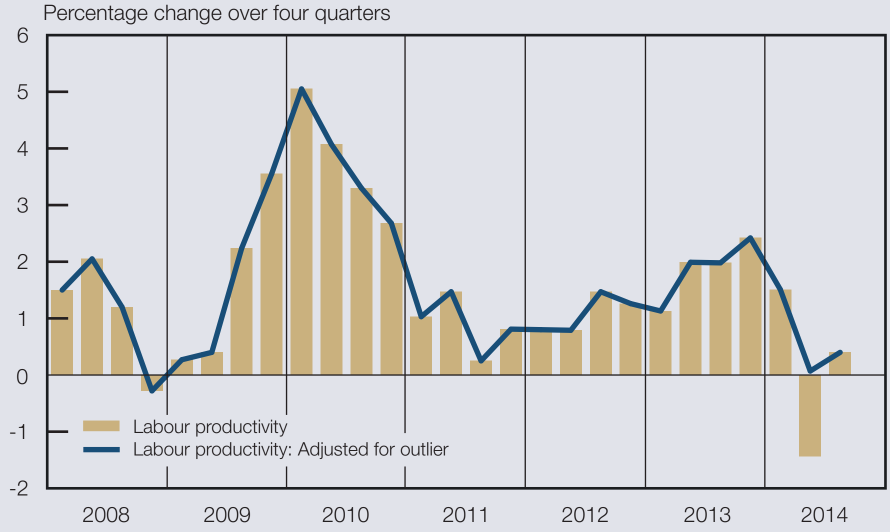


Figure B3.2: Formal non-agricultural remuneration growth per worker



Moreover, since labour productivity as measured by the South African Reserve Bank is defined as real output per worker in the formal non-agricultural sector of the economy, the measurement of this indicator was also distorted by the inclusion of the temporary IEC workers in the second quarter of 2014. Thus, when excluding these temporary workers from the calculation, year-on-year growth in formal non-agricultural labour productivity amounted to 0,1 per cent in the second quarter of 2014, compared to a misleading decrease of 1,4 per cent when these workers are included, as shown in Figure B3.3.

Figure B3.3: Formal non-agricultural labour productivity



Prices

The marked decline in international crude oil prices in recent months suppressed global inflationary pressures and contributed largely to significantly lower domestic inflation. Headline consumer price inflation initially accelerated and breached the 6,0 per cent upper limit of the inflation target range in April 2014, peaking at 6,6 per cent in May and June before moderating substantially in ensuing months to 4,4 per cent in January 2015.[3] Notwithstanding this moderation in the latter part of the year, headline consumer price inflation still accelerated from an annual rate of 5,7 per cent in 2013 to 6,1 per cent in 2014 – the fourth successive year of acceleration in annual headline consumer price inflation.

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

Consumer and producer price inflation

Annual percentage change

	Weights	2013	2014
Headline consumer price inflation	100,00	5,7	6,1
Consumer goods price inflation	49,86	5,1	6,2
Consumer services price inflation	50,14	6,3	6,0
Producer price inflation for final manufactured goods	100,00	6,0	7,5
Producer price inflation for intermediate manufactured goods	100,00	7,9	8,2
Producer price inflation for electricity and water	100,00	10,6	9,9
Producer price inflation for mining	100,00	5,3	4,2
Producer price inflation for agriculture, forestry and fishing	100,00	2,6	5,3

Producer price inflation was also favourably affected by declining international crude oil prices and commodity prices in general, resulting in a moderation in most measures of producer price inflation in the latter half of 2014. Twelve-month producer price inflation for intermediate manufactured goods moderated from a high of 10,5 per cent in February 2014 to 3,4 per cent in January 2015, largely due to a slowdown in price inflation of basic and fabricated metals, and chemical, rubber and plastic products. Similarly, producer price inflation for final manufactured goods moderated for nine consecutive months from a recent peak of 8,8 per cent in

April 2014 to 3,5 per cent in January 2015, as price inflation for coal, petroleum, chemical, rubber and plastic products, electrical machinery, and transport equipment moderated notably over the period.

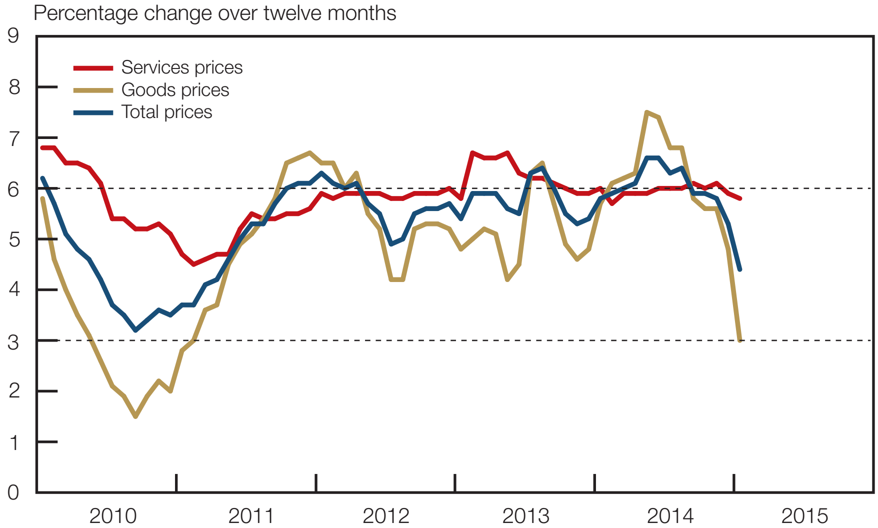
Producer price inflation for electricity and water slowed throughout most of 2014 before accelerating from a recent low of 7,4 per cent in September 2014 to 9,0 per cent in January 2015 as electricity producer price inflation picked up pace. Producer price inflation for mining products moderated markedly from 7,8 per cent in July 2014 to -1,7 per cent in January 2015, reflecting the decline in commodity prices. Driven largely by movements in agricultural food prices, in particular products of crops and horticulture, producer price inflation of agriculture, forestry and fishing products moderated notably from 11,7 per cent in March 2014 to -1,8 per cent in January 2015.

After remaining fairly elevated for a prolonged period, the twelve-month rate of increase in the unit value index for imported commodities[4] slowed markedly in the closing months of 2014, from 19,2 per cent in July to 1,8 per cent in December, aided by a relatively stable rand exchange rate throughout 2014 following three consecutive years of exchange rate depreciation. The recent moderation in price inflation of imported commodities was fairly pervasive among the various subcategories. Nevertheless, the slowdown in price inflation was most pronounced for imported crude petroleum and food products as the international prices of these products receded notably in the second half of 2014.

4 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.

Responding to the moderation in producer price inflation, targeted headline consumer price inflation decelerated from a recent peak of 6,6 per cent in May and June 2014 to 4,4 per cent in January 2015 – its fifth successive month of being within the inflation target range. The recent moderation in consumer price inflation resulted mainly from the slowdown in consumer goods price inflation from 7,5 per cent in May 2014 to 3,0 per cent in January 2015, driven largely by a deceleration in non-durable goods price inflation from 8,6 per cent to 2,5 per cent over the same period. In turn, the slowdown in non-durable goods price inflation resulted primarily from a notable deceleration in petrol price inflation following the sharp reduction in international crude oil prices and, to a lesser extent, from a gradual moderation in consumer food price inflation. Following a prolonged period of sustained gradual acceleration, durable goods price inflation slowed from 4,6 per cent in June 2014 to 3,2 per cent in November as price inflation for new vehicles and household appliances moderated somewhat. However, price inflation in these goods accelerated anew in the ensuing two months, bringing durable goods price inflation to 3,9 per cent in January 2015. Conversely, semi-durable goods price inflation continued to accelerate gradually throughout 2014, amounting to 5,4 per cent in December, largely due to higher clothing and footwear prices.

Targeted consumer price inflation



Although consumer services price inflation has remained close to the upper limit of the inflation target range for a protracted period, it nevertheless moderated marginally from 6,1 per cent in November 2014 to 5,8 per cent in January 2015. The most recent marginal deceleration in consumer services price inflation resulted from slight moderations in the price inflation of restaurant and hotel services, public transport services and housing rent.

A welcome trend has been the gradual moderation in domestic food price inflation in recent months from fairly elevated levels in mid-2014, as international food prices continued to decrease. The slowdown in domestic food price inflation was led by agricultural producer food price inflation, which decelerated markedly from 13,3 per cent in March 2014 to -3,0 per cent in January 2015 as the prices of crop and horticultural products decreased notably. However, producer price inflation of live animals, milk and eggs remained stubbornly elevated, amounting to 12,3 per cent in January 2015. Producer food price inflation at the manufactured level initially also slowed, albeit marginally, from 9,5 per cent in April 2014 to 8,1 per cent in September, before accelerating somewhat to 8,8 per cent in December. Encouragingly, manufactured producer food price inflation moderated to 8,0 per cent in January 2015. Unfortunately, additional cost pressures, such as rapidly rising electricity and labour costs, are keeping final manufactured food price inflation elevated.

Agricultural producer food prices

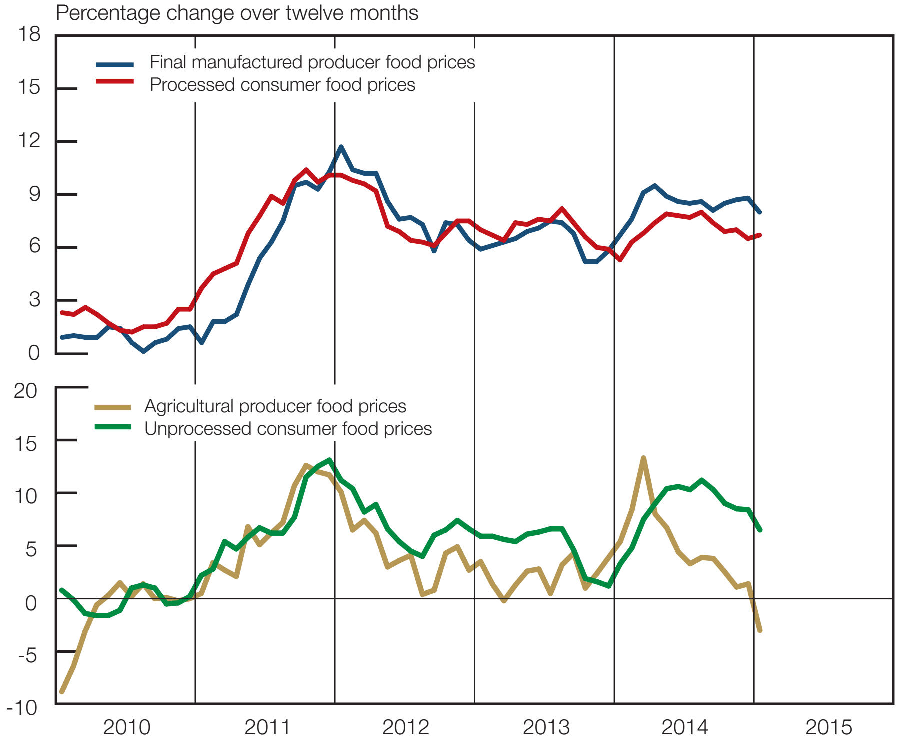
Percentage change over twelve months

	Weights	2014		2015
		Nov	Dec	Jan
Products of crop and horticulture	52,48	-6,8	-6,8	-14,5
Cereals and other crops	24,38	-6,7	-8,7	-17,5
Fruit and vegetables	28,10	-6,4	-5,3	-10,5
Live animals and animal products	47,52	10,5	11,9	12,3
Live animals	33,87	11,6	13,6	13,7
Milk and eggs	11,91	9,0	10,2	10,5
All items	100,00	1,1	1,4	-3,0

Subsequent to the moderation in producer food price inflation, consumer food price inflation followed suit with a slight lag, slowing from a recent high of 9,5 per cent in August 2014 to 6,6 per cent in January 2015. The deceleration in consumer food price inflation was led by slowing bread and cereals price inflation in response to falling crop prices. However, the moderation in consumer food price inflation became more broad-based in recent months, with the exception of meat price inflation which remained elevated, consistent with high producer price inflation for live animals. Food price increases remain a major source of domestic inflationary pressure, and despite moderating in recent months, food price inflation remained at fairly high levels and in excess of the upper limit of the inflation target range. In addition, drought conditions in some areas of the country could threaten maize and sugar crops in 2015, possibly placing renewed upward pressure on domestic food prices.

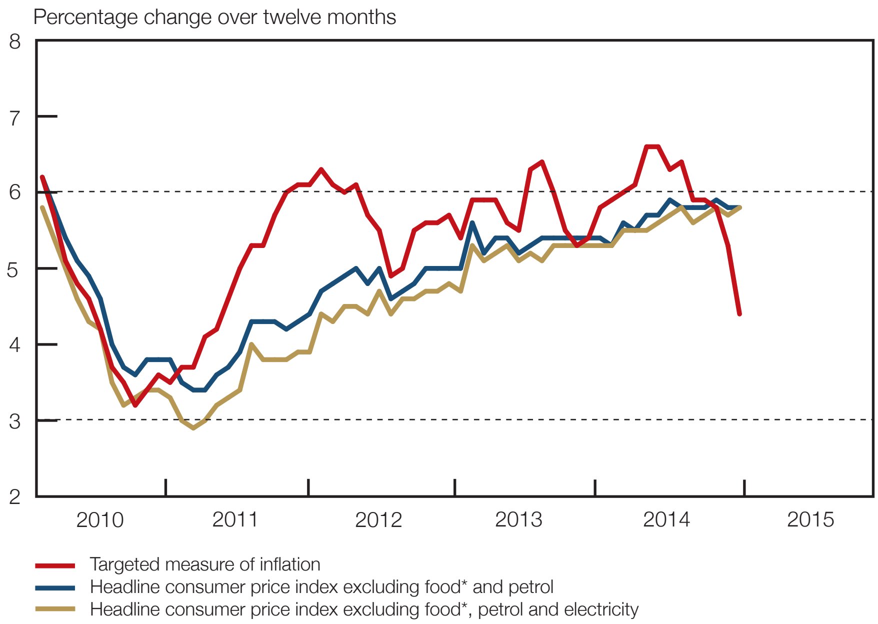
The United Nations Food and Agriculture Organisation's (FAO) international food price index (denominated in US dollar) decreased by 3,7 per cent in 2014 from 2013, with the sharpest year-on-year falls registered by cereals, dairy products, oils and sugar. Only the FAO meat price index recorded an increase, advancing by 8,1 per cent on average in 2014. The international cereals price index decelerated significantly by 12,5 per cent on average in 2014 as international prices of all cereals subsided, driven by record production volumes and large stocks. More recently, the FAO food price index fell further in January 2015 as international cereals prices receded by 3,6 per cent in the month. The decrease in cereal prices resulted largely from a marked decrease in international wheat prices, reflecting abundant supplies and increasing expectations that inventories will reach decade-high levels.

Food price inflation



Most measures of underlying inflation appear to have stabilised just below the upper limit of the inflation target range since the second half of 2014. Subtracting the impact of the more volatile food, non-alcoholic beverages and petrol prices from the calculation of targeted headline consumer price inflation, underlying price inflation quickened gradually to 5,9 per cent in July 2014 and subsequently remained broadly unchanged, amounting to 5,8 per cent in January 2015. Similarly, when further excluding the impact of electricity prices from the calculation, the resultant underlying measure of inflation accelerated steadily to 5,8 per cent in August 2014 and stabilised around that level in subsequent months. Conversely, trimmed mean consumer price inflation displayed more volatility in accelerating from 5,1 per cent in November 2013 to 6,2 per cent in May 2014 before receding notably to 4,8 per cent in January 2015.

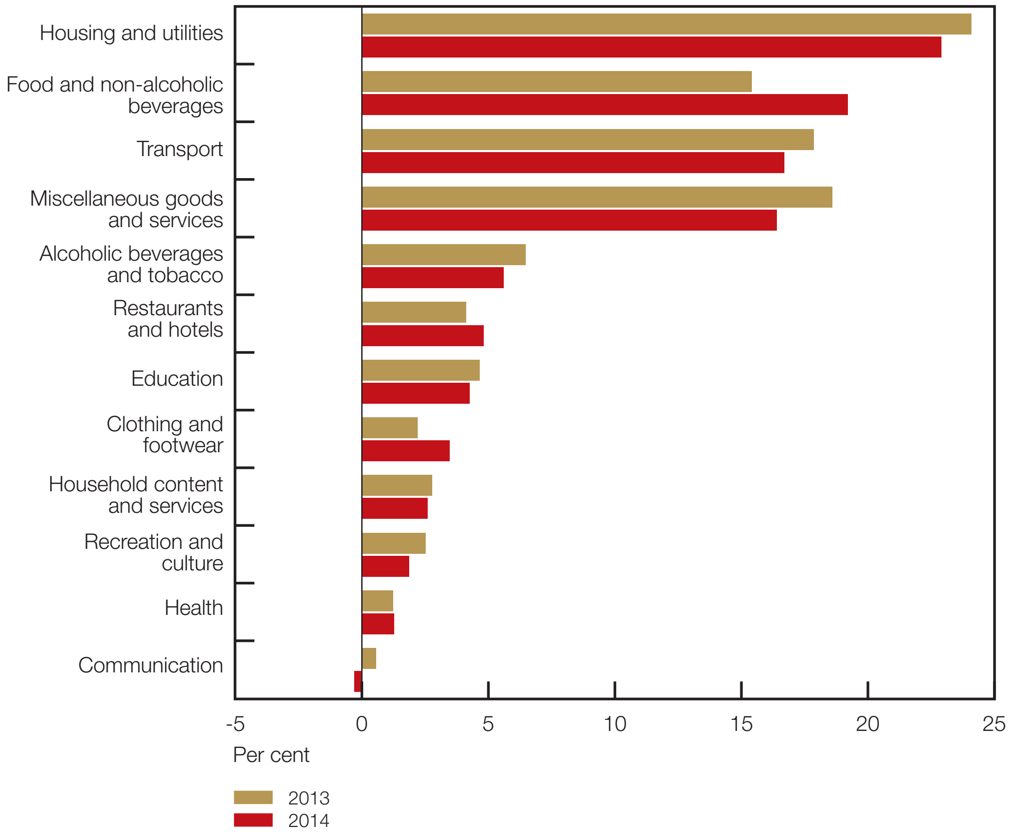
Underlying measures of consumer price inflation



* Food includes non-alcoholic beverages

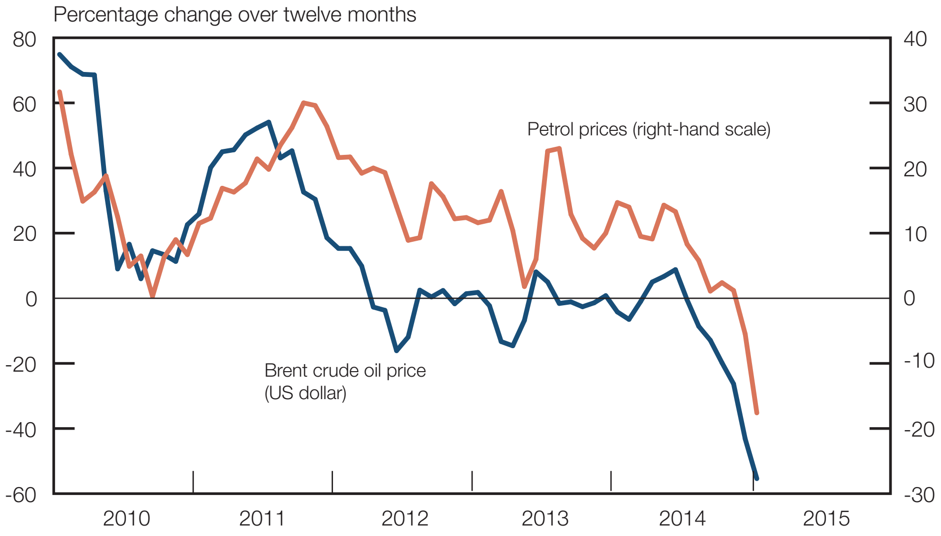
An analysis of price changes based on the classification of individual consumption by purpose (COICOP) categories suggests a slight intensification in inflationary pressures on average from 2013 to 2014. As such, in 2014 annual consumer price inflation exceeded the upper limit of the inflation target range in six of the twelve COICOP categories (as opposed to five categories in 2013), while four categories recorded price increases within the inflation target range (compared to six categories in 2013) and two categories registered rates of change below the lower limit of the inflation target range (compared to only one category in 2013). The accompanying graph shows that the housing and utilities category remained the main contributor to annual consumer price inflation in 2014, followed by the food and non-alcoholic beverages category, which moved up from the third position in 2013.

Contributions to annual average headline consumer price inflation by COICOP category



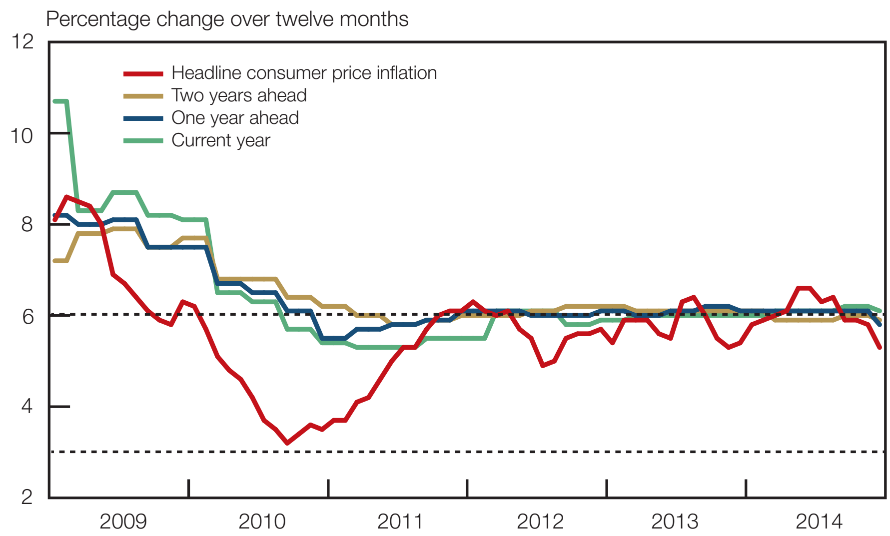
Recent outcomes of administered price inflation were still primarily driven by changes in domestic petrol prices. Administered price inflation slowed notably from 8,9 per cent in May 2014 to -1,4 per cent in January 2015 as petrol price inflation decelerated markedly from 14,0 per cent to -17,6 per cent over the same period. The dramatic slowdown in domestic petrol price inflation resulted chiefly from the sharp drop in international crude oil prices since mid-2014; the average price of Brent crude oil fell from around US$112 per barrel in June 2014 to around US$48 in January 2015. In addition, the exchange rate of the rand remained relatively stable over the period. When excluding the effect of petrol and electricity prices from the calculation of administered prices, this rate of increase has been decelerating since the middle of 2013, amounting to 5,8 per cent in January 2015.

International oil and domestic petrol price inflation



Inflation expectations, as reflected in the *Inflation Expectations Survey* conducted by the BER, have remained largely unchanged around the upper limit of the inflation target range for almost three years. However, in the fourth quarter of 2014, all surveyed groups lowered their expectations for 2015 somewhat. Analysts and trade union representatives revised their expectations downwards to 5,4 per cent and 5,9 per cent respectively, while business representatives reduced their expectations to 6,2 per cent. Whereas business representatives see inflation remaining stable at 6,2 per cent in 2016, analysts and trade union representatives expect inflation to edge up to 5,5 per cent and 6,0 per cent respectively. Average five-year inflation expectations declined marginally from 5,9 per cent in the third quarter of 2014 to 5,8 per cent in the fourth quarter. Household inflation expectations remained stable at 6,3 per cent over the same period.

Inflation expectations



Source: Bureau for Economic Research, Stellenbosch University

While the marginal reduction in inflation expectations in the fourth quarter of 2014 is a welcome development, it is too early to assess whether this represents the start of a more sustained downward trend. Even at these slightly lower levels, inflation expectations remain uncomfortably close to the upper limit of the inflation target range.

Headline consumer price inflation expectations

Per cent, as surveyed in the fourth quarter of 2014

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2014..	6,1	6,1	6,0	6,1
2015..	5,4	6,2	5,9	5,8
2016..	5,5	6,2	6,0	5,9

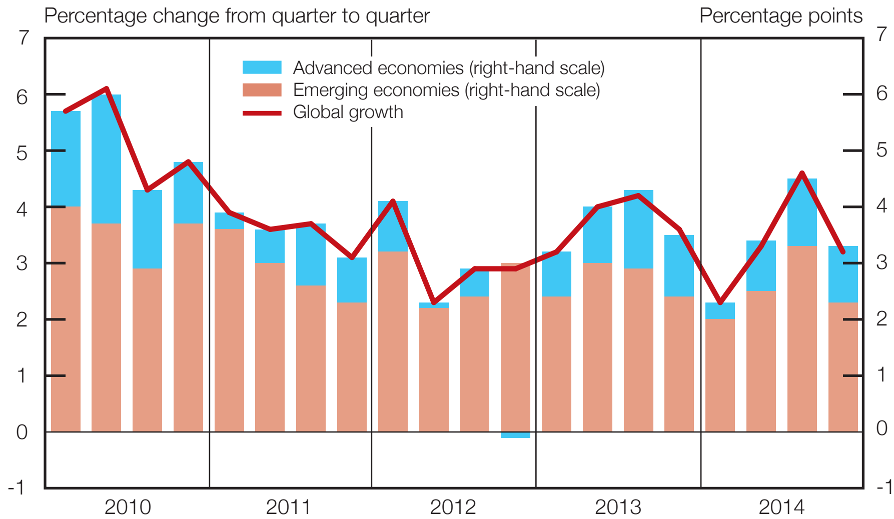
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

After accelerating to 4,6 per cent in the third quarter of 2014, global economic growth slowed markedly to an annualised rate of 3,2 per cent in the final quarter of the year. The moderation in global growth resulted mainly from slower growth in emerging-market economies, especially India, China and Russia.

Global growth and contributions from advanced and emerging economies



Seasonally adjusted annualised rates

Sources: National statistical offices, JPMorgan and staff calculations

In the January 2015 *World Economic Outlook Update*, the International Monetary Fund (IMF) downgraded its global growth forecasts for both 2015 and 2016 by 0,3 percentage points to 3,5 per cent and 3,7 per cent respectively. The downward revision was brought about by a weaker medium-term growth outlook for China, Russia, the euro area, Japan and the major oil-exporting countries. The risks to the global growth outlook were seen to be more balanced than in October 2014. Growth projections for sub-Saharan Africa were revised downwards by 0,9 and 0,8 percentage points to 4,9 per cent and 5,2 per cent in 2015 and 2016 respectively. The deterioration in regional growth prospects largely reflected lower oil and commodity prices.

Real growth in advanced economies

Percentage change in real gross domestic product at seasonally adjusted annualised rates

	2013					2014				
Countries	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
United States..............	2,7	1,8	4,5	3,5	2,2	-2,1	4,6	5,0	2,2	2,4
Japan.........................	5,6	3,3	1,4	-1,2	1,6	5,1	-6,4	-2,6	1,5	0,0
Euro area....................	-1,5	1,4	0,7	1,1	-0,5	1,1	0,3	0,7	1,3	0,9
United Kingdom	2,4	2,6	2,9	1,6	1,7	2,7	3,0	2,6	2,2	2,6
Canada	3,2	2,0	2,7	2,9	2,0	1,0	3,8	3,2	2,4	2,5
Australia	1,3	2,9	1,7	3,0	2,1	4,4	1,9	1,4	2,2	2,7
New Zealand	0,0	1,7	4,3	2,4	2,5	3,6	2,7	4,2	n.a.	n.a.
Advanced economies..	1,6	2,1	2,7	2,3	1,3	0,6	1,7	2,5	n.a.	n.a.

Source: Bloomberg, JPMorgan, national statistical offices and staff calculations

Growth in the US slowed to 2,2 per cent in the fourth quarter of 2014 after having expanded firmly by 5,0 per cent in the third quarter. The lower growth rate can be ascribed to an increase in the value of imports, lower federal government spending and decelerations in non-residential fixed investment and exports. The unemployment rate edged down to 5,5 per cent in February 2015 and the labour force participation rate declined by 0,1 percentage points to 62,8 per cent. Labour market conditions improved with a monthly average of 322 000 jobs per month created in the four months to February 2015. The US Federal Open Market Committee (FOMC) reiterated that the process of interest rate normalisation would be slow and gradual, and that all its actions would be data dependent.

In the euro area, economic growth accelerated at a faster-than-expected rate of 1,3 per cent in the fourth quarter of 2014, supported by better growth in Germany, the region's largest economy. According to Eurostat, annual consumer price inflation in the euro area amounted to -0,3 per cent in February 2015; this was the third monthly decline in consumer prices, largely driven by the oil price. The European Central Bank (ECB) in January 2015 announced a quantitative easing programme involving monthly asset purchases of about €60 billion until at least September 2016. Greece also returned to the centre of the euro area crisis following the electoral success of anti-austerity parties in the January 2015 election. Following difficult negotiations in early 2015, the new coalition government has since reached an agreement with its euro area partners to extend the financial assistance programme by four months until 30 June 2015.

Japan emerged from a technical recession in the fourth quarter of 2014 as real output expanded by 1,5 per cent. The faster pace of increase in output can be attributed to positive contributions from net exports and personal consumption. Headline inflation in January 2015 amounted to 2,4 per cent, implying that consumer price inflation was around 0,4 per cent after removing the effect of the increase in sales tax in April 2014. The Bank of Japan has since left its quantitative and qualitative easing programme unchanged after having expanded the annual pace of increase in the monetary base from around ¥60–¥70 trillion to ¥80 trillion in October 2014.

The United Kingdom registered an increase of 2,2 per cent in real output in the fourth quarter of 2014. Headline inflation moderated to 0,3 per cent in January 2015, which was 0,2 percentage points less than in December 2014. The Bank of England has left its policy rate unchanged at a record low 0,5 per cent.

Real growth in selected emerging-market economies

Percentage change in real gross domestic product at seasonally adjusted annualised rates

	2013					2014				
Countries	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Russia	0,7	2,2	2,3	2,5	1,3	-3,1	1,6	1,8	n/a	n/a
Turkey	7,3	6,7	1,9	3,2	4,1	7,3	-1,8	1,8	n/a	n/a
Poland	1,2	3,2	3,6	3,2	1,7	4,1	2,4	3,2	2,8	3,3
Emerging Europe	2,6	3,6	2,5	2,9	2,1	0,8	0,8	2,4	n/a	n/a
China	7,1	6,9	9,2	7,1	7,7	6,4	7,4	8,3	7,2	7,4
India	6,0	7,7	7,3	4,7	6,9	7,2	7,0	14,0	2,0	7,4
Indonesia	6,1	5,3	5,4	5,8	5,6	4,0	4,9	5,2	5,7	5,0
Emerging Asia	6,2	6,7	8,1	6,1	7,1	5,9	7,0	9,1	5,9	6,9
Brazil	0,7	8,4	-2,0	1,9	2,5	-0,7	-2,4	0,3	n/a	n/a
Mexico	2,0	-3,5	4,5	1,3	1,1	1,4	4,2	2,1	2,7	2,1
Argentina	2,0	4,4	1,3	-1,2	2,9	-2,7	3,1	-2,1	n/a	n.a.
Latin America	1,8	4,5	1,2	1,9	2,5	-0,8	0,9	1,4	n/a	n/a
Emerging economies	4,8	5,9	5,8	4,9	5,4	3,9	4,9	6,6	n/a	n/a

Sources: Bloomberg, JPMorgan, national statistical offices and staff calculations

Economic growth in emerging Asia decelerated sharply to 5,9 per cent in the fourth quarter of 2014. The moderation in growth was mainly due to slower growth in China and India. Annual growth in China amounted to 7,4 per cent in 2014, slightly lower than the government's target of 7,5 per cent and the lowest rate of growth in almost a quarter of a century. Inflation in China accelerated to 1,4 per cent in February 2015 although producer prices have been falling for 35 consecutive months. The People's Bank of China (PBOC) lowered its policy rate by 40 basis points in November 2014 and an additional 25 basis points in early March 2015, the first adjustments in over two years. In February 2015, the PBOC also lowered the reserve requirement rate by 0,5 percentage points. Real output growth in India moderated significantly from 14,0 per cent in the third quarter of 2014 to 2,0 per cent in the fourth quarter, while inflation accelerated to 5,1 per cent in January 2015 mainly due to higher food prices. However, a favourable inflation outlook has led to two 25 basis point reductions in India's policy rate to 7,5 per cent.

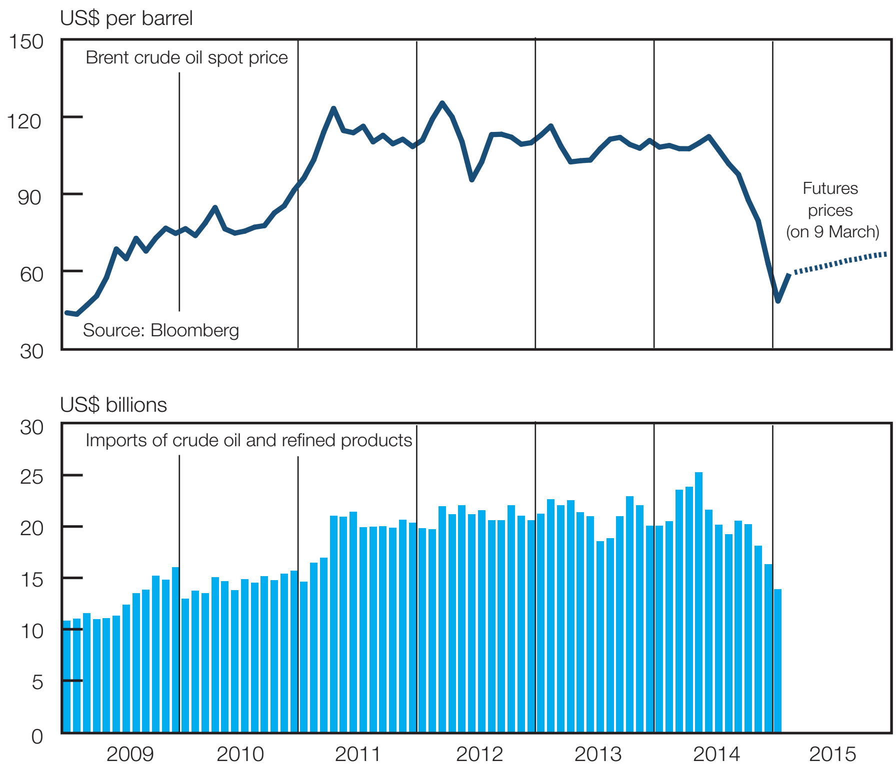
Real output growth in emerging Europe slowed in the fourth quarter of 2014. The Russian economy stagnated in the final quarter of 2014 as the support provided by the depreciating ruble was offset by the tension in Ukraine, sanctions and low crude oil prices. Inflation in Russia accelerated to 16,7 per cent in February 2015 – the highest rate since March 2002. The central bank of Russia raised its policy rate by a cumulative 750 basis points between October and December 2014, before reducing it by 200 basis points in January 2015. According to preliminary estimates, Turkey is expected to have recorded robust growth in the fourth quarter of 2014, supported mainly by government expenditure and significantly higher exports. The Turkish central bank lowered its policy rate by 50 basis points in January 2015 and by another 25 basis points in February, despite inflation remaining persistently above the 5,0 per cent target.

Growth in Latin America accelerated marginally in the fourth quarter of 2014, supported by somewhat firmer economic activity in Argentina, Brazil and Mexico. Mexico in particular, benefited from the pick-up in economic growth in the US. Even though growth in Brazil accelerated marginally in the fourth quarter of 2014, it still remained subdued. High inflation in Brazil led to a cumulative increase of 175 basis points in the central bank's policy rate from October 2014 to 12,75 per cent. The central bank of Mexico kept its policy rate unchanged at 3 per cent, judging that slack in the domestic economy outweighed the inflationary risk stemming from the peso's depreciation. In October 2014, the central bank of Chile lowered its policy rate by 25 basis points to 3,0 per cent due to the slowdown in output.

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 of world exports relative to that of the preceding three months) eased to 3,8 per cent in December 2014. The slowdown was largely due to deteriorating export activity in emerging economies, with growth falling to 0,9 per cent in December. Export volumes contracted by 1,3 per cent in emerging Asia and stagnated in Africa and the middle East.

The price of Brent crude oil plummeted to a six-year low of US$45 per barrel in January 2015. The sharp fall was driven by the strong US dollar and lower forecasted global demand while supply continued to rise. Prices have subsequently recovered to levels of around US$60 per barrel since mid-February 2015 as a decline in the number of rigs in shale formations is expected to slow US production and curb supply. Global oil supply increased to 94,3 million barrels per day in the last quarter of 2014 with Iraqi output reaching a 35-year high, compensating for lower production in Libya. Brent crude oil futures contracts for delivery in the second quarter of 2015 traded around US$60 per barrel in early March 2015.

International oil price and South African imports of crude oil and refined products



Current account[5]

Slower growth in gross domestic expenditure than in gross domestic production and a marginal improvement in South Africa's terms of trade gave rise to a steady narrowing of the deficit on current account in the final quarter of 2014. Even though global economic activity lost some momentum in the fourth quarter of 2014, South African export volumes picked up notably, in part due to reduced strike activity, relatively favourable conditions in some export destinations and the more competitive exchange value of the rand. Simultaneously, relatively weak growth in domestic demand moderated the increases in import volumes. As a result, the country's annualised trade deficit narrowed from a revised R77 billion in the third quarter of 2014 to R35 billion in the fourth quarter. The improvement in the trade balance was, however, partly offset by larger net income payments to non-residents. The current-account deficit accordingly shrank from 5,8 per cent of gross domestic product in the third quarter of 2014 to 5,1 per cent in the fourth quarter.

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

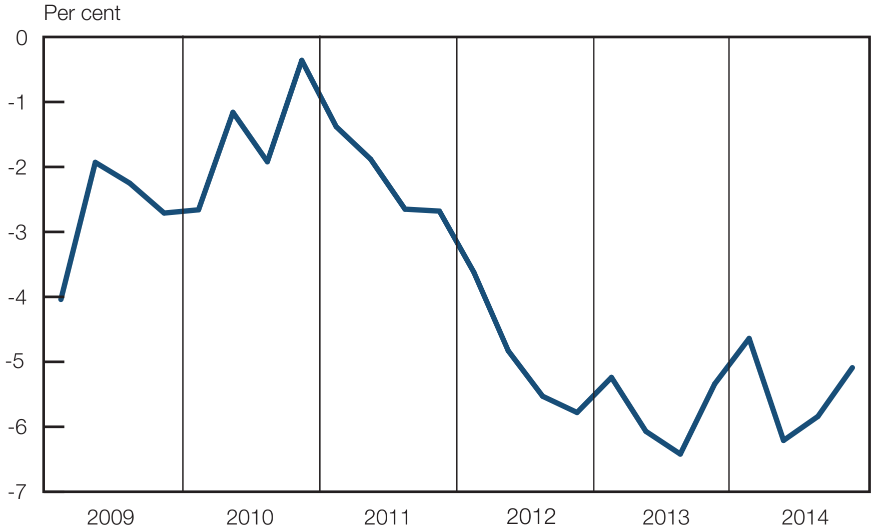
Balance of payments on current account

R billions, seasonally adjusted and annualised

	2013	2014				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	869	966	909	931	959	941
Net gold exports	64	62	64	63	62	63
Merchandise imports	-1 001	-1 099	-1 064	-1 071	-1 056	-1 072
Trade balance	**-68**	**-72**	**-90**	**-77**	**-35**	**-69**
Net service, income and current transfer payments	-135	-101	-142	-145	-163	-138
Balance on current account	**-204**	**-173**	**-232**	**-223**	**-198**	**-207**
As percentage of gross domestic product	*-5,8*	*-4,6*	*-6,2*	*-5,8*	*-5,1*	*-5,4*

Components may not add up to totals due to rounding

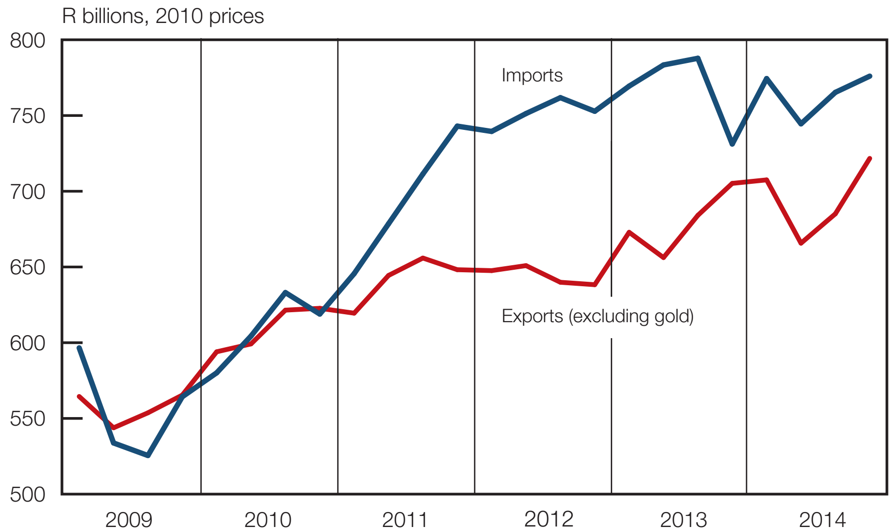
Ratio of current-account balance to gross domestic product



Benefiting from a reduction in strike activity and increased global demand, the physical quantity of South Africa's merchandise exports, largely mining and manufactured goods, advanced by 2,9 per cent and 5,3 per cent respectively in the third and fourth quarters of 2014. Pronounced increases were registered in the exports of especially platinum group metals and mineral products, particularly coal and iron ore. As a result, increased volumes of bulk cargo were shipped from the Saldanha Bay iron ore terminal and from the Richards Bay coal terminal – coal exports were largely destined for India, Spain, Morocco and the United Kingdom. By contrast, the export volumes of base metals and articles of base metals contracted over the period. Export quantities of aluminium and copper declined in part due to electricity constraints and lower demand from China. For 2014 as a whole, an all-time high of 71,3 million tonnes of coal was exported through the Richards Bay coal terminal; still well below the terminal's annual capacity of 91 million tonnes.

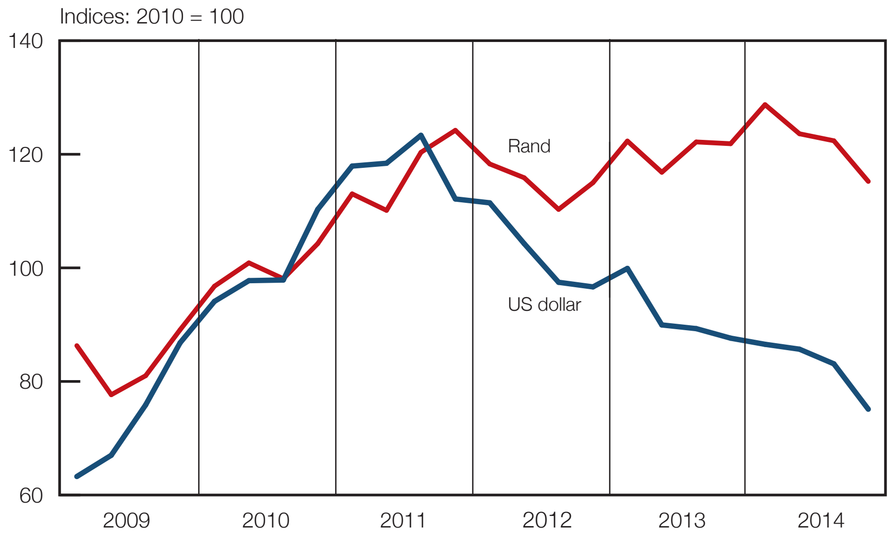
In the fourth quarter of 2014 the volume of manufactured exports rose for the second consecutive quarter, buoyed by higher exports of machinery and electrical equipment, and vehicles and transport equipment. By contrast, the volume of agricultural exports contracted in the final quarter of 2014 following an increase in the preceding quarter. This decline mainly resulted from a notable decrease in citrus and maize exports. For 2014 as a whole, the volume of merchandise exports advanced by 2,3 per cent, lower than the increase of 5,5 per cent recorded in 2013.

Real exports and imports of goods



The US dollar price of a basket of South African-produced non-gold export commodities continued to trend lower in the fourth quarter of 2014, decreasing by 7,5 per cent after a decline of 2,7 per cent in the third quarter. The strengthening of the US dollar during the fourth quarter of 2014 largely weighed down the price of major non-gold commodities over the period, while the decline in the crude oil price occurred alongside lower prices of most base metals. Significant decreases were noted in the prices of iron ore, copper, coal, platinum and nickel. The drop in the price of nickel and iron ore was brought about by an oversupply and high inventory holdings in international markets. However, the rate of decline in the price of a basket of South African produced non-gold export commodities was partly cushioned by the depreciation in the external value of the rand in the fourth quarter of 2014. This, together with a decrease in the prices of other merchandise exports, resulted in a drop of about 2,2 per cent in the rand price of merchandise exports.

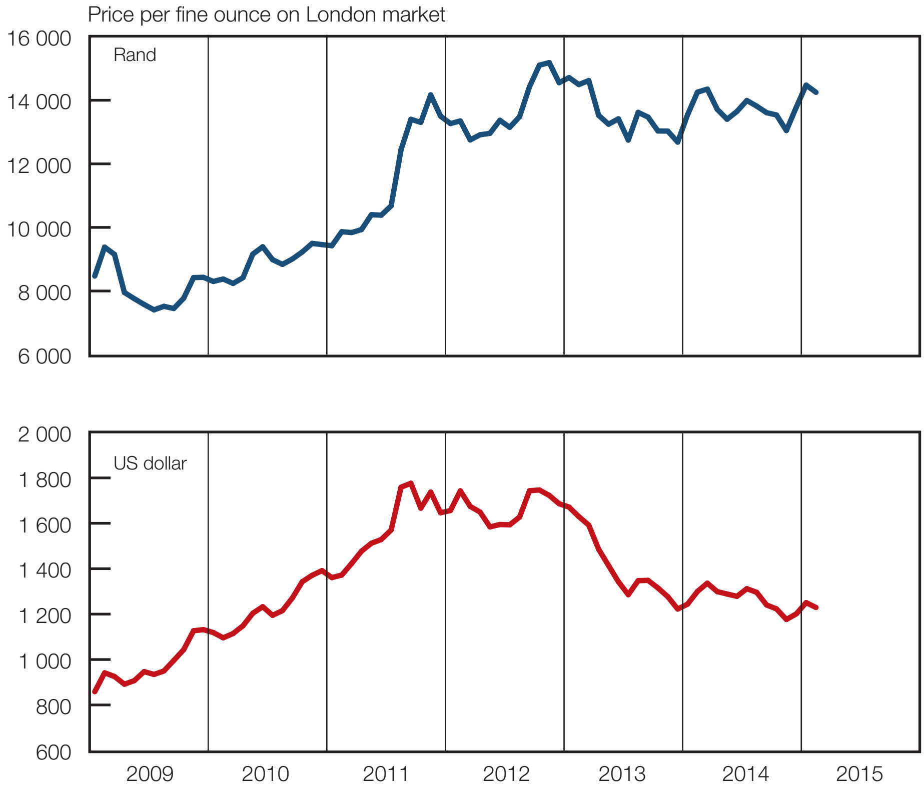
International prices of South African export commodities



The fairly strong performance of merchandise export volumes more than outweighed the decrease in export prices in the fourth quarter of 2014. As a result, the value of merchandise exports advanced by a further 3,0 per cent over the period. For 2014 as a whole, the value of merchandise exports rose by 8,3 per cent compared with an increase of 15,2 per cent in 2013.

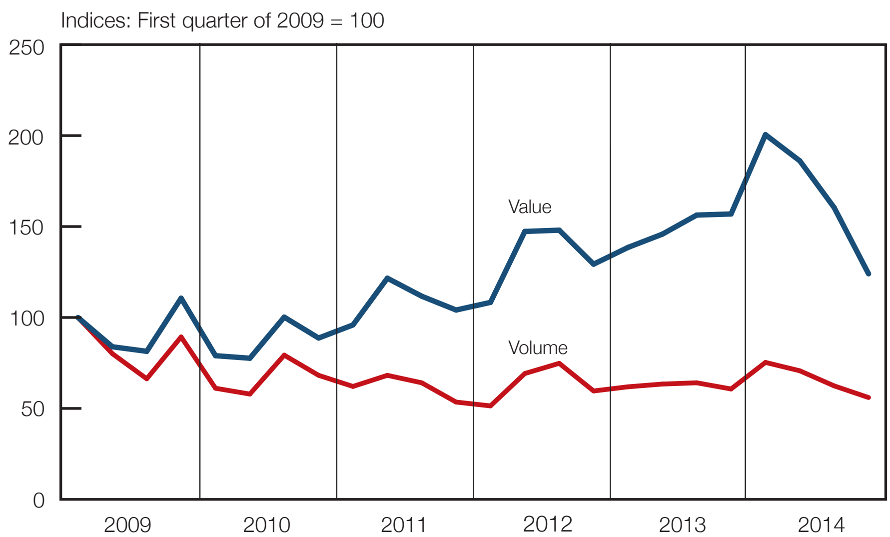
Owing in part to the strengthening of the US dollar, the fixing price of gold on the London market receded by 6,4 per cent in the final quarter of 2014, declining from US$1 283 per fine ounce in the third quarter of 2014 to US$1 200 per fine ounce in the fourth quarter. Over the same period, the average realised rand price of gold decreased by roughly 2,0 per cent partly due to exchange rate movements. A marginal increase in the physical quantity of gold exports, together with the decline in the realised price of gold in the fourth quarter of 2014, resulted in the export earnings of South African gold producers decreasing by about 1,0 per cent over the same period.

Gold price

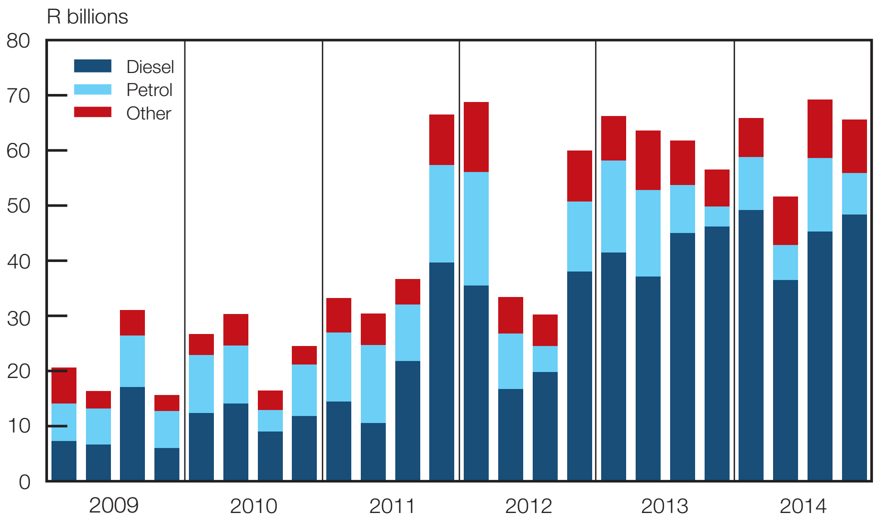


After having increased by 2,8 per cent in the third quarter of 2014, growth in the volume of merchandise imports slowed to 1,4 per cent in the fourth quarter. Firm demand for imported chemical products, machinery and electrical equipment, and vehicles and transport equipment raised the volume of manufactured imports over the period. At the same time, the physical quantity of imported mining products contracted, notwithstanding an increase in the importation of base metals and articles of base metals. The import volume of mineral products declined by about 6,5 per cent in the fourth quarter of 2014. The increasing dependency on diesel-powered open cycle gas turbines by Eskom to ensure the continuity of South Africa's electricity supply partly kept the demand for fuel firm throughout 2014.

Crude oil imports



Value of refined imports

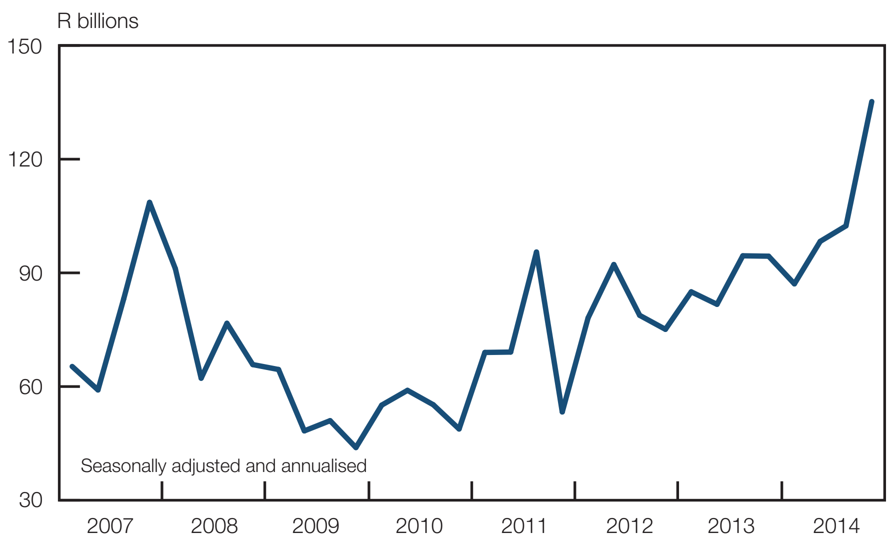


South Africa's import penetration ratio increased marginally from 25,2 per cent in the third quarter of 2014 to 25,6 per cent in the fourth quarter. On an annual basis, this ratio appears to have levelled off at around 25,3 per cent, which was slightly less than the ratio of 25,6 per cent recorded in 2013.

International crude oil prices receded further in the fourth quarter of 2014 and contributed meaningfully to the 2,7 per cent decline in the rand price of merchandise imports. The value of merchandise imports consequently declined by 1,4 per cent in the final quarter of 2014 following an increase of 0,7 per cent in the third quarter. For 2014, the value of merchandise imports rose by 7,1 per cent – significantly slower than the rate of increase of almost 17 per cent registered in 2013.

The deficit on the overall services, income and current transfer account widened by about 12 per cent from R145 billion in the third quarter of 2014 to R163 billion in the fourth quarter largely on account of markedly higher gross dividend payments by private companies (i.e. companies not listed on the JSE Limited) to their foreign parent companies. These increased dividend payments could have been partly encouraged by exchange rate movements and the random dividend policies of many of these companies. As shown in the accompanying graph, the level of dividend payments in the fourth quarter of 2014 exceeded its all-time high recorded during the period of firm economic growth in 2007. For 2014, gross dividend payments to the rest of the world increased at a rate of 19 per cent compared with an increase of 9,7 per cent in 2013.

Dividend payments to non-residents



Gross dividend receipts from the rest of the world increased by about 14 per cent in the fourth quarter of 2014; for the year as a whole, dividend receipts rose by 35 per cent. Owing in part to the depreciation of the exchange value of the rand, dividend receipts surged by roughly 50 per cent in both 2012 and 2013. Interest payments to foreign creditors and investors remained broadly unchanged from the third to the fourth quarter of 2014, culminating in an increase of 16,3 per cent for the year as a whole, compared with an increase of 27 per cent in 2013. This lower rate of increase in interest payments can partially be explained by the moderation in net purchases by non-residents of rand-denominated government debt over the period.

Net payments for international trade in services in the category 'other services' decreased somewhat in the fourth quarter of 2014 as gross payments in the subcategories relating to technical services and intellectual property displayed decreases. For 2014 as a whole, net payments for total services decreased mainly due to a sustained increase in travel receipts throughout the year.

South Africa's terms of trade improved slightly in the fourth quarter of 2014 as import prices of goods and services, strongly affected by the decline in Brent crude oil prices, decelerated at a faster pace than that of export prices. On a full-year basis the country's terms of trade deteriorated marginally from 2013 to 2014.

Financial account

Capital flows to most emerging-market economies tapered off in 2014, affected by expectations around the timing and pace of the US Federal Reserve's policy tightening and the implied policy divergence with the euro area and Japan. The anticipated rise in US policy rates and the adverse effect on the acquisition of fixed-income securities in emerging markets were somewhat countered by the announcement of further quantitative easing by the ECB and the Bank of Japan. In addition to these developments, capital flows to emerging markets were also affected by the sharp drop in the international price of Brent crude oil in the fourth quarter of 2014 and the concomitant uncertainty in that market.

Net financial transactions

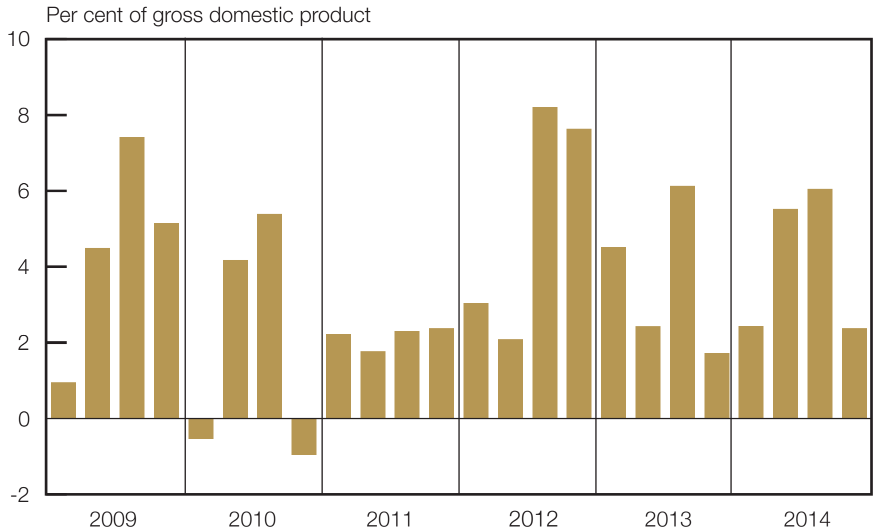
R billions

	2013	2014				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	80,1	7,2	27,4	10,2	17,2	62,0
Portfolio investment	69,5	12,3	27,4	50,8	-16,8	73,7
Financial derivatives	-188,3	-48,0	-43,7	-39,6	-63,6	-194,8
Other investment	50,4	38,0	5,1	49,7	53,8	146,6
Change in assets						
Direct investment	-64,1	-7,7	-14,4	-43,8	-9,4	-75,3
Portfolio investment	-11,5	-8,9	-11,2	-3,2	-0,9	-24,2
Financial derivatives	195,8	54,2	48,4	40,3	68,4	211,3
Other investment	3,2	-29,4	2,9	17,2	-17,4	-26,8
Reserve assets	-4,7	4,7	10,0	-23,4	-7,9	-16,6
Total identified financial transactions*	130,4	22,4	51,8	58,3	23,3	155,8
As percentage of gross domestic product	*3,7*	*2,4*	*5,5*	*6,1*	*2,4*	*4,1*

* Including reserve assets but excluding unrecorded transactions

During 2014 the financial account of the balance of payments (including reserve assets but excluding unrecorded transactions) recorded a sizeable net inflow of capital to the value of R155,8 billion; the net inward movement of capital in the fourth quarter of 2014 alone amounted to R23,3 billion. Net capital inflows into South Africa in 2014 mainly took the form of net other investment, largely driven by excess international liquidity.

Balance on financial account



Including reserve assets but excluding unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment flows into South Africa accelerated from inflows of R10,2 billion in the third quarter of 2014 to inflows of R17,2 billion in the fourth quarter. The majority of these inflows once again comprised loan finance extended by foreign parent companies to their subsidiaries in South Africa, particularly in the telecommunications sector. For 2014, inward foreign direct investment amounted to R62,0 billion, somewhat less than the R80,1 billion recorded in 2013. According to a report titled "Global investment trends monitor" by the United Nations Conference on Trade and Development (UNCTAD), global foreign direct investment inflows declined by 8 per cent in 2014 due to the fragile recovery in global economic activity, policy uncertainty and geopolitical risks. Foreign direct investment flows to developed countries declined by 14 per cent, while direct investment flows to developing economies rose by 4 per cent over the period. At the regional level, flows to developing Asia increased alongside muted flows to the African region.

Inward foreign portfolio investment changed abruptly from a substantial inflow of R50,8 billion in the third quarter of 2014 to a net outflow of R16,8 billion in the fourth quarter as foreign investors disposed of domestic equity and, to a lesser extent, debt securities. Foreign investors became more risk-averse during the second half of the fourth quarter of 2014 as emerging-market indicators weakened amid uncertainty regarding the timing and impact of monetary tightening in the US on emerging markets in particular. Following general elections in Greece, concerns regarding the country's ability to remain in the euro area further dampened the risk appetite in financial markets, including South Africa. Despite having recorded outflows of capital in the fourth quarter of 2014, inward portfolio investment increased marginally from R69,5 billion in 2013 to R73,7 billion in 2014 as a whole.

Other inward investment flows into South Africa amounted to R53,8 billion in the fourth quarter of 2014, compared to the inflow of R49,7 billion in the third quarter. The capital inflow in the fourth quarter of 2014 can mainly be attributed to a substantial increase in foreign currency-denominated loans extended to the South African banking sector. On an annual basis, other inward investment flows almost tripled from R50,4 billion in 2013 to R146,6 billion in 2014.

South African-owned assets abroad

While South African entities continued to expand their business activities abroad through equity investments, foreign subsidiaries and associates repaid loans to their South African parent companies in the fourth quarter of 2014. On a net basis, outward direct investment showed an outflow of R9,4 billion in the fourth quarter of 2014, considerably less than the outflow of R43,8 billion recorded in the third quarter. On an annual basis, outward foreign direct investment increased from R64,1 billion in 2013 to R75,3 billion in 2014.

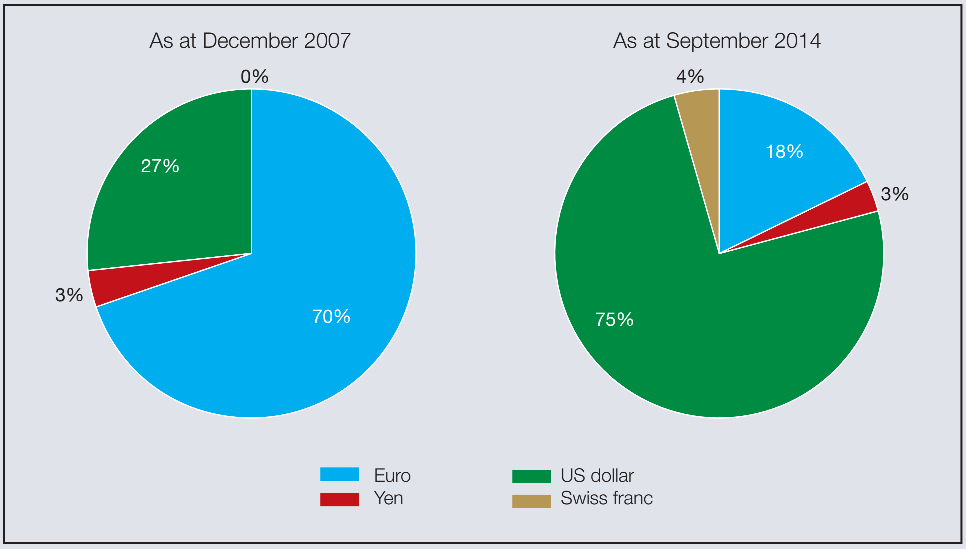
Outward portfolio investment decreased to an outflow of R0,9 billion in the fourth quarter of 2014 compared with an outflow of R3,2 billion in the third quarter. Investments made in foreign equity securities were almost fully neutralised by the net sale of foreign debt securities by the banking sector over the period. The acquisition of foreign portfolio assets more than doubled from R11,5 billion in 2013 to R24,2 billion in 2014, boosted especially by increased investment abroad during the first half of 2014. This increase partly reflected the relative stability in global financial markets over the period.

Other outward investment reversed to an outflow of R17,4 billion in the fourth quarter of 2014 compared with an inflow of R17,2 billion in the preceding quarter. The reversal of capital flows occurred primarily as a result of an increase in the domestic banking sector's foreign-currency deposit holdings. Other outward investment changed from an inflow of R3,2 billion in 2013 to an outflow of R26,7 billion in 2014.

Box 4 Currency composition of South Africa's foreign currency-denominated bond liabilities

The South African government's foreign currency-denominated debt remains relatively small in magnitude at about 10 per cent of overall government debt. Within that total, however, the composition by currency has changed considerably over the past seven years. The composition of foreign currency-denominated bonds issued by South Africa changed significantly from the end of 2007 to the end of September 2014, reflecting the response of the bond issuers to the impact of the financial crisis, the resultant availability of global liquidity, and the extent of perceived financial market stability of specific economies. Over the period, the composition of the portfolio of foreign bonds issued by South Africa changed from being largely dominated by long-term eurobond issuances to strong dominance by US dollar issuances, as shown in Figure B4.1 below[1].

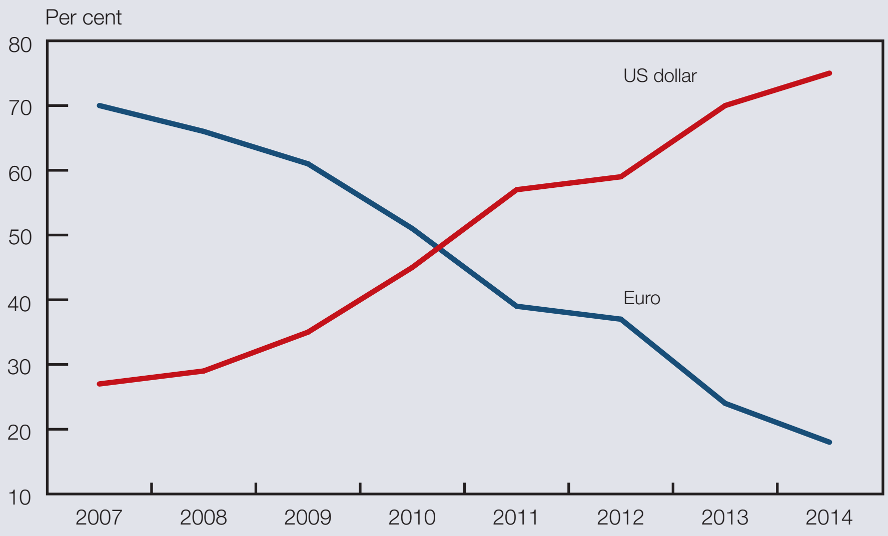
Figure B4.1: Currency composition of South Africa's non-rand bond debt



1 All bonds were converted to a common currency using market exchange rates at the end of the respective period.

The line graph below depicts the evolution over time of the shares of bonds denominated in US dollar and euro. The decline in the euro-denominated bonds issued by South Africa coincided with the tighter international funding conditions in Europe.

Figure B4.2: Share of top two currencies in total non-rand bond debt



Foreign debt

South Africa's gross external debt inched higher from US$141,8 billion at the end of June 2014 to US$142,3 billion at the end of September, mainly as a result of international bond issuances by the national government. Borrowing activity of most other sectors remained fairly subdued over the period. Expressed in rand terms, South Africa's external debt advanced from R1,5 trillion at the end of June 2014 to R1,6 trillion at the end of September.

Foreign currency-denominated debt increased from US$62,2 billion at the end of the second quarter of 2014 to US$64,7 billion at the end of the third quarter, lifted by issuances of three international government bond issues totalling US$2,2 billion.

South Africa's rand-denominated debt, expressed in US dollar, decreased from US$79,6 billion at the end of June 2014 to US$77,7 billion at the end of September largely due to the depreciation of the rand against the US dollar. Expressed in rand terms, however, South Africa's rand-denominated debt continued to increase, buoyed by the higher incurrence of debt by the banking and private non-banking sectors.

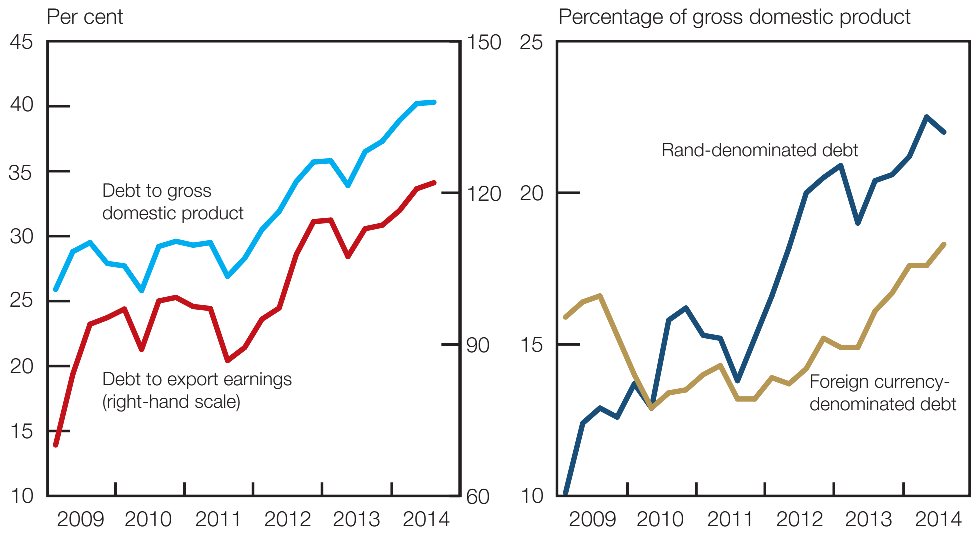
Foreign debt of South Africa

US$ billions at end of period

	2013			2014		
	2nd qr	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Foreign currency-denominated debt..............	57,1	60,0	61,2	62,9	62,2	64,7
Debt securities	18,5	21,6	21,8	22,0	20,1	21,9
Other..	38,6	38,4	39,4	40,9	42,2	42,8
Public sector	9,4	9,6	9,1	9,1	9,1	8,8
Deposit-taking institutions...........................	11,7	10,4	12,1	13,5	13,9	14,5
Non-monetary private sector	17,5	18,4	18,3	18,3	19,1	19,5
Rand-denominated debt	72,8	76,1	75,3	75,6	79,6	77,6
Debt securities..	39,7	42,3	41,1	40,1	44,1	41,6
Other	33,1	33,8	34,2	35,5	35,5	36,0
Total foreign debt	129,9	136,1	136,5	138,5	141,8	142,3
As percentage of gross domestic product....	*33,9*	*36,5*	*37,3*	*38,9*	*40,2*	*40,3*
As percentage of total export earnings.........	*107,4*	*112,9*	*113,6*	*116,2*	*120,3*	*121,2*

As a result of a muted increase in the country's total external debt obligations, the ratio of total external debt to gross domestic product moved essentially sideways at around 40,3 per cent from the end of June 2014 to the end of September. Simultaneously, the ratio of external debt to annualised export proceeds rose from 120,3 per cent to 121,2 per cent at the end of the second and third quarters of 2014 respectively. Relative to the country's total external debt, rand-denominated debt declined marginally from 56,1 per cent at the end of June 2014 to 54,6 per cent at the end of September.

Foreign debt ratios



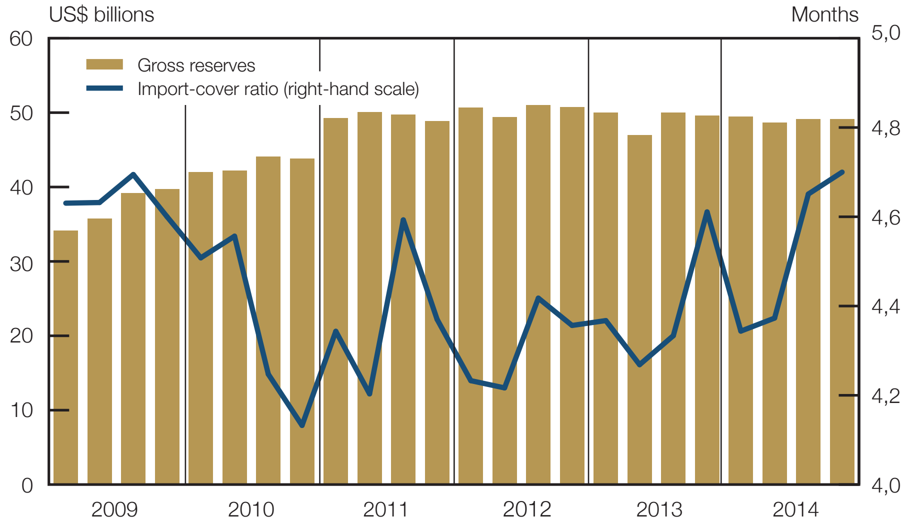
South Africa's short-term foreign currency-denominated debt (i.e. debt with an original maturity of less than one year and other longer-term foreign currency-denominated debt maturing within the next twelve months) accounted for 43,6 per cent of total foreign currency-denominated debt at the end of September 2014. This was a slight deterioration in the ratio compared with the 42,9 per cent recorded at the end of June 2014.

International reserves and liquidity

South Africa's international reserves increased by R7,9 billion in the fourth quarter of 2014 following an increase of R23,4 billion in the third quarter. During 2014 as a whole, the country's international reserves improved by R16,6 billion compared with an increase of R4,7 billion in 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) decreased marginally from US$49,6 billion at the end of December 2013 to US$49,1 billion at the end of September 2014, remaining unchanged at the end of December 2014. The level of gross reserves, however, decreased to US$47,2 billion at the end of February 2015, largely due to unfavourable revaluation effects.

Gross international reserves



The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services, and income payments) increased marginally from 4,6 months at the end of September 2014 to 4,7 months at the end of December 2014 as imports increased at a slower pace than the accumulation of reserves. From 2011 to 2013 the annual average import cover ratio remained flat at 4,3 months, before increasing to 4,5 months in 2014.

South Africa's international liquidity position decreased from US$45,5 billion at the end of December 2013 to US$42,7 billion at the end of December 2014 before declining further to US$41,9 billion at the end of February 2015.

Exchange rates

The US dollar appreciated further against most major currencies in the final quarter of 2014, underpinned by favourable labour market data and firm growth rates since the second quarter of 2014. The euro depreciated, on balance, by 11,8 per cent against the US dollar in 2014 to levels last recorded in 2003. A number of emerging-market currencies depreciated noticeably in 2014 with the Ukrainian hryvnia, Russian ruble and the Argentine peso posting the worst performances.

The nominal effective exchange rate of the rand declined, on balance, by 2,8 per cent in 2014, compared with a decline of 18,6 per cent in 2013. The trade-weighted exchange rate of the rand increased, on balance, by 0,3 per cent in the fourth quarter of 2014 following a decline of 2 per cent in the third quarter. The rand did, however, regain some momentum, rebounding by 4,0 per cent in October 2014 supported by a positive Medium Term Budget Policy Statement and portfolio investment inflows. The domestic currency weakened by 0,3 per cent in November 2014 amid South Africa's credit rating downgrade from Baa1 to Baa2 by Moody's rating agency as electricity challenges became more acute. In December 2014, the trade-weighted exchange rate of the rand weakened further along with other emerging-market currencies and declined by 3,2 per cent. Sentiment towards emerging-market currencies, including the rand, was generally weighed down by the persistent weakness of the euro area, a slowing Chinese economy and an unexpected Japanese recession.

Despite having depreciated against the US dollar, the rand appreciated against the euro, partly reflecting the differences in economic performance between the US and euro area. Divergence was also evident in the monetary policies pursued by the US Federal Reserve and the ECB. While the US Federal Reserve ended its quantitative easing programme, the ECB recently announced that its programme would be expanded from March 2015.

Exchange rates of the rand

Percentage change

	31 Mar 2014 to 30 Jun 2014	30 Jun 2014 to 30 Sep 2014	30 Sep 2014 to 31 Dec 2014	31 Dec 2014 to 27 Feb 2015
Weighted average*	-0,4	-2,0	0,3	3,7
Euro	0,7	1,7	1,3	9,0
US dollar	-0,2	-5,6	-2,9	0,6
Chinese yuan	-0,4	-6,5	-1,8	1,6
British pound	-2,5	-1,2	1,5	1,6
Japanese yen	-1,7	1,9	6,2	0,3

* Against a basket of 20 currencies

Exchange rates of the rand against selected currencies

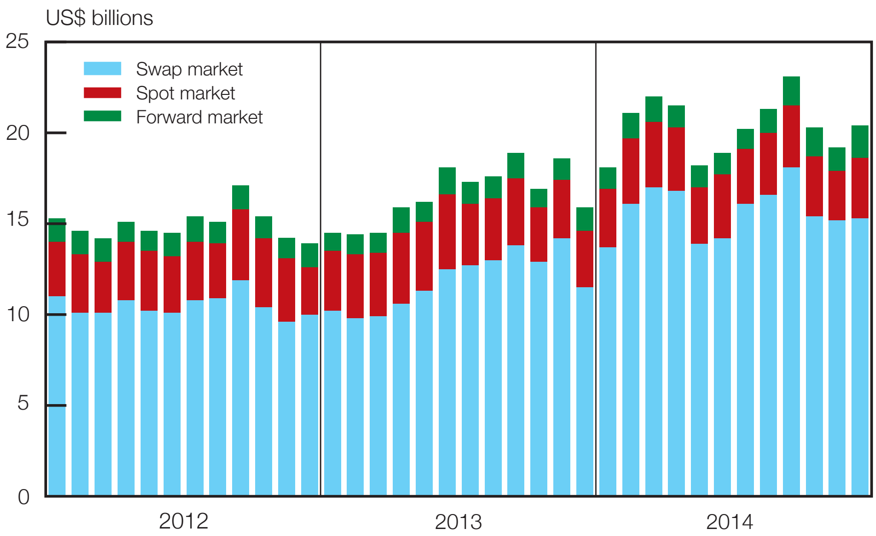
Indices: 30 April 2014 = 100

The South African rand started 2015 on a firm footing, increasing on a trade-weighted basis by 3,7 per cent in January and February, supported by monetary stimulus measures by the ECB and the People's Bank of China over the period.

The real effective exchange rate of the rand strengthened by 4,2 per cent from December 2013 to December 2014, eroding some of the competitiveness of South African producers. Despite this movement, the rand's real external value nevertheless remained in low territory.

The net average daily turnover in the South African foreign-exchange market decreased by 7,3 per cent from US$26,0 billion in the third quarter of 2014 to US$24,1 billion in the fourth quarter. The fourth-quarter level, which is traditionally lower due to the year-end holidays, was still 12,5 per cent higher than the corresponding level in 2013.

Net average daily turnover against the rand



The net average daily turnover in the rand foreign-exchange market declined by 7,7 per cent from US$21,5 billion in the third quarter of 2014 to US$19,9 billion in the fourth quarter, weighed down by decreases of 9,9 per cent and 5,8 per cent in swap and spot transactions respectively. Transactions in third currencies also contracted over the period. The fourth-quarter level was 2,6 per cent lower than the corresponding level in 2013. Swap transactions contributed 77 per cent to the net average daily turnover in the rand market, with non-residents accounting for 62 per cent of transactions in the swap market.

Monetary developments, interest rates and financial markets

Structural and regulatory issues in 2014 and early 2015

In the past 14 months the operating environment for the banking sector remained challenging, characterised by lustreless and divergent global growth with ongoing uncertainty about the normalisation of monetary policies and a subdued domestic macroeconomic environment. In addition, a moderate tightening of domestic monetary policy from January 2014 added a cumulative 75 basis points to the repurchase rate during the year. Alongside a sovereign rating downgrade of the country, seven major South African banks were downgraded by one notch by an international rating agency during the year, potentially impacting on the banking sector's cost of funding and access to liquidity. Despite the challenging environment, the banking sector remained profitable and sound, with the total capital-adequacy ratio remaining well above the Basel III minimum regulatory capital requirements. The quality of bank assets remained healthy, with the ratio of impaired advances to gross loans and advances edging lower during 2014 and the first month of 2015 to reach levels last recorded in 2008.

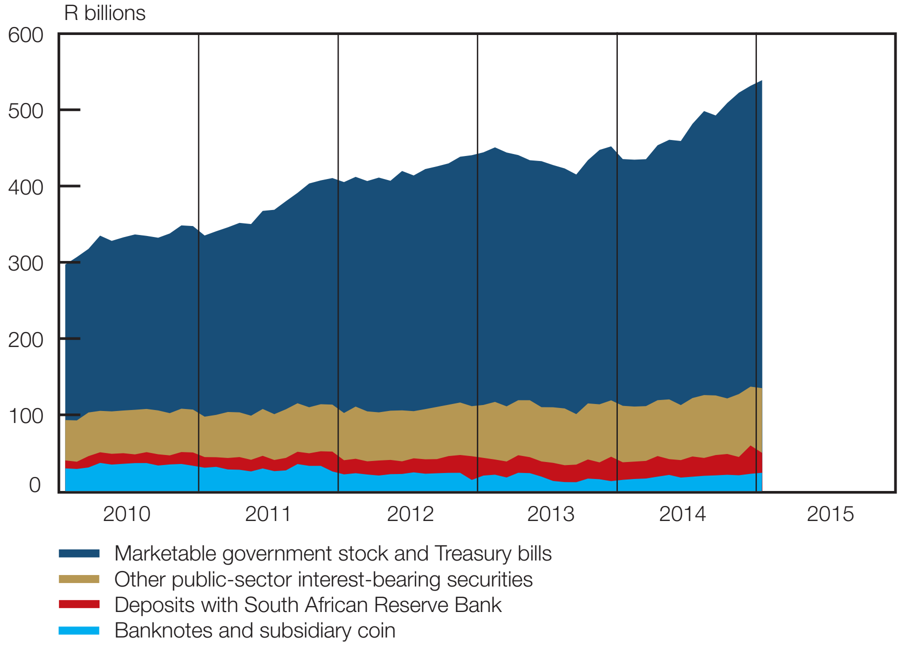
The South African banking sector continued to be dominated by four large banks, which together account for 83 per cent of the total assets of the South African banking sector. In January 2015 there were 33 banking institutions registered in South Africa, unchanged from the preceding year, while the number of foreign banks with approved local representative offices in South Africa declined to 40, down from 42 in January 2014.

Size of the South African private banking sector

	January 2014		January 2015	
	Number of institutions	Total assets (R billions)	Number of institutions	Total assets (R billions)
Locally controlled banks	10	2 918	10	3 153
Foreign-controlled banks	6	834	6	863
Mutual banks	3	3	3	3
South African branches of foreign banks	14	232	14	266
Total registered banks	**33**	**3 987**	**33**	**4 289**

Banks maintained their focus on the regulatory proposals of Basel III during the course of 2014. This included a gradual build-up of high-quality liquid assets to ensure compliance with the first phase of the liquidity coverage ratio (LCR), which became effective on 1 January 2015. The LCR requires banks to hold adequate stock of high-quality liquid assets to provide for a 30 calendar day liquidity stress scenario. Banks are required to meet an LCR requirement of 60 per cent from January 2015, which will progressively rise to 100 per cent as from 1 January 2019. High-quality liquid assets fall into level 1 and level 2 assets, with level 1 assets expected to account for at least 60 per cent of the total and level 2 assets limited for the remaining 40 per cent. Assets eligible as level 1 high-quality liquid assets in South Africa include, among other things, cash, qualifying central bank reserves, and specified marketable securities backed by sovereigns, central banks, public-sector entities, multilateral development banks and the South African government. Level 2 assets include specified corporate bonds and marketable securities backed by sovereigns, central banks and public-sector entities that are assigned a 20 per cent risk weight under the Basel II standardised approach for credit risk. Because South Africa has a constrained supply of high-quality liquidity assets, the Bank has made available a committed liquidity facility (CLF) to commercial banks to support them in adhering to the LCR requirement.

Composition of selected high quality liquid assets held by banks



Following recommendations from the Bank, in August 2014 the Minister of Finance placed African Bank Investments Limited (ABIL)under curatorship in terms of the provisions of sections 69(1) and 69(2) of the Banks Act 94 of 1990 (the Banks Act). The curatorship created a focus on the legislative environment and highlighted the necessity to revise some of the unnecessarily stifling provisions of section 69 of the Banks Act. Subsequently, in an effort to enhance the curatorship of banks in order to make the financial sector safer and protect depositors, the Minister of Finance tabled the Banks Amendment Bill in Parliament in November 2014. The aim of the Bill is to amend section 69 of the Banks Act by enabling the curator to make decisions on behalf of corporate shareholders, in addition to the bank's shareholders, when managing the business of the bank; to empower the Minister to enable the curator to raise funds and provide security over the assets in respect of such funding; and to facilitate the transfer of all or part of a bank's business to a successor entity pursuant to a transfer under section 54 of the Banks Act and to facilitate the implementation of the said measures by the curator.

After slow growth in 2013, the capital market funding activity of the banking sector once again accelerated in 2014. The total outstanding value of domestic bonds and commercial paper issued by banks increased by R25,3 billion in 2014 to R272,1 billion, compared to an increase of R11,9 billion in 2013. The banking sector reduced its reliance on, and improved the term profile of, institutional funding as banks gradually started to intensify their focus on the implementation of the Basel III net stable funding ratio (NSFR) framework in 2018. Institutional funding's share in total bank funding declined from a high of 40 per cent in 2010 to 34,4 per cent in 2014, while the share of short-term debt within institutional funding fell from a peak of 63,1 per cent in 2008 to 56,1 per cent in 2014.

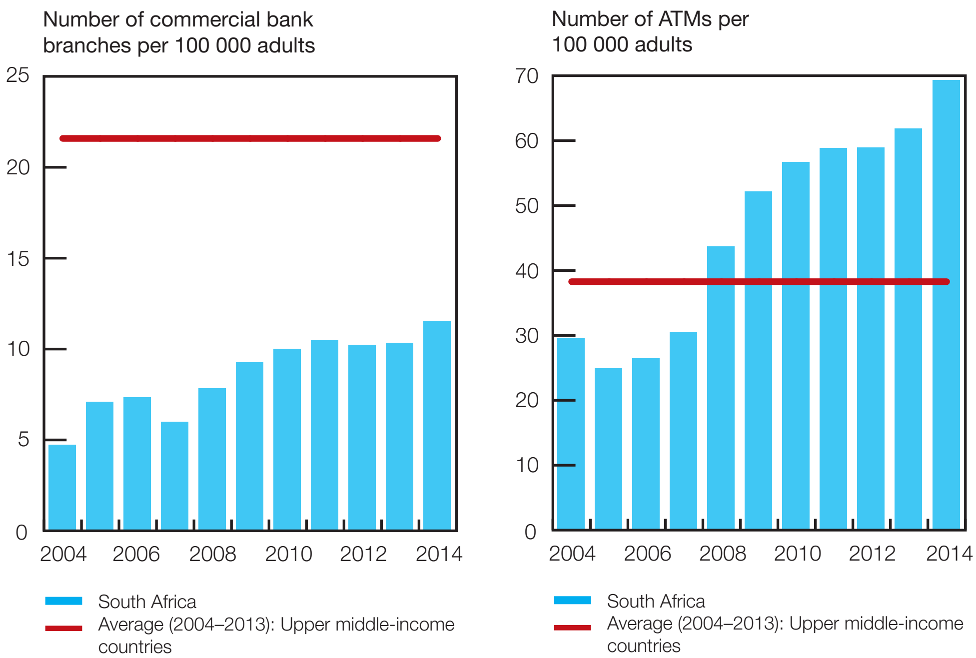
Following the publication of some revisions and updates to the NSFR standard in October 2014, the Basel Committee on Banking Supervision issued proposals for public comment on the NSFR disclosure standards in December 2014. Similar to the LCR disclosure framework, this requirement will improve the transparency of regulatory funding requirements, reinforce the risk management and supervision of funding liquidity risk, strengthen market discipline and help to reduce uncertainty in the markets.

The expansion of local banks into Africa gained further prominence in 2014. Because of the subdued growth outlook for South Africa, the positive growth differential offered by certain

African economies and the resultant potential for higher revenues remain a core motive behind banks' expansion plans. South Africa's four largest banks have a variety of foreign subsidiaries and business activities in Africa, spread across a considerable number of countries, thus presenting unique challenges and opportunities.

Banks continued to grow their customer base during the period by providing competitive and innovative banking products, opening new branch networks and extending their automated teller machine (ATM) footprint. The total number of bank branches and ATMs has increased significantly since 2004, in line with the Financial Sector Charter commitment to make banking services more accessible to all South Africans. However, the South African banking sector appears to lag behind most of its peers in the upper middle-income countries when measured in terms of branch network penetration per 100 000 adults, but outperformed most of these countries in terms of the number of ATMs per 100 000 adults. With respect to housing development, the banking sector and various stakeholders in the private and public sector were signatories to the Social Contract for the Development of Sustainable Human Settlements in October 2014. The signatories committed, among other things, to deliver 1,5 million housing opportunities, including 111 000 affordable housing opportunities for the gap market, over the next five years. The agreement followed the first social contract signed in 2005, which resulted in the creation of more than 1,2 million housing units in five years.

Bank penetration through bank branches and automated teller machines



Sources: South African Reserve Bank and International Monetary Fund

In March 2014, the Bank published new interchange rates applicable to card-related payment streams as part of its review of the relevance of interchange rates applied in all payment streams in South Africa. The new interchange rates applicable to card-related streams followed the release of ATM interchange fees which were announced in December 2013 and became applicable on 1 April 2014. The methodology adopted by the Bank in determining interchange rates in the card sphere followed a cost-based approach and the new interchange rate structure will result in twelve rates for cards, as opposed to the existing three rates, and a fixed rate for cash-backed transactions performed at point-of-sale. It will be implemented in March 2015.

In April 2014, the Bank imposed administrative sanctions ranging from R10 million to R60 million on four large banks as a result of deficiencies identified by the Bank regarding their compliance with relevant provisions of the Financial Intelligence Centre Act 38 of 2001 which aims to combat money laundering, tax evasion and terrorist financing activities. Due to instances of non-compliance, administrative sanctions were imposed on a further two banks in February 2015.

The Department of Trade and Industry released the Draft National Credit Regulations for Affordability Assessment for public comment in August 2014. The criteria therein stipulate certain necessary expense norms or minimum living expenses per income category and are intended to address the underlying weaknesses in affordability assessments and to help combat reckless lending and borrowing. The regulations require credit providers to ensure that the consumer has sufficient income available to fund the proposed credit instalment. Amounts to be deducted from gross income include statutory deductions such as income tax and unemployment insurance contributions; maintenance payments; and all other committed payment obligations and debt, including such obligations as may appear from the credit applicant's credit records as held by any credit bureau. After the above-mentioned subtractions, the amount available to the consumer from his or her income must be enough to service the new debt being applied for and still have enough left to cover the stipulated necessary expense norm.

Proposed necessary expense norms

Monthly gross income		Minimum monthly fixed factor	Monthly fixed factor + percentage of income above band minimum
Minimum R	Maximum R	R	Per cent
0,00	800,00	0,00	100,00
800,01	6 250,00	800,00	6,75
6 250,01	25 000,00	1 541,67	9,00
25 000,01	50 000,00	3 375,00	8,20
50 000,01	Unlimited	5 425,00	6,75

The implementation of tax-free savings accounts became effective from 1 March 2015 through an amendment to the Income Tax Act 58 of 1962, to allow for the exemption of amounts received or accrued in respect of tax-free investments. The regulations list the service providers that can offer tax-free savings and investments to the public and administer those accounts on their behalf. These providers include licensed banks, long-term insurance companies, managers of registered collective investment schemes, authorised users, linked investment service providers and the government. The products that qualify as tax-free savings and investments include collective investment schemes, mainly unit trusts and exchange-traded funds, although products that charge performance fees or expose an investor to excessive market risk do not qualify. The products must generally allow individuals to access their savings and investments within seven business days upon request. The contributions in respect of tax-free investments are limited to a maximum of R30 000 per year, with a maximum lifetime contribution limit of R500 000.

The Economic Research and Statistics Department of the Bank implemented improvements to the measurement of cross-border transaction activity of the banking sector towards the end of 2013, in adherence to the enhancements requested by the Committee on the Global Financial System Working Group as part of a broader international effort to close data gaps revealed by the 2008 financial crisis. The Department has been participating in the Locational Banking Statistics survey since the end of 2009. In its latest form, the survey covers banks' domestic and international transactional activities in far more detail than before. The survey provides quarterly information on:

– banks' credit exposures by country and counterparty sector;
– the supply of bank credit (both cross-border and domestically sourced) to the financial and non-financial sectors of individual countries; and
– banks' funding risks, including currency (and, to a lesser extent, maturity) mismatches in assets and liabilities.

The South African regulatory authorities and private sector continue to strive for fast and efficient access to the South African capital markets as evidenced by the *Global Competitiveness Report 2013-2014,* where South Africa was ranked third out of 148 economies in the financial market development category. The JSE Limited continued to improve and extend its services during 2014. In January 2014, Arqaam Capital (Arqaam) – a specialist emerging-markets investment bank in Dubai – became the first entity from the Gulf region to join the JSE as an equity member. This provided African market opportunities to Arqaam's clients.

The JSE amended its listings requirements in February 2014 to reduce the timetable relating to capital raising through rights offers in order to promote funding efficiency. In the rights offer/claw-back offer timetable, the number of days required to undertake a rights offer was reduced from 31 to 21 days.

In March 2014, the JSE launched several new services for listed companies to assist them in promoting their businesses. These services include, among other things, a refurbished venue to be used by listed companies for their results presentations and other corporate events, and training on improving investor and media relations skills and knowledge of listings requirements.

The JSE implemented amendments to its Equities Rules on 28 March 2014 in order to give effect to the requirements of the Financial Markets Act 19 of 2012. Some of the amendments made relate to requirements to perform investment services, the involuntary termination of JSE membership, and qualifications required to manage investments and provide advice to clients.

The JSE launched its high-technology colocation centre in May 2014. The facility allows for fast trading and market data access for all JSE markets, the deployment of new trading strategies, cost saving for JSE clients and improved risk mitigation.

In moving towards the Group of Twenty (G-20) directive to have a regulated platform for all over-the-counter (OTC) derivatives, the National Treasury, the South African Reserve Bank and the Financial Services Board (FSB) in July 2014 released draft regulations for public comment. While they seek to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse, the proposed regulations aim to harmonise the South African regulatory framework with those implemented in other G-20 jurisdictions. Furthermore, the FSB in November 2014 published the *Eighth progress report on implementation of the OTC derivatives market reforms*.

In August 2014 the President of South Africa signed into law the Local Government: Municipal Property Rates Amendment Act 29 of 2014, which seeks to regulate categories of property in respect of which rates may be levied, among other things.

Various amendments were made to the JSE listings requirements with effect from 30 September 2014. These spanned a wide range, from enhanced responsibility of sponsors in relation to listing applications to extending the period within which directors have to report dealings in securities from 24 hours to three business days and creating a fast-track listing process for international companies wishing to have a secondary listing on the JSE.

The JSE and the Nigerian Stock Exchange (NSE) are currently working towards developing a partnership that would benefit both African exchanges. In this collaboration, among other things, South African companies would be able to list on the NSE and Nigerian companies on the JSE.

The JSE also made progress in 2014 with its T+3 project which will ultimately result in the domestic equities market moving from the current T+5 settlement-day cycle to a shorter T+3 settlement-day cycle, thereby routinely settling three days after entering into an equities transaction

In February 2015, the JSE further amended its listings requirements to include a separate section for oil and gas companies, effective from 10 March 2015.

The Association for Savings and Investment South Africa (ASISA) approved the new standard on calculating the net asset value (NAV) for collective investment scheme (CIS) portfolios in March 2014. The standard is intended to establish various standards for fair and consistent disclosure, specify the principles to be adopted in calculating NAVs for CIS portfolios, align domestic standards and procedures with international best practices, and provide guidance in the interpretation and application of the adopted principles. The new standard replaced the Association of Collective Investments standard on pricing and valuation.

The FSB and the National Treasury released draft regulations and a related explanatory memorandum for hedge funds in South Africa in April 2014. The regulation of hedge funds will be effected through the Collective Investment Schemes Control Act 45 of 2002.

The date to publish final regulations on the demarcation between health insurance policies and medical schemes has been postponed to allow sufficient time to process the comments received on the draft released in April 2014. The regulations are expected to be finalised by the second quarter of 2015. These regulations will specify the types of health insurance policies that are permissible under the Long-term Insurance Act 52 of 1998 and Short-term Insurance Act 53 of 1998, and therefore excluded from regulation under the Medical Schemes Act 131 of 1998, despite those health insurance policies meeting the definition of the business of a medical scheme.

The National Treasury and the FSB released proposed amendments to insurance binder regulations issued under the short-term and long-term insurance acts in July 2014 for public comment. Binder regulations govern the manner in which insurers outsource binder functions. The proposed amendments strengthen the existing regulations and enhance policyholder protection by clarifying the definition of an associate and underwriting manager, clarifying what constitutes matters incidental to binder functions, authorising the Registrar of Insurance companies to prescribe and limit fees applicable to binder functions, and excluding the South African Special Risk Insurance Association (SASRIA) from the regulatory scope.

The National Treasury and the FSB released a technical report on the *Consumer credit insurance market in South Africa* for comment in July 2014. The report concludes that credit insurance has a significant impact on the overall cost of secured and unsecured credit. The report further points out a number of poor market practices such as lack of transparency, and outlines a set of policy responses to strengthen the existing regulatory framework to improve the value of consumer credit insurance to consumers and curb abuse. The report is part of the wider initiative to address the problem of household over-indebtedness and to ensure that consumers are treated fairly by financial services providers.

In August 2014, the FSB released a board notice governing the advertising, marketing and information disclosure requirements for collective investment schemes under the Collective Investment Schemes Control Act 45 of 2002. This notice aims to provide a legal framework which will assist investors to base their investment decisions on accurate information that is aligned with relevant international disclosure standards and practices.

The FSB released a guidance note on the reporting of the performance of portfolios that created side pockets for the ABIL debt paper in October 2014. The side-pocket portfolios were created for purposes of separating illiquid ABIL debt instruments after it was placed under curatorship in August 2014. The creation of these portfolios contributed to net outflows in money-market funds over the same period.

The FSB released a discussion paper titled *Retail distribution review* in November 2014. The objective of the review is to ensure that financial products are distributed in ways that support the delivery of the treating customers fairly (TCF) outcomes. The paper proposes the introduction of structural interventions designed to change incentives, relationships and current business models in order to deliver fair outcomes to customers. These interventions would place greater responsibility on product suppliers to ensure the delivery of fair customer outcomes through their chosen distribution channel, limit the types of remuneration that intermediaries can earn, and enable customers to understand and compare the nature, value and cost of advice and other related services provided by financial intermediaries.

The National Treasury released a revised draft of the Financial Sector Regulation Bill in December 2014. This Bill gives effect to the government's decision to adopt a twin peaks model of financial regulation, the first draft having been published in December 2013. Changes that have been incorporated in the second draft of the Bill include improving its legal enforceability, providing both the prudential and market conduct regulators with additional powers to enable them to supervise and enforce financial sector laws and regulations, aligning the Bank's powers for systemic oversight with its mandate for financial stability, and introducing a legal framework for regulating and supervising financial groups from both a prudential and market conduct perspective. It also proposes the inclusion of the National Credit Regulator as a full member of the Financial Stability Oversight Committee because of the importance of this regulator for systemic stability.

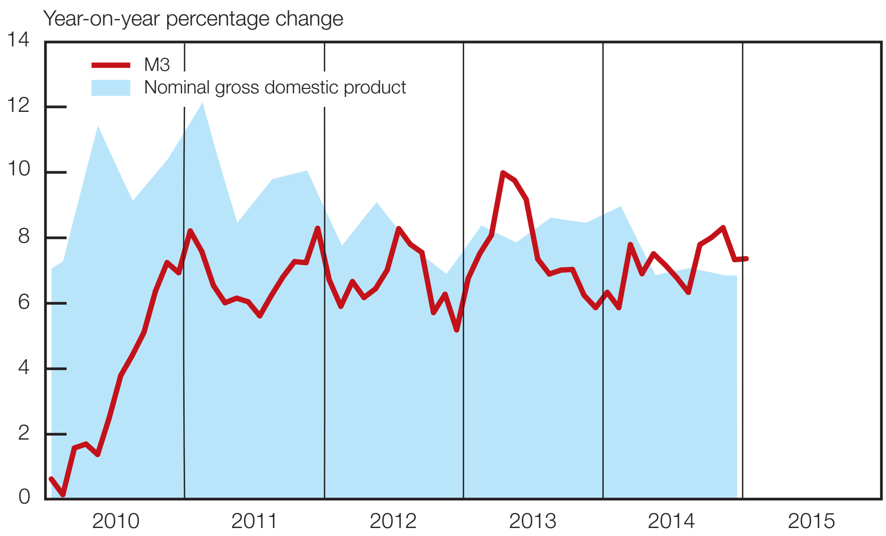
The National Treasury also published a discussion document in December 2014 on *Treating customers fairly in the financial sector: a market conduct policy framework for South Africa*. This policy framework proposes a regulatory and supervisory framework for the new Financial Sector Conduct Authority in order to ensure that customers are treated fairly by financial institutions. Through this policy framework, the Financial Sector Conduct Authority would be empowered to supervise financial institutions more intensively by not only monitoring compliance with rules, but also taking strict corrective actions against financial institutions that do not comply with regulatory principles.

Money supply

Growth in the broadly defined money supply (M3) remained in single-digit territory during 2014, broadly replicating the sideways trend observed over the preceding three years. Household deposits and deposits of non-financial companies rose more strongly in 2014 than deposits of the financial corporate sector. During the course of 2014, twelve-month growth in M3 fluctuated higher from 5,9 per cent in February to a recent high of 8,3 per cent in November, underpinned by strong growth in household deposits. For 2014 as a whole, growth averaged 7,2 per cent, slightly below the average growth rate of 7,4 per cent in nominal gross domestic product over the same period. In January 2014, growth over twelve months came to 7,4 per cent. Factors that probably contributed to the mildly accelerating growth in deposit holdings include:

– an environment of rising interest rates which improved returns on deposits;
– positive real wealth effects as share and fixed property prices increased, including a build-up in precautionary and speculative balances;
– a rise in foreign currency-denominated deposit holdings partly boosted by the depreciation in the exchange value of the rand; and
– rising nominal and real expenditure, albeit at a lustreless pace.

Growth in M3 and in gross domestic product

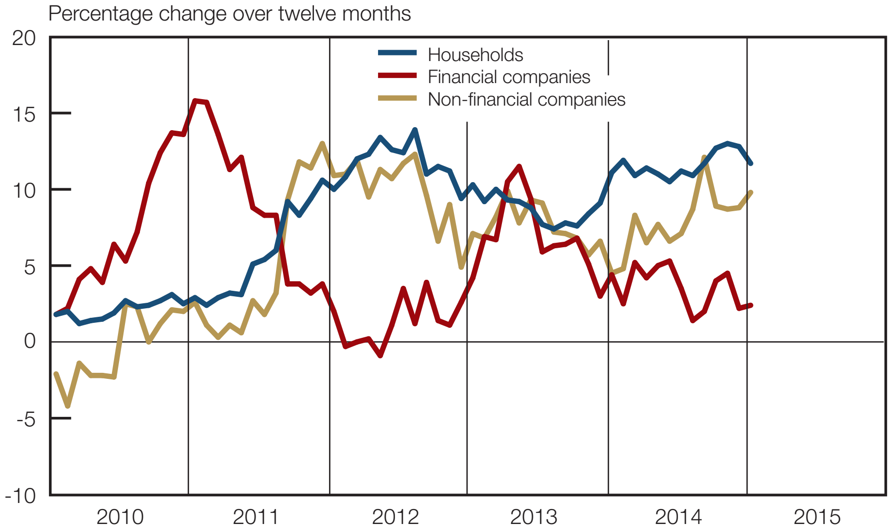


Analysed by maturity, the growth in cash, cheque and demand deposits (M1) continued to exceed that of M3 during 2014, implying a preference for liquidity over long-term deposits. However, year-on-year growth in M1 decelerated from a peak of 16,1 per cent in March 2014 to 9,9 per cent in December, with a slight uptick to 10,6 per cent in January 2015. The rise in interest rates in January and July 2014 probably contributed to the softer growth in liquid deposits, while the long-term deposit category improved from negative growth at the start of the year to positive growth from November. Year-on-year growth in long-term deposits came to 3,9 per cent in January 2015.

Money supply declined by R7,2 billion in the fourth quarter of 2014, largely on the back of deposit holdings of the corporate sector which declined by R35,2 billion. This decrease was largely due to deposit holdings of financial companies of R41,6 billion, which was softened somewhat by an increase of R6,5 billion in the deposits of non-financial companies. At the same time, deposits of the household sector increased by R27,9 billion.

Overall, M3 increased by R183,9 billion in 2014 – the highest annual increase since 2008. The household and corporate sectors contributed nearly equally to the growth in M3, as opposed to 2013 when the corporate sector dominated growth. Measured over twelve months, growth in the deposit holdings of the household sector broadly maintained the upward trajectory that started in August 2013 and fluctuated higher from 11,1 per cent in January 2014 to 13,0 per cent in November. Thereafter growth moderated somewhat to 11,7 per cent in January 2015. By contrast, year-on-year growth in the deposit holdings of the corporate sector fluctuated around an average of 5,4 per cent in 2014. The deceleration was mainly due to weakening growth in the deposit holdings of financial companies which waned from 11,5 per cent in May 2013 to 2,2 per cent in December 2014 and 2,4 per cent in January 2015. Overall, the contribution made by financial companies to growth in M3 waned from around 21 per cent in 2012 and 2013 to 12 per cent in 2014. Year-on-year growth in deposits of non-financial companies displayed some resilience as it improved from a low of 4,5 per cent in January 2014 to a high of 12,1 per cent in September before moderating somewhat to 9,8 per cent in January 2015. The rise in deposits of non-financial companies may partly be ascribed to companies building up working capital balances.

M3 holdings of households and companies



Statistically, the decline in M3 during the fourth quarter of 2014 is mainly attributable to a decrease in net foreign assets, coupled with a decline in net other assets and liabilities of the monetary sector. The increase in claims on the private sector and in net claims on the government sector softened the overall decline in M3 in the fourth quarter of 2014. Net claims on the government sector increased following a decline in government deposits alongside a rise in government securities held by the banking sector in the fourth quarter of 2014. The decrease in net other assets and liabilities resulted mainly from a rise in other liabilities of banks to domestic counterparties, while the decline in net foreign assets resulted from a rise in foreign liabilities in the form of non-resident foreign-currency funding and derivative positions.

Statistical counterparts of change in M3

R billions

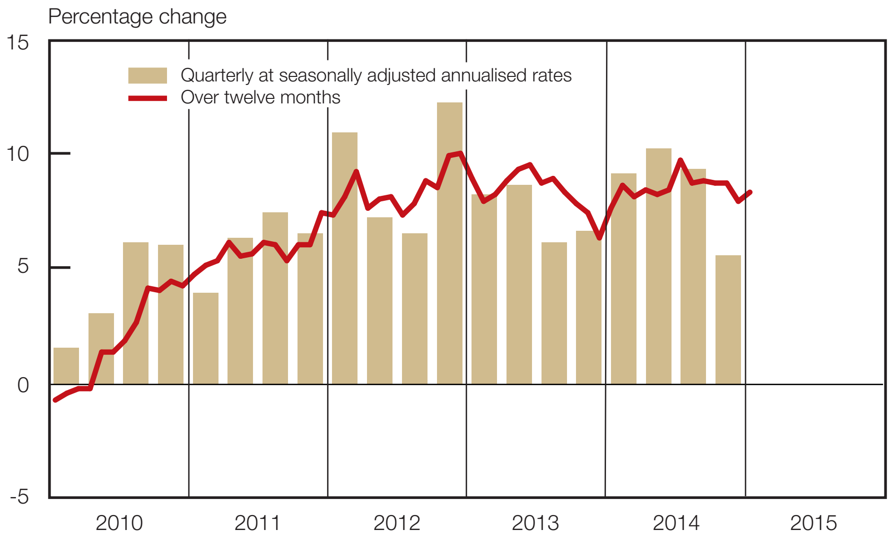
	2014				
	1st qr	2nd qr	3rd qr	4th qr	Year
Net foreign assets	-3,3	-1,4	-7,5	-28,5	-40,7
Net claims on the government sector	-1,0	5,6	21,6	6,8	33,0
Claims on the private sector	96,4	38,6	53,3	32,9	221,2
Net other assets and liabilities	-13,3	-0,9	3,0	-18,5	-29,7
Total change in M3..............................	78,8	41,8	70,4	-7,2	183,9

The income velocity of circulation of M3 rose from 1,42 in the second quarter of 2013 to 1,47 in the first quarter of 2014, when growth in M3 fell below that of nominal gross domestic product. Velocity declined to 1,45 in the fourth quarter of 2014, led by stronger growth in M3 which surpassed growth in nominal gross domestic product. Overall, growth in M3 has been keeping pace with growth in nominal gross domestic product since 2011, suggesting a somewhat abundant supply of money within the relatively constrained economic growth environment.

Credit extension

Growth in bank credit extended to the private sector has been maintaining a fairly steady pace of expansion as it has lingered around the 8 per cent level for the past three years, consistent with the subdued economic activity over this period. In January 2015 year-on-year growth in total loans and advances came to 8,3 per cent. The growth in bank lending over the past year was largely driven by increased demand for credit by the corporate sector, while growth in credit extension to households remained moderate, resulting in a modest reduction in the ratio of household debt to disposable income. Tighter monetary policy from January 2014 accompanied by stricter credit conditions contributed to the sluggish take-up of credit by the household sector. While households appeared to be deleveraging, the corporate sector continued to exploit the current historical low interest rate environment.

Total loans and advances to the private sector



Total loans and advances to the private sector expanded by R192 billion during 2014, which was considerably higher than the increase of R146 billion recorded in 2013. However, the quarterly growth in loans and advances amounted to R16,5 billion in the fourth quarter of 2014, less than half the R35,8 billion increase recorded during the fourth quarter of 2013. This slowdown was also reflected in the quarter-to-quarter[6] growth rate which steadily declined from 10,3 per cent in the second quarter of 2014 to 9,4 per cent in the third quarter and 5,6 per cent in the fourth quarter. The decline in aggregate credit extension during the fourth quarter of 2014 was largely due to a decline in the use of general loans and instalment sale credit by the corporate sector.

6 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 role as the dominant driver of credit extension during 2014. Growth in the asset-backed credit categories remained relatively subdued but edged slightly higher during the course of 2014, mostly on account of an improvement in the extension of mortgage advances.

Following healthy increases in the first three quarters of 2014, other loans and advances declined by R2,9 billion in the fourth quarter. This compares to an increase of R25,0 billion recorded during the fourth quarter of 2013. However, on aggregate, other loans and advances grew by R121 billion during 2014, significantly higher than the R85 billion increase recorded during 2013. The corporate sector's contribution to this acceleration increased to 85 per cent in 2014, compared with 69 per cent a year earlier. By contrast, the contribution of the household sector plunged from 31 per cent to 15 per cent over the same period. 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 16,7 per cent in July 2014, before gradually declining to 12,2 per cent in December 2014 and 12,8 per cent in January 2015. The revival in corporate credit demand can be ascribed to, among others things, working capital requirements, demand for trade finance, floor plan loans, expansion activity, and renewable energy deals.

Composition of total loans and advances by type of credit

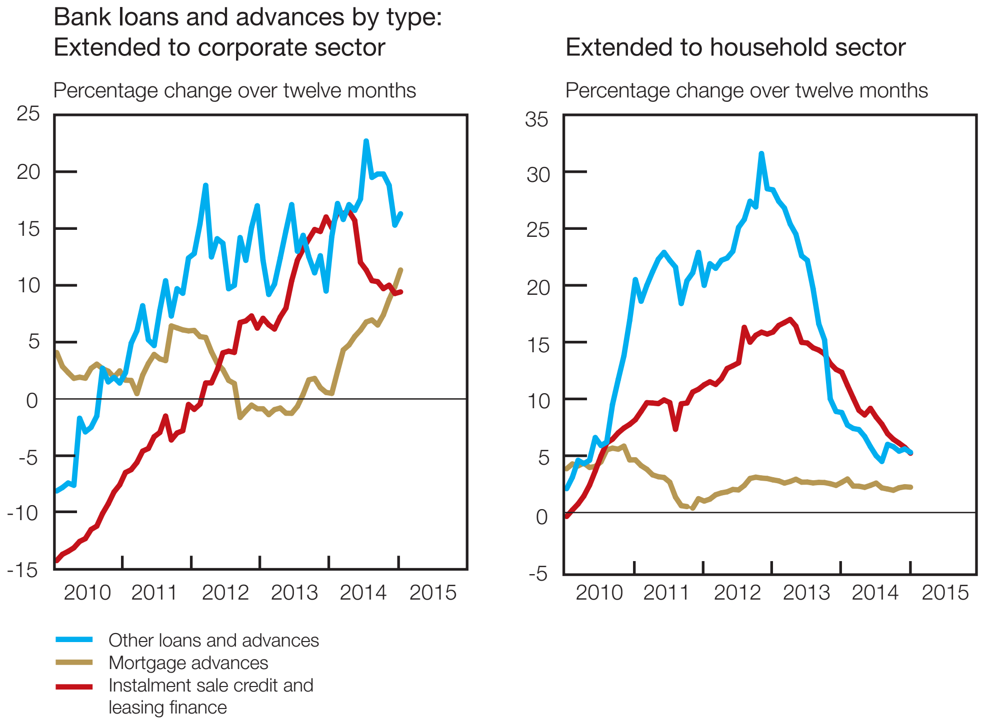
Type of credit	Year-on-year change (R billions)			Percentage of total loans and advances*		
	2009	2013	2014	2009	2013	2014
Household sector						
Instalment sale credit and leasing finance	-1,0	25,9	13,3	8,0	9,5	9,3
Mortgage advances	26,8	18,9	18,4	38,9	33,2	31,5
Other loans and advances	4,2	26,2	18,0	8,6	13,1	12,9
Overdrafts	*-1,9*	*4,5*	*1,7*	*1,4*	*1,4*	*1,4*
General loans	*9,0*	*11,4*	*6,9*	*4,4*	*8,1*	*7,8*
Credit card advances	*-3,0*	*10,3*	*9,4*	*2,8*	*3,6*	*3,7*
Total loans and advances to the household sector	30,0	71,0	49,7	55,5	55,8	53,6
Corporate sector						
Instalment sale credit and leasing finance	-14,1	13,8	9,3	4,7	4,1	4,1
Mortgage advances	8,2	1,7	29,6	14,9	12,3	12,5
Other loans and advances	-34,2	59,1	103,5	24,9	27,8	29,7
Overdrafts	*-7,8*	*6,4*	*23,0*	*5,4*	*4,7*	*5,2*
General loans	*-27,7*	*50,6*	*80,1*	*19,3*	*22,9*	*24,2*
Credit cards advances	*1,4*	*2,1*	*0,4*	*0,2*	*0,2*	*0,2*
Total loans and advances to the corporate sector	-40,1	74,5	142,3	44,5	44,2	46,4
Total loans and advances to the private sector	**-10,1**	**145,6**	**192,0**	**100,0**	**100,0**	**100,0**

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

Twelve-month growth in general loans to households (i.e. unsecured lending) 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 the subsequent months growth improved slightly, albeit from a low base, reaching 4,1 per cent in January 2015. The slowdown in this credit category reflects caution by households in the wake of the interest rate increases in 2014 and relatively tight lending conditions, further constrained by weak income growth and tenuous employment prospects.

Mortgage advances, the largest component of total loans and advances, rose by R48 billion in 2014, more than double the increase of R21 billion recorded in the preceding year. The increase in mortgage advances is also evident from the rising trend in advances applied for, granted and paid out which started around April 2013, initially led by a pick-up in farm mortgages. During 2014, amounts applied for and granted were dominated by mortgage advances for commercial property. Twelve-month growth in mortgage advances gradually edged higher throughout 2014 and finally broke through the 4 per cent level in December. In January 2015, growth came to 4,7 per cent. Although growth remains significantly below the pre-crisis levels, it nonetheless exceeded the average growth rates of around 2 per cent recorded in the preceding three 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, although capital repayments slowed somewhat after the increase in interest rates 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 2014. The quarterly growth in instalment sale credit and leasing finance amounted to R6,5 billion in the fourth quarter of 2014, lower than the R9,6 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 6,8 per cent in December 2014 and 6,5 per cent in January 2015 due to a reduction in passenger vehicle sales in particular. According to a NAAMSA report, 2014 turned out to be a difficult year for the South African automotive industry with domestic new vehicle sales under pressure. Sales were also impeded by banks clamping down on credit.



The corporate sector's reliance on bank-intermediated funding edged higher in 2014, significantly outperforming credit extension to the household sector. The noticeable increase in credit extension to the corporate sector was particularly robust in general loans and bank overdrafts.

Year-on-year growth in credit extension to the corporate sector accelerated from 10,2 per cent in January 2014 to 17,0 per cent in July, but slowed somewhat in subsequent months to reach 14,3 per cent in January 2015. The recovery in loans and advances extended to the corporate sector in 2014 was partly boosted by the renewable energy initiative of government. By economic sector, growth in the fourth quarter of 2014 was dominated by the finance, insurance, real-estate and business services sector, supported by the sector for electricity, gas and water.

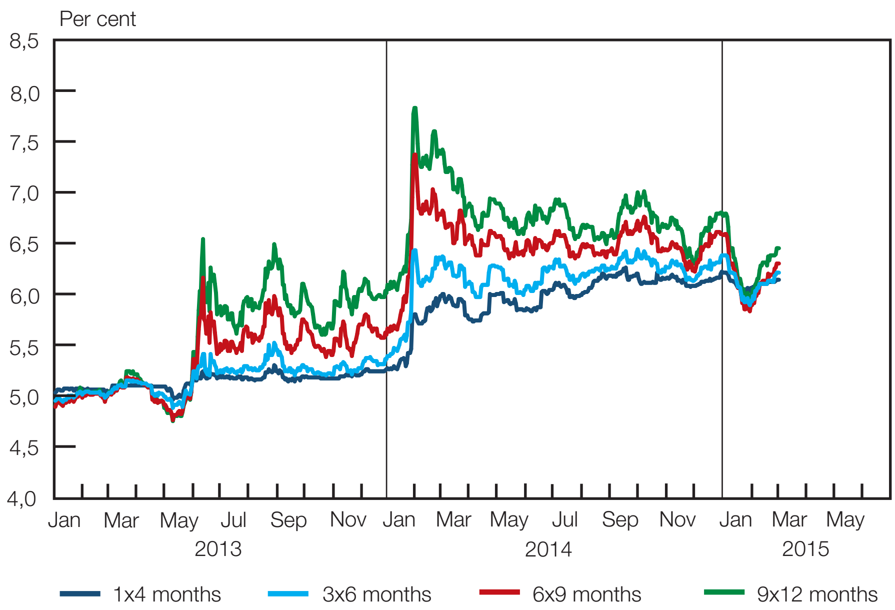
Twelve-month growth in credit extension to the household sector has been receding over the past two years as it declined from a recent high of 10,4 per cent in November 2012 to a low of 3,5 per cent in January 2015. Growth remained significantly lower than the buoyant double-digit growth rates recorded prior to 2009. Quarterly growth in credit extension to households slowed from R17,1 billion in the fourth quarter of 2013 to R15,8 billion in the same quarter of 2014. The decline was largely evident in the slowing of instalment sale credit and general loans to the household sector.

Interest rates and yields

The Monetary Policy Committee (MPC) decided to keep the repurchase rate unchanged at 5,75 per cent per annum at its January 2015 meeting. The decision followed in the wake of the continued decline in international oil prices and its favourable impact on the near-term inflation outlook. While the nominal exchange rate of the rand, wage and salary increases in excess of inflation, and productivity growth posed upside risks to the inflation outlook, the overall risks were viewed to be more or less balanced, with no evidence of excess demand pressures on inflation. The MPC noted that the lower inflation path allowed some room to pause in the interest rate normalisation process, particularly against the backdrop of a relapse in economic activity. While the growth forecast was revised downwards, the MPC stated that the impact of further monetary policy accommodation on growth would likely be limited in the absence of progress being made in the alleviation of the electricity-supply constraints. For the full statement see page 95 of this *Quarterly Bulletin*.

The declining oil prices in the build-up to the January 2015 MPC meeting, as well as the announcement by the European Central Bank (ECB) that it would embark on an asset-purchasing programme, contributed to a decline in forward rate agreements (FRAs). The most pronounced declines were recorded at the medium to longer ends of the maturity spectrum. For example, the 9x12-month FRA decreased by 87 basis points from 6,79 per cent on 2 January 2015 to as low as 5,92 per cent on 29 January. Over the same period, the 1x4 FRA declined by 18 basis points to 6,03 per cent. Forward rates again picked up during February 2015, alongside a weaker exchange value of the rand and a slight increase in oil prices. By 6 March 2015, the rate on the 9x12 FRA stood at 6,60 per cent, while the 1x4 FRA recorded 6,15 per cent.

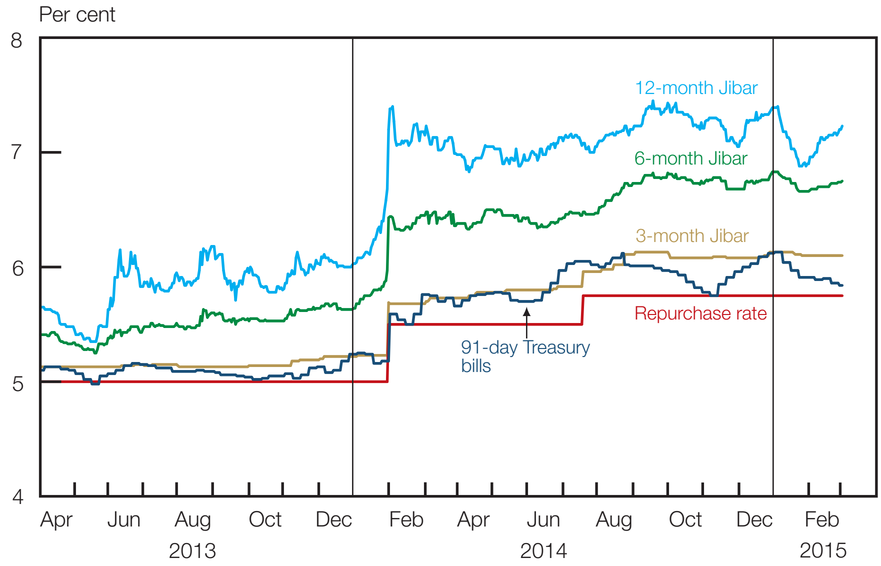
Forward rate agreements



Aligned with the unchanged monetary policy stance, short-term money-market rates remained fairly stable during the fourth quarter of 2014 and the early part of 2015. The three-month Johannesburg Interbank Average Rate (Jibar) initially remained anchored between 6,08 and 6,09 per cent from early October to late December 2014, but then inched higher to reach 6,13 per cent on 29 December 2014. The rate remained at this level until mid-January 2015 before retreating to 6,10 per cent on 26 January. By 6 March 2015, the rate had increased slightly to 6,12 per cent.

The tender rate on 91-day Treasury Bills fluctuated higher during the fourth quarter of 2014, with the rate ranging between 5,75 and 6,12 per cent. The rate then started trending lower, declining from 6,13 per cent in early January 2015 to 5,89 per cent on 6 February. The rate stabilised around this level, only inching lower to 5,81 per cent by 6 March.

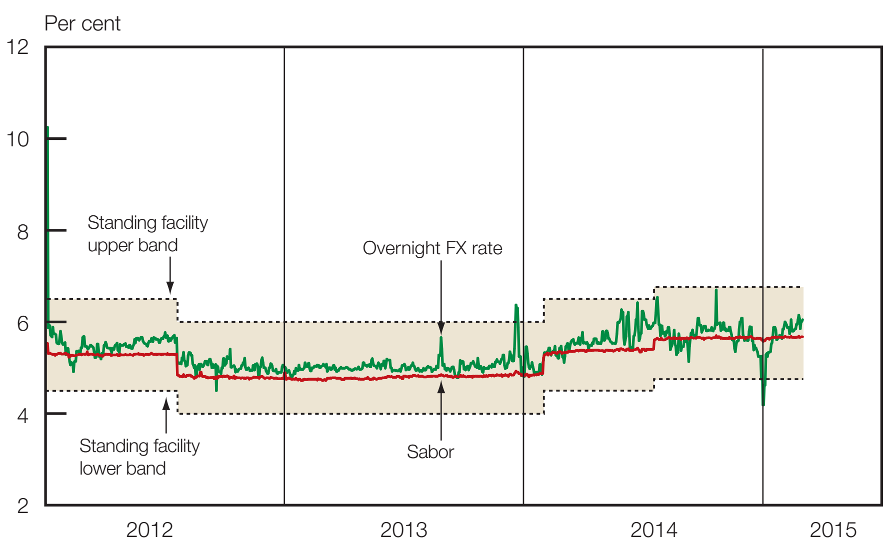
Money-market rates



The South African Benchmark Overnight Rate (Sabor) on deposits and the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) remained relatively stable, fluctuating well within the standing facility limits during the fourth quarter of 2014 and early 2015. The overnight FX rate subsequently fell by 107 basis points on 31 December 2014 as a result of excess liquidity in the forward market when selected offshore banks unwound some of their long rand positions. The Sabor and overnight FX rates stood at 5,66 and 5,84 per cent respectively at the end of January 2015, and recorded 5,67 and 5,76 per cent on 6 March.

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.

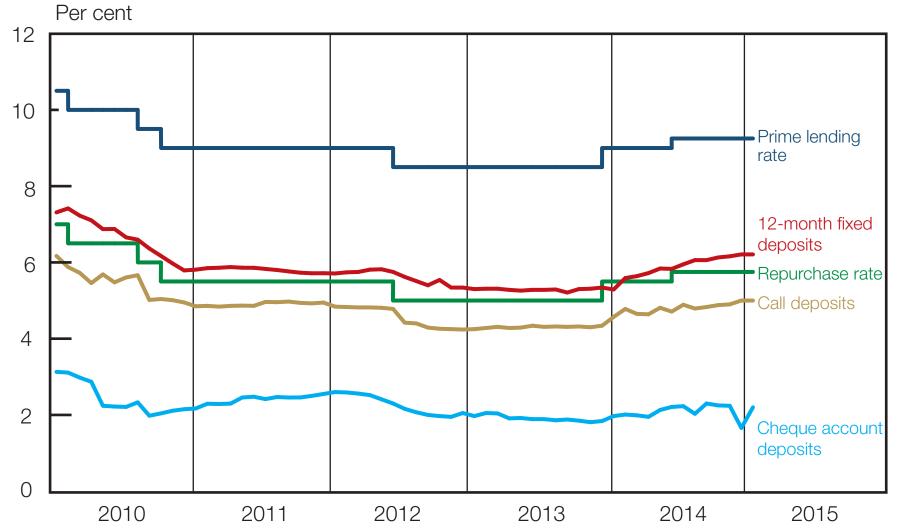
Benchmark overnight rates



The one-month implied rate increased from a recent low of 5,92 per cent on 18 November 2014 to 6,91 per cent on 11 December, after which it remained high for most of December due to high demand for liquidity during the festive season. A similar pattern was observed for the longer-term rates. Implied rates once again declined and displayed less volatility during the course of January 2015 when the seasonal strain on liquidity abated.

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 and January 2015 MPC meetings. Rates on different deposit and loan categories of private-sector banks broadly fluctuated in line with the unchanged policy rate.

Selected bank deposit and lending rates

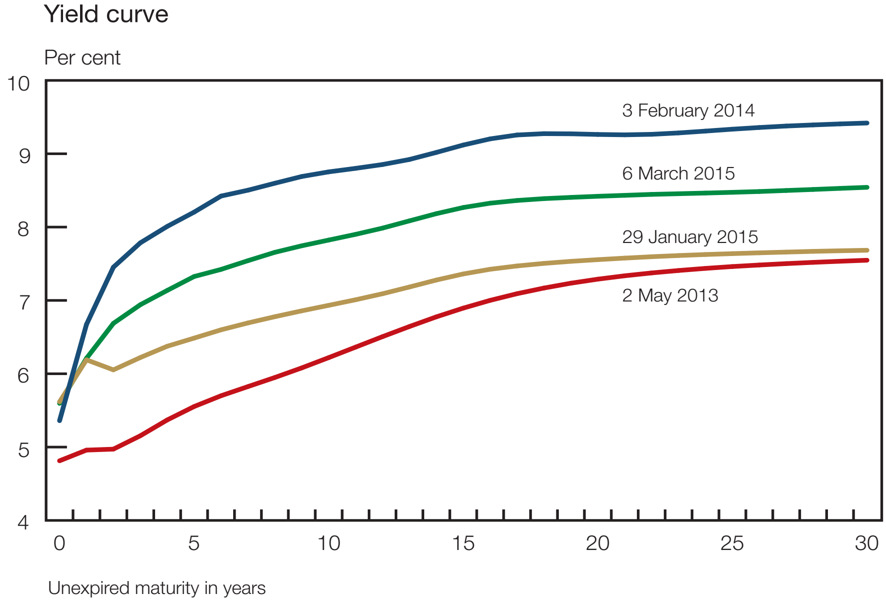


In line with US bond yields, *South African bond yields* started to move generally lower from February 2014. This gained momentum in January 2015 when South African bond yields fell notably, supported by an improved inflation outlook due to falling oil prices. Also contributing to lower yields were developments in the euro area, plagued by the risk of deflation, where the ECB announced an expanded asset purchase programme in January 2015. This programme, to be carried out until at least September 2016, has already increased investor appetite for higher-yielding returns in emerging-market economies such as South Africa. At the end of January 2015, the daily average yield on the South African R186 government bond (maturing in 2025/26/27) reached 7,07 per cent – its lowest level since May 2013. This was 181 basis points lower than the high of 8,88 per cent reached at the end of January 2014. The yield subsequently rose to 7,80 per cent on 6 March 2015. The daily closing yield on the US 10-year government bond followed a similar trend as it receded by 100 basis points from 31 January 2014 to 1,66 per cent on 30 January 2015, before rising to 2,24 per cent on 6 March.

Following these developments in the bond market, the *yield curve* moved lower during 2014 to January 2015, before moving higher to the beginning of March. With the extreme short end of the curve broadly anchored to the repurchase rate, the shape of the yield curve flattened as the yield gap, measured as the difference between yields at the extreme long and short ends of the curve, narrowed from 406 basis points on 3 February 2014 to 295 basis points on 6 March 2015.

In line with the recent downward trend in domestic bond yields, the *currency risk premium*[7] on South African government bonds narrowed from a recent high of 401 basis points in May 2014 to 370 basis points in February 2015. The decline in the yield on rand-denominated government bonds was more pronounced than the decline in the yield on US dollar-denominated bonds.

7 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 nine-to-eleven-year maturity range.

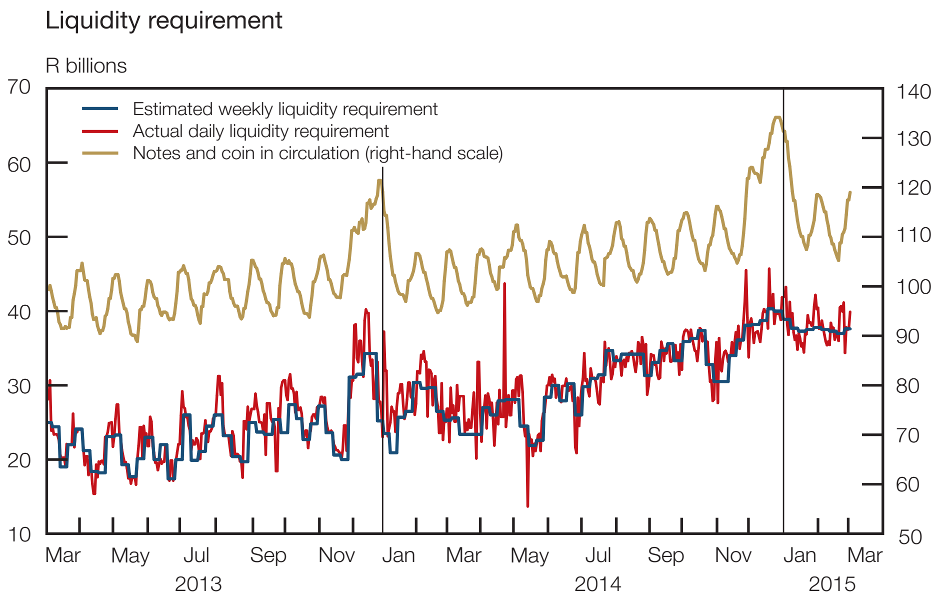


The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[8] yield spread above US government bonds continued to fluctuate and widened from 283 basis points in July 2014 to 399 basis points in February 2015, as investors remained risk averse towards emerging markets and as the US Federal Reserve ended its quantitative easing purchases. Similarly, the *sovereign risk premium* on South African government US dollar-denominated bonds in the nine-year maturity range trading in international markets widened from 169 basis points in September 2014 to 191 basis points in February 2015.

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

Money market

The money market experienced its normal seasonal rise in demand for liquidity during the fourth quarter of 2014. From October to December 2014, the actual daily liquidity requirement of private-sector banks fluctuated within a range of between R27,6 billion and R45,7 billion. The average daily liquidity requirement of R36,6 billion during this period was R3,8 billion more than the average daily liquidity requirement recorded in the third quarter of 2014. Notes and coin in circulation reached a daily peak of R134,2 billion in December 2014, an increase of R12,8 billion when compared to the daily peak of R121,4 billion recorded in December 2013.

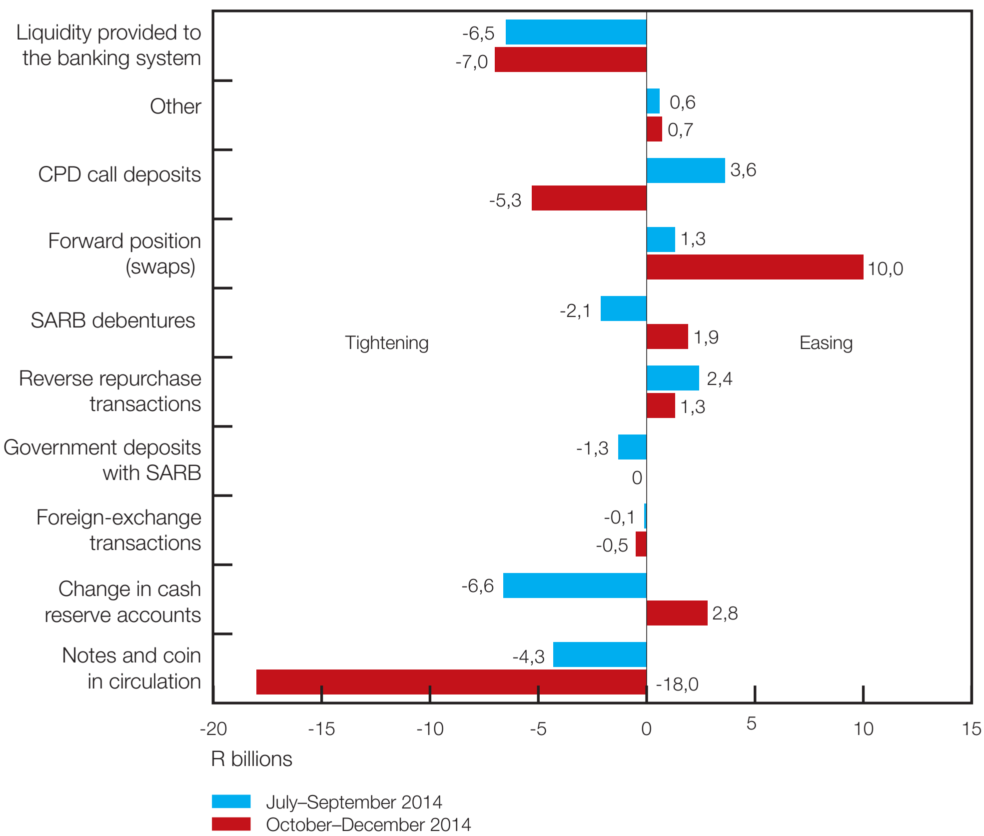


During the fourth quarter of 2014, liquidity to the net amount of R7 billion was drained from the money market, marginally higher than the net drainage of R6,5 billion recorded in the preceding quarter. In January 2015, a further net drainage of R2,3 billion was recorded. On balance, the net effect of the change in the amount of notes and coin in circulation outside the Bank and banks' required cash reserve deposits tightened money-market liquidity by R15,2 billion during the fourth quarter of 2014. In January 2015, the opposite occurred when the combined effect of these two aggregates expanded market liquidity by R8,5 billion.

The Bank utilised its liquidity management instruments to partly offset the factors impacting on money-market liquidity conditions and injected R7,9 billion into the money market during the final quarter of 2014. In January 2015, liquidity management operations drained R11,2 billion from the market, mostly through the conducting of foreign-exchange swaps for liquidity management purposes.

During the fourth quarter of 2014, spot sales of foreign exchange by the Bank amounted to R0,5 billion, which had a minor contracting impact on money-market liquidity. At the same time, maturing foreign-exchange swaps of R10 billion, previously entered into for liquidity management purposes, served to expand money-market liquidity.

Factors influencing money-market liquidity



The accompanying table provides a summary of the outstanding balances of selected liquidity management instruments.

Liquidity management balances

R billions

	Dec 2013	Dec 2014
Longer-term reverse repurchase transactions	6,15	2,60
SARB debentures	3,18	4,94
Corporation for Public Deposits call deposits with SARB*	2,73	9,23
Cash reserve accounts	66,60	72,51
Outstanding swaps	36,71	22,29
Of which: Money-market swaps	*3,00*	*0,00*
Sterilisation swaps	*33,71*	*22,29*

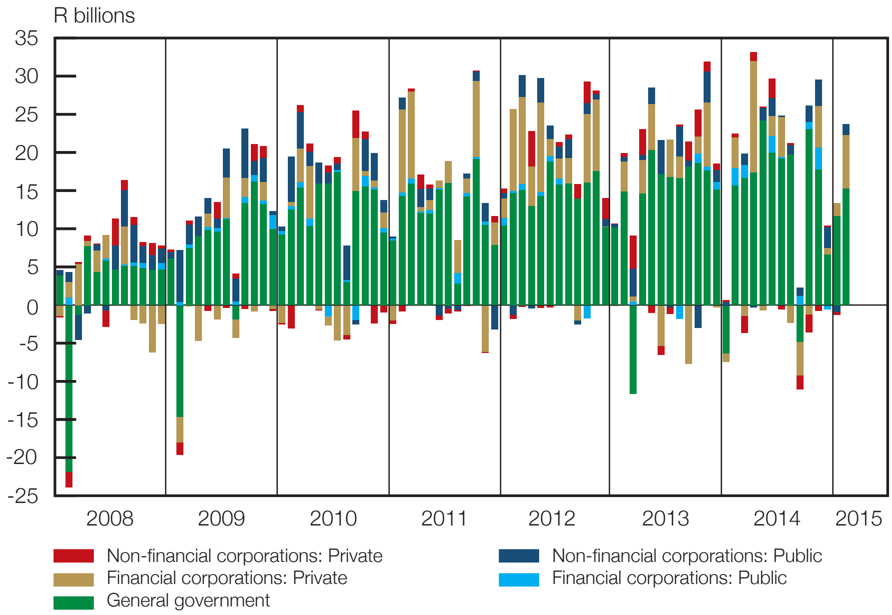
* SARB: South African Reserve Bank

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R14,4 billion were effected from the government tax and loan accounts during the fourth quarter of 2014, with R53,0 million of this amount accruing to the bond portfolio of the Bank.

Bond market

Given the dominance of national government and the importance of domestic debt issues to fund the fiscal deficit, debt issuances in the *primary bond market* remained brisk in 2014. Supplemented by public corporations' need to fund capital projects, net issues by the public sector amounted to R198 billion in 2014, slightly higher than the net issues of R193 billion recorded in 2013. The national government again contributed the bulk of debt issuances in 2014 with net issues of R167 billion, while R29 billion was raised by public corporations – more than half of that raised by non-financial corporations.

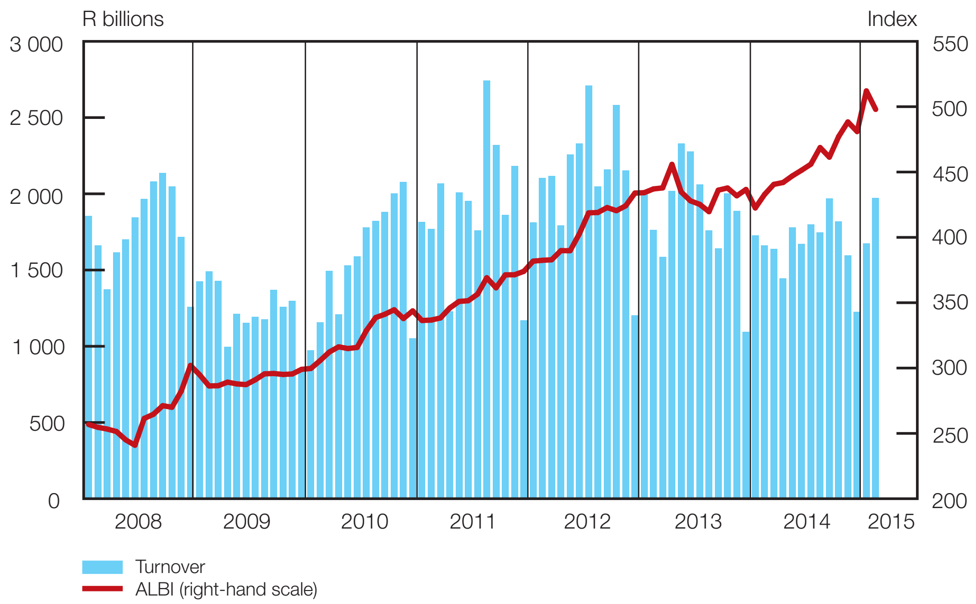
Net issues in the primary bond market



By contrast, net issuances by the private sector – predominantly by financial corporations – occurred on a smaller scale in 2014: net issues of R30 billion in 2013 were followed by net issues of R18 billion in 2014 as the economy slowed, and concern and nervousness were amplified after the ABIL curatorship and bank credit-rating downgrades. The total outstanding nominal value of debt securities listed on the JSE increased by R216 billion in 2014 and by a further R35 billion in the first two months of 2015 to reach R2,1 trillion at the end of February 2015.

While the All-Bond Index (ALBI) increased, *turnover* in the secondary bond market lost some of its earlier vigour in 2014. The daily average turnover of R81 billion in 2014 was 10 per cent lower than the value traded in 2013. As a result, liquidity in the bond market, which is measured as the nominal value of bonds traded relative to the nominal amount in issue, declined from 11 times in 2013 to 9 times in 2014. The ALBI recorded an increase of 10 per cent in 2014. In the first two months of 2015, the daily average turnover amounted to R89 billion.

Bond market turnover and All-Bond Index



Non-resident issuer interest in rand-denominated bonds in the *European bond markets* remained strong in 2014. This could be attributed to, among other things, the higher demand for these higher-yielding bonds in the European bond markets as the ECB's asset purchase programme injected liquidity both into that market and others. On the contrary, the bond issuances in the *Japanese Uridashi bond market* dwindled. The depressed issuances of these bonds in the Japanese Uridashi bond market follows the decision by the Government Pension Investment Fund (GPIF) of Japan to upscale its overall equity holdings while simultaneously reducing its bond holdings by 25 per cent. Consequently, net issues in both markets amounted to R19 billion in 2014, more than the net issues of R8,0 billion registered in 2013. In the first two months of 2015 net issues in both markets amounted to R2,9 billion.

Rand-denominated bonds issued in international bond markets

R millions

	Eurorand		Uridashi		Total	
	2013	2014	2013	2014	2013	2014
Issues	24 644	28 804	10 251	1 882	34 895	30 686
Redemptions	10 460	6 784	16 461	4 828	26 921	11 612
Net	14 184	22 020	-6 210	-2 947	7 974	19 074

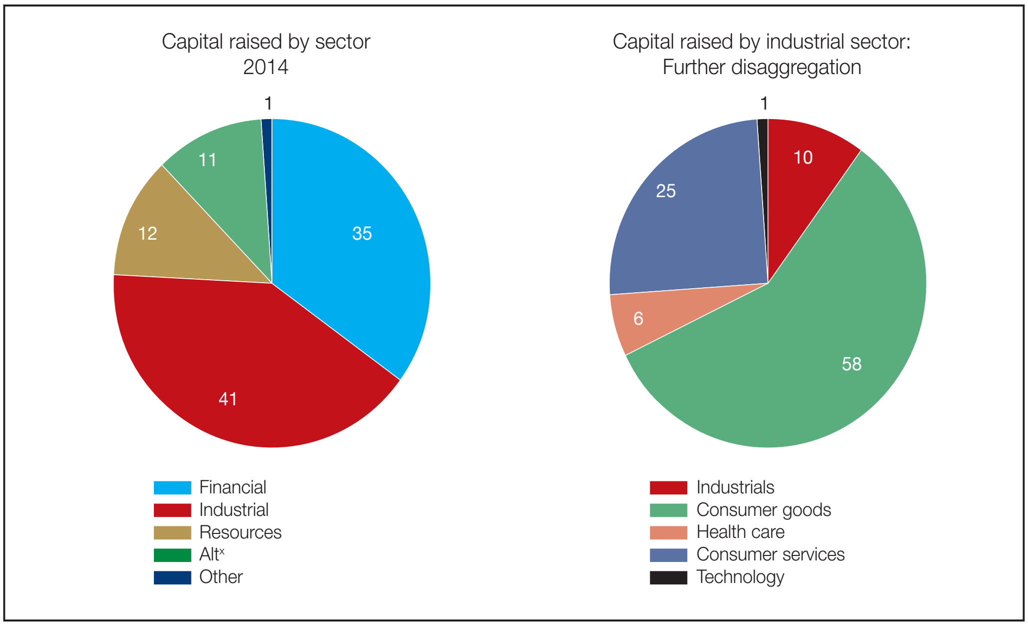
Non-residents were consistently net sellers of South African debt securities in 2014. They reduced their holdings of domestic bonds by R28 billion in the third quarter of 2014, followed by further exchange-reported net sales of R26 billion in the final quarter. This was partly due to negative global sentiment towards emerging markets, which was triggered by, among other factors, the US Federal Reserve ending its monetary easing programme. After recording their second highest monthly net sales of domestic bonds in December 2014, non-residents increased their holdings of domestic bonds in January 2015. However, they reverted to net sales in February, contributing to net sales of R5,7 billion in the first two months of 2015.

Share market

The performance of equity funding on the JSE was strong in 2014. *Equity capital raised* in the domestic and international primary share markets by companies listed on the JSE amounted to R153 billion in 2014, which was 65 per cent higher than the amount raised in 2013. Equity capital raising activity was concentrated in companies listed in the financial and industrial sectors, which dominated equity funding in 2014 with shares of 35 and 41 per cent respectively. Dividing the industrial sector further, as shown in the accompanying graph, more than half of the industrial sector's equity funding in 2014 was accounted for by companies in the consumer goods subsector. Proceeds were utilised mostly for acquisitions, both abroad and domestically.

Capital raised in the primary share market

Per cent



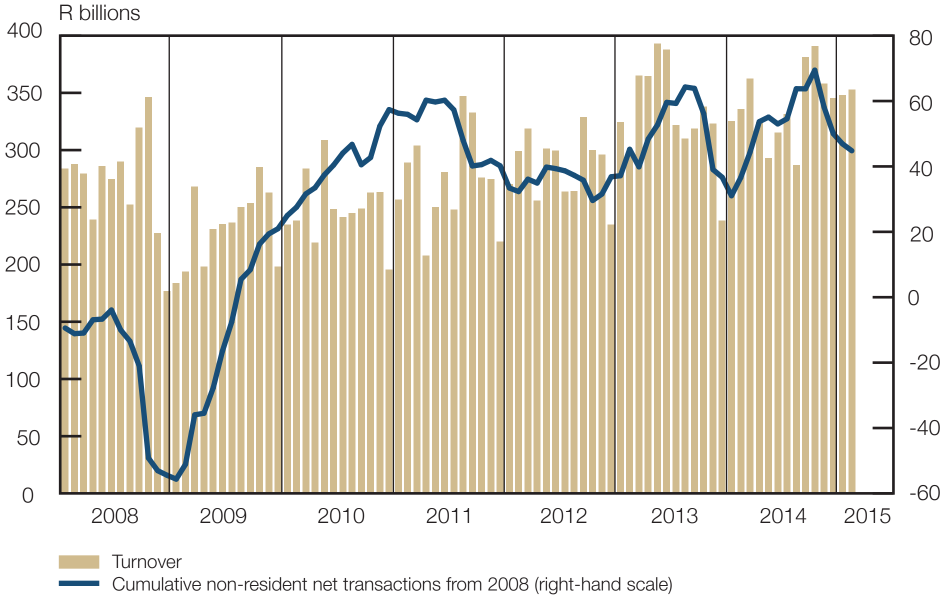
Robust funding in the primary share market was consistent with the high level of share prices and rising number of companies listed on the JSE, as new listings exceeded delistings in 2014 for the first time since 2008. The number of company listings came to 329 on the main board at the end of February 2015, while 60 were listed on the Alternative Exchange (Alt^X) and 3 on the development and venture capital boards. The most prominent method of raising capital was the waiver of pre-emptive rights where shares were issued for cash to the general market or specific investors. Equity financing amounted to R43 billion in the first two months of 2015.

Number of listings on the JSE

	Alt[x]	Venture and development capital boards	Main board	Total	New listings: Total for the year	Delistings: Total for the year
December 2012	63	5	334	402	14	18
December 2013	60	5	324	389	13	26
December 2014	58	3	330	391	24	22
February 2015	60	3	329	392	2	1

Turnover in the secondary share market of the JSE averaged R16,3 billion per day in 2014, which was only 2 per cent higher than the R16,0 billion per day registered in 2013. Subsequently, turnover edged higher to R17,1 billion per day in the first two months of 2015. Meanwhile, the *market capitalisation* of the JSE increased by 15 per cent from a recent low in January 2014 to R12,1 trillion in July, receding somewhat in the remainder of 2014 before rising to a new record level of R12,2 trillion in February 2015

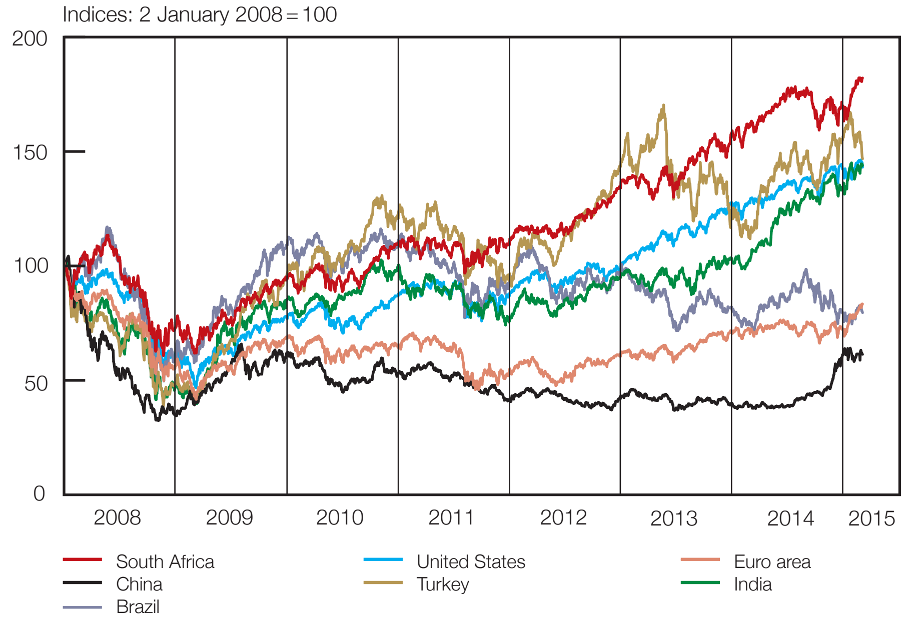
Turnover and non-resident net transactions on the secondary share market of the JSE



After recording exchange-reported net purchases of R11 billion in the third quarter of 2014, *non-residents* more than offset these with net sales of shares to the amount of R14 billion in the fourth quarter. Despite this, non-residents recorded net purchases of shares amounting to R13 billion for 2014 as a whole, compared with the almost negligible net sales of R164 *million* in 2013. Non-resident investors continued to be net sellers of shares in the first two months of 2015, recording net sales to the amount of R5,2 billion.

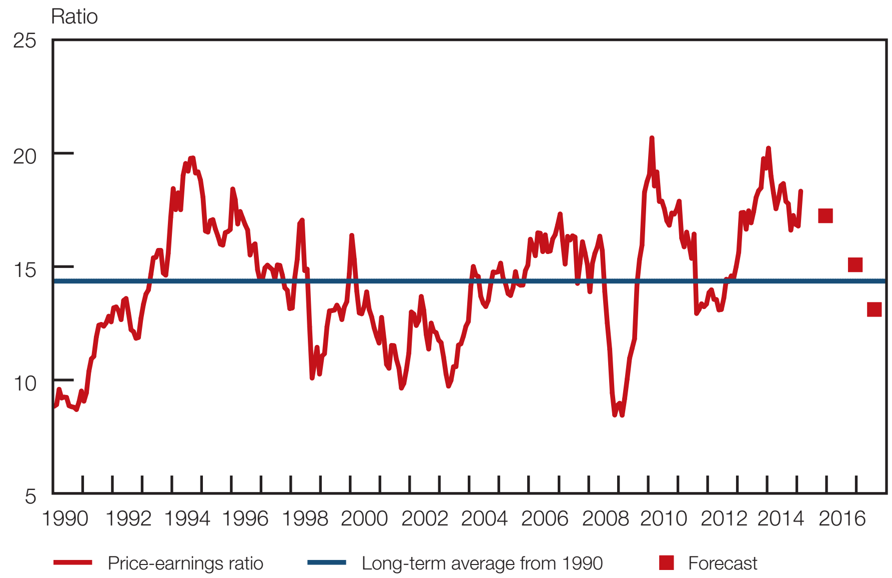
Domestic *share prices* entered 2015 on a positive note, recovering from the losses incurred in late 2014. The FTSE/JSE All-Share Price Index (Alsi) reached a high of 52 242 index points on 29 July 2014 before declining to a recent low of 46 673 index points on 15 October. This was mainly as a result of global risk aversion due to concerns over weak global economic growth prospects, lower international commodity prices, fears over renewed economic instability in the eurozone, and less accommodative monetary policy in the US. However, in early 2015 the Alsi rebounded, with the largest gain recorded by the resources sector. The domestic share market benefited from the lower international oil prices, while the weaker rand also boosted some share prices. From its mid-October low, the Alsi increased by 14 per cent to an all-time high of 53 347 index points on 6 March 2015.

Share prices in local currency



The strong rise in share prices outstripped earnings growth, resulting in an increase in the *price-earnings ratio* of all classes of shares from 12,9 in August 2011 to 20,2 in January 2014. Price-earnings ratios exceeding 20 were previously observed in early 2010. Subsequently, the price-earnings ratio dropped off to 16,8 in January 2015, before rising to 18,3 in February. The recent levels of the price-earnings ratio were higher than its long-term average of 14,4, measured from 1990 to date. Market analysts on average expect the price-earnings ratio to fall below its long-term average by 2017, partly reflecting growth in future earnings of companies.

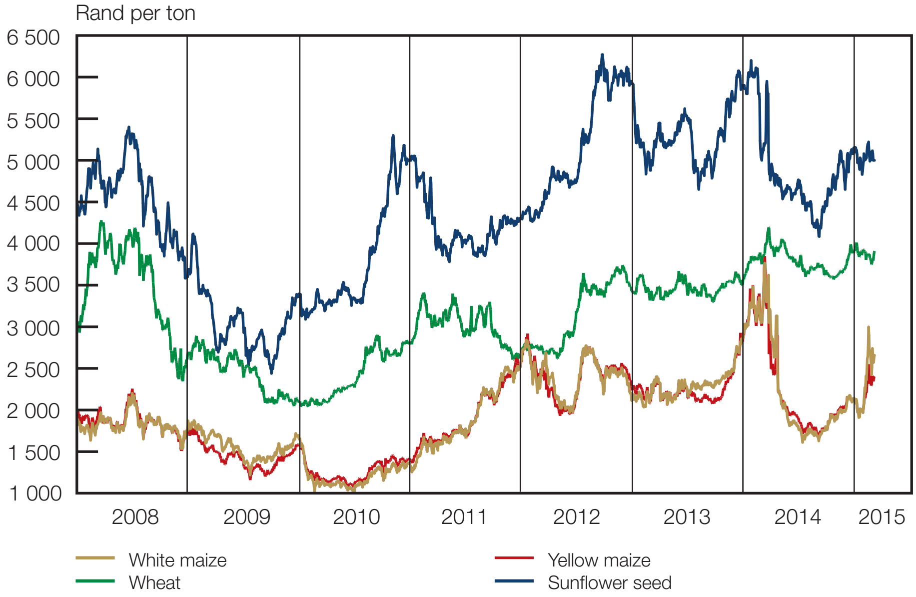
Price-earnings ratio of all classes of shares



Market for exchange-traded derivatives

The 2,7 million *commodity futures and options contracts* traded on the Commodity Derivatives Market of the JSE in 2014 were 2 per cent lower than volumes traded in 2013. A strong decline in domestic grain prices arising from bumper crop harvests was the major feature of 2014, but from late 2014 this made way for renewed price increases. These were fuelled by the weaker rand and projections of lower future crop production as farmers indicated reduced planting intentions for the 2015 production season, and as dry, hot weather in certain provinces caused damage to crops. Domestic wheat prices remained relatively stable, supported by expectations of tight supplies after Russia, one of South Africa's largest wheat suppliers, announced plans to slow its wheat exports.

South African grain prices



Trading activity in *currency and interest rate derivatives* on the JSE registered buoyant increases in 2014 as participants continued to hedge against adverse currency and bond yield movements. Equity derivatives activity also registered brisk increases in 2014, as shown in the table below.

Derivatives turnover on the JSE

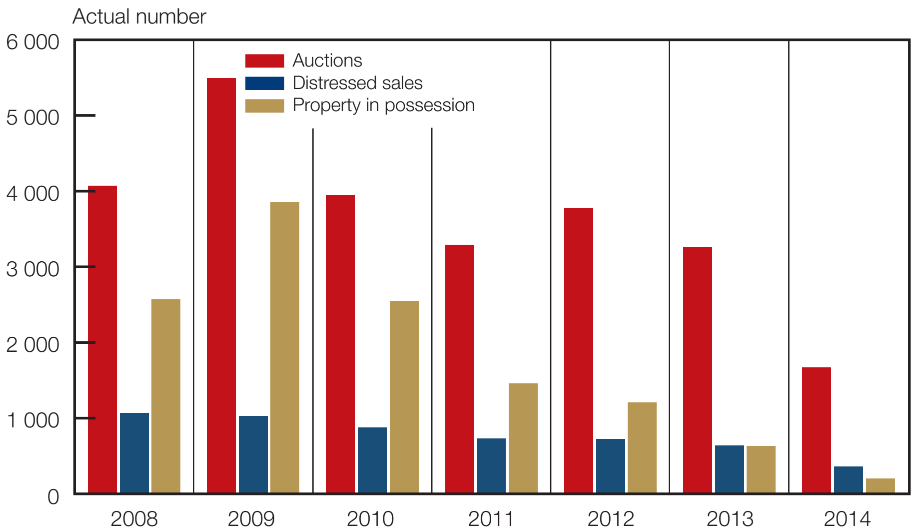
Type of derivative	Value (R billions)		Change over one year (Per cent)	
	2014	Jan–Feb 2015	2014	Jan–Feb 2015
Equity	5 982	695	18	-9
Warrants	1	0,1	8	-10
Commodity	491	109	0	15
Interest rate	657	175	27	40
Currency	516	51	54	-34

Real-estate market

The residential property market followed a steady upward trajectory in 2014 and early 2015, with year-on-year rates of increase in house prices across the different barometers ranging between 6 and 8 per cent in February 2015. House price inflation occurred alongside more balanced housing demand and supply conditions, as the positive impact of lower inflation and fuel cost savings was moderated by increases in the repurchase rate, slow economic growth and sluggish employment. The average time residential properties remained on the market increased from 11,4 weeks in the third quarter of 2014 to 12,3 weeks in the fourth quarter. The number of residential property transfers, which refer to all residential property purchases made, including all cash and mortgage bond-funded transactions, tapered off from early 2012 to February 2015 and was 22 per cent lower in 2014 compared with 2013, as mortgage credit growth remained weak and consumer confidence constrained.

The issuing of a sale-in-execution notice can lead to forced sales in the real-estate market. Together with the downward bias in residential property sale-in-execution notices issued by banks, all three outcomes of forced sales, namely auctions, distressed sales and property in possession declined in 2014 when compared with 2013, indicating some improvement in the risk environment for banks.

Forced sales in the residential real-estate market



Source: Lightstone

Non-bank financial intermediaries

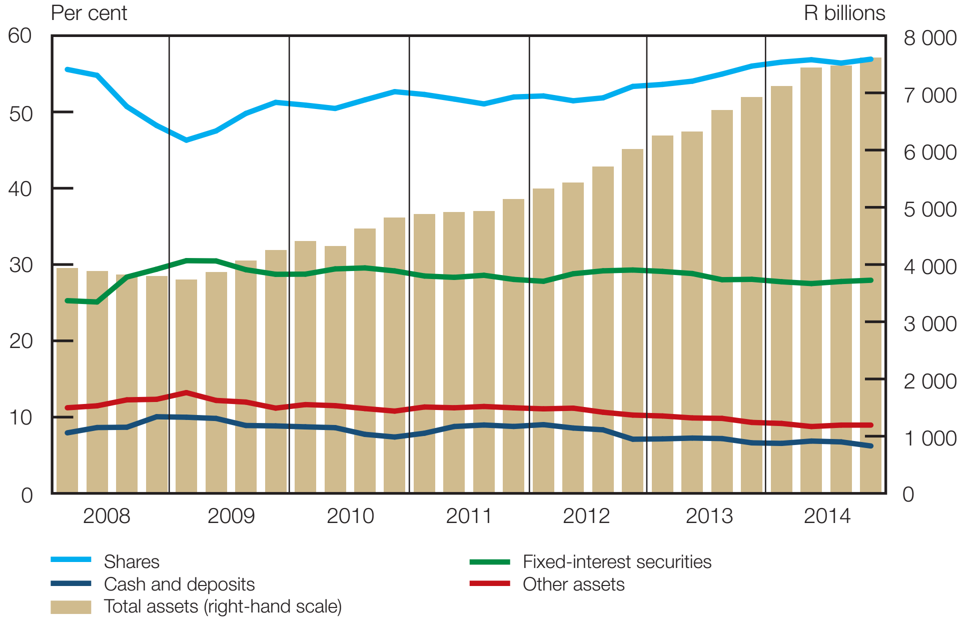
The increase in equity market prices supported the balance sheet of non-bank financial institutions[9] in 2014. The consolidated total assets of these institutions grew by 10 per cent from 2013 to 2014; however, this was lower than the increase of 15 per cent registered from 2012 to 2013. The asset base of non-bank financial institutions was especially buoyed by growth in the assets of unit trusts and the Public Investment Corporation: as a ratio of gross domestic product the consolidated assets of these two types of institutions increased from 89 per cent in 2013 to 94 per cent in 2014.

Non-bank financial institutions effected moderate changes to their asset allocation, with shares increasing from 56 per cent of total assets in 2013 to 57 per cent in 2014. The proportion of cash and deposits declined by 1 percentage point from 2013 to 6 per cent of total assets in 2014 amid a general moderation in risk aversion in the financial markets. A pronounced decline

9 These institutions consist of unit trusts, the Public Investment Corporation, long- and short-term insurers, public and private pension funds, participation bond schemes, finance companies and non-monetary public financial corporations.

in cash and deposits was registered by unit trusts, where money-market funds recorded net outflows of about R39 billion over the same period.

Asset holdings of non-bank financial institutions



Exposure to fixed-interest securities remained at 28 per cent of total assets in 2013 and 2014, despite a decline in bond yields which supported holdings of government bonds. Similarly, holdings of other assets remained at 8 per cent of total assets over the same period.

Non-bank financial institutions are likely to benefit from regulatory changes to be implemented in 2015, such as the introduction of tax-free saving products. Current cyclical factors, such as

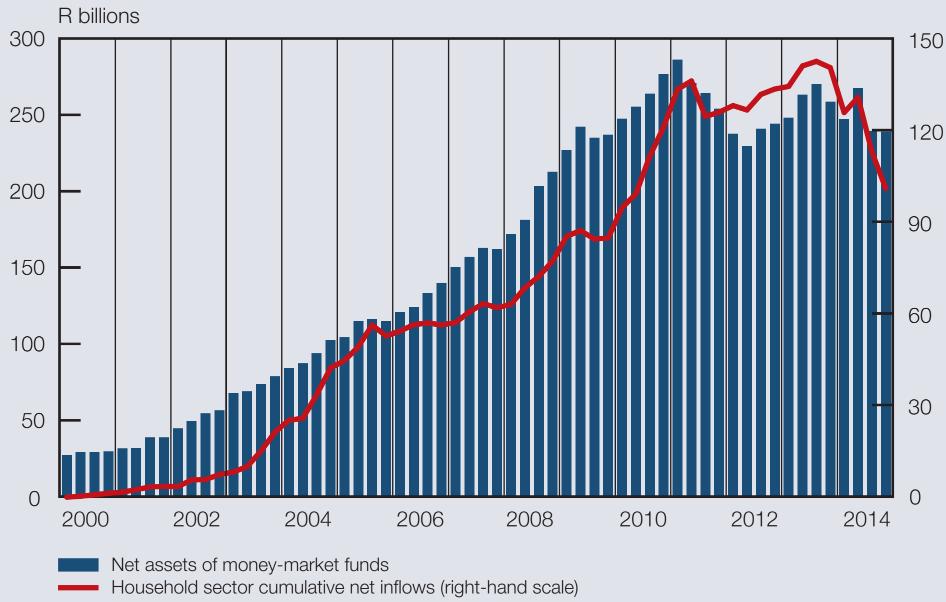
Box 5 Money-market funds

Although relatively small compared with other non-bank financial institutions, money-market funds play an important intermediation role in the economy, especially by providing wholesale funding to the banking sector. Money-market funds are collective investment schemes that invest in short-term fixed income instruments such as bank deposits. These portfolios are often used by investors as a proxy for bank-based savings and they seek to maximise interest income, while preserving capital. The net assets[1] of money-market funds increased from R30 billion in 2000 to R277 billion in 2010, before declining to R239 billion in 2014. The unprecedented growth in the balances of these funds was largely driven by investment from the household sector, which recorded cumulative net inflows of R101 billion from 2000 to 2014.

The moderation in net assets of money-market funds in the second half of 2014 was due to African Bank Investments Limited (ABIL) being placed under curatorship. The net outflows were partly exacerbated by the regulatory notice released by the Financial Services Board, which required money-market funds to create a side-pocket portfolio for ABIL debt instruments. The market value of the side-pocket portfolio as approved in August 2014 amounted to R4,6 billion. The impact of ABIL on money-market funds was probably lessened by the collective investment scheme regulation that restricts the funds' investment in debt instruments of listed banks to less than 30 per cent for issuers with market capitalisation of more than R20 billion.

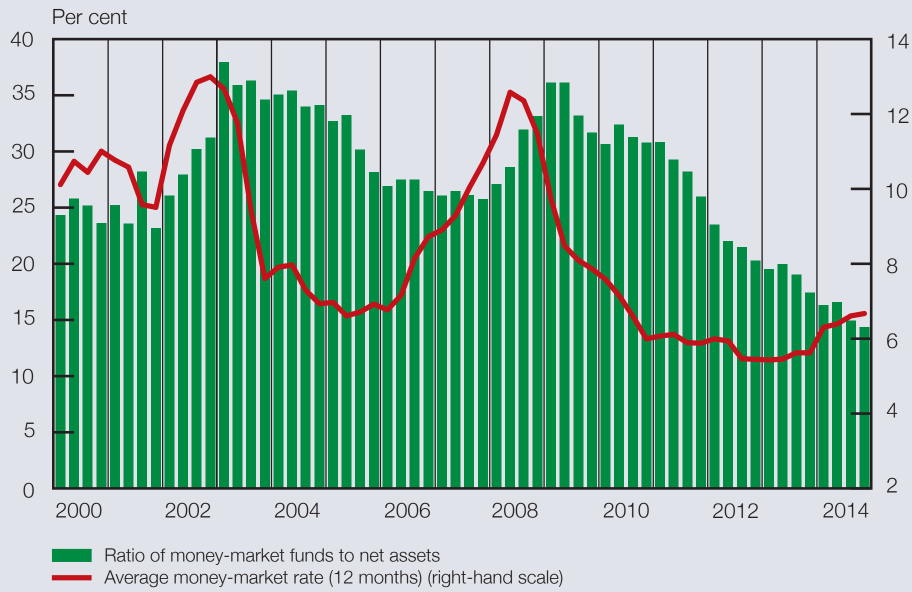
1 Measured as fair market value of all assets less fair value of liabilities

Figure B5.1: Money-market funds



The share of unit trust saving has gradually gravitated away from money-market funds towards non-money-market funds between 2008 and 2014, as investors seek higher returns offered by alternative portfolios such as equity and balanced funds. The ratio of money-market funds to the total net assets of unit trusts declined markedly from 36 per cent in the first quarter of 2009 to 14 per cent in the final quarter 2014, alongside a general moderation in risk aversion in financial markets and an improvement in investors' sentiment. The protracted decline in interest rates from 2009 and an increase in equity prices have contributed to a shift to non-money-market portfolios.

Figure B5.2: Ratio of money-market funds to net assets of unit trusts



The growth in net assets of money-market funds is likely to be negatively influenced by the deterioration in the financial position of households, the performance of competing asset classes and the introduction of Basel III – which might force banks to reduce short-term wholesale funding. Similarly, other regulatory changes, such as the adoption of a twin peaks model of financial regulation and the introduction of tax-free saving and investment products, will affect these funds.

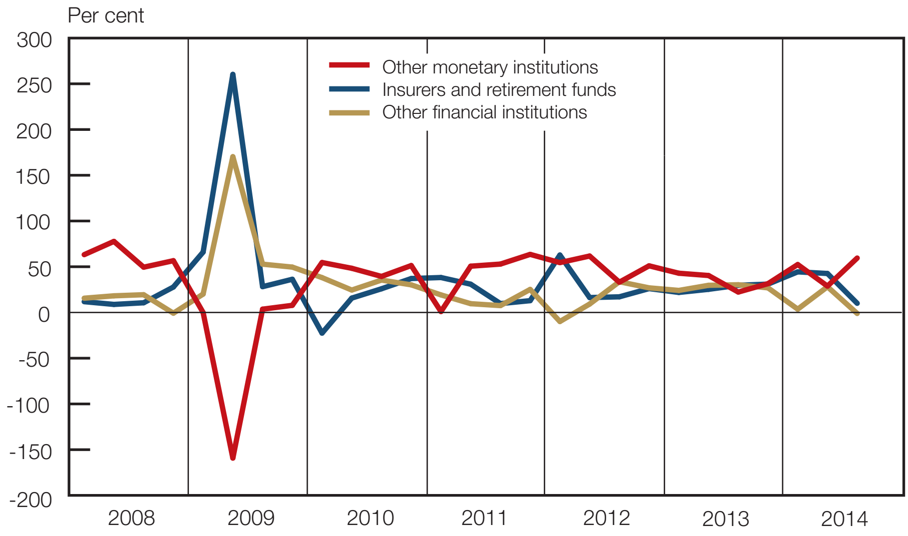
the decline in the rate of inflation, lower bond yields and the continued increase in domestic and global equity prices, are likely to support the balance sheets of these institutions.

Flow of funds

During the third quarter of 2014 the domestic economy registered higher capital flows from *non-residents* than in the second quarter of 2014. The bulk of inflows were recorded in the other portfolio and investment categories as non-residents extended short-term loans and purchased equity and long-term debt instruments. Inflows through these securities collectively amounted to R109 billion during the third quarter of 2014. Most of the inflows channelled through short-term loans were absorbed by the domestic banking sector, while the private non-financial corporate business enterprises sector took up the balance. Non-residents' debt-related inflows of R23 billion emanated from National Treasury's issuances of international bonds during the third quarter of 2014. Correspondingly, the proceeds from the sale of these bonds increased the South Africa's international reserves in rand terms.

Total *financial intermediation* flows amounted to R177 billion or 27 per cent of the total flows in the third quarter of 2014. Intermediation was mainly driven by other monetary institutions, as demand for credit by the corporates increased. These institutions extended credit of R37 billion in bank loans and advances and R19 billion in mortgage loans, which was still relatively historically low and constrained the aggregate spending level during the analysis period. Other monetary institutions' share of total financial intermediation accounted for 60 per cent while insurers and retirement funds was 10 per cent. The main instruments used by insurers and retirement funds for intermediation were bonds and equity – they acquired more bonds and reduced their equity holdings, partly due to uncertainties regarding the timing of monetary policy tightening in the US and volatile financial markets.

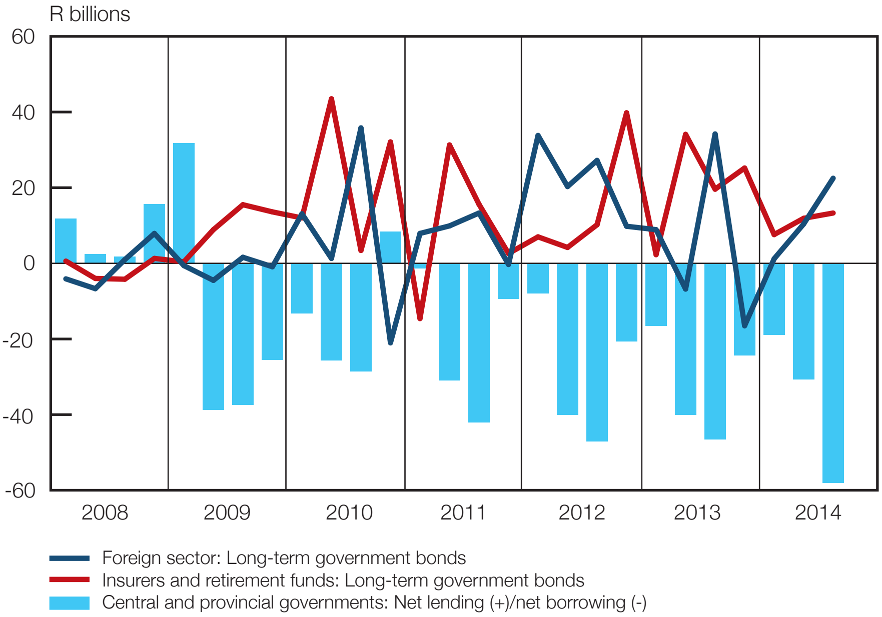
Share of financial intermediation by sector



The *general government sector* widened its financing deficit position to R65 billion in the third quarter of 2014 from the amount recorded a quarter earlier. This comprised deficits of R58 billion by central and provincial governments and R6,6 billion by local governments. The financing shortfall was met through issuances by national government of Treasury bills and government bonds in the domestic market. These were augmented by funds raised in the international market, which included the first issue of a Sukuk (Islamic) bond over the period under review. Insurers and retirement funds remained the largest source of national government funding in the domestic market as they extended R30 billion worth of long-term government bonds, including those which were acquired by the Public Investment Corporation.[10]

10 The bulk of assets under management by the Public Investment Corporation belong to the Government Employee Pension Fund.

Government funding by sector



The *non-financial corporate business enterprises sector* continued to embark on capital spending, adding capital assets to the value of R148 billion during the third quarter of 2014. Private non-financial corporate businesses contributed R112 billion to this amount. This capital expansion was financed through the sale of equity, the incurrence of long-term and mortgage loans, and bank loans and advances. Over the same period, private businesses increased their holdings of cash and deposits with financial institutions. Meanwhile, capital outlays by public non-financial corporate businesses were mainly driven by Eskom and Transnet during the third quarter of 2014. Capital expenditure is set to continue in the electricity, transport and logistics sectors of the domestic economy, along with government's commitment to avoid future infrastructure bottlenecks, given the recent costly electricity outages.

The *household sector* recorded a surplus position of R9,5 billion in the third quarter of 2014. The surplus funds were invested with insurers and retirement funds, with cash and deposit holdings at banks also rising. Households' demand for credit grew at a slower pace during the third quarter of 2014. For example, bank loans and advances to households amounted to R4,6 billion and mortgage loans to R3,8 billion over the period under review, as the level of consumer confidence remained weak.

Public finance

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

Non-financial public-sector borrowing requirement[11]

In April–December 2014 the non-financial public-sector borrowing requirement amounted to R165,6 billion – some R20,6 billion higher than in the same period of fiscal 2013/14. The widening resulted from higher cash deficits recorded by the non-financial public enterprises and corporations, and by national and local government. The non-financial public enterprises and corporations recorded a notably higher cash deficit, although their capital spending continued to exceed their borrowing requirement. The higher cash deficit of national government resulted from higher grant transfers to other levels of general government, of which provincial governments received the greater share.

Non-financial public-sector borrowing requirement

R billions

Level of government	Apr–Dec 2013*	Apr–Dec 2014*
Consolidated general government	98,9	102,4
National government	122,0	132,6
Extra-budgetary institutions	-5,0	-7,7
Social security funds	-10,0	-19,2
Provincial governments	-7,6	-10,0
Local governments	-0,5	6,8
Non-financial public enterprises and corporations	46,1	63,2
Total**	**145,0****	**165,6 ****
As percentage of gross domestic product	*5,4*	*5,8*

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

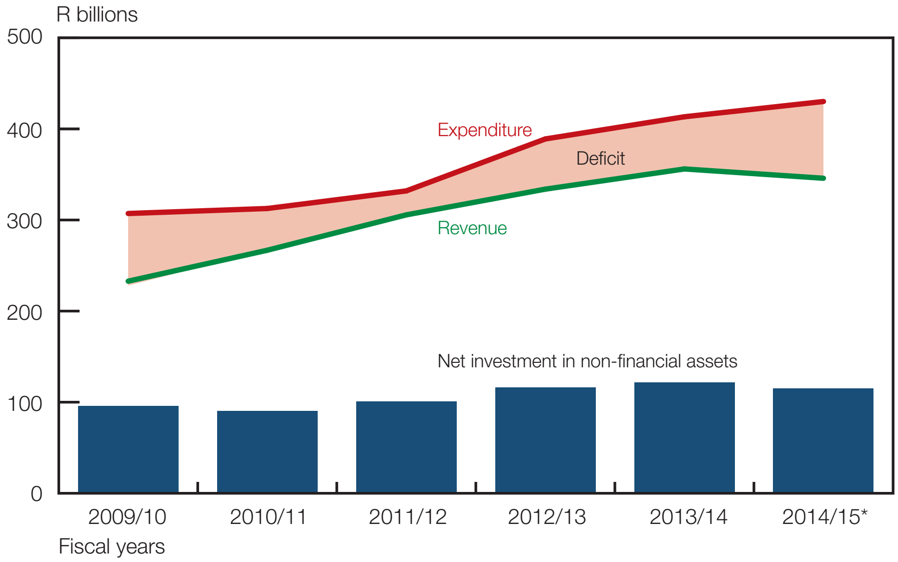
As a percentage of gross domestic product, the non-financial public-sector borrowing requirement amounted to 5,8 per cent in the first three quarters of fiscal 2014/15, higher than the ratio of 5,4 per cent recorded in the same period a year earlier.

The financial activities of the *non-financial public enterprises and corporations* resulted in a preliminary cash deficit of R63,2 billion in the first three quarters of fiscal 2014/15 – some R17,0 billion higher than the cash deficit recorded in the same period of the previous fiscal year. The widening of the cash deficit was on account of pronounced growth in total expenditure which outpaced the slower growth in total revenue.

With the state-owned electricity company, Eskom, facing technical and financial difficulties, government in early 2015 underlined its commitment to stabilising Eskom's finances by granting the power utility a capital injection of R23 billion to be paid in three instalments, with the first transfer to be made by June 2015. Government's short- and medium-term plans to address the current energy constraint involve improving maintenance at Eskom's power stations, enhancing electricity-generating capacity and managing electricity demand. The long-term strategic plan involves the pursuit of alternative energy sources such as gas, hydroelectric, solar and nuclear power.

Net investment in non-financial assets by the non-financial public enterprises and corporations amounted to R86,4 billion during the first three quarters of fiscal 2014/15, or 9,7 per cent less than in the same period a year earlier. The lower level of infrastructure spending was mainly attributed to a significant decline in cash outlays on capital goods recorded in the final quarter of 2014 by Eskom and Transnet.

Finances of non-financial public enterprises and corporations



* April–December 2014, annualised

Box 6 Revision of Government Finance Statistics data

South Africa's national accounts compilers implemented key recommendations of the latest edition of the *System of National Accounts* (2008 SNA) from late 2014. Accordingly, the general government data also had to be revised. The revisions were also aligned with the recommendations of the Government Finance Statistics Manual 2014 (GFSM 2014). According to these manuals a number of economic items had to be reclassified. The categories affected are expenditure on goods and services and expenditure on non-financial assets.

The items affected were all previously included under spending on current goods and services, but had to be reclassified as expenditure on non-financial assets – in other words, capital expenditure. The items involved are:

– research and development; and
– military weapon systems.

As a consequence of the capitalisation of these expenditure items, expenditure on goods and services decreased and that on non-financial assets increased. In addition to this, capital outlays on computer hardware and software have now been split between information, communications and technology (ICT) equipment and computer software. The GFS data has been revised from fiscal 2000/01 onwards and are published in this *Quarterly Bulletin*.

In the first three quarters of fiscal 2014/15, cash receipts from operating activities of *national government* amounted to R727 billion – representing a year-on-year rate of increase of 8,8 per cent when compared with the first nine months of the preceding fiscal year. Firm tax collections from personal income tax and taxes on property contributed to the rise in national government cash receipts.

National government cash payments for operating activities recorded the same year-on-year rate of increase as cash receipts from operating activities to amount to R848 billion in April–December 2014. Grants paid to other levels of government accounted for the bulk of these cash payments.

Net cash flow from operating activities together with net investment in non-financial assets resulted in an overall national government cash deficit of R133 billion in the first nine months of the current fiscal year. This was R10,6 billion higher than the cash deficit recorded in the corresponding period of fiscal 2013/14.

Provincial governments' financial activities resulted in a cash surplus of R10,0 billion in April–December 2014. This was R2,4 billion higher than the cash surplus recorded in the same period of fiscal 2013/14. The increase in the cash surplus was on account of strong growth in cash receipts from operating activities which outpaced the increase in total expenditure.

Total provincial governments' cash receipts amounted to R349 billion in the first three quarters of fiscal 2014/15, representing a year-on-year rate of increase of 8,5 per cent. While a minor part of this amount consisted of own revenue, the increase in total cash receipts of provincial governments was essentially attributable to grants from national government. These grants, consisting of equitable share transfers together with conditional grants earmarked for specific purposes, amounted to R338 billion in the first three quarters of fiscal 2014/15.

In the period under review, cash payments for operating activities together with net investment in non-financial assets amounted to R339 billion, or 7,9 per cent more than in the first nine months of fiscal 2013/14. The increase in total expenditure was mainly driven by an increase in provincial governments' compensation of employees, which rose by 7,3 per cent in the first three quarters of fiscal 2014/15.

Provincial governments' deposits with the Corporation for Public Deposits increased from R13,1 billion at the end of March 2014 to R19,1 billion at the end of December 2014. At the same time, their deposits with private banks increased from R10,5 billion to R15,4 billion, while their overall indebtedness to banks decreased marginally from R1,8 billion to R1,0 billion over the same period.

Local governments recorded a cash *deficit* of R6,8 billion in the first nine months of fiscal 2014/15, in contrast with a cash *surplus* of R0,5 billion recorded in the same period of fiscal 2013/14. Strong increases in cash payments outpaced the increase in cash receipts over the period.

In April–December 2014 local government cash receipts from operating activities amounted to R228 billion, showing a year-on-year rate of increase of 8,1 per cent compared with the same period of the previous fiscal year. This increase emanated from strong growth in own revenue, together with grants received from national and provincial government. Sales of water, electricity and gas, the main drivers of municipal own revenue, amounted to R87 billion in April–December 2014. During the period under review, municipalities received an amount of R61 billion as inter-governmental transfers from national and provincial government by means of equitable share transfers, conditional grants and general fuel levy sharing with metropolitan municipalities.

Cash payments for operating activities amounted to R193 billion in the first three quarters of fiscal 2014/15, representing an increase of 12,6 per cent year on year. Bulk purchases of water, electricity and gas contributed to the increase in cash payments for operating activities. During the period under review, net investment in non-financial assets recorded an increase of 7,6 per cent year on year to amount to R42 billion.

A preliminary financial analysis of *extra-budgetary institutions* indicated a cash surplus of R7,7 billion in the first nine months of fiscal 2014/15 – significantly higher than the cash surplus of R5,0 billion recorded in the same period a year earlier.

Social security funds recorded a cash surplus of R19,2 billion in the period under review, almost double the surplus recorded a year earlier. The higher cash surplus can be attributed to a significant increase in cash receipts from operating activities. However, the liabilities of these funds, mainly related to road accident claims, remained at an elevated level.

Budget comparable analysis of national government finance

During the first nine months of fiscal 2014/15, the levels of national government expenditure and revenue fell below the original (February 2014) and the revised (October 2014) budget projections, with spending outpacing revenue and thus resulting in a slightly higher-than-projected cash-book deficit for the period.

Expenditure by national government reached R828 billion in the first nine months of fiscal 2014/15, or 8,1 per cent more than in April–December 2013. The *Budget Review 2014* envisaged that national government spending would increase by 9,0 per cent year on year to amount to R1 139 billion in fiscal 2014/15. However, in the 2014 *Medium Term Budget Policy Statement* (MTBPS), expenditure was revised downwards to R1 133 billion, representing a year-on-year rate of increase of 8,4 per cent. Expenditure on core social and economic programmes would be maintained, with reductions projected for non-essential goods and services. Relative to gross domestic product, national government expenditure totalled 28,8 per cent in the first three quarters of fiscal 2014/15 – higher than the 28,4 per cent recorded in the same period a year earlier.

National government finances: Key statistics

Year-on-year growth rates

	Budgeted Feb 2014 Full 2014/15	Revised Oct 2014 Full 2014/15	Actual Apr–Dec 2014
		Per cent	
Expenditure	9,0	8,4	8,1
Revenue	9,3	8,6	7,7
Deficit	**R176 bn**	**R176bn**	**R143bn**

The table below shows that in the nine months to December 2014, national government expenditure growth fell notably short of budgeted projections in the case of capital expenditure and only exceeded the budget estimates in the case of current payments.

National government expenditure in fiscal 2014/15

Expenditure item	Originally budgeted: Full 2014/15		Actual Apr–Dec 2014	
	R billions	Percentage change*	R billions	Percentage change*
Voted amounts	631,8	9,0	460,2	7,8
Current payments	*181,0*	*6,2*	*130,3*	*7,0*
Transfers and subsidies	*433,1*	*9,6*	*321,7*	*8,0*
Payments for capital assets	*17,7*	*26,1*	*8,1*	*13,8*
Statutory amounts**	507,2	9,1	367,5	8,6
Of which: *Interest on debt*	*114,8*	*13,6*	*76,6*	*13,5*
Total expenditure	**1 139,0**	**9,0**	**827,7**	**8,1**

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

In the first nine months of fiscal 2014/15, current payments recorded an increase of 7,0 per cent year on year. The Justice, Crime Prevention and Security cluster contributed 74,7 per cent to total current payments with the Departments of Police and Defence and Military Veterans contributing the largest share in this cluster.

Although transfers and subsidies recorded a solid increase in the period April–December 2014, it still fell below the original and revised budgeted increase for this spending category. The increase in transfers and subsidies came mainly from the Social Services cluster, which accounted for 52,6 per cent of the total. This cluster consists of departments responsible for public education, health and social services. Further contributions were from the Departments of Cooperative Governance and Traditional Affairs, Transport and Human Settlements.

Expenditure on capital assets was originally budgeted to amount to R17,7 billion in fiscal 2014/15, or increase by 26,1 per cent year on year. However, in the MTBPS 2014 this spending item was revised downwards to increase by 18,9 per cent year on year. During April–December 2014, payments for capital assets recorded an increase of only 13,8 per cent year on year, owing to the Departments of Police and Water Affairs and Sanitation falling behind with their spending plans. The Department of Police planned to upgrade and build new police facilities to improve the accessibility of police services, while payments for capital assets by the Department of Water Affairs and Sanitation were for bulk water infrastructure build schemes mainly through the Regional Implementation and Support Programme.

In the first three quarters of fiscal 2014/15, interest paid on national government debt recorded a year-on-year rate of increase of 13,5 per cent, amounting to R76,6 billion. The larger interest bill resulted from the higher issuance of debt instruments. This statutory amount was originally budgeted to increase by 13,6 per cent but this was revised slightly downwards to 13,1 per cent in the MTBPS 2014.

Equitable share transfers to provinces – the main source of provincial governments' revenue – totalled R272 billion in the first nine months of fiscal 2014/15, or 7,4 per cent more than in the first three quarters of the preceding fiscal year. In the *Budget Review 2014,* these transfers were expected to amount to R362 billion and were kept broadly unchanged in the MTBPS 2014.

In April–December 2014, an amount of R6,8 billion was transferred to metropolitan municipalities as their share of the general fuel levy. The *Budget Review 2014* had envisaged that R10,2 billion would be paid from the National Revenue Fund to metropolitan municipalities through this channel in the full fiscal year.

Revenue of national government amounted to R684 billion in the first nine months of fiscal 2014/15 – some 7,7 per cent more than in the same period of the previous fiscal year. According to the *Budget Review 2014*, national government revenue was projected to increase by 9,3 per cent year on year to amount to R963 billion. However, this projection was revised downwards to R957 billion, and now represents an increase of 8,6 per cent. Growth in revenue was below the original and revised budgeted projections, mainly on account of more subdued economic growth. As a ratio of gross domestic product, national government revenue totalled 23,8 per cent in April–December 2014, compared with a ratio of 23,6 per cent recorded in the first nine months of fiscal 2013/14.

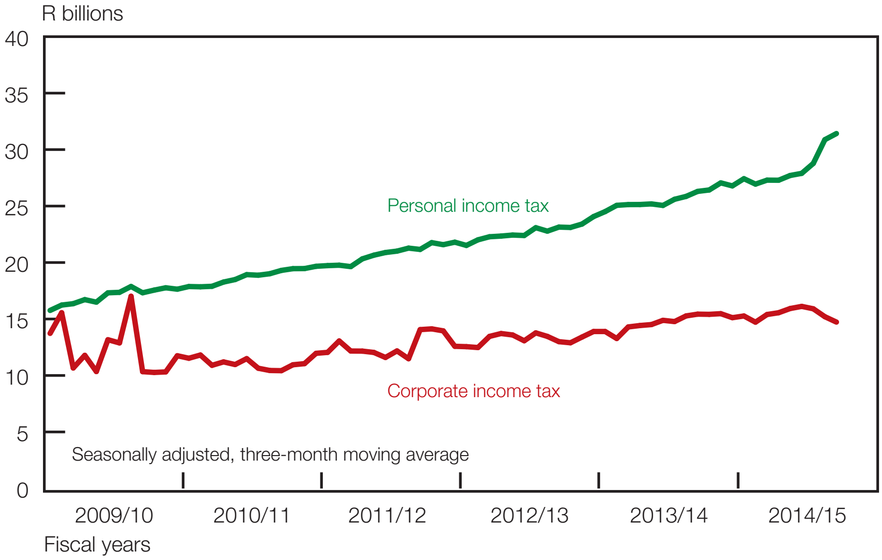
National government revenue in fiscal 2014/15

Revenue source	Originally budgeted: Full 2014/15		Actual Apr–Dec 2014	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	557,0	9,7	402,1	9,9
Income tax on individuals	*335,9*	*8,0*	*247,2*	*13,3*
Income tax on companies	*198,9*	*10,8*	*138,7*	*3,0*
Payroll taxes	13,4	7,7	9,9	8,7
Taxes on property	11,5	9,4	9,2	19,9
Taxes on goods and services	361,2	11,3	256,5	10,5
Value-added tax (VAT)	*267,2*	*12,4*	*188,3*	*11,1*
Domestic VAT	*290,9*	*10,4*	*211,9*	*9,2*
Import VAT	*151,7*	*15,7*	*95,4*	*3,8*
Taxes on international trade and transactions	50,5	12,8	28,7	-11,6
Import duties	*50,3*	*13,9*	*28,0*	*-7,7*
Other revenue**	21,0	-12,7	16,8	-18,6
Less: SACU*** payments	51,7	19,3	38,8	19,3
Total revenue	962,8	9,3	684,3	7,7

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

Growth in revenue collections was underpinned by solid increases in personal income tax and taxes on property, but was held back by a slowdown in income tax on companies, import value-added tax (VAT), alongside a contraction in import duties.

Personal and corporate income tax collections



Taxes on income, profits and capital gains were boosted by buoyant receipts of personal income tax and withholding tax on dividends. Higher receipts from personal income tax could in part be attributed to collections on bonus payments, alongside significant once-off pay-as-you-earn collections related to share options exercised. Withholding tax on dividends continued on an upward trend, owing to profit and dividend growth with some cash-flush companies returning funds to shareholders through higher-than-usual dividend pay-outs. Corporate income tax collections were sluggish owing to lower provisional payments from the mining, coal and petroleum sectors in December 2014.

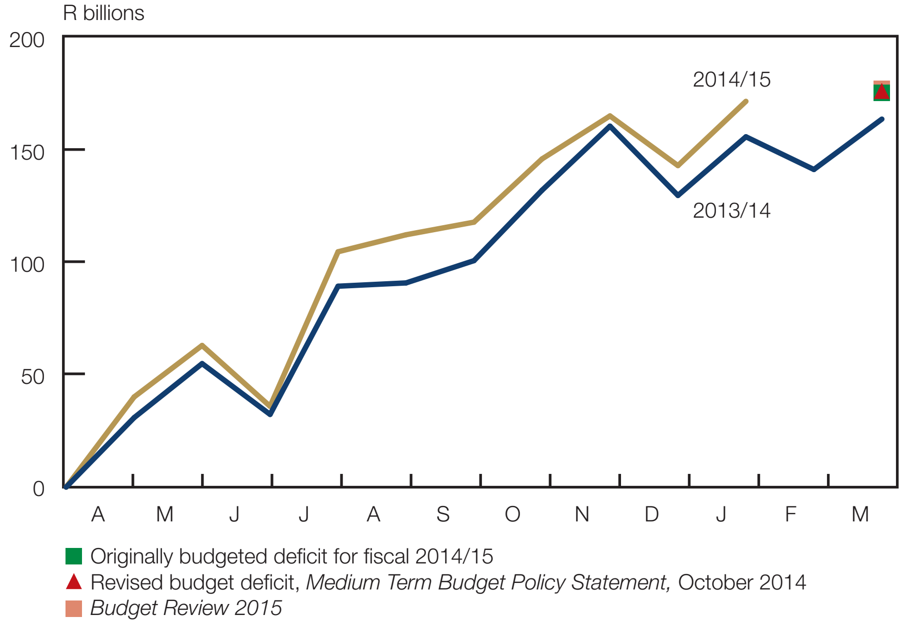
Robust collections from transfer duties and securities transfer tax contributed to the sharp acceleration recorded in taxes on property. Higher transfer duties mirrored the improved performance of the real-estate market, whereas proceeds from the securities transfer tax signalled vibrant activity in the financial markets.

The increase in VAT, fuel levy and other excise duties contributed to higher collections from taxes on goods and services, which were above the revised budgeted expectations in April–December 2014. Domestic VAT collections fell slightly below budgeted projections owing to a contraction in VAT payments by the strike-ridden mining and quarrying sector. While import VAT collections fell far below the original budget, they exceeded the revised estimates prepared in October 2014 owing to brisk imports of motor vehicle components, mainly sourced from Germany and Japan. VAT refunds were lower as refunds to the mining and trade sectors were muted, especially in December 2014.

In the first three quarters of fiscal 2014/15, taxes on international trade and transactions contracted substantially, owing to the reclassification of a considerable amount of imported fuel levy from customs duties to fuel levy and a contraction in vehicle imports.

Netting national government revenue and expenditure yielded a cash-book deficit of R143 billion in April–December 2014. This cash-book deficit could be compared with a cash-book deficit of R130 billion recorded in the first three quarters of fiscal 2013/14. The rise in national government spending outperformed the increase in revenue, resulting in the widening of the cash-book deficit. As a proportion of gross domestic product, the cash-book deficit amounted to 5,0 per cent in the first nine months of fiscal 2014/15 – slightly higher than the deficit ratio of 4,8 per cent recorded in the corresponding period of fiscal 2013/14. In the *Budget Review 2014,* a cash-book deficit of R176 billion was envisaged in fiscal 2014/15; this was kept broadly unchanged in the MTBPS 2014, and the outcomes up to December 2014 seem consistent with that projection for the full fiscal year.

Cumulative deficit of national government



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

The primary deficit[12] of national government amounted to R67 billion in the first nine months of fiscal 2014/15, compared with R63 billion recorded a year earlier. As a ratio of gross domestic product the primary deficit reached 2,3 per cent in April–December 2014 – similar to the primary deficit ratio recorded in the same period of the previous year. The primary balance is a useful indicator of current fiscal effort, since interest payments are predetermined by the size of previous deficits.

During the first nine months of fiscal 2014/15, the cash-flow deficit of national government amounted to R124 billion – some R28 billion less than the cash-flow deficit recorded in the first nine months of fiscal 2013/14. There was a considerable difference of about R19 billion between the cash-book deficit and the cash-flow deficit in the first nine months of fiscal 2014/15. The lower cash-flow deficit stemmed from higher cash-flow revenue, alongside a substantial amount in expenditure falling due at the end of fiscal 2012/13 that was only paid out in April 2013, bolstering the base level of cash-flow expenditure in fiscal 2013/14. In the first three quarters of fiscal 2014/15, the net borrowing requirement amounted to R130 billion, substantially lower than the borrowing requirement of R157 billion recorded in the same period a year earlier.

Over the period under review, the bulk of government's borrowing needs were satisfied by means of domestic debt instruments, as reflected in the accompanying table. Of the domestic government bonds issued from April to December 2014, some R50,6 billion was raised from inflation-linked bonds, bringing the balance of these instruments to R349 billion at the end of December 2014.

National government financing in fiscal 2014/15

R billions

Item or instrument	Originally budgeted: Full 2014/15[1]	Actual Apr–Dec 2014	Actual Apr–Dec 2013
Deficit[2]	**176,2**	**124,5[3]**	**152,1[3]**
Plus: Cost/profit on revaluation of foreign debt at redemption[4]	5,9	5,3	5,4
Net borrowing requirement	**182,1**	**129,7**	**157,5**
Treasury bills	23,0	44,2	25,8
Domestic government bonds	128,5	116,6	134,1
Other financing[5]	–	-17,0	-12,8
Foreign bonds and loans	7,2	14,2	6,4
Change in available cash balances[6]	23,4	-28,2	3,8
Total net financing[7]	**182,1**	**129,7**	**157,5**

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

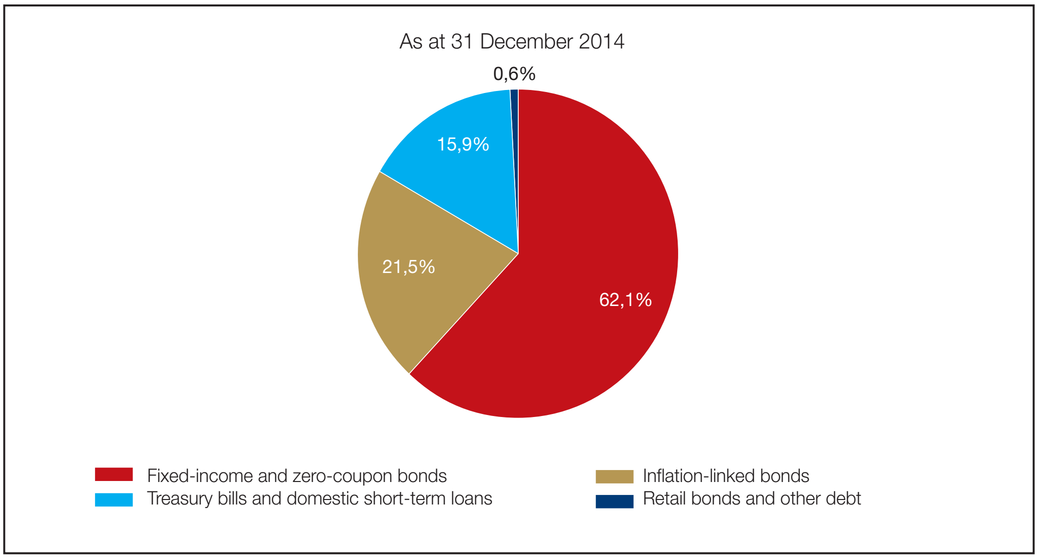
Treasury bills were issued at an average interest rate of 6,1 per cent in the first three quarters of fiscal 2014/15, whereas conventional bonds were sold at an average yield of 8,2 per cent and inflation-linked bonds at an average real yield of 1,8 per cent per annum. Between March and December 2014, the average outstanding maturity of national government's domestic marketable bonds increased from 154 to 162 months.

Net issues to the value of R14,2 billion were recorded in foreign bonds and loans during April–December 2014, in the process extending the average remaining maturity of foreign marketable bonds from 95 months at the end of March 2014 to 117 months as at 31 December 2014.

National government cash balances rose by R28 billion in the first nine months of the current fiscal year, bringing these balances to R235 billion at the end of December 2014. Deposits with the Bank increased by R9 billion to R162 billion between March and December 2014.

Composition of domestic debt of national government

Per cent



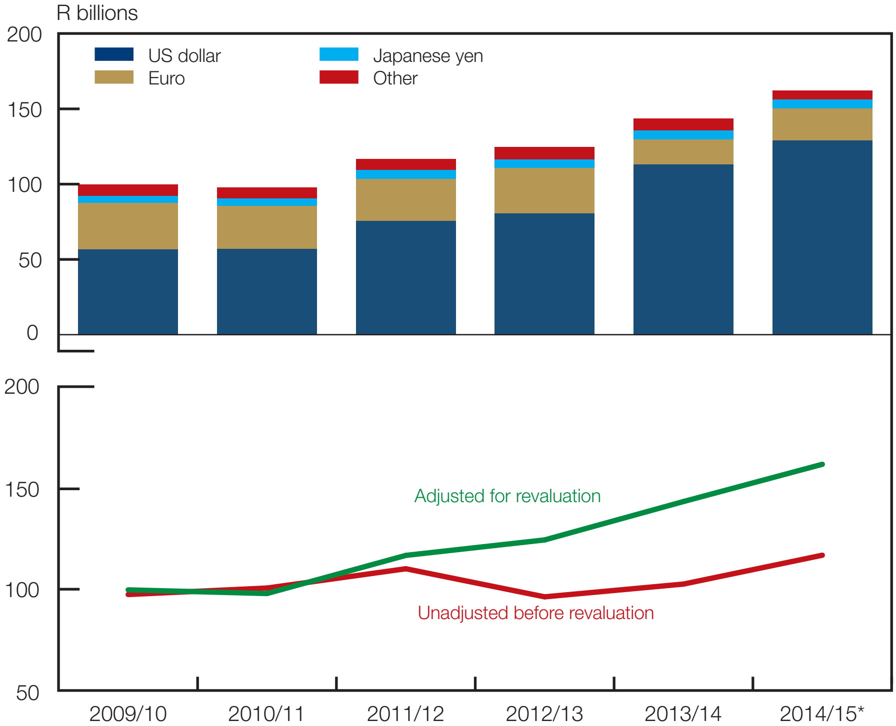
The national government's domestic debt increased from R1 441 billion as at 31 March 2014 to R1 626 billion as at 31 December 2014. Higher issuances of domestic short-term loans and government bonds contributed to the considerable rise in the domestic debt of national government. Domestic debt continued to account for about 90 per cent of total gross loan debt, with foreign debt accounting for the balance.

Between March and December 2014, foreign debt of national government increased from R144 billion to R162 billion. The increase in foreign debt emanated from both the issuance of new bonds and revaluation effects as the weaker exchange rate of the rand raised the rand value of debt commitments denominated in foreign currency.

Foreign debt, before taking into account revaluation effects, amounted to R117 billion as at 31 December 2014. The difference between foreign debt valued at historical exchange rates (when the debt instruments were issued) and foreign debt valued at prevailing exchange rates amounted to R45 billion as at 31 December 2014. The widening of the gap can be attributed to a further weakening of the rand during December 2014.

Total gross loan debt of national government, which includes domestic and foreign debt, increased sharply from R1 585 billion at the end of March 2014 to R1 788 billion as at 31 December 2014. During the period under review total gross loan debt as a share of gross domestic product increased from 43,9 per cent to 47,1 per cent.

National government foreign debt



As at 31 March of each fiscal year

* As at 31 December 2014

The Budget for fiscal 2015/16 to 2017/18

Fiscal policy stance

The Minister of Finance tabled his first National Budget in Parliament on 25 February 2015. The *Budget* gave expression to the strategy announced in the October 2014 *MTBPS*, where a policy path was provided that narrows the budget deficit from both the revenue and expenditure side, thereby stabilising the government debt ratio over the medium to longer term. In the February 2015 *Budget* this policy path was refined further and details of the measures proposed to narrow the deficit were provided.

While fiscal policy had supported the economic recovery for the past several years, the countercyclical approach had reached its limits as the budget deficit was largely structural and could thus not be adequately reduced through a cyclical upturn in revenues. Part of the main fiscal policy thrust was building an economy for the future in the wake of slower growth by improving the long-term health of public finances, addressing the electricity constraint and building a sustainable and innovative economy with emphasis on investment-led growth, while sustaining the social gains of democracy.

The fiscal outlook presented in the *Budget* reflected downward revisions to economic growth, with lower revenue expected to be collected over the medium term compared with the projections published in October 2014. Projected real growth in gross domestic product was revised downwards for the fifth consecutive year. On the other hand the projections also incorporated the significant decline in oil prices and its favourable impact on inflation and South Africa's terms of trade. Government was actively managing risks to the fiscal outlook, which included weaker-than-expected growth in gross domestic product, higher-than-inflation increases in the wage bill, and weaker balance sheets of state-owned companies.

Since the start of the global financial crisis in 2008, increased expenditure had been sustained by a wider budget deficit to cushion the economy. From the 2017/18 fiscal year real growth in expenditure would become more closely aligned with long-term average growth in gross domestic product. This reform was expected to bolster fiscal sustainability, while allowing the budget to play a more predictable role in stabilising the economy.

The budget allocations reflected government's continued commitment to prioritise infrastructure investment and social programmes that support those citizens most in need. Total public-sector infrastructure spending of R813 billion was projected over the next three years.

As identified in the National Development Plan (NDP), poverty needed to be eliminated and inequality reduced. Therefore, South Africa would require much higher levels of economic growth, supported by accelerated implementation of structural reforms. Working together – government, business, labour and civil society – would speed up these reforms over the period ahead.

Netting national government revenue and expenditure would result in a cash-book deficit of R181 billion in fiscal 2014/15 – some R1,1 billion higher than the original budget deficit. Government was committed to reducing the budget deficit over the medium term by decreasing the expenditure ceiling by R25 billion over the next two years, increasing taxes, strengthening budget preparation and expenditure controls, containing personnel numbers and ensuring that the financing of state-owned companies did not increase national government's budget deficit.

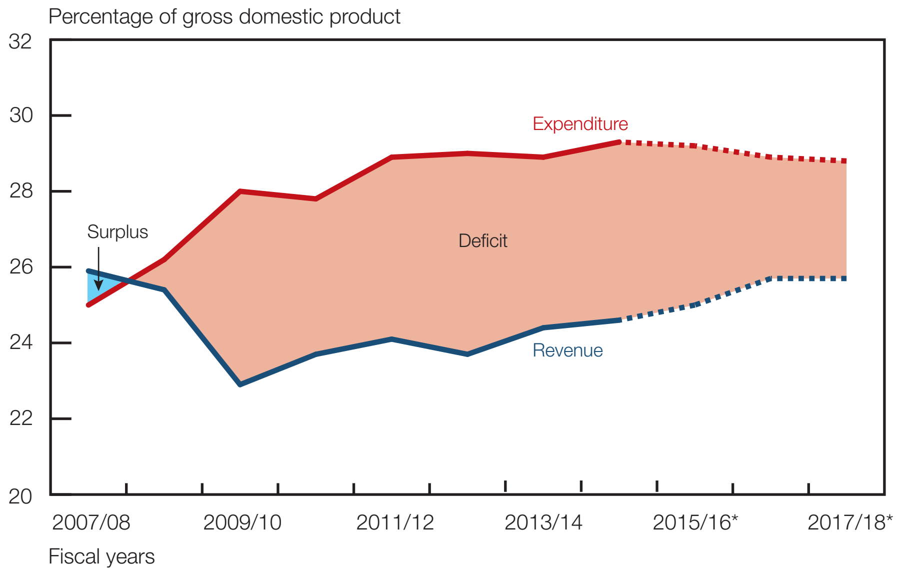
The following table shows the revised main budget estimates for fiscal 2014/15 and the three-year budget period.

Main budget estimates[1], February 2015

Component	2014/15		2015/16		2016/17		2017/18	
	R bn	Annual change (Per cent)	R bn	Annual change (Per cent)	R bn	Annual change (Per cent)	R bn	Annual change (Per cent)
Expenditure	1 135,1	8,3	1 222,3	7,7	1 309,9	7,2	1 420,9	8,5
State debt cost[2]	115,0	13,7	126,4	9,9	141,0	11,5	153,4	8,8
Current payments..................	191,0	6,3	197,9	3,6	210,6	6,4	222,7	5,7
Transfers and subsidies	810,3	8,1	873,0	7,7	925,6	6,0	980,1	5,9
Payments for capital assets...	15,5	10,4	16,7	8,0	17,4	4,2	19,3	11,1
Payments for financial assets[3]	3,4	0,2	3,4	-0,5	0,3	-89,7	0,4	5,7
Contingency reserve and unallocated funds	-	-	5,0	-	15,0	-	45,0	-
Expenditure as ratio of GDP	*29,3%*		*29,2%*		*28,9%*		*28,8%*	
Revenue	954,3	7,6	1 049,3	10,0	1 166,0	11,1	1 265,4	8,5
Revenue as ratio of GDP.......	*24,6%*		*25,0%*		*25,7%*		*25,7%*	
Tax revenue (net of SACU[4] payments)	927,3	8,2	1 030,3	11,1	1 142,7	10,9	1 244,3	8,9
Non-tax revenue[5]..................	27,0	-11,8	19,0	-29,5	23,3	22,4	21,1	-9,3
Budget balance[6] before borrowing and debt repayment	-180,9		-173,1		-144,0		-155,5	
Balance as ratio of GDP	*-4,7%*		*-4,1%*		*-3,2%*		*-3,2%*	
Balance as ratio of GDP: October 2014 MTBPS[7].........	*-4,1%*		*-3,2%*		*-3,0%*			

1 Components may not add up to totals due to rounding
2 Includes interest, management cost and the cost of raising loans
3 Consists mainly of lending to public corporations or making equity investments in them for policy purposes; previously included in transfers and subsidies
4 Southern African Customs Union
5 Including extraordinary receipts
6 Deficit – surplus +
7 *Medium Term Budget Policy Statement 2014*

National government finance



* *Budget Review 2015*

The tax measures introduced in the 2015 *Budget* to raise more revenue included:

- an increase in personal income taxes for middle and high income earners, with the top marginal rate rising from 40 per cent to 41 per cent;
- an increase in the taxes and levies on fuel;
- Higher taxes on alcohol and tobacco; and
- an increase in transfer duty on more expensive properties; and
- an increase in the electricity levy from 3,5c/kWh to 3,5c/kWh.

As a ratio of gross domestic product, the cash-book deficit of national government was projected to amount to 4,7 per cent in fiscal 2014/15. The package of measures introduced in the 2015 *Budget* would reduce this to 4,1 per cent in 2015/16, and a deficit of 3,2 per cent was projected for both the outer years of the planning horizon; this gradual reduction of the deficit was seen as supporting growth.

In fiscal 2014/15, the primary balance was estimated to reach a deficit of 1,7 per cent of gross domestic product. This could be compared with a deficit ratio of 1,6 per cent recorded in fiscal 2013/14. The primary deficit as a ratio of gross domestic product was projected to narrow over the medium-term period, averaging 0,4 per cent.

Government's borrowing plans over the three-year planning horizon continued to reflect a prudent approach to accumulating and managing debt. The domestic capital market would remain the main source of financing over the medium term. In conjunction with the JSE, the Financial Services Board and other market participants, government planned to introduce a new electronic trading platform for government bonds to promote transparency and liquidity.

National government financing

R billions

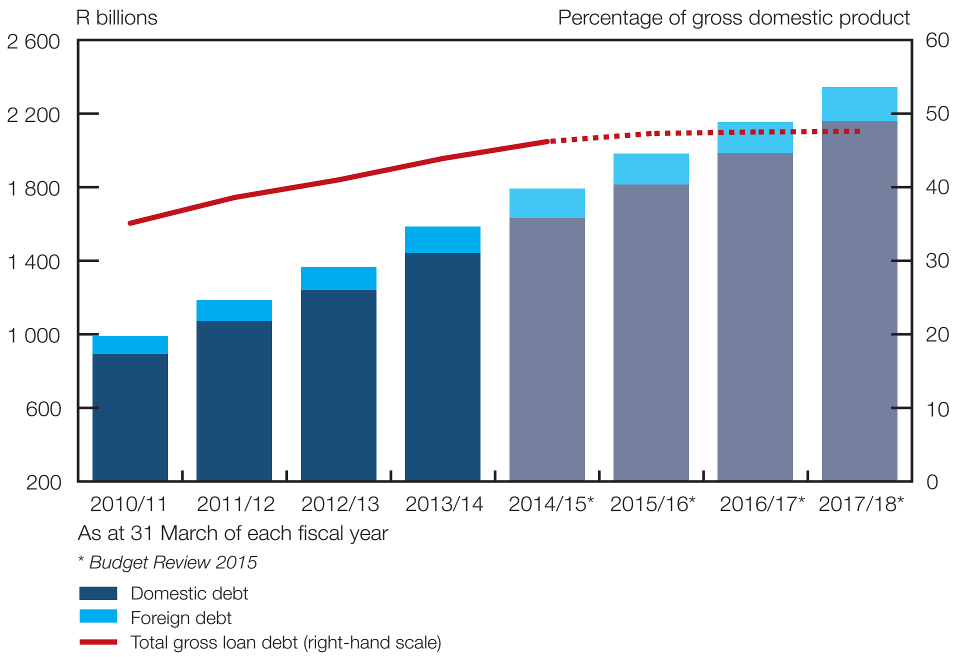
Item or instrument	Revised estimate	Medium-term estimates		
	2014/15	2015/16	2016/17	2017/18
Deficit/net borrowing requirement	**180,9**	**173,1**	**144,0**	**155,5**
Treasury bills	10,0	13,0	20,0	40,0
Domestic government bonds (net)[1]	156,4	144,8	115,6	97,7
Foreign bonds and loans (net)[2]	8,4	7,8	4,2	13,4
Changes in cash and other balances[3]	6,0	7,4	4,1	4,4
Total net financing[4]	**180,9**	**173,1**	**144,0**	**155,5**

1 Including retail bonds
2 Including revaluation of foreign bonds and loans
3 Increase – decrease +
4 Components may not add up to totals due to rounding

Domestic short-term borrowing consists of Treasury bill issuance and borrowing from the public sector through the Corporation for Public Deposits, into which provinces and some state-owned companies are required to invest their surplus cash. Over the medium term, Treasury bill issuance was expected to increase from R13 billion in fiscal 2015/16 to R40 billion in fiscal 2017/18.

In fiscal 2014/15, investment in government's retail bonds amounted to R2,3 billion, of which R1 billion was the reinvestment of maturing bonds and capitalised interest. Government would consider introducing additional retail bond products to help improve the country's saving culture. A total of R9 billion is currently invested in these bonds.

Total gross loan debt of national government



Gross loan debt of national government was projected to amount to R1 791 billion in fiscal 2014/15, or 46,2 per cent of gross domestic product. Over the medium term, gross loan debt relative to gross domestic product was expected to average 47,5 per cent, with the level of debt rising to R2 345 billion by the end of March 2018.

Total public-sector debt – the summation of national government gross loan debt and the debt of state-owned companies and local government – equalled 59,1 per cent of gross domestic product in fiscal 2013/14. While this figure was expected to increase, it would do so more slowly, in line with slower government debt accumulation and lower borrowing by state-owned companies.

Public-sector borrowing requirement*

R billions

Level of government	Revised estimate	Medium-term estimates		
	2014/15	2015/16	2016/17	2017/18
National government	180,9	173,1	144,0	155,5
Public entities (extra-budgetary institutions)	-5,7	0,3	0,6	-3,0
Social security funds	-19,0	-11,6	-27,8	-29,6
Provincial governments	-2,9	-0,2	-0,6	-1,7
Local authorities	9,0	9,5	9,8	10,0
General government borrowing**	162,3	171,1	126,0	131,2
Percentage of gross domestic product	*4,2%*	*4,1%*	*2,8%*	*2,7%*
Non-financial public enterprises and corporations	85,4	83,8	65,3	61,5
Public-sector borrowing requirement**	247,7	254,9	191,3	192,7
Percentage of gross domestic product	*6,4%*	*6,1%*	*4,2%*	*3,9%*
Estimated gross domestic product	3 879,9	4 191,8	4 538,8	4 926,1

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

Over the three-year projection period, consolidated government expenditure was expected to increase by 7,9 per cent from R1 243 billion in fiscal 2014/15 to R1 562 billion in 2017/18, although it would not be uniform across all functions. Real spending would grow by an annual average of 2,5 per cent over the next three years. At an annual average of 10,1 per cent, debt-service cost was the fastest-growing item of expenditure, driven by the increase in government borrowing since fiscal 2008/09.

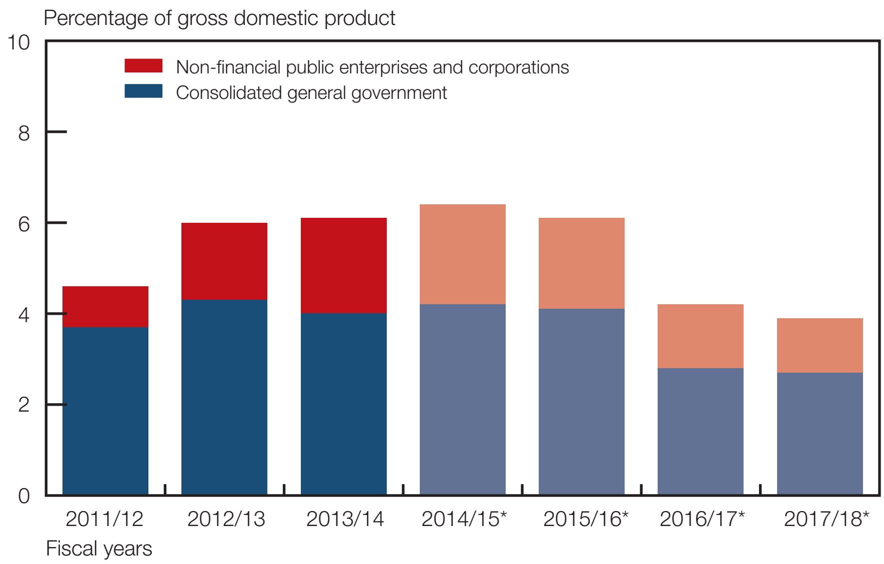
Fiscal constraints meant that transfers to provincial and local governments would grow slower in the period ahead than it had been in the past. National government transfers to provinces would increase from R440 billion in fiscal 2014/15 to R468 billion in fiscal 2015/16, accelerating further to R526 billion in fiscal 2017/18. Provincial transfers would grow at an average annual rate of 6,2 per cent over the medium term. Conditional grants administered and transferred by national departments to their provincial counterparts would total R274 billion over the same period.

Changes to conditional grants in the 2015 *Budget* included the creation of a *maths, science and technology grant* to replace the *Dinaledi school grant* and the *technical secondary schools recapitalisation grant.* The new grant would allow the Department of Basic Education to provide a more comprehensive programme of support to schools to improve teaching and learning outcome in maths, science and technology.

Social grant expenditure increased, yet remained stable at 3,0 per cent of gross domestic product. Grant beneficiary numbers associated with the recent re-registration of grants had been unusually high, and caused government to consider moderate increases in social grants in line with inflation projections. The issue would be reviewed in the build-up to the October *2015 MTBPS*.

Transfers to local government make up 9 per cent of the total division of revenue in the form of equitable and conditional grants over the medium term. Over the next three years, municipalities needed to reduce spending on non-core items and renew their focus on delivering basic services. To this end, the Minister of Cooperative Governance and Traditional Affairs announced the 'Back to Basics' initiative, an approach to improve the performance of local government.

Public-sector borrowing requirement



* *Budget Review 2015*

The public-sector borrowing requirement was forecast to decline from 6,4 per cent of gross domestic product in fiscal 2014/15 to 3,9 per cent in fiscal 2017/18. The higher borrowing requirement in fiscal 2014/15 reflected the higher borrowing plans by state-owned companies.

The consolidated government deficit was partially offset by surpluses accumulated by social security funds, provincial governments as well as other public entities. Social security funds continued to hold large cash surpluses, with their cash surplus projected to increase from R19 billion in fiscal 2014/15 to R29,6 billion in fiscal 2017/18.

The borrowing requirement of non-financial public enterprises and corporations was projected to increase slightly as a percentage of gross domestic product, from 2,1 per cent in fiscal 2013/14 to 2,2 per cent in fiscal 2014/15, but then to trend downwards and average 1,5 per cent over the medium term.

Over the medium term, capital expenditure by state-owned companies was projected to reach R362 billion with Eskom, Transnet and the South African National Roads Agency Limited (SANRAL) accounting for the bulk of the expenditure. Capital programmes were projected to increase the debt of state-owned companies by R79 billion in fiscal 2015/16. Nevertheless, these companies' capital expenditure continued to exceed their incurrence of new debt.

Statement of the Monetary Policy Committee

29 January 2015

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 inflation outlook has been dominated by the further decline in international oil prices, from around US$75 per barrel in late November to current levels of around US$46 per barrel. Domestic petrol prices declined by almost R2 per litre over the period (and over R3 per litre since August), and a further sizeable decrease is expected in February. This decline in domestic prices occurred despite some offsetting effects from a further depreciation of the rand against the US dollar.

The near-term inflation outlook has therefore changed significantly, but the favourable impact of these developments on both inflation and growth in the longer term will depend on the persistence of the oil price decline. Even a moderate increase in oil prices going forward will reverse the favourable inflation trajectory, and the inflation and growth benefits, while welcome, are expected to be temporary. At the same time, the impact of load shedding and a deterioration of the global growth outlook are likely to offset some of the positive impacts of the lower petrol price on domestic growth.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas maintained its recent downward trend and measured 5,8 per cent and 5,3 per cent in November and December respectively, down from its recent peak of 6,6 per cent in May and June 2014. This trend reflected continued moderation in food and petrol prices. Food price inflation measured 7,4 per cent in December, down from 7,7 per cent in November, while petrol prices declined by 5,5 per cent. By contrast, core inflation, which excludes food, petrol and electricity, remained near the upper end of the inflation target range, but moderated to 5,7 per cent in December from 5,8 per cent previously.

Headline producer price inflation for final manufactured goods was also favourably impacted by declining oil and agricultural crop prices, and measured 6,5 per cent and 5,8 per cent in November and December respectively compared with 6,9 per cent and 6,7 per cent in the preceding two months.

The decline in international oil prices has prompted a downward revision of the oil price assumption in the Bank's forecasting model, with a significant impact on the near-term inflation forecast. The longer term impact will be dependent on the persistence of these lower prices, which have been a reaction to global supply and demand factors as well as a change in the behavior of key oil producers. With supply still plentiful and global growth prospects remaining relatively subdued, lower oil prices are expected to persist for some time. However, our forecast makes provision for a moderate increase over the next two years.

Having averaged 6,1 per cent in 2014, inflation is now expected to average 3,8 per cent in 2015, compared with the previous forecast of 5,3 per cent, and to reach a low of 3,5 per cent in the second quarter of this year compared with 5,1 per cent previously. The steep decline in 2015, however, produces a strong base effect in 2016, and, when combined with a slightly higher oil price assumption and a depreciated nominal effective exchange rate of the rand, results in an average inflation forecast of 5,4 per cent for the year (5,5 per cent previously), and 5,3 per cent in the final quarter.

The impact on core inflation is far less pronounced. Core inflation is expected to average 5,5 per cent and 5,1 per cent in 2015 and 2016 respectively, from 5,7 per cent and 5,3 per cent previously. The peak is expected at 5,8 per cent in the first quarter of 2015.

Inflation expectations as reflected in the survey conducted by the Bureau for Economic Research at Stellenbosch University moderated from 6,1 per cent in the third quarter of 2014 to 5,8 per cent in the final quarter. Analysts and trade unionists revised their forecasts for 2015 downwards by 0,3 percentage points to 5,4 per cent and 5,9 per cent respectively, while the forecasts of business people were 0,2 percentage points lower at 6,2 per cent. Forecasts for 2016 are unchanged for the latter category, but both analysts and trade unionists expect a 0,1 percentage point increase in 2016 relative to 2015. While this downward revision is a welcome development, it is too early to assess whether or not this represents the start of a sustained downward trend. At these levels, expectations still remain uncomfortably close to the upper end of the target range.

According to the Reuters poll of economic analysts conducted in January 2015, the median inflation expectation is 5,0 per cent in 2015, rising to 5,5 per cent in 2016. The low point of the inflation trend is expected in the second quarter, with the median at 4,6 per cent, but with expectations ranging from 3,4 per cent to 5,9 per cent. Inflation expectations as reflected in inflation-linked bonds have been volatile, having increased in response to the weaker exchange rate in November 2014, but since mid-December have exhibited a steep decline. Both the 5-year and 10-year break-even rates have declined to levels below 5,5 per cent.

The global economic growth outlook remains mixed, despite a strong performance by the United States (US) economy, lower international oil prices and the quantitative easing announced by the European Central Bank (ECB). The US economy grew at an annualised rate of 5,0 per cent in the third quarter of 2014, the fastest quarterly growth since 2003. The unemployment rate continued to decline as job creation accelerated, and lower oil prices have provided a boost to consumption expenditure. Growth in the United Kingdom (UK) also remains robust, despite slower fourth-quarter growth. By contrast, growth prospects in a number of other advanced economies have deteriorated, with Japan in a technical recession and the eurozone remaining weak amid fears of deflation.

Lower oil and other commodity prices have had divergent implications for growth forecasts of different emerging-market economies. Deteriorating prospects in some emerging markets contributed to the lowering of the International Monetary Fund's (IMF) 2015 global growth forecast by 0,3 percentage points to 3,5 per cent, with notable downward revisions to Brazil, China, Mexico, Nigeria and Russia. Growth in China is now expected to moderate to 6,8 per cent from 7,4 per cent in 2014 as the economy continues to rebalance towards domestic consumption and reduce vulnerabilities in its banking system. Although Africa remains one of the high-growth regions, weaker commodity prices pose a risk to the outlook.

The impact of lower oil prices on global inflation is expected to influence monetary policy responses. Although the US Federal Reserve (the Fed) has indicated that policy rates are still likely to rise from around the middle of the year, recent market expectations are pricing in a later start, as inflation remains low. Furthermore, Fed guidance suggests that normalisation, when it does begin, is likely to be at a gradual pace. Whereas the UK had been expected to be the first of the advanced economies to begin raising policy rates in the first half of this year, the lower expected inflation trajectory has changed expectations to later in 2015 or early 2016.

While the UK and US contemplate monetary tightening, the ECB has embarked on open-ended quantitative easing, amid risks of deflation, and the slowdown in Japan is also expected to result in a resumption of asset purchases. Since the previous meeting of the MPC, monetary policy rates have been lowered in Canada, China, Denmark, Egypt, India, Norway, Switzerland and Turkey, while policy has been tightened in Brazil, Nigeria and Russia.

Global foreign-exchange market volatility increased in recent weeks in anticipation of quantitative easing by the ECB; possible risks to the euro from the Greek elections; the ending of the Swiss franc floor against the euro; and changing expectations regarding the timing and pace of US policy normalisation. Since the previous MPC meeting, the euro has depreciated by about 10 per cent against the US dollar. Over the same period, the rand depreciated by 5 per cent against the US dollar and by 1,5 per cent against the pound sterling, but appreciated by about 6 per cent against the euro. Given the relatively high weight of the euro in the trade-weighted index, the nominal effective exchange rate of the rand depreciated by 0,6 per cent.

Market perceptions of a possible delay in US normalisation, coupled with the ECB action, has changed global market risk sentiment and improved the near-term prospects for capital flows to emerging markets. This follows a generalised sell-off in December. These flows are likely to be highly volatile and expected to be more discriminating than in the past. The spill-over effects of the ECB quantitative easing on the rand are therefore not expected to be as pronounced as was the case with the US quantitative easing.

Capital flows to South Africa have been in line with these global developments. During December 2014, non-resident net sales of bonds and equities amounted to R17,9 billion and R8,2 billion respectively. This trend reversed in late December, as portfolio flows to emerging markets resumed, and in the first three weeks of January 2015, non-residents were net purchasers of bonds to the value of R5,8 billion, while net equity sales amounted to R1,5 billion.

The rand has also been affected by domestic factors, including the disappointing domestic growth and current-account deficit outcomes, as well as a resumption of load shedding by Eskom. The rand is expected to remain sensitive to developments on the current account of the balance of payments, which measured 6,0 per cent of gross domestic product (GDP) in the third quarter of 2014. Non-oil commodity prices have been on a declining trend since around 2011, so the recent decline in the oil price represents a positive terms of trade shock that could have a favourable impact on the current account. However, this effect is expected to be limited, in part due to the possible constraining effects of load shedding on exports.

The domestic economic growth outlook remains subdued. Despite an expected growth acceleration in the fourth quarter of 2014 following an annualised growth rate of 1,4 per cent in the previous quarter, growth for 2014 is expected to average 1,4 per cent, with at least 1 percentage point lost to work stoppages. The Bank's forecast for growth in 2015 has been revised down from 2,5 per cent to 2,2 per cent, and that for 2016 from 2,9 per cent to 2,4 per cent. This forecast attempts to take account of electricity-supply disruptions which more than offset the positive growth impact of lower oil prices. The Bank's composite business cycle indicator has followed a moderate downward trend in the past months, confirming the subdued outlook. More positively, the Rand Merchant Bank/Bureau for Economic Research (RMB/BER) Business Confidence Index returned to net positive levels for the first time since the first quarter of 2013, when it increased by 5 points to 51 index points in the fourth quarter of 2014.

The mining sector, which expanded output by 6,2 per cent on a three-month-to-three-month basis in November, is expected to contribute positively to fourth-quarter growth, despite the 1,2 per cent month-to-month contraction in that month. Nevertheless, platinum output still remains below pre-strike levels, and the sector is likely to face headwinds in 2015 from lower commodity prices and electricity-supply uncertainty. The outlook for the manufacturing sector, which contracted for three consecutive quarters, is looking more positive following the resolution of the strikes in the sector, with a three-month-to-three-month increase in November of 4,1 per cent. However, output declined by 2,1 per cent on a month-to-month basis due to electricity-supply disruptions. The Kagiso Purchasing Managers' Index (PMI) declined to 50,2 index points in December from 53,3 points in November, indicating an expectation of positive but subdued growth in the sector.

Although gross fixed capital formation was the largest contributor to GDP growth in the third quarter of 2014, the trend remains weak. Growth in gross fixed capital formation measured 2,1 per cent in the third quarter of 2014 following two consecutive quarters of contraction. While the private sector investment reversed its negative trend in the previous two quarters, at 0,7 per cent it remains extremely low.

The weak growth and investment trends are reflected in the slow rate of formal sector employment creation. According to the Quarterly Employment Survey of Statistics South Africa, employment levels decreased by 5,9 per cent on a seasonally adjusted basis in the third quarter of 2014, mainly due to the termination of temporary employment contracts related to the general elections in the second quarter. This contributed to the annualised 20,8 per cent decline in public-sector employment, while private-sector employment over the quarter increased by 0,1 per cent or 2 000 jobs. Compared with a year ago, employment increased by 1,0 per cent, predominantly in the public sector.

Growth in real final consumption expenditure by households remains weak, despite a slight acceleration in the third quarter of 2014 to 1,3 per cent from 1,1 per cent in the previous quarter. However, expenditure on durable goods increased at an annualised rate of 6,2 per cent, and reflected in stronger new vehicle sales. Retail trade sales improved in November with a month-to-month increase of 1,5 per cent, and year-on-year by 2,6 per cent. Consumption expenditure is expected to get some boost from lower petrol prices. Consumer confidence, while still relatively low, also showed a slight improvement in the fourth quarter of 2014, having increased to a level of zero from the previous level of -1.

Trends in bank credit extension to the private sector continue to reflect tight conditions for households while credit to the corporate sector remains buoyant. Growth over twelve months in total loans and advances to the private sector measured 8,7 per cent in November. However, growth in loans to households, which has been steadily declining over the year, reached a low of 3,6 per cent in November 2014, while that to the corporate sector recorded 15,2 per cent. Growth in general loans to the private sector, mainly unsecured lending, remains weak, despite an increase to 2,9 per cent in November, growth in instalment sale credit and leasing finance moderated further to 6,1 per cent, while mortgage advances continued to grow below 3 per cent in line with the subdued housing market. These trends are assessed to be a reflection of both continued tight credit conditions and weak demand, as household indebtedness remains high.

Wage settlements indicate a continuation of above-inflation wage and salary increases. According to Statistics South Africa data, nominal remuneration per worker in the formal non-agricultural sector increased at a year-on-year rate of 6,9 per cent in the third quarter of 2014. With labour productivity growth of 0,3 per cent, growth in nominal unit labour costs amounted to 6,7 per cent in the quarter. According to Andrew Levy Employment Publications, the average settlement rate in collective bargaining agreements amounted to 8,1 per cent in 2014, compared with 7,9 per cent in 2013. The outcome of the public-sector wage settlement, due to be implemented in April, is expected to have an important bearing on the general trend of wage settlements in the economy in 2015.

Food prices remain a major source of inflation pressure with increases still in excess of the headline inflation rates. However, the moderation observed in recent months is expected to continue, despite the reversal of the downward trend in manufactured food prices at the producer level since October. Agricultural food price inflation remains low, having measured 1,4 per cent in December, with a bumper maize crop expected this year. Global food prices have continued to decline, with the Food and Agriculture Organization's food price index declining by 3,7 per cent in 2014.

The inflation landscape has changed significantly in recent weeks, but the outlook for international oil prices is highly uncertain. Unless a persistent oil price decline is assumed, the impact on the inflation trajectory will dissipate over time. The key issue for the MPC is the extent to which second round effects become evident and lead to a more generalised inflation moderation over the forecast period, and to a further and sustained decline in inflation expectations. The forecast of core inflation at this stage indicates a relatively muted decline in underlying inflation.

The rand exchange rate against the US dollar remains an upside risk to the inflation outlook and is vulnerable to the timing and pace of US policy normalisation, despite the partial offset from a weaker euro. Further depreciation of the rand against the US dollar could also erode the positive benefits of lower oil prices on inflation. The slow pace of contraction of the current account will continue to keep the rand sensitive to both domestic and external factors.

Along with the exchange rate, wage and salary increases in excess of inflation and productivity growth remain an upside risk to the inflation outlook. Unless nominal wage increases moderate in the lower inflation environment, the beneficial effects of the depreciated currency on competitiveness will be eroded. The MPC views the overall risks to the inflation outlook to be more or less balanced, with no evidence of excess demand pressures on inflation.

Notwithstanding a downward revision to the growth forecast, the risks are assessed to be moderately on the downside. This is due to the likely protracted nature of the electricity supply constraints, and their consequences for domestic output, as well as for business and consumer confidence. However, given the supply-side nature of this constraint, the impact of further monetary policy accommodation on growth is likely to be limited, in the absence of progress being made in the alleviation of electricity constraints. In addition, the implementation of structural reforms is necessary to raise potential growth.

For some time we have emphasised that we are in a process of interest rate normalisation. The lower inflation path gives us some room to pause in this process, particularly against the backdrop of continued weakness in the economy. The MPC has therefore unanimously decided to keep the repurchase rate unchanged at 5,75 per cent per annum.

The MPC is aware that the moderation in inflation could raise expectations of lower interest rates. The MPC is of the view that the bar for further accommodation remains high and would require a sustained decline in the inflation rate and inflation expectations.