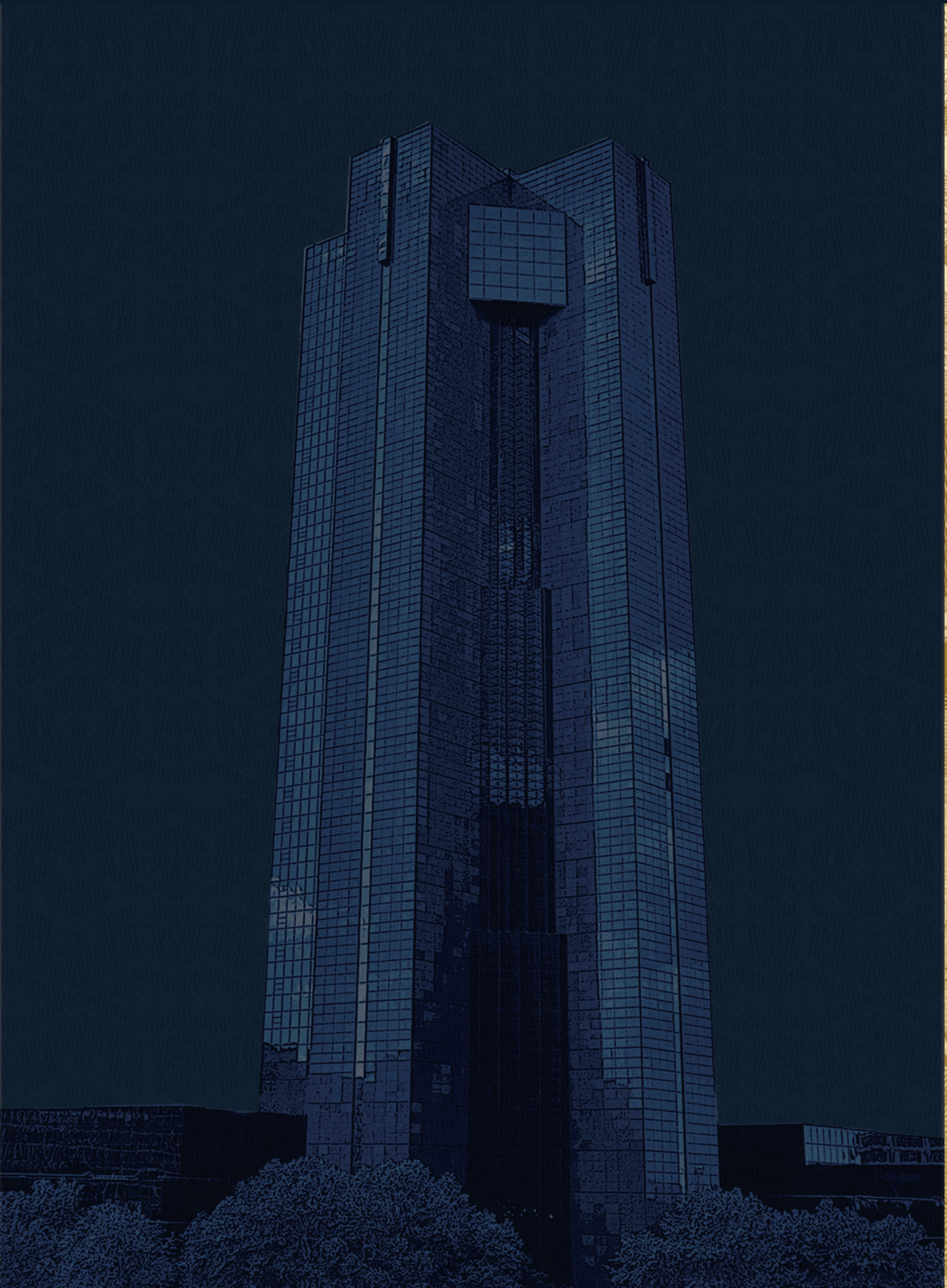
Quarterly Bulletin

December 2016



South African Reserve Bank

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Introduction

Real growth in the global economy accelerated somewhat in the third quarter of 2016 as both the advanced and the emerging-market economies gained some traction, led by the United States (US) and India. World trade volumes remained lustreless. In the major advanced economies inflation accelerated somewhat but still remained very low, largely shrugging off the impact of the recovery in international commodity prices from their January lows and allowing central banks to maintain their ultra-accommodative monetary policies. In the emerging-market economies inflation was generally higher, but with considerable variation in inflation outcomes and monetary policies.

Towards the end of 2016, the election of a new US president favouring major policy changes, including more protectionism and greater emphasis on domestic infrastructure brought further uncertainty to global financial markets. The Organization of the Petroleum Exporting Countries (OPEC) also agreed to cutbacks in oil production, which bolstered international oil prices and is set to add to cost-push inflation.

In South Africa the erratic pattern of economic activity continued, with real economic growth slowing notably in the third quarter of 2016 to a mere 0,2 per cent. The deterioration was largely brought about by a contraction in manufacturing output, with the most pronounced declines registered in the subsectors producing petroleum, basic iron and steel, and motor vehicles. Against a background of weak manufacturing activity, a fairly moderate winter and higher real electricity prices, electricity production also contracted during the quarter under review. Real value added by the tertiary sector rose at a slower pace in the third quarter as activity in the retail and motor-trade subsectors declined and the pace of growth in the finance and transport subsectors slowed. Production by government benefitted from the temporary activities related to the local government elections held in August 2016. With agricultural production also in the doldrums in the wake of widespread drought conditions, only the mining sector managed a firm increase in real value added in the third quarter as iron ore, diamond and copper mines raised their output.

Viewed from the expenditure side, the main reason for the deterioration in the rate of growth in real gross domestic product (GDP) in the third quarter of 2016 was a sharp decline in real net exports, reversing the strong positive contribution that this expenditure component had made in the preceding quarter. Consumption and capital spending outcomes improved somewhat in the quarter under review.

The pace of growth in real consumption expenditure by both government and households accelerated in the third quarter of 2016. Government stepped up its real outlays to facilitate the local government elections held in August. Household spending progressed at a stronger rate than disposable income, buoyed by purchases of non-durable goods and services. Growth in real spending by households on semi-durable goods moderated during the quarter under review, while purchases of durable goods contracted further, albeit at a slower rate than before. This largely reflected a reduction in expenditure on personal transport equipment and computers. Relative to disposable income, households managed to reduce their indebtedness further, continuing the debt consolidation trend that had started at the time of the global financial crisis.

Real gross fixed capital formation registered its fourth successive quarterly decline in the third quarter of 2016, albeit at a slower pace than before. With business confidence low and economic activity weak, capital outlays by the private sector contracted marginally. Real fixed capital expenditure by public corporations also edged lower during the quarter under review. By contrast, general government raised its real capital expenditure as the improvement of national and provincial roads continued. Inventory investment turned positive in the third quarter as firms in the mining, trade and transport sectors raised their stock levels.

As a counterpart to the poor economic growth outcome, employment creation remained subdued and the official unemployment rate increased to a record-high level in the third quarter of 2016. Wage settlements moderated slightly in the first three quarters of the year but remained above the rate of consumer price inflation. Since mid-2016, the twelve-month rate of consumer price inflation has again accelerated to levels moderately above the upper limit of the inflation target range, pushed higher by food prices which reflected the impact of the drought alongside a depreciated exchange rate of the rand. However, with international food price inflation fairly well-behaved and the exchange value of the rand having staged a recovery recently, some of the food-related inflationary pressures may be expected to moderate in the near future.

The exchange rate of the rand depreciated rapidly towards the end of 2015 and in early 2016 as political events eroded confidence, adding to the woes of declining international prices of export commodities and deteriorating terms of trade. However, the prices of South Africa's key export commodities have risen significantly since their January 2016 lows, the terms of trade has strengthened, and the conclusion of a large international mergers and acquisitions transaction has improved sentiment towards the rand, contributing to a notable recovery in the effective exchange rate. Against this backdrop, the trade balance switched from a sizeable surplus in the second quarter of 2016 to a small deficit in the third quarter as the extraordinarily high platinum exports of the second quarter, achieved by processing and drawing down inventories, normalised. Both the value and the volume of exports fell back in the third quarter of 2016 while imports also receded, primarily on account of weak domestic demand. Simultaneously the shortfall on the services, income and current transfer account widened slightly as net payments for services increased. As a result, the deficit on the current account of the balance of payments widened to 4,1 per cent of GDP.

The current account deficit was financed through a mix of financial flows, of which inward portfolio investment made the largest contribution in the quarter under discussion. Under these circumstances, the authorities also accumulated more international reserves towards the end of the year. South Africa's international investment position remained positive as the country's overall foreign assets exceeded its foreign liabilities.

The banking sector's balance sheet continued to expand quite slowly in the year to date, with both the broad money supply and bank advances to the private sector registering single-digit year-on-year growth rates. Advances to households remained subdued whereas advances to companies displayed more vibrant growth, most notably advances to electricity firms and to entities involved in transport and communication. With house prices recording fairly slow rates of increase, low residential property turnover and little job creation, mortgage lending continued to lack momentum.

Turnover in the financial markets was brisk in the third quarter of 2016, with some repositioning prompted by factors such as swings in sentiment, fluctuations in financial rates, and the decision of the British electorate to leave the European Union. Nonetheless, overall domestic share prices have been fluctuating essentially sideways over the past two years.

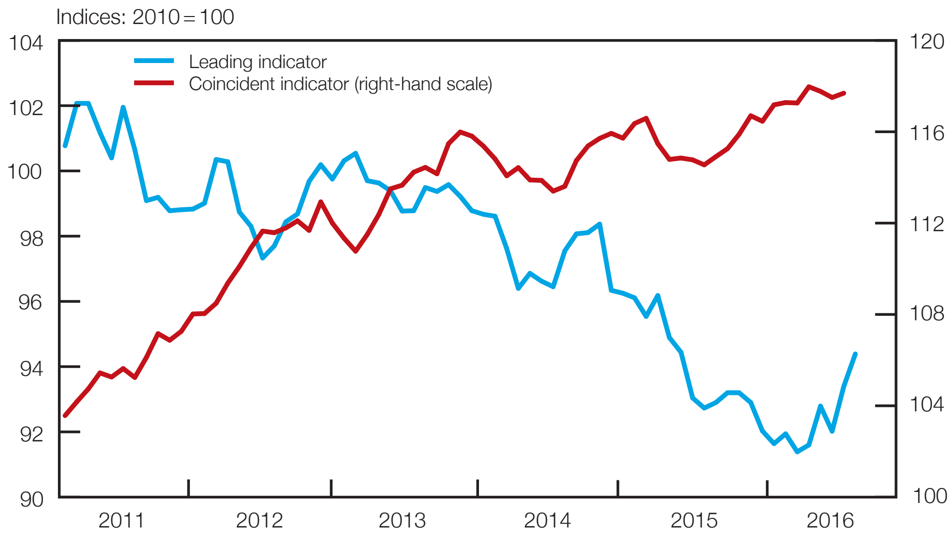
With inflation pressures and risks somewhat reduced, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) has kept the repurchase rate unchanged at 7 per cent per annum since its March 2016 meeting. Other money-market interest rates have aligned themselves with this anchor rate, and orderly conditions have continued to prevail in the money market.

The sluggish economic growth was reflected in a moderate undercollection of tax. However, in the first half of fiscal 2016/17 the non-financial public-sector borrowing requirement narrowed marginally as the public enterprises and corporations experienced a smaller cash shortfall than in the same period a year earlier. Government continued to face strong economic headwinds, an environment of fragile growth that needs to be nurtured, and at the same time a need for real progress with fiscal consolidation in order to regain fiscal space.

Balancing these factors, the *Medium Term Budget Policy Statement (MTBPS)* released in October 2016 provided for the continuation of fiscal consolidation at a measured pace, with a modest further increase in taxes and a moderate reduction in government's expenditure ceiling. This contributed to the confirmation in late November and early December 2016 of South Africa's investment grade sovereign credit rating by all three the major credit rating agencies.

The SARB's composite leading business cycle indicator started rising from May 2016, as reflected in the accompanying graph. Movements in this indicator typically lead the general business cycle by between 6 and 12 months.

Composite leading and coincident business cycle indicators



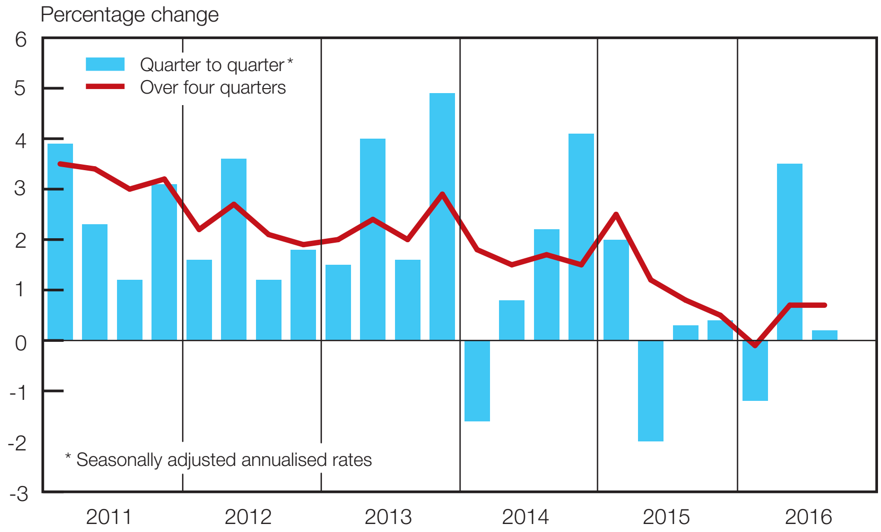
Domestic economic developments

Domestic output[1]

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

Real economic growth in South Africa slowed notably in the third quarter of 2016 – a continuation of the more volatile performance characterising the domestic economy in recent times. Following an acceleration to an annualised rate of 3,5 per cent in the second quarter, growth in *real gross domestic product* (GDP) moderated to only 0,2 per cent in the third quarter.

Real gross domestic product



The disappointing performance in the third quarter of 2016 reflected a contraction in the real output of the secondary sector alongside slower growth in the real value added by the primary and tertiary sectors. Notwithstanding the firm performance in the second quarter, real GDP in the first nine months of 2016 was 0,4 per cent higher than in the corresponding period in 2015. The Minister of Finance in his *Medium Term Budget Policy Statement (MTBPS)* in October 2016 lowered South Africa's growth projection for 2016 to 0,5 per cent, while the International Monetary Fund (IMF) in its October 2016 *World Economic Outlook (WEO)* estimated economic growth of 0,1 per cent for South Africa over the same period.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	6,3	-10,9	-10,8	-0,5	0,9	-15,1	12,0	3,8
Agriculture	-11,3	-20,4	-11,8	-6,7	-5,9	-6,5	-0,8	-0,3
Mining	12,7	-7,8	-10,5	1,4	3,2	-17,5	16,1	5,1
Secondary sector	-0,4	-4,9	2,5	-1,3	0,0	0,1	5,2	-2,5
Manufacturing	-2,1	-6,3	4,7	-2,5	-0,3	0,6	8,1	-3,2
Tertiary sector	1,7	0,8	1,5	1,4	1,6	0,8	1,9	0,5
Non-primary sector	*1,2*	*-0,5*	*1,7*	*0,8*	*1,3*	*0,7*	*2,7*	*-0,2*
Total	2,0	-2,0	0,3	0,4	1,3	-1,2	3,5	0,2

If the contributions of the mining and manufacturing sectors are excluded, growth in real GDP would have decelerated from an annualised increase of 1,8 per cent in the second quarter of 2016 to 0,3 per cent in the third quarter.

The real value added by the *primary sector* increased at a slower pace in the third quarter of 2016. Following an increase of 12,0 per cent in the second quarter of 2016, growth in real output of the primary sector moderated to an annualised rate of 3,8 per cent in the third quarter due to the weaker performance of the mining sector over the period.

A slight further decline in the real value added by the *agricultural sector* was registered in the third quarter of 2016 – the seventh consecutive quarterly decline in real output of the sector. In addition to the devastating effect of drought conditions on field crop production, livestock production moderated as farmers began to rebuild herds following forced culling in the previous production season as a consequence of these unfavourable weather conditions.

According to the final estimates of the Crop Estimates Committee released in October 2016, the commercial maize crop for the 2015/16 season totalled 7,5 million tons, a decrease of roughly 24 per cent from the 2014/15 production season. Yellow maize production contracted by 17,9 per cent while the production of white maize decreased by almost a third over the period.

Commercial maize crop estimates

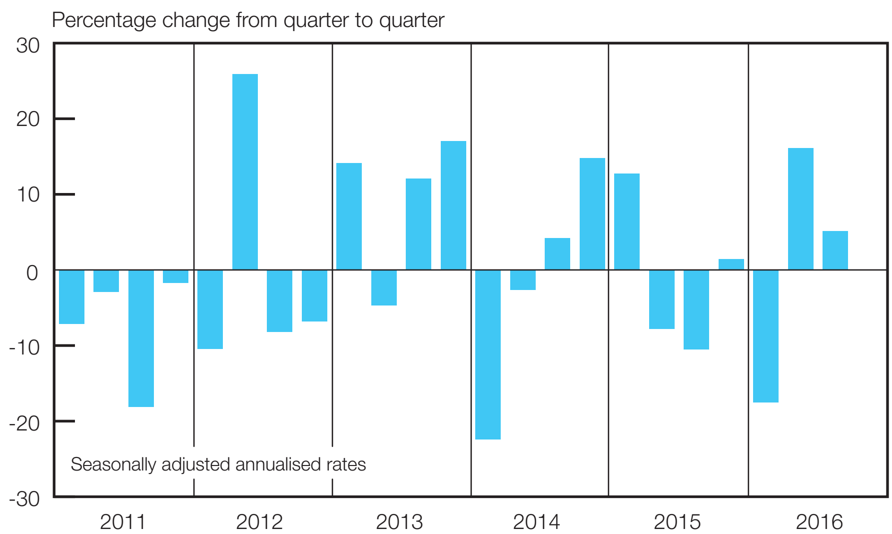
	Final production estimate	Final production estimate	Percentage change
	2015/16	2014/15	
Crop (million tons)..	7,5	10,0	(24,3)
Area planted (million hectares)..........................	1,9	2,7	(26,6)

Source: Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries

The real value added by the *mining sector* increased for a second successive quarter although the rate of growth in the third quarter was lower than in the second quarter. Following an increase of 16,1 per cent in the second quarter of 2016, growth in the real value added by the mining sector slowed to an annualised rate of 5,1 per cent in the third quarter, adding 0,4 percentage points to overall GDP growth. The increase in mining production largely emanated from firm increases in the production of iron ore, diamonds and copper, which more than offset declines in the output volumes of platinum, gold and coal mines over the period.

Notwithstanding these increases, activity in the mining sector continues to be restrained by, among other factors, escalating production costs, labour disputes, production stoppages due to safety concerns, low commodity prices and weak demand.

Real value added by the mining sector

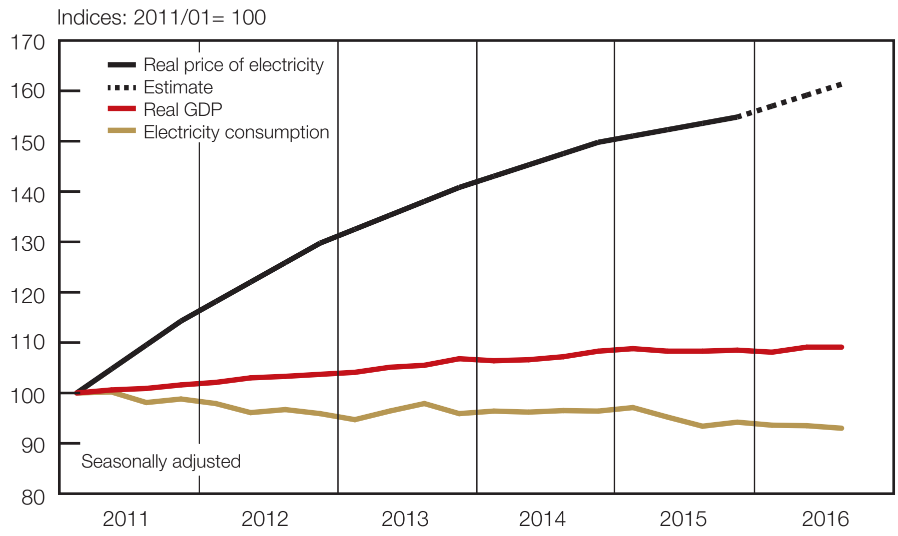


Having increased firmly in the second quarter of 2016, the real value added by the *secondary sector* contracted at an annualised rate of 2,5 per cent in the third quarter. Real output of the manufacturing as well as the electricity, gas and water subsectors declined, whereas activity in the construction sector increased over the period.

After registering positive growth in the first two quarters of 2016, real output of the *manufacturing sector* contracted in the third quarter. Weighed down by lower production of both durable and non-durable manufactured products, the real value added by the manufacturing sector contracted at an annualised rate of 3,2 per cent over the period – subtracting 0,4 percentage points from overall economic growth in the third quarter. The contraction was broad-based, with production volumes declining in eight of the ten subsectors. Pronounced declines were registered in the subsectors supplying petroleum and chemical products, basic iron and steel, and motor vehicles. The production of motor vehicles continued to be hampered by weak domestic demand, rising input costs and low business confidence levels. The utilisation of production capacity in the manufacturing sector remained broadly unchanged, increasing only marginally from a seasonally adjusted 82,0 per cent in the second quarter of 2016 to 82,2 per cent in the third quarter.

Consistent with the fairly moderate winter, generally weak economic environment and dwindling activity in the manufacturing sector, activity in the sector supplying *electricity, gas and water* contracted further in the third quarter of 2016. The real value added by the electricity sector declined at annualised rates of 1,8 per cent and 2,9 per cent respectively in the second and third quarters of 2016.

The real price and consumption of electricity



Load-shedding has been largely avoided over the past five quarters due to the interplay of various factors. Supply capacity has been enhanced by improved maintenance of existing capacity and the gradual commissioning of new capacity by Eskom alongside additional energy obtained from renewable energy projects. Simultaneously, electricity consumption remained sluggish, partly as a result of weak domestic economic activity, the low demand from electricity-intensive metal processing firms as well as lower levels of electricity consumed by households. The lower levels of electricity consumption by households were partly attributable to mild winter temperatures experienced during June and August. The rising real price of electricity, as shown in the accompanying graph, also restrained the demand for electricity. With declining electricity consumption and rising production, electricity exports gained further pace over the period while imports tapered off.

The real value added by the *construction sector* increased at a pedestrian pace in the third quarter of 2016. Growth in the real output of the construction sector picked up slightly from an annualised rate of -0,2 per cent in the second quarter of 2016 to 0,3 per cent in the third quarter. Activity in the residential and non-residential building segments contracted over the period while civil construction activity accelerated over the period.

An acceleration in growth in the real output of the government subsector was more than fully neutralised by a decline in the real value added by the commerce subsector and the slower pace of increase in activity in the finance and transport subsectors in the third quarter of 2016. Growth in the real value added by the *tertiary sector* consequently moderated from an annualised rate of 1,9 per cent in the second quarter of 2016 to 0,5 per cent in the third quarter.

Consistent with subdued consumer confidence levels, the real value added by the *commerce sector* contracted in the third quarter of 2016. Growth in the real output of the commerce sector slowed from an annualised rate of 1,4 per cent in the second quarter of 2016 to a decline of 2,1 per cent in the third quarter as activity in the retail and motor-trade subsectors declined, while wholesale trade activity tapered off. Lower sales – especially of fuels and of machinery, equipment and supplies – impacted on activity in the wholesale trade subsector. Retail trade activity retracted in the third quarter of 2016, affected by lower sales, particularly by retailers of hardware products and household furniture, appliances and equipment. Production in the motor-trade subsector contracted in the third quarter as domestic demand for new passenger vehicles and commercial vehicles remained under pressure with both consumers and business enterprises attempting to contain spending in a strained economic environment. The real value added by the accommodation sector increased at a slower pace in the third quarter of 2016.

Following an increase of 2,9 per cent in the second quarter of 2016, real output of the *transport, storage and communication sector* slowed to an annualised rate of 0,3 per cent in the third quarter. Industrial action in the petroleum industry brought about slight disruptions in the transport of fuel to petrol stations, which may have influenced scheduled transport activities due to the impact on the logistics value chain. Passenger and railway freight transport contracted over the period while shipping-container trade at port and dock operations decreased due to a decline in international trade volumes in the third quarter.

Growth in activity in the *finance, insurance, real-estate and business services sector* decelerated from an annualised rate of 2,9 per cent in the second quarter of 2016 to 1,2 per cent in the third quarter, contributing only 0,2 percentage points to overall GDP growth. Higher growth in the financial markets – mainly boosted by increased activity in the secondary share market – was fully offset by slower growth in the real-estate and business services subsectors.

Growth in the real value added by *general government* accelerated to an annualised rate of 1,8 per cent in the third quarter of 2016. This increase was largely underpinned by additional workers that had been temporarily employed to assist with the local elections in August 2016.

Real gross domestic expenditure

Subsequent to two successive quarters of contraction, *real gross domestic expenditure* increased in the third quarter of 2016. Following a decline of 4,2 per cent in the second quarter of 2016, real gross domestic expenditure increased at an annualised rate of 8,1 per cent in the third quarter. Stronger growth in real final consumption expenditure by households and general government alongside a firm accumulation of inventories outpaced a decline in real gross fixed capital formation over the period. Real gross domestic expenditure nevertheless contracted by 0,6 per cent in the first three quarters of 2016 when compared to the corresponding period in 2015.

Real gross domestic expenditure

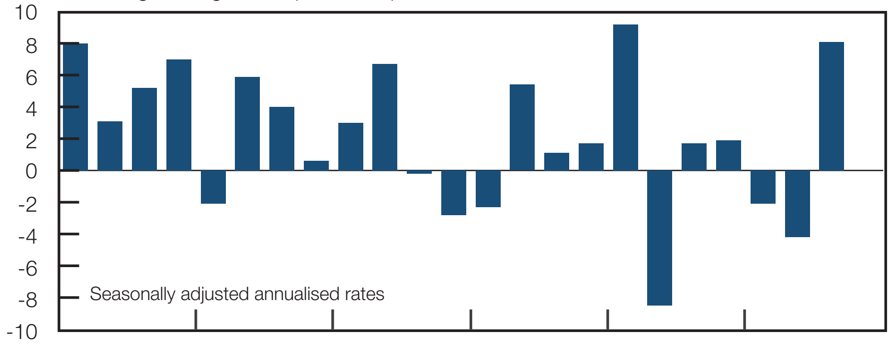
Percentage change at seasonally adjusted annualised rates

Component	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure								
Households	2,0	0,3	2,4	2,1	1,7	-1,7	1,4	2,6
General government	-1,7	1,6	0,8	2,6	0,2	1,2	1,4	2,1
Gross fixed capital formation	2,6	-0,9	4,6	-2,8	2,5	-10,0	-6,8	-1,0
Domestic final demand	**1,4**	**0,3**	**2,5**	**1,2**	**1,6**	**-2,8**	**-0,3**	**1,8**
Change in inventories (R billions)*	68,4	-10,6	-16,9	-4,2	9,2	1,2	-28,3	20,0
Gross domestic expenditure**	**9,2**	**-8,5**	**1,7**	**1,9**	**1,7**	**-2,1**	**-4,2**	**8,1**

* At constant 2010 prices
** Including the residual

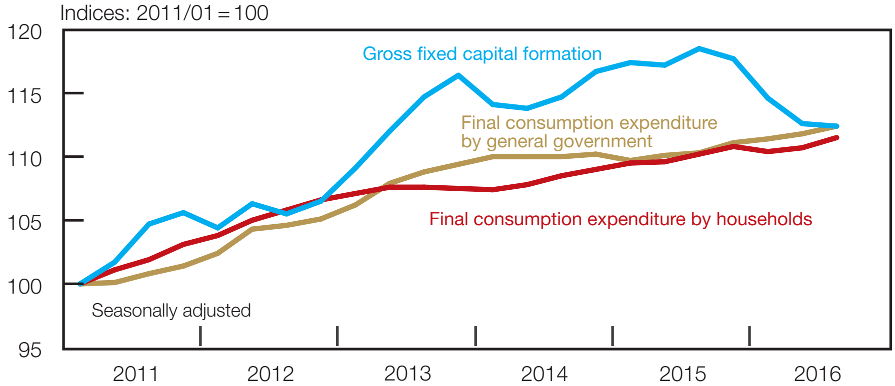
Real gross domestic expenditure

Percentage change from quarter to quarter



Components of real gross domestic final demand

Indices: 2011/01 = 100



As reflected in the accompanying table, decreases in real net exports and in real gross fixed capital formation collectively subtracted 7,8 percentage points from overall economic growth in the third quarter of 2016. Real inventories made the largest contribution to growth in real GDP by adding 6,3 percentage points over the period, while real final consumption expenditure by households added 1,6 percentage points.

Contribution of expenditure components to growth in real gross domestic product

Percentage points

Component	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure								
Households	1,2	0,2	1,4	1,3	1,0	-1,0	0,8	1,6
General government	-0,4	0,3	0,2	0,5	0,0	0,2	0,3	0,4
Gross fixed capital formation	0,5	-0,2	1,0	-0,6	0,5	-2,2	-1,4	-0,2
Change in inventories	7,0	-10,2	-0,8	1,7	0,0	0,7	-3,9	6,3
Net exports	-7,0	6,9	-1,5	-1,5	-0,4	1,0	7,9	-7,6
Residual	0,6	1,0	0,0	-0,9	0,1	0,1	-0,2	-0,3
Gross domestic expenditure	2,0	-2,0	0,3	0,4	1,3	-1,2	3,5	0,2

Final consumption expenditure by households

Real final consumption expenditure by households picked up pace in the third quarter of 2016, edging higher from an annualised rate of 1,4 per cent in the second quarter of 2016 to 2,6 per cent in the third quarter. Spending on non-durable goods and on services increased at a faster pace, while growth in real outlays on semi-durable goods moderated. Conversely, expenditure on durable goods contracted further over the period. Despite the decline in real household spending in the first quarter of 2016, the level of real spending by households was still 0,9 per cent higher in the first three quarters of 2016 than in the corresponding period in 2015.

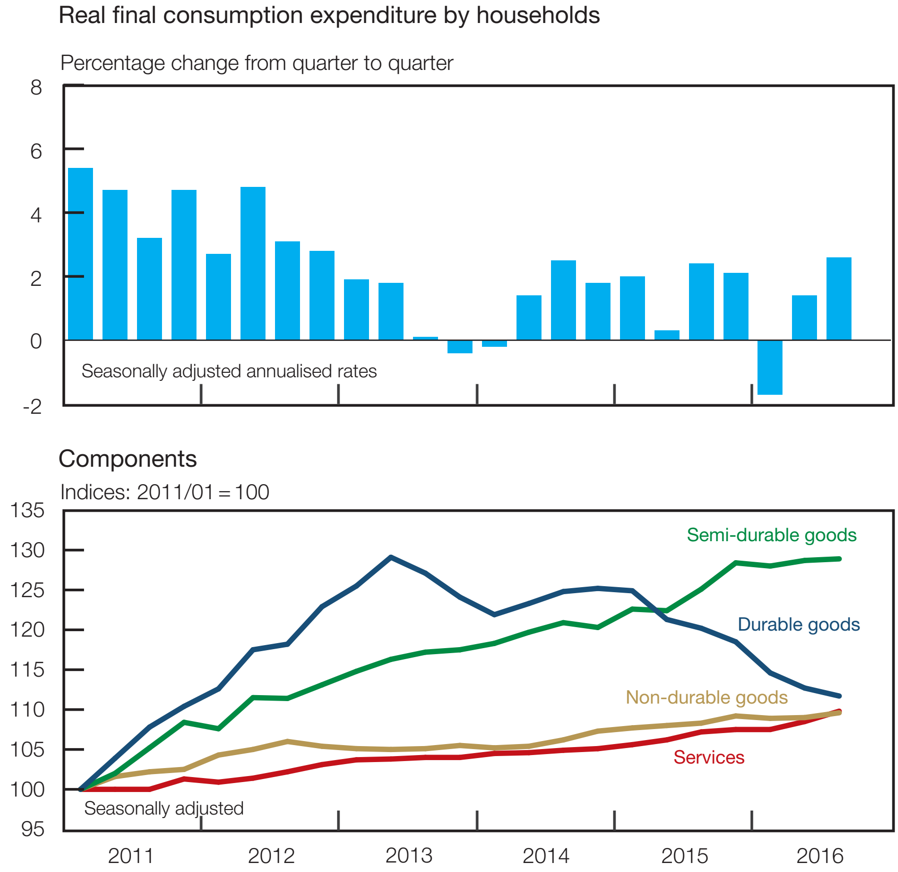
Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Category	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods	-1,1	-11,0	-3,6	-5,5	-2,1	-12,5	-6,4	-3,8
Semi-durable goods	8,0	-0,5	8,9	11,1	4,0	-1,2	2,1	0,6
Non-durable goods	1,5	1,3	1,1	3,1	2,2	-0,9	0,4	2,3
Services	1,9	2,4	3,6	1,1	1,8	0,1	3,8	4,7
Total	2,0	0,3	2,4	2,1	1,7	-1,7	1,4	2,6

Real outlays by households on *durable goods* declined further in the third quarter of 2016. Following six successive quarters of negative growth fluctuating between 1,1 per cent and 12,5 per cent, real spending on durable goods declined at an annualised rate of 3,8 per cent in the third quarter of 2016. Household expenditure on personal transport equipment and on computers and related equipment contracted further along with a moderation in household expenditure on other durable goods over the period. The demand for durable goods continued to be dampened by the low level of economic activity, subdued growth in credit extension and relatively low consumer confidence levels.

Growth in real spending by households on *semi-durable goods* moderated from an annualised rate of 2,1 per cent in the second quarter of 2016 to 0,6 per cent in the third quarter. Slower growth in spending on household textiles, furnishings and glassware; motor car tyres, parts and accessories as well as on recreational and entertainment goods was only partly neutralised by increased purchases of clothing and footwear, which most likely benefitted from favourable price developments over the period.



Households' real expenditure on *non-durable goods* picked up in the third quarter of 2016. Following an increase of 0,4 per cent in the second quarter of 2016, annualised growth in real outlays on non-durable goods accelerated to 2,3 per cent in the third quarter. Growth in spending on food, beverages and tobacco – the largest component in the non-durable basket – and on medical and pharmaceutical products accelerated somewhat over the period

Growth in real expenditure by households on *services* picked up pace from an annualised rate of 3,8 per cent in the second quarter of 2016 to 4,7 per cent in the third quarter. Increased spending on household services resulted largely from firm growth in spending on miscellaneous services.

Growth in *real disposable income* of households accelerated from an annualised rate of 1,7 per cent in the second quarter of 2016 to 2,0 per cent in the third quarter. Consistent with the slower pace of increase in nominal spending by households in the third quarter of 2016, growth in household debt moderated. Consumers were reluctant to incur more debt, evident from quarter-to-quarter declines in households' use of instalment sales credit and leasing finance in the third quarter. As a percentage of annualised disposable income, household debt decreased from 75,1 per cent in the second quarter of 2016 to 74,0 per cent in the third quarter, while the cost of servicing debt as a percentage of disposable income edged lower from 9,7 per cent in the second quarter of 2016 to 9,6 per cent in the third quarter.

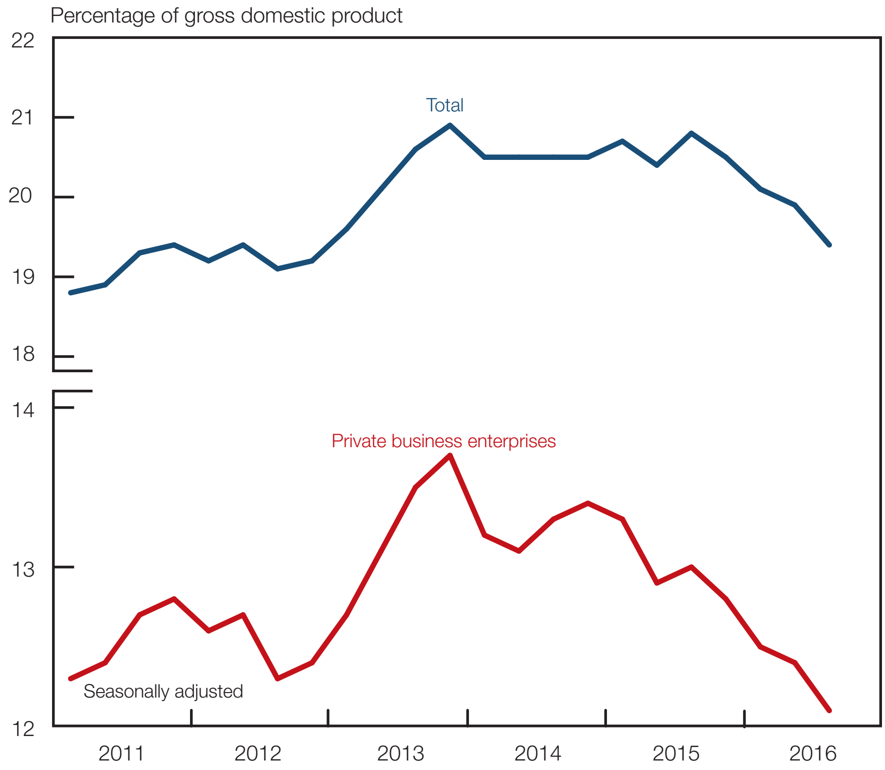
Final consumption expenditure by government

Real final consumption expenditure by general government increased at an annualised rate of 2,1 per cent in the third quarter of 2016 compared with a rate of 1,4 per cent in the second quarter. Growth in real spending on compensation of employees accelerated while non-wage goods and services increased at a somewhat slower pace over the period. The increase in government consumption expenditure was mainly associated with the temporary appointment of additional staff and increased spending incurred by the Independent Electoral Commission (IEC) during the municipal elections in August 2016. Boosted by the IEC's expenditure since the opening months of the year, government's real outlays in the first three quarters of 2016 were 1,6 per cent higher compared with the corresponding period in 2015.

Fixed capital formation

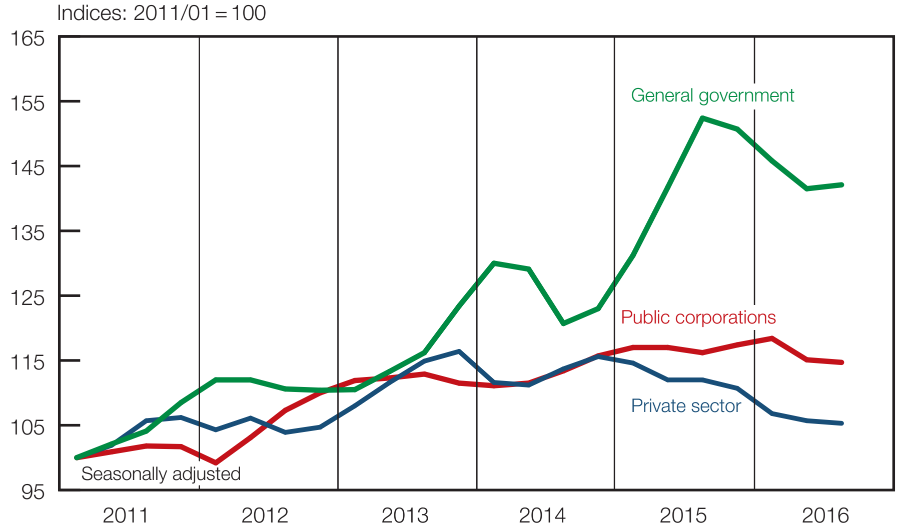
Real gross fixed capital formation declined for the fourth successive quarter in the third quarter of 2016, albeit at a slower pace. Having contracted at an annualised rate of 6,8 per cent in the second quarter of 2016, real capital outlays declined at a rate of 1,0 per cent in the third quarter. Increased real capital spending on machinery and other equipment as well as on construction works, which advanced at rates of 15,6 per cent and 13,0 per cent respectively in the third quarter of 2016, partly neutralised lower spending on most other asset categories. Gross fixed capital formation as a ratio of GDP tapered off from 20,5 per cent at the end of 2015 to 19,4 per cent in the third quarter of 2016.

Gross fixed capital formation



The prolonged decline in real capital spending by private business enterprises – comprising nearly two-thirds of total capital investment – continued in the third quarter of 2016. Capital expenditure by public corporations contracted for the second consecutive quarter, albeit at a somewhat slower pace than in the second quarter. By contrast, capital spending by general government advanced marginally over the period. Consistent with the subdued economic conditions and low business confidence, aggregate real gross fixed capital formation was 3,9 per cent lower in the first three quarters of 2016 when compared with the level in the corresponding period in 2015.

Real gross fixed capital formation by institutional sector



Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Sector	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Private business enterprises ...	-3,4	-9,0	0,0	-4,4	-0,6	-13,3	-4,1	-1,6
Public corporations................	4,4	0,1	-2,9	4,1	3,5	3,5	-10,5	-1,3
General government.............	29,5	36,3	33,5	-4,4	14,6	-12,3	-11,2	1,5
Total.....................................	**2,6**	**-0,9**	**4,6**	**-2,8**	**2,5**	**-10,0**	**-6,8**	**-1,0**

Having contracted by 13,3 per cent and 4,1 per cent in the first and second quarters of 2016 respectively, real fixed capital outlays by *private business enterprises* declined at an annualised rate of 1,6 per cent in the third quarter. Capital spending by the manufacturing sector rose in the third quarter, partly boosted by increased investment in vehicle assembly plants on, in particular, construction works as well as machinery and equipment. Notwithstanding the uptick in capital spending by the manufacturing sector in the third quarter of 2016, indications are that the sector remains under pressure, as evidenced by the headline Purchasing Managers' Index (PMI) which fell from 53,0 index points in the second quarter of 2016 to 48,9 index points in the third quarter.

Following a contraction of 10,5 per cent in the second quarter of 2016, real fixed capital expenditure by *public corporations* declined by 1,3 per cent in the third quarter. An increase in capital outlays by the electricity and transport subsectors on various projects somewhat offset a decline in expenditure by other public entities during the quarter. Despite the deferment of some of Transnet's capital spending, increased capital outlays by the transport subsector reflected the acquisition of coaches as part of the rolling stock programme of the Passenger Rail Agency of South Africa.

Subsequent to three successive quarters of negative growth, real fixed capital spending by *general government* reversed course and increased at an annualised rate of 1,5 per cent in the third quarter of 2016. The bulk of capital outlays by general government reflected spending on the improvement and maintenance of both national and provincial roads over the period.

Inventory investment

Following an annualised decline of R28,3 billion (at 2010 prices) in the second quarter of 2016, *real inventories* increased by R20,0 billion in the third quarter. The higher stock levels could largely be attributed to an accumulation of inventories in the mining, trade and transport sectors. The accumulation of inventories in the mining sector largely reflected an increase in the stock level of, in particular, platinum, palladium, coal and iron ore. The average pace of destocking amounted to R2,4 billion in the first three quarters of 2016 compared with an accumulation of R13,6 billion in the corresponding period in 2015.

Factor income

Growth in total *nominal factor income,* measured over four quarters, amounted to 7,3 per cent in both the second and the third quarters of 2016. Consistent with the sluggish economy, the pace of growth in aggregate gross operating surpluses in the economy, remained below that of remuneration of employees.

Measured over a year, growth in total *compensation of employees* decelerated slightly from 8,1 per cent in the second quarter of 2016 to 8,0 per cent in the third quarter. The somewhat slower growth in wages and salaries was most evident in the general government sector, while compensation of employees in most other sectors increased at a somewhat faster pace over the period. However, the ratio of compensation of employees to total factor income rose from 53,9 per cent in the second quarter of 2016 to 54,4 per cent in the third quarter.

Despite the challenging domestic operating environment, generally lacklustre economic activity and rising inflationary pressures, the year-on-year rate of growth in the aggregate *gross operating surplus* accelerated from 6,4 per cent in the second quarter of 2016 to 6,6 per cent in the third quarter. This pickup was most notable in the agricultural and transport sectors while gross operating surpluses in almost all other sectors increased at a slower pace. Nonetheless, the share of the gross operating surplus in total factor income moderated from 46,1 per cent in the second quarter of 2016 to 45,6 per cent in the third quarter.

Gross saving

South Africa's *national saving rate* fell back somewhat in the third quarter of 2016. Measured as a percentage of GDP, gross saving weakened from 16,7 per cent in the second quarter of 2016 to 16,4 per cent in the third quarter. The lower saving rate reflected a decline in saving levels by the household sector and general government, while saving by corporate business enterprises picked up over the period. The foreign financing ratio – the share of foreign capital inflows in the financing of gross capital formation – increased from a relatively low rate of 14,6 per cent in the second quarter of 2016 to 19,8 per cent in the third quarter.

Gross saving by the *corporate sector* as a percentage of GDP increased from 13,6 per cent in the second quarter of 2016 to 14,6 per cent in the third quarter. This was the net result of a steady pace of increase in the gross operating surpluses of business enterprises in the third quarter of 2016, alongside subdued dividend and tax payments over the period. The corporate saving rate has gradually declined from a recent high of 16,4 per cent in the first quarter of 2015 to a low of 13,4 per cent in the first quarter of 2016 before gaining upward momentum in the most recent two quarters.

Saving by *general government* decreased from 1,9 per cent of GDP in the second quarter of 2016 to 0,8 per cent in the third quarter. Aggregate government income rose slightly in the third quarter of 2016, as an increase in value-added tax received fully offset a decline in company tax over the period. Simultaneously, growth in consumption expenditure by general government accelerated in the current quarter, contributing to the lower saving performance.

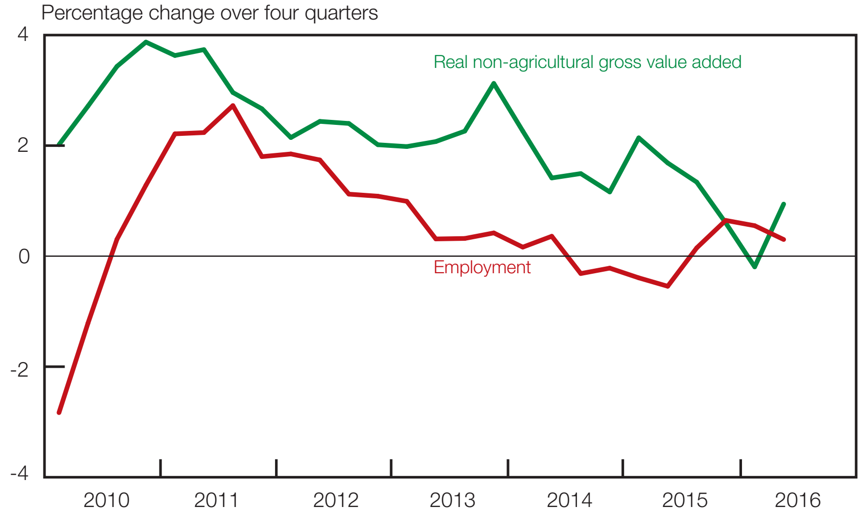
Measured as a percentage of GDP, gross saving by the *household sector* fell back somewhat from 1,2 per cent in the second quarter of 2016 to 1,1 per cent in the third quarter. Although compensation of employees – the largest contributor to the disposable income of households – picked up pace in the latest quarter, the concurrent slower pace of increase in both nominal consumption expenditure by households and disposable income resulted in a lower saving rate being registered in the third quarter of 2016.

Employment

Formal non-agricultural employment decreased in the second quarter of 2016 following the termination of temporary employment opportunities created by the Independent Electoral Commission (IEC) and a further decline in private-sector employment. According to the *Quarterly Employment Statistics (QES)* survey by Statistics South Africa (Stats SA), the number of people formally employed in the non-agricultural sector of the economy decreased by 4,0 per cent on a seasonally adjusted and annualised basis in the second quarter of 2016, representing a loss of 93 600 jobs and lowering the level of total formal non-agricultural employment to an estimated 9,2 million.[2]

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

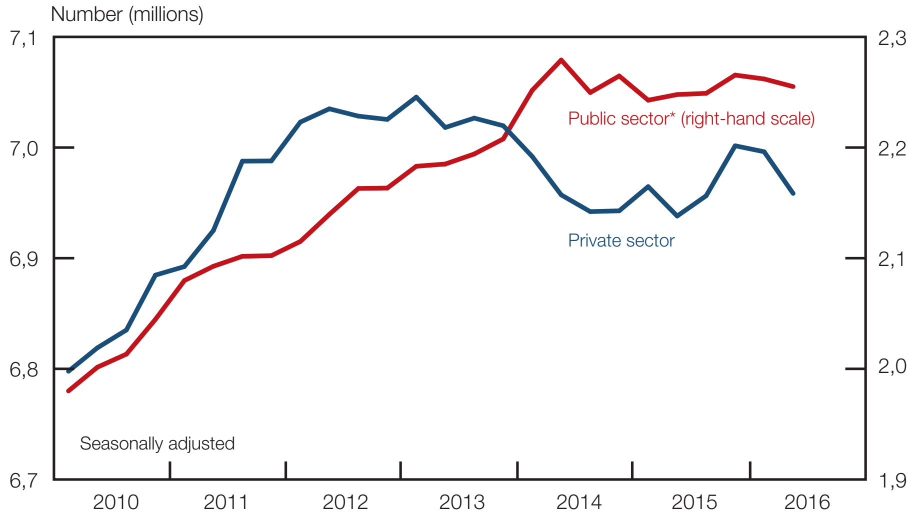
Formal non-agricultural employment* and output growth



* Adjusted for election-related outliers

The decrease in formal non-agricultural employment in the second quarter of 2016 resulted from declines in both public- and private-sector employment. Public-sector employment decreased markedly by 9,3 per cent, largely due to the termination of around 51 000 temporary employment opportunities created by the IEC to assist with preparations for the August 2016 municipal elections, thereby reversing the large increase in temporary IEC employment in the previous quarter. In addition, national departments as well as the public transport, storage and communication sector reduced their staff complement, while employment levels increased at local governments.

Formal non-agricultural employment: public/private split



* Adjusted for election-related outliers

Private-sector employment decreased for a second successive quarter, with the rate of decline accelerating to 2,1 per cent in the second quarter of 2016. Employment losses were fairly broad-based among the various subsectors, with only the gold-mining and construction sectors recording employment gains in the second quarter. Employment losses were most pronounced in the trade, catering and accommodation services sector, followed by the private community, social and personal services sector and the manufacturing sector.

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

Sector	Change over one quarter 2nd qr 2016		Change over four quarters to 2nd qr 2016		Cumulative job losses (-) gains (+)	
	Number	Per cent annualised	Number	Per cent	2nd qr 2010 to 1st qr 2014	2nd qr 2014 to 2nd qr 2016
Total mining	-600	-0,5	-31 400	-6,4	600	-34 100
Gold mining	1 200	4,3	2 000	1,8	-41 100	-1 500
Other mining	-1 800	-2,0	-33 500	-8,9	41 700	-32 600
Manufacturing	-6 700	-2,3	-15 700	-1,4	-46 500	-34 100
Construction	1 100	0,8	6 200	1,2	10 600	-15 400
Trade, catering and accommodation services	-26 000	-5,3	19 200	1,0	68 700	29 500
Private transport, storage and communication services	-1 100	-1,3	4 200	1,3	5 900	-6 200
Finance, insurance, real-estate and business services	-1 000	-0,2	39 300	1,9	132 400	28 600
Community, social and personal services	-3 400	-2,9	-1 300	-0,3	22 400	-1 700
Total private sector	**-37 700**	**-2,1**	**20 500**	**0,3**	**194 100**	**-33 400**
National departments	-4 700	-3,8	7 900	1,7	44 000	27 200
Provinces	700	0,3	-11 500	-1,1	109 600	-42 100
Local governments	5 700	7,4	9 800	3,1	72 000	10 300
Public transport, storage and communication services	-5 600	-17,1	-12 600	-9,7	26 700	-13 100
Other public-sector enterprises, including electricity and IEC**	-51 900	-51,8	13 600	5,5	19 400	21 100
Total public sector	**-55 900**	**-9,3**	**7 200**	**0,3**	**271 700**	**3 300**
Grand total	**-93 600**	**-4,0**	**27 700**	**0,3**	**465 800**	**-30 100**

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

** Independent Electoral Commission

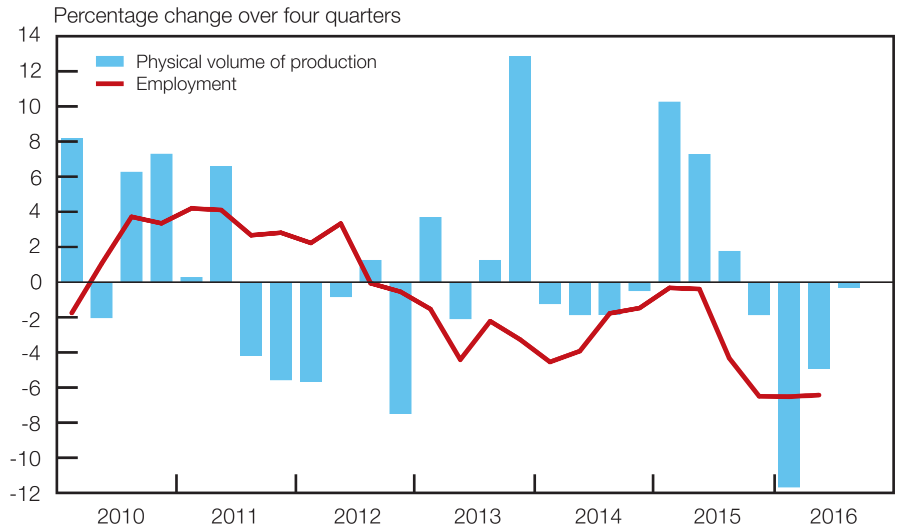
Source: Statistics South Africa, *Quarterly Employment Statistics* (*QES*) survey

The accompanying table shows that around 194 000 formal private-sector employment opportunities were created between the second quarter of 2010 and the first quarter of 2014 – the most recent upward phase in the employment cycle. Subsequently, the prolonged period of weak domestic and global output growth, low business confidence levels and higher levels of uncertainty began to have a negative impact on private-sector employment creation. After remaining fairly resilient during the second half 2015, the private sector continued to shed jobs in the first half of 2016, with a cumulative 33 000 private-sector jobs being lost since the second quarter of 2014. The bulk of these job losses occurred in the goods-producing sectors of the economy. Conversely, the trade, catering and accommodation services sector and the finance, insurance, real-estate and business services sector were the only two subsectors that created employment opportunities over this period.

Notwithstanding continued economic and political uncertainly, weak output and employment growth, South Africa's position in the global competitiveness index of the World Economic Forum (WEF) improved marginally from 49th position out of 140 countries in 2015/16 to 47th out of 138 countries in 2016/17. The improved ranking resulted from marginal improvements in almost all aspects of competitiveness, notably enhanced local and international competition and the link between remuneration and productivity. Some of South Africa's worst scores still related to labour market inefficiencies, notably cooperation in labour-employer relations (138th), flexibility of wage determination (135th), and hiring and firing practices (135th) – all disappointing from an employment creation perspective.

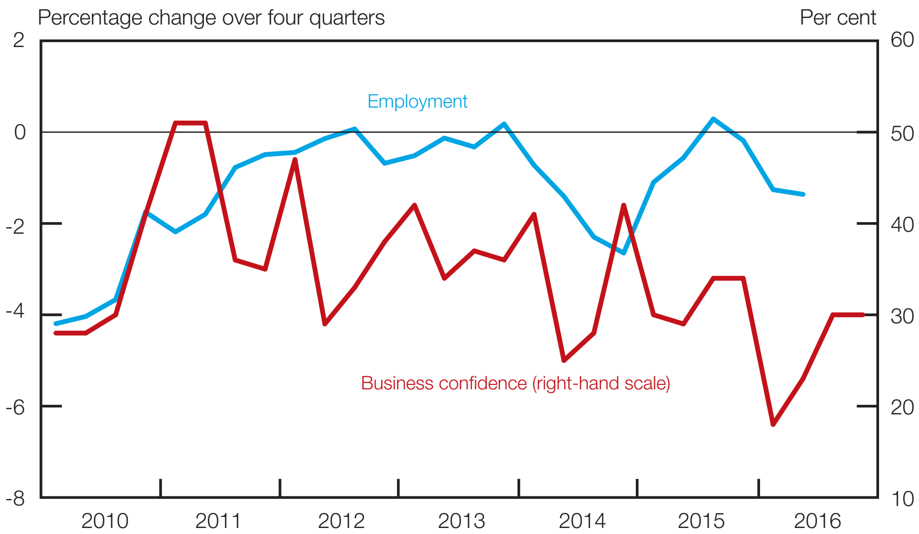
Although mining-sector employment decreased for a seventh consecutive quarter in the second quarter of 2016, the pace of labour paring slowed significantly in the first half of the year. While job shedding continued in the non-gold mining sector, the gold-mining sector created employment opportunities in the second quarter of 2016, aided by an increase in the international price of gold and the depreciation in the exchange rate of the rand over the past year. Continued job shedding in the non-gold-mining sector could be ascribed to sustained weak global and domestic output growth, a lack of investment due to policy uncertainty, and surplus capacity in many mining subsectors. In addition, the mining sector has been characterised by a turbulent industrial relations environment in recent years. The Association of Mineworkers and Construction Union (AMCU), however, recently signed a three-year wage settlement agreement with the major platinum producers, thereby averting possible labour strike action and ensuring some stability and certainty in the platinum-mining industry over the next three years.

Mining-sector output and employment growth



Employment in the manufacturing sector decreased for a third consecutive quarter in the second quarter of 2016, with the pace of labour paring accelerating marginally in each successive quarter. Although the exporters of manufactured goods have benefitted somewhat from a more depreciated exchange rate of the rand, weak domestic demand conditions amid rising input costs resulted in a difficult operating environment for manufacturers. This is corroborated by the *Manufacturing Survey* of Stellenbosch University's Bureau for Economic Research (BER) for the third quarter of 2016, which noted that on balance more respondents reported a further decline in domestic order and sales volumes. Business confidence among manufacturers, however, improved from 23 index points in the second quarter of 2016 to a still low 30 index points in the third quarter, in part supported by fewer respondents rating the general political climate as a serious constraint on business conditions. Unfortunately, following the prolonged weakness in domestic demand indicators, the net majority of respondents reported a further decline in the number of factory workers in the third quarter of 2016, suggesting continued job shedding in the manufacturing sector in the short run.

Employment growth and business confidence in the manufacturing sector



Source: Statistics South Africa and Bureau for Economic Research, Stellenbosch University

Following three years of job shedding, employment in the construction sector increased for a second consecutive quarter in the second quarter of 2016, albeit at a much slower pace than in the first quarter. The marginal growth in construction-sector employment was consistent with an improvement in confidence levels in the sector. The First National Bank (FNB)/BER Civil Confidence Index increased for a second consecutive quarter, from 41 index points in the second quarter of 2016 to 52 in the third quarter, largely due to an increase in construction activity and a fall in tendering competition. The recent announcement by the Minister of Finance in the *Medium Term Budget Policy Statement* of planned infrastructure investment of more than R980 billion over the next three years could provide an additional boost to construction-sector confidence. In addition, the FNB/BER Building Confidence Index improved marginally by 4 index points to a level of 38 in the third quarter of 2016. However, non-residential building confidence fell further by 2 index points to 32 over the period, as respondents reported a marked increase in tendering competition and weak building activity. Building confidence in the residential sector increased from 39 index points to 49 index points in the third quarter of 2016.

After registering moderate employment growth throughout 2015, employment levels in the services sectors of the economy receded in the first half of 2016. Employment in the finance, insurance, real-estate and business services sector decreased further in the second quarter of 2016, albeit at a much slower pace than before. The trade, catering and accommodation services sector shed around 26 000 jobs over the same period, as weak domestic demand conditions translated into slower growth in retail trade sales and a further contraction in new vehicle sales. The disposable income of households is increasingly coming under pressure, following a moderation in nominal wage growth together with an acceleration in consumer price inflation. However, results from the latest Ernest & Young (EY)/BER *Retail Survey* show that business confidence among retailers recovered to 43 index points in the third quarter of 2016 from 26 index points in the second quarter, primarily due to a marked improvement in the sentiment of non-durable goods retailers. According to the BER, trading conditions deteriorated in both the durable and the semi-durable goods sectors, indicating that consumers are shifting spending away from luxury to essential items.

According to the *Quarterly Labour Force Survey (QLFS)* conducted by Stats SA, the number of persons employed in South Africa increased by 288 000 from the second quarter of 2016 to the third quarter, increasing the total level of employment to roughly 15,83 million. However, total employment only increased marginally by 5 000 in the year to the third quarter of 2016, with the year-on-year growth rate accelerating slightly from -0,7 per cent in the second quarter of 2016 to 0,0 per cent in the third quarter. Employment gains in the formal sector were almost fully offset by employment losses in the informal sector and the agricultural sector in the year to the third quarter of 2016.

Disappointingly, the number of unemployed persons increased notably by 239 000 from the second to the third quarter of 2016 and by 455 000 over four quarters, bringing the total number of unemployed South Africans to around 5,87 million – the highest number on record. Encouragingly, however, the number of discouraged job seekers decreased significantly by 235 000 from the second quarter of 2016 to the third quarter, representing the largest quarterly drop in discouraged work seekers since the inception of the *QLFS* in 2008. As a result, the official unemployment rate increased from 26,6 per cent in the second quarter of 2016 to 27,1 per cent in the third quarter – its highest level since the inception of the *QLFS* in 2008. In addition, the seasonally adjusted unemployment rate increased from 26,5 per cent to 26,8 per cent over the same period. Disconcertingly, the youth unemployment rate rose from 49,9 per cent in the second quarter of 2016 to 54,2 per cent in the third quarter.

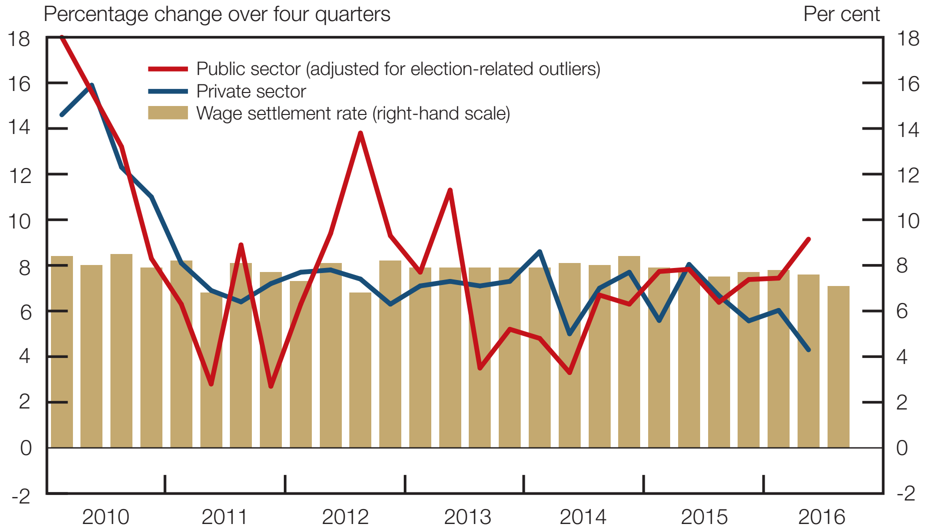
Labour cost and productivity

The year-on-year rate of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy decelerated for a fourth consecutive quarter, from 6,0 per cent in the first quarter of 2016 to 5,8 per cent in the second quarter, due to a notable deceleration in private-sector remuneration growth. These rates of increase fell short of the concurrent rate of consumer price inflation.

Private-sector remuneration growth per worker decelerated from a year-on-year rate of 6,0 per cent in the first quarter of 2016 to 4,3 per cent in the second quarter. Remuneration growth slowed in the non-gold-mining sector (to 8,4 per cent); the trade, catering and accommodation services sector (3,6 per cent); the finance, insurance, real-estate and business services sector (2,3 per cent) and the construction sector (-1,1 per cent). Conversely, remuneration growth quickened in the gold-mining sector (31,3 per cent); the private community, social and personal services sector (8,6 per cent); the manufacturing sector (5,8 per cent) and the private transport, storage and communication services sector (5,0 per cent).

Public-sector remuneration growth per worker accelerated from 7,8 per cent in the first quarter to 9,2 per cent in the second quarter of 2016, when the 51 000 temporary employment opportunities created by the IEC are excluded from the calculation.

Growth in nominal remuneration per worker and wage settlement rates*

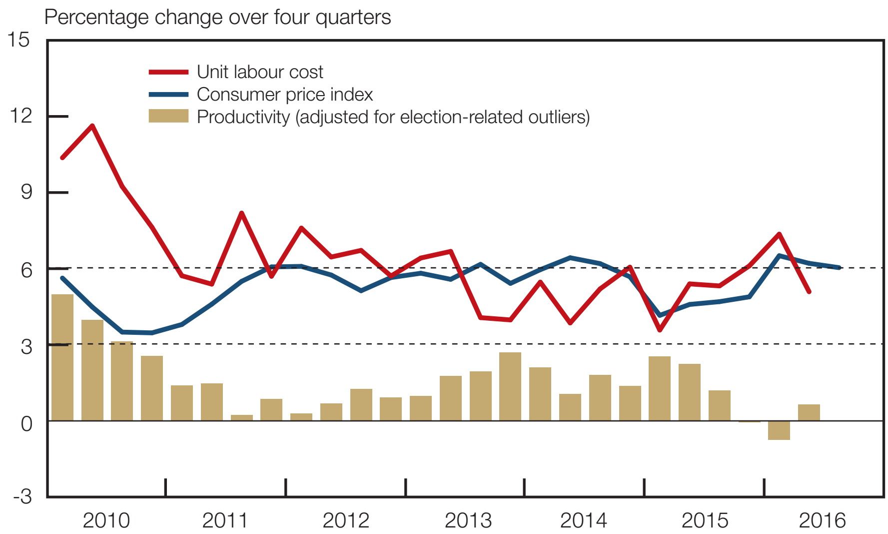


* Quarterly estimate based on cumulative data provided by Andrew Levy Employment Publications

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements moderated marginally to 7,5 per cent in the first nine months of 2016 from 7,7 per cent for the same period in 2015. The number of working days lost due to strike action increased from 270 000 in the first nine months of 2015 to 500 000 over the same period in 2016. Wages remained the major strike trigger, accounting for 85 per cent of working days lost.

Labour productivity growth in the formal non-agricultural sector of the economy accelerated from a year-on-year contraction of 1,3 per cent in the first quarter of 2016 to a marginal expansion of 0,6 per cent, as output growth increased while year-on-year employment growth moderated in the second quarter. Growth in nominal unit labour cost slowed from 7,4 per cent in the first quarter of 2016 to 5,1 per cent in the second quarter. The moderation in nominal unit labour cost growth resulted from a deceleration in total remuneration growth in the year to the second quarter of 2016, coupled with an acceleration in output growth over the same period.

Labour productivity, nominal unit labour cost and consumer price inflation



Prices

Headline consumer price inflation peaked at 7,0 per cent in February 2016 before moderating to 5,9 per cent in August, thus falling to within the inflation target range of 3 to 6 per cent for the first time since December 2015. The moderation in consumer price inflation resulted largely from a notable deceleration in petrol price inflation and a slowdown in consumer services price inflation. Headline consumer price inflation, however, subsequently increased again to 6,1 per cent in September 2016, following an acceleration in petrol and durable goods price inflation.[3]

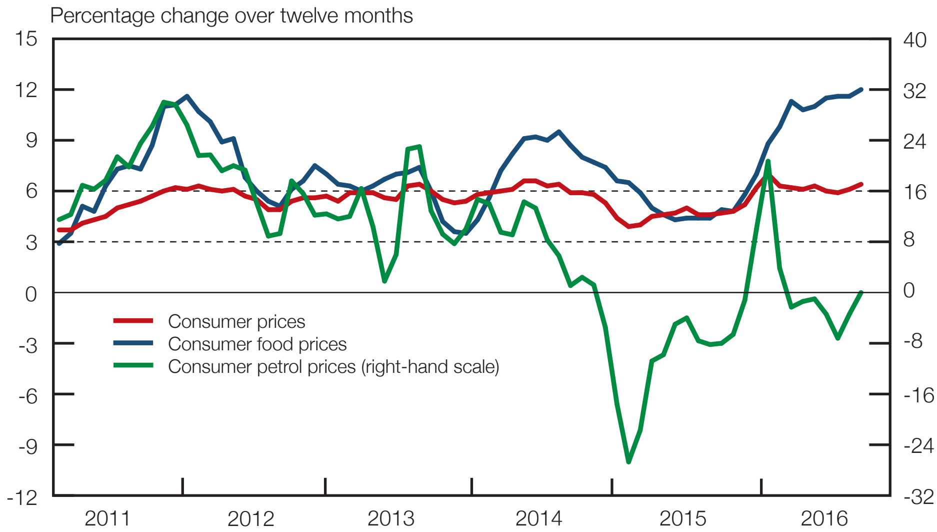
3 All rates mentioned reflect year-on-year changes, unless stated to the contrary.

After reaching a peak of 8,1 per cent in February 2016, producer price inflation for final manufactured goods slowed to 6,5 per cent in May as coal and petroleum products inflation eased. Headline producer price inflation thereafter accelerated to 7,4 per cent in July 2016 before slowing again to 6,6 per cent in September and October. Driven largely by the depreciation in the exchange value of the rand in the second half of 2015 and rising international commodity prices in the first half of 2016, intermediate manufactured producer goods price inflation accelerated notably to 9,2 per cent in June 2016 before slowing to 6,2 per cent in October. Similarly, producer price inflation for mining products accelerated markedly in the first eight months of 2016, from -0,7 per cent in December 2015 to 21,0 per cent in August, following the recovery in commodity prices since the beginning of the year. Mining producer price inflation then moderated to 11,7 per cent in October 2016 in response to a marginal decrease in commodity prices in that month.

Producer price inflation for agricultural, forestry and fishing products remained elevated throughout the first half of the year and stood at 20,2 per cent in June 2016 before moderating to 11,1 per cent in October. This moderation could be attributed to the deceleration in agricultural producer price inflation following the gradual dissipation of the low 2015 base. Similarly to the other measures of producer price inflation, inflation for electricity and water remained elevated despite slowing from 12,3 per cent in April 2016 to 8,5 per cent in October. Both electricity and water price inflation moderated over the period.

Consumer goods price inflation, in particular non-durable goods price inflation, remained the primary driver of the recent movements in headline consumer price inflation. Consumer goods price inflation moderated from a recent peak of 7,9 per cent in February 2016 to 6,1 per cent in August, as non-durable goods price inflation slowed markedly from 9,6 per cent to 6,1 per cent over the same period. The deceleration in non-durable goods price inflation resulted almost entirely from a marked reversal in petrol price inflation, from 20,7 per cent in February 2016 to -7,2 per cent in August, due to a combination of the gradual erosion of the low price base in the preceding year, relatively stable international crude oil prices, and a less depreciated exchange value of the rand. Subsequently, consumer goods price inflation accelerated to 7,1 per cent in October 2016 on account of a quickening in petrol and food price inflation.

Consumer food and petrol price inflation



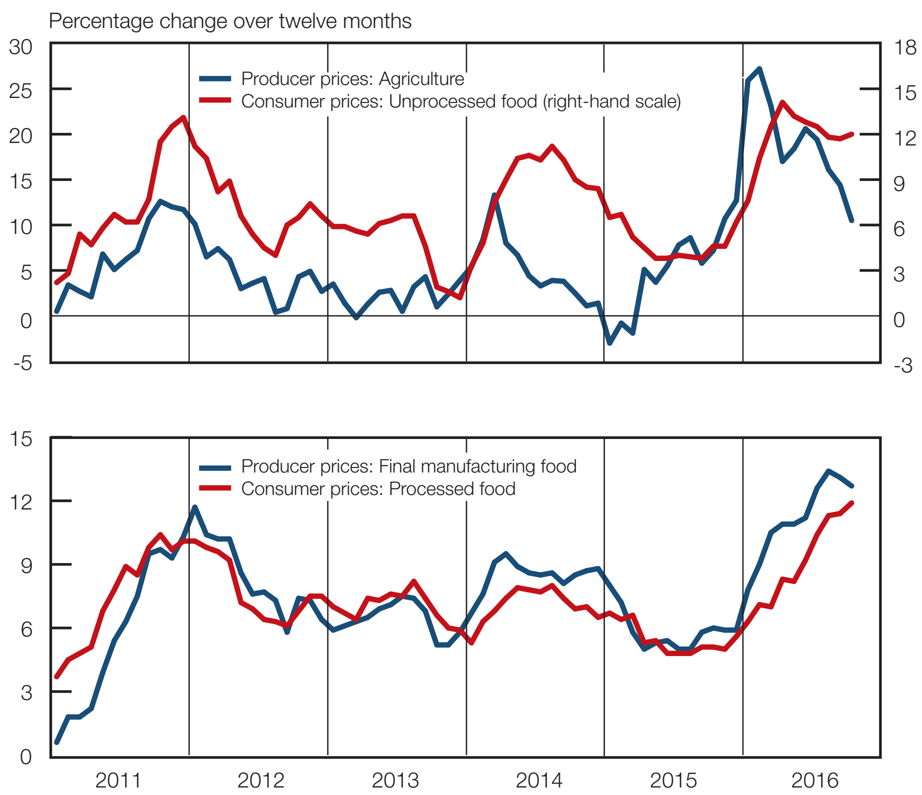
Durable and semi-durable goods price inflation accelerated further in recent months as the depreciation in the exchange rate of the rand throughout 2015 and early 2016 continued to feed into the supply chain. Despite a prolonged contraction in the real value of durable goods consumption by South African households, durable goods price inflation nevertheless accelerated notably throughout 2016, reaching 7,3 per cent in September, driven largely by an increase in the price inflation of new motor vehicles and household appliances. Similarly, albeit less pronounced, semi-durable goods price inflation accelerated to 5,5 per cent in October 2016 as the price inflation of books, clothing and footwear picked up pace throughout the year.

In contrast to the movements in consumer goods price inflation, consumer services price inflation moderated from 6,1 per cent in February 2016 to 5,6 per cent in September. The moderation was driven largely by a notable slowdown in education price inflation, reflecting the zero per cent increase in tertiary education fees in 2016 as well as a deceleration in dwelling rental price inflation, which has the highest weight in the consumer services price basket. However, consumer services price inflation quickened somewhat to 5,8 per cent in October 2016 due to faster-rising hotel and funeral services prices.

The US dollar-denominated international food price index of the United Nations (UN) Food and Agriculture Organization (FAO) increased throughout the year and, in October 2016, reached its highest level since March 2015, driven mostly by stronger sugar and dairy quotations during the month. The year-on-year change in the international food price index accelerated from -16,5 per cent in January 2016 to 9,1 per cent in October. Exacerbated by the earlier depreciation in the exchange rate of the rand, the twelve-month change in the rand-denominated FAO food price index accelerated to 21,7 per cent in June 2016 before moderating to 12,7 per cent in October following the appreciation in the exchange rate of the rand from May 2016 onwards. International cereals prices have receded notably in recent months on account of ample global supplies and high inventory levels. Coupled with the recent exchange rate movements, this resulted in the year-on-year change in the FAO international cereals price index (converted to rand) moderating markedly from 21,8 per cent in May 2016 to -6,6 per cent in October.

South African agricultural producer food price inflation accelerated strongly to peak at 27,2 per cent in February 2016 on account of the prolonged drought conditions experienced throughout the country. While agricultural producer food price inflation remained elevated, it subsequently moderated to 10,5 per cent in October 2016 as the majority of subcategories recorded slower price increases. By contrast, producer food price inflation at the manufactured level accelerated throughout 2016 to reach a peak of 13,4 per cent in August – its highest level since the inception of the new methodology for measuring producer price inflation in 2008 – before moderating marginally to 12,7 per cent in October. Despite the slight moderation, producer food price inflation remained elevated in the bulk of the manufactured producer food price subcategories.

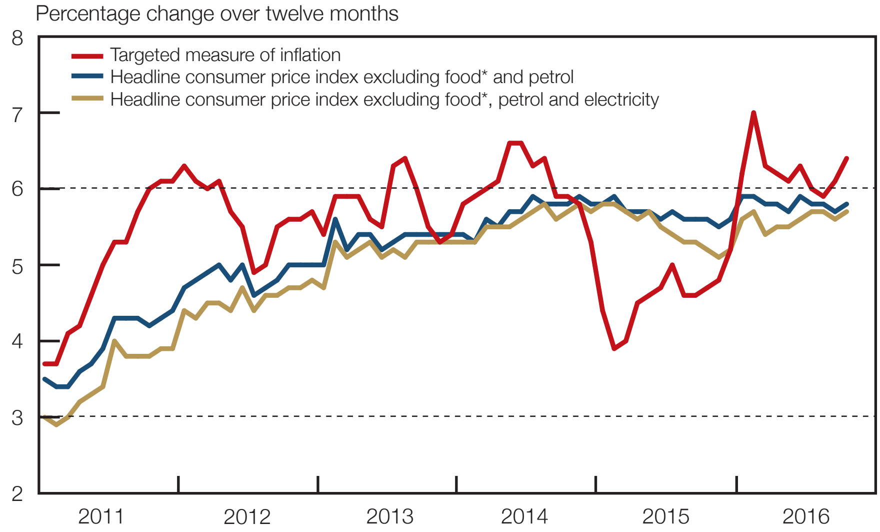
Food price inflation



Following the marked acceleration in agricultural and manufactured producer food price inflation, consumer food price inflation more than doubled from around 4,5 per cent in mid-2015 to 12,0 per cent in October 2016. However, in response to the deceleration in price inflation of agricultural commodities, unprocessed consumer food price inflation appears to have already peaked at 14,1 per cent in April 2016 before slowing gradually to 12,0 per cent in October. By contrast, processed consumer food price inflation continued to accelerate in recent months and amounted to 11,9 per cent in October 2016. The pace of acceleration in consumer food price inflation has slowed notably in recent months, with the sustained quickening in processed food price inflation being largely offset by the moderation in unprocessed food price inflation. Although food price inflation remained at double-digit rates in most of the nine consumer food price subcategories in October 2016, meat prices recorded the lowest rate of inflation by far at 5,5 per cent. When farmers begin to rebuild their herds after the protracted drought, the associated acceleration in meat price inflation could again bolster consumer food price inflation given its high weight within the consumer food price basket.

Most measures of underlying inflation accelerated and hovered close to the upper limit of the inflation target range in the first ten months of 2016. Subtracting the impact of food, non-alcoholic beverages and petrol prices from the calculation of headline inflation, the resultant measure of underlying inflation moderated from a high of 5,9 per cent in June 2016 to 5,7 per cent in September before accelerating to 5,8 per cent in October. If – in addition to food, non-alcoholic beverages and petrol prices – electricity prices are also excluded, underlying inflation accelerated from 5,4 per cent in March 2016 to 5,7 per cent in October.

Headline and underlying measures of consumer price inflation



* Food includes non-alcoholic beverages.

Price changes based on the classification of individual consumption by purpose (COICOP) categories suggest a marginal acceleration in inflationary pressures in October 2016. Consumer price inflation accelerated in eight of the twelve COICOP categories, moderated in one category, and remained unchanged in three categories in October 2016. While the twelve-month rates of increase in four of the COICOP categories exceeded the upper limit of the inflation target range of 6 per cent in October, seven of these categories recorded price increases within the inflation target range and only one category registered a rate of change below 3 per cent. The accompanying table shows that the food and non-alcoholic beverages category recorded the highest year-on-year rate of increase by far in the most recent four months, confirming that food price pressures remain the dominant driver of domestic consumer price inflation following the protracted drought.

Headline consumer price inflation in COICOP categories

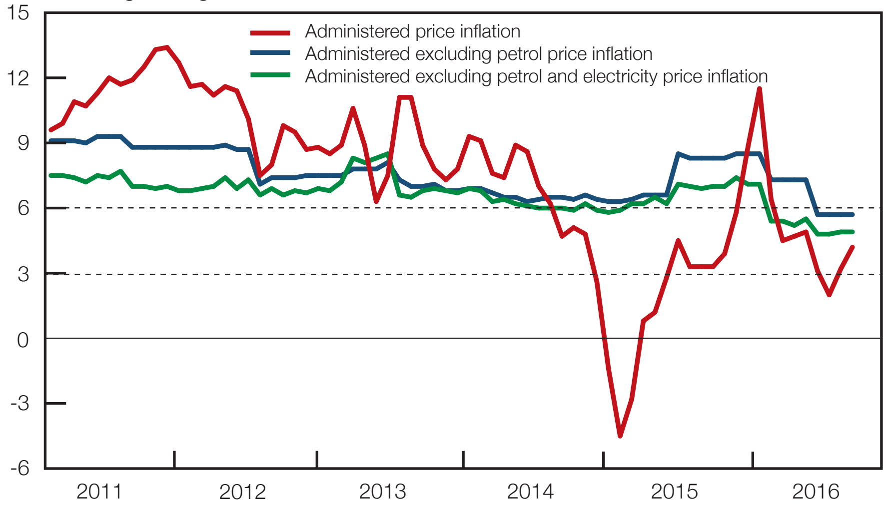
Percentage change over twelve months

	Weights	2016			
		Jul	Aug	Sep	Oct
Food and non-alcoholic beverages................	15,41	11,3	11,3	11,3	11,7
Miscellaneous goods and services	14,72	7,0	6,9	7,2	7,5
Restaurants and hotels.................................	3,50	6,9	6,6	6,7	6,9
Recreation and culture	4,09	6,3	6,7	6,9	6,7
Housing and utilities	24,52	5,8	5,8	5,4	5,4
Clothing and footwear	4,07	4,7	5,0	5,3	5,4
Alcoholic beverages and tobacco.................	5,43	5,2	5,2	5,2	5,2
Health...	1,46	5,3	5,1	5,0	5,1
Education	2,95	4,6	4,6	4,6	4,6
Transport..	16,43	3,1	2,0	3,5	4,3
Household content and services	4,79	4,1	3,9	4,0	4,1
Communication	2,63	-0,1	-0,2	-0,2	-0,1
All items headline consumer price index	**100,00**	**6,0**	**5,9**	**6,1**	**6,4**

Administered price inflation rose to 11,5 per cent in February 2016 on account of a marked acceleration in petrol price inflation, which amounted to 20,7 per cent in the same month. Petrol price inflation subsequently moderated to -7,2 per cent in August 2016, largely due to favourable base effects, thereby lowering administered price inflation to 2,0 per cent in the month before it increased somewhat to 4,2 per cent in October. When the effect of petrol prices is excluded from the calculation, administered price inflation moderated from 8,5 per cent in both January and February 2016 to 5,7 per cent in July and remained at this level up to October. When further excluding electricity prices from the calculation, the rate of increase in administered prices slowed from 7,1 per cent in February 2016 to 4,9 per cent in October on account of a moderation in the price inflation of water and municipal assessment rates. This measure of underlying administered price inflation has remained within the inflation target range since March 2016.

Administered price inflation

Percentage change over twelve months



Average headline consumer price inflation expectations of financial analysts, business representatives and trade union representatives receded marginally in the third quarter of 2016 when compared with the second quarter. On average, inflation expectations for 2016 were lowered from 6,3 per cent in the second quarter of 2016 to 6,2 per cent in the third quarter. Likewise, average inflation expectations for 2017 fell from 6,2 per cent to 6,0 per cent over the same period, while expectations for 2018 remained unchanged at 5,9 per cent. Average five-year inflation expectations also remained unchanged at 5,9 per cent in the third quarter of 2016. While financial analysts and business representatives lowered their inflation expectations over all of the forecast horizons, trade union representatives raised their expectations over most of the forecast periods. Nevertheless, the results for the third quarter of 2016 suggest that inflation expectations have remained anchored close to the upper limit of the inflation target range.

Headline consumer price inflation expectations

Per cent, as surveyed in the third quarter of 2016

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2016..	6,4	6,0	6,3	6,2
2017..	5,7	6,1	6,3	6,0
2018..	5,3	6,1	6,2	5,9
The next five years	5,5	6,0	6,2	5,9

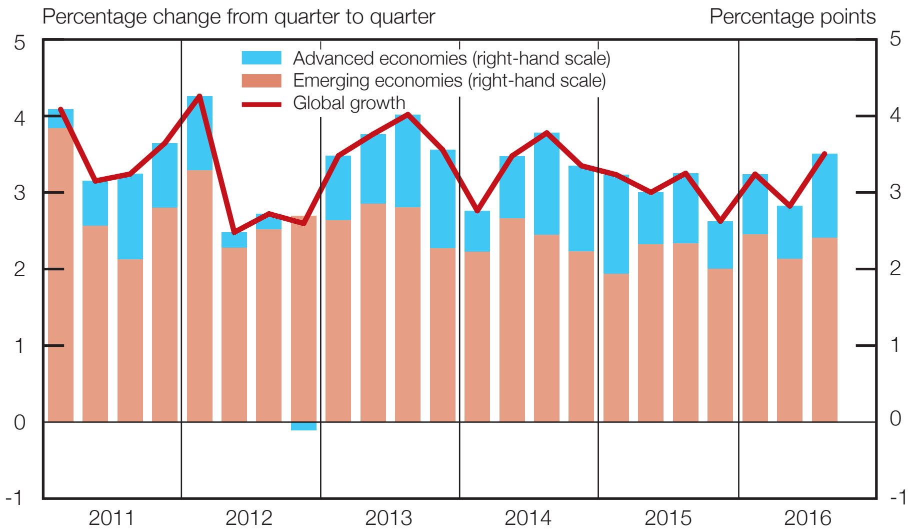
Source: Bureau for Economic Research, Stellenbosch University

Foreign trade and payments

International economic developments

Real global output growth improved in the third quarter of 2016, reaching 3,5 per cent on an annualised basis, up from 2,8 per cent in the second quarter. This acceleration was observed in both advanced and emerging-market economies. Growth in advanced economies accelerated to 2,2 per cent in the third quarter, mainly due to improved economic performances in the US and Canada. At the same time, real output growth in emerging-market economies accelerated to 4,7 per cent as slower growth in China was offset by higher growth in India, Russia and several Latin American economies.

Real global output growth and contributions from advanced and emerging-market economies



Seasonally adjusted annualised rates

Sources: Bloomberg, Haver Analytics, International Monetary Fund, JPMorgan, national statistical offices and staff calculations

In its October 2016 *World Economic Outlook*, the International Monetary Fund (IMF) left its global growth forecasts for 2016 and 2017 unchanged relative to the July projections, at 3,1 per cent and 3,4 per cent respectively. Although the 2016 forecast for advanced economies was revised downwards by 0,2 percentage points to 1,6 per cent, this was offset by an improvement in the outlook for emerging-market economies of 0,1 percentage points, to 4,2 per cent. The IMF's forecast for US growth in 2016 was lowered by 0,6 percentage points due to worse-than-expected growth in the second quarter. By contrast, the outlook for economic growth in the euro area and Japan improved marginally. In addition, growth prospects for major emerging-market economies such as Russia and Brazil were also revised upwards.

Real GDP growth in the US rebounded to 3,2 per cent in the third quarter of 2016 following unexpectedly weak figures in the preceding three quarters. The expansion was driven by an increase in personal consumption expenditure as well as increased exports and an accumulation of inventories. The Federal Open Market Committee left the federal funds rate unchanged at its November 2016 meeting but signalled that the case for a rate increase has continued to strengthen. The deflator for personal consumption expenditure – the Federal Reserve's preferred inflation measure – accelerated for the third consecutive month in October 2016 to 1,4 per cent.

Economic growth in Japan decelerated to 1,3 per cent in the third quarter of 2016 from 1,8 per cent in the second quarter. Although headline inflation – the measure used by the Bank of Japan for its inflation target – turned positive in October 2016, core inflation (excluding fresh food) has been negative for eight consecutive months, measuring -0,4 per cent. The Bank of Japan remains concerned about deflation and responded by lowering its inflation forecast and moving the projected timing for attaining its inflation target from the 2017 to the 2018 fiscal year. Both fiscal and monetary policy measures have been eased further. The central bank is conducting its bond-buying in such a way that yields on ten-year Japanese government bonds – the benchmark for long-term interest rates – remain at around zero. Furthermore, the Bank of Japan has committed to deliberately overshooting its inflation target of 2 per cent to encourage a sustained rise in inflation expectations.

Real output growth in selected advanced economies

Percentage change at seasonally adjusted annualised rates

	2014		2015					2016		
Country/region	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
United States................	2,3	2,4	2,0	2,6	2,0	0,9	2,6	0,8	1,4	3,2
Japan...........................	2,1	0,0	6,3	-0,5	0,8	-1,8	0,6	2,8	1,8	1,3
Euro area......................	1,8	1,2	3,2	1,5	1,3	2,0	1,9	2,0	1,2	1,4
United Kingdom	3,4	3,1	1,0	2,0	1,2	2,7	2,2	1,7	2,7	2,0
Canada	2,4	2,5	-1,0	-0,4	2,3	0,5	1,1	2,7	-1,3	3,5
Australia	1,8	2,7	4,4	0,3	3,3	2,4	2,4	4,0	2,5	-1,9
New Zealand................	3,4	3,0	1,0	1,5	3,2	3,7	2,5	3,5	3,8	2,0
Advanced economies...	2,2	1,9	2,8	1,5	1,8	1,2	2,1	1,7	1,5	2,2

Underlined numbers indicate projections. Some regional totals include countries with forecasted data.

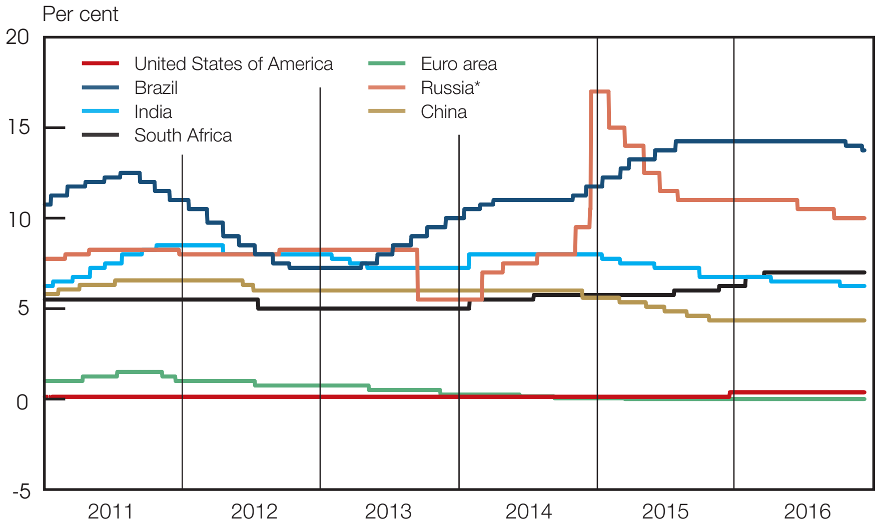
Sources: Bloomberg, national statistical offices and staff calculations

In the euro area, real GDP growth accelerated marginally from 1,2 per cent in the second quarter of 2016 to 1,4 per cent in the third quarter. The improved performance in the third quarter could mainly be attributed to output rebounding in France after contracting in the previous quarter. Meanwhile, euro area headline consumer price inflation accelerated marginally to 0,6 per cent in November, continuing a positive trend since June. The European Central Bank expects inflation to accelerate further during 2016 and 2017, and as such has maintained its policy stance and confirmed that quantitative easing would continue until at least March 2017.

In the United Kingdom (UK), real economic growth slowed to 2,0 per cent in the third quarter of 2016 from 2,7 per cent in the second quarter. At its November MPC meeting, the Bank of England revised its growth forecasts for 2017 upwards to 1,4 per cent and for 2018 down to 1,5 per cent. Meanwhile, consumer price inflation reached a 22-month high of 1,0 per cent in September 2016 while core inflation (excluding energy and unprocessed food) accelerated to 1,3 per cent. Although inflation decelerated marginally in October, it is expected to breach the central bank's target of 2 per cent next year due to the impact of sterling depreciation following the UK vote to leave the European Union. Nonetheless, the central bank left its current policy stance unchanged. While policy in the advanced economies was steadily accommodative, major emerging-market economies pursued more divergent policies, as shown in the graph on the next page.

Economic growth in emerging Asia accelerated somewhat to 6,7 per cent in the third quarter of 2016. Lower growth in China, Indonesia and the Philippines was partly offset by an increase in the growth rate of the Indian economy. Real GDP growth in China slowed to 6,7 per cent in the third quarter of 2016 from 7,1 per cent in the second quarter.

Policy interest rates in selected advanced and emerging economies



* Russia adopted new policy tools in September 2013. The old and new policy rates are shown on the same line in the graph.

Sources: Bloomberg and national central banks

The process of rebalancing the economy and addressing overcapacity in highly indebted state-owned enterprises has slowly gained momentum. However, recent research by the Bank for International Settlements has signalled China's rising debt-to-GDP ratio as a potential risk to the global economy. Producer prices rose by 1,2 per cent in October 2016, following a 0,1 per cent increase in September. Consumer price inflation in China has remained stable at around 2 per cent.

Real growth in selected emerging-market economies

Percentage change at seasonally adjusted annualised rates

	2014		2015					2016		
Country/area	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
China	7,0	7,3	6,7	7,2	6,7	6,5	6,9	6,5	7,1	6,7
India	3,3	7,2	7,0	10,4	7,9	4,8	7,6	9,6	5,5	8,3
Indonesia	4,8	5,0	4,1	4,8	5,2	5,8	4,8	3,9	6,0	4,5
Emerging Asia	**5,9**	**6,8**	**6,3**	**7,6**	**6,7**	**5,9**	**6,7**	**6,9**	**6,4**	**6,7**
Russia	-1,1	0,7	-10,1	-4,1	0,4	-1,6	-3,7	1,2	-1,9	0,5
Turkey	5,5	3,0	4,3	5,5	4,1	4,7	4,0	2,6	1,2	0,8
Poland	2,8	3,3	5,7	2,0	4,5	5,3	3,6	-0,4	3,2	0,8
Emerging Europe	**1,4**	**1,8**	**-2,9**	**-0,6**	**2,4**	**1,4**	**-0,1**	**1,5**	**0,3**	**0,8**
Brazil	0,9	0,1	-3,6	-9,0	-6,0	-4,5	-3,8	-1,8	-1,7	-3,3
Mexico	2,9	2,2	2,4	3,4	2,2	1,8	2,5	1,9	0,2	4,0
Argentina	2,5	-2,5	8,1	4,6	0,3	-2,4	2,5	-1,8	-8,0	-2,8
Latin America	**1,9**	**1,0**	**0,1**	**-2,1**	**-1,2**	**-1,3**	**0,0**	**-1,0**	**-2,1**	**-0,3**
Emerging economies	**4,4**	**4,6**	**3,8**	**4,5**	**4,6**	**3,9**	**4,0**	**4,7**	**4,1**	**4,7**

Underlined numbers indicate projections. Some regional totals include countries with forecasted data.

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

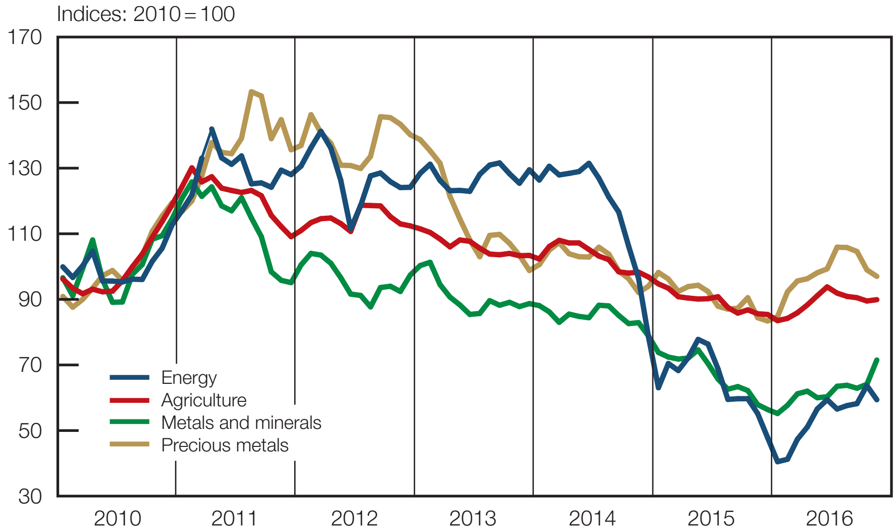
Economic growth in India rose to 8,3 per cent in the third quarter of 2016 from 5,5 per cent in the previous quarter. By contrast, growth in Indonesia slowed to 4,5 per cent in the third quarter from 6,0 per cent in the second quarter. Inflation in India decelerated from 6,1 per cent in July 2016 to 4,2 per cent in October, while inflation in Indonesia eased from 4,5 per cent in March to 2,8 per cent in August before accelerating to 3,6 per cent in November. The Reserve Bank of India reduced its policy rate by 25 basis points to 6,25 per cent in October 2016. Bank Indonesia expects that inflation will moderate to the lower end of the inflation target band and in October lowered its policy rate for the sixth time this year, to 4,75 per cent.

Real output growth in emerging Europe rebounded to 0,8 per cent in the third quarter of 2016. Growth in Russia turned marginally positive, at 0,5 per cent, following negative growth of almost 2 per cent in the previous quarter. Turkish GDP growth is expected to decelerate to 0,8 per cent in the third quarter while Polish growth slowed to 0,8 per cent. Turkish inflation decelerate somewhat, from 8,8 per cent in July to 7,0 per cent in November. Inflation has also slowed in Russia, from a peak of 16,9 per cent in March 2015 to 5,8 per cent in November 2016. Having experienced deflation previously, consumer prices in Poland remained unchanged in November from the previous year. The central bank of Russia lowered its policy rate by 50 basis points to 10 per cent in September 2016, whereas the policy rate was kept unchanged in Poland. After lowering policy rates eight times in 2016, Turkey's central bank increased its policy rate by 50 basis points to 8,0 per cent at its November 2016 meeting.

In Latin America, economic activity contracted at a rate of 0,3 per cent in the third quarter of 2016 – marking six successive quarters of negative growth. Real growth rebounded in Colombia, Chile and Mexico. Brazil and Venezuela remain in recession, with their real GDP declining at rates of 3,3 per cent and 7,5 per cent respectively in the third quarter. Inflation in Brazil decelerated from 10,7 per cent in January 2016 to a 17-month low of 7,9 per cent in October. The declining inflationary pressures prompted the central bank of Brazil to reduce its policy rate by 25 basis points to 13,75 per cent in November, marking the second rate cut in 2016. While other central banks in the region have held rates steady, the Mexican central bank raised its policy rate by 50 basis points to 5,25 per cent in November, following a similar increase in September. The Mexican monetary authority attributed its decision to the depreciation of the peso.

According to the CPB Netherlands Bureau for Economic Policy Analysis, world trade volumes (as measured by the three-month moving average of world exports) expanded by 0,9 per cent in September 2016, almost unchanged from the previous month. Export volumes of advanced economies increased by 2,6 per cent in September, up from 0,5 per cent in August. In emerging-market economies, export volumes contracted by 1,0 per cent, following an expansion of 1,7 per cent in the previous month.

International commodity prices

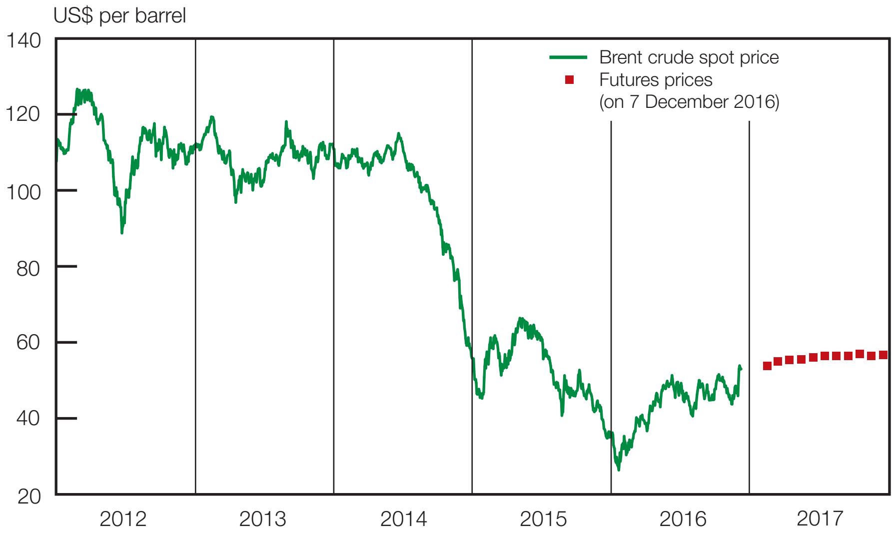


Source: World Bank

Most commodity prices staged a recovery in the first half of 2016 from their January lows. Metal and mineral prices increased further by 18,7 per cent between June and November 2016, while energy prices remained unchanged over the same period. Precious metal prices contracted by 2,4 per cent over that period, while agricultural prices declined by 4,2 per cent.

The price of Brent crude oil (which makes up 84,5 per cent of the weight in the World Bank's energy index) rebounded by more than 90 per cent from mid-January 2016 to US$50 per barrel in early June. The increase in crude oil prices largely resulted from the depreciation of the US dollar and falling US oil production. After fluctuating between US$45 and US$50 per barrel between September and November, oil prices increased sharply in early December to US$53 per barrel following an agreement by the Organization of the Petroleum Exporting Countries to reduce oil production by 1,2 million barrels per day. Brent crude oil futures prices for delivery in the first and second quarters of 2017 were trading in early December at levels of around US$55 per barrel and US$56 per barrel respectively.

International crude oil prices



Source: Bloomberg

Current account[4]

The surplus on the trade account of the balance of payments switched into a small deficit in the third quarter of 2016 in response to weaker international demand for domestically produced goods. In addition to a contraction in export volumes, export earnings were also affected by the strengthening in the exchange value of the rand which more than offset the benefit arising from higher international commodity prices.

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

Balance of payments on current account

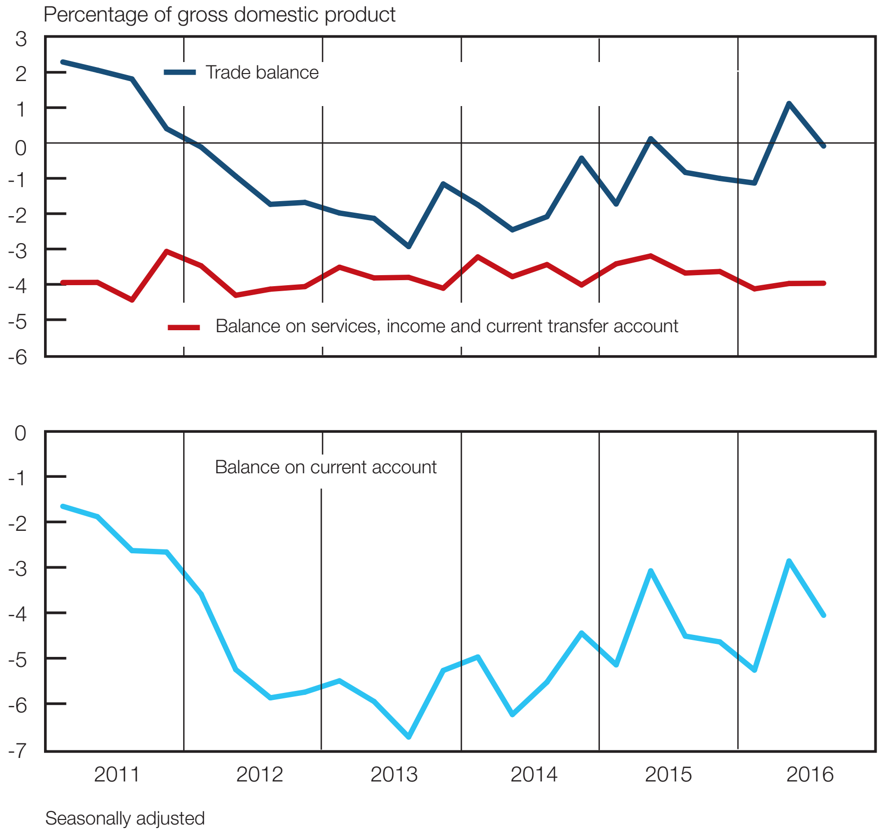
R billions, seasonally adjusted and annualised

	2015					2016		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	940	984	984	988	974	1 005	1 112	1 033
Net gold exports	63	71	65	72	68	52	55	47
Merchandise imports	-1 070	-1 050	-1 082	-1 101	-1 076	-1 105	-1 119	-1 083
Trade balance	-68	5	-34	-41	-34	-48	48	-4
Net service, income and current transfer payments	-134	-128	-148	-150	-140	-174	-171	-172
Balance on current account	-202	-123	-182	-191	-174	-221	-123	-176
As percentage of gross domestic product	*-5,1*	*-3,1*	*-4,5*	*-4,6*	*-4,3*	*-5,3*	*-2,9*	*-4,1*

Components may not add up to totals due to rounding off.

Domestic demand for foreign-produced goods contracted further in the third quarter of 2016, albeit at a slower pace than in export volumes. Alongside a widening of the shortfall on the service, income and current transfer account, the deficit on the current account of the balance of payments widened from R123 billion in the second quarter of 2016 to R176 billion in the third quarter. As a ratio of GDP, the current-account deficit widened from 2,9 per cent in the second quarter of 2016 to 4,1 per cent in the third quarter.

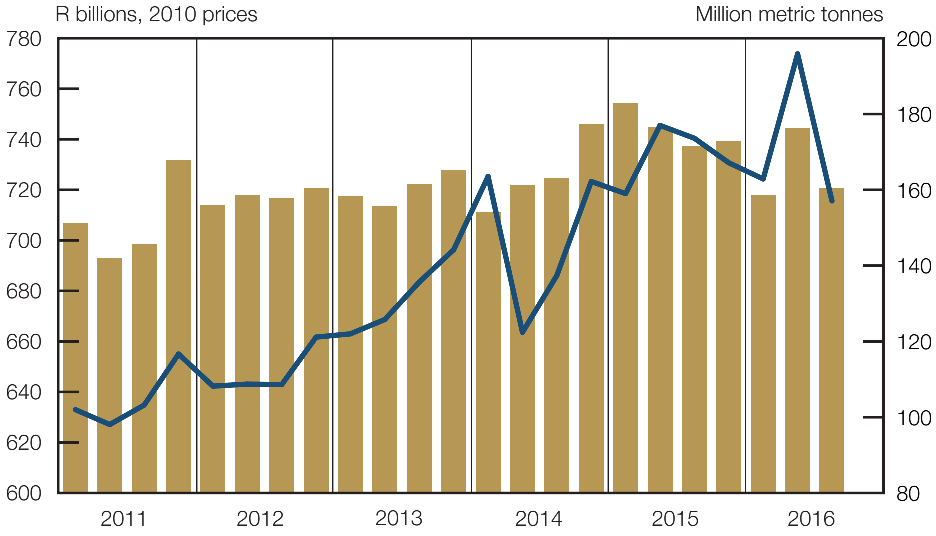
Balance of payments: current account



The value of merchandise exports fell by 7,2 per cent in the third quarter of 2016, having increased by 10,6 per cent in the second quarter. Decreases occurred in the export value of mining as well as manufactured products. In the mining products category, declines were registered in the export value of especially base metals and articles of base metals, precious stones as well as platinum-group metals. Platinum exports surged in the second quarter of 2016 as the production backlog that had been caused by the shutdown of a platinum refinery was processed and exported; as production normalised, platinum exports fell back in the third quarter. By contrast, the value of iron ore exports advanced in the third quarter of 2016 following the restructuring of one of South Africa's largest iron ore producers. The value of coal exports also picked up over the period, despite a 14-day maintenance shutdown in the middle of July 2016.

Having increased for five successive quarters, the overall value of manufactured exports contracted by 6,3 per cent in the third quarter of 2016. The value of manufactured exports was weighed down by declines in the value of vehicles and transport equipment, machinery and electrical equipment, and prepared foodstuffs. The export of 15 locally manufactured railway coaches to a neighbouring country was insufficient to counter the decline in the total value of exported vehicles and transport equipment over the period. These coaches comprised the last batch to be dispatched from a total order of 37 coaches; the first batch comprising 22 coaches was exported in the second quarter of 2016.

Volume of merchandise exports, excluding gold

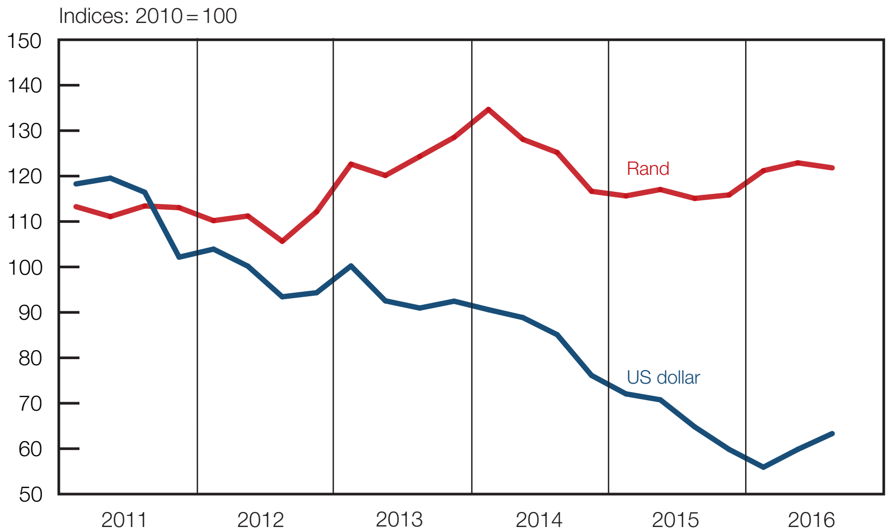


Seasonally adjusted and annualised

Sources: South African Reserve Bank and National Ports Authority

The volume of exported bulk and break bulk cargo handled at national ports shrank by 9 per cent from the second to the third quarter of 2016. Accordingly, the volume of merchandise exports, which had advanced by 6,8 per cent in the second quarter of 2016, contracted by 7,5 per cent in the third quarter.

International prices of South African non-gold export commodities

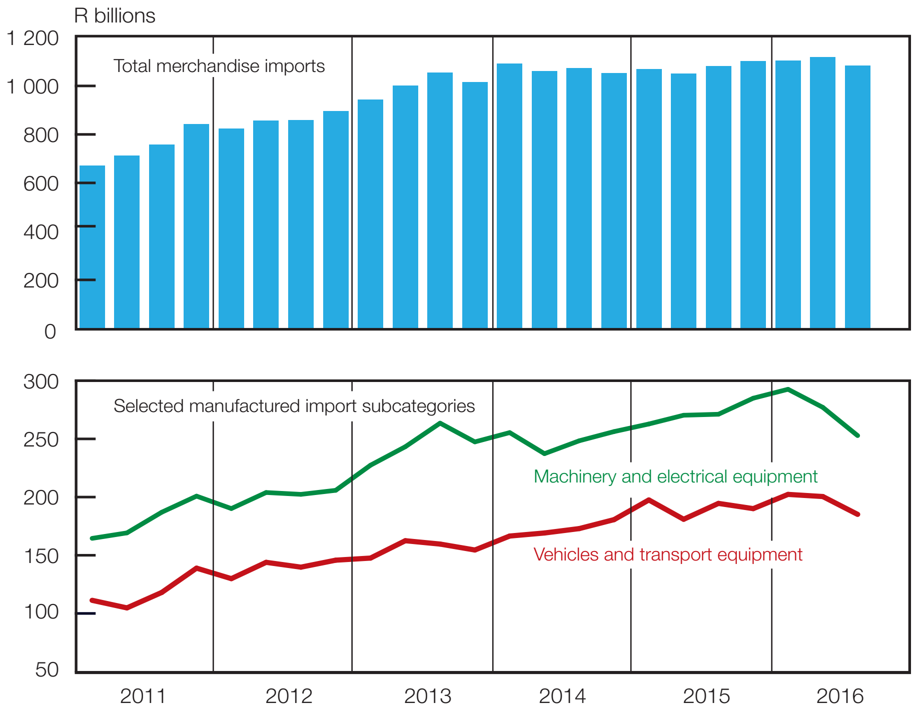


In the third quarter, the overall rand price level of merchandise exports increased marginally further, marking a sixth consecutive quarterly increase. As far as the commodities component of exports is concerned, the US dollar price of a basket of South African-produced non-gold commodities increased for a second consecutive quarter, rising by 5,7 per cent in the third quarter of 2016. Pronounced increases were registered in the prices of, inter alia, nickel, coal and platinum. The price of nickel rose amid strong demand for stainless steel coupled with the anticipated tightening of nickel output from the Philippines – the world's largest producer of nickel. The international price of coal surged due to policy measures introduced by the Chinese authorities to reduce coal output in China. However, owing to the appreciation in the exchange value of the rand, the rand price of South African-produced non-gold commodities declined by 0,9 per cent over the period.

The London fixing price of gold rose from US$1 275 per fine ounce in June 2016 to US$1 337 per fine ounce in July, in part due to the surprise outcome of the Brexit vote. It remained broadly unchanged in August before declining towards the end of September as prospects for higher interest rates in the US increased. Ultimately, the price of gold on the London market increased from US$1 258 per fine ounce in the second quarter of 2016 to US$1 335 per fine ounce in the third quarter. In rand terms, however, the average realised rand price of net gold exports decreased marginally alongside a contraction of 13,8 per cent in the volume of net gold exports. As a result, the value of South Africa's net gold exports decreased by 14,6 per cent in the third quarter of 2016 compared with an increase of 5,0 per cent in the preceding quarter.

The value of merchandise imports, which had risen by 1,3 per cent in the second quarter of 2016, contracted by 3,2 per cent in the third quarter on account of weak domestic demand. A decrease in the value of manufactured imports was only partly neutralised by increases in the value of mining and agricultural imports over the period. In the category for manufactured imports, pronounced decreases were noted in the value of imported machinery and electrical equipment, vehicles and transport equipment, chemical products as well as textiles and textile articles. Conversely, the value of mining imports increased from the second to the third quarter of 2016. This increase was primarily due to a surge in the value of mineral imports, particularly crude oil and refined oil products such as petrol and diesel.

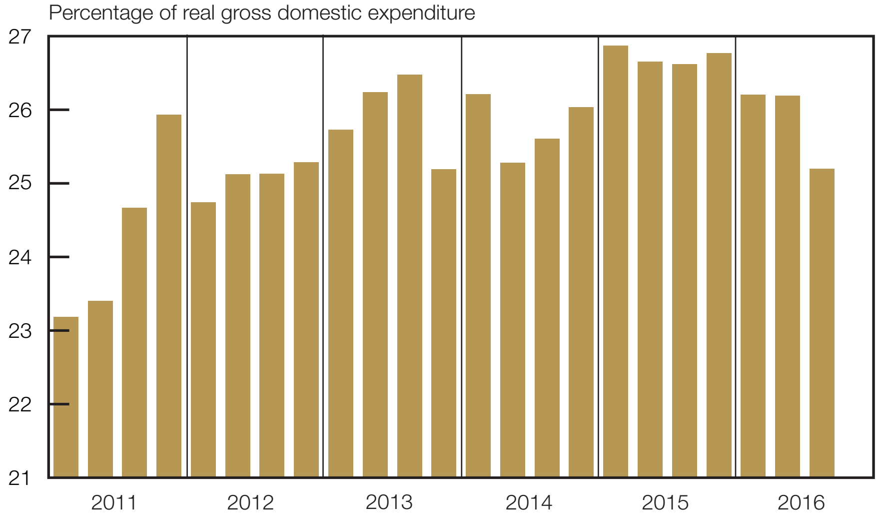
Value of merchandise imports



Seasonally adjusted and annualised

The volume of merchandise imports receded for a third successive quarter, falling by 1,9 per cent in the third quarter of 2016. Decreases in the volume of non-oil imports were only partially offset by a rise in the volume of mining imports. The volume of imported bulk and break bulk cargo handled at national ports remained subdued after declining in the second quarter of 2016. As a result, the country's import penetration ratio declined from 26,2 per cent in the second quarter of 2016 to 25,2 per cent in the third quarter. The rand price of merchandise imports declined by 1,3 per cent in the third quarter of 2016 after having increased by 2,4 per cent in the preceding quarter.

Real merchandise imports



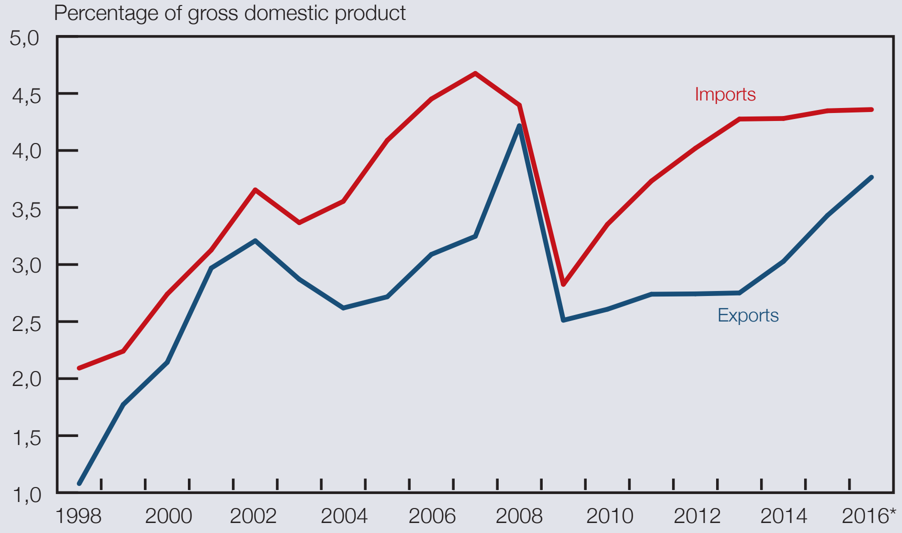
Seasonally adjusted. Underlying data at constant 2010 prices

The country's terms of trade improved further in the third quarter of 2016 as export prices increased marginally alongside declining import prices.

Box 1 South Africa's international trade in motor vehicles and components

A notable feature of South Africa's foreign trade is the structural increase over time in both the imports and the exports of motor vehicles and components. The accompanying graph illustrates these increases relative to the country's gross domestic product.

South Africa's international trade in motor vehicles and components



* First three quarters

The manufacturing of motor vehicles and components in South Africa has been bolstered by industry developments, supported by government programmes, that allow for greater international specialisation and economies of scale. Vehicle manufacturers have scaled up the production of a limited number of models in South Africa, in order to satisfy not only the local-market but also the export-market demand for those models. Simultaneously they have turned to importing other models where such economies of scale would be more difficult to achieve.

Previously the industry had been more inward-looking and protected; in many instances local manufacturing of a fairly wide range of models had been undertaken despite relatively low volumes, tuned predominantly to supplying the local market.

More detail – notably the split between vehicles and key component categories – is provided in the accompanying table.

South Africa's international trade in motor vehicles and components

R millions

	Exports					Imports				
Year	Vehicles	Catalytic converters	Tyres	Other parts and components	Total	Vehicles	Catalytic converters	Tyres	Other parts and components	Total
1998	2 993	1 494	860	2 876	8 222	3 893	310	704	11 026	15 933
1999	7 435	2 608	1 117	3 635	14 794	4 105	186	738	13 672	18 701
2000	10 636	4 711	1 315	3 614	20 275	7 613	137	873	17 311	25 934
2001	16 591	9 055	1 475	3 938	31 059	10 229	259	895	21 329	32 713
2002	21 602	9 334	2 434	5 688	39 058	14 014	332	1 243	28 894	44 483
2003	22 370	8 220	2 211	5 258	38 060	14 725	365	1 360	28 186	44 636
2004	22 773	8 338	2 241	5 321	38 673	20 458	337	1 404	30 280	52 480
2005	27 145	9 994	2 097	5 308	44 544	28 794	256	1 693	36 285	67 027
2006	32 278	15 905	2 261	6 370	56 814	36 905	452	2 176	42 340	81 874
2007	35 809	21 813	2 307	8 572	68 501	45 752	418	3 573	48 886	98 629
2008	62 532	24 413	3 225	9 728	99 898	40 877	695	3 741	58 871	104 185
2009	40 986	12 353	2 556	7 087	62 982	28 518	640	3 121	38 593	70 871
2010	47 061	14 946	2 214	7 443	71 664	40 156	912	4 043	46 996	92 107
2011	51 599	19 725	2 956	8 562	82 842	52 965	838	4 940	54 091	112 835
2012	60 050	16 338	3 310	9 555	89 254	61 944	633	5 985	62 228	130 790
2013	66 616	18 371	3 460	9 190	97 637	72 003	899	7 345	71 497	151 744
2014	83 569	19 516	3 570	8 772	115 428	70 491	792	7 437	84 472	163 192
2015	105 063	20 280	3 826	8 510	137 679	70 303	1 037	7 471	95 695	174 505
2016*	93 476	17 318	2 798	6 845	120 436	45 857	941	6 138	86 472	139 407

* January to September

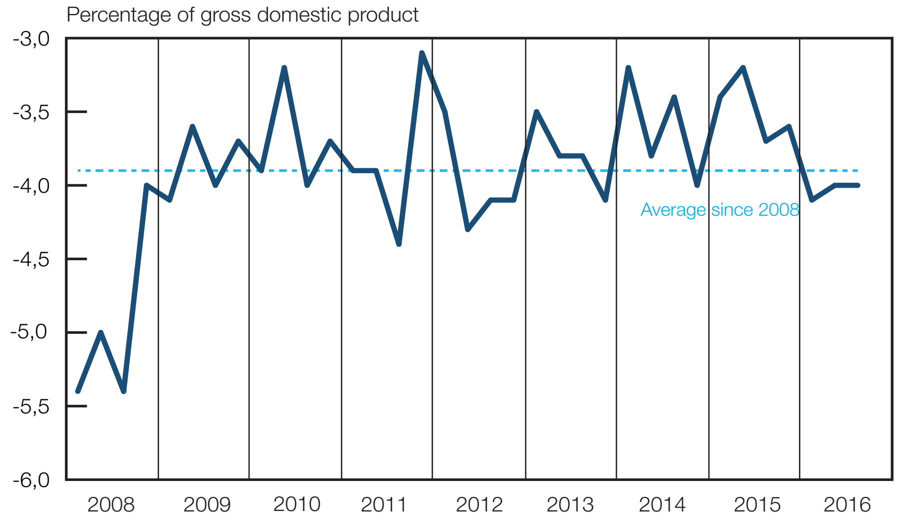
Data include all international trade, including that with Botswana, Lesotho, Namibia and Swaziland.
Sources: South African Revenue Service and South African Reserve Bank estimates

The shortfall on the services, income and current transfer account widened from R171 billion in the second quarter of 2016 to R172 billion in the third quarter. As a percentage of GDP, the deficit on this account remained unchanged and aligned with the longer-term average ratio of almost similar magnitude, as indicated in the graph on the next page.

The somewhat larger shortfall could primarily be attributed to an increase in net payments for services, in particular services of a technical nature. Gross travel receipts decreased for a second consecutive quarter in the third quarter of 2016, albeit slightly.

The increase in net payments for services in the third quarter of 2016 was partially offset by a decline in net income payments to foreign investors; gross dividend payments to the rest of the world decreased more than gross dividends received from abroad over the period.

Balance on services, income and current transfer account



However, when the first three quarters of 2016 are compared with the corresponding period in 2015, gross dividend payments to the rest of the world showed virtually no growth – a clear reflection of a weak domestic economic environment. Gross dividend payments rose by 19 per cent and 6 per cent in 2014 and 2015 respectively.

Financial account

Global financial markets continued to be characterised by some degree of volatility in the third quarter of 2016. In early July 2016, markets were still assessing the impact of the Brexit which eventually affected, in the main, some parts of Europe. In addition, volatility was encountered amid the European Central Bank's decision to keep its monetary policy stance unchanged at its September meeting. The announcement of the downward revision of the interest rate path outlook by the US Federal Reserve over the same period partly restored investors' appetite for high-yielding emerging-market assets. The attractiveness of emerging-market assets also benefitted from reduced concerns about China's economic growth and from the stabilisation of commodity prices. The inflow of capital showed some degree of differentiation across emerging-market economies, with South Africa attracting a higher inward capital flow in the third quarter of 2016 relative to the second quarter.

Net financial transactions

R billions

	2015				2016		
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities							
Direct investment	5,5	16,1	14,3	22,0	11,4	8,6	7,0
Portfolio investment	55,0	11,9	-0,3	106,0	18,1	33,0	38,8
Financial derivatives	-74,3	-71,0	-103,0	-320,9	-149,6	-103,8	-116,1
Other investment	-20,0	8,1	44,2	72,3	-6,7	-13,8	26,3
Change in assets							
Direct investment	-9,6	-16,2	-38,5	-73,2	-22,3	-6,5	-1,4
Portfolio investment	-9,7	-11,2	-10,9	-36,5	8,9	-2,1	-16,4
Financial derivatives	70,9	78,3	103,3	325,8	148,5	94,4	115,0
Other investment	-22,0	42,2	47,9	46,8	14,9	2,9	-22,5
Reserve assets	1,4	0,5	-5,1	9,1	4,2	1,2	7,8
Total identified financial transactions*	-2,9	58,8	51,9	151,2	27,4	13,8	38,4
As percentage of gross domestic product	*-0,3*	*5,8*	*5,1*	*3,8*	*2,6*	*1,3*	*3,5*

* Including reserve assets but excluding unrecorded transactions
Inflow (+) / outflow (-)

The net inflow of capital on the financial account of the balance of payments (including reserve assets but excluding unrecorded transactions) surged from R13,8 billion in the second quarter of 2016 to R38,4 billion in the third quarter. The categories for direct investment, portfolio investment and other investment recorded net capital inflows over the period. Overall, financial account inflows amounted to 3,5 per cent of GDP in the third quarter of 2016, up from 1,3 per cent during the second quarter.

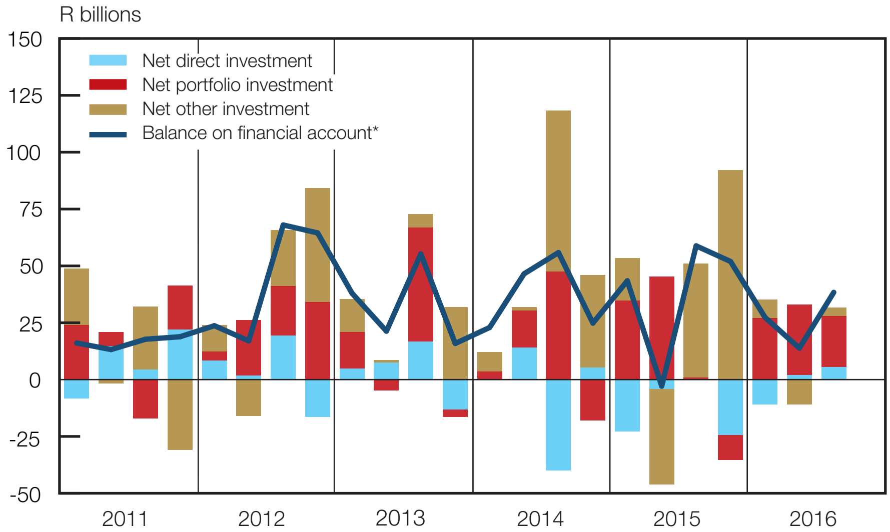
Foreign-owned assets in South Africa

South Africa's direct investment liabilities increased moderately in the third quarter of 2016. Non-resident investors acquired direct investment assets to the value of R7,0 billion in the third quarter of 2016, having invested R8,6 billion in the second quarter. The inflow of capital was predominantly in the form of loans extended by foreign parent companies to their South African subsidiaries.

Inward portfolio investment into South Africa increased in the third quarter of 2016 as non-resident investors acquired domestic portfolio assets to the value of 38,8 billion; inward portfolio investment to the value of R33,0 billion had been registered in the second quarter. The capital inflow in the third quarter of 2016 mainly reflected the acquisition of domestic debt securities by foreign investors searching for higher-yielding assets. National Treasury successfully issued two international bonds to the value of US$3 billion in October 2016 at a coupon rate of 4,3 per cent – lower than the coupon rate of 4,88 per cent attached to the US$1,25 billion bond issued in the second quarter of 2016. Amid concerns of a possible downgrade of the country's sovereign credit rating by official rating agencies in December 2016, portfolio investment into South African equities showed an outflow to the value of R5,9 billion in the third quarter of 2016 following a capital outflow of R1,6 billion in the preceding quarter.

Other investment flows into South Africa amounted to R26,3 billion in the third quarter of 2016 following an outflow of capital to the value of R13,8 billion in the second quarter. The inflow of other investment capital can largely be attributed to short-term borrowing by the domestic banking sector.

Balance of payments: financial account



* Including financial derivatives and reserve assets

South African-owned assets abroad

South African entities continued to acquire foreign direct investment assets in the third quarter of 2016, but at a reduced pace. The value of foreign assets acquired by domestic entities amounted to R6,5 billion in the second quarter of 2016 and R1,4 billion in the third quarter, amid increased volatility in global financial markets.

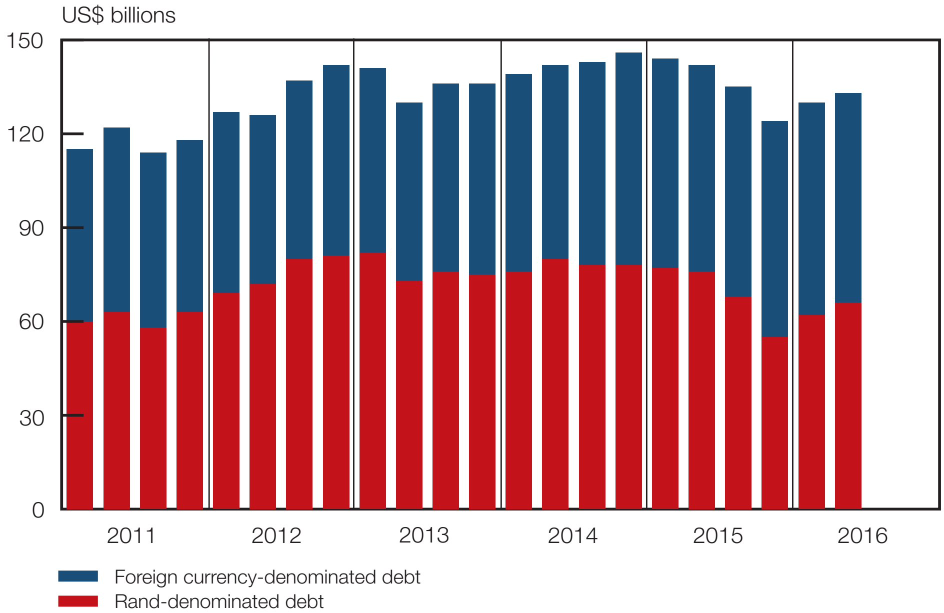
South African residents acquired foreign portfolio assets to the value of R16,4 billion in the third quarter of 2016 following the acquisition of portfolio assets amounting to R2,1 billion in the second quarter. The surge in the acquisition of foreign portfolio assets mainly took the form of a rise in equity securities held by the domestic private sector.

Capital flows relating to other outward investment switched from an inflow of R2,9 billion in the second quarter of 2016 to an outflow of R22,5 billion in the third quarter as the domestic banking sector extended short-term loans to non-resident parties to finance offshore activities over the period.

Foreign debt

South Africa's total outstanding foreign debt increased further from US$129,3 billion at the end of the first quarter of 2016 to US$132,4 billion at the end of the second quarter. The increase in foreign debt commitments in the second quarter of 2016 can be ascribed to an accumulation of rand-denominated debt, while foreign currency-denominated debt declined for a second consecutive quarter. Expressed in rand terms, South Africa's gross external debt rose from R1 924 billion to R1 955 billion over the same period.

Total external debt



Foreign currency-denominated external debt declined for a second consecutive quarter from US$67,6 billion at the end of the first quarter of 2016 to US$66,9 billion at the end of the second quarter. The decrease in foreign currency-denominated external debt was mainly driven by redemptions of international debt securities augmented by long-term loan repayments by the domestic banking sector. 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) decreased 47,3 per cent of total foreign currency-denominated debt at the end of March 2016 to 42,8 per cent at the end of June.

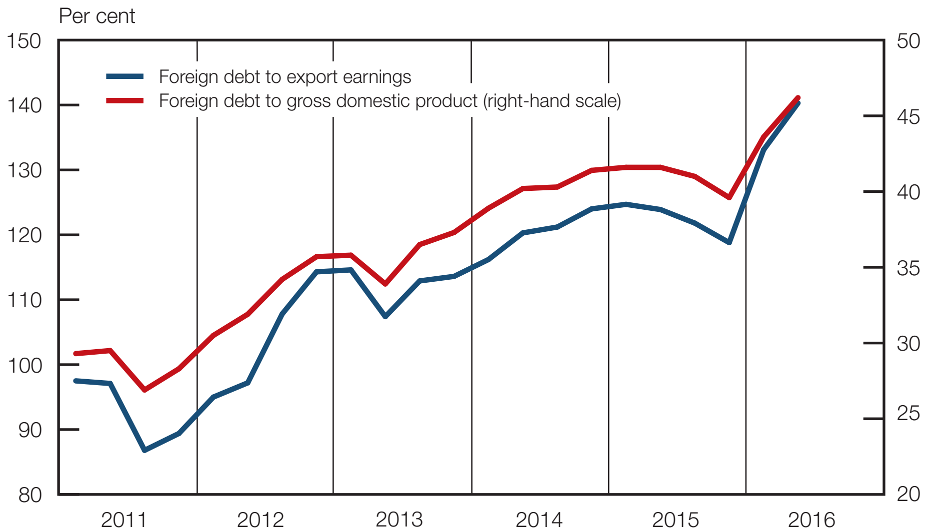
Foreign debt of South Africa

US$ billions at end of period

	2015				2016	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Foreign currency-denominated debt	67,0	65,7	66,6	69,3	67,6	66,9
Debt securities	23,6	23,9	23,8	23,3	22,6	22,5
Other	43,3	41,8	42,8	46,0	45,0	44,4
Public sector	7,3	7,7	7,8	7,7	8,1	8,0
Deposit-taking institutions	17,7	16,3	16,5	19,9	17,9	16,8
Non-monetary private sector	18,3	17,8	18,5	18,4	19,0	19,6
Rand-denominated debt	77,4	76,0	67,9	54,8	61,7	65,5
Debt securities	39,4	38,8	34,5	28,7	32,8	36,2
Other	38,0	37,2	33,4	26,1	28,8	29,3
Total foreign debt	144,4	141,7	134,5	124,1	129,3	132,4
As percentage of gross domestic product	*41,6*	*41,6*	*41,0*	*39,6*	*43,6*	*46,2*
As percentage of total export earnings	*124,9*	*123,8*	*121,5*	*118,8*	*133,5*	*140,7*

The country's rand-denominated external debt, expressed in US dollar, increased from US$61,7 billion at the end of March 2016 to US$65,5 billion at the end of the second quarter. This was largely on account of the appreciation of the exchange value of the rand, the net purchases by non-residents of domestic government bonds and, to a lesser extent, the rise in short- and long-term debt obligations of the private non-banking sector. Relative to the country's total external debt, rand-denominated debt increased marginally from 48,7 per cent at the end of the first quarter of 2016 to 49,5 per cent at the end of the second quarter.

External debt ratios



South Africa's external debt as a ratio of GDP increased from 43,6 per cent at the end of March 2016 to 46,2 per cent at the end of June – higher than the average ratio of 41,8 per cent recorded during the preceding eight quarters. The ratio of external debt to export earnings rose from 133,5 per cent to a new record high of 140,7 per cent over the same period.

International investment position

South Africa's positive net international investment position improved marginally from a revised R461 billion at the end of March 2016 to R463 billion at the end of June, as the value of both South Africa's foreign liabilities and foreign assets increased at a similar pace.

The market value of South Africa's foreign liabilities (arising from inward investment) advanced from R5 689 billion at the end of March 2016 to R5 738 billion at the end of June. This mainly reflected an increase in the market value of portfolio investment, while the market value for the categories of direct investment, financial derivatives and 'other' investment decreased. While the JSE All-share index remained broadly unchanged from the end of March 2016 to the end of June, portfolio investment liabilities increased, mainly due to the valuation effects emanating from strong price gains for the shares of gold-mining companies and other shares popular with non-resident investors.

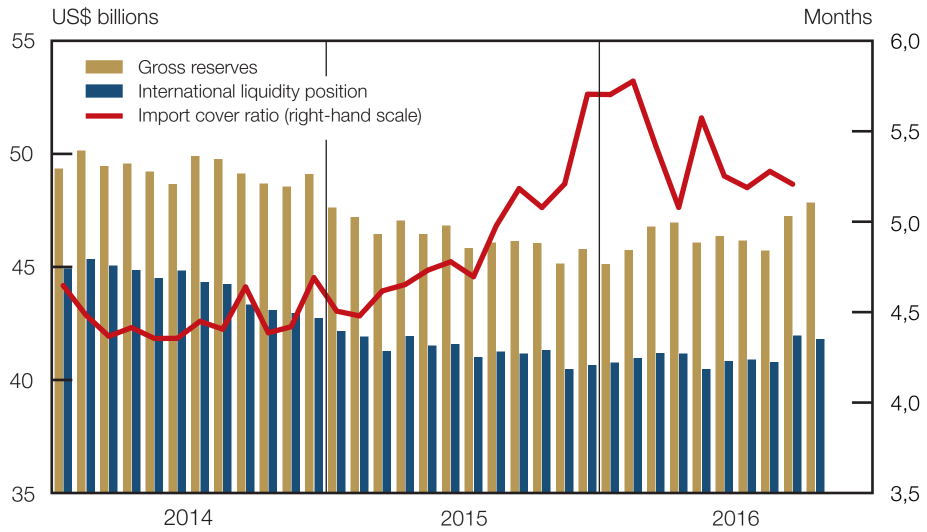
The market value of South Africa's foreign assets (arising from outward investment) rose to R6 201 billion at the end of June 2016 compared with R6 150 billion at the end of March. The increase in the market value of foreign assets largely resulted from an increase in direct investment and, to a lesser degree, portfolio investment. Market valuation adjustments boosted the stock of direct investment assets, while a further positive performance of global equity markets increased the country's foreign portfolio asset position. The increase in these foreign asset categories was partly countered by declines in the market value of financial derivatives, 'other' investment and reserve assets.

As a ratio of South Africa's GDP, the country's foreign liabilities decreased from an all-time high of 139,2 per cent at the end of March 2016 to 137,9 per cent at the end of June while the country's foreign assets declined from 150,5 per cent to 149,1 per cent over the same period. This resulted in the country's positive net international investment position retreating slightly to 11,1 per cent of GDP at the end of June 2016 compared with 11,3 per cent at the end of March.

International reserves and liquidity

South Africa's international reserves declined further by R8,4 billion in the third quarter of 2016 after decreasing by R1,2 billion in the second quarter. Measured in US dollar, South Africa's gross gold and other foreign reserves (i.e. the international reserves of the SARB before accounting for reserve-related liabilities) increased from US$46,4 billion at the end of June 2016 to US$47,2 billion at the end of September before rising further to US$47,8 billion at the end of October. The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services as well as income payments) decreased from 5,3 months at the end of June 2016 to 5,2 months at the end of September.

International reserves



South Africa's international liquidity position increased from US$40,8 billion at the end of June 2016 to US$42,0 billion at the end of September, but declined marginally to US$41,8 billion at the end of October.

Exchange rates

From a low base, the exchange value of the South African rand recovered significantly during the first two quarters of 2016 and strengthened further in the third quarter, appreciating on balance by 5,6 per cent on a trade-weighted basis as persistently low and even negative interest rates in the developed economies encouraged international investors to search for yield in emerging-market economies. The local currency appreciated notably against the British pound in the aftermath of the British vote to leave the European Union, cumulatively gaining 38 per cent from the end of December 2015 to the end of October 2016.

Exchange rates of the rand

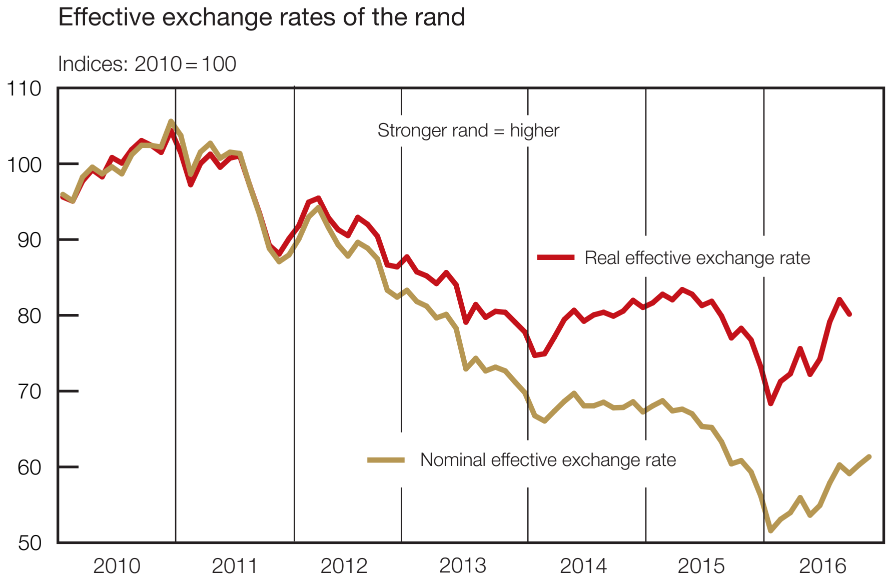
Percentage change

	31 Dec 2015 to 31 Mar 2016	31 Mar 2016 to 30 Jun 2016	30 Jun 2016 to 30 Sep 2016	30 Sep 2016 to 30 Nov 2016
Weighted average*	**2,5**	**2,1**	**5,6**	**3,7**
Euro	0,7	2,9	5,0	5,0
US dollar	4,7	0,8	5,7	-0,2
Chinese yuan	4,2	3,6	6,1	3,1
British pound	8,0	7,7	9,6	3,7
Japanese yen	-2,2	-7,9	3,9	11,4

* Against a basket of 20 currencies

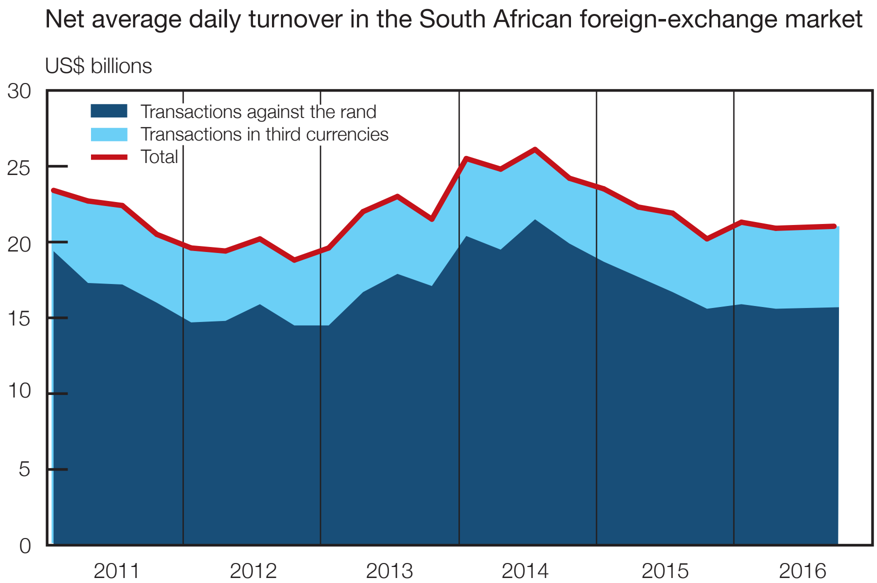
In July 2016, the South African rand appreciated, on balance, by 4,6 per cent on a trade-weighted basis as expectations of extended monetary stimulus from major central banks increased following the British vote to exit the European Union. South African financial markets were negatively affected by domestic political developments which ultimately caused the nominal effective exchange rate of the rand to weaken by 2,1 per cent in August 2016. Nonetheless, the domestic currency subsequently recovered its losses when it appreciated by 3,2 per cent in September. Factors supporting the rand in the third quarter of 2016 were, among others, investors' search for yield amid expectations that the interest rates in advanced economies would remain low for a considerable period of time, the anticipation of inflows after SABMiller shareholders voted in favour of the Anheuser-Busch InBev takeover bid, and a better-than-expected current-account deficit and domestic economic growth data for the second quarter of 2016. While the rand depreciated again in early October 2016 as domestic political tension heightened, the currency recovered as tensions subsided and on balance appreciated significantly during the month. However, the surprise outcome of the US presidential election and the associated expectations of higher US interest rates contributed to some depreciation of the exchange rate of the rand in early November.

The real effective exchange rate of the rand increased by 17 per cent from its recent low in January 2016 to September. While this resulted in a deterioration in the competitiveness of local producers in foreign markets, at its most recent levels the real effective exchange rate of the rand was still 9 per cent below its average of the past 15 years.



Turnover in the South African foreign-exchange market

The net average daily turnover in the South African market for foreign exchange increased marginally from US$20,8 billion in the second quarter of 2016 to US$20,9 billion in the third quarter. Turnover in the rand market edged higher from US$15,6 billion in the second quarter of 2016 to US$15,7 billion in the third quarter. Transactions of the local currency against the US dollar remain the dominant driver of the total turnover in the South African foreign-exchange market, constituting approximately 72 per cent of the total turnover.



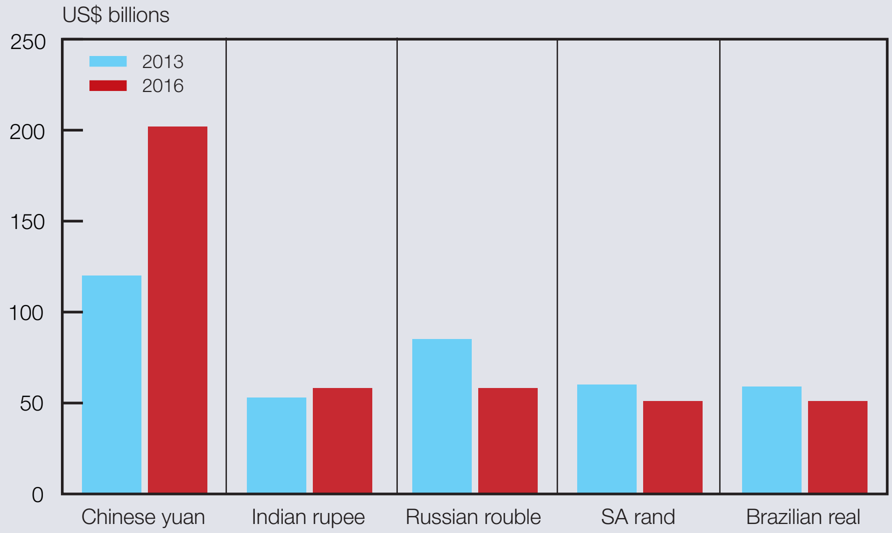
Despite this slight increase in the net average daily turnover in the rand market, the value of domestic currency transactions against the US dollar, which constitute about 95 per cent of this market, inched lower from US$15,1 billion in the second quarter of 2016 to US$15,0 billion in the third quarter. The rand against the euro currency pair increased its share in this market from 1,8 per cent in the second quarter of 2016 to 2,5 per cent in the third quarter. The net daily turnover in the market for third currencies remained unchanged at US$5,2 billion over this period. At the end of the third quarter, South African banks' commitments to purchase foreign currency totalled US$205 billion and to sell foreign currency amounted to US$211 billion. During the third quarter, swap and forward currency transactions averaged US$12,7 billion per day in the rand market.

Box 2 BIS triennial survey, 2016: daily turnover of the BRICS currencies in the foreign-exchange market

The Bank for International Settlements (BIS) conducts a global survey on foreign-exchange and derivatives market activity every three years. The survey aims to obtain comprehensive and internationally consistent information on the size and structure of and activity in foreign-exchange and over-the-counter (OTC) derivatives markets. The results of the April 2016 survey, released in September, show that the turnover in the global foreign-exchange markets declined from US$5,4 trillion per day in 2013 to US$5,1 trillion in 2016.

Daily turnover in the Chinese yuan foreign-exchange market rose by 68,3 per cent from an average of US$120 billion per day in April 2013 to US$202 billion per day in April 2016. Consequently, the Chinese yuan became the world's eighth-most traded currency, overtaking the Mexican peso to become the most actively traded emerging-market currency. The Indian rupee's average daily foreign-exchange turnover increased by 9,4 per cent from US$53 billion to US$58 billion between April 2013 and April 2016, while the daily foreign-exchange turnover in the Russian rouble decreased substantially by 31,8 per cent from an average of US$85 billion to US$58 billion over the period. Daily turnover in the South African rand foreign-exchange market averaged US$51 billion in April 2016 compared with US$60 billion in April 2013. In Brazil, the real average stood at US$51 billion in April 2016 compared with US$59 billion in April 2013.

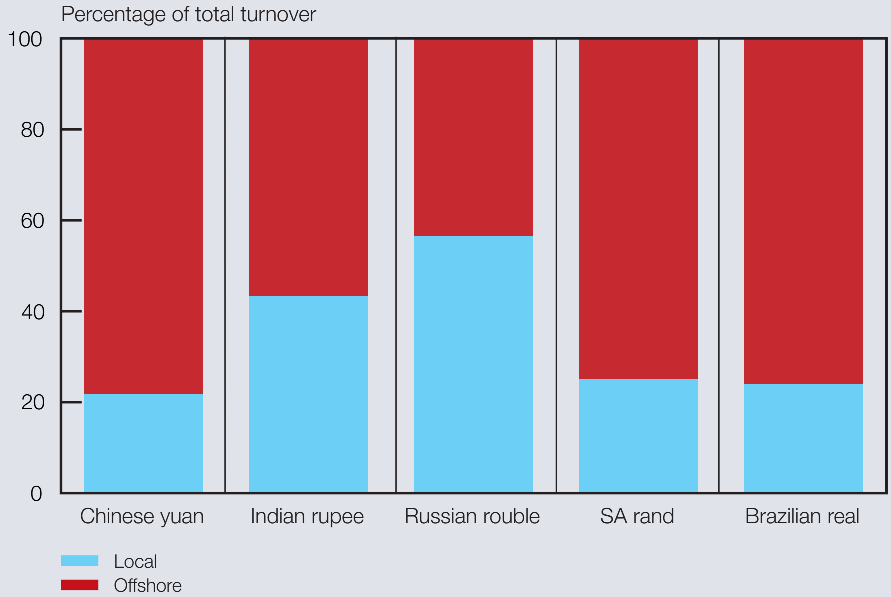
Turnover in BRICS currencies



Source: Bank for International Settlements

About 78 per cent of the Chinese yuan trade is conducted outside the Chinese market, mostly in Hong Kong. The Russian rouble has the smallest fraction of trading taking place offshore, with about 56 per cent of its trading taking place in the domestic market. As far as the South African rand is concerned, about 75 per cent of its trading takes place offshore, mostly in the United Kingdom. Almost 76 per cent of the Brazilian real's trade is conducted offshore, mainly in the United States. A high percentage of offshore Indian rupee trading occurs in Singapore.

Trading BRICS currencies: geographical split



Source: Bank for International Settlements

Monetary developments, interest rates and financial markets

Money supply

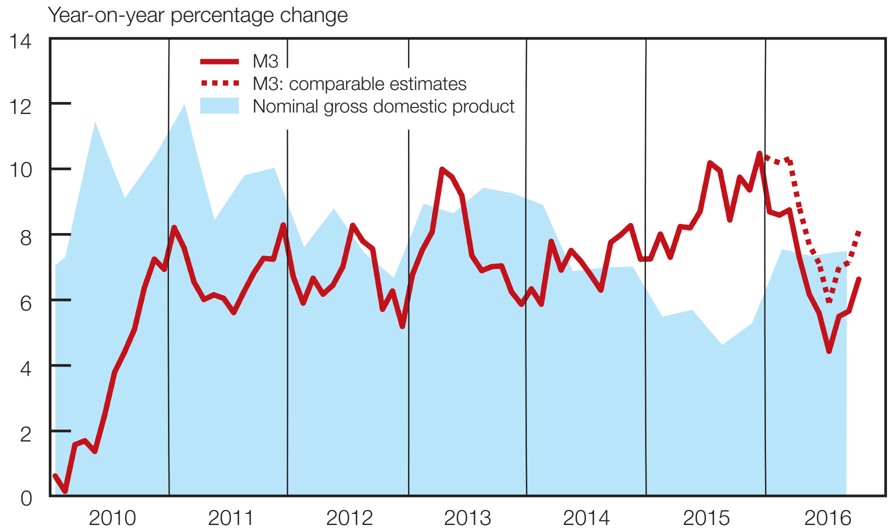
Growth in the broadly defined money supply (M3) decelerated significantly during the first half of 2016, reaching a rate of 4,4 per cent in July before recovering in the following three months to October. The slower year-on-year growth in M3 coincided with a firmer rate of expansion in nominal GDP in the second and third quarters of 2016, resulting in a reversal of the trend where growth in M3 exceeded that of GDP from mid-2014. Factors which may have contributed to the slower growth in M3 include:

- a methodological change[5] to the monetary statistics which partly affected the value of deposits reported by banks from January 2016;
- a lower transactions demand for money arising from muted domestic expenditure;
- significant withdrawals of deposits by public corporations, selected asset managers and pension funds; and
- drawdowns of equitable share transfers by local authorities, received earlier in the year.

5 In their balance-sheet reporting for the BA 900 form, banks were requested to move certain short-term debt instruments, such as structured and credit-linked notes, from deposit to debt securities as they fall outside the definition of money. For an overview of the change, see Box 2 on page 44 of the September 2016 *Quarterly Bulletin*.

The modest recovery in deposits from August 2016 was especially due to an increase in corporate deposits which picked up from year-on-year growth of 1,3 per cent in July to 4,9 per cent in October. At the same time, deposits of the household sector maintained firm rates of increase, although the pace of growth slowed marginally from 13,6 per cent in December 2015 to 11,1 per cent in August and 10,4 per cent in October 2016.

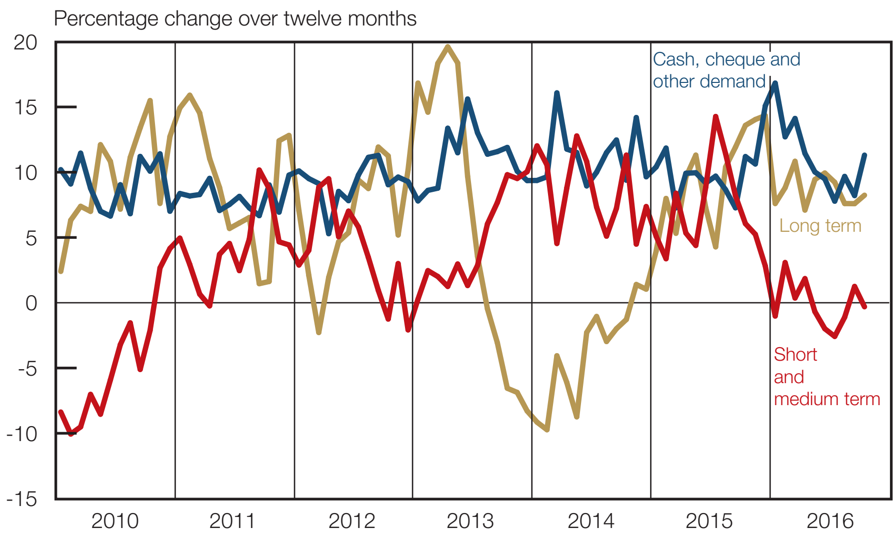
M3 and gross domestic product



Reflecting the slower growth in M3 relative to GDP, the income velocity of the circulation of M3 increased from 1,39 in the fourth quarter of 2015 to 1,41 and 1,42 in the first and second quarters of 2016 respectively. It remained at 1,42 in the third quarter. The quarter-to-quarter seasonally adjusted and annualised growth in M3 receded from 4,6 per cent in the second quarter of 2016 to 3,1 per cent in the third quarter, its weakest pace since the third quarter of 2014.

In terms of maturity structure, the contraction in the money supply was relatively broad-based. The year-on-year rate of growth in short- and medium-term deposits, which comprise around 33 per cent of total deposits, fell below zero from May 2016 to October with only a brief reprieve in September. The more transaction-orientated M1 – notes, coin, cheque, transmission and other demand deposits – comprising around 48 per cent of total deposits, continued to grow although its growth rate halved from 16,8 per cent in January 2016 to 7,8 per cent in July. Subsequently, growth accelerated to 11,3 per cent in October. Growth in long-term deposits,

Growth in deposits by maturity

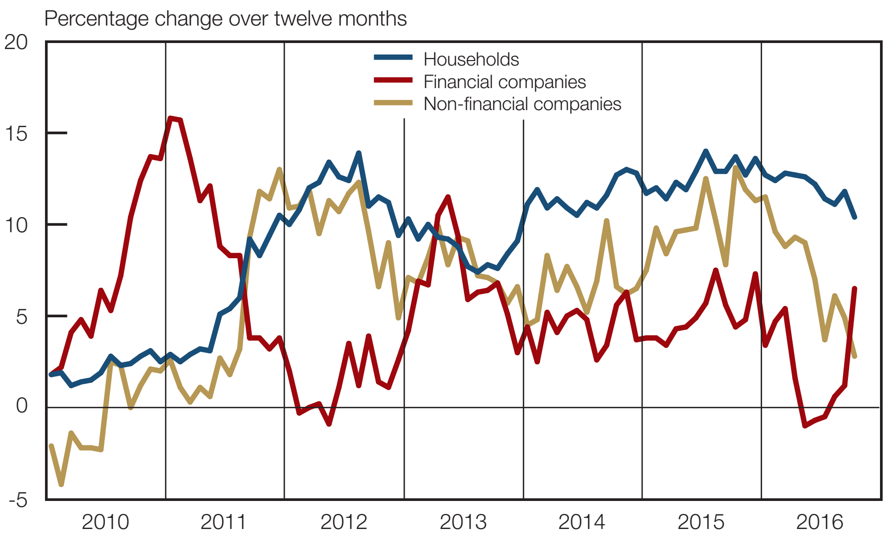


which showed an upward trend early in 2016 on account of rising interest rates, was the category most affected by the methodological change mentioned earlier and fell from 10,8 per cent in March to 8,2 per cent in October.

M3 holdings of households and companies

	Quarter-on-quarter change (R billions)					Percentage of total M3 deposit holdings	
	2015		2016			2015	2016
	3rd qr	4th qr	1st qr	2nd qr	3rd qr	4th qr	3rd qr
Households	27,4	38,5	11,5	31,4	27,1	32,1	33,1
Companies	41,4	7,0	35,6	-33,0	47,2	67,9	66,9
Financial	*10,1*	*-25,8*	*11,3*	*-3,0*	*31,5*	*37,6*	*37,4*
Non-financial................	*31,2*	*32,8*	*24,4*	*-29,9*	*15,7*	*30,3*	*29,5*
Total M3 deposits...........	**68,7**	**45,4**	**47,2**	**-1,6**	**74,3**	**100,0**	**100,0**

M3 holdings of households and companies



The deposit holdings of the corporate sector increased by R47,2 billion in the third quarter of 2016, more than fully reversing the decline of R33,0 billion recorded in the previous quarter when non-financial companies reduced their deposits with banks. The pickup in the third quarter mainly represented an increase in deposits by financial companies, such as companies involved in fund management and securities trading. Non-financial corporates recorded only moderate growth in their deposits in the third quarter of 2016, while the deposit growth of the household sector remained relatively firm. Households continued to take advantage of relatively higher interest rates, which made depository savings and other interest-earning investment products more attractive. Overall M3 increased by R74,3 billion in the third quarter of 2016, compared with a decline of R1,6 billion in the second quarter.

Statistical counterparts of change in M3

R billions

	2015	2016		
	4th qr	1st qr	2nd qr	3rd qr
Net foreign assets	48,0	-24,7	7,6	-73,5
Net claims on the government sector	-13,1	-0,4	8,4	75,0
Claims on the private sector	87,8	78,8	-19,0	68,6
Net other assets and liabilities	-77,2	-6,5	1,5	4,2
Total change in M3	**45,4**	**47,2**	**-1,6**	**74,3**

While the domestic counterparts of change in M3 expanded during the third quarter of 2016, net foreign assets decreased significantly, partly affected by the appreciation of the exchange value of the rand which devalued the gold and foreign-exchange assets as well as the foreign derivative holdings of the monetary sector. At the same time, there was a temporary increase in the foreign liabilities of the monetary sector, mainly due to a short-term foreign currency loan entered into by the SARB which was used to facilitate certain transactions in the foreign exchange market as part of its operational responsibilities. The decrease in net foreign assets was fully offset by the significant increase in net claims on the government sector, which was the result of a large decrease in government deposits, a rise in the holdings of government securities, and an increase in funds extended to government from the Corporation for Public Deposits. The counterparts to M3 were further supported by an increase in claims on the private sector which represented increased demand for credit, especially by the corporate sector.

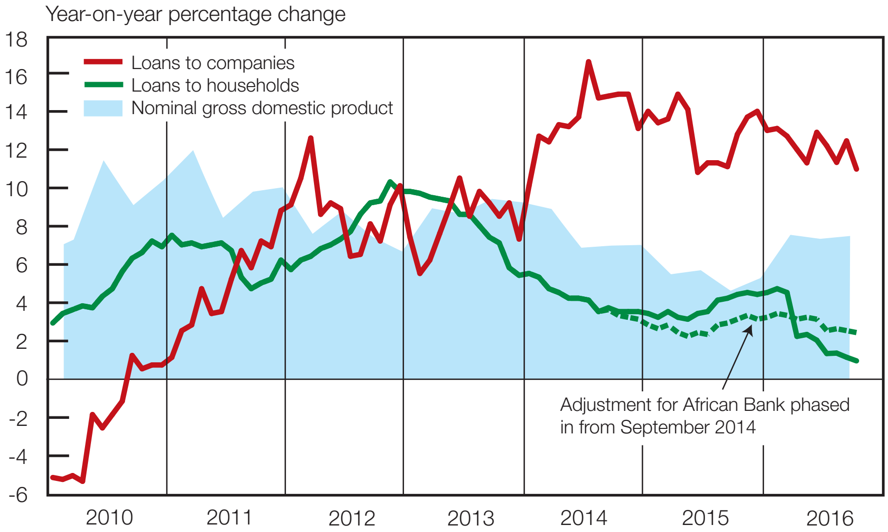
Credit extension

After relatively stable growth of around 8 per cent since 2012, the year-on-year pace of change in bank credit extended to the domestic private sector gradually decelerated in 2016 to reach a low of 5,9 per cent in October – a deceleration which was partly affected by a technical correction[6] in the data. The corporate sector's credit demand remained relatively strong, with its year-on-year growth averaging about 12,4 per cent in the first three quarters of 2016. The financial strain experienced by consumers remained evident in the continued weak expansion in credit growth to the household sector during 2016. The gradual rise in lending rates, relatively high household debt levels and debt service costs, fragile real household incomes and weak job prospects, among other things, continue to weigh heavily on the already vulnerable finances of households.

The ratio of credit to GDP declined moderately in the second and third quarters of 2016 due to a rebound in growth in nominal GDP as well as a moderation in total loans and advances growth. Consumer confidence remained weak amid continued concern about households' finances, contributing to the subdued demand for credit. Business confidence remained in the doldrums, although it improved somewhat in the third quarter of 2016. Nonetheless, corporate credit demand remained relatively healthy, illustrating the continued existence of pockets of vigorous activity and opportunity.

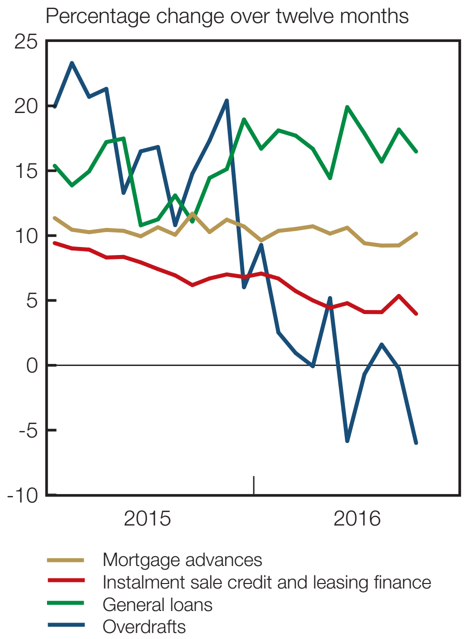
6 In April 2016, the newly restructured African Bank was included in banking sector surveys while the old entity, whose data had been held constant since July 2014, was removed. Due to, among other things, the repayment of loans by clients and the movement of selected assets to a non-bank entity, the balance sheet of the new bank differs substantially from that of the old entity.

Bank loans and gross domestic product

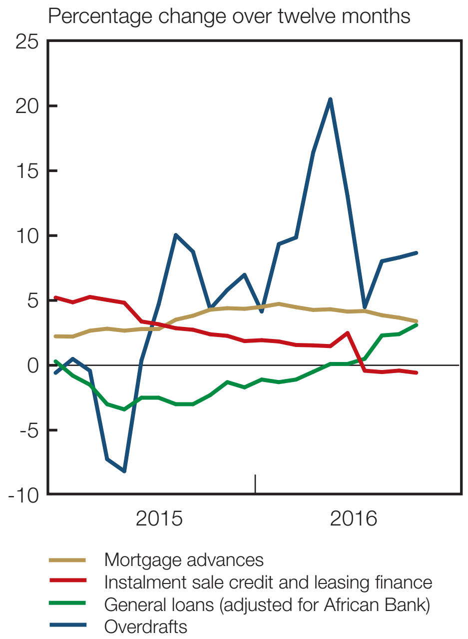


Total loans and advances increased by R57,6 billion in the third quarter of 2016, significantly higher than the decline of R23,6 billion recorded in the second quarter but lower than the increase of R69,4 billion in the third quarter of 2015. This brought the increase in loans and advances in the first nine months of 2016 to R128,7 billion, down from the increase of R176,5 billion over the same period in 2015. The slowdown during 2016 was partly affected by the incorporation of the newly available data on the restructured African Bank. This technical correction to the data had its largest impact on credit extension to the household sector. The corporate sector extended its dominance of credit demand during the third quarter of 2016.

Selected loans and advances extended to corporate sector



Selected loans and advances extended to household sector

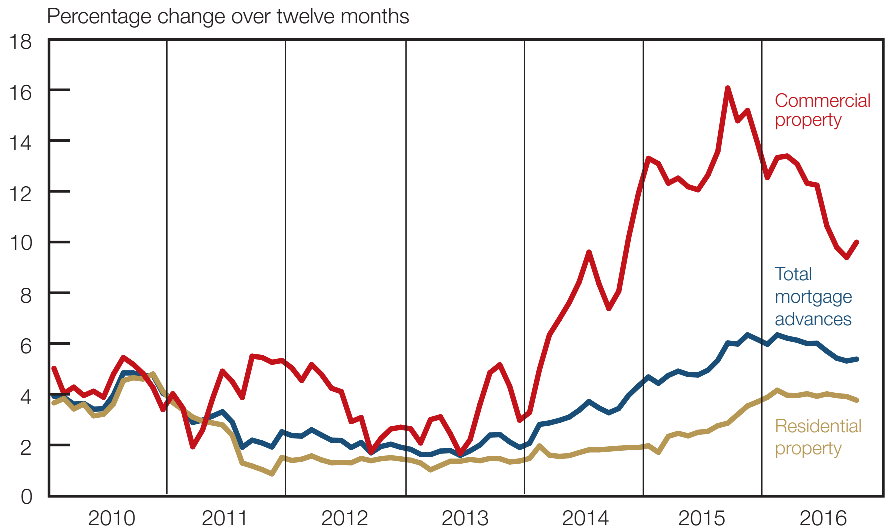


By value, the main category of credit utilised by the corporate sector, namely *general loans*, rose by R31,7 billion in the third quarter of 2016 compared with a decline of R0,5 billion in the previous quarter. General loans to corporates include term funding and structured loan funding to non-financial companies as well as to financial companies involved in, among other things, securities trading, life insurance, fund management, and vehicle financing. Following the technical correction of the data in the second quarter of 2016, general loans to the household sector increased by a moderate R2,9 billion in the third quarter. The quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances to the private sector declined from 8,0 per cent in the first quarter of 2016 to 3,7 per cent in both the second and the third quarters of the year.

Bank credit extension to households remained muted, with a moderate pickup in the first ten months of 2016. Twelve-month growth in general loans to households, adjusted for the technical effect caused by the restructured African Bank, measured 3,1 per cent in October 2016, up from negative growth for most of 2015. This contrasted sharply with growth rates in excess of 30 per cent registered in 2011 and 2012.

Mortgage advances remain the largest category of credit extension, but lost some ground in recent years. As a ratio of total loans and advances, mortgage advances declined from a peak of around 54 per cent in 2010 to slightly below 43 per cent in the first ten months of 2016. Following pedestrian growth of less than 2 per cent in 2013, year-on-year growth in mortgage advances exceeded 6 per cent towards the end of 2015 and early 2016 before decelerating to 5,4 per cent in October. This deceleration reflected both a slowdown in household demand and weaker growth in demand for commercial property. Growth in mortgage advances on commercial property moderated to 10,0 per cent in October 2016 from a peak of 16,1 per cent in September 2015. While growth in mortgage advances on residential property has been gaining momentum, picking up from year-on-year growth of 2 per cent in early 2015, the pace has remained sluggish, with growth rates only increasing to around 4 per cent towards the latter months of 2016. While capital repayments on residential property tend to curtail growth in mortgage advances, these repayments have been lower in the first nine months of 2016 when compared to the same period in 2015. The slowdown is partly explained by the impact of relatively higher interest rates which place greater strain on consumers' ability to repay more capital than contractually required.

Mortgage advances



The rate of expansion in *instalment sale credit and leasing finance*, which mainly represents the financing of new and second-hand vehicles, continued to slow in the first ten months of 2016. Growth over twelve months declined from 6,5 per cent in January 2015 to 0,9 per cent in October 2016, exacerbated by a securitisation transaction of R6,7 billion which took place in July. Year-on-year growth in the instalment sale financing of new passenger vehicles has been decelerating since the second half of 2015, while growth in the financing of used passenger vehicles remained positive and fluctuated broadly sideways over the same period. However, the demand for used vehicles by consumers is currently not sufficient to boost credit extension significantly.

Demand for loans by companies slowed in the second quarter of 2016 but recovered somewhat in the subsequent quarter. The quarter-on-quarter increase in credit extension to the corporate sector amounted to R53,1 billion in the third quarter of 2016, slightly exceeding the increase of R52,2 billion recorded in the same period of 2015. Both financial and non-financial companies increased their reliance on bank funding during the third quarter.

By economic sector, the electricity, gas and water sector had a healthy demand for credit in the third quarter of 2016, followed by rail and transport companies, including companies involved in mobile telecommunications and networks. The effects of the prolonged drought may partly have influenced the agricultural sector to increase its reliance on bank funding. Growth in credit extension to the manufacturing sector moderated somewhat but remained healthy, probably indicating expectations of an improving outlook for the sector. Subdued mining production and revenue continued to hamper credit growth in the sector, having recorded negative growth in three quarters of 2016.

Growth in bank credit by economic sector over the year to September 2016

Sector	Percentage change	Percentage of total credit extension*
Electricity, gas and water	49	2,1
Transport, storage and communication	33	3,5
Agriculture, forestry and fishing	17	2,2
Finance and insurance	12	19,3
Manufacturing	12	4,6
Real estate	12	9,9
Wholesale and retail trade	5	5,0
Business services	4	3,4
Community, social and personal services	4	8,1
Construction	-9	0,8
Mining and quarrying	-23	2,0
Households	6	34,8
Other	-7	4,4
Total	8	100,0

* Expressed as a percentage of the outstanding balance

Interest rates and yields

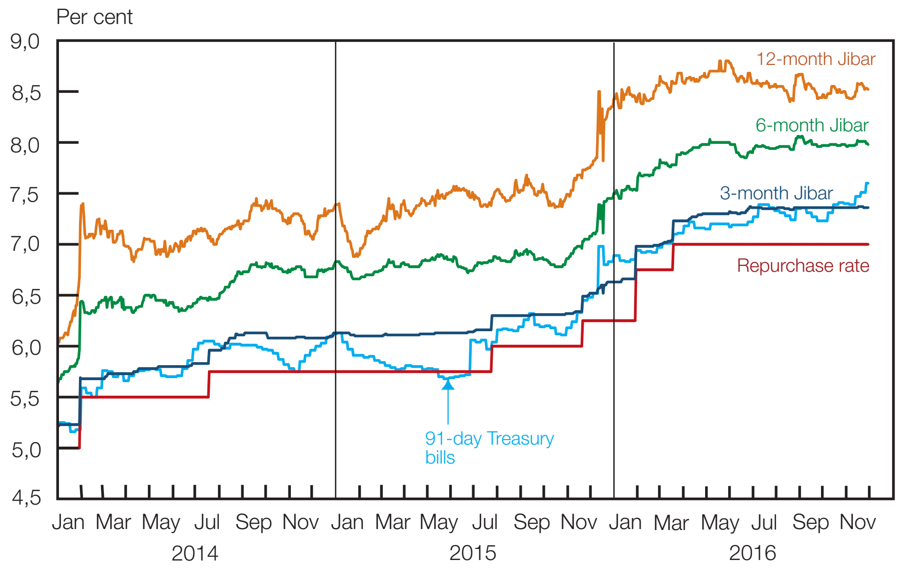
The Monetary Policy Committee (MPC) increased the repurchase rate by 50 basis points to 6,75 per cent per annum on 29 January 2016, and by a further 25 basis points to 7,00 per cent on 18 March, which brought the cumulative increase since the start of the tightening cycle in early January 2014 to 200 basis points. In the subsequent months to September 2016, the MPC assessed the risks to the inflation outlook to be more balanced, partly due to a somewhat stronger exchange value of the rand and continued low exchange rate pass-through to inflation. While food prices remained a major risk due to drought conditions, favourable weather patterns could result in food price inflation falling faster than the forecast. The growth outlook remained constrained, as reflected in a more or less unchanged outlook for the next two years. The MPC indicated that the end of the tightening cycle may be close, given the improvements in the inflation forecast, the relatively weak domestic economic outlook, and the assessment of the balance of risks. For the full September and November 2016 MPC statements, see pages 78 and 84 of this *Quarterly Bulletin*.

Changes in the repurchase rate since 2008

Date effective	Repurchase rate	Change (basis points)
2008/06/13	12,00	
2008/12/12	11,50	-50
2009/02/06	10,50	-100
2009/03/25	9,50	-100
2009/05/04	8,50	-100
2009/05/29	7,50	-100
2009/08/14	7,00	-50
2010/03/26	6,50	-50
2010/09/10	6,00	-50
2010/11/19	5,50	-50
2012/07/20	5,00	-50
2014/01/30	5,50	50
2014/07/18	5,75	25
2015/07/24	6,00	25
2015/11/20	6,25	25
2016/01/29	6,75	50
2016/03/18	7,00	25

Short-term money-market rates have remained relatively stable in conjunction with the unchanged policy rate since March 2016, while longer-dated instruments tended to oscillate alongside fluctuations in the exchange rate of the rand. Towards the end of August and early September 2016, longer-dated money-market rates inched higher as the rand depreciated in response to domestic political developments, while market participants also factored in the possibility of an interest rate increase by the US Federal Reserve at its September meeting.

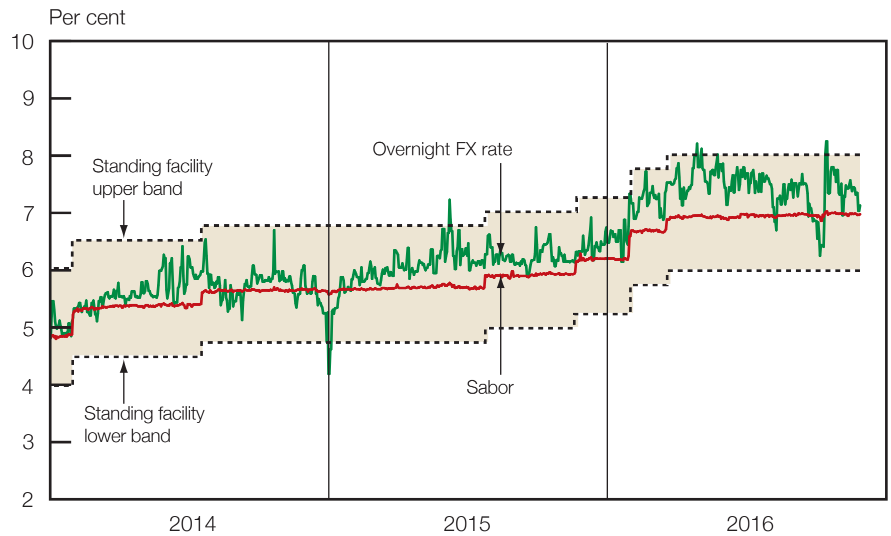
Money-market rates



However, long-term rates moderated when market conditions and movements in the exchange rate of the rand stabilised. For example, the benchmark twelve-month Johannesburg Interbank Average Rate (Jibar) increased by 27 basis points from 8,40 per cent on 18 August 2016 to 8,67 per cent by 30 August before decreasing to 8,43 per cent on 23 September 2016. Thereafter, the rate remained somewhat range-bound, fluctuating between 8,43 and 8,58 per cent to 5 December. The benchmark three-month Jibar generally trended sideways in recent months. The rate remained anchored at 7,36 per cent from 24 August 2016 to 5 December. By contrast, the tender rate on 91-day Treasury bills recorded sporadic modest fluctuations, increasing from 7,23 per cent on 23 September 2016 to 7,41 per cent on 21 October before decreasing slightly to 7,39 per cent in early November. On 5 December the rate had risen to 7,62 per cent.

Consistent with the orderly conditions that prevailed in the domestic interbank market, the South African Benchmark Overnight Rate (Sabor) on deposits remained relatively stable and well within the standing facility limits during the twelve months of 2016. However, major fluctuations in the overnight foreign exchange (FX) rate were encountered in October 2016, owing mainly to an exceptionally large international merger transaction that influenced market activity and liquidity. The overnight FX rate initially declined from 7,5 per cent in mid-September to as low as 6,25 per cent on 6 October. The rate then escalated to a high of 8,25 per cent on 14 October 2016, breaching the upper standing facility level for the first time in the past five months. However, the high demand for cash which pushed up rates was short-lived and the overnight FX rate receded when normal conditions returned to the market. It amounted to 7,35 per cent at the end of October and stood at 7,49 per cent on 5 December 2016.

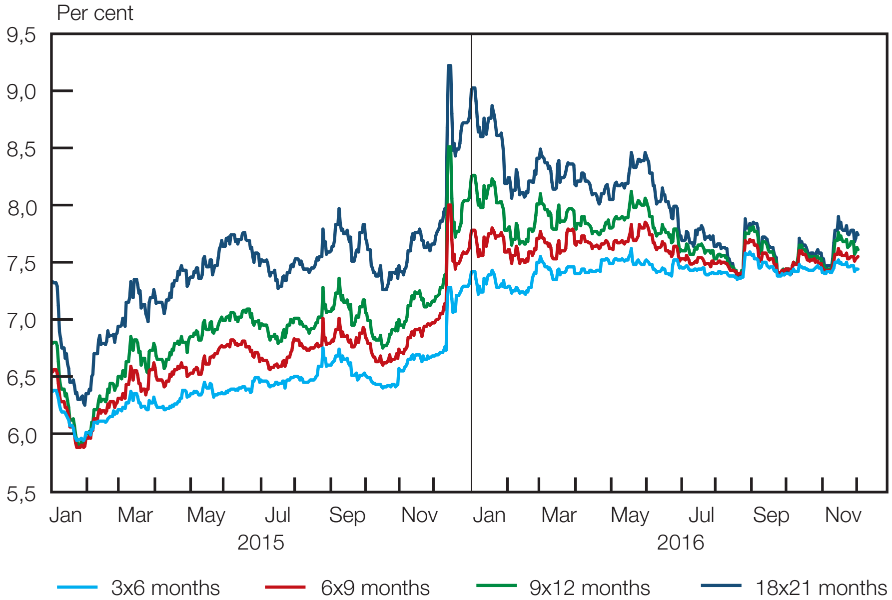
Benchmark overnight rates



Rates on forward rate agreements (FRAs), which depict market expectations of future interest rates, trended sideways and even lower in the past four months. The more benign movements probably indicate expectations that the rising interest rate cycle has come to an end. However, there was some volatility towards the end of August 2016 when market participants attached a higher probability to an interest rate increase by the US Federal Reserve at its September 2016 policy meeting. Heightened risk aversion in light of domestic political uncertainty related to the position of the Minister of Finance may also have played a role. Longer-term forward rates then started to decline after the US Federal Reserve kept rates unchanged and the charges against the Minister of Finance were withdrawn. Generally, there has been an improvement in investor appetite for emerging-market assets, following growing expectations that global monetary policy will remain accommodative for a longer period. However, the unexpected outcome of the US general election again amplified uncertainty in the global and domestic financial markets.

The 9x12 FRA rate increased by 40 basis points from 7,40 per cent on 18 August 2016 to 7,80 per cent on 29 August. The rate then moderated when the exchange value of the rand appreciated and political conditions stabilised, reaching 7,43 per cent on 3 November. The long-term rate rose sharply to 7,73 per cent on 16 November in the aftermath of the US election but moderated somewhat thereafter. On 5 December, the long-term rate had fallen back to 7,59 per cent. Similarly, the rate on the 3x6 FRA decreased from 7,59 per cent on 29 August to 7,40 per cent on 3 November before accelerating to 7,50 per cent on 11 November. The rate then displayed a downward trend with limited fluctuation to early December when it amounted to 7,44 per cent.

Forward rate agreements



From a high base, *South African government bond yields* trended downwards during the first half of 2016. This trend continued until mid-August due to various factors, including:

- the appreciation in the exchange value of the rand;
- lower economic growth projections;
- inflation outcomes that were generally lower than expected; and
- non-residents' sustained appetite for domestic government bonds.

From mid-August, bond yields reversed course, fluctuating higher mostly due to spurts of rand depreciation that resulted from political tensions surrounding the South African Minister of Finance and, later on, relative strength of the US dollar following the outcome of the recent US presidential elections.

The domestic five-year South African government bond yield declined by 194 basis points from a high of 9,86 per cent on 11 December 2015, induced by exceptional uncertainty, to 7,92 per cent on 18 August 2016, before rising to 8,49 per cent on 5 December. Similarly, the five-year US government bond yield declined by a lesser 86 basis points from 30 December 2015 to a low on 5 July 2016, before increasing by 92 basis points to 5 December.

The *sovereign risk premium*[7] on US dollar-denominated South African government bonds in the six-year maturity range trading in international markets narrowed by 145 basis points from January 2016 to November. Likewise, the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[8] yield spread above US government bonds narrowed from 443 basis points in January 2016 to 383 basis points in November, in line with investors' general interest in emerging markets' US dollar-denominated bonds given the yield differential. Over the same period, the

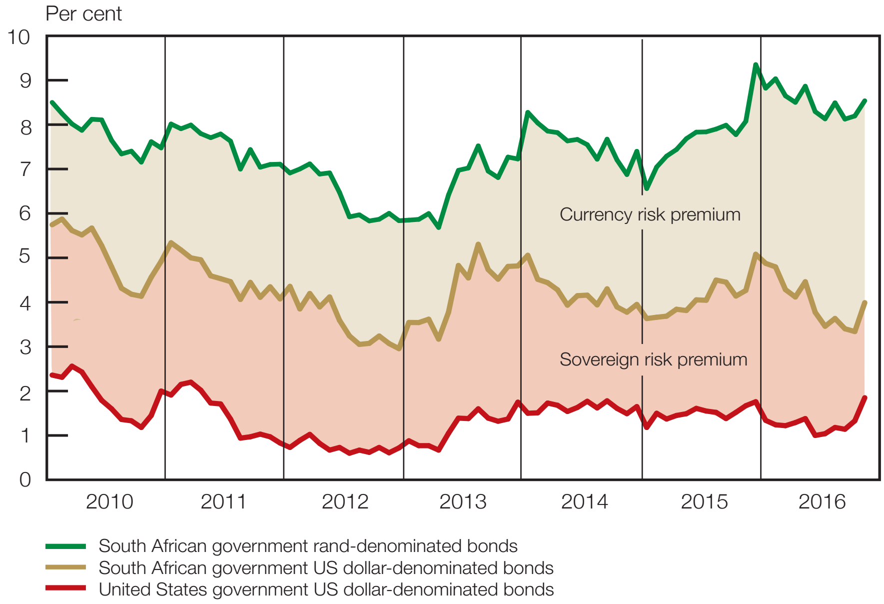
7 The differential between the yield on South African government US dollar-denominated bonds and that on US dollar-denominated bonds of the US government.

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

currency risk premium[9] on South African government bonds widened by 61 basis points as the South African government US dollar-denominated bond yield declined by more than the yield on rand-denominated bonds.

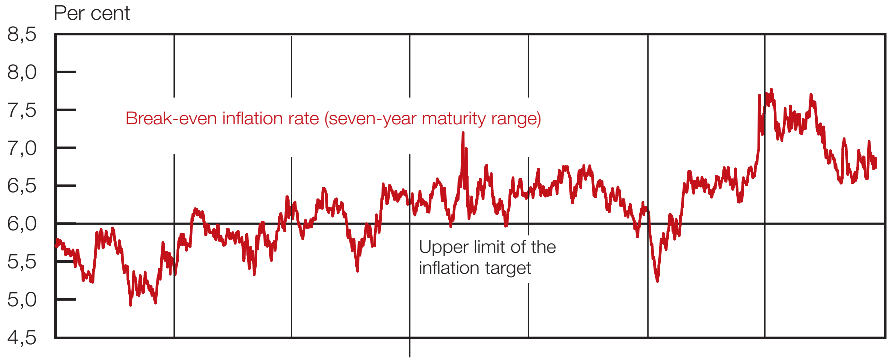
9 The differential between the South African government bond yield on rand-denominated debt issued in the domestic market and the yield on South African government US dollar-denominated bonds issued in the United States, both in the five-to-six-year maturity range.

Government bond yields

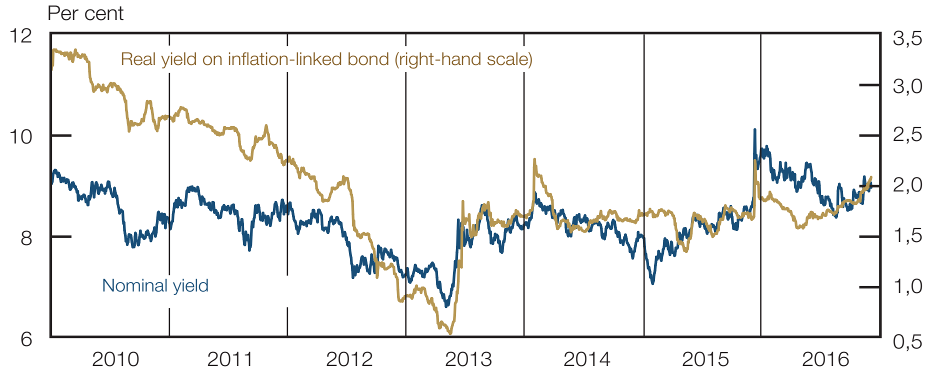


Consistent with the moderation in inflation pressures, *break-even inflation rates*, measured as the difference between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds, trended generally lower across maturities during 2016 but still remained above the 6 per cent upper level of the inflation target range. The break-even inflation rate in the seven-year maturity range, shown in the accompanying graph, declined noticeably by 103 basis points from 7,77 per cent on 18 January 2016 to 6,74 per cent on 5 December.

Break-even inflation rate



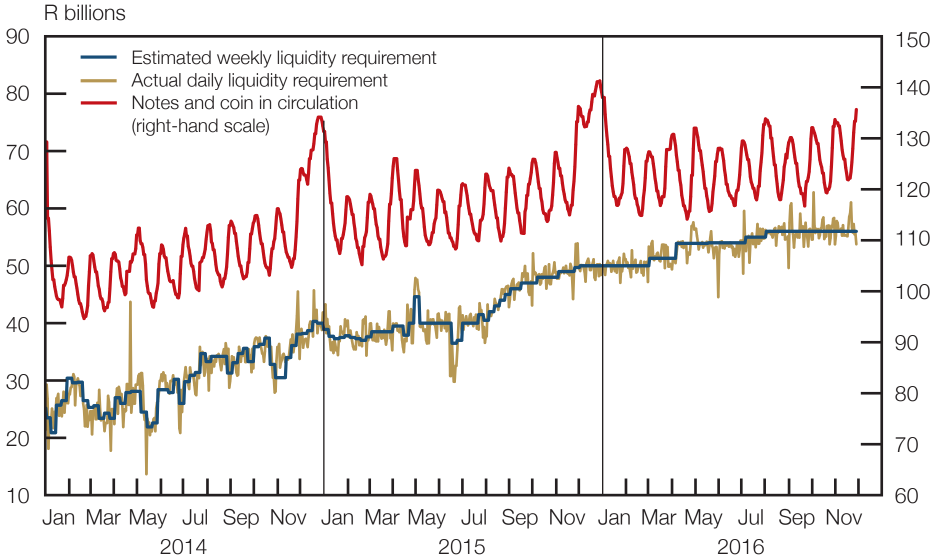
Government bond yields



Money market

During the third quarter of 2016, the actual daily liquidity requirement of private-sector banks varied between a low of R48,6 billion and a high of R60,9 billion, somewhat higher and wider than the range of R44,5 billion to R57,6 billion recorded in the second quarter of 2016. The gradual longer-term rise in the daily liquidity requirement of private-sector banks conformed to the strategy introduced in recent years to improve the broad alignment of the money-market shortage with underlying conditions in the money market, arising from the secular upward trends in notes and coin in circulation and in banks' required cash reserve holdings. The approach is aimed at enhancing the robustness of monetary policy implementation. Since the introduction of the new liquidity management strategy in August 2013, the actual average liquidity requirement has increased from R22,8 billion to levels of just over R60,0 billion in recent months.

Liquidity requirement



During the third quarter of 2016, liquidity to the net amount of R1,8 billion was drained from the money market, compared with the net drainage of R4,6 billion recorded in the second quarter of 2016. In the September quarter of 2016, notes and coin in circulation contracted the market by R4,0 billion. Daily liquidity disparities were intermittently addressed through commercial banks placing funds on their cash reserve accounts with the SARB, contracting the money market by R3,5 billion.

The utilisation of the SARB's liquidity management instruments had minimal impact on money-market liquidity in the third quarter of 2016. An increase in deposits of the Corporation for Public Deposits held at the SARB served to contract the market by R3,1 billion. Spot purchases of foreign exchange by the SARB amounted to R5,9 billion, with a consequential expansionary impact on money-market liquidity which neutralised some of the contracting factors during this period. In October 2016, liquidity management operations served to drain R13,2 billion from the market, while overall money-market conditions were characterised by a net injection of R1,0 billion.

Money-market liquidity flows

R billions (easing + tightening –)

	2016		
	Apr–Jun	Jul–Sep	Oct
Notes and coin in circulation	2,5	-4,0	-1,6
Change in cash reserve accounts	-2,2	-3,5	-0,4
Money-market effect of SARB* foreign-exchange transactions in spot market	-0,1	5,9	16,1
Government deposits with SARB	-3,3	0,0	0,0
Use of liquidity management instruments	-3,2	-0,1	-13,2
Reverse repurchase transactions	-1,3	1,7	0,0
SARB debentures	0,9	0,3	0,5
Forward position (swaps)	-3,2	1,0	-13,4
Corporation for Public Deposits' call deposits with SARB	0,9	-3,1	-0,2
Other items net	1,7	-0,2	0,1
Liquidity provided to banking system	**-4,6**	**-1,8**	**1,0**

* SARB: South African Reserve Bank

The significant increase in the forward position during October reflected foreign exchange swaps conducted to sterilise foreign exchange purchases which related to an exceptionally large international merger transaction. The forward transactions partly offset the expansionary impact of spot foreign exchange transactions undertaken by the SARB during this period.

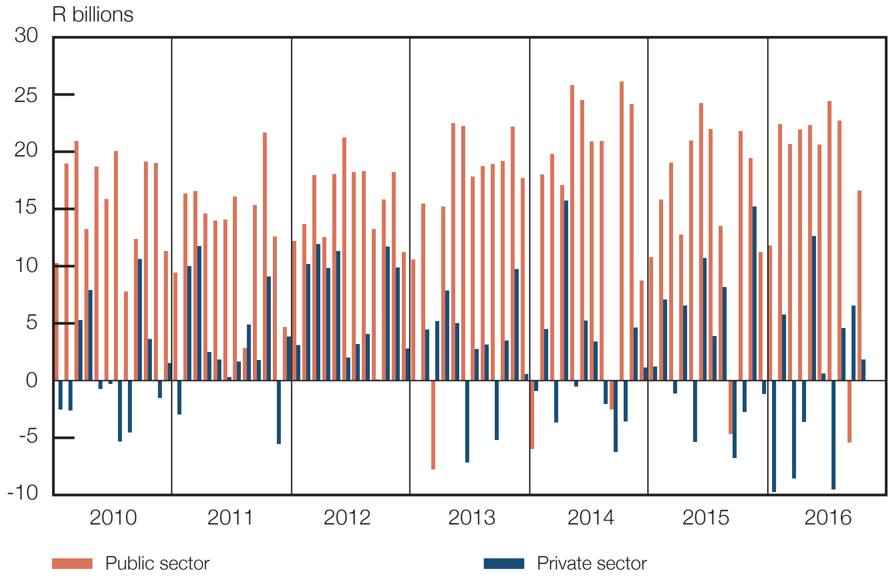
Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R42,3 billion were effected from the government tax and loan accounts during July to September 2016, with only R364 million of this amount accruing to the SARB.

Bond market

Public-sector funding activity in the local *primary bond market* remained robust in the first ten months of 2016. The net nominal issues of public-sector bonds of R178 billion recorded in the first ten months of 2016 were 14 per cent higher than in the same period of 2015. Net issues of public-sector bonds were, however, dragged lower by the redemption of the R159 government bond in September 2016; this was the third and final tranche of the R157 bond. By contrast, net issues of private-sector bonds dwindled to only R1 billion in the ten months to October 2016 when compared with net issues of R22 billion over the same period of 2015. Banks' net issues of R12 billion were offset by net redemptions of securitisation bonds amounting to R13 billion, while non-bank companies recorded net issues of R1 billion during 2016.

National Treasury issued two more international bonds at the end of September 2016 – the US$3 billion 12-year and 30-year bonds which were priced at coupon rates of 4,3 per cent and 5 per cent respectively. The national government's issuance of these longer-dated bonds was partly aimed at affording the existing 2019/20 bondholders the opportunity of rebalancing their portfolios by lengthening their securities investment exposure. The international issuance of the pair cited above marked government's second entry into the international capital market in 2016, the first having been a US$1,25 billion ten-year bond issue in April. The oversubscription to these transactions somewhat reflected positive investor appetite, despite the domestic economy's fragile state. National Treasury raised R34 billion through these bond issuances, net of switches on 12 October 2016.

Net issues in the domestic bond market by sector



Supported by higher trading volumes and generally declining domestic bond yields, along with positive investor sentiment during most of 2016, *turnover* in the secondary bond market remained firm during the first eleven months of 2016. The daily average turnover amounted to R116 billion during this period – 20 per cent higher than in the corresponding period in 2015. The All-Bond Index echoed this positive sentiment in the domestic bond market with a 14 per cent gain thus far in 2016.

The issuances of rand-denominated debt in the *European and Japanese bond markets* remained brisk during the eleven months to November 2016, driven mainly by a continued search for higher yields. Combined issuances in both these markets came to R36 billion over this period, with bond issues in the European bond market alone contributing 70 per cent of the total issuances.

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

R millions

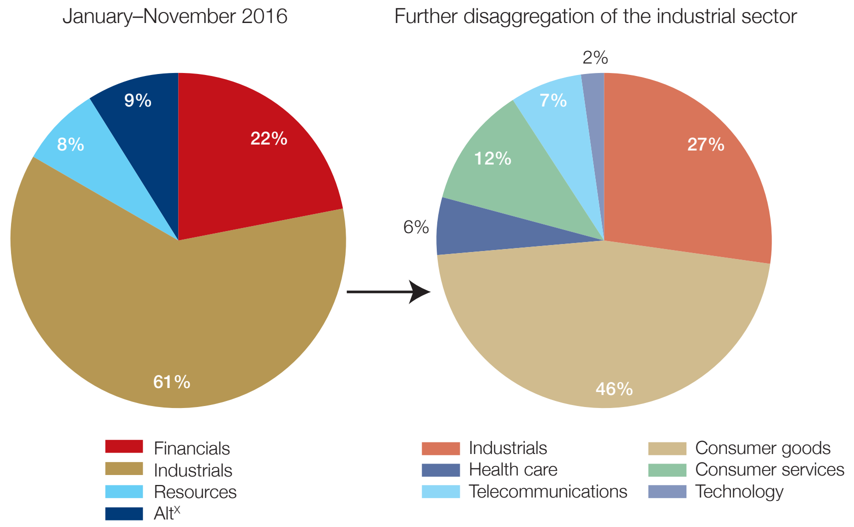
	Eurorand		Uridashi		Total	
	2015	2016	2015	2016	2015	2016
Issues	20 361	25 363	6 158	10 642	26 519	36 006
Redemptions	8 457	12 941	6 661	12 387	15 118	25 328
Net	11 904	12 422	-503	-1 744	11 402	10 678

Non-residents' favourable interest in the domestic bond market continued during most of 2016, as foreign investors maintained their search for higher yield in emerging markets. After being marginal net sellers of local bonds in the second quarter of 2016, exchange-reported data indicate that non-residents reverted to being net purchasers in the third quarter. However, holdings of domestic debt securities dwindled in October and November 2016, following concerns regarding South Africa's political stability and scepticism as to whether fiscal consolidation efforts would be sufficient to prevent a possible South African sovereign ratings downgrade. Cumulatively, net sales by non-residents of domestic bonds amounted to R19 billion in the eleven months to November 2016, compared with net sales of R20 billion over the same period of 2015.

Share market

Companies listed on the JSE continued to display less exuberant *equity capital-raising activity* in the domestic and international share markets during the eleven months to November 2016. This trend persists alongside fragile domestic economic growth and volatility experienced in global equity markets. Consequently, the capital value of new shares issued on the JSE of R108 billion in the first eleven months of 2016 was 45 per cent lower than in the corresponding period of 2015. Companies with secondary listings and those with primary listings on the JSE contributed nearly equally to the total capital raised during the period under review. Despite the poor performance of industrial share prices which have declined by 10 per cent thus far in 2016, companies in the industrial sector accounted for no less than 61 per cent of the total equity capital raised. As shown in the accompanying graph, further disaggregation reveals that nearly half of the industrial sector's equity funding in the eleven months to November 2016 was accounted for by companies in the consumer goods subsector. This was mainly as a result of capital raised by an integrated retailer to repay money that had been borrowed for recent acquisitions in Europe and North America.

Capital raised by sector

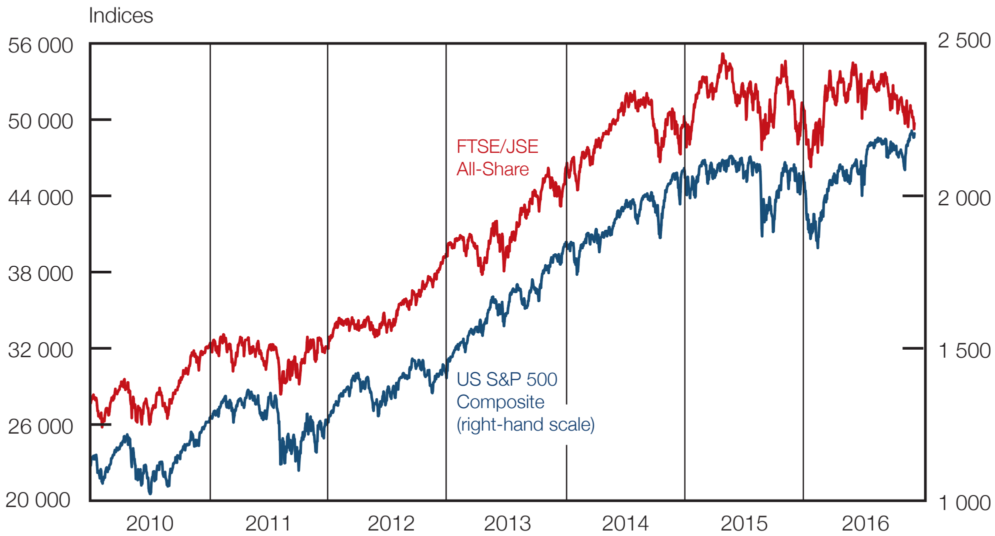


Despite the broadly unchanged level of share prices, *turnover* in the secondary share market of the JSE was 21 per cent higher in the first eleven months of 2016 at a daily average of R24 billion compared with the corresponding period of 2015. Activity was supported by the sizable number of deals and volumes traded. After hovering around R15 trillion for most of 2016, the *market capitalisation* of the JSE declined to R13 trillion in October, mostly as a result of the delisting of a large UK beer company, and remained on this level in November.

According to exchange-reported data, international investor sentiment continued to deteriorate as *non-residents* remained net sellers of domestic shares in 2016. Non-residents recorded net sales of shares amounting to R117 billion in the first eleven months of 2016, compared with net purchases of R7 billion over the same period in 2015. Factors contributing to the waning appetite in the domestic secondary share market included volatile financial markets, economic growth concerns as well as uncertainty in the domestic political environment which raised the risk of potential credit ratings downgrades.

Over the past two years, domestic share prices have moved broadly sideways in volatile global financial markets amid a subdued domestic and global economic growth environment. However, in recent months the *FTSE/JSE All-Share Price Index* (Alsi) trended lower and, on balance, declined by 9 per cent from a recent high of 54 474 index points on 30 May 2016 to 49 714 index points on 5 December. The gradual downward trend in the share price index was a result of some lower international share markets, not least due to concerns over the solvency of a large German bank and the downgrade of Turkey's sovereign credit rating to below investment grade. The weakness of the Alsi to the beginning of December was also exacerbated by lower international commodity prices in recent months, political developments, prospects of higher interest rates in the US, and the possibility that the European Central Bank might gradually cut back on its quantitative easing programme. By contrast, the US S&P 500 Composite Index reached an all-time high on 25 November 2016.

Share prices in local currency



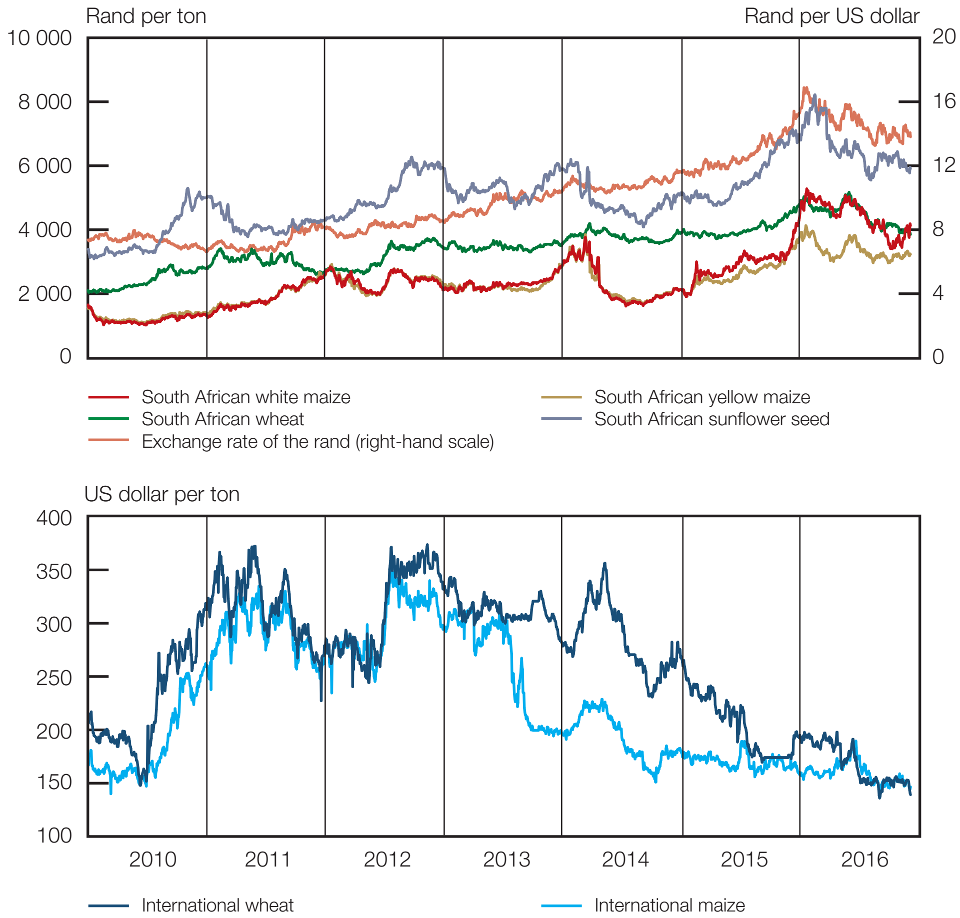
The historical *price-earnings ratio* for all ordinary shares listed across all sectors and boards on the JSE retreated from record-high levels in the first half of 2016 to a level of 32,8 in November 2016. This was mainly due to improved earnings of companies in the resources sector, in particular the gold-mining as well as oil and gas producers subsectors.

Market for exchange-traded derivatives

From their record-high levels registered at the beginning of the year, domestic agricultural commodity prices generally trended downwards during 2016. The downward pressure on domestic grain prices was a reflection of lower international grain prices, owing to favourable crop conditions and adequate global supplies; prospects of an increased area to be planted in 2016/17; the appreciation in the exchange value of the rand; and ongoing talks about the possible review of the current Genetically Modified Organisms (GMO) restrictions on US white maize imports. Since the peak of R5 280 per ton on 20 January 2016, the spot price of white maize has declined by 22 per cent to R4 130 per ton on 5 December. The domestic wheat prices declined by 25 per cent from a record high of R5 171 per ton on 30 May 2016 to R3 853 per ton on 5 December in line with six-year-low international wheat prices. Against the backdrop of declining international wheat prices, the South African authorities provided protection to domestic producers against subsidised wheat imports by increasing the wheat import tariff in August 2016 from R1 224 per ton previously to a record high of R1 591 per ton.

The JSE introduced the Quanto Brent Crude Oil Can-do contract in October 2016, denominated in rand. The underlying product is the Brent crude oil contract as traded on the New York Mercantile Exchange. The contract is suitable for investors seeking pure commodity exposure without the associated exchange rate risk.

Grain prices and the exchange rate



During the eleven months to November 2016, the value of trades in the interest rate derivatives market of the JSE registered a noticeable increase when compared with the corresponding period of 2015, boosted by a generally downward trend in bond yields with bouts of volatility. The turnover in all derivatives traded on the JSE in the period under review is shown in the table below.

Derivatives turnover on the JSE, January to November 2016

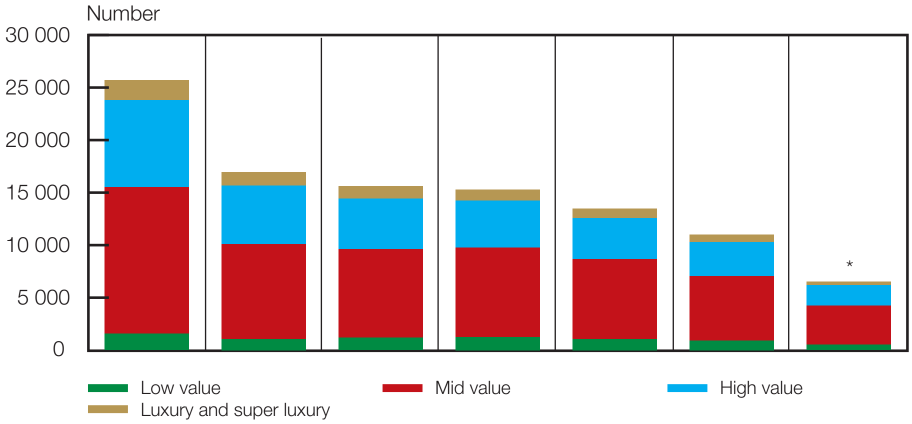
Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity	6 063	5
Warrants	1	11
Commodity	913	36
Interest rate	1 087	50
Currency	691	39

Real-estate market

Domestic residential property price inflation continued to slow during 2016. This subdued performance of the property market was partly a reflection of weak economic and employment growth as well as low levels of credit extension. The year-on-year rate of increase in nominal house prices across the various price barometers ranged between 2 per cent and 6 per cent in November 2016.

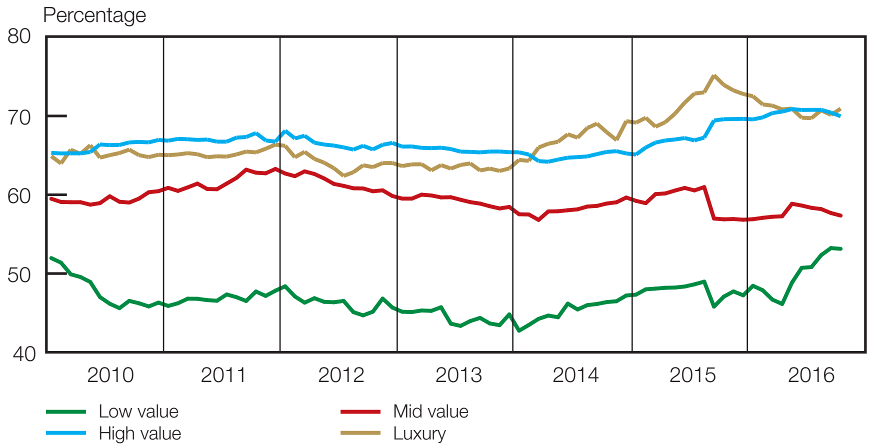
In line with slow growth in mortgage advances, residential property sale-in-execution notices issued by banks continued to inch lower as they had been doing since the high levels reached in 2009 and 2010. The most common cause of such a notice is when the owner of a bonded property is no longer able to pay the monthly instalments on the mortgage bond. Over time, most of these notices related to the mid-value housing segment. The issuing of a sale-in-execution notice is usually a precursor of a forced sale in the real-estate market. In turn, there are three outcomes of forced sales, namely auctions, distressed sales (properties sold on a date very close to the auction date) and the taking into possession of the property in question by the mortgage loan provider. The distressed sale factor for these distressed sales, which is the percentage of the value of the property likely to be recovered when the property is sold in a distressed sale, is the highest for luxury and high-value houses, although the distressed sale factor for low-value houses has improved noticeably in recent months.

Residential property sale-in-execution notices



* January to October 2016

Value recovery ratio in distressed sales of residential property



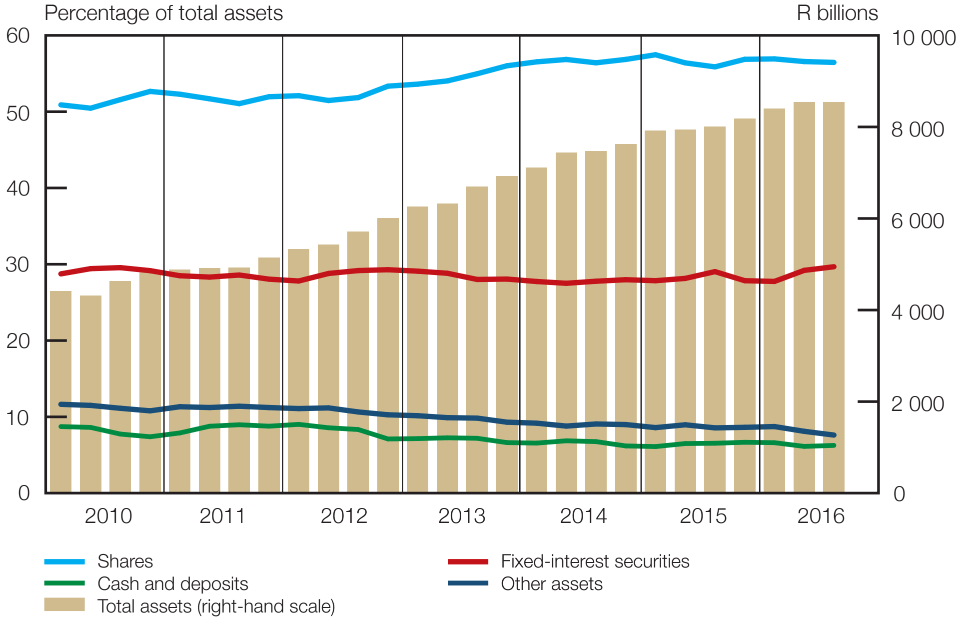
Source: Lightstone

Non-bank financial intermediaries

The decline in domestic share prices had a negative effect on the balance sheet of non-bank financial institutions[10] in the third quarter of 2016. This equity market effect was, however, neutralised by higher bond prices over the same period. The consolidated assets of these institutions increased by 0,6 per cent from the second quarter of 2016 to R8,6 trillion in the third quarter. In the first three quarters of 2016, the balance sheet of non-bank financial institutions increased by 5 per cent, which was similar to the increase registered in the corresponding period of 2015.

Reflecting lower share prices, holdings of shares by non-bank financial institutions declined by 1 percentage point from the second quarter of 2016 to 56 per cent of total assets in the third quarter. The proportion of assets invested in shares declined by 1 percentage point in the first three quarters of 2016. The equity exposure of the Public Investment Corporation and long-term insurers declined the most in the third quarter of 2016.

Asset holdings of non-bank financial institutions



As a share of total assets, funds invested in fixed-interest securities increased by 1 percentage point to 30 per cent between the second and the third quarters of 2016. Holdings of this asset class were supported by new investment alongside higher bond prices in the third quarter of 2016. Holdings of cash and deposits by non-bank financial institutions remained unchanged at 6 per cent of total assets in the second and third quarters of 2016. Investment in money-market unit trusts increased by R12 billion from the second quarter of 2016 to R23 billion in the third quarter, alongside high volatility in financial markets.

The value of loans extended by non-bank financial institutions to households and companies remained unchanged at 5 per cent of total assets in the second and third quarters of 2016. Despite weak household demand and generally difficult economic conditions, the year-on-year change in credit extended by finance companies increased from 7 per cent in the second quarter of 2016 to 9 per cent in the third quarter.

The relatively small growth in the balance sheet of non-bank financial institutions is likely to have a negative effect on the financial assets of households. The decline in private- and public-sector formal employment levels might have a negative effect on net inflows into non-bank financial institutions. This, coupled with the current economic environment, suggests that activity in these institutions will largely depend on movements in asset prices.

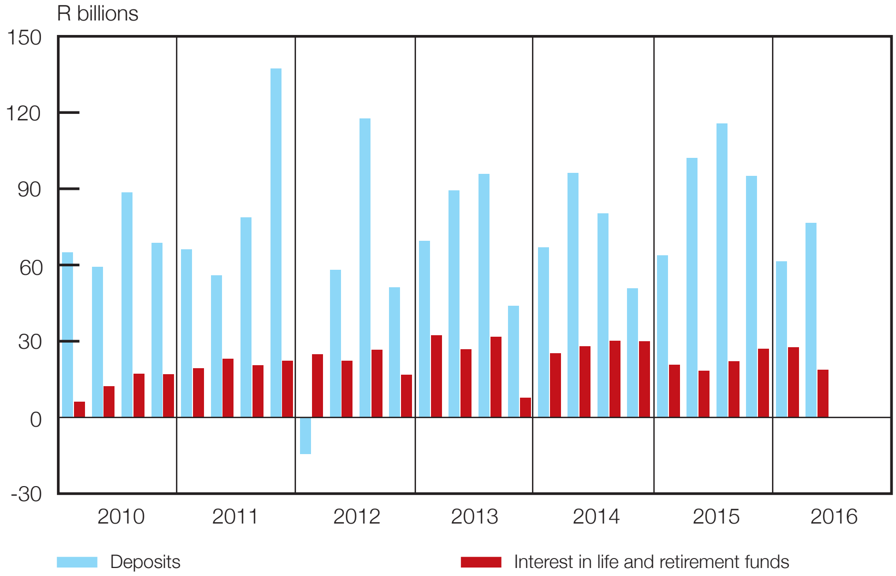
10 These consist of unit trusts, the Public Investment Corporation, long- and short-term insurance companies, public and private pension funds, participation bond schemes, finance companies, and non-monetary public financial corporations.

Flow of funds

Net investment inflows from the *non-resident sector* into the domestic economy slowed from R63 billion recorded in the first quarter of 2016 to R20 billion in the second quarter, against a backdrop of lustreless global economic growth and volatile financial markets amid raised levels of uncertainty. However, non-resident investors increased their purchases of domestic debt securities notably during the review period as they acquired R39 billion in government bonds, in pursuit of higher yielding assets. The interest in government bonds was probably also supported by credit rating agencies' upholding of the domestic sovereign credit rating at an investment grade.

Financial intermediation remained subdued in the second quarter of 2016 as demand for loans remained moderate against a backdrop of weak business and consumer confidence. Loans extended by *financial intermediaries* amounted to R35 billion in the second quarter of 2016, about R10 billion less than in the first quarter. Intermediation flows through fixed-interest securities amounted to R84 billion while equities intermediation was R63 billion during the second quarter of 2016. The intermediaries' funding through deposits amounted to R77 billion, from the R62 billion registered a quarter earlier. This increase was mainly due to deposits by households and central and provincial governments. At the same time the intermediaries received R19 billion through contributions into retirement and life funds during the second quarter of 2016.

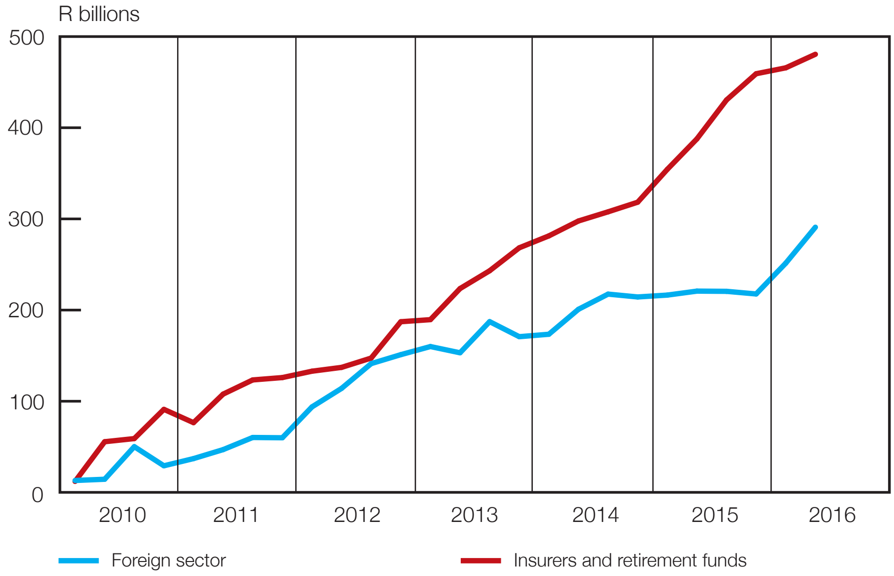
Financial intermediaries: main sources of funds



The *general government sector* maintained its gross fixed capital formation levels in the second quarter of 2016, while revenue collection moderated. Thus, the financing gap of general government increased during the review period. The financing shortfall of R36 billion was more than offset by proceeds from the issuances of government bonds and Treasury bills in the domestic market, collectively amounting to R66 billion. Furthermore, proceeds of R34 billion from the issuances of long-term government bonds in the international market supplemented the domestically available sources of funding. However, the redemption of a €750 million South African government bond earlier in the second quarter of 2016 partly counteracted the accumulation of foreign currency. Other financial institutions and non-residents continued to acquire government paper, alongside favourable bond prices.

The financing deficit of the *non-financial corporate business enterprises* widened to R34 billion in the second quarter of 2016 compared with R17 billion in the first quarter of 2016, as their capital spending accelerated to R158 billion from R127 billion. Capital spending increased markedly in both the public and private corporate enterprises categories by 14 per cent and 29 per cent, respectively during the review period. An amount of only R13 billion was acquired through mortgage loans to supplement corporate businesses' internal funds, while R71 billion was raised through equity issuances.

Cumulative acquisition of long-term government bonds by sector



The *household sector* continued to acquire loans at a slower pace during the second quarter of 2016, as household debt levels remained elevated alongside poor prospects for employment and income levels. In particular, their mortgage borrowing was subdued at R5,2 billion from R12 billion recorded in the first quarter of 2016. During the same period, households' incurrence of bank loans and advances recorded a reduction of R33 billion from an increase of R11 billion in the first quarter of 2016. The reduction was due to the incorporation of the credit aggregate data from the restructured African Bank. Having increased their holdings of deposits and their interest in retirement and life funds, the households were able to record a financing surplus of R28 billion during the second quarter of 2016 from a deficit of R65 billion a quarter earlier. The increase in deposits was consistent with higher interest rates and a subdued level of consumer confidence.

Public finance[11]

Non-financial public-sector borrowing requirement[12]

11 In this section, unless stated otherwise, year-on-year rates of increase compare April–September 2016 to April–September 2015.

12 This is calculated as the cash deficit/surplus of the consolidated central, provincial and local governments, and non-financial public enterprises and corporations.

In the first half of fiscal 2016/17 (April–September 2016), the *non-financial public-sector borrowing requirement* amounted to R128 billion – R2,8 billion lower than the amount recorded in the same period of the previous fiscal year. The relatively lower borrowing requirement resulted mainly from a narrowing of the cash deficit of non-financial public enterprises and corporations, alongside a decline in the provincial government cash surplus. Extra-budgetary institutions, social security funds and local governments all recorded marginal increases in cash surpluses in April–September 2016 when compared with the same period in 2015.

Non-financial public-sector borrowing requirement

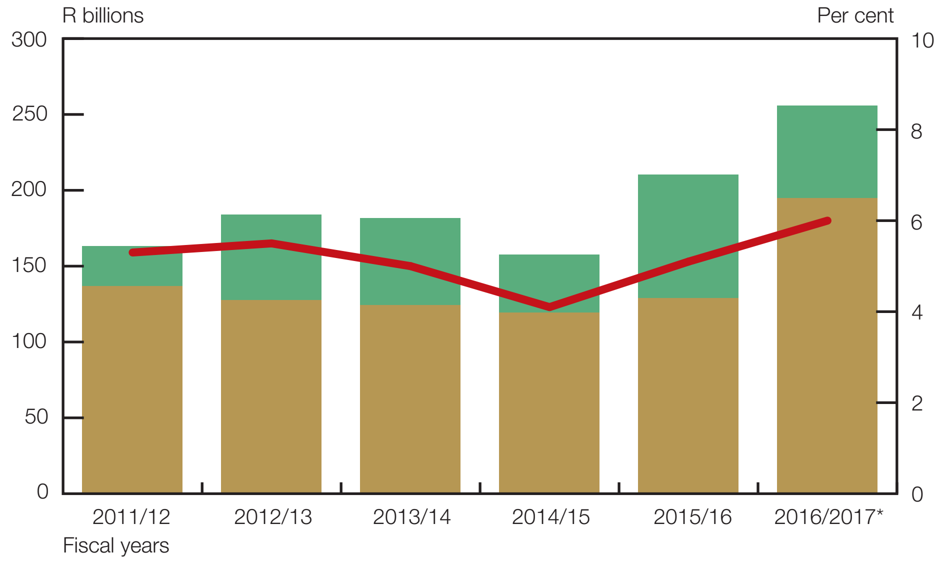
R billions

Level of government	Apr–Sep 2015*	Apr–Sep 2016*
Consolidated general government	94,9	97,5
National government	117,8	117,0
Extra-budgetary institutions	-4,8	-5,0
Social security funds	-7,5	-7,9
Provincial governments	-9,1	-4,0
Local governments	-1,4	-2,5
Non-financial public enterprises and corporations	35,9	30,5
Total**	130,8 **	128,0**
As percentage of gross domestic product	*6,5*	*5,9*

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

As a ratio of GDP, the non-financial public-sector borrowing requirement amounted to 5,9 per cent in the first half of fiscal 2016/17, lower than the ratio of 6,5 per cent recorded in the same period of the previous fiscal year.

Non-financial public-sector borrowing requirement



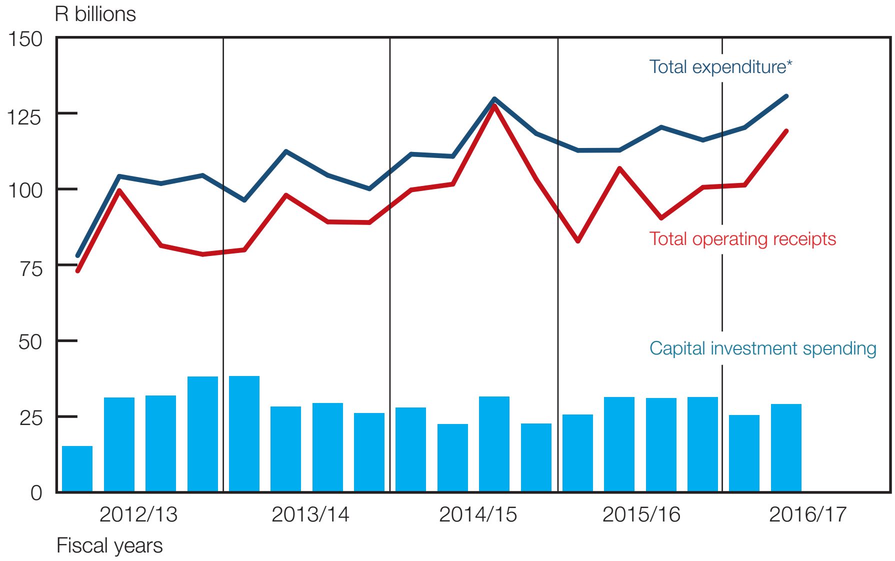
* April–September 2016, annualised

Consolidated general government
Non-financial public enterprises and corporations
Percentage of GDP (right-hand scale)

The borrowing requirement of the consolidated general government amounted to R97,5 billion in the first half of fiscal 2016/17, or R2,6 billion higher than in the same period of the previous fiscal year. As a ratio of GDP, the consolidated general government borrowing requirement amounted to 4,5 per cent in the period under review, lower than the 4,7 per cent recorded in the same period a year earlier.

The preliminary cash deficit of the *non-financial public enterprises and corporations* narrowed by R5,5 billion and amounted to R30,5 billion in the first half of fiscal 2016/17 when compared with the same period a year ago. Notable growth in operating revenue outpaced expenditure growth over the period under review. Total cash receipts from operating activities rose by 16,3 per cent year on year. Eskom benefitted from higher electricity prices and improved reliability of electricity supply, while Transnet experienced improved rail container traffic volumes.

Financial activities of non-financial public enterprises and corporations



* Including both current and capital spending

Against a backdrop of heightened uncertainty and lower business confidence, growth in capital spending by major state-owned companies moderated. During April–September 2016, capital expenditure by non-financial state enterprises and corporations amounted to R54,7 billion, representing a 3,9 per cent contraction compared with the same period a year earlier. Although it recovered somewhat in the second quarter of fiscal 2016/17, the overall moderation in capital spending could be associated with, among other things, general delays in or the postponement of infrastructure programmes and deteriorating balance-sheet positions of some state-owned companies.

In financing capital investment programmes, state-owned companies continued to source funding from domestic and international capital markets, development financing institutions and multilateral agencies, including export credit agencies. As at 30 September 2016, the total outstanding listed debt of non-financial public enterprises and corporations amounted to R255 billion, representing a year-on-year increase of 9,6 per cent. In an environment characterised by uncertainty, volatile domestic and international capital markets, higher levels of indebtedness and increased state funding costs, public enterprises most recently had to raise funding at higher interest rates. Thus, borrowing costs continued to rise.

Government has begun taking bold steps to improve the governance, oversight and financial sustainability of state-owned companies. Following the release of recommendations by the Presidential State-owned Companies Review Committee in 2013, the Presidential State-owned Companies Coordinating Council – an inter-ministerial committee chaired by the Deputy President – was established by Cabinet in July 2016 with the mandate to oversee the stabilisation and reform of state-owned companies.

An analysis of *national government* finance statistics indicated that cash receipts from operating activities amounted to R540 billion in the first half of fiscal 2016/17, or 6,1 per cent more than in the same period of the previous fiscal year. Higher cash receipts were driven by positive growth recorded in all major tax categories.

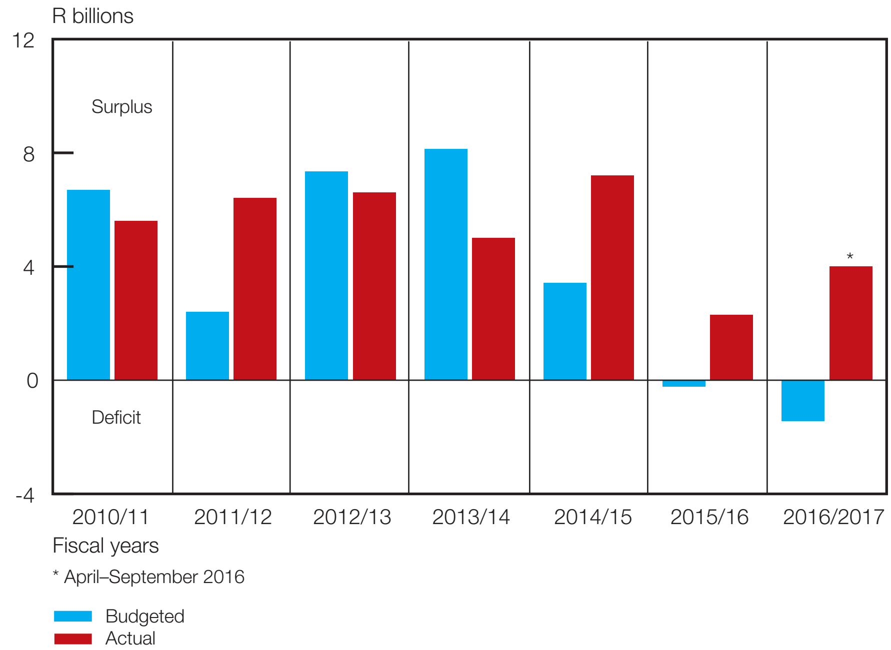
National government's cash payments for operating activities amounted to R649 billion during the period under review, representing a year-on-year increase of 4,8 per cent. Compensation of employees increased at a year-on-year rate of 10,0 per cent and amounted to R70,9 billion in the first half of fiscal 2016/17. In the same period, the total grants paid to other levels of government accounted for 55,5 per cent of total cash payments for operating activities and amounted to R360 billion.

Net cash flow from operating activities, together with net investment in non-financial assets, yielded a cash deficit of R117 billion in the first half of fiscal 2016/17. This could be compared with the cash deficit of R118 billion recorded in the same period a year earlier.

The financial activities of *provincial governments* resulted in a cash surplus of R4,0 billion in April–September 2016, significantly lower than the cash surplus of R9,1 billion recorded in the same period of the previous year. For fiscal 2016/17 as a whole, the 2016 Budget projected a total provincial government cash deficit of R1,0 billion.

Total provincial government revenue amounted to R261 billion in the first half of fiscal 2016/17, representing a year-on-year rate of increase of 6,8 per cent. Equitable share and conditional grants from national government continued to dominate provincial governments' total revenue. Total grants received increased by 6,6 per cent year on year and amounted to R252 billion during April–September 2016.

Provincial government finances



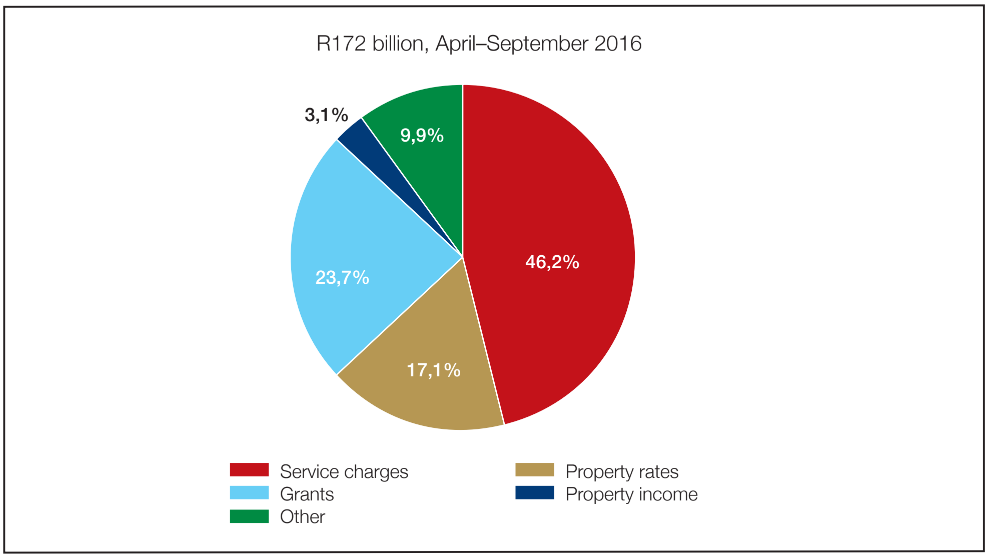
Provincial governments' total expenditure amounted to R257 billion in the period under review, some 9,2 per cent more when compared with the first half of the previous fiscal year. The pronounced growth in expenditure was mainly driven by an increase in provincial governments' compensation of employees, which rose by 8,3 per cent and amounted to R155 billion in the first half of fiscal 2016/17. This spending category accounted for more than 60 per cent of total provincial government expenditure. Personnel spending on educators and health practitioners contributed R134 billion, or 86,6 per cent, of the total provincial salary bill in April–September 2016.

Provincial governments' deposits with the Corporation for Public Deposits increased from R19,0 billion at the end of March 2016 to R19,6 billion at the end of September. At the same time, their deposits with private banks increased from R17,3 billion to R20,7 billion, while their overall indebtedness to banks narrowed marginally from R0,7 billion at the end of March 2016 to R0,3 billion at the end of September.

Preliminary data show that *local government* recorded a cash surplus of R2,5 billion in the first half of fiscal 2016/17. This was R1,0 billion more when compared with the same period a year earlier. The increase resulted from a brisk rise in total revenue which outpaced growth in total expenditure.

Cash receipts from the operating activities of local government amounted to R172 billion over the period under review, representing a year-on-year increase of 8,2 per cent. Municipal own revenue – sales of water, electricity and gas together with property rates – continued to drive growth in local government revenue.

Composition of municipal operating revenue



Local governments' cash payments for operating activities increased by 11,1 per cent year on year, and amounted to R145 billion. This increase was primarily on account of higher purchases of goods and services. In April–September 2016, the net investment in non-financial assets amounted to R24,3 billion, some R2,5 billion lower than the amount recorded over the same period a year earlier.

Preliminary financial estimates of *extra-budgetary institutions* resulted in a cash surplus of R1,6 billion during July–September 2016, bringing the cash surplus to a cumulative R5,0 billion in the first two quarters of the current fiscal year. Total grants received from national government increased by 9,5 per cent year on year and amounted to R69,6 billion, which contributed almost 60,0 per cent to total revenue in April–September 2016.

In the first half of fiscal 2016/17*, social security funds* recorded a preliminary cash surplus of R7,9 billion, slightly higher than the cash surplus of R7,5 billion recorded in the same period of fiscal 2015/16.

Budget comparable analysis of national government finance

National government revenue fell below the original 2016 Budget projections, while expenditure increased in accordance with budgeted projections in the first half of fiscal 2016/17. As a consequence, the level of expenditure exceeded national government revenue, resulting in a slightly higher cash-book deficit in the first six months of fiscal 2016/17 when compared with the same period a year earlier.

National government finances: key statistics, 2016/17

Year-on-year percentage change*

	Budgeted** Full 2016/17	Actual Apr–Sep 2016
Expenditure	5,9	6,3
Revenue	8,7	7,8
Memo: cash-book deficit	R156 billion	R124 billion

* Fiscal 2015/16 to fiscal 2016/17
** *Budget Review 2016*

Expenditure by national government amounted to R645 billion in the first two quarters of fiscal 2016/17, or 6,3 per cent more than in the same period in fiscal 2015/16. As a ratio of GDP, national government expenditure amounted to 29,9 per cent during the half-year under review, remaining slightly lower than the 30,2 per cent recorded in the same period a year earlier. The *Budget Review 2016* envisaged that national government expenditure would amount to R1 318 billion in fiscal 2016/17, representing a year-on-year rate of increase of 5,9 per cent. However, in the *Medium Term Budget Policy Statement 2016 (MTBPS 2016)*, budgeted national government spending was revised downwards by about R9,6 billion and amounted to R1 309 billion, or an increase of 5,2 per cent on a year-on-year basis.

National government expenditure in fiscal 2016/17

Expenditure item	Originally budgeted Full 2016/17		Actual Apr–Sep 2016	
	R billions	Percentage change*	R billions	Percentage change*
Voted amounts	721,1	3,1	355,1	4,5
Of which: Current payments	*208,6*	*7,6*	*101,1*	*9,8*
Transfers and subsidies	*493,3*	*7,6*	*243,7*	*5,1*
Payments for capital assets	*14,4*	*-21,1*	*5,6*	*18,0*
Payments for financial assets	*4,9*	*-83,2*	*4,7*	*-57,4*
Statutory amounts**	597,2	9,6	289,8	8,5
Of which: Interest on debt	*147,6*	*14,7*	*71,6*	*14,4*
Total expenditure	1 318,3	5,9	644,8	6,3

* Fiscal 2015/16 to fiscal 2016/17
** Including extraordinary payments

The increase in national government expenditure was mainly on account of higher voted expenditure, which consists of current payments, transfers and subsidies, and payments for capital and financial assets.

Current payments increased at a year-on-year rate of 9,8 per cent in the period under review. In the *Budget Review 2016*, this spending category was expected to record an increase of 7,6 per cent. The Justice, Crime Prevention and Security cluster accounted for 72,6 per cent of total current payments. The main contributors to this cluster were the departments of Correctional Services, Defence and Military Veterans, and Police, which accounted for about 91,1 per cent of current payments by the cluster.

Transfers and subsidies increased by 5,1 per cent on a year-on-year basis, falling below the 2016 Budget projection of a 7,6 per cent increase as a number of departments lagged behind with their projected spending. The departments of Education, Health, Social Development, Transport as well as Cooperative Governance and Traditional Affairs accounted for 74,6 per cent of total transfers and subsidies.

Payments for capital assets recorded a substantial year-on-year rate of increase of 18,0 per cent in the first half of fiscal 2016/17. However, in the *Budget Review 2016,* this category of spending was projected to record a year-on-year decline as fewer funds were set aside for capital expenditure in fiscal 2016/17. During the period under discussion, payments for financial assets recorded a substantial annual decline, primarily as a result of a high base set with a one-off transfer of R25,0 billion to Eskom and the New Development Bank which took place in fiscal 2015/16.

Interest payments on national government debt increased by 14,4 per cent in the first six months of fiscal 2016/17 when compared with the first six months of fiscal 2015/16, and amounted to R71,6 billion. The *Budget Review 2016* expected that interest payments would reach R148 billion for fiscal 2016/17 as a whole, representing a year-on-year rate of increase of 14,7 per cent.

Equitable share transfers to provinces increased by 7,3 per cent on a year-on-year basis and amounted to R205 billion in the first half of fiscal 2016/17. According to the *Budget Review 2016*, this spending category was projected to reach R411 billion in fiscal 2016/17, some 6,3 per cent more than in the preceding fiscal year.

Metropolitan municipalities received R3,7 billion in August 2016 as their share of the general fuel levy. This was the first of three equal payments, with the next payment expected in December 2016.

After accounting for cash-flow adjustments,[13] the cash-flow expenditure of national government amounted to R628 billion in the first six months of fiscal 2016/17, or 5,8 per cent more than in the same period in fiscal 2015/16.

The revenue of national government amounted to R520 billion[14] in the first half of fiscal 2016/17, representing a year-on-year rate of increase of 7,8 per cent. All the major tax categories increased on a year-on-year basis. Notwithstanding these increases, revenue performed below 2016 Budget projections during the period under review. In the first six months of fiscal 2016/17, national government revenue was R7,7 billion below the monthly budgeted revenue for the first six months. As a percentage of GDP, national government revenue nevertheless remained broadly unchanged at 24,1 per cent in the first half of fiscal 2016/17 when compared with the same period a year earlier.

The *Budget Review 2016* projected that national government revenue would reach R1 162 billion in fiscal 2016/17, representing a year-on-year rate of increase of 8,8 per cent. In the *MTBPS 2016*, expected national government revenue was revised downwards by about R18,0 billion to an amount of R1 144 billion in fiscal 2016/17, representing a year-on-year rate of increase of 7,0 per cent. Gross tax revenue was revised downwards by R23,0 billion in the *MTBPS 2016* but was partly offset by an upward revision in non-tax revenue.

Taxes on income, profits and capital gains amounted to R303 billion in the first six months of fiscal 2016/17, or 8,2 per cent more than during the same period in fiscal 2015/16. Collections from this tax category fell below budgeted projections, owing to lower receipts from personal income tax. The slowdown in personal income tax collections resulted from lower pay-as-you-earn and provisional tax receipts, primarily due to lower wage increases and bonus payments in the financial and public sectors. Corporate income tax increased above 2016 Budget projections mainly due to higher provisional payments, alongside a decline in corporate income tax refunds. The *Budget Review 2016* projected that taxes on income, profits and capital gains would record a year-on-year rate of increase of 10,1 per cent in fiscal 2016/17.

13 These are adjustments to total expenditure arising from timing differences between the recording of transactions and bank clearances, along with late departmental requests for funds.

14 In the calculation by the South African Reserve Bank, revenue excludes premiums on debt portfolio restructuring and loan transactions. These came to R2,5 billion in April–September 2016.

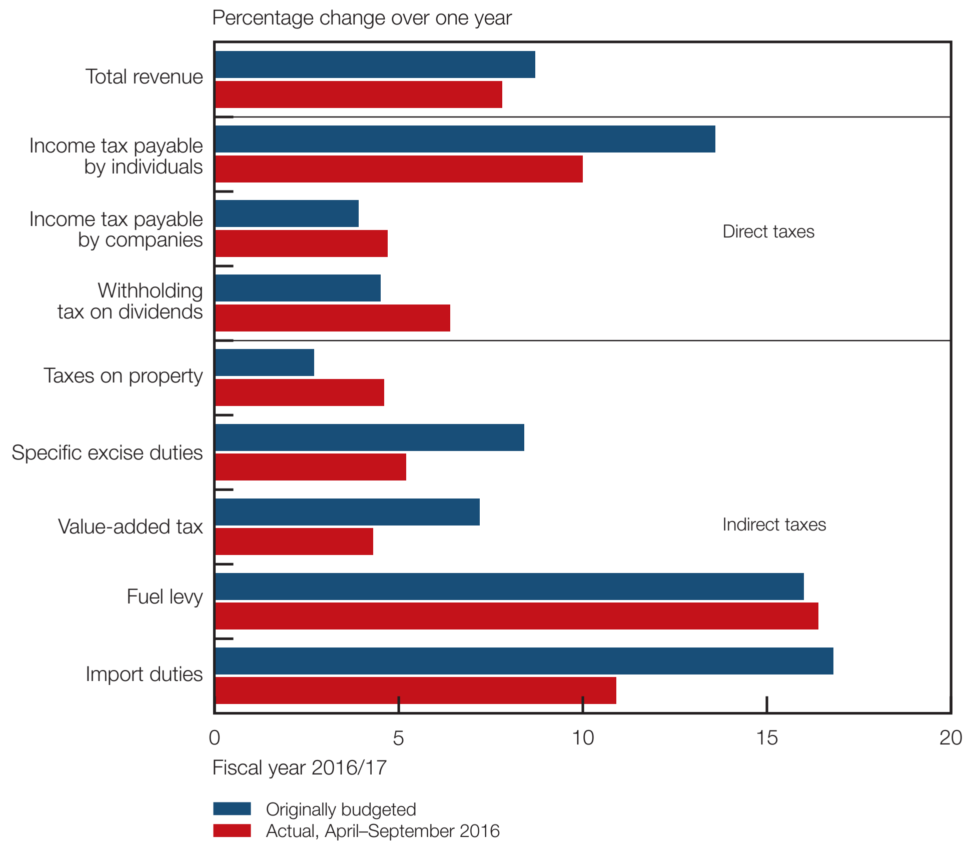
National government revenue in fiscal 2016/17

Revenue source	Originally budgeted Full 2016/17		Actual Apr–Sep 2016	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	668,4	10,1	303,4	8,2
Income tax on individuals	*442,2*	*13,6*	*198,0*	*10,0*
Income tax on companies	*200,9*	*3,9*	*93,1*	*4,7*
Payroll taxes	17,6	15,9	7,1	-2,5
Taxes on property	15,5	2,7	7,6	4,6
Taxes on goods and services	418,6	8,5	183,5	6,1
Value-added tax (VAT)	*301,3*	*7,2*	*130,2*	*4,3*
Domestic VAT	*322,4*	*8,4*	*155,2*	*6,4*
Import VAT	*164,0*	*8,8*	*67,3*	*3,7*
Taxes on international trade and transactions	54,5	16,2	21,2	9,9
Import duties	*54,0*	*16,8*	*21,1*	*10,9*
Other revenue**	26,8	-46,0	17,4	-18,1
Less: SACU*** payments	39,4	-22,7	19,7	-23,7
Total revenue	1 162,0	8,7	520,4	7,8

* Fiscal 2015/16 to fiscal 2016/17
** Including extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions that amounted to R2,5 billion in April–September 2016
*** Southern African Customs Union

Taxes on property amounted to R7,6 billion in the first half of fiscal 2016/17, some 4,6 per cent more than in the first half of fiscal 2015/16. The increase in this tax category was driven by increased collections of transfer duties, which recorded a year-on-year rate of increase of 11,4 per cent as the rate of duty on large-value property transactions was raised.

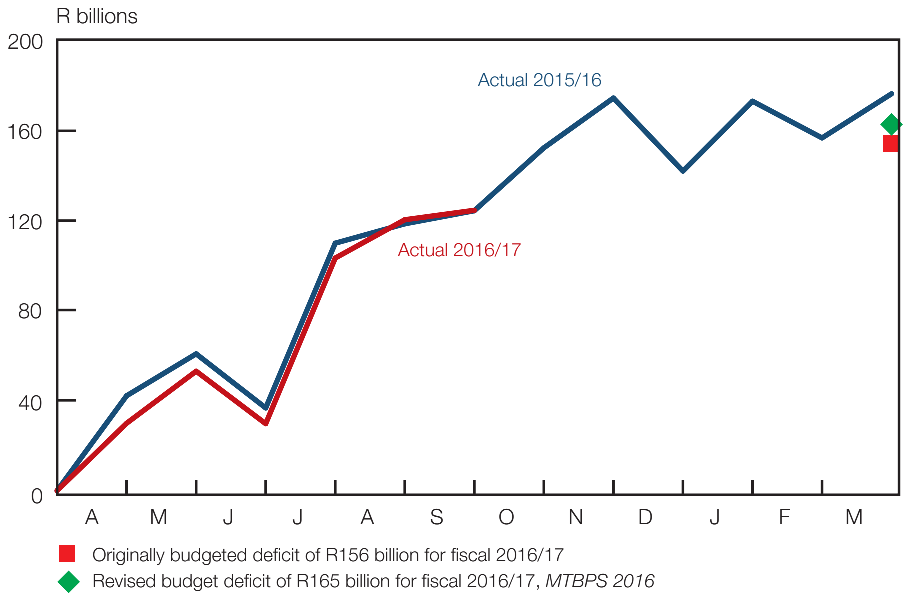
Components of national government revenue



Taxes on goods and services amounted to R183 billion in the first six months of fiscal 2016/17, representing a year-on-year rate of increase of 6,1 per cent. For fiscal 2016/17 as a whole, the *Budget Review 2016* projected that taxes on goods and services would increase at a year-on-year rate of 8,5 per cent. The weaker performance of this tax category compared to budgeted expectations could be attributed to a slowdown in value-added tax (VAT) and excise duties collections. The slowdown in VAT may be attributable to subdued growth in consumption expenditure by households which continue to be constrained by low consumer confidence, sluggish employment, and rising debt service cost. Lower excise duties stemmed from a contraction in collections on cigarettes and tobacco.

Taxes on international trade and transactions reached R21,2 billion in the first half of fiscal 2016/17, or 9,9 per cent more than in the same period of the previous fiscal year. The increase in this tax category reflected higher import duty collections, although receipts from import duties slowed in the July–September quarter partly as a result of a contraction in vehicle imports.

Cumulative deficit of national government



The net result of national government revenue and expenditure was a cash-book deficit of R124 billion in the first six months of fiscal 2016/17, which was just R0,2 billion more than the cash-book deficit recorded in the corresponding period of fiscal 2015/16. Relative to GDP, the cash-book deficit amounted to 5,8 per cent in the first half of fiscal 2016/17, lower than the ratio of 6,2 per cent recorded in the same period a year earlier. In the *Budget Review 2016*, the cash-book deficit was expected to amount to R156 billion in fiscal 2016/17, or 3,6 per cent of GDP. The *MTBPS 2016*, however, revised the projected cash-book deficit upwards to R165 billion.

The primary balance (the deficit/surplus calculated by excluding interest payments from total expenditure) recorded a deficit of R52,8 billion in April–September 2016, or R8,8 billion less than in the same period a year earlier. As a ratio of GDP, the primary balance reached 2,5 per cent in the first half of fiscal 2016/17 compared with 3,1 per cent in the same period of the previous fiscal year.

The cash-flow deficit of national government remained unchanged at R105 billion in the first half of fiscal 2016/17 when compared with the same period of the previous fiscal year. After accounting for the cost of revaluation of foreign debt at maturity, the net borrowing requirement of national government amounted to R113 billion in April–September 2016, some R7,3 billion higher than the amount recorded in the same period of the previous year.

National government financing in fiscal 2016/17

R billions

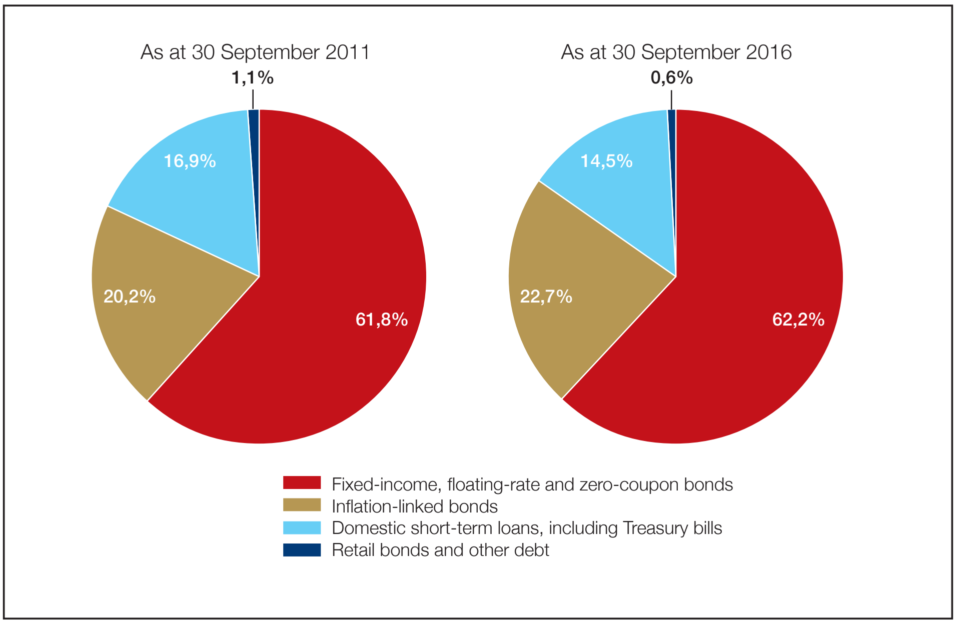
Item or instrument	Actual Apr–Sep 2015	Originally budgeted Full 2016/17[1]	Actual Apr–Sep 2016
Cash flow deficit[2]	105,0[3]	156,3[4]	105,0[3]
Plus: Cost/profit on revaluation of foreign debt at redemption[5]	0,6	8,1	7,9
Net borrowing requirement	105,6	164,4	112,9
Treasury bills	32,1	25,0	48,8
Domestic government bonds	52,2	116,2	49,4
Foreign bonds and loans	-1,2	15,9	11,4
Change in available cash balances[6]	22,6	7,3	3,3
Total net financing[7]	105,6	164,4	112,9

1 *Budget Review 2016*
2 Including extraordinary receipts and payments
3 Cash-flow deficit which differs from the cash-book deficit
4 Cash-book deficit
5 Cost + profit –
6 Increase – decrease +
7 Components may not add up to totals due to rounding

The net borrowing requirement was largely financed through the issuance of domestic debt instruments: Treasury bills and bonds. Net issuances of Treasury bills and short-term loans from the Corporation for Public Deposits amounted to R48,8 billion in the first half of fiscal 2016/17. The average yield on funds raised through Treasury bills was 6,8 per cent in the first half of fiscal 2016/17. For fiscal 2016/17 as a whole, national government plans to raise R116 billion through domestic long-term government bonds and R25,0 billion through Treasury bills.

During the first half of fiscal 2016/17, net issuances of domestic bonds and other financing amounted to R49,4 billion. Of this total, inflation-linked bonds accounted for R37,2 billion, bringing the outstanding balance of these instruments to R446 billion at the end of September 2016. These bonds represent 26,8 per cent of total domestic marketable bonds. Conventional bonds attracted an average interest rate of 8,6 per cent and inflation-linked bonds a real rate of 1,8 per cent per annum.

Composition of domestic debt of national government



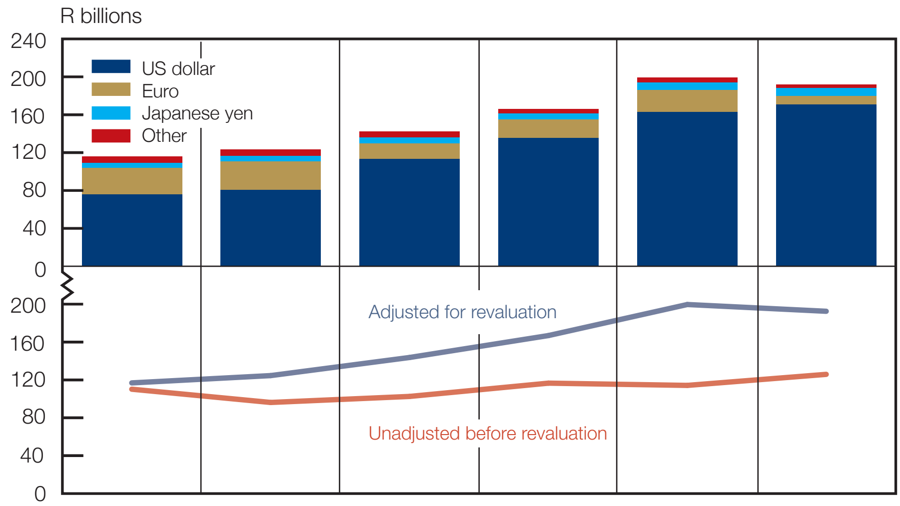
Fixed-income, floating-rate and zero-coupon bonds comprise the largest component of national government domestic debt – about 62,2 per cent of the total as at 30 September 2016. This ratio has remained relatively stable in the past five years, increasing only slightly from the 61,8 per cent level registered in September 2011.

Net issuances of foreign bonds and loans to the value of R11,4 billion were recorded during the first six months of fiscal 2016/17. The average outstanding maturity of foreign marketable bonds increased from 102 months in March 2016 to 104 months in September 2016 as some bonds matured.

The funding activities of national government reduced the available cash balances by R3,3 billion to R208 billion as at the end of September 2016. Of the balances as at the end of September 2016, deposits with the SARB accounted for 72,0 per cent, or R171 billion, while the remaining balances were held with commercial banks.

National government's domestic debt, accounting for 91 per cent of total gross loan debt, amounted to R1 963 billion as at the end of September 2016 – R144 billion more than at the end of March 2016. This increase in domestic debt was the result of higher net issuances of domestic marketable instruments: bonds and Treasury bills. As a percentage of GDP, domestic debt increased from 44,5 per cent at the end of March 2016 to 46,3 per cent at the end of September 2016. The *Budget Review 2016* estimated this ratio at 45,7 per cent for fiscal 2016/17. The average unexpired maturity of national government's domestic marketable bonds rose from 179 months as at 31 March 2016 to 184 months as at 30 September 2016.

National government: foreign currency-denominated debt



As at 31 March of each fiscal year

* As at 30 September 2016

The foreign debt of national government amounted to R192 billion as at 30 September 2016, some R7,1 billion less than the amount recorded as at 31 March 2016. This increase in foreign debt could primarily be attributed to the exchange rate revaluation effects. National government foreign debt, before accounting for exchange rate revaluation effects, stood at R126 billion at the end of September 2016, compared with R192 billion after revaluation effects – a revaluation of about R67 billion. As a percentage of GDP, foreign debt decreased from 4,9 per cent of GDP at the end of March 2016 to 4,5 per cent at the end of September.

Although there were no new issues in the July–September quarter of fiscal 2016/17, government had successfully placed US$3 billion in new notes maturing in 2028 (12 years) and 2046 (30 years) in the international capital markets through an innovative one-day new issue and tender switch transaction during October 2016. The amount was made up of US$2 billion (approximately US$700 million in a switch and US$1,3 billion in a tender offer in new cash) on the 12-year tranche and US$1 billion in new cash on the 30-year tranche. The 12-year bond was priced at a coupon rate of 4,3 per cent (at par value) which represents a spread of 273,8 basis points above the 10-year US Treasury benchmark bond, while the 30-year bond was priced at a coupon rate of 5 per cent (at par value) which represents a spread of 272 basis points above the 30-year US Treasury benchmark bond.

Combining domestic and foreign liabilities, the total gross loan debt of national government amounted to R2 156 billion at the end of September 2016 compared with R2 019 billion at the end of March 2016. As a ratio of GDP, total gross loan debt rose from 49,4 per cent to 50,9 per cent between March 2016 and September. The *Budget Review 2016* envisaged that total gross loan debt would total R2 234 billion, or 50,9 per cent of GDP, at the end of March 2017.

The 2016 *Medium Term Budget Policy Statement*

The Minister of Finance presented the *Medium Term Budget Policy Statement (MTBPS)* to Parliament on 26 October 2016. The 2016 *MTBPS* was presented against a backdrop of significant domestic and global economic and political challenges marked by high levels of uncertainty. Rising national debt levels and debt service costs as well as the consistent downward adjustment of growth projections and tax revenue shortfalls, among other things, have reduced the authorities' degrees of freedom in setting fiscal policy.

Against this background, the 2016 *MTBPS* projected a growth rate of 0,5 per cent for 2016, representing a downward revision from the 0,9 per cent projected in the February 2016 Budget. There have been consistent downward revisions to growth forecasts in recent years, which also highlight the underlying structural impediments in the domestic economy. Although economic growth was estimated to pick up moderately over the medium term, there remained significant domestic constraints to the outlook, presenting the risk of lower growth outcomes which would significantly undermine the fiscal consolidation and debt stabilisation plans of government.

Macroeconomic projections: February 2016 Budget and October 2016 *MTBPS*

	2015			2016		2017		2018		2019
				Medium-tem forecast						
Percentage change	Budget	*MTBPS*	Outcome	Budget	*MTBPS*	Budget	*MTBPS*	Budget	*MTBPS*	*MTBPS*
Real gross domestic product	2,0	1,5	1,3	0,9	0,5	1,7	1,3	2,4	2,0	2,2
Consumer prices	4,3	4,8	4,6	6,8	6,4	6,3	6,1	5,9	5,9	5,8
Gross domestic product at current prices (R billions)................	4 113	4 031	4 014	4 306	4 300	4 657	4 617	5 053	4 981	5 385

These growth projections are substantially lower than the targets set out in the National Development Plan which, among other things, recognises that faster, broad-based economic growth is a necessary prerequisite for economic transformation, job creation and poverty reduction in South Africa. The 2016 *MTBPS* also revised the consumer price inflation forecast for 2016 down to 6,4 per cent compared with 6,8 per cent projected in the February 2016 Budget, as shown in the accompanying table.

In response to these developments, the 2016 *MTBPS* proposed a revised fiscal framework which would continue to aim at a measured consolidation path that avoids an abrupt contraction in expenditure while prioritising capital investment and stabilising national debt as a share of GDP. The 2016 *MTBPS* recognised that the proposed measures are likely to have a short-term dampening impact on economic growth. However, in the medium to long term, these measures would potentially have a positive impact on growth.

The proposed measures include tax proposals that would raise an additional R13 billion in fiscal 2017/18, combined with measures announced in the 2016 Budget that would bring the total tax revenue increase to R28 billion in fiscal 2017/18. Additional measures would also be proposed to raise R15 billion in fiscal 2018/19, bringing the total additional revenue proposed to R43 billion over the next two years. The 2016 *MTBPS* also proposed a reduction in the expenditure ceiling of R26 billion over the next two years: R10 billion and R16 billion in 2017/18 and 2018/19 respectively.

The 2016 *MTBPS* also made various revisions to the fiscal framework projections initially contained in the 2016 Budget; these are summarised in the accompanying table. The consolidated government's total revenue for fiscal 2016/17 has been revised downwards by about R23 billion, or a 1,8 per cent shortfall from the amount of R1 324 billion estimated in the February 2016 Budget.

Consolidated fiscal framework: February 2016 Budget and October 2016 *MTBPS*

	2015/16			2016/17		2017/18		2018/19		2019/20
				Medium-term forecast						
R billion/ Percentage of GDP	Budget	*MTBPS*	Outcome	Budget	*MTBPS*	Budget	*MTBPS*	Budget	*MTBPS*	*MTBPS*
Consolidated government revenue	1 188,9	1 220,8	1 220,9	1 324,3	1 301,0	1 436,7	1 416,9	1 571,6	1 537,9	1 670,4
Percentage of GDP	*18,4%*	*29,7%*	*29,9%*	*30,2%*	*29,7%*	*30,2%*	*30,1%*	*30,4%*	*30,3%*	*30,4%*
Consolidated government expenditure	1 351,0	1 378,7	1 373,1	1 463,3	1 451,5	1 572,1	1 564,0	1 695,2	1 676,0	1 809,4
Percentage of GDP	*32,2%*	*33,6%*	*31,3%*	*33,3%*	*33,1%*	*33,1%*	*33,3%*	*32,8%*	*33,0%*	*32,9%*
Non-interest expenditure	1 218,6	1 244,7	1 237,8	1 308,9	1 297,0	1 403,4	1 393,3	1 509,6	1 487,5	1 603,8
Percentage of GDP	*29,1%*	*30,3%*	*30,3%*	*29,8%*	*29,6%*	*29,5%*	*29,6%*	*29,2%*	*29,3%*	*29,2%*
Primary balance...	-29,7	-48,4	-40,6	15,4	17,3	33,4	2,7	62,0	18,5	27,6
Percentage of GDP	*-0,7%*	*-1,2%*	*-1,0%*	*0,4%*	*-0,4%*	*0,7%*	*0,1%*	*1,2%*	*0,4%*	*0,5%*
Budget deficit (fiscal balance)...............	-162,2	-157,9	-152,2	-139,0	-150,5	-135,3	-147,1	-123,6	-138,2	-139,0
Percentage of GDP	*-3,9%*	*-3,7%*	*-3,7%*	*-3,2%*	*-3,4%*	*-2,8%*	*-3,1%*	*-2,4%*	*-2,7%*	*-2,5%*
Gross loan debt...	1 983,2	2 009,0	2 018,9	2 233,6	2 246,4	2 422,6	2 466,5	2 606,9	2 689,8	2 870,5
Percentage of GDP	*47,3%*	*49,0%*	*49,4%*	*50,9%*	*51,3%*	*51,0%*	*52,5%*	*50,5%*	*53,0%*	*52,3%*
Net loan debt	1 781,3	1 785,7	1 804,6	2 003,4	2 004,4	2 194,8	2 209,2	2 382,4	2 417,1	2 632,4
Percentage of GDP	*42,5%*	*43,5%*	*44,2%*	*45,7%*	*45,8%*	*46,2%*	*47,0%*	*46,2%*	*47,6%*	*47,9%*

Amid disappointing domestic economic growth performance, the shortfall in revenue could largely be attributed to the underperformance of both personal income tax and VAT collections. The expected revenue for the full 2016/17 fiscal year from these two sources was revised downwards by R12,5 billion and R7,9 billion respectively. Therefore, as government aims to raise additional tax revenue over the next three years, additional measures are set to be announced in the February 2017 Budget. As a proportion of GDP, the consolidated government revenue was expected to rebound from a revised estimated ratio of 29,7 per cent in fiscal 2016/17 to average 30,3 per cent per annum in the subsequent three fiscal years.

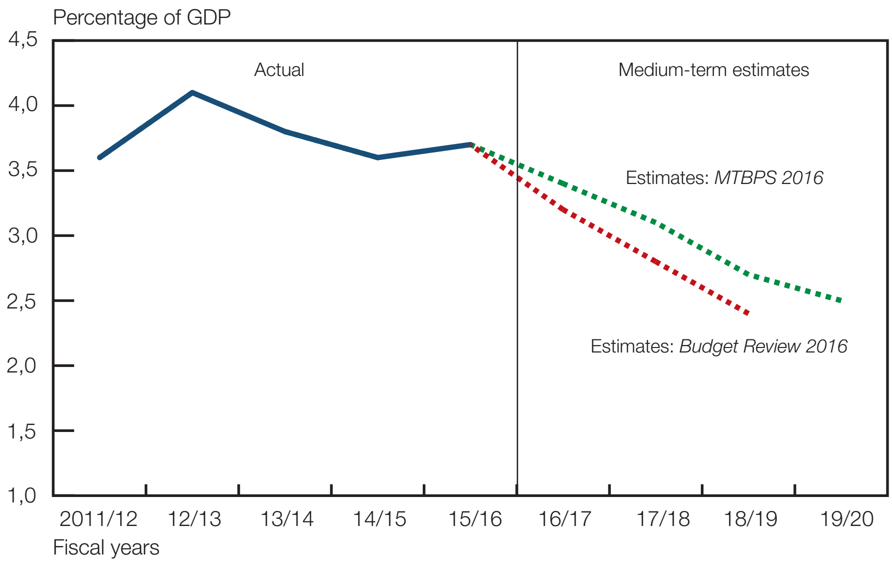
15 'Consolidated government expenditure' refers to total expenditure by national and provincial government, social security funds and selected public entities, including transfers to municipalities, businesses or other entities. This may not be comparable with the South African Reserve Bank consolidated general government expenditure analysis which is based on the International Monetary Fund's Government Finance Statistics framework.

Consistent with the expenditure ceiling approach introduced in the 2012 Budget, in the *MTBPS* consolidated government expenditure[15] for 2016/17 was trimmed by 0,8 per cent, or R11,8 billion, from originally budgeted estimates to a level of R1 452 billion. Government spending would increase by 7,6 per cent per annum over the next three years to reach R1 809 billion in fiscal 2019/20. State debt-service cost, which accounted for 10,5 per cent of consolidated spending in fiscal 2016/17, remained the fastest-growing expenditure category but was expected to rise at a slower pace when compared with the previous three years.

Over the medium term, government non-interest expenditure would rise at an average rate of 1,2 per cent per annum in real terms, with the bulk of additional spending allocations earmarked towards infrastructure and social services. Post-school education and training was set to be the fastest-growing spending category of government non-interest expenditure. This spending category was prioritised, with additional funding allocated to the National Student Financial Aid Scheme and directly to universities, increasing by 18,5 per cent and 10,9 per cent per annum respectively over the medium term. Government would reprioritise spending from other priorities towards higher education to facilitate the containment of university fee increases. The general government wage bill was set to rise by a moderate 6,9 per cent per annum over the medium term as the filling of public-sector vacancies would be carefully managed along with the upcoming wage negotiations in 2017/18.

With consolidated government expenditure higher than revenue, the originally budgeted deficit of R139 billion, or 3,2 per cent of GDP, for fiscal 2016/17 was revised slightly higher to R151 billion, or 3,4 per cent of GDP. Through a combination of tax and expenditure measures over the medium term, the budget deficit would be contained at levels below R150 billion per annum and was set to narrow to 2,5 per cent of GDP by fiscal 2019/20. At the same time, a turnaround of the primary balance was projected, from a *deficit* of 0,4 per cent of GDP in fiscal 2016/17 to a *surplus* of 0,5 per cent in fiscal 2019/20.

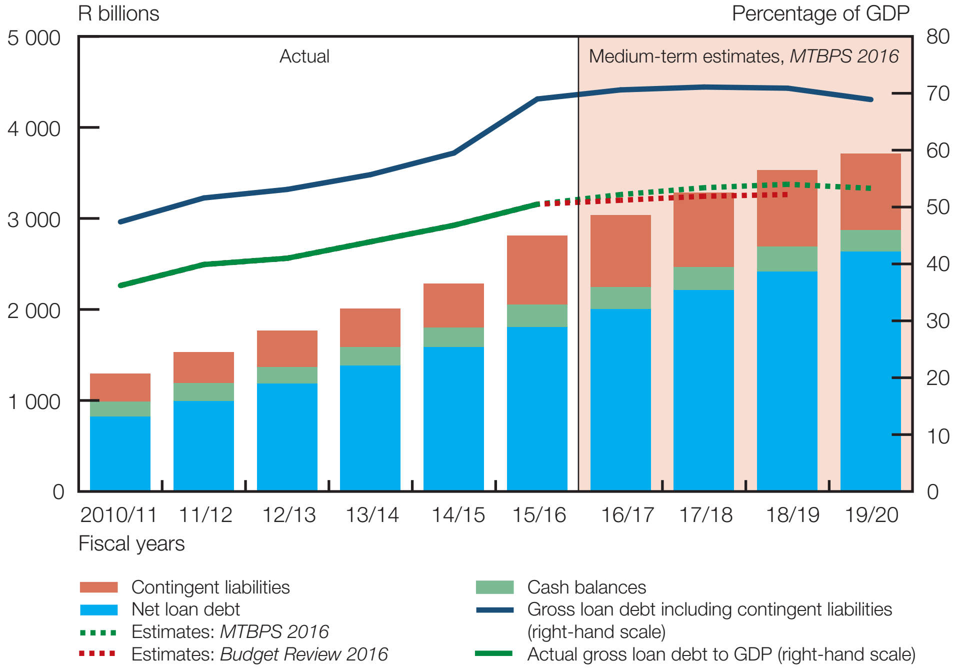
Consolidated government budget deficit



The domestic capital market was set to remain the main source of financing of the government deficit. The bond-switch programme – exchanging short-term for longer-term debt – had progressed well and would continue to ease refinancing pressures on targeted areas of domestic and foreign redemptions. Government also envisaged issuing bonds to the value of US$6 billion in the international capital markets over the medium term.

The relatively higher budget deficits resulted in a considerable build-up of government debt. The 2016 Budget projected that the total gross loan debt of national government would reach R2 234 billion by the end of fiscal 2016/17. This amount was revised upwards by R12,8 billion to R2 246 billion in the 2016 *MTBPS*, and is projected to increase further to R2 871 billion by fiscal 2019/20. While facing various economic headwinds, government once again reiterated its commitment to rebuilding fiscal resilience and stabilising national debt as a share of GDP, and assuring the long-term sustainability of public finances.

National government debt



The February 2016 Budget estimated that national government's gross loan debt as a percentage of GDP would stabilise at around 51 per cent over the medium term. In the October 2016 *MTBPS,* this ratio was revised marginally higher to an estimated 53,0 per cent in fiscal 2018/19 before receding to 52,3 per cent in fiscal 2019/20. Even though government aimed to maintain its 'deficit neutral' policy stance on intervention to support state-owned companies, there has been a notable increase in the level of contingent liabilities (which include government guarantees to state-owned companies), as observed in the accompanying graph.

After taking into account available cash balances, the government net loan debt is expected to stabilise at around 47,5 per cent of GDP over the medium-term period – almost 1,5 percentage points higher than the ratio originally estimated in February 2016.

The revised debt figures remained within the IMF debt sustainability benchmarks. Nevertheless, the rising level of debt, however gradual, commands vigilance since its continuation would limit the authorities' future fiscal space.

Statement of the Monetary Policy Committee

22 September 2016

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

Headline consumer price inflation declined to within the target range of 3–6 per cent in August, in line with the expectations of the South African Reserve Bank (the Bank). Nevertheless, higher inflation outcomes are forecast in the near term before a sustained return to within the target range during 2017. While domestic economic growth prospects appear more favourable following the positive surprise in the second quarter of this year, the outlook remains constrained against a backdrop of weak domestic fixed investment and low levels of business and consumer confidence.

Risks from the global environment persist, although the volatility in global financial markets in the wake of the Brexit decision has subsided. Prospects for a resumption of monetary policy tightening in the United States (US) remain a key risk to the pattern of global capital flows and to emerging market exchange rates in general, with continued uncertainty regarding the timing and pace of future moves.

The year-on-year inflation rate, as measured by the consumer price index (CPI) for all urban areas, measured 6,0 per cent and 5,9 per cent in July and August respectively, down from 6,3 per cent in June. Food price inflation accelerated to a recent high of 11,6 per cent, with the category of food and non-alcoholic beverages contributing 1,7 percentage points to the overall inflation outcome. Goods price inflation measured 6,1 per cent in August, down from 6,5 per cent in July, while services price inflation was unchanged at 5,7 per cent. The Bank's measure of core inflation – which excludes food, fuel and electricity – was also unchanged at 5,7 per cent.

Producer price inflation for final manufactured goods increased in June and July to 6,8 per cent and 7,4 per cent respectively, following a decline to 6,5 per cent in May. This acceleration was mainly due to the impact of the drought on manufactured food price inflation, which measured 12,6 per cent in July. This was its highest level since January 2009. Producer price inflation for agricultural products also remained elevated at around 20 per cent.

The latest inflation forecast of the Bank has improved over the first four quarters of the forecast horizon, and remains more or less unchanged for the rest of the period. Inflation is expected to peak at 6,7 per cent in the fourth quarter of this year, compared with 7,1 per cent previously, with an earlier sustained return to within the target range now forecast to occur during the second quarter of 2017. Inflation is expected to average 6,4 per cent in 2016 and 5,8 per cent in 2017, compared with 6,6 per cent and 6,0 per cent previously. The forecast for 2018 is unchanged at an average of 5,5 per cent. The downward revisions are due in part to a lower starting point, lower administered price inflation assumptions (including petrol, electricity, and rates and taxes inflation) as well as a less depreciated exchange rate assumption.

Compared with the previous forecast, core inflation is expected to average 0,1 percentage point less, at 5,7 per cent in 2016 and 5,6 per cent in 2017, and is unchanged at 5,3 per cent in 2018. Core inflation is expected to remain within the target range over the forecast period, with a peak of 5,9 per cent in the final quarter of this year.

Inflation expectations, as reflected in the survey conducted by the Bureau for Economic Research, have remained relatively unchanged, but with some variations between the different groups of respondents. Average inflation expectations declined by 0,2 per cent to 6,0 per cent for 2017 and remained unchanged at 5,9 per cent for 2018. While the expectations of both analysts and business people declined, those of trade union officials remained unchanged for 2017 but increased for 2018. The long-term, five-year-ahead inflation expectations are unchanged at 5,9 per cent, and remain uncomfortably close to the upper end of the target range.

The inflation expectations of analysts, as reflected in the Reuters Econometer survey, have also shown successive declines during the past few months, with the median expectation for inflation to return to within the target range during the second quarter of 2017. The longer-term expectations of market participants implicit in the break-even inflation rates (the yield differential between conventional bonds and inflation-linked bonds) declined further since the previous meeting of the Monetary Policy Committee (MPC), although they remain above the upper end of the inflation target range.

The global growth outlook remains subdued, amid slowing growth in the advanced economies and a general downward revision to forecasts. Although prospects for the US economy remain relatively favourable, outcomes have not been consistently positive, as evidenced by the recent weak consumer expenditure and manufacturing sector data. Nevertheless, labour market conditions have improved and the investment slowdown appears to have bottomed.

Although the short-term impacts of the Brexit vote on the economy of the United Kingdom (UK) have not been as negative as initially feared, growth forecasts have been revised down as concerns persist regarding the longer-term investment outlook. The euro area recovery remains steady but subdued. The Japanese economy remains caught in a deflation and low growth bind, following a weak second quarter.

The recent firmer trend in commodity prices has improved growth prospects for commodity-producing emerging markets in particular, along with more favourable capital inflows. It is unclear how long these positive developments will continue. Indications are that the negative growth cycles in both Russia and Brazil have turned; both countries are expected to record positive, but weak rates of growth in the near term. The Chinese economy appears to have stabilised following concerns about a slowdown earlier in the year, but concerns regarding the financial sector persist.

Given the broadly benign global inflation environment, apart from in some emerging markets, monetary policies have generally remained accommodative, with further loosening or a loosening bias in a number of the advanced economies. A notable exception is the US, where the bias remains for a resumption of interest rate normalisation but the timing remains uncertain. Following the decision of the Federal Reserve yesterday to keep rates unchanged, the market expectation is for the next move to be in December. The data-dependent nature of future decisions means that these prospects are likely to change with new data releases, imparting a degree of volatility to financial markets and to global capital flows. The US policy rate trajectory is still expected to be moderate.

The exchange rate of the rand has been affected by these global events, but has also been impacted by domestic fundamentals and political developments. Since the previous meeting of the MPC, the rand has traded in a range of R13,28 and R14,73 against the US dollar – and has appreciated by 6,3 per cent against the US dollar, by 4,3 per cent against the euro, and by 5,2 per cent on a trade-weighted basis.

The rand initially appreciated markedly in line with other emerging market currencies as the chances of US Federal Reserve tightening receded in August following disappointing labour market data. At that stage, the rand recorded its strongest level since October 2015. This trend was reversed following increased domestic risk perceptions, which were also reflected in rising domestic government bond yields. More recently, the rand has been positively affected by the stronger gross domestic product (GDP) growth outcome and a significant narrowing of the current account deficit, following a sizeable trade account surplus in the second quarter. Although this may in part reflect a delayed adjustment to the depreciated exchange rate of the rand, the trade surplus is not expected to be sustained at similar levels in the coming months.

The marked appreciation of the rand during the past few days appears to be driven by expectations of unchanged US monetary policy as well as by speculation regarding possible purchases of the rand related to a major M&A transaction. The rand, however, remains vulnerable to future changes in the US monetary policy stance, domestic political developments as well as to the risk of a possible ratings downgrade later in the year. Nevertheless, the upside risk to inflation from the exchange rate appears to have moderated somewhat.

The domestic economy remains weak despite the positive growth surprise in the second quarter of 2016, when an annualised growth rate of 3,3 per cent was recorded. This was driven by a rebound in the primary sector and a surge in real exports. Mainly as a result of the higher starting point, the Bank's forecast for economic growth for 2016 has been revised upwards: from 0 per cent to 0,4 per cent. The forecasts for the next two years have been increased too, albeit marginally by 0,1 percentage points, to 1,2 per cent and 1,6 per cent respectively. Estimates of potential output growth are unchanged, implying a persistence of below-potential growth. The trend in the Bank's composite leading indicator of economic activity remains indicative of subdued growth.

While the second quarter growth performance was more favourable, data for July suggest that this improvement is unlikely to be sustained in the third quarter. Both the mining and manufacturing sectors recorded negative month-to-month growth rates in July, and the Barclays Purchasing Managers' Index (PMI) declined sharply in August following five consecutive months above the neutral 50-point mark. Stresses are also evident in the construction sector, with a further sharp decline in building plans passed during July.

A key constraint to the growth outlook remains the sluggish state of domestic gross fixed capital formation, which contributed negatively to GDP growth during the first two quarters of this year. In the second quarter of 2016, domestic fixed investment contracted in both the private and the public sectors (including government and public corporations). Private-sector fixed investment has recorded negative or zero growth for six consecutive quarters, reflecting low levels of business confidence. The Rand Merchant Bank/Bureau for Economic Research (RMB/BER) business confidence index remains below the neutral level despite an improvement in the third quarter.

This adverse investment climate and rising costs have contributed to the further deterioration in employment prospects, particularly in the mining and manufacturing sectors. The official unemployment rate increased to 26,6 per cent in the second quarter, from 25,0 per cent a year earlier. The increase in employment that was recorded in the second quarter was almost entirely attributable to temporary employment opportunities related to the municipal elections.

Consumption expenditure by households remains weak, despite a return to positive growth following the first-quarter contraction. The annualised growth of 1,0 per cent suggests that consumers remain under pressure. Durable goods consumption continued to contract in the second quarter and is consistent with the further decline in the First National Bank/Bureau for Economic Research (FNB/BER) consumer confidence index. In July, retail trade sales declined further, in contrast to positive wholesale trade sales. Domestic new vehicle sales continued their negative trend in July and August, while exports of motor vehicles have remained robust.

The outlook for consumption expenditure growth is expected to remain constrained given the unfavourable employment outlook, the absence of significant positive wealth effects, and the slow pace of growth in the real disposable income of households. Average wage growth and wage settlement rates have declined slightly, but there are risks of increases in excess of inflation and productivity gains.

Credit extension to households continues to contract in real terms, likely driven by both supply- and demand-side considerations. However, there has been a moderate increase in mortgage credit extension. As before, growth in credit extension to the corporate sector has been more resilient but below its recent peaks.

Food prices remain a significant driver of inflation given the persistent drought, although long-range weather forecasts suggest improved rainfall prospects in the coming months. Food price inflation is still expected to reach a peak in the fourth quarter of this year, at around 12,3 per cent, slightly lower than forecast previously. Spot and futures prices of wheat and maize have declined in recent weeks, but meat prices are expected to rise further as farmers restock their herds. Global food price inflation has increased, mainly due to an acceleration in the price of sugar.

International oil prices have fluctuated between US$40 and US$50 per barrel for the past six months, amid uncertainty relating to a possible supply freeze by the Organization of the Petroleum Exporting Countries (OPEC). The assumption for Brent crude oil in the Bank's forecasting model is unchanged, and assumes a moderate increase over the forecast period. After two consecutive months of price declines totalling R1,17 per litre, the domestic petrol price is expected to increase in October due to adverse movements in both the exchange rate and international product prices.

The MPC has noted improvements in the expected inflation trajectory during the course of the year. Apart from the tighter stance of monetary policy, this has also been driven by lower starting points, as inflation surprised at times on the downside, and changed assumptions underlying the forecast. The expected peak in headline inflation is notably lower, and an earlier return to within the target range is also expected. Most of the changes have been for the current and coming year, whereas the changes in the forecast for 2018 have been marginal. Changes to the core inflation forecast have been less pronounced, but it is no longer expected to breach the upper end of the target range. Despite these improvements, the longer-term inflation trajectory remains uncomfortably close to the upper end of the target range, with high wage settlement rates and inflation expectations contributing to this persistence.

The MPC assesses the risks to the inflation forecast to be more or less balanced at this stage. The current level of the rand is stronger than that implicit in the forecast, and, in conjunction with continued low levels of pass-through from the rand to inflation, the risks are assessed to have moderated somewhat. However, some of the positive factors impacting on the rand may be temporary, and the currency remains vulnerable to both domestic and external shocks.

The other major risk to the inflation outlook relates to food prices. The forecast still expects food prices to peak in the final quarter of this year. The future trajectory of these prices will be highly dependent on the normalisation of rainfall in the coming months. Favourable weather patterns could see food price inflation falling faster than that implicit in the forecast.

Despite the improved growth performance in the second quarter, the growth outlook remains constrained, as reflected in the more or less unchanged outlook for the next two years. The MPC assesses the risk to the growth forecast to be broadly balanced as growth prospects remain dependent on global conditions, the implementation of structural reforms as well as changes in business and consumer confidence.

Given the improvements in the inflation forecast, the weak domestic economic outlook and the assessment of the balance of risks, the MPC has unanimously decided to keep the repurchase rate unchanged at 7,0 per cent per annum.

The MPC remains concerned about the overall inflation trajectory which remains in the upper end of the inflation target range. The MPC is of the view that, should the current forecasts transpire, we may be close to the end of the tightening cycle. The MPC is aware that a number of the favourable factors which have contributed to the improved outlook can change very quickly, resulting in a reassessment of this view. The bar for monetary accommodation, by contrast, remains high, as the MPC would need to see a more significant and sustained decline of the inflation trajectory to within the inflation target range.

Summary of assumptions: Monetary Policy Committee meeting on 22 September 2016*

1. Foreign-sector assumptions

Percentage changes (unless otherwise indicated)	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real GDP growth in South Africa's major trading-partner countries	3,0%	3,1%	2,8%	2,7%	2,9%	3,1%
					(3,0%)	(3,3%)
2. International commodity prices in US$ (excluding oil)	-6,4%	-9,8%	-19,3%	-4,5%	5,5%	1,0%
				(-8,5%)	(1,0%)	(1,5%)
3. Brent crude (US$/barrel)	108,8	99,2	52,5	44,3	53,5	57,5
				(44,6)		
4. World food prices (US$)	-1,6%	-3,8%	-18,7%	-4,9%	3,0%	3,0%
				(-6,0%)	(2,0%)	
5. International wholesale prices	0,3%	-0,1%	-3,5%	-1,1%	1,1%	1,2%
				(-1,3%)	(1,0%)	
6. Real effective exchange rate of the rand (index 2010 = 100)	81,91	79,17	80,08	75,67	78,00	78,00
				(74,01)	(75,00)	(75,00)
7. Real effective exchange rate of the rand	-10,1%	-3,3%	1,1%	-5,5%	3,1%	0,0%
				(-7,6%)	(1,3%)	

2. Domestic-sector assumptions

Percentage changes (unless otherwise indicated)	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real government consumption expenditure	3,8%	1,8%	0,2%	1,5%	1,0%	1,0%
2. Administered prices	8,7%	6,7%	1,7%	5,1%	6,7%	7,3%
				(5,7%)	(7,4%)	(7,9%)
– Petrol price	11,8%	7,2%	-10,7%	1,0%	7,0%	7,9%
				(2,2%)	(7,6%)	
– Electricity price	8,7%	7,2%	9,4%	9,3%	7,7%	8,0%
				(9,6%)	(8,5%)	(9,0%)
3. Potential growth	2,0%	1,7%	1,5%	1,4%	1,5%	1,7%
4. Repurchase rate (per cent)	5,00	5,57	5,89	6,91	7,00	7,00

The figures in brackets represent the previous assumptions of the Monetary Policy Committee.
* For an explanation of foreign-sector assumptions and domestic-sector assumptions, see pages 90 and 91.

Selected forecast results: Monetary Policy Committee meeting on 22 September 2016

Selected forecast results (quarterly)

Year-on-year percentage change	Actual							Forecast												
	1	2	3	4	2015	1	2	3	4	2016	1	2	3	4	2017	1	2	3	4	2018
1. Headline inflation............................	4,2	4,6	4,7	4,9	4,6	6,5	6,2	6,2	6,7	6,4	6,2	5,8	5,8	5,5	5,8	5,4	5,4	5,5	5,6	5,5
							(6,2)	(6,5)	(7,1)	(6,6)	(6,6)	(6,1)	(5,8)	(5,5)	(6,0)	(5,4)	(5,5)	(5,5)	(5,6)	(5,5)
2. Core inflation..................................	5,7	5,6	5,3	5,2	5,5	5,5	5,5	5,7	5,9	5,7	5,8	5,7	5,5	5,4	5,6	5,3	5,3	5,3	5,4	5,3
							(5,5)	(5,9)	(6,1)	(5,8)	(6,0)	(5,9)	(5,4)	(5,2)	(5,7)	(5,2)	(5,2)	(5,3)	(5,4)	(5,3)

The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

Per cent	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real gross domestic product (GDP) growth	2,3%	1,6%	1,3%	0,4%	1,2%	1,6%
				(0,0%)	(1,1%)	(1,5%)
2. Current account as a ratio to nominal GDP.............................	-5,9	-5,3	-4,3	-4,0	-4,2	-4,4
				(-4,2)	(-4,4)	(-4,7)

The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Statement of the Monetary Policy Committee

24 November 2016

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

Headline consumer price inflation declined to within the target range of 3–6 per cent in August, in line with the expectations of the South African Reserve Bank (the Bank). Nevertheless, higher inflation outcomes are forecast in the near term before a sustained return to within the target range during 2017. While domestic economic growth prospects appear more favourable following the positive surprise in the second quarter of this year, the outlook remains constrained against a backdrop of weak domestic fixed investment and low levels of business and consumer confidence.

Since the previous meeting of the Monetary Policy Committee (MPC), the global economic and political landscape has changed significantly following the presidential election in the United States (US). The high degree of uncertainty surrounding the economic policies of the new administration is expected to persist for some time, creating a more challenging and volatile environment for emerging markets in particular. Higher US long bond yields, along with expectations of a tighter stance of monetary policy by the US Federal Reserve (Fed) than previously expected, have contributed to the reversal of the recent positive sentiment towards emerging markets. The prospect of rising protectionism and its implications for world trade are also a concern.

These developments have also affected capital flows to South Africa, with implications for the rand and bond yields. Domestic growth and inflation dynamics have remained more or less in line with expectations, but risks to the inflation outlook have increased moderately.

The year-on-year inflation rate, as measured by the consumer price index (CPI) for all urban areas, measured 6,1 per cent and 6,4 per cent in September and October respectively, compared with 5,9 per cent in August. The October outcome was marginally above the forecast of the South African Reserve Bank (SARB). Food price inflation accelerated further to a recent high of 12,0 per cent, with the category of food and non-alcoholic beverages contributing 1,8 percentage points to the overall inflation outcome. Goods price inflation measured 7,1 per cent in October, up from 6,6 per cent in September, with non-durable goods inflation increasing to 7,6 per cent. Services price inflation increased from 5,6 per cent to 5,8 per cent. The SARB's measure of core inflation – which excludes food, fuel and electricity – measured 5,7 per cent, up from 5,6 per cent.

Producer price inflation for final manufactured goods measured 6,6 per cent in September and October, down from 7,2 per cent in August. The main contributor to the October outcome was the category of food products, beverages and tobacco products, which contributed 4,0 percentage points and reflects the continued impact of the drought on food prices.

The latest inflation forecast of the SARB is broadly unchanged over the forecast period, despite a moderate upward adjustment to the food price forecast in the later quarters. The annual averages are unchanged at 6,4 per cent for 2016 and 5,8 per cent and 5,5 per cent respectively in the coming two years. Inflation is expected to peak at 6,6 per cent in the fourth quarter of this year, marginally lower than in the previous forecast, with a sustained return to within the target range still expected to occur during the second quarter of 2017. The higher food price assumption is offset by a slightly more appreciated exchange rate assumption.

Core inflation is expected to average 0,1 percentage points less in each year of the forecast period compared with the previous forecast, at 5,6 per cent this year and 5,5 per cent and 5,2 per cent in 2017 and 2018 respectively. Core inflation is expected to remain within the target range over the forecast period, with a peak of 5,8 per cent in the final quarter of this year.

The annual inflation expectations of economic analysts, as reflected in the Reuters Econometer survey conducted in November, are broadly unchanged since September and are similar to those of the SARB. The median forecast for the current and next two years are 6,3 per cent, 5,8 per cent and 5,6 per cent respectively. Bond market expectations implicit in the break-even inflation rates, i.e. the yield differential between conventional government bonds and inflation-linked bonds, increased in the wake of the recent depreciation of the rand. They remain above the upper end of the inflation target range.

The global outlook became increasingly uncertain during the year following the decision of the United Kingdom (UK) to leave the European Union and the outcome of the US presidential election. While the new policy direction in the US is still unclear, the markets have interpreted the outcome as being positive for US growth in the short run, with commitments to tax cuts and higher fiscal spending on infrastructure. These policies are expected to result in higher growth and inflation, particularly against the backdrop of an increasingly tight labour market. Nevertheless, the timing and extent of the expenditure boost is highly uncertain at this stage.

While an increase in infrastructure expenditure could be positive for commodity prices, other aspects of the possible new policy direction are likely to have an adverse effect on emerging markets. These include a possibly more aggressive tightening of US monetary policy in response to higher inflation and growth, which could also reduce the multiplier effect of the fiscal expansion. Together with the recent sharp increase in US long bond yields, the possibility of such actions has led to a reversal of capital flows to emerging markets, reminiscent of the market reaction to the so-called US taper tantrum in 2013. The impact on emerging market currencies and bond markets, including in South Africa, is already evident. Given the high degree of uncertainty, the financial markets may have overreacted.

A further concern for emerging markets is the potential change of trade policies that may impact on existing trade treaties, as well as unilateral increases in tariff protection in the US. The outlook for emerging markets has therefore become more uncertain. The lingering concerns about the sustainability of the recovery in the Chinese economy have been revived by the possibility of tariff increases on Chinese exports. Countries with strong direct trade links with the US, in particular Mexico, are most vulnerable to increased trade barriers. A more protectionist US stance could reinforce the already slow growth of global trade.

The short-term fallout of the Brexit vote on the UK economy has been limited to date, in part due to the accommodative monetary policy response. The longer-term impact remains unclear as the terms of withdrawal are still to be negotiated and there are concerns that a delay in clarity could undermine investment. The Eurozone is expected to continue with its slow but steady recovery, and the Japanese economy continues to battle with deflation.

Global inflation remains generally benign. Since the previous meeting of the MPC, a number of countries have loosened monetary policy. Expansionary policies are expected to persist in the Eurozone, Japan and the UK, despite emerging inflation pressures in the latter. By contrast, a persistence of significant outflows from emerging markets in response to the possibility of a tighter US monetary policy stance could pose challenges for monetary policies in a number of these economies.

These new global developments have impacted on the domestic bond and foreign exchange markets. The rand appreciated steadily from the middle of October in response to some positive domestic developments as well as inflows from a large mergers and acquisitions transaction. The currency was trading at around R13,20 against the US dollar just before the elections. It then reached its weakest point of R14,60 against the US dollar in the wake of the surprise outcome, before recovering somewhat. Domestic long bond yields (R186) initially spiked by about 60 basis points, but the increase has since moderated to about 25 basis points. Since the previous meeting of the MPC, the rand has depreciated by about 5,7 per cent against the US dollar and by about 1,1 per cent on a trade-weighted basis.

The rand is expected to remain sensitive to changes in the stance of US monetary policy. A US rate increase is generally expected in December and probably largely priced in, but of greater significance for the rand will be the signals from the Federal Open-market Committee (FOMC) regarding the trajectory of future increases. The rand will also remain sensitive to the sovereign ratings announcements due later this month and early in December.

On the positive side, the rand has been given support by the generally improved trade account in recent months. However, the deficit on the current account of the balance of payments is expected to have widened in the third quarter of this year.

The financing of the deficit may become more challenging should the recent significant non-resident sales of bonds and equities persist. During October and on a month-to-date basis, non-residents have been net sellers of domestic bonds and equities to the value of R42,7 billion and R19,7 billion respectively.

The domestic economic growth outlook remains subdued, although the low point of the cycle appears to be behind us. The SARB's forecast remains unchanged at 0,4 per cent for 2016 and 1,2 per cent and 1,6 per cent respectively for the next two years. While the estimate for potential real gross domestic product (GDP) growth was revised down marginally to 1,3 per cent, rising to 1,5 per cent by 2018, the output gap is expected to remain negative over the forecast period. The SARB's composite leading business cycle indicator improved in August and September, continuing a recent generally positive albeit gradual upward trend.

Available monthly data suggest that growth in the third quarter is likely to be positive but well below the rate recorded in the second quarter. The mining sector contributed positively to GDP growth in the quarter. The physical volume of manufacturing output declined despite a positive month-to-month outcome in September. The Barclays Purchasing Managers' Index (PMI), which declined further in October, has remained below the neutral 50 index point level for three consecutive months. The weak trends in manufacturing are consistent with the continued low levels of business confidence despite a moderate improvement in the third quarter. More positively, the services sector is expected to sustain its positive growth rate, with the tourism sector being particularly buoyant.

Consumption expenditure by households remains subdued, with declining retail trade sales and static wholesale trade sales in the third quarter of this year. Although new motor vehicle sales increased sharply on a month-to-month basis in October, a sizeable proportion of this is attributed to car rental companies; challenging conditions in the new vehicle sector persist.

Consumers continue to face a number of constraints. Employment growth is particularly weak. Household debt levels, while moderating, are still elevated. And wealth effects are muted amid stagnant equity and residential property markets. Furthermore, growth in credit extension to households remains subdued.

The slow growth in household disposable incomes is also reflected in a gradual decline in wage growth, with growth in nominal remuneration per worker declining to 5,8 per cent in the second quarter. When an adjustment is made for the increase in labour productivity, growth over four quarters in nominal unit labour costs measured 5,1 per cent in the second quarter. The Andrew Levy Employment Publications survey reports an average wage settlement rate in collective bargaining agreements of 7,5 per cent in the first three quarters of the year and 7,1 per cent in the third quarter. This may be indicative of wage settlements becoming more sensitive to the persistently high unemployment rates.

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According to the Medium Term Budget Policy Statement (MTBPS) released in October, fiscal consolidation is set to continue at a measured pace. A moderate degree of slippage is expected in the near term, as tax receipts are negatively affected by the economic slowdown. In order to prevent an excessive widening of the fiscal deficit, the MTBPS proposes a reduction in the expenditure ceiling and tax increases, to be announced in February. A revised deficit of 3,4 per cent of GDP is expected in the current fiscal year, steadily narrowing to 2,5 per cent of GDP in the 2019/20 fiscal year.

Food price inflation remains a significant driver of inflation. It remains sensitive to the continuing drought. While food price inflation is still expected to moderate from early 2017, the pace of decline is expected to be slower than previously forecast. This has led to an upward revision to the food price assumption in the forecast during the outer quarters in particular. The change is mainly due to the delayed impact of meat prices, which are now expected to peak only in early 2018 as farmers rebuild their herds during 2017.

Brent crude oil prices reached a year-high of US$52 per barrel in early October following the decision of the Organization of the Oil Exporting Countries (OPEC) to curtail production. Since then, prices have declined following doubts about the prospects for an agreement on the distribution of production cuts across the cartel. Some price volatility is expected in the short run as negotiations on production cuts continue. The SARB's forecast maintains the assumption of a moderate upward trajectory of international oil prices over the forecast period. The domestic price of 93 octane petrol increased by a cumulative 88 cents per litre in October and November, with almost all of the increase due to higher international product prices. The current over-recovery indicates that, should current trends persist, about half of that increase could be reversed in December.

The MPC is of the view that a high degree of uncertainty surrounds the nature and timing of possible policy changes emanating from significant developments in the global economic environment. This elevated uncertainty creates a more challenging environment especially for emerging markets, as evidenced in the recent changed pattern of capital flows. Financial markets are thus likely to remain volatile for some time.

Since the previous meeting of the MPC, the inflation forecast has remained largely unchanged. Whereas the risks to the inflation forecast were previously assessed to be more or less balanced, the MPC now assesses the risks to be moderately to the upside. This is mainly due to the possible impact of adverse global developments on the exchange rate. The risk of domestically generated shocks to the exchange rate also remains. Nevertheless, despite its high degree of volatility, the rand has displayed relative resilience in the face of numerous shocks over the past year.

The domestic growth outlook is unchanged and remains constrained against the backdrop of weak business and consumer confidence. The risks to the growth forecast are assessed to be broadly balanced. Domestic demand pressures remain weak, and consumers are expected to remain under pressure for some time.

The MPC has accordingly decided to keep the repurchase rate unchanged at 7,0 per cent per annum. The decision was unanimous.

The MPC remains concerned that the inflation trajectory is uncomfortably close to the upper end of the target range. Furthermore, the uncertain environment and moderately higher risks to the inflation outlook require continued vigilance. While the MPC retains the view that we may be close to the end of the hiking cycle, this position may be reassessed should the upside risks transpire.

Summary of assumptions: Monetary Policy Committee meeting on 24 November 2016*

1. Foreign-sector assumptions

Percentage changes (unless otherwise indicated)	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real GDP growth in South Africa's major trading-partner countries...	3,0%	3,1%	3,0%	2,8%	2,9%	3,1%
			2,8%	2,7%		
2. International commodity prices in US$ (excluding oil).........................	-6,4%	-9,8%	-19,3%	-4,5%	5,5%	1,0%
3. Brent crude (US$/barrel)	108,8	99,2	52,5	44,0	53,5	57,5
				(44,3)		
4. World food prices (US$)	-1,6%	-3,8%	-18,7%	-1,6%	5,5%	2,5%
				(-4,9%)	(3,0%)	(3,0%)
5. International wholesale prices	0,3%	-0,1%	-3,5%	-1,2%	1,1%	1,2%
				(-1,1%)		
6. Real effective exchange rate of the rand (index 2010 = 100)	81,91	79,17	80,08	76,67	81,00	81,00
				(75,67)	(78,00)	(78,00)
7. Real effective exchange rate of the rand..	-10,1%	-3,3%	1,1%	-4,3%	5,7%	0,0%
				(-5,5%)	(3,1%)	

2. Domestic-sector assumptions

Percentage changes (unless otherwise indicated)	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real government consumption expenditure	3,8%	1,8%	0,2%	1,5%	1,0%	1,0%
2. Administered prices..	8,7%	6,7%	1,7%	5,2%	6,4%	7,6%
				(5,1%)	(6,7%)	(7,3%)
– Petrol price	11,8%	7,2%	-10,7%	1,4%	5,7%	8,9%
				(1,0%)	(7,0%)	(7,9%)
– Electricity price..	8,7%	7,2%	9,4%	9,3%	7,7%	8,0%
3. Potential growth..	2,0%	1,7%	1,5%	1,3%	1,4%	1,5%
				(1,4%)	(1,5%)	(1,7%)
4. Repurchase rate (per cent)..	5,00	5,57	5,89	6,91	7,00	7,00

The figures in brackets represent the previous assumptions of the Monetary Policy Committee.

* For an explanation of foreign-sector assumptions and domestic-sector assumptions, see pages 90 and 91.

Selected forecast results: Monetary Policy Committee meeting on 24 November 2016

Selected forecast results (quarterly)

Year-on-year percentage change	Actual							Forecast												
	1	2	3	4	2015	1	2	3	4	2016	1	2	3	4	2017	1	2	3	4	2018
1. Headline inflation............................	4,2	4,6	4,7	4,9	4,6	6,5	6,2	6,1	6,6	6,4	6,1	5,7	5,8	5,5	5,8	5,5	5,5	5,5	5,6	5,5
								(6,2)	(6,7)	(6,4)	(6,2)	(5,8)	(5,8)	(5,5)	(5,8)	(5,4)	(5,4)	(5,5)	(5,6)	(5,5)
2. Core inflation..................................	5,7	5,6	5,3	5,2	5,5	5,5	5,5	5,7	5,8	5,6	5,6	5,6	5,5	5,4	5,5	5,2	5,2	5,2	5,3	5,2
								(5,7)	(5,9)	(5,7)	(5,8)	(5,7)	(5,5)	(5,4)	(5,6)	(5,3)	(5,3)	(5,3)	(5,4)	(5,3)

The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

Per cent	Actual			Forecast		
	2013	2014	2015	2016	2017	2018
1. Real gross domestic product (GDP) growth	2,3%	1,6%	1,3%	0,4%	1,2%	1,6%
2. Current account as a ratio to nominal GDP.............................	-5,9	-5,3	-4,3	-3,8	-4,3	-4,4
				(-4,0)	(-4,2)	

The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Foreign-sector assumptions

1. **Trading-partner gross domestic product** (GDP) growth is determined broadly using the Global Projection Model (GPM) of the International Monetary Fund (IMF), which is then adjusted to aggregate the GDP growth rates of South Africa's major trading partners on a trade-weighted basis. Individual projections are done for the four largest trading partners: the euro area, China, the United States (US) and Japan. The remaining trading partners are grouped into three regions: emerging Asia (excluding China), Latin America, and the Rest of Countries bloc. The assumption takes account of country-specific 'consensus' forecasts as well as IMF regional growth prospects.

2. The **commodity price index** is a weighted aggregate price index of the major South African export commodities based on 2010 prices. The composite index represents the total of the individual commodity prices multiplied by their smoothed export weights. Commodity price prospects generally remain commensurate with global liquidity as well as commodity supply/demand pressures as reflected by the pace of growth in the trading-partner countries.

3. The **Brent crude oil price** is expressed in US dollar per barrel. The assumption incorporates an analysis of the factors of supply, demand (using global growth expectations) and inventories of oil (of all grades) as well as the expectations of the US Energy Information Administration (EIA), the Organization of the Petroleum Exporting Countries (OPEC) and Reuters.

4. **World food prices** uses the composite food price index of the Food and Agriculture Organization of the United Nations (FAO) in US dollar. The index is weighted using average export shares and represents the monthly change in the international prices of a basket of five food commodity price indices (cereals, vegetable oil, dairy, meat and sugar). World food price prospects incorporate selected global institution forecasts for food prices as well as imbalances from the anticipated trend in international food supplies relative to expected food demand pressures.

5. **International wholesale prices** refers to a weighted aggregate of the producer price indices (PPIs) of South Africa's major trading partners, as per the official real effective exchange rate calculation of the South African Reserve Bank (the Bank). Although individual country consumer price index (CPI) inflation forecasts provide a good indication for international wholesale price pressures, the key drivers of the assumed trend in global wholesale inflation are oil and food prices as well as expected demand pressures emanating from the trends in the output gaps of the major trading-partner countries. Other institutional forecasts for international wholesale prices are also considered.

6. The **real effective exchange rate** is the nominal effective exchange rate of the rand deflated by the producer price differential between South Africa and an aggregate of its trading-partner countries (as reflected in the *Quarterly Bulletin* published by the Bank). Although the nominal rate is a weighted average of South Africa's 20 largest trading partners, particular focus is placed on the rand outlook against the US dollar, the euro, the Chinese yuan, the British pound and the Japanese yen. The assumed trend in the real effective exchange rate remains constant from the latest available quarterly average over the projection period. However, due to the time delay in the calculation of the real effective exchange rate, the most recent trend in the nominal effective exchange rate is adjusted with the assumed trend for the domestic and foreign price differential for the current quarter. This may result in a technical annual adjustment over the current and next forecast year that differs from zero.

Domestic-sector assumptions

1. **Government consumption expenditure** (real) is broadly based on the most recent National Treasury budget projections. However, since these projections take place twice a year, the most recent actual data points also play a significant role in the assumptions process.

2. **Administered prices** represent the total of regulated and non-regulated administered prices as reflected by Statistics South Africa (Stats SA). Their weight in the consumer price index basket is 18,48 per cent and the assumed trend over the forecast period is largely determined by the expected pace of growth in petrol prices, electricity tariffs, school fees as well as water and other municipal assessment rates.

   The petrol price is an administered price and comprises 5,68 per cent of the overall basket. The basic fuel price (which currently accounts for roughly half of the petrol price) is determined by the exchange rate and the price of petrol quoted in US dollars at refined petroleum centres in the Mediterranean, the Arab Gulf and Singapore. The remainder of the petrol price is made up of wholesale and retail margins as well as the fuel levy and contributions to the Road Accident Fund (RAF). Since most taxes and retail margins are changed once a year, the assumed trajectory of the petrol price largely reflects the anticipated trend in oil prices and the exchange rate.

   The electricity price is an administered price measured at the municipal level with a weight of 4,13 per cent in the CPI basket. Electricity price adjustments generally take place in July and August of each year, and the assumed pace of increase over the forecast period reflects the multi-year price determination (MYPD) by the National Energy Regulator in respect of Eskom, with a slight adjustment for measurement at municipal level.

3. The **pace of potential growth** is derived from the Bank's semi-structural potential output model. The measurement accounts for the impact of the financial cycle on real economic activity and introduces economic structure via the relationship between potential output and capacity utilisation in the manufacturing sector (see South African Reserve Bank Working Paper Series WP/14/08).

4. The **repurchase rate** (commonly called the 'repo rate') is the official monetary policy instrument and represents the interest rate at which banks borrow money from the Bank. Although the rate is held constant over the forecast period, this assumption is relaxed in alternative scenarios where, for instance, the policy rate responds to deviations of output from its potential and the gap between future inflation and the inflation target, in other words, via a stylised 'Taylor rule', one that is based on market expectations of the future path of the policy rate, and other paths (as requested).

Notes to tables

Capital market interest rates and yields – Table S–29

In addition to the already published nominal yields on conventional government bonds, a real yield on an inflation-linked bond in the 10 years and over maturity category trading on the JSE was added under 'yields and price indices on bonds traded on the stock exchange' in table KB201.

The further development of integrated economic accounts for South Africa – institutional sector balance sheets[1]

by B de Beer, H Wagner and M Kock[2]

1. Introduction

The 2008 global financial crisis and the adverse economic conditions in its wake, which are still felt today, illustrate the extent of integration between real economic activity and financial markets, both within an economy and among countries. Although significant bodies of economic and financial statistics existed at the time, there were crucial areas that were poorly covered. The limited availability and comparability of time series data across countries compounded the problem, making it difficult to track the interconnectedness of global economic and financial activity. On a global scale, economic agents have financial positions with each other which create a link for contagion, contingent upon the structure of national institutional sector balance sheets and concomitant exposures. This is further exacerbated by the existence of complex financial instruments both on and off balance sheet which create serious financial stability risks. The scarcity or non-existence of data on the network of domestic and international financial positions contributes significantly to inherent economic and financial stability risks.

From this realisation emerged the Group of Twenty (G-20)[3] Data Gaps Initiative (DGI). This initiative constitutes a set of 20 recommendations on the enhancement of economic and financial statistics. The intention is to close the identified data gaps through the development of new data sourcing methods and the improvement of existing ones. The focus is on broadening and improving the scope of available and comparable economic and financial data as well as the early monitoring of stress within institutional sectors to inform appropriate policy intervention. The first phase of the Data Gaps Initiative (DGI-1) commenced in 2009. Recommendation 15 is of specific importance to this article as it deals with sector accounts focusing on standardised institutional sector coverage of national balance sheet and from whom-to-whom, including flow-of-funds data. In September 2015, the second phase of the Data Gaps Initiative (DGI-2) was endorsed with sector accounts now dealt with in recommendation 8. The integrated economic accounts in the System of National Accounts (SNA 2008) provide ample scope and guidance for the compilation of integrated and harmonised stock positions and accumulation accounts for an economy to partially address some of the identified data gaps. The compilation of integrated sector accounts has therefore become a key priority on the international statistical agenda. All the G-20 member economies have already developed or are in the process of developing these statistics. The South African Reserve Bank established a project to further develop the integrated economic accounts for the South African economy in 2015. This is in the interest of providing reliable and relevant statistics for national policy formulation and to fulfill South Africa's international statistical commitments.

The main focus of the integrated economic accounts project thus far has been the development of institutional sector balance sheets, financial assets and liabilities as well as non-financial assets. The first preliminary and experimental results rendered the following high-level institutional sector balance sheets at market prices as at 31 December 2011, as shown in Table 1. The total balanced asset position of the resident institutional sectors of the domestic South African economy amounted to R28,3 trillion, or approximately 9 times the gross domestic product (GDP) recorded for the year.

1 This article serves as the inaugural publication of newly developed experimental institutional sector balance sheet data sets for the South African economy. This provides the first harmonised view of the estimated size of the balanced financial institutional sector balance sheets and stock positions of selected non-financial assets. The intention is to compile and publish this data as well as accumulation accounts on a quarterly basis at some future date. At this stage, the data published and discussed in this article should be treated as preliminary and experimental.

2 The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank.

3 The Group of Twenty is an international forum for ministers of finance and central bank governors of 19 of the largest advanced and emerging economies and the European Union.

Table 1 Summary balance sheet by institutional sector at market prices, 31 December 2011

R trillions

	Non-financial corporations		Financial corporations		General government		Households		Total domestic economy		Rest of the world	
	A	L	A	L	A	L	A	L	A	L	A	L
Non-financial assets*	4,2		0,3		2,2		2,7		9,4			
Financial assets and liabilities	2,0	5,6	10,7	10,7	0,9	1,6	5,4	1,4	18,9	19,3	3,1	2,7
Net worth**		0,6		0,3		1,5		6,7		9,0		
Total assets and liabilities	6,2	6,2	11,0	11,0	3,1	3,1	8,1	8,1	28,3	28,3	3,1	2,7

A = assets
L = liabilities
* Total produced assets, including underlying land
** Total assets minus financial liabilities

The total assets of the domestic economy consisted of non-financial assets of R9,4 trillion and financial assets of R18,9 trillion. The liability side comprised financial liabilities of R19,3 trillion and net worth (non-financial and financial assets minus financial liabilities) of R9 trillion. The non-financial corporate sector held 45 per cent of non-financial assets while the financial corporate sector accounted for more than half of total financial assets and liabilities. The household sector had the largest net worth position at R6,7 trillion. The rest of the world sector had assets in South Africa of R3,1 trillion while South African sectors had claims on the rest of the world of R2,7 trillion.

2. Project overview

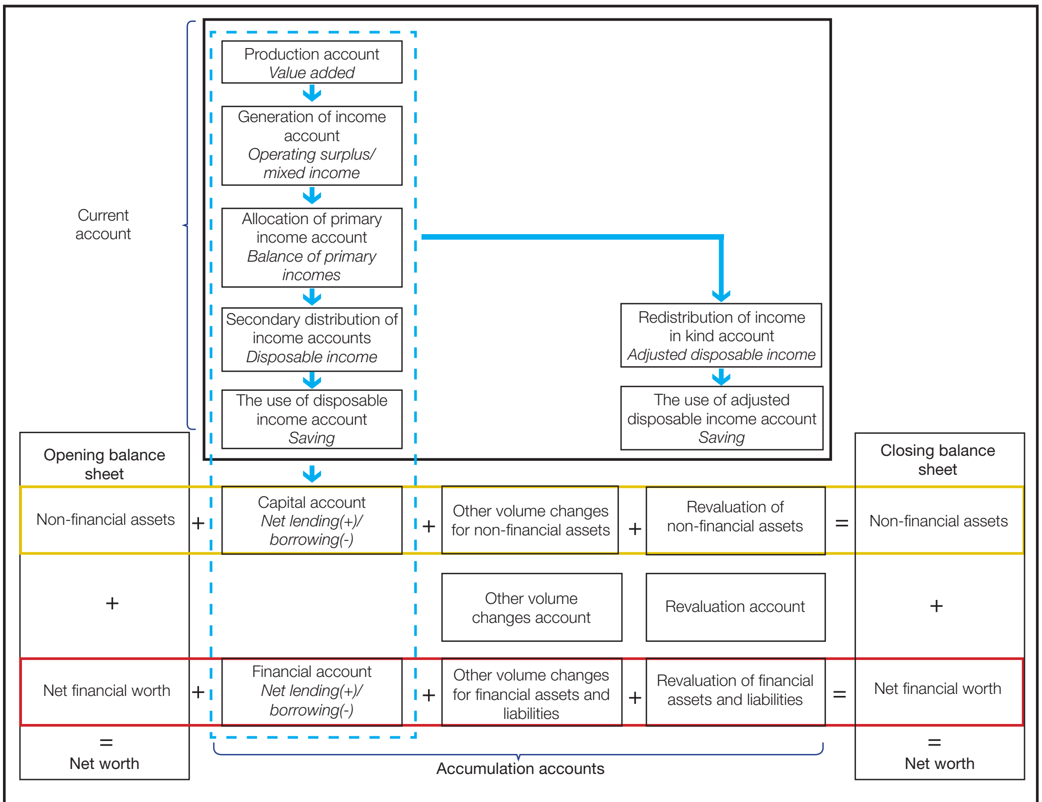
In South Africa, the further development of the integrated economic accounts entails a harmonised set of macroeconomic accounts that link the real and financial spheres of the economy. These additional data sets are intended to provide quarterly data for the period from 2010 to the present.

2.1 The integrated economic accounts framework

In the integrated economic accounts, the real economy is represented by current and capital accounts as well as non-financial asset and accumulation accounts. The current account comprises the production, generation and allocation of income, distribution and redistribution of income accounts, as well as its utilisation. Currently, only these accounts and high-level financial assets and liabilities as well as the non-financial assets of households are published on an annual basis. However, this information needs to be extended in terms of institutional sector breakdown as well as to a quarterly frequency. The coverage of the financial sphere of the economy is obtained through the development of a full set of financial balance sheets and accumulation accounts.

The components of the integrated economic accounts are illustrated in Figure 1. The black block represents the components of the current account. The blue dotted line represents the transactional accounts, commencing with the production account through to the financial account. The orange block represents the non-financial asset accounts, from the opening balance sheet position through the accumulation accounts to the closing balance sheet position. The red block represents the financial balance sheets and accumulation accounts, beginning with the opening stock positions of financial assets and liabilities, on a gross basis, through the accumulation accounts to the closing financial balance sheet.

Figure 1 Integrated economic accounts



Source: System of National Accounts 2008

The net financial worth of an institutional sector is calculated by subtracting the sector's financial liabilities from its financial assets. The net worth of an institutional sector is obtained by either adding the stock of non-financial assets to its net financial worth at a specific point in time or as total assets minus financial liabilities, as in Table 1. The accumulation accounts record flows that give rise to changes in entries in the balance sheets from the start to the end of the accounting period. There are four accumulation accounts: the capital account, the financial account, the other volume changes account, and the revaluation account.[4]

The focus of the current accounts is on real economic activity; it does not describe any financial operations. There is, however, a close interconnection as financial activities tend to mirror real economic activity. This is the case when economic agents either lend to others in instances where they do not spend all their revenue or borrow from others when outlay requirements surpass their resources. The household sector is a good example of this as this sector typically consumes less than its income while additional funds are saved through investment in specific assets, both non-financial and financial. In contrast, the non-financial corporate sector usually needs additional resources to invest in fixed assets and has to borrow funds from other sectors. This borrowing can be in the form of a loan from a bank or issuing debt and/or equity.

4 The *capital account* records acquisitions and disposals of non-financial assets as a result of transactions with other economic units, internal bookkeeping transactions linked to production (such as changes in inventories and consumption of fixed capital), and the redistribution of wealth by means of capital transfers. The *financial account* records acquisitions and disposals of financial assets and liabilities, also through transactions. The *other volume changes account* records changes in the amounts of the assets and liabilities held by institutional units or sectors as a result of factors other than transactions, for example the destruction of fixed assets by natural disasters. The *revaluation account* records those changes in the values of assets and liabilities that result from changes in market prices, also referred to as nominal holding gains and losses.

2.2 Institutional sectors

One of the anchor parameters underlying the project is institutional sector delineation. For the integrated economic accounts to be harmonised with the broad suite of macroeconomic analysis, the aggregate activities of similar institutions are grouped into institutional sectors, some of which are divided into subsectors. Each institutional sector and subsector groups together the institutional units with a similar type of economic behaviour.

Table 2 Institutional sectors

<table>
<tr><th>Main institutional sectors</th><th colspan="3">Subsectors</th></tr>
<tr><td rowspan="2">Non-financial corporations</td><td colspan="3">Public</td></tr>
<tr><td colspan="3">Private</td></tr>
<tr><td rowspan="10">Financial corporations</td><td rowspan="4">Monetary financial institutions</td><td rowspan="2">Monetary authority</td><td>Central bank</td></tr>
<tr><td>Corporation for Public Deposits</td></tr>
<tr><td rowspan="2">Other monetary financial institutions</td><td>Deposit-taking corporations (banks)</td></tr>
<tr><td>Money-market funds</td></tr>
<tr><td rowspan="4">Other financial corporations*</td><td colspan="2">Non-money-market investment funds</td></tr>
<tr><td colspan="2">Other financial intermediaries**</td></tr>
<tr><td colspan="2">Financial auxiliaries</td></tr>
<tr><td colspan="2">Captive financial institutions and money lenders</td></tr>
<tr><td rowspan="2">Insurance corporations and pension funds</td><td colspan="2">Insurance corporations</td></tr>
<tr><td colspan="2">Pension funds</td></tr>
<tr><td rowspan="2">General government</td><td colspan="3">Central and provincial government</td></tr>
<tr><td colspan="3">Local government</td></tr>
<tr><td>Households***</td><td colspan="3"></td></tr>
<tr><td>Rest of the world</td><td colspan="3"></td></tr>
</table>

* Except monetary financial institutions as well as insurance corporations and pension funds
** Except insurance corporations and pension funds
*** Including non-profit institutions serving households

Source: System of National Accounts 2008

The institutional sector delineation applied in the integrated economic accounts is obtained from a combination of delineation contained in the SNA 2008 as well as national requirements. The subsectors of the five main institutional sectors are shown in Table 2. Currently, various data sources are used for the different institutional sectors, except for the private non-financial corporate sector which is measured using derived data from the other counterparty sectors.

2.3 Non-financial assets

Non-financial assets consist of both produced and non-produced assets. The produced non-financial assets in turn comprise fixed assets used in production, inventories and valuables (see Table 4). Valuables are not included in the scope of the project due to data constraints. The market value of fixed assets is derived as the sum of gross fixed capital formation of such assets (i.e. expenditure on fixed assets) less the consumption of fixed assets (i.e. depreciation) revalued to market prices. Fixed assets in turn consist of dwellings, buildings other than dwellings, other structures, machinery and equipment, cultivated biological resources and intellectual property. The market value of total inventory holdings in the domestic economy is derived from inventory holdings at constant prices adjusted for end-period prices.[5]

5 Excluding military inventory

Non-produced non-financial assets consist of natural assets and assets created through legal agreement from which the owners can extract economic benefits. Natural assets include land and mineral reserves whereas leases, licences and permits are created through legal agreements. Natural resources consist of land, mineral and energy resources, non-cultivated biological resources, other natural resources and radio spectra. Currently, only the market value of land underlying dwellings, buildings other than dwellings and other structures is reported. The market value of land underlying assets is derived as a ratio of the value of the non-depreciated produced asset situated on the land.

The market value of land – whether residential, industrial or different types of farmland – differs markedly and sufficient price data are not available to make accurate estimations. The market value of South Africa's various national parks and other recreational holiday retreats as well as other land belonging to general government further complicates estimations. Data constraints also inhibit the estimation of mineral and energy reserves.

2.4 Financial instruments

The eight main financial asset and liability categories in the financial balance sheets and accumulation accounts are shown in Table 3.

Table 3 Financial instrument delineation in the financial balance sheets and accumulation accounts

Financial instrument	Description
Monetary gold and special drawing rights	Monetary gold is gold to which monetary authorities have title and which is held as reserve assets. Special drawing rights are international reserve assets created by the International Monetary Fund which are allocated to its members to supplement existing reserve assets.
Currency and deposits	Currency and deposits refer to currency in circulation and deposits, both in national currency and in foreign currencies.
Debt securities	Debt securities are negotiable financial instruments serving as evidence of debt.
Loans	Loans are created when creditors lend funds to debtors.
Equity and investment fund shares or units	Equity and investment fund shares or units are residual claims on the assets of the institutional units that issued the shares or units.
Insurance, pension and standardised guarantee schemes	Insurance, pension and standardised guarantee schemes items include: a) non-life insurance technical reserves; b) life insurance and annuity entitlements; c) pension entitlements, claims of pension funds on pension managers, and entitlements to non-pension funds; and d) provisions for calls under standardised guarantees.
Financial derivatives and employee stock options	Financial derivatives are financial instruments linked to a specified financial instrument, indicator or commodity through which specific financial risks can be traded in financial markets in their own right. Employee stock options are agreements made on a given date under which an employee has the right to purchase a given number of shares of the employer's stock at a stated price either at a stated time or within a period of time immediately following the vesting date.
Other accounts receivable and/or payable	Other accounts receivable and/or payable are financial assets and liabilities created as counterparts to transactions where there is a timing difference between these transactions and the corresponding payments.

Source: System of National Accounts 2008

3. Preliminary results[6]

The further development of the integrated economic accounts into all their dimensions is a project that will stretch over an extended period of time. The first milestone, to develop a high-level quarterly core dataset for 2010 and 2011, has been achieved. This section expands the discussion of the data contained in Table 1.

6 These are experimental results subject to future adjustment.

3.1 Non-financial assets

A key statistical objective is to gauge the overall size of the market value of the stock of total produced non-financial assets in the South African economy. Total produced non-financial assets amounted to R7,5 trillion in the fourth quarter of 2011, or about 2,5 times the GDP recorded for the year.

Within produced fixed assets, the market value of dwellings, without underlying land, amounted to R2,2 trillion as at the end of 2011 for the domestic economy as a whole, with the household sector owning 77 per cent of that total. Due to data constraints, this excludes motor homes, boats, caravans and other items utilised as permanent residence. The market value of buildings other than dwellings and other structures, also excluding underlying land, amounted to R3,2 trillion as at the end of 2011. Of this, the non-financial corporate sector owned 53 per cent, followed by general government with 39 per cent. The market value of machinery and equipment amounted to R1,4 trillion as at the end of 2011, with 76 per cent owned by the non-financial corporate sector. Machinery and equipment consists of transport equipment, information technology equipment, other machinery and equipment, and weapon systems. This is the third-largest asset group and accounts for 18 per cent of total produced non-financial assets. The market value of cultivated biological resources amounted to only R23,4 billion as at the end of 2011, with 63 per cent owned by the household sector. This consists of animal and plant resources yielding repeat products. The market value of intellectual property products amounted to R157 billion as at the end of 2011 and accounted for only 2 per cent of total produced non-financial assets. Intellectual property products consist of research and development, mineral exploration and evaluation, and computer software. Databases, entertainment, literacy and artistic originals as well as other intellectual property products like new information and specialised knowledge are not part of the compilation at this stage due to data constraints.

Table 4 Non-financial asset stock positions at market prices, 31 December 2011

R millions

	Non-financial corporations	Financial corporations	General government	House-holds	Total domestic economy
Total produced assets	**3,673,489**	**294,319**	**1,660,095**	**1,905,073**	**7,532,976**
Total fixed assets	3,112,793	278,497	1,656,494	1,872,662	6,920,446
Dwellings	243,334	10,070	237,628	1,660,831	2,151,863
Buildings other than dwellings	733,769	113,287	312,168	66,309	1,225,533
Other structures	983,612	7,198	938,444	68,365	1,997,619
Machinery and equipment	1,042,563	119,189	141,076	62,126	1,364,954
Cultivated biological resources	8,781	-	-	14,659	23,440
Intellectual property	100,734	28,753	27,178	372	157,037
Inventories	560,696	15,822	3,601	32,411	612,530
Non-produced assets					
Total underlying land	**563,191**	**33,113**	**525,811**	**760,363**	**1,882,478**
Dwellings	85,424	5,331	114,941	744,668	950,364
Buildings other than dwellings and other structures	477,767	27,782	410,870	15,695	932,114
Total real estate*	**2,523,906**	**163,668**	**2,014,051**	**2,555,868**	**7,257,493**
Dwellings	328,758	15,401	352,569	2,405,499	3,102,227
Buildings other than dwellings and other structures	2,195,148	148,267	1,661,482	150,369	4,155,266
Total produced assets, including underlying land	**4,236,680**	**327,432**	**2,185,906**	**2,665,436**	**9,415,454**

* Fixed assets and underlying land

Within produced assets, the market value of total inventory holdings in the domestic economy amounted to R613 billion or 8 per cent of total produced non-financial assets as at the end of 2011. Of this amount, the non-financial corporate sector held 92 per cent.

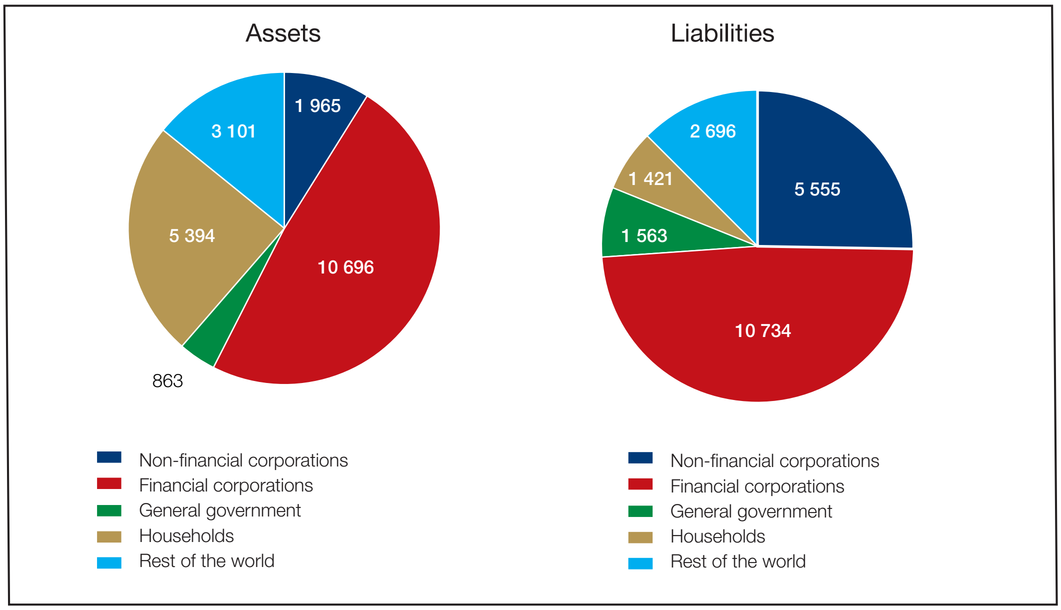
The market value of underlying land amounted to R1,9 trillion as at the end of 2011, with 51 per cent related to dwellings and 49 per cent to buildings other than dwellings and other structures. The total value of real estate comprising both fixed assets and underlying land amounted to R7,3 trillion as at the end of 2011, with underlying land contributing 26 per cent. The real-estate value of dwellings accounted for 43 per cent and that of households 33 per cent. In aggregate, total produced assets and underlying land as measured amounted to R9,4 trillion.

3.2 Financial assets and liabilities

The overall size of the market value of the balanced stock of financial assets and liabilities held by both residents and non-residents in the South African economy amounted to R22 trillion as at 31 December 2011, as shown in Table 5, or about seven times the GDP recorded for the year. The distribution by value of financial assets and liabilities per institutional sector is shown in Figure 2.

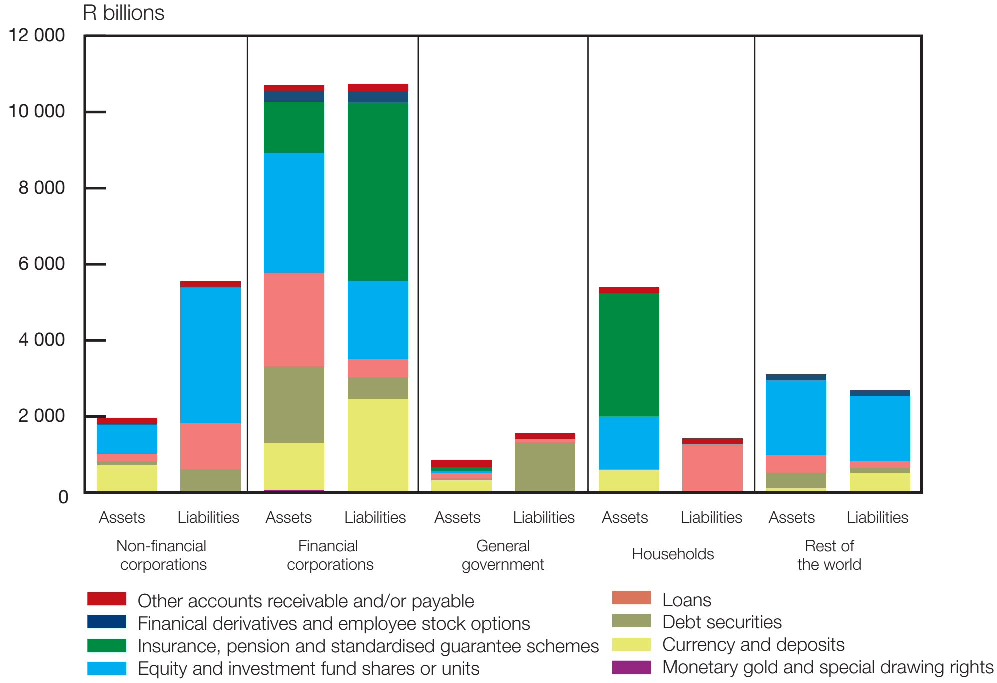
Figure 2 Market value of total financial assets and liabilities per institutional sector, 31 December 2011

R billions



Three important observations emerge from viewing the financial asset and liability data sets. The first is that the overall values of the financial assets and liabilities of the financial corporate sector are fairly similar. The second observation is that the financial liabilities of the household sector are significantly less than its financial assets. Thirdly, the financial liability position of the non-financial corporate sector is markedly larger than its financial asset position.

Figure 3 Market value of total financial assets and liabilities by institutional sector and financial instrument, 31 December 2011



Additional insight into the financial instrument-specific make-up of the financial assets and liabilities of the institutional sectors as at 31 December 2011 is provided in Figure 3. From this analysis, it is evident that the majority of the financial liabilities of the non-financial corporate sector is vested in equity and investment fund shares or units – approximately 64 per cent. This is to be expected as this instrument provides the majority of the funding for private non-financial corporations. The second-largest liability instrument for non-financial corporations is loans – at 22 per cent. On the asset side, equity and investment fund shares or units as well as currency and deposits account for 39 per cent and 37 per cent of the asset position respectively. For the financial corporate sector, equity and investment fund shares or units and then loans represent the largest asset categories – 30 per cent and 23 per cent respectively. The high exposure to equity and investment fund shares or units represents investment by financial intermediaries such as unit trusts in equity, while loans represent a significant asset for deposit-taking corporations (banks). On the liability side, the majority of the value consists of insurance, pension and standardised guarantee schemes as well as currency and deposits – 44 per cent and 23 per cent respectively. Of the 44 per cent allocated to insurance, pension and standardised guarantee schemes, a significant amount relates to household interests in pension funds. The 23 per cent related to currency and deposits to a large extent reflects the deposits by various institutional sectors with banks. On the liability side of general government, debt securities represent 84 per cent of the total value. This is to be expected as national government has an extensive debt security issuance programme to finance its activities. The majority of household assets is in the form of pension claims on the financial sector, which represent about 60 per cent of the total household asset position. As is to be expected, 90 per cent of the household liability position is made up of loans. For the rest of the world sector, the equity and investment fund shares or units represent the bulk of its asset and liability position – approximately 64 per cent on each side.

3.3 From-whom-to-whom positions

The analysis done thus far is necessary but not sufficient as it provides only an assessment of the absolute size of institutional sectors in the economy and their positions as net lenders or borrowers. This analysis does not reveal any information on institutional sector-by-sector linkages or the extent of these linkages. As alluded to earlier in this article, it is precisely these linkages that are of importance to understand the possible implications for financial stability.

Thus, what is needed is thorough from-whom-to-whom information. Due to the application of the underlying principles of the SNA 2008 to the development of the financial balance sheets, it could be extended to incorporate a from-whom-to-whom analysis.[7]

7 Apart from the analytical value obtainable for the construction and depiction of the financial balance sheets on a from-whom-to-whom basis, it is also an important compilation tool for enhancing the quality and consistency of data. The advantage of this approach is that it allows for the cross-validation of information among debtors and creditors and as such enhances the consistency of reported data.

The balanced financial asset and liability stock positions of the four domestic institutional sectors as well as the rest of the world, on a from-whom-to-whom basis, as at 31 December 2011 is shown in Table 5. For the resident institutional sectors, aggregated (i.e. non-consolidated) data are presented. This means that intra-sectoral positions, transactions, nominal holding gains and losses as well as other volume changes are not eliminated.

Total financial assets amount to just more than R22 trillion, with total financial liabilities amounting to just less than R22 trillion. The difference of R51 billion relates to the monetary gold assets of the central bank which does not have a counterparty liability.

The horisontal view of Table 5 provides the total financial assets of each institutional sector vis-à-vis the institutional sector against which these claims are held. For example, of the R10,7 trillion financial assets of the financial corporate sector, R2,5 trillion represents claims against the non-financial corporate sector and R4,1 trillion represents claims against the financial corporate sector itself. Similarly, the vertical view of Table 5 provides an institutional sector counterparty breakdown of an institutional sector's liabilities.

Table 5 From-whom-to-whom market value positions of total financial assets and liabilities between resident institutional sectors as well as the rest of the world, 31 December 2011

R billions

Institutional sectors		Liabilities by resident institutional sector and residency						
		Non-financial corporations	Financial corporations	General government	House-holds	Rest of the world	Total	
Assets by resident institutional sector and residency	Non-financial corporations	60	966	15	77	848	**1 965**	22 020
	Financial corporations	2 525	4 075	1 002	1 270	1 773	**10 696**	
	General government	162	537	89	74	1	**863**	
	Households	1 070	4 149	102	0	73	**5 394**	
	Rest of the world	1 738	1 007	355	0	0	**3 101**	
	Total	5 555	10 734	1 563	1 421	2 696	-405*	
		21 969						51**

* This value is equal to the net international investment position excluding monetary gold which has no counterparty classification in the financial balance sheets.

** This is the value of the monetary gold held by the South African Reserve Bank as at 31 December 2011; it equates to the difference between the balanced assets and liabilities because monetary gold has no counterparty classification in the financial balance sheets.

Important to note is that the rest of the world sector is compiled from the perspectives of foreign economies – which basically results in the inverse of South Africa's international investment position. The financial assets of the rest of the world issued by the rest of the world are not covered and will thus always be zero due to the fact that this data are not relevant from South Africa's perspective. The holdings of financial instruments by non-residents (vis-à-vis resident sectors as debtors) are shown as South African liability positions (rest of the world asset positions) in the rest of the world balance sheet, while acquisitions and disposals by non-residents of financial instruments issued by residents are shown as financial transactions in the rest of the world financial account. Similarly, the holdings of financial instruments by residents vis-à-vis non-residents are shown as South African asset positions (rest of the world liability positions) in the rest of the world balance sheet. Thus, the rest of the world financial asset position of R3,1 trillion and financial liability position of R2,7 trillion in Table 5 reflect the inverse of South Africa's international investment position. The positive difference of R0,4 trillion indicates South Africa's negative international investment position.

4. Conclusion

The data shown and discussed in this article are the outcome of the project thus far and should be treated as preliminary and experimental. In addition, it should be noted that certain source data need to be broadened and improved to close material data gaps. Future development work will focus on the utilisation of the balanced asset and liability stock positions to estimate nominal holding gains and losses at detailed financial instrument level whereafter financial transactions will be derived as the residual. This data set will facilitate detailed from-whom-to-whom accounts of stock positions, transactions (flow of funds), revaluations and other volume changes.

The further development of integrated economic accounts for South Africa is an ongoing process. The first phase, discussed above, has laid the foundation and the subsequent phases will build on this. The first priority is to expand the data set to cover the period from 2012 to 2016. Further effort will be directed at expanding the institutional sector and financial instrument coverage as well as improving the data coverage and quality. There is a significant advantage in using the sector accounts approach contained in the SNA 2008 framework as it ensures data consistency and international comparability. This allows for a systematic understanding of the important relationships in the South African economy, such as the relationship between economic flows in the real and financial spheres as well as the issue of financial interconnectedness and linkages among the various components in the economic value chain.