Domestic economic developments

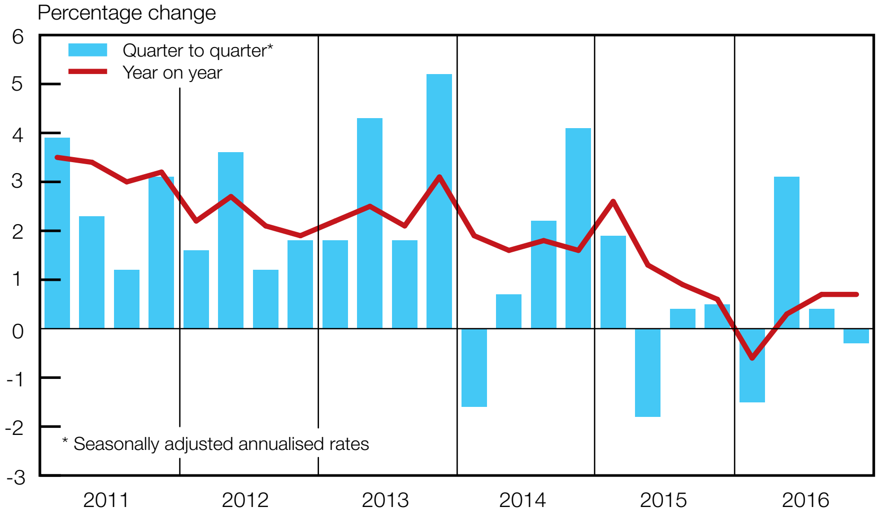
Domestic output [1,2]

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

2. The analysis in this section of the review is based on a revised set of national accounts estimates. These revisions are based on more detailed or more appropriate data that have become available.

Real economic growth in South Africa slowed further and turned negative in the fourth quarter of 2016. *Real gross domestic product* (GDP) contracted at an annualised rate of 0.3% in the fourth quarter of 2016 following marginal growth of 0.4% in the third quarter. The disappointing performance in the fourth quarter reflected a decrease in the real value added by the primary and secondary sectors. By contrast, growth in real output of the tertiary sector accelerated over the period.

Real gross domestic product



Source: Stats SA

Despite the disappointing performance in the fourth quarter, growth in real GDP in the non-primary sector improved from 0.1% in the third quarter of 2016 to an annualised rate of 0.8% in the fourth quarter.

Real gross domestic product

Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Sector	2015	2016				
	Year*	Q1	Q2	Q3	Q4	Year*
Primary sector	1.4	-19.0	9.1	3.2	-9.0	-5.4
Agriculture	-6.1	-8.7	-7.8	-0.2	-0.1	-7.8
Mining	3.9	-21.8	14.6	4.2	-11.5	-4.7
Secondary sector	0.0	-0.1	4.8	-2.5	-1.8	0.2
Manufacturing	-0.2	0.6	7.6	-3.3	-3.1	0.7
Tertiary sector	1.6	1.4	1.9	0.8	1.6	1.4
Non-primary sector	*1.2*	*1.0*	*2.5*	*0.1*	*0.8*	*1.1*
Total	1.3	-1.5	3.1	0.4	-0.3	0.3

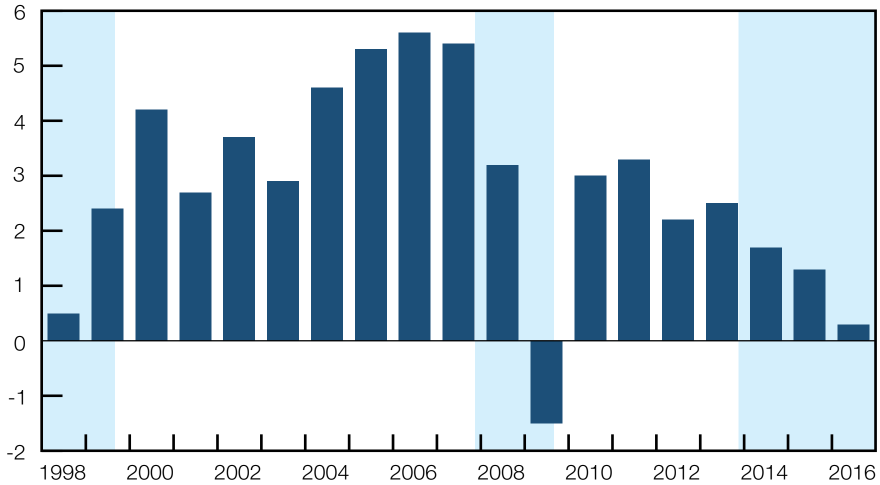
* Percentage change over one year

Source: Stats SA

On an annual basis, growth in real GDP moderated further from 1.3% in 2015 to 0.3% in 2016, mainly due to two quarters of negative quarter-to-quarter growth. With the exception of 2009, when real GDP contracted by 1.5%, this was the lowest annual growth rate since 1998. The moderation in annual output growth is consistent with the South African economy currently being in a downward phase of the business cycle that commenced in December 2013.

Real gross domestic product

Annual percentage change



Downward phases of the business cycle

Sources: Stats SA and SARB

The lacklustre performance of the South African economy in 2016 could, to a large extent, be attributed to weak consumer demand, an acceleration in consumer price inflation, stagnant formal sector employment, persistent subdued business and consumer confidence levels that suppressed fixed investment, and the adverse effects of the prolonged drought conditions experienced in many parts of the country. However, the increase in the composite leading business cycle indicator since May 2016 suggests improved economic activity in 2017.

Following two consecutive quarters of positive growth, the real value added by the *primary sector* contracted at an annualised rate of 9.0% in the final quarter of 2016. Agricultural output declined at a slower pace, alongside a significant contraction in the real output of the mining sector. For 2016 as a whole, the real gross value added by the primary sector declined by 5.4%, subtracting 0.5 percentage points from overall GDP growth.

The pace of decline in the real value added by the *agricultural sector* slowed marginally from 0.2% in the third quarter of 2016 to 0.1% in the fourth quarter. Although dry conditions prevailed in certain parts of the country, summer rains provided some relief. Dry underground soil conditions, however, impacted negatively on the production of field crops and horticulture over the period. Despite livestock benefitting from increased rainfall in the quarter, the rebuilding of herds will likely take some time. The real gross value added by the agricultural sector contracted for eight consecutive quarters up to the fourth quarter of 2016, reflecting the devastating impact of the prolonged drought on agricultural output. Accordingly, the level of production in the agricultural sector was 7.8% lower in 2016 than in 2015.

Early indications augur well for the 2016/17 maize planting and production season. According to the first estimate by the Crop Estimates Committee, released in February 2017, the commercial maize crop for the 2016/17 season is expected to amount to 13.9 million tons, 79% more than the final 2015/16 crop. The area planted is expected to have increased by almost a third from the previous season, to 2.6 million hectares. In addition, the yield per hectare is estimated to increase significantly, from approximately 4 tons per hectare in the 2015/16 season to around 5.3 tons per hectare in the 2016/17 season.

Commercial maize crop estimates

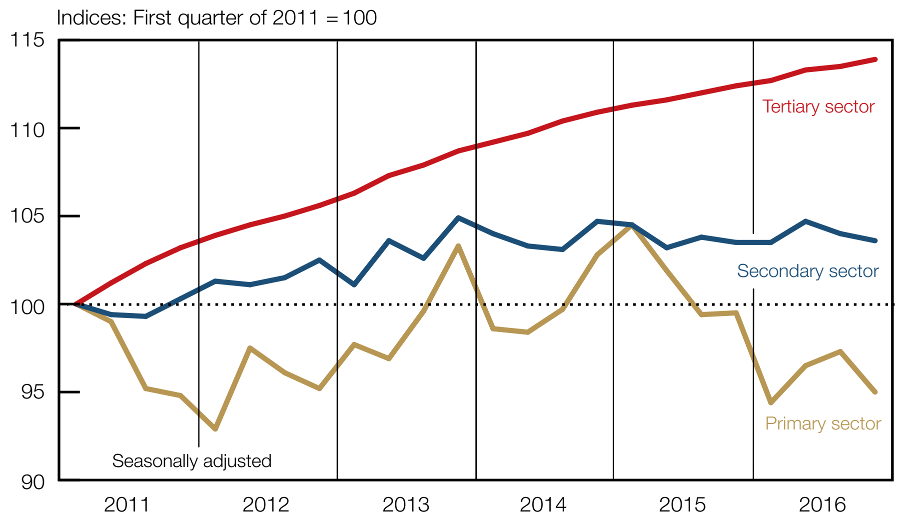
	Crop (Million tons)	Area planted (Million hectares)
2015/16: Final	7.8	1.9
2016/17: First production forecast	13.9	2.6

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

The volatile quarter-to-quarter growth pattern in *mining production* continued in the fourth quarter of 2016. Following annualised increases of 14.6% and 4.2% in the second and third quarter of 2016 respectively, real output in the mining sector contracted anew at an annualised rate of 11.5% in the fourth quarter, subtracting 0.9 percentage points from overall GDP growth in the fourth quarter. The contraction resulted from lower production in all major mineral groups, in particular gold, platinum, coal and iron ore. Platinum production continued to trend downwards, while coal production decreased in the fourth quarter of 2016, partly due to depleted mines being shut down and maintenance done at some other mines.

On an annual basis, real output of the mining sector contracted in 2016 as production in all mineral groups declined over the period, with the exception of building materials. Despite the increase in commodity prices, although still relatively low, the decrease in mining output could in part be attributed to low levels of confidence and legislative uncertainty in the mining sector as well as steep increases in the cost of electricity and steel, and the cost of ensuring the safety of mine workers. Growth in real mining output slowed notably from 3.9% in 2015 to -4.7% in 2016, subtracting 0.4 percentage points from overall annual GDP growth.

Real gross domestic product by main sector

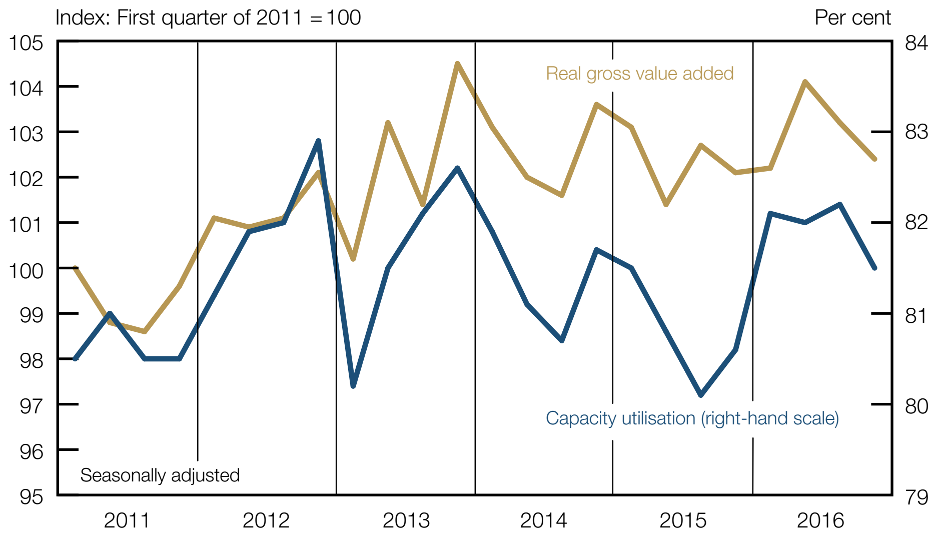


Source: Stats SA

Real output of the *secondary sector* declined by 2.5% in the third quarter of 2016 and by a further 1.8% in the fourth quarter. Increases in the real value added by the electricity, gas and water as well as the construction subsectors were more than offset by a further decrease in activity in the manufacturing sector.

Real value added by the *manufacturing sector* contracted further in the fourth quarter of 2016, impacted by a lack of demand and persistent negative sentiment. Following a quarter-to-quarter annualised decline of 3.3% in the third quarter of 2016, real output of the manufacturing sector receded by a further 3.1% in the fourth quarter, subtracting 0.4 percentage points from overall fourth-quarter GDP growth. Production declines were fairly broad-based, but most pronounced in the subsectors supplying food and beverages; textiles, clothing and footwear; wood products; petroleum products; glass and non-metallic mineral products; motor vehicles and other transport equipment; and furniture. According to the National Association of Automobile Manufacturers of South Africa (NAAMSA), the production of motor vehicles was hampered by the refurbishment and temporary closure of a large manufacturing plant in December 2016. The utilisation of production capacity in the manufacturing sector remained low and decreased from 82.2% in the third quarter of 2016 to 81.5% in the fourth quarter, with insufficient demand for especially durable manufactured goods cited as the main reason for underutilisation.

Real gross value added and capacity utilisation in the manufacturing sector



Source: Stats SA

Annual growth in real output of the manufacturing sector gradually tapered off between 2010 and 2015, before improving somewhat in 2016. Following an annual decline of 0.2% in 2015, manufacturing production increased by 0.7% in 2016, thereby adding 0.1 percentage points to overall GDP growth in 2016. The marginally positive growth in manufacturing output in 2016 resulted largely from increased production of motor vehicles, underpinned by firm export demand in the second quarter of the year. The slight improvement in annual manufacturing production could further be linked to, among other factors, sufficient electricity supply over the period and the absence of prolonged industrial action in the sector. However, production activity in the manufacturing sector continued to be restrained by, among other factors, the protracted decline in agricultural output, the contraction in mining output, higher electricity prices feeding into production costs, persistent low business confidence, local infrastructure constraints, and sluggish domestic demand.

The real value added by the *electricity, gas and water sector* advanced at a rate of 2.4% in the fourth quarter of 2016, after having contracted for three consecutive quarters. Although both the volume of electricity consumed and produced increased in the fourth quarter, the level of electricity consumed was still significantly lower than that of electricity produced. Regular scheduled maintenance done in preceding months, the addition of new electricity generating capacity, and improved plant performance contributed to a strong increase in the supply of electricity over the period. Nevertheless, negative quarter-to-quarter growth in output of the electricity, gas and water sector in the first three quarters of 2016 culminated in a decline of 3.5% for the year as a whole – significantly larger than the decline of 1.5% recorded in 2015.

Activity in the *construction sector* remained subdued in the fourth quarter of 2016. The real value added by the construction sector increased marginally at an annualised rate of 0.4% in the fourth quarter of 2016, slightly slower than in the preceding quarter. Residential building activity improved while activity in the non-residential building segment remained lackluster over the period.

Growth in output of the *services sector* accelerated to 1.6% in the final quarter of 2016 as the real value added by the trade, transport and finance sectors expanded at a faster pace, alongside a moderation in real output growth of the general government services sector over the period.

Growth in real output of the *commerce sector* reverted from -2.0% in the third quarter of 2016 to an annualised increase of 2.1% in the fourth quarter, mainly underpinned by increased activity in the retail trade subsector. Retailers of textiles, clothing, footwear and leather goods as well as hardware, paint and glass registered increased sales over the period. In addition, the real value added by the wholesale trade, catering and accommodation, and the motor trade subsectors rose at a faster pace in the fourth quarter of 2016. Despite the improved performance in the fourth quarter, growth in real outlays in the trade sector moderated from 1.4% in 2015 to 1.2% in 2016, impacted mainly by low business and consumer confidence, slower growth in the disposable income of households, subdued credit extension and weak employment growth.

Quarter-to-quarter growth in real output of the *transport, storage and communication sector* accelerated from an annualised rate of 1.7% in the third quarter of 2016 to 2.6% in the fourth quarter. Activity in the telecommunications subsector was buoyant as the number of active subscribers to mobile networks continued to increase. In addition, real activity in land freight transport also increased over the period.

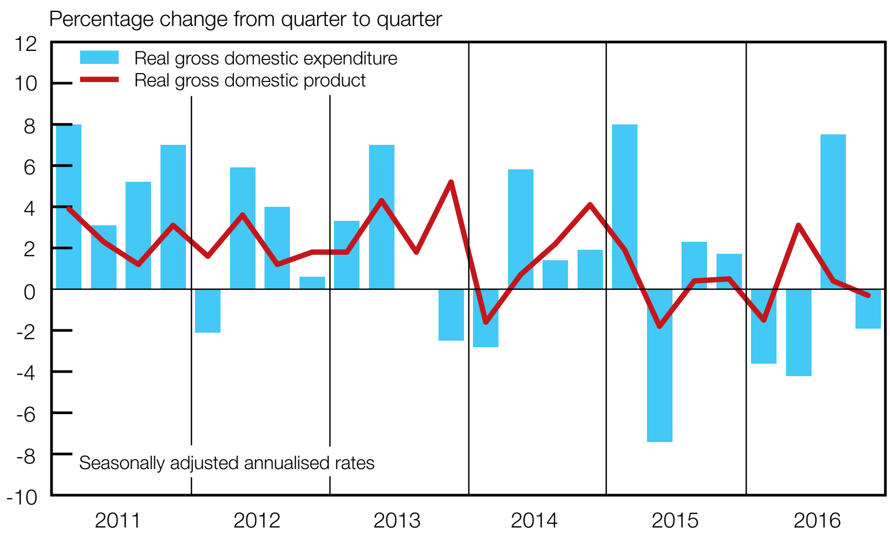
Growth in the real value added by the *finance, insurance, real estate and business services sector* picked up from an annualised rate of 1.3% in the third quarter of 2016 to 1.6% in the fourth quarter. The faster pace of increase reflected an improvement in commercial banking activity, in particular other income received, while insurance activity remained buoyant over the period. Trading activity in the equity and derivatives market contracted during the quarter. In keeping with subdued overall economic growth, growth in real output of the finance, insurance, real estate and business services sector moderated from 2.8% in 2015 to 1.9% in 2016.

The real value added by *general government* increased at a somewhat slower pace of 0.9% in the fourth quarter of 2016, largely reflecting a deceleration in employment growth by general government over the period.

Real gross domestic expenditure

In keeping with the contraction in real GDP in the fourth quarter of 2016, *real gross domestic expenditure* also declined. Following an annualised increase of 7.5% in the third quarter of 2016, real gross domestic expenditure contracted by 1.9% in the fourth quarter. Real final consumption expenditure by general government increased at a slower pace in the fourth quarter of 2016, together with the de-accumulation of real inventories. Growth in real final consumption expenditure by households was sustained, while gross fixed capital formation increased in the final quarter of 2016. For 2016 as a whole, real gross domestic expenditure declined by 0.8%. This is the first annual contraction in real gross domestic expenditure since 2009 when the impact of the global financial crisis was at its worst, and is indicative of the subdued domestic demand environment.

Real gross domestic product and expenditure



Source: Stats SA

Real gross domestic expenditure

Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Component	2015	2016				
	Year*	Q1	Q2	Q3	Q4	Year*
Final consumption expenditure						
Households	1.7	-1.5	1.2	2.2	2.2	0.8
General government	0.5	1.5	2.8	1.9	0.3	2.0
Gross fixed capital formation	2.3	-10.4	-2.8	-3.5	1.7	-3.9
Domestic final demand	**1.6**	**-2.8**	**0.7**	**1.0**	**1.7**	**0.1**
Change in inventories (R billions)**	12.4	-2.2	-37.0	10.8	-16.4	-11.2
Gross domestic expenditure* **	**1.8**	**-3.6**	**-4.2**	**7.5**	**-1.9**	**-0.8**

* Percentage change over one year
** At constant 2010 prices
*** Including residual

Sources: Stats SA and SARB

The change in real inventories subtracted 3.5 percentage points from growth in real GDP in the fourth quarter of 2016, while net exports added 1.7 percentage points. For 2016 as a whole, gross fixed capital formation and the change in inventories subtracted 0.8 percentage points respectively from overall economic growth, while real net exports made a positive contribution of 1.2 percentage points.

Contributions of expenditure components to growth in real gross domestic product

Percentage points

Component	2015	2016				
	Year	Q1	Q2	Q3	Q4	Year
Final consumption expenditure						
Households	1.0	-0.9	0.7	1.3	1.3	0.5
General government	0.1	0.3	0.6	0.4	0.1	0.4
Gross fixed capital formation	0.5	-2.2	-0.6	-0.7	0.3	-0.8
Change in inventories	-0.1	-1.1	-4.6	6.2	-3.5	-0.8
Net exports	-0.5	2.2	7.5	-6.8	1.7	1.2
Residual	0.1	0.2	-0.5	0.0	-0.2	-0.2
Gross domestic product	**1.3**	**-1.5**	**3.1**	**0.4**	**-0.3**	**0.3**

Source: SARB

Final consumption expenditure by households

Growth in *real final consumption expenditure by households* remained unchanged at 2.2% in both the third and fourth quarters of the year. Real outlays on both non-durable goods and services increased at a slower pace in the final quarter of 2016. However, spending on durable and semi-durable goods improved from a contraction in the third quarter to positive growth in the fourth quarter of 2016. Growth in real consumption expenditure by households moderated from 1.7% in 2015 to 0.8% in 2016.

Real final consumption expenditure by households

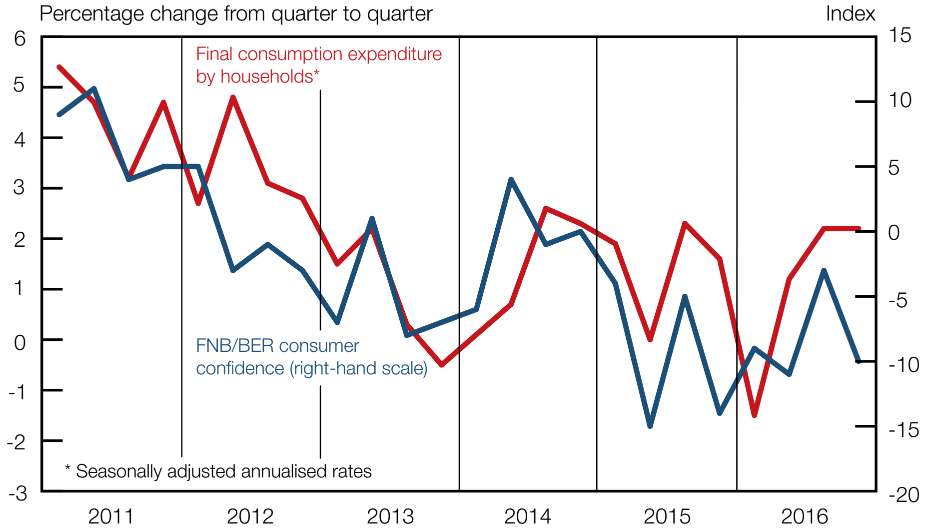
Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Component	2015	2016				
	Year*	Q1	Q2	Q3	Q4	Year*
Durable goods	-1.9	-15.3	-5.4	-3.2	0.2	-7.3
Semi-durable goods	4.0	2.4	1.6	-0.9	6.8	3.3
Non-durable goods	2.2	-1.1	0.4	1.1	0.3	0.9
Services	1.5	0.6	3.1	5.0	3.2	2.1
Total	**1.7**	**-1.5**	**1.2**	**2.2**	**2.2**	**0.8**

* Percentage change over one year

Source: Stats SA

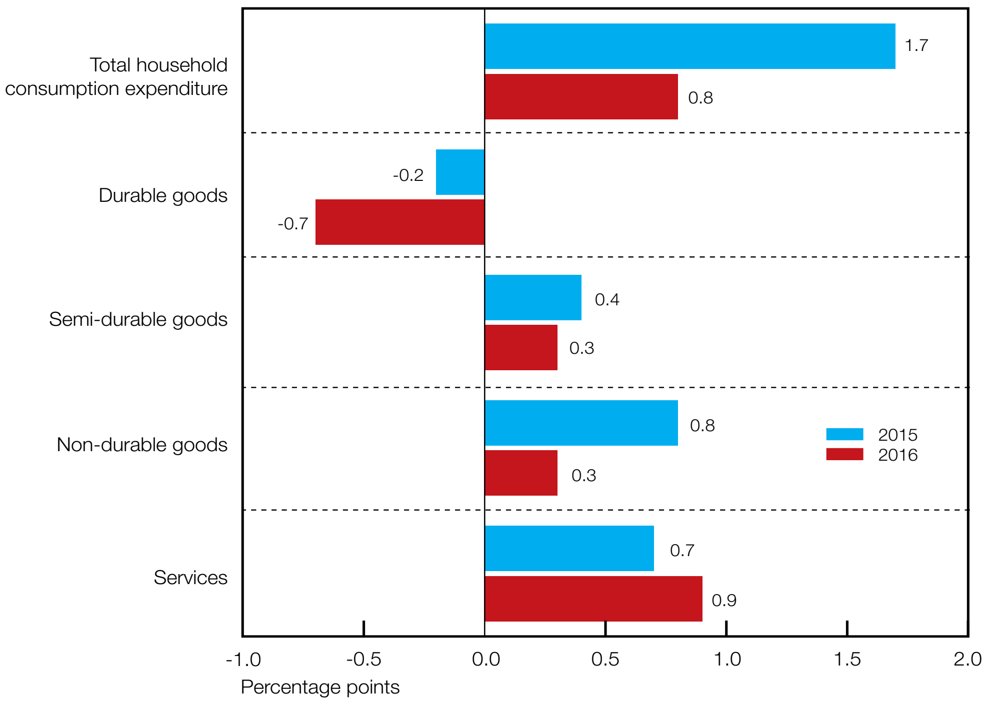
Real final consumption expenditure by households and consumer confidence



Sources: Stats SA and FNB/BER

Following seven consecutive quarters of annualised declines, real outlays by households on *durable goods* rose somewhat in the fourth quarter of 2016. After contracting at an annualised rate of 3.2% in the third quarter of 2016, real spending on durable goods increased at an annualised rate of 0.2% in the fourth quarter. A further decline in real spending on personal transport equipment – the largest component in the durable goods basket – was fully offset by an acceleration in growth in all other durable goods components over the period. On a calendar-year basis, spending on durable goods declined by 1.9% in 2015 and by a further 7.3% in 2016, subtracting 0.7 percentage points from growth in aggregate household consumption expenditure in 2016. Subdued economic activity, increased inflationary pressures, a moderation in wage growth, marginally higher interest rates and low consumer confidence levels all likely contributed to the contraction in spending on durable goods in 2016.

Contributions to growth in real final consumption expenditure by households



Source: Stats SA

Real spending on personal transport equipment contracted for the third year in succession, while expenditure on most other durable goods subcategories increased at a slower pace over the period.

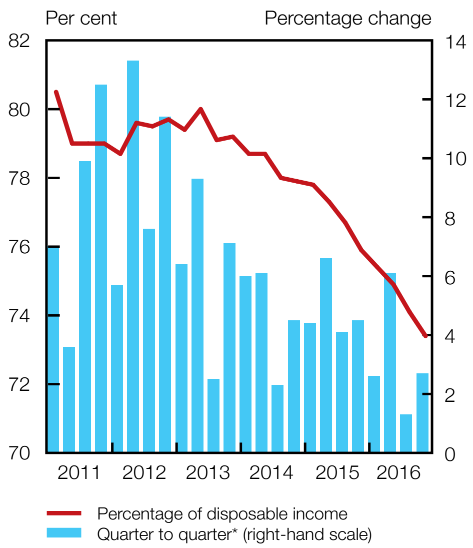
Growth in real outlays on *semi-durable goods* accelerated to 6.8% in the fourth quarter of 2016 following an annualised rate of decline of 0.9% in the third quarter. Spending on clothing and footwear, household textiles, and semi-durable recreation and entertainment goods advanced at a faster pace, while real expenditure on motorcar tyres, parts and accessories declined further over the period.

Following an increase of 1.1% in the third quarter of 2016, annualised growth in real spending on *non-durable goods* slowed to 0.3% in the fourth quarter. Increases in expenditure on food, beverages and tobacco; household fuel and power; and medical and pharmaceutical products were partly offset by lower real spending on household consumer goods, petroleum products and non-durable recreation and entertainment goods.

Growth in real expenditure by households on *services* – the largest component of household consumption expenditure – slowed somewhat from an annualised rate of 5.0% in the third quarter of 2016 to 3.2% in the fourth quarter. Increased spending on transportation services was partly offset by slower growth in outlays on miscellaneous services. For 2016 as a whole, real expenditure on services rose by 2.1%, slightly higher than the 1.5% recorded in 2015. Expenditure on services made the largest contribution of 0.9 percentage points to growth in real household spending in 2016.

Household debt increased marginally in the fourth quarter of 2016. However, as a percentage of annualised disposable income, household debt decreased from 74.1% in the third quarter of 2016 to 73.4% in the fourth quarter. On balance, the cost of servicing household debt as a percentage of disposable income inched lower from 9.6% in the third quarter of 2016 to 9.5% in the fourth quarter.

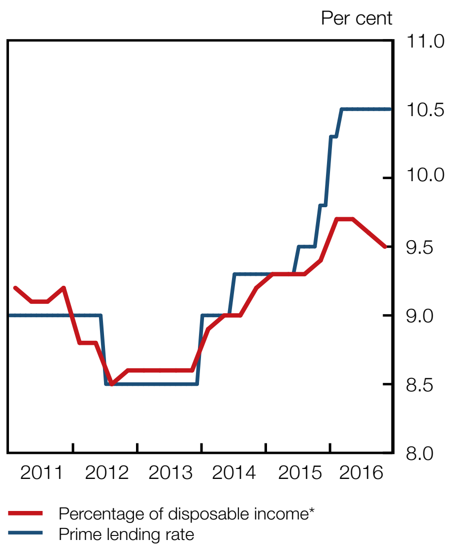
Household debt



* Seasonally adjusted annualised rates

Source: SARB

Household debt-service cost and prime lending rate



* Seasonally adjusted

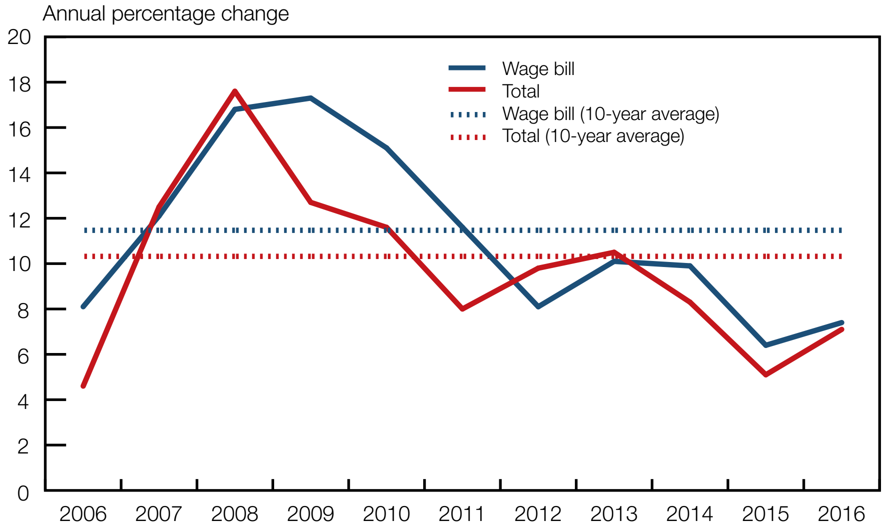
On an annual basis, growth in household debt slowed from 4.6% in 2015 to 3.9% in 2016, and the ratio of household debt to disposable income edged lower from 76.9% to 74.4% over the same period. However, largely reflecting two moderate increases in the prime lending rate early in 2016, the debt-service cost of households rose somewhat from 9.3% of disposable income in 2015 to 9.6% in 2016.

Final consumption expenditure by government

Growth in *real final consumption expenditure by general government* moderated to an annualised rate of 0.3% in the fourth quarter of 2016 following an increase of 1.9% in the third quarter. In the final quarter of 2016, spending on the compensation of employees increased at a somewhat slower pace, together with a decline in real outlays on non-wage goods and services. This could partly be attributed to the normalisation in real spending by general government following elevated spending by the Independent Electoral Commission (IEC) during the municipal elections in August 2016. However, government's real outlays for 2016 as a whole still grew by 2.0%, notably more than the moderate increase of 0.5% in 2015.

Consistent with fiscal consolidation, annual growth in both overall nominal general government consumption expenditure and government's wage bill remained below their respective 10-year averages in recent years.

Nominal consumption expenditure by general government



Source: Stats SA

Fixed capital formation

Real gross fixed capital formation advanced at an annualised rate of 1.7% in the fourth quarter of 2016 after having contracted for four consecutive quarters. Growth in real capital outlays by general government accelerated noticeably in the fourth quarter of 2016. By contrast, real fixed capital spending by both private business enterprises and public corporations declined further over the period.

Overall, real gross fixed capital formation declined by 3.9% in 2016 following an increase of 2.3% in 2015, as 2016 was characterised by political uncertainty, subdued economic growth and continued low business confidence levels. The contraction in 2016 represented the first negative annual growth rate since 2010. As a percentage of GDP, gross fixed capital formation receded from 20.4% in 2015 to 19.6% in 2016, falling to below the 20% level for the first time since 2012, on an annual basis.

Following a decrease of 5.6% in the third quarter of 2016, real fixed capital outlays by *private business enterprises* contracted more moderately by 1.7% in the fourth quarter. This marked the fifth consecutive quarterly decline in private sector capital spending.

Real gross fixed capital formation

Quarter-to-quarter percentage change at seasonally adjusted annualised rates

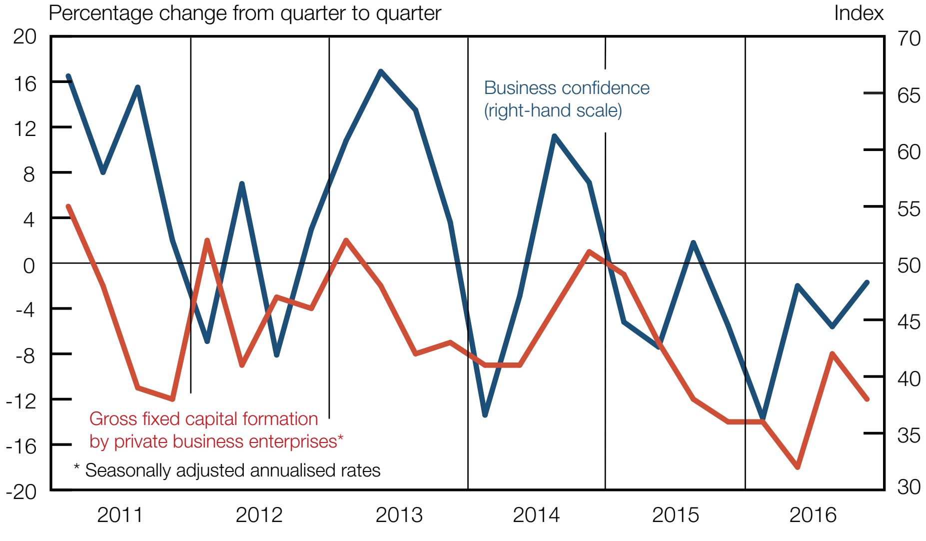
Sector	2015	2016				
	Year*	Q1	Q2	Q3	Q4	Year*
Private business enterprises	-0.5	-13.7	-2.0	-5.6	-1.7	-6.0
Public corporations.......................	2.8	3.3	0.8	-5.8	-3.3	-1.6
General government	13.4	-12.4	-9.0	6.6	19.8	1.1
Total	**2.3**	**-10.4**	**-2.8**	**-3.5**	**1.7**	**-3.9**

* Percentage change over one year

Source: Stats SA

Aggregate real capital outlays by private business enterprises contracted by 0.5% in 2015 and by a further 6.0% in 2016, adversely affected by low business confidence and subdued economic growth. A decline in expenditure on new independent renewable energy projects contributed to the reduction in investment activity by the private sector in 2016.

Real gross fixed capital formation and business confidence

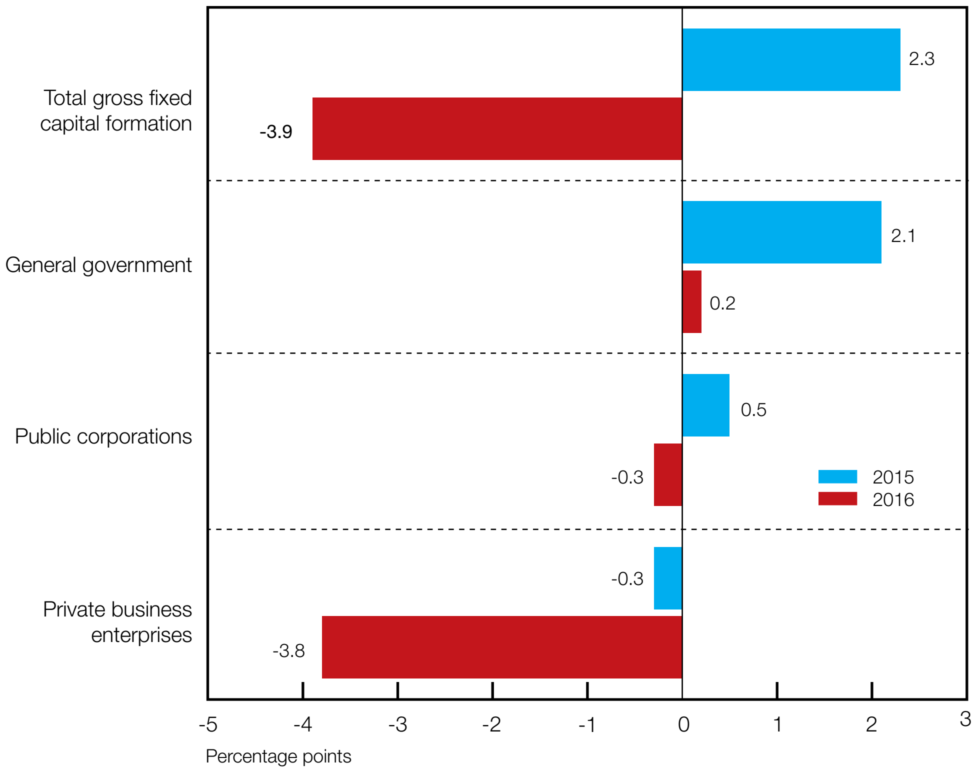


Sources: Stats SA and RMB/BER

Following a contraction of 5.8% in the third quarter of 2016, real gross fixed capital spending by *public corporations* declined further by 3.3% in the fourth quarter. Increased capital investment on construction works, by the electricity and transport subsectors in particular, was somewhat offset by strong decreases in capital outlays by other sectors over the period.

Growth in real fixed capital expenditure by *general government* accelerated significantly from 6.6% in the third quarter of 2016 to 19.8% in the fourth quarter, and contributed 3.4 percentage points to overall growth in capital investment in the fourth quarter. The continued roll-out of several government investment programmes, which were largely focused on water infrastructure projects, the maintenance of roads and the refurbishment of schools, supported capital spending over the period. Despite the marked acceleration in capital investment in the second half of the year, capital spending by general government increased by only 1.1% in 2016 following a robust increase of 13.4% in 2015.

Contributions to growth in real gross fixed capital formation



Source: Stats SA

Inventory investment

Following an annualised accumulation of R10.8 billion (at 2010 prices) in the third quarter of 2016, *real inventory holdings* decreased by R16.4 billion in the fourth quarter.

Real inventory levels declined significantly in the fourth quarter of 2016 as platinum inventories were run down in the mining sector on account of a firm increase in the exports of these products. The destocking in the mining sector was partly offset by a build-up of inventories in the manufacturing sector. Industrial and commercial inventories increased from 12.1% of non-agricultural GDP in the third quarter of 2016 to 12.6% in the fourth quarter. Subsequent to a build-up of inventories in 2015, real inventory levels decreased by R11.2 billion in 2016.

Factor income

Growth in *total nominal factor income*, measured over four quarters, decelerated from 7.0% in the third quarter of 2016 to 6.6% in the fourth quarter, mainly due to a moderation in the compensation of employees. Gross operating surpluses of business enterprises increased at a faster pace over the period. For 2016 as a whole, growth in total nominal factor income accelerated to 6.6% from 6.0% in 2015, reflecting higher consumer price inflation and wage growth over the period.

The year-on-year pace of increase in total *compensation of employees* decelerated from 8.1% in the third quarter of 2016 to 7.0% in the fourth quarter. Growth in salaries and wages in most of the major sectors in the economy, especially the general government sector, moderated over the period. Consequently, the ratio of compensation of employees to total factor income decreased marginally from 54.4% in the third quarter of 2016 to 54.2% in the fourth quarter. For 2016 as a whole, growth in aggregate employee remuneration accelerated to 7.8%, marginally higher than the rate of increase of 7.4% in 2015.

Measured over four quarters, the rate of increase in the aggregate *gross operating surplus* inched higher from 5.8% in the third quarter of 2016 to 6.0% in the fourth quarter. The pickup was concentrated in the mining and finance subsectors, whereas gross operating surpluses in the electricity, trade, transport and general government subsectors increased at a slower pace. By contrast, the gross operating surplus in the construction sector declined over the period. For the year as a whole, the total gross operating surplus increased by 5.3%, benefitting from the continued improvement in international commodity prices, especially towards the end of the year, and the depreciation in the exchange value of the rand in preceding years. Nonetheless, the share of gross operating surpluses in total factor income edged lower from 46.5% in 2015 to 45.9% in 2016.

Gross saving

Gross saving measured as a percentage of GDP (i.e. the *national saving rate*) improved from 16.2% in the third quarter of 2016 to 17.0% in the fourth quarter. The stronger savings performance stemmed largely from significantly higher saving by corporate business enterprises, which represents the bulk of domestic saving. Household saving remained stable, while gross saving by general government decreased somewhat in the fourth quarter of 2016. The share of foreign capital inflows in the financing of gross capital formation shrank from 18.9% in the third quarter of 2016 to 9.2% in the fourth quarter. Following three consecutive annual increases, the total domestic saving ratio inched lower from 16.3% in 2015 to 16.2% in 2016.

As a percentage of GDP, gross saving by the *corporate sector* increased from 14.4% in the third quarter of 2016 to 15.2% in the fourth quarter, mainly due to substantially lower dividend payments over the period. However, the corporate saving rate weakened from 15.0% in 2015 to 14.2% in 2016, reflecting ongoing muted economic activity in the business sector.

Gross saving by *general government* decreased marginally from 0.6% of GDP in the third quarter of 2016 to 0.5% in the fourth quarter, mainly on account of the negative impact of lower tax receipts from individuals. In addition, nominal consumption expenditure by government rose at a slower pace over the period. The government's saving rate advanced to 0.8% in 2016 from 0.3% in 2015.

The saving rate of the *household sector* remained at 1.2% in both the third and fourth quarters of 2016. An uptick in the quarterly pace of increase in disposable income was offset by a slight increase in nominal household consumption expenditure in the fourth quarter. On an annual basis, the household saving rate increased for the fourth consecutive year and inched higher from 1.0% in 2015 to 1.2% in 2016.

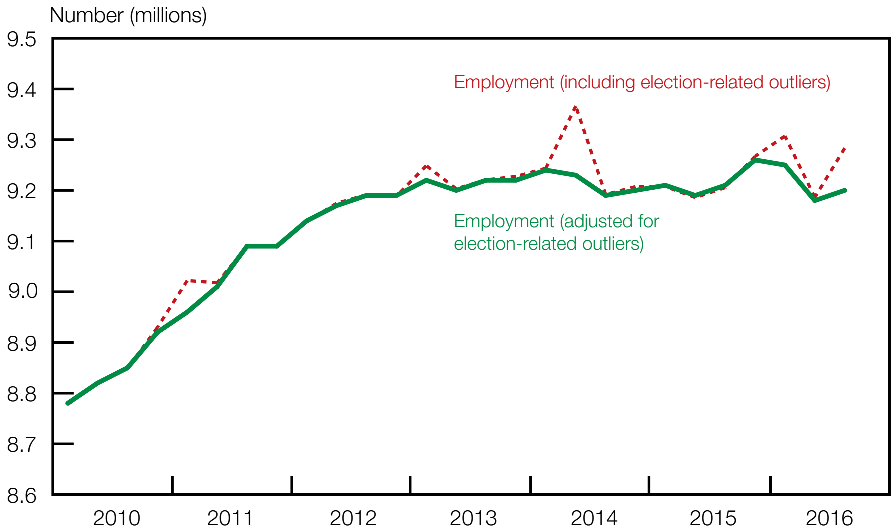
Employment

The South African economy remained unable to create significant employment opportunities in the third quarter of 2016 given an environment of sustained low output growth. Temporary election-related employment opportunities only brought some financial relief to those who afforded these jobs and consequently introduced volatility to the quarterly formal non-agricultural employment series for analysis purposes, as indicated in the figure on the next page.

According to Statistics South Africa's (Stats SA) *Quarterly Employment Statistics (QES)* survey,[3] formal non-agricultural employment increased by 4.3% on an annualised basis in the third quarter of 2016. Around 97 000 jobs were created in this quarter, elevating the level of total formal non-agricultural employment to an estimated 9.3 million. However, around 73 000 of these jobs represented temporary employment opportunities created by the IEC to assist with the August 2016 municipal elections.

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

Formal non-agricultural employment



Sources: Stats SA and SARB

Box 1 Statistical linking of formal non-agricultural employment and earnings time series

The analysis on formal non-agricultural employment and earnings in the *Quarterly Bulletin* is based on employment and earnings data from the *Quarterly Employment Statistics (QES)* survey, a business enterprise survey published by Statistics South Africa (Stats SA). In addition, time series measuring public and private sector formal non-agricultural employment and earnings are published in the statistical tables section of the *Quarterly Bulletin* on pages S–136 and S–137. However, these time series contain numerous structural breaks, rendering them inadequate for long-term analysis of South African labour market conditions.

The structural breaks in the data occurred in the third quarter of 2002, the fourth quarter of 2004, the second quarter of 2006, the second quarter of 2013 and, most recently, the second quarter of 2015. These structural breaks (which usually increase the overall level of employment and earnings) were the result of ongoing improvements by Stats SA to the measurement of formal non-agricultural employment and earnings.

Initially, Stats SA published formal non-agricultural employment and earnings data in the Survey of Total Employment and Earnings (STEE). In March 2001, the STEE was renamed the Survey of Employment and Earnings (SEE) in selected industries, as Stats SA replaced its business register (based on sectoral economic censuses and updated with other sources) with an integrated business frame. From June 2005, the SEE was replaced by the *QES* survey. The *QES* survey covers only employing businesses registered for value-added tax (VAT) at the South African Revenue Service (SARS), whereas the SEE covered both employing and non-employing VAT-registered businesses.

Stats SA has sporadically updated the business sampling frame (BSF), from which the sample of the *QES* survey is drawn, by adding new enterprises and removing dormant enterprises to ensure the relevance and quality of the BSF. These enhancements to the coverage of the BSF have consequently resulted in a number of structural breaks in the time series measuring formal non-agricultural employment and earnings. According to Stats SA, the level shifts in the employment and earnings estimates may be assumed to be, but not limited to, the following:

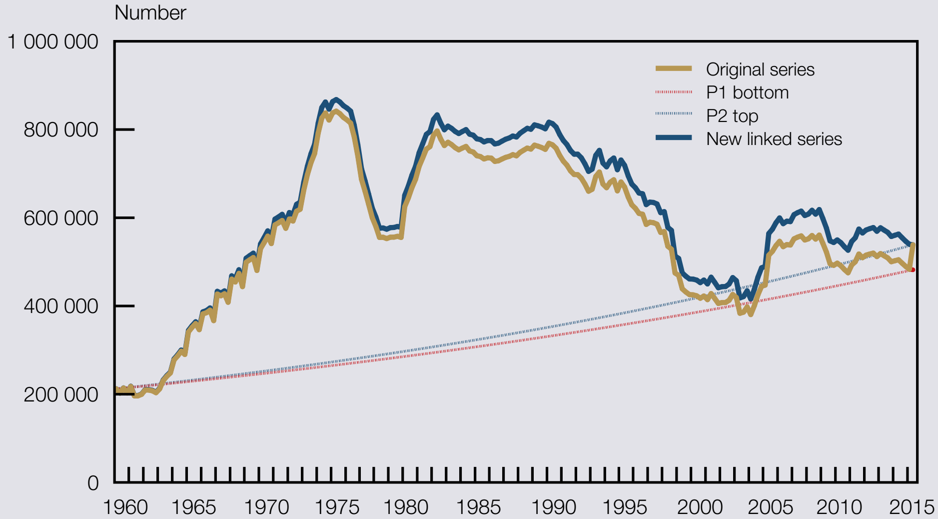
- general growth in the South African economy;
- small businesses growing to the extent that they are captured in the registration process;
- greater compliance with administrative requirements to register as an employer;
- increased coverage of employer entities on Stats SA's business register through enhanced use of administrative data; and
- an extension of the boundary of the formal sector due to legislative changes.

The most recent update of the *QES* survey's BSF was published in the March 2016 release of the *QES* survey. The new sample, which was introduced from the second quarter of 2015, resulted in an upward adjustment of roughly 200 000 in the level of total formal non-agricultural employment, and is therefore not directly comparable to historical data.

Up to the December 2016 *Quarterly Bulletin*, the South African Reserve Bank (SARB) published the formal non-agricultural employment and earnings time series containing the structural breaks in the statistical tables. However, the analysis in the Quarterly Economic Review section was based on formal non-agricultural employment and earnings time series that were statistically linked by the SARB for internal use. The SARB analyses and publishes separate employment and earnings time series for the private and public sectors as well as their respective subsectors. The structural breaks occurred mostly in the private subsectors, since public sector employment and earnings have always been measured quite comprehensively in the *QES* survey. The employment and earnings time series of each subsector were linked individually, for each structural break, and then aggregated to obtain total formal non-agricultural employment and earnings.

The statistical linking methodology employed by the SARB will briefly be explained using the linking of employment in the construction sector at the most recent structural break as an example. The historical starting point of the time series (the first quarter of 1960) was kept unchanged, since revising the data from the beginning would lift the starting point of the time series to an unrealistic level appropriate for that period. A line is then projected from the starting point of the time series to the end point of the time series based on the old frame (P1 in the accompanying figure). Likewise, another line is projected from the starting point of the time series to the end point of the time series based on the new frame (P2 in the accompanying figure). The original time series is divided by P1 to obtain a linking factor. The linking factor is then multiplied by P2, yielding the new linked time series. Although this methodology results in a slightly steeper long-term trend in the linked time series, the cyclical movement and the seasonal pattern of the original time series are retained.

Contruction sector employment



Source: Stats SA and own calculations

To facilitate better analysis of labour market developments by users, the SARB decided to publish the linked formal non-agricultural employment and earnings time series. From the March 2017 *Quarterly Bulletin*, tables KB701, KB702 and KB814 on pages S–136, S–137 and S–156 respectively will contain the statistically linked time series.

References

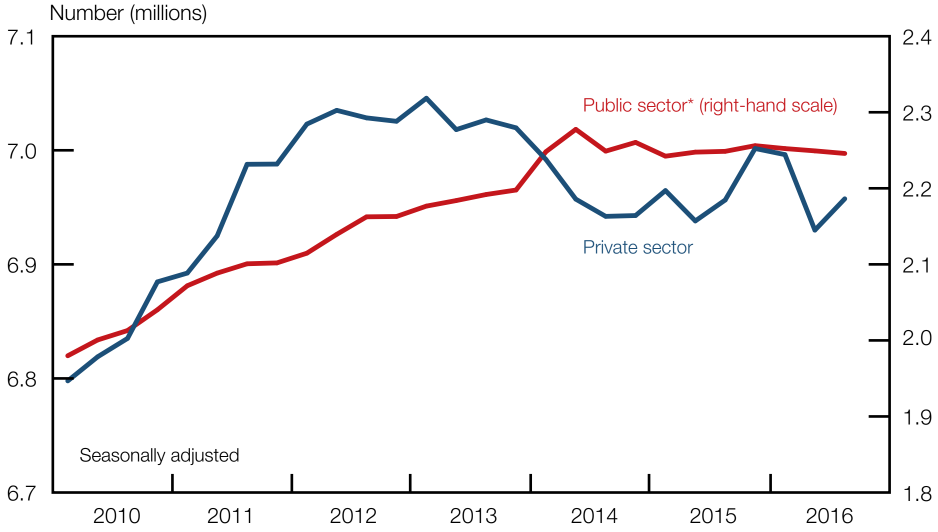
Statistics South Africa. 2005. Statistical release P0275. 'Survey of employment and earnings, March 2005'. Pretoria: Statistics South Africa.

Statistics South Africa. 2015. Statistical release P0277. 'Quarterly employment statistics (QES), December 2014'. Pretoria: Statistics South Africa.

Statistics South Africa. 2016. Statistical release P0277. 'Quarterly employment statistics (QES), March 2016'. Pretoria: Statistics South Africa.

Public sector employment increased markedly by 12.9% in the third quarter of 2016, almost exclusively due to the addition of the temporary IEC employees in that quarter. When excluding these temporary jobs, public sector employment decreased by 0.6%. This may reflect government's commitment to fiscal consolidation by containing further public sector employment growth. Local governments as well as the public transport, storage and communication sector reduced their staff complement, while employment at national departments and provinces increased only marginally.

Formal non-agricultural employment



* Adjusted for election-related outliers

Sources: Stats SA and SARB

Private sector employment increased by 1.6% in the third quarter of 2016, following two consecutive quarterly declines. Employment levels picked up marginally in most subsectors. Employment gains were recorded in the private community, social and personal services sector; the construction sector; the trade, catering and accommodation services sector; the mining sector; and the finance, insurance, real estate and business services sector. These gains were offset somewhat by job losses in the manufacturing and the private transport, storage and communication services sectors. Disappointingly, the level of private sector employment remained virtually unchanged from a year earlier as only about 1 000 jobs were created in the year to the third quarter of 2016.

The accompanying table indicates that formal non-agricultural employment growth emanated largely from the public sector during the current downward phase in the employment cycle – from the second quarter of 2014 to the third quarter of 2016. Cumulatively, public sector employment increased by roughly 74 000 jobs, while the private sector shed around 34 500 jobs over this period. The bulk of private sector job losses occurred in the goods-producing sectors of the economy, while most of the services subsectors managed to record some employment gains over this period. Private sector job losses coincided with a prolonged period of weak domestic and global output growth, poor investment growth, low business confidence levels and increased uncertainty. These factors contributed to the South African economy entering its 40th month of the current downward phase in the business cycle in March 2017. This is reflected by the correlation between the year-on-year change in the composite coincident business cycle indicator and the year-on-year growth rate in formal non-agricultural employment (excluding election-related outliers). Employment growth is only expected to improve once the South African economy enters the next upward phase of the business cycle. Encouragingly, the SARB's composite leading business cycle indicator has been trending upwards since May 2016, suggesting improved economic growth prospects in 2017.

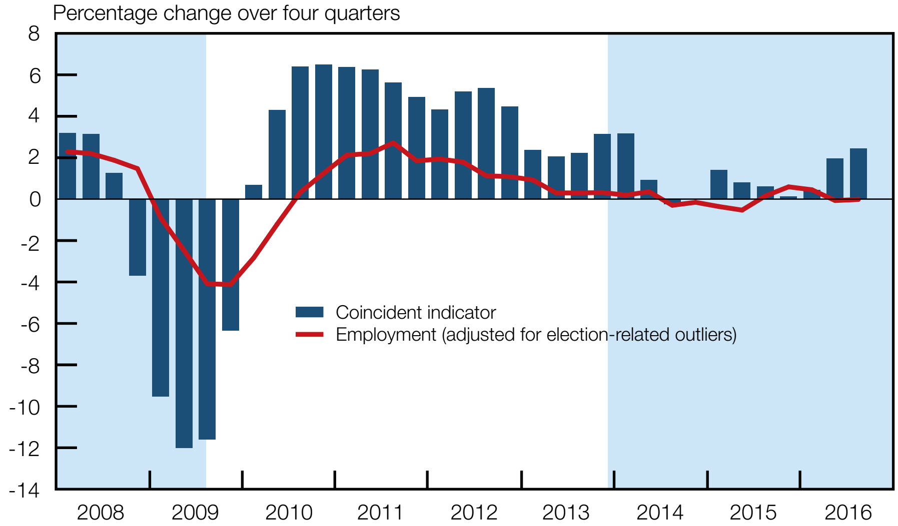
Change in enterprise-surveyed formal non-agricultural employment by sector[1]

Sector	Change over one quarter Q3 2016		Change over four quarters to Q3 2016		Cumulative job losses (-) gains (+)	
	Number	Per cent annualised	Number	Per cent	Q2 2010 to Q1 2014[2]	Q2 2014 to Q3 2016[3]
Total mining	1 200	1.1	-16 700	-3.5	600	-31 900
Gold mining	600	2.2	3 100	2.7	-41 100	-700
Other mining	600	0.7	-19 800	-5.5	41 700	-31 200
Manufacturing	-2 900	-1.0	-22 600	-2.0	-46 500	-40 100
Construction	5 300	4.0	3 400	0.6	10 600	-15 800
Trade, catering and accommodation services	14 000	3.0	17 500	0.9	68 700	39 700
Private transport, storage and communication services	-1 500	-1.8	-7 200	-2.1	5 900	-15 000
Finance, insurance, real estate and business services	5 600	1.1	22 200	1.1	132 400	24 800
Community, social and personal services	5 700	5.0	4 400	0.9	22 400	3 800
Private sector	**27 500**	**1.6**	**1 000**	**0.0**	**194 100**	**-34 500**
National departments	1 000	0.8	-4 500	-0.9	44 000	28 100
Provinces	1 800	0.7	-4 500	-0.4	109 600	-40 300
Local governments	-9 900	-11.7	6 400	2.1	72 000	1 100
Public transport, storage and communication services	-1 300	-4.4	-10 400	-8.2	26 700	-14 400
Other public sector enterprises, including electricity and IEC[4]	78 100	186.3	89 600	36.1	19 400	99 500
Total public sector	**69 600**	**12.9**	**76 800**	**3.4**	**271 700**	**74 000**
Grand total	**97 100**	**4.3**	**77 800**	**0.8**	**465 800**	**39 500**

1 Seasonally adjusted. Components may not add up to totals due to rounding off
2 Representing the most recent upward phase in the formal non-agricultural employment cycle
3 Representing the current downward phase in the formal non-agricultural employment cycle
4 Independent Electoral Commission

Source: Stats SA, *Quarterly Employment Statistics (QES)* survey

Formal non-agricultural employment and the composite coincident business cycle indicator

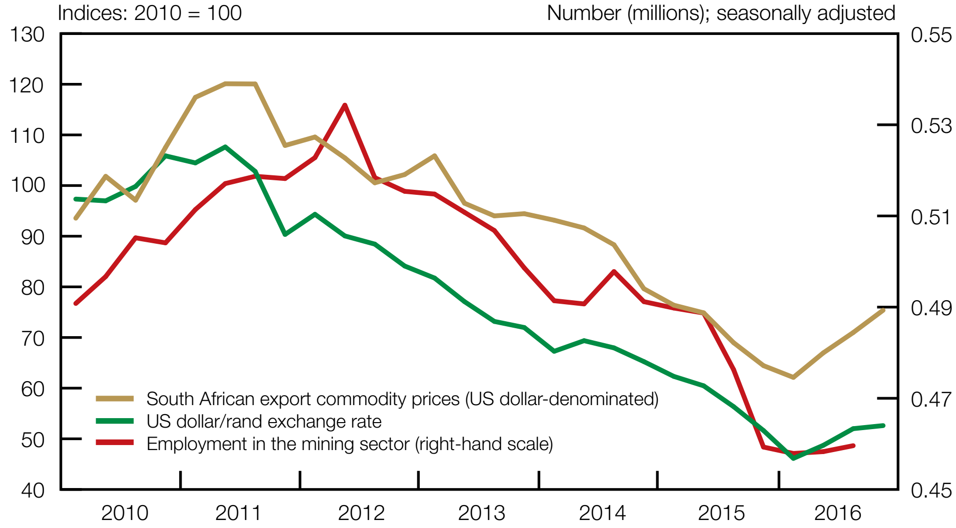


Shaded areas indicate downward phases of the business cycle

Sources: Stats SA and SARB

Employment in the mining sector increased marginally for a second successive quarter in the third quarter of 2016, following a prolonged period of contraction. Employment gains, measured as an annualised change over one quarter, were more pronounced in the gold-mining sector than in the non-gold mining sector. Job growth in the gold-mining sector was likely supported by a notable increase in the US dollar price of gold throughout 2016 as well as the earlier depreciation in the exchange rate of the rand. In addition, and as shown in the accompanying figure, the increase in a broader basket of South African export commodity prices since the start of 2016 supported some job creation in the mining sector. However, the South African mining sector continues to be hampered by an uncertain regulatory and legislative environment as well as sporadic output disruptions due to safety stoppages.

Mining-sector employment and commodity prices



Sources: Stats SA and SARB

Employment in the manufacturing sector decreased for a fourth consecutive quarter in the third quarter of 2016, albeit at a slower pace. Employment losses were largely related to weak output growth as reflected by the contraction in real gross value added in the sector at an annualised 3.2% in the third quarter of 2016. In addition, the Absa Purchasing Managers' Index deteriorated further from an average of 48.9 index points in the third quarter of 2016 to 47.0 index points in the fourth quarter, suggesting that the sector remained under pressure in the final quarter of 2016. According to the Manufacturing Survey released by Stellenbosch University's Bureau for Economic Research (BER), business confidence in the manufacturing sector remained unchanged at 30 index points in the fourth quarter of 2016. Manufacturers noted that the general political climate and insufficient domestic demand remained the most constraining factors in the fourth quarter of 2016. However, manufacturers benefitted somewhat from a slight appreciation in the exchange rate of the rand as the average purchasing price of raw materials decreased. A net majority of only 2% of respondents reported a further decline in the number of factory workers in the fourth quarter of 2016, suggesting a continuation of job shedding in the manufacturing sector in the short run, albeit at a slower pace.

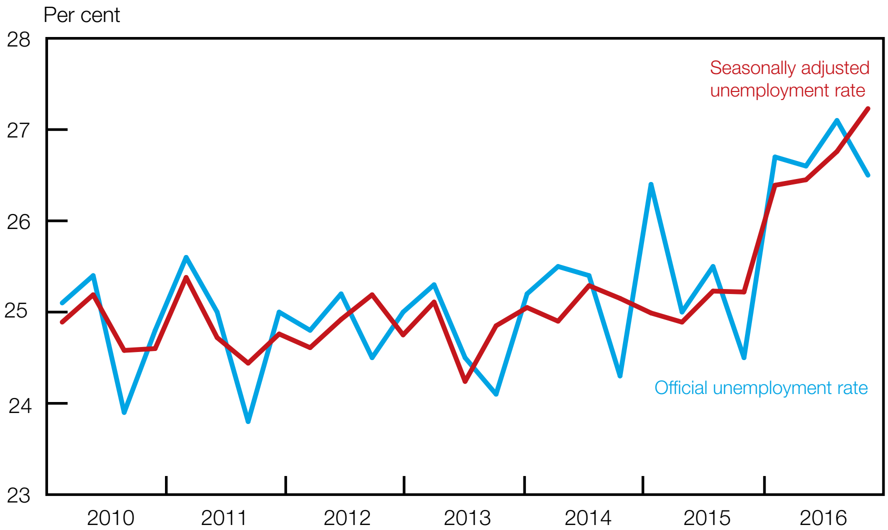
Employment in the construction sector increased at an annualised rate of 4.0% in the third quarter of 2016, resulting in a marginal increase of 0.6% compared with the same period in 2015. Despite some volatility, construction sector employment has trended marginally upwards since the start of 2016. A similar trend is visible in building and construction confidence indicators. Following a cumulative 24 index point rise in the second and third quarter of 2016, the First National Bank/Bureau for Economic Research (FNB/BER) Civil Confidence Index dropped by 17 index points to a level of 35 in the fourth quarter of 2016. Confidence fell largely due to the lower growth in construction activity, stronger competition and, as a result, lower profitability. Conversely, the FNB/BER Building Confidence Index improved further by 2 index points to a level of 40 in the fourth quarter of 2016. The improvement was mostly driven by growth in residential building activity, which led to improved profitability and higher residential contractor confidence. However, non-residential building confidence remained weak over this period as profitability deteriorated and respondents reported a decrease in tendering competition.

After contracting for two successive quarters, the finance, insurance, real estate and business services sector registered modest employment growth in the third quarter of 2016. Likewise, after shedding close to 30 000 jobs in the second quarter of 2016, the trade, catering and accommodation services sector created approximately 14 000 jobs in the third quarter. However, results from the EY/BER Retail Survey show that business confidence among retailers and wholesalers fell in the fourth quarter of 2016 after a strong recovery in the third quarter. According to the BER, trading conditions improved somewhat in the semi-durable goods category, while the non-durable and durable goods sectors came under renewed pressure in the fourth quarter.

According to the *Quarterly Labour Force Survey* (*QLFS*) conducted by Stats SA, the number of persons employed in South Africa increased by 235 000 from the third quarter of 2016 to the fourth quarter. This raised the total level of employment to approximately 16.02 million. However, employment numbers are usually boosted in the fourth quarter of each year by the temporary employment of seasonal workers. As such, total employment increased by only 51 000 in the year to the fourth quarter of 2016, representing a year-on-year growth rate of only 0.3%. Employment losses in the formal sector were more than offset by employment gains in the agricultural sector in the year to the fourth quarter of 2016. Informal sector employment increased marginally over this period.

The number of unemployed persons decreased by 92 000 from the third to the fourth quarter of 2016, largely due to temporary seasonal jobs. However, the number of unemployed persons increased by 588 000 over four quarters, bringing the total to around 5.78 million. The number of discouraged job seekers remained broadly unchanged between the third and fourth quarter of 2016, but increased by a marginal 14 000 over four quarters. As a result, the official unemployment rate decreased from 27.1% in the third quarter of 2016 to 26.5% in the fourth quarter. Disconcerting, however, is that the seasonally adjusted unemployment rate increased from 26.8% to 27.2% over the same period – its highest level since the inception of the *QLFS* in 2008. The youth unemployment rate receded somewhat, from 54.2% in the third quarter of 2016 to 50.9% in the fourth quarter, up from 50.4% a year earlier.

Unemployment rate



Sources: Stats SA and SARB

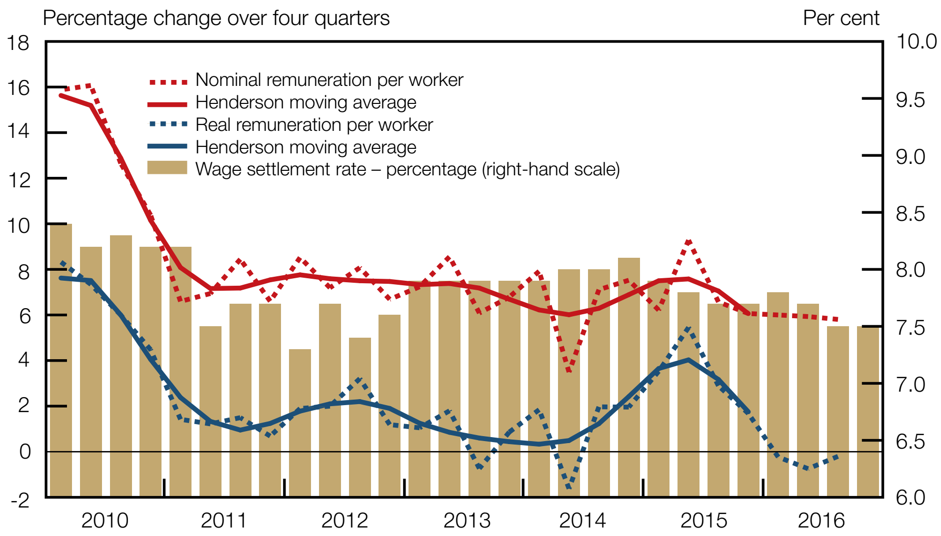
Labour cost and productivity

The year-on-year rate of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy slowed for a fifth consecutive quarter, from 5.9% in the second quarter of 2016 to 5.8% in the third quarter. Growth in public sector remuneration per worker decelerated, while growth in private sector remuneration per worker accelerated. Growth in the average real salaries and wages per worker in the formal non-agricultural sector accelerated marginally from -0.7% in the second quarter of 2016 to -0.2% in the third quarter, but nevertheless remained negative for a third successive quarter.

The sharp deceleration in public sector remuneration growth per worker, from 9.1% in the second quarter of 2016 to 4.9% in the third quarter, was largely as a result of the creation of about 73 000 temporary employment opportunities by the IEC, which temporarily lowered the average remuneration per public sector worker. Nevertheless, nominal wage growth moderated at all tiers of the public sector, except local government. When the temporary IEC employees are excluded from the calculation, public sector remuneration growth per worker still decelerated from 9.4% in the second quarter of 2016 to 8.6% in the third quarter.

Private sector remuneration growth per worker accelerated from 4.5% in the second quarter of 2016 to 5.9% in the third quarter. Remuneration growth quickened in the trade, catering and accommodation services sector (from 3.8% to 6.9%); the manufacturing sector (from 5.9% to 6.2%); the finance, insurance, real estate and business services sector (from 2.5% to 6.0%) and the construction sector (from -0.8% to 1.7%). By contrast, remuneration growth slowed in the mining sector (from 12.8% to 7.9%); the private community, social and personal services sector (from 8.5% to 5.8%); and the private transport, storage and communication services sector (from 6.8% to 4.5%).

Formal non-agricultural remuneration per worker and wage settlement rates



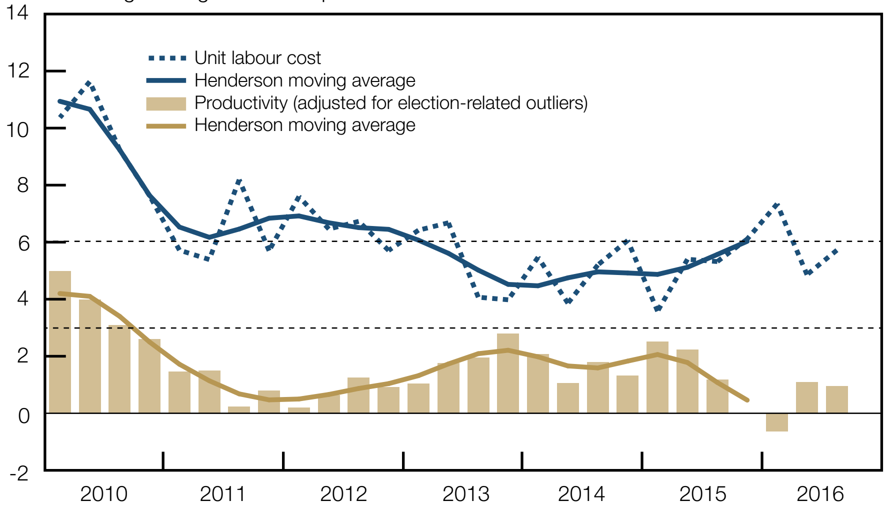
Sources: Stats SA, SARB and Andrew Levy Employment Publications

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements moderated marginally from 7.7% in 2015 to 7.5% in 2016. In addition, the number of working days lost due to strike action fell from 640 000 to 550 000 over the same period. Wages remained the major cause of strikes, accounting for 86% of working days lost.

Year-on-year growth in labour productivity in the formal non-agricultural sector of the economy decelerated from 1.0% in the second quarter of 2016 to 0.1% in the third quarter, as output growth slowed marginally while year-on-year employment growth accelerated. When adjusting for election-related outliers, the slowdown in labour productivity growth was less pronounced at 0.9%. Growth in nominal unit labour cost accelerated from 4.9% in the second quarter of 2016 to 5.7% in the third quarter as year-on-year growth in total remuneration accelerated alongside slowing output growth. Despite the acceleration, growth in nominal unit labour cost nevertheless remained within the inflation target range.

Labour productivity and nominal unit labour cost

Percentage change over four quarters



Sources: Stats SA and SARB

Prices

South Africa's headline consumer price inflation rate accelerated sharply from an annual average of 4.6% in 2015 to 6.4% in 2016, despite fairly subdued global inflation. In 2016, domestic inflationary pressures were largely driven by exogenous cost pressures as domestic demand remained weak and output growth slowed further. The acceleration in headline consumer price inflation was largely as a result of a marked increase in international crude oil prices, delayed exchange rate pass-through following the depreciation in the exchange value of the rand throughout 2015, and the significant drought-induced acceleration in domestic food price inflation.

Headline consumer price inflation mostly exceeded the upper limit of the inflation target range in 2016 and only briefly receded to within the target range at 5.9% in August.[4] Overall consumer price inflation then accelerated further to 6.8% in December 2016, before slowing somewhat to 6.6% in January 2017. Although the recent quickening in consumer price inflation was initially driven by higher petrol prices and, to a lesser extent, higher food prices, inflation accelerated across a wide range of consumer goods and services categories in December. In February 2017 Stats SA released a reweighted and rebased headline consumer price index (CPI) for all urban areas, which was statistically linked to the previous headline CPI for all urban areas.

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

Box 2 The consumer price index reweighted and rebased

In February 2017 Statistics South Africa (Stats SA) published the most recent periodic revision of the weights and products – based on the classification of individual consumption by purpose (COICOP) – included in the consumer price index (CPI) basket, effective from January 2017. These revisions ensure that the CPI reflects the most recent consumer spending patterns, and that the reference period of the index remains appropriate and recent while adhering to international best practice.

Whereas the previous update of the CPI weights in February 2013 was based on results from the 2010/11 Income and Expenditure Survey (IES), the February 2017 update was based on Stats SA's Living Conditions Survey (LCS) conducted in 2014/15. According to Stats SA, the LCS surveys household expenditure in the same way as the IES, but also includes additional measures on poverty levels and trends.

The LCS collected information from 23 380 households across South Africa over a period of 12 months. The survey was conducted by applying a combination of the diary method and a recall questionnaire. Households documented their daily acquisitions in diaries provided by Stats SA over a period of two weeks and were also required to complete a household questionnaire over a four-week period. Similar to when the IES was utilised during previous revisions, it was necessary for Stats SA to augment the LCS results with additional data sources to attain more appropriate expenditure levels, and thus more accurate CPI weights. These additional sources included other Stats SA surveys, summarised transaction data from retailers, excise tax receipts, and data from industry associations and regulatory bodies.

The new CPI basket of goods and services contains 412 items, compared with 396 items in the previous basket. The items added to, and removed from, the basket are shown in the following table.

Items added to, and removed from, the new CPI basket

Items entering the basket	Items exiting the basket
Goods	
Food	**Food**
Savoury biscuits	Sweet corn (cream style)
Rusks	Tinned peas
Instant noodles	Spreads (Marmite and Bovril)
Frozen pastry products (pizzas or pies)	
Hot cereals (porridge)	
Ready-mixed flour	
Chicken giblets	
Corned beef	
Beef offal	
Mutton offal	
Fresh pears	
Peanuts	
Chewing gum	
Household contents	**Household contents**
Coffee mugs	Freezers
Sheets and pillow cases	Fans
Sandwich makers/toasters	Teapots
Cooking pots	
Transport	
Diesel	
Recreation	**Recreation**
Video games	Pre-recorded DVDs
Soccer balls	Blank CDs and DVDs
Toy cars	Board games
Crayons	Tennis balls
	Automated pool cleaners
	Health
	Public theatre and ward fees
	Communication
	Stamps

Items added to, and removed from, the new CPI basket

Items entering the basket	Items exiting the basket
Services	
Housing	
Levies for sectional title properties	
Transport	
Car wash/valet services	
Driving lessons	
Driving licence	
Car rental	

In addition to changing the composition of the basket somewhat, Stats SA also amended the groupings of certain products. In most cases, products previously grouped together are now separated and allocated a specific weight. Stats SA noted that the advantage of defining products more specifically is to facilitate the monitoring of prices that may be relevant for particular economic and policy purposes. These products are:

- beef, which previously had a single weight (although a number of different products were surveyed), will now have four specific beef products, each with their own weight, namely mince, stewing beef, steak and offal;
- frozen chicken portions, which are now classified as IQF [individually quick frozen] and non-IQF, each with their own weight;
- baby food, which is now split into baby cereal and baby formula;
- hamburgers, which previously formed part of meat-based dishes in the 'meals away from home' category, will now be a separate product; and
- hotels, and bed and breakfast establishments, which were previously one product, will now be separated.

The weights of 5 of the 12 main COICOP categories increased, while those of 6 decreased and 1 remained unchanged. The category that registered the largest weight increase is food and non-alcoholic beverages, from 15.41% in the previous basket to 17.24% in the new basket, mostly due to increased expenditure on hot and cold beverages, meat, fish, milk, eggs, cheese, fruit and the 'other food' category. Conversely, the proportion spent on bread and cereals, and on oils and fats fell. The weight of the recreation and culture category also increased substantially, from 4.09% in the previous basket to 5.16% in the new basket, largely due to increased expenditure on television subscriptions. The transport category's weight decreased the most, from 16.43% in the previous basket to 14.28% in the new basket, mainly as a result of decreases in the proportions for fuel, running costs and public transport. The weight of education decreased, from 2.95% in the previous basket to 2.53% in the new basket, due to decreases in the expenditure share of primary, secondary and tertiary education.

In line with international best practice, Stats SA price-updated the new set of weights and also rebased the CPI. The LCS recorded household expenditure values over a 12-month period. These values were inflated and deflated to the mid-point (i.e. May 2015). Stats SA then price-updated the May 2015 values with the relevant CPI indices to December 2016 – known as the 'weights reference period'. The final CPI weights were calculated from these price-updated expenditure values. The purpose of price-updating is to adjust the weights to account for differences in the relative price movements of goods and services since the LCS 2014/15 was conducted.

Since changes in the CPI represent a weighted average of price changes, revisions to the weights can have a significant effect on the level of, and changes in, the index. In order to reduce the impact of these changes and to obtain a continuous CPI time series, it is necessary to link the previous set of indices to the new set of indices. The practice of applying a base month instead of a base year was adopted in 2013. Stats SA rebased the CPI from an index level of 100 in December 2012 to an index level of 100 in December 2016. The previous and new indices were linked in December 2016, as the indices using the previous weights and those using the new weights all equal 100 in that month, as do all aggregations of the indices. The index levels for January 2017 were then calculated as usual (i.e. the sum of the lower-level indices multiplied by their weights).

In addition to the new set of weights, Stats SA also made additional changes to the monthly CPI publication, including:

- discontinuing the CPIs for primary and secondary urban areas while retaining the CPI for all urban areas;
- publishing additional tables with indices for 41 product groups for the total country, and for rural areas and each province; and
- in the interest of providing more information on inequality, expanding the number of expenditure groups for which it publishes CPIs from five (quintiles) to 10 (deciles).

Comparison of weights for the new and previous CPI basket

	New CPI (Per cent)	Previous CPI (Per cent)	Difference (Percentage points)
Food and non-alcoholic beverages	17.24	15.41	+1.83
Alcoholic beverages and tobacco	5.82	5.43	+0.39
Clothing and footwear	3.83	4.07	-0.24
Housing and utilities	24.62	24.52	+0.10
Household contents and services	4.35	4.79	-0.44
Health	1.40	1.46	-0.06
Transport	14.28	16.43	-2.15
Communication	2.63	2.63	0.00
Recreation and culture	5.16	4.09	+1.07
Education	2.53	2.95	-0.42
Restaurants and hotels	3.09	3.50	-0.41
Miscellaneous goods and services	15.05	14.72	+0.33
Goods	48.70	49.86	-1.16
Services	51.30	50.14	+1.16
Total	100.00	100.00	0.00

Following the reweighting and rebasing of the CPI, the headline CPI for all urban areas will remain the inflation target measure for monetary policy purposes. With the inclusion of diesel in the new CPI basket, where applicable, fuel now refers to petrol and diesel in, for example, the measures of underlying (or core) inflation.

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Statistics South Africa. 2017. 'Living conditions of households in South Africa: an analysis of household expenditure and income data using the LCS 2014/15', January. Pretoria: Statistics South Africa.

Statistics South Africa. 2017. 'Introduction of new weights and basket for the consumer price index', January. Pretoria: Statistics South Africa.

Most measures of *producer price inflation* accelerated notably in 2016, driven largely by higher international commodity prices and rising domestic food prices. Producer price inflation for final manufactured goods almost doubled from an annual average of 3.6% in 2015 to 7.0% in 2016, largely due to an acceleration in inflation for food products, coal and petroleum products, rubber and plastic products, machinery and transport equipment. Likewise, producer price inflation for intermediate manufactured goods accelerated from an annual average of 0.8% to 6.8% over the same period as price inflation accelerated in all of the major subcategories, notably chemical, rubber and plastic products; glass and glass products; and basic and fabricated metals.

Consumer and producer price inflation

Annual average percentage change

	Weights	2014	2015	2016	Jan 2017*
Headline consumer prices	100.00	6.1	4.6	6.4	6.6
Consumer goods	48.70	6.2	3.4	6.9	7.6
Consumer services	51.30	6.0	5.8	5.8	5.7
Producer prices					
Final manufactured goods	100.00	7.5	3.6	7.0	5.9
Intermediate manufactured goods	100.00	8.2	0.8	6.8	6.7
Electricity and water	100.00	9.9	11.1	10.4	10.0
Mining	100.00	4.2	-4.1	11.5	10.7
Agriculture, forestry and fishing	100.00	5.3	4.7	16.4	-2.9

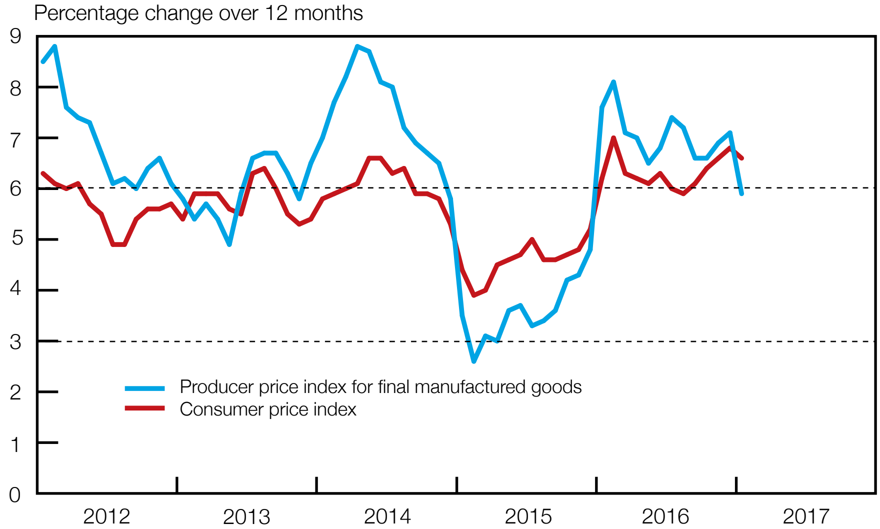
* Changes in prices from January 2016 to January 2017

Source: Stats SA

The recovery in international commodity prices in 2016, together with the depreciation in the exchange value of the rand throughout 2015, caused producer price inflation for mining products (prices of domestically produced mining commodities) to accelerate sharply from an annual average of -4.1% in 2015 to 11.5% in 2016. Similarly, reflecting the effect of the prolonged drought, producer price inflation for agriculture, forestry and fishing products quickened notably from an annual average of 4.7% in 2015 to 16.4% in 2016. Producer price inflation for electricity and water – both administered prices – remained elevated in 2016, moderating marginally from an annual average of 11.1% in 2015 to 10.4% in 2016. In 2016, electricity price inflation moderated somewhat, while producer price inflation for water accelerated sharply.

Headline consumer and producer price inflation

Percentage change over 12 months

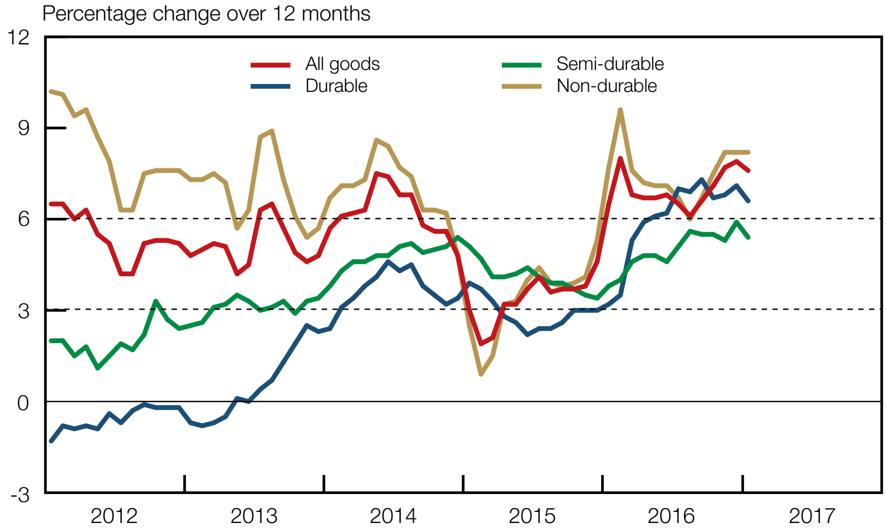


Source: Stats SA

Consumer *goods price inflation* remained the main driver of overall consumer price inflation in 2016. Given its dominant weight in the consumer goods basket, recent movements in consumer goods price inflation was largely shaped by changes in non-durable goods price inflation, in particular petrol price inflation. Consumer goods price inflation quickened notably from 6.1% in August 2016 to 7.8% in December, before moderating slightly to 7.6% in January 2017. Likewise, non-durable goods price inflation quickened from 6.1% to 8.2% in December 2016 and January 2017, driven largely by higher food and petrol prices.

Apart from the recent acceleration in non-durable goods price inflation, durable and semi-durable goods price inflation accelerated throughout 2016, amounting to 7.1% and 5.9% respectively in December. Higher durable and semi-durable goods price inflation may reflect some delayed exchange rate pass-through following the depreciation in the exchange value of the rand in 2015, evident in a fairly broad range of product categories such as new vehicles, household appliances, clothing and footwear, books and stationery. Both durable and semi-durable goods price inflation slowed in January 2017, to 6.6% and 5.4% respectively.

Consumer goods price inflation



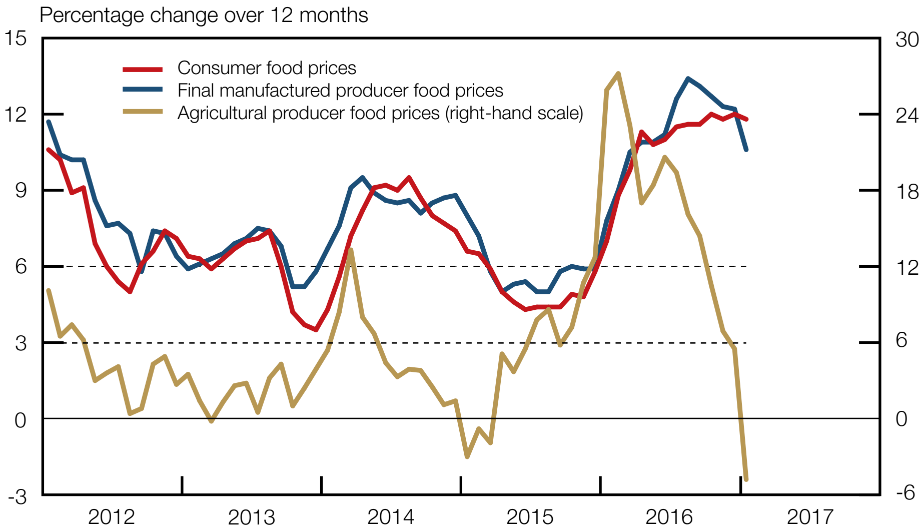
Source: Stats SA

By contrast, *consumer services price inflation* remained fairly stable in 2016 and moderated gradually from 6.1% in February to 5.6% in November. Subsequently, consumer services price inflation accelerated to 5.9% in December due to an increase in housing and utility services inflation, restaurant and hotel services, and recreation and culture services, before moderating once again to 5.7% in January 2017.

International *food prices*, in US dollar terms, rose throughout 2016 and into the opening months of 2017. The international food price index of the Food and Agriculture Organization (FAO) of the United Nations (UN), in US dollars, recorded its highest value in 23 months in January 2017, driven largely by a surge in sugar prices, and higher cereal and vegetable oil prices. However, the 12-month change in the rand-denominated FAO food price index moderated to -3.2% in January 2017, supported by the appreciation in the exchange value of the rand. International cereal prices fell continuously over the past four years, suppressed by ample global supplies, good harvest prospects and the strengthening in the US dollar. However, international cereal prices rose marginally in recent months but remained below their level of a year ago. Aided by the appreciation in the exchange value of the rand, the year-on-year change in the FAO international cereals price index (expressed in rand terms) moderated markedly from 21.8% in May 2016 to -18.5% in January 2017.

Domestic agricultural producer food price inflation slowed significantly in recent months, from double-digit rates during most of 2016 to -4.8% in January 2017. Producer price inflation of cereals and other crops receded markedly on account of expectations of a much improved domestic maize crop in 2017. Likewise, fruit and vegetable price inflation moderated notably following good rainfall in many parts of the country. By contrast, live animal producer price inflation accelerated markedly from 5.3% in November 2016 to 12.4% in January 2017 as higher demand for meat during the festive season coincided with the rebuilding of herds by farmers after the drought.

Producer and consumer food prices



Source: Stats SA

Producer food price inflation at the manufactured level responded to the significant slowdown in agricultural producer food price inflation with a slight lag, moderating from a recent peak of 13.4% in August 2016 to 10.6% in January 2017. Despite the recent moderation, the majority of manufactured producer food price subcategories still recorded double-digit rates of increase in January 2017. In addition, substantial pass-through from the notable acceleration in live animal price inflation became visible in the prices of manufactured meat and meat products, as price inflation in this category accelerated from 3.6% in September 2016 to 12.4% in January 2017.

Food prices

Annual average percentage change

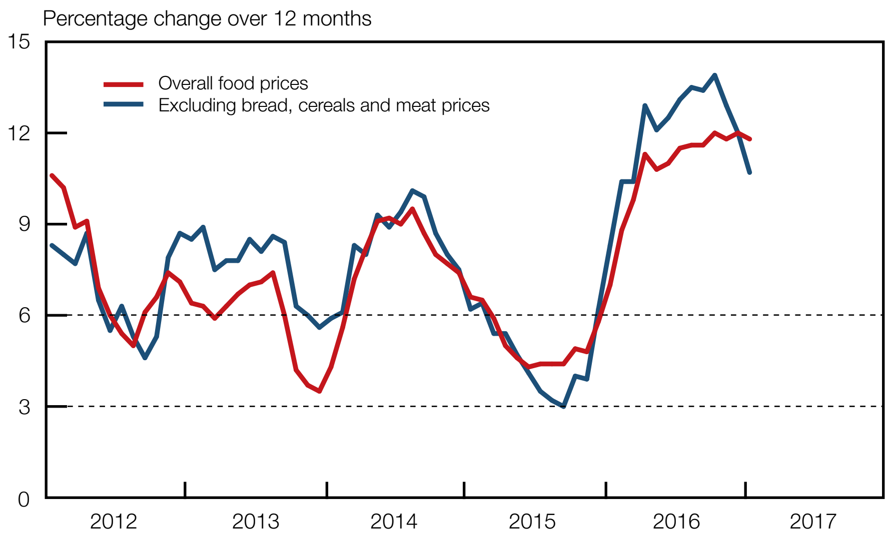
	2015	2016	Jan 2017*
Agricultural producer prices	5.1	17.1	-4.8
Manufactured producer food prices...........	5.8	11.4	10.6
Consumer food prices	5.1	10.8	11.8

* Changes in prices from January 2016 to January 2017

Source: Stats SA

In contrast to producer food price inflation, food price inflation at the consumer level accelerated throughout 2016 to 12.0% in December, before moderating marginally to 11.8% in January 2017. On an annual average basis, consumer food price inflation more than doubled from 5.1% in 2015 to 10.8% in 2016, reflecting the impact of the prolonged drought on domestic food prices. The acceleration in consumer food price inflation was fairly broad-based throughout 2016. When excluding the prices of bread, cereals and meat (together accounting for 56% of the consumer food price basket) consumer food price inflation accelerated briskly, peaking at 14.4% in October 2016 before slowing to 10.7% in January 2017. Although this measure of consumer food price inflation receded in recent months, overall food price inflation remained elevated due to a continued acceleration in bread and cereals price inflation to 17.4% in December 2016 – its highest level since April 2009. In addition, consumer meat price inflation accelerated in the latter months of 2016, from 5.0% in September to 8.9% in January 2017. Although all meat subcategories registered price increases over this period, the acceleration was most pronounced in poultry prices, which was likely affected by an outbreak of Avian flu in Europe in November and the implementation of import tariffs on frozen bone-in chicken from the European Union (EU) in December.

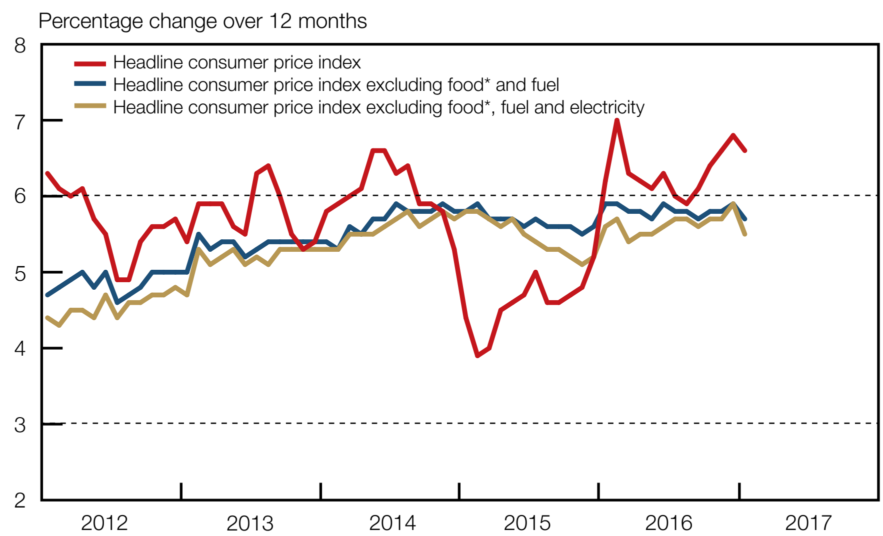
Consumer food price inflation



Sources: Stats SA and SARB

Most measures of *underlying inflation* accelerated somewhat in the opening months of 2016 and then moved broadly sideways up to November. In December 2016, however, all measures of underlying inflation accelerated closer to the upper limit of the inflation target range, before receding again in January 2017. Excluding the impact of food, non-alcoholic beverages and fuel prices from the calculation of headline inflation, the resultant measure of underlying inflation accelerated somewhat from 5.7% in September 2016 to 5.9% in December, before slowing again to 5.7% in January 2017. When further excluding electricity prices, underlying inflation remained broadly unchanged at around 5.7% between July and November 2016, before also accelerating to 5.9% in December. The gradual upward movement in this measure of underlying inflation throughout 2016 resulted largely from an acceleration in exchange rate sensitive goods price inflation following the depreciation in the exchange value of the rand in 2015. However, this measure of underlying inflation moderated to 5.5% in January 2017 due to slowing services, and durable and semi-durable goods price inflation.

Headline and underlying measures of consumer price inflation

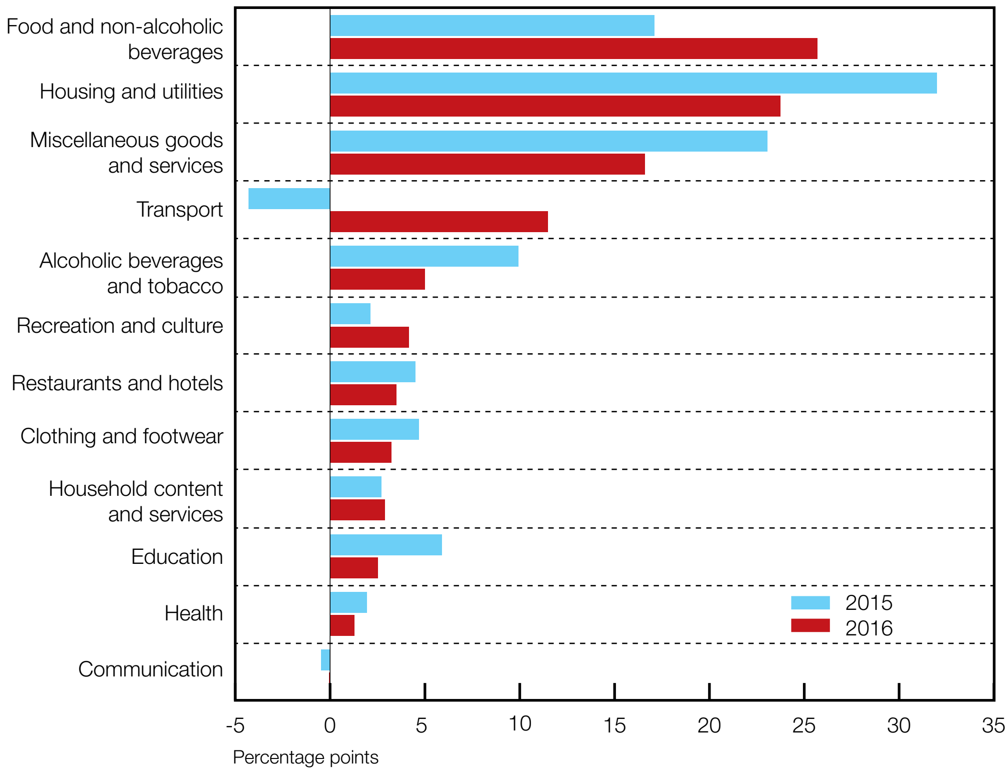


* Food includes non-alcoholic beverages

Source: Stats SA

The escalation in inflationary pressures from 2015 to 2016 is corroborated by price changes based on the classification of individual consumption by purpose (COICOP) categories. In 2016, annual average consumer price inflation exceeded the upper limit of the inflation target range in 5 of the 12 COICOP categories, compared with 4 in 2015. In addition, annual average price inflation accelerated in seven COICOP categories in 2016, while moderating in the other five. The accompanying figure shows that food and non-alcoholic beverages were the main contributors to annual consumer price inflation in 2016, surpassing housing and utilities which contributed the most in 2015. A notable change occurred in the contribution of the transport category, which moved from the last position in 2015 to the fourth position in 2016. This resulted from an acceleration in price inflation for new vehicles and petrol following the depreciation in the exchange value of the rand in 2015, together with rising international crude oil prices throughout 2016.

Contributions to annual average headline consumer price inflation by COICOP category



Source: Stats SA

Movements in *administered price inflation* largely reflected changes in petrol prices throughout 2016. A marked slowdown in petrol price inflation from 20.7% in February 2016 to -7.2% in August resulted in administered price inflation slowing from 11.5% to 2.0% over the same period. Subsequently, administered price inflation accelerated to 6.2% in January 2017 on account of higher fuel prices.

Administered price inflation, excluding fuel prices, moderated from 8.5% in January and February 2016 to 5.7% in July, and remained at this rate up to January 2017. Administered price inflation, excluding both fuel and electricity prices, moderated from 7.1% in January 2016 to 5.0% in January 2017.

Average headline inflation expectations in the fourth quarter of 2016, as measured in the *Inflation Expectations Survey* conducted by the BER, moved lower over the entire forecast period. Average headline inflation expectations for 2017 decreased by 0.2 percentage points to 5.8% from the previous quarter. Analysts, business people and trade union representatives all lowered their expectations – this was the first instance since the third quarter of 2015 that average inflation expectations for 2017 fell below the upper limit of the inflation target range. On balance, survey participants also lowered their inflation expectations for 2018 to 5.8%.

Headline consumer price inflation expectations

Per cent, as surveyed in the fourth quarter of 2016

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2016..	6.3	6.0	5.8	6.0
2017..	5.6	6.0	5.7	5.8
2018..	5.4	6.0	5.9	5.8
The next five years	5.5	6.1	5.9	5.8

Source: BER, Stellenbosch University

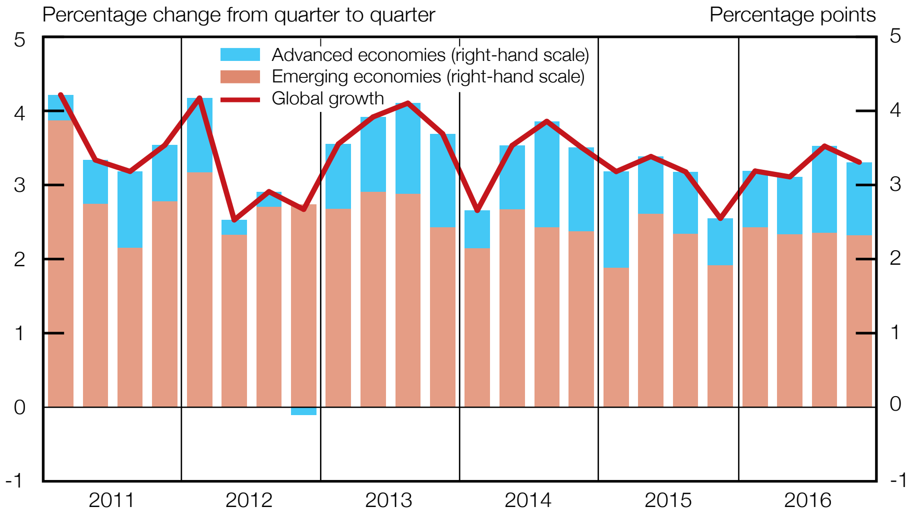
Average five-year inflation expectations receded marginally from 5.9% in the third quarter of 2016 to 5.8% in the fourth quarter. Households also lowered their inflation expectations gradually from a recent peak of 7.1% in the second quarter of 2015 to 6.0% in both the third and fourth quarters of 2016.

Foreign trade and payments

International economic developments

Growth in real global output weakened marginally to an annualised rate of 3.3% in the fourth quarter of 2016 from 3.5% in the third quarter. The deceleration reflected a slowdown in advanced economies. Real output growth in advanced economies slowed to 2.1%, mainly due to a disappointing fourth quarter in the United States (US). By contrast, real GDP in emerging market economies expanded by 4.5% in the fourth quarter of 2016, unchanged from the growth rate posted in the previous quarter.

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



Seasonally adjusted annualised rates

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

In its January 2017 *World Economic Outlook Update*, the International Monetary Fund (IMF) left its global growth forecasts for 2017 and 2018 unchanged at 3.4% and 3.6% respectively. The outlook for advanced economies improved somewhat over this two-year horizon, reflecting stronger activity during the second half of 2016 as well as expected fiscal stimulus in the US. This contrasts with the less favourable prospects for emerging market economies, notably Brazil, India and Mexico.

Real output growth in the US slowed to a weaker than expected 1.9% in the fourth quarter of 2016, significantly below the 3.5% recorded in the third quarter. This slowdown was mainly due to a decline in net exports (the result of a stronger US dollar) and a moderation in the growth of personal consumption expenditure. This resulted in annual GDP growth of only 1.6% in 2016 – the weakest growth rate in five years. The Federal Open Market Committee (FOMC) raised the target for the federal funds rate by 25 basis points to a range of 0.75%–1% at its March 2017 meeting. This increase followed a 25 basis point increase in December 2016. US consumer price inflation accelerated to 2.5% in January 2017, while the personal consumption expenditure (PCE) price index, the US Federal Reserve's preferred inflation measure, increased to 1.9%.

Real output growth in the Japanese economy slowed from 1.3% in 2015 to 1.0% in 2016. Real output increased by 1.2% in the fourth quarter of 2016, unchanged from the pace registered in the third quarter. Headline inflation (the measure used by the Bank of Japan (BoJ) for its inflation target) remained in positive territory for the fourth consecutive month, amounting to 0.4% in January 2017. Core inflation (excluding fresh food) moved into positive territory for the first time in 13 months, measuring 0.1% in January 2017. The BoJ expects inflation to meet its target of 2.0% in the 2018/19 fiscal year. Furthermore, the BoJ is committed to deliberately overshooting the inflation target to encourage a sustained rise in inflation expectations.

Real growth in selected advanced economies

Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Country/region	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2015 Year*	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 Year*
United States................	2.0	2.6	2.0	0.9	2.6	0.8	1.4	3.5	1.9	1.6
Japan...........................	5.3	0.0	0.6	-1.0	1.3	1.9	2.2	1.2	1.2	1.0
Euro area.......................	3.3	1.6	1.1	2.0	1.9	2.1	1.3	1.7	1.6	1.7
United Kingdom	1.0	1.9	1.1	2.8	2.2	0.6	2.3	2.3	2.9	2.0
Canada	-1.0	-0.4	2.3	0.5	0.9	2.7	-1.2	3.8	2.6	1.3
Australia	4.4	0.8	2.9	2.2	2.4	4.3	3.1	-2.0	4.4	2.4
New Zealand	0.3	0.5	3.8	4.4	2.5	2.8	2.7	4.3	1.7	3.2
Advanced economies...	**2.7**	**1.6**	**1.7**	**1.3**	**2.1**	**1.6**	**1.6**	**2.4**	**2.1**	**1.7**

* Percentage change over one year
Underlined numbers indicate projections. Some regional totals include countries with forecasted data.

Sources: Bloomberg, national statistical offices and own calculations

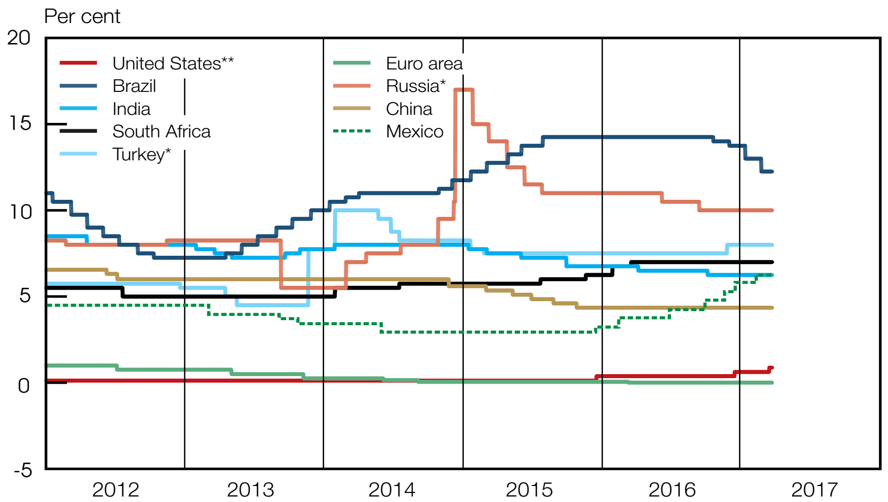
For the euro area as a whole, real GDP growth decelerated marginally from 1.7% in the third quarter of 2016 to 1.6% in the fourth quarter, hindered by slower growth in Italy, Portugal and the Netherlands. Annual growth for 2016 was also slightly weaker at 1.7% compared to 1.9% for 2015. Meanwhile, headline consumer price inflation in the euro area accelerated to 2.0% in February 2017, largely reflecting higher energy prices. The European Central Bank (ECB) expects headline inflation to pick up further in the near term. However, core inflation remained unchanged at 0.9% and the ECB expects underlying inflationary pressures to remain subdued. The ECB kept the monetary policy stance unchanged in March 2017 after reducing the pace of quantitative easing purchases to €60 billion from €80 billion in December 2016, but confirmed that quantitative easing would continue until at least December 2017.

Real economic growth in the United Kingdom (UK) accelerated to 2.9% in the fourth quarter of 2016 from 2.3% in the third quarter, mainly due to a surge in exports and final consumption by households. The Bank of England (BoE), at the February 2017 Monetary Policy Committee meeting, revised growth forecasts for 2017 and 2018 upwards to 2.0% and 1.6% respectively. Meanwhile, consumer price inflation reached an almost three-year high of 1.8% in January 2017, while core inflation (excluding energy and unprocessed food) remained unchanged at 1.5%. The BoE expects inflation to quicken substantially over the coming months and to breach the central bank's target of 2% in the first half of 2018 due to the impact of sterling depreciation following the UK's decision to leave the EU. The BoE left its current policy stance unchanged at 0.25% in February and March 2017.

The monetary policy settings in advanced economies showed some divergence as the US growth outlook appears more robust than that of other advanced economies. The FOMC raised the target for the federal funds rate above the long-standing zero lower bound in December 2015, while other major advanced economies have kept policy rates as low as technically possible. Divergent policies were also evident among emerging market economies. The central banks of Mexico and Turkey tightened monetary policy due to the weak exchange values of their currencies, while several other emerging markets eased policy because of subdued economic growth performances or declining inflationary pressures.

Real economic growth in emerging Asia decelerated somewhat to 6.0% in the fourth quarter of 2016 from 6.5% in the third quarter. Real GDP growth in China slowed marginally to 6.6% in the fourth quarter from 6.8% in the third quarter. Producer price inflation continued to accelerate, reaching a 16-year high of 7.8% in February 2017, while consumer price inflation moderated sharply to 0.8%.

Policy interest rates in selected advanced and emerging economies



* Russia and Turkey adopted new policy tools in September 2013 and January 2014 respectively. The old and new policy rates are shown on the same line in the figure.
** Middle of range

Sources: Bloomberg and national central banks

Real output growth in India slowed significantly to 5.1% in the fourth quarter of 2016 from 7.4% in the previous quarter. The slowdown in economic growth was mostly attributed to the demonetisation initiative which removed the 500- and 1 000-denomination rupee notes as legal tender. These two denominations accounted for roughly 86% of all cash in circulation in India and, as such, disrupted consumption expenditure. After moderating since mid-2016, consumer price inflation in India accelerated from 3.2% in January 2017 to 3.7% in February. Following several reductions over the past two years, the Reserve Bank of India kept its policy rate unchanged at 6.25% in February 2017, given expectations that below-target inflation will be temporary.

Real output growth in selected emerging market economies

Quarter-to-quarter percentage change at seasonally adjusted annualised rates

	2015					2016				
Country/area	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3	Q4	Year*
China............................	6.7	7.2	6.8	6.4	6.9	6.6	7.1	6.8	6.6	6.7
India	5.5	13.3	7.6	3.9	7.9	10.2	6.6	7.4	5.1	7.0
Indonesia.......................	4.3	4.8	5.0	6.3	4.9	3.7	5.9	4.2	5.8	5.0
Emerging Asia	**6.0**	**8.3**	**6.6**	**5.6**	**6.7**	**7.1**	**6.7**	**6.5**	**6.0**	**6.4**
Russia	-10.1	-4.1	0.4	-1.6	-3.7	1.2	-1.9	0.4	1.5	-0.5
Turkey	7.9	5.7	4.8	7.5	6.1	-1.5	4.4	-1.1	2.4	2.1
Poland...........................	6.1	2.0	4.9	4.1	3.9	0.0	4.1	1.6	7.0	2.8
Emerging Europe..........	**-2.0**	**-0.5**	**2.6**	**1.9**	**0.3**	**0.6**	**1.2**	**0.3**	**2.8**	**1.1**
Brazil	-3.8	-8.6	-6.0	-4.7	-3.8	-2.4	-1.3	-2.9	-3.4	-3.6
Mexico	2.5	3.3	2.3	1.6	2.6	1.9	0.4	4.3	2.9	2.3
Argentina.......................	7.1	7.0	0.3	-2.4	2.6	-3.3	-7.5	-0.9	3.7	-2.3
Latin America	**0.0**	**-1.7**	**-1.2**	**-1.4**	**0.1**	**-1.3**	**-1.6**	**0.1**	**0.0**	**-1.1**
Emerging economies....	**3.7**	**5.1**	**4.6**	**3.8**	**4.1**	**4.7**	**4.5**	**4.5**	**4.5**	**4.0**

* Percentage change over one year
Underlined numbers indicate projections. Some regional totals include countries with forecasted data.

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

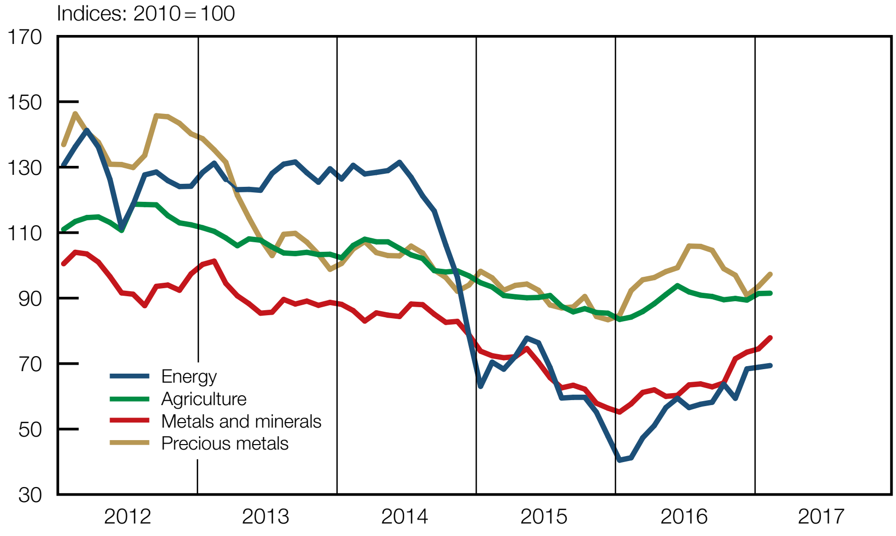
By contrast, economic growth in Indonesia accelerated to 5.8% in the fourth quarter of 2016 from 4.2% in the third quarter, and consumer price inflation accelerated to 3.8% in February 2017 from 3.5% in the previous month. The Bank of Indonesia also kept the policy interest rate unchanged at 4.75% in February 2017 after reducing it by a cumulative 50 basis points during 2016.

Real output growth in emerging Europe rebounded strongly to 2.8% in the fourth quarter of 2016 from 0.3% in the third quarter. Russia's GDP expanded for a second successive quarter in the fourth quarter of 2016, with growth accelerating from 0.4% in the third quarter to a projected 1.5% in the fourth quarter. Real economic growth in Turkey likely rebounded to 2.4% in the fourth quarter of 2016 after contracting by 1.1% in the previous quarter. Turkish consumer price inflation accelerated to 10.1% in February 2017 – the highest reading in almost five years. By contrast, inflation in Russia slowed further, from a recent peak of 16.9% in March 2015 to 4.6% in February 2017. Inflation in Poland rose to 1.8% in January 2017 – the highest in more than four years – due to the continuing depreciation of the zloty. Despite the acceleration, inflation remained slightly below the midpoint of the central bank's inflation target (2.5% plus/minus 1.0 percentage point). The central banks of Russia and Poland kept policy rates unchanged in February and March 2017 at 10.0% and 1.5% respectively. Meanwhile, Turkey's central bank kept the policy rate unchanged at its January 2017 meeting – after raising it by 50 basis points to 8.0% at its November 2016 meeting – but nonetheless tightened monetary policy further by increasing the overnight repurchase and late liquidity window rates.

Real economic activity in Latin America remained stagnant in the fourth quarter of 2016. Mexico, the region's second largest economy, lost some momentum in the fourth quarter of 2016 after experiencing solid growth in the third quarter. Brazil's economy declined by 3.4% in the fourth quarter of 2016 – the eighth successive quarter of economic contraction. By contrast, preliminary indicators suggest that growth rebounded in Argentina. Consumer price inflation in Brazil decelerated to a six-year low of 4.8% in February 2017, prompting the central bank to reduce the policy rate by 75 basis points to 12.25%. This marked the fourth rate cut in the current easing cycle. While other central banks in the region held rates steady, the Mexican central bank raised the policy rate by 50 basis points to 6.25% in February 2017, following a similar increase in November. The Mexican monetary authority attributed the decision to the recent depreciation of the peso.

Global trade improved noticeably towards the end of 2016. According to the CPB Netherlands Bureau for Economic Policy Analysis, world trade volumes (calculated as the three-month average of world exports relative to that of the preceding three months) expanded by an annualised 6.9% in December 2016, up from 2.9% in the previous month. Growth in export volumes of advanced economies accelerated from 3.2% in November 2016 to 5.8% in December. In emerging market economies, export volumes increased by 8.1%, following an expansion of 2.5% in the previous month.

International commodity prices

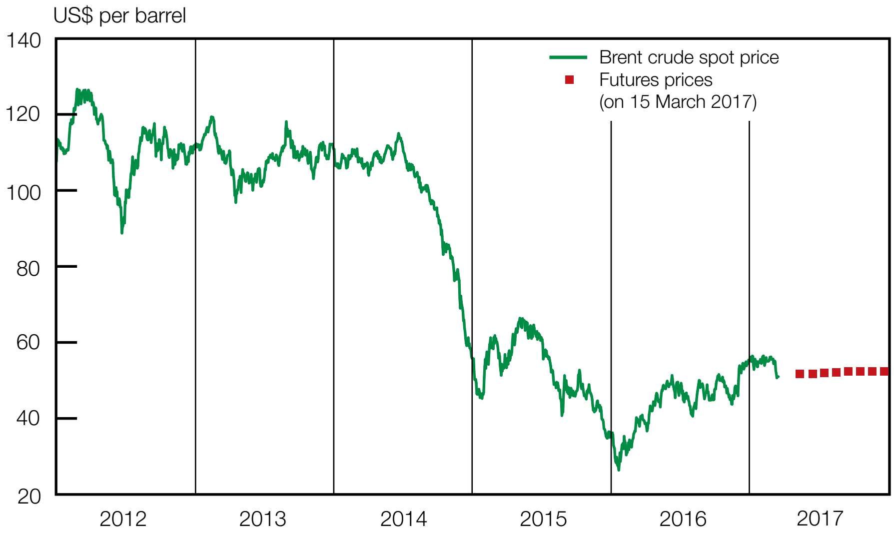


Source: World Bank

Most commodity prices staged a recovery in 2016 from lows at the beginning of the year and maintained an upward trend at the start of 2017. Energy prices increased by 20.5% from August 2016 to February 2017. Over the same period, metal and mineral prices increased by 22.1%. Precious metal prices decreased by 8.0% over the period, while agricultural commodity prices remained broadly unchanged.

The price of Brent crude oil (which accounts for 84.5% of the weight in the World Bank's energy index) increased significantly from a recent low of US$44 per barrel in November 2016 to an average of US$54 per barrel in December. This followed an agreement by the Organization of the Petroleum Exporting Countries (OPEC) to reduce oil production by 1.2 million barrels per day and by non-OPEC producers to cut output by 0.6 million barrels per day. Oil prices were trading in a narrow range of around US$55 per barrel in January and February 2017. However, Brent crude oil prices declined to US$51 per barrel in mid-March 2017 as Saudi Arabia raised output and US crude inventories reached new record high levels following a surge in US shale production due to the higher oil prices. Brent crude oil futures prices for delivery in the second half of 2017 were trading at levels of around US$52 per barrel in mid-March.

International crude oil prices



Source: Bloomberg

Current account[5]

South Africa's trade balance switched from a deficit of R7 billion in the third quarter of 2016 to a surplus of R56 billion in the fourth quarter. This reflected an increase in the export earnings of domestic producers amid improved foreign demand for domestically produced goods and higher prices of selected commodities. Domestic demand for foreign-produced goods, in particular intermediate goods, slowed for the second consecutive quarter resulting in the contraction in the value of merchandise imports in the fourth quarter. On an annual basis, the trade balance improved markedly to a surplus of R15 billion in 2016 from a deficit of R38 billion in 2015. The improvement in 2016 reflected both a narrowing in the trade deficits with Europe and Asia, and a widening trade surplus with Africa.

The improvement in the trade balance coincided with a narrowing of the shortfall on the services, income and current transfer account, from R159 billion in the third quarter of 2016 to R132 billion in the fourth quarter. Accordingly, the deficit on the current account of the balance of payments narrowed from R166 billion to R76 billion over the same period. As a ratio of GDP, the deficit narrowed from 3.8% in the third quarter of 2016 to 1.7% in the fourth quarter. For 2016 as a whole, the ratio narrowed to 3.3% from 4.4% in 2015.

5 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

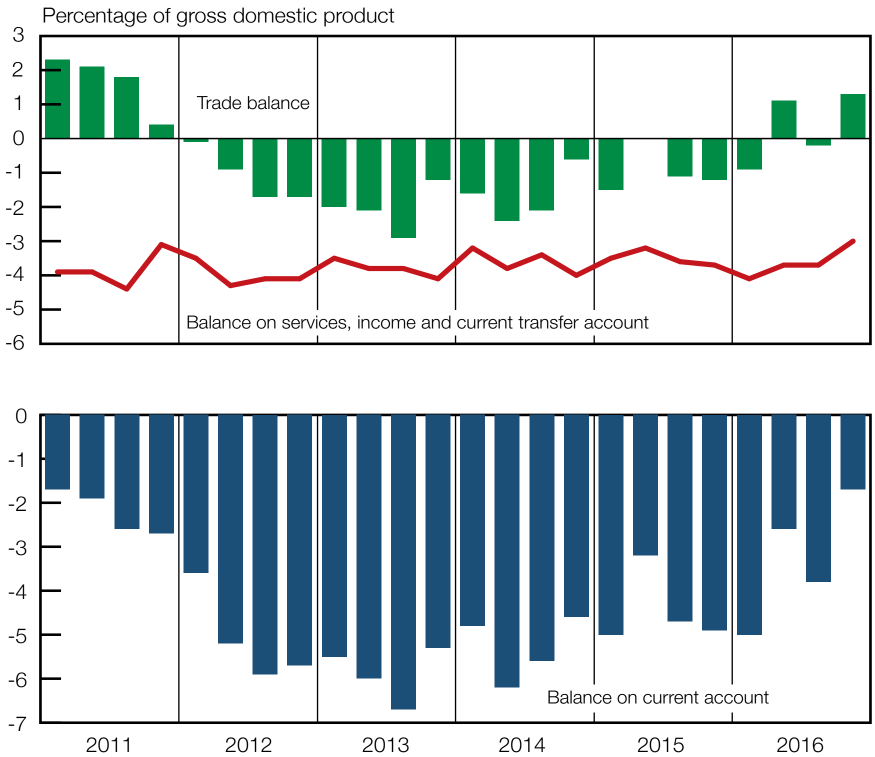
	2015					2016				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Merchandise exports.........	944	978	979	982	971	1 006	1 104	1 033	1 071	1 054
Net gold exports................	63	71	65	72	68	52	54	47	49	51
Merchandise imports.........	-1 065	-1 048	-1 087	-1 105	-1 076	-1 097	-1 110	-1 086	-1 065	-1 090
Trade balance...................	-59	1	-43	-51	-38	-39	48	-7	56	15
Net service, income and current transfer payments..	-135	-127	-146	-151	-140	-173	-160	-159	-132	-156
Balance on current account.............................	-194	-126	-189	-203	-178	-212	-113	-166	-76	-142
As a percentage of GDP	*-4.9*	*-3.1*	*-4.6*	*-4.9*	*-4.4*	*-5.0*	*-2.6*	*-3.8*	*-1.7*	*-3.3*

Components may not add up to totals due to rounding off

Sources: Stats SA and SARB

The value of merchandise exports increased by 3.7% in the fourth quarter of 2016 following a notable decline of 6.4% in the third quarter. The fourth-quarter increase reflected the higher export value of mining products that more than offset a decrease in the value of exported manufactured goods. Following a brief contraction in the third quarter of 2016, the value of mining exports rebounded strongly in the fourth quarter, largely due to an increase in the export earnings of mineral products, mainly iron ore and coal. Apart from the rise in the international prices of these commodities in the fourth quarter of 2016, a surge in the value of coal exports also reflected the continued recovery in the volume of exported coal following the brief maintenance shutdown of the Richards Bay coal export line in the third quarter. The volume of exported iron ore increased by approximately 11% in the fourth quarter of 2016, buoyed by stronger demand for the mineral from China, Japan, South Korea and the Netherlands.

Balance of payments: current account

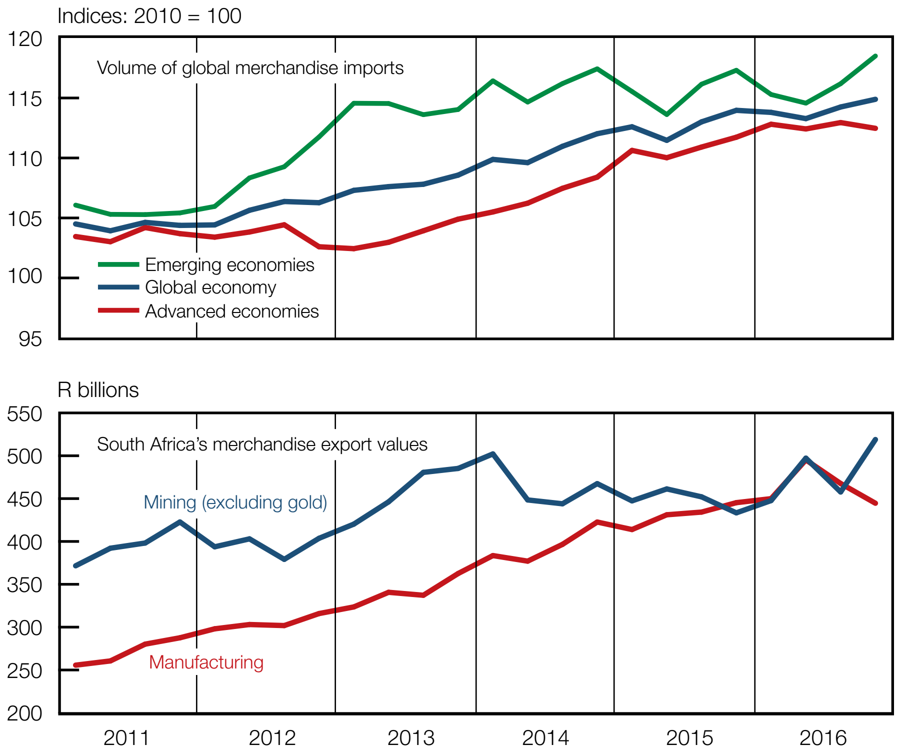


Seasonally adjusted and annualised

Sources: Stats SA and SARB

The export value of platinum group metals decreased in the fourth quarter of 2016, affected by the breakdown of a smelter in September. Nonetheless, the value of all exported mining products increased by 13.4% in the fourth quarter of 2016, lifting the export earnings of domestic mining companies by 7.1% for the year as a whole.

Global demand and South Africa's merchandise export values



Seasonally adjusted and annualised

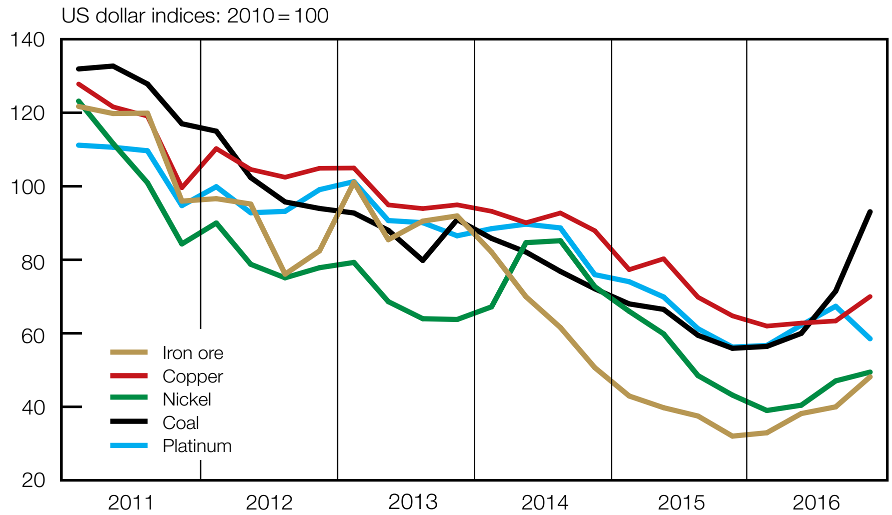
Sources: CPB Netherlands Bureau for Policy Analysis, Stats SA and SARB

The value of exported manufactured products contracted by 4.9% in the fourth quarter of 2016, weighed down by a decrease in the export values of vehicles and transport equipment, machinery and electrical equipment as well as optical and professional equipment. The value of exported vehicles and transport equipment declined for a second consecutive quarter due to a sharp decline in passenger and light commercial vehicle exports. Despite the poor performance of the domestic manufacturing sector in external markets in the second half of 2016, the value of exported manufactured goods advanced by 7.7% for the year as a whole.

The total volume of exported bulk and break bulk cargo handled at South Africa's national ports increased in the fourth quarter of 2016 alongside a rise of 2.9% in the volume of merchandise exports. Supported by a rise in the final quarter of 2016, the ratio of real merchandise exports to GDP edged higher from 23.9% in 2015 to 24.2% in 2016.

The US dollar price of a basket of South African-produced non-gold export commodities increased significantly by 10.1% in the fourth quarter of 2016, following gains of 6.2% in the third quarter. The international prices of coal and iron ore increased noticeably in the fourth quarter of 2016. The international prices of copper and nickel also rose in the fourth quarter, but the price of platinum declined by 13%. The rise in international commodity prices supported the total rand price of merchandise exports. However, the strengthening in the external value of the rand in the final quarter of 2016 constrained the pace of increase, resulting in the price increasing only marginally by 0.7% over the period.

International prices of selected South African export commodities



Source: World Bank

The volume of South Africa's net gold exports increased by 17.5% in the fourth quarter of 2016, supported by strong international demand for domestically produced gold, especially from India. In addition, several central banks purchased gold in the international markets during the final quarter of 2016 – Russia: 72.5 tonnes, China: 4.1 tonnes, Jordan: 3.1 tonnes and Kazakhstan: 6.5 tonnes. Nevertheless, the volume of net gold exports contracted on an annual basis by 38.4% in 2016, in line with lower gold production by domestic miners.

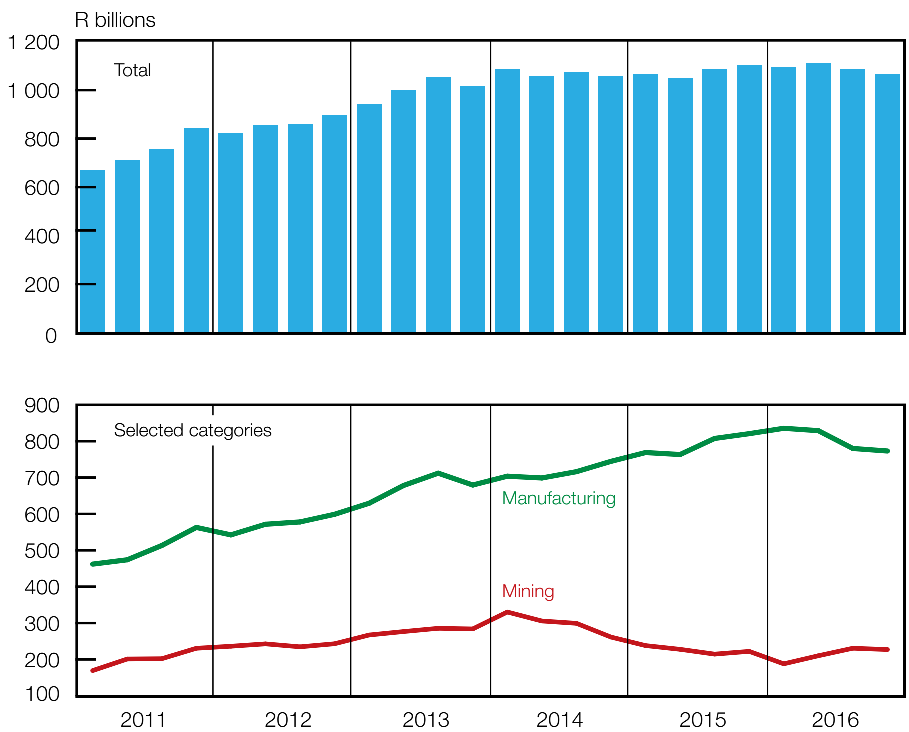
The US dollar price of gold on the London market decreased by 8.7%, from an average of US$1 335 per fine ounce in the third quarter of 2016 to US$1 219 per fine ounce in the fourth quarter, as investors favoured the US dollar as a safe haven. The average realised rand price of net gold exports declined by 9.5% in the fourth quarter of 2016. This decline was exacerbated by the increase in the external value of the rand in the quarter. The overall export earnings of South African gold producers increased by 6.3% in the fourth quarter of 2016, but contracted by 25.2% for the year as a whole.

The value of merchandise imports remained fairly stable in 2016, but contracted somewhat in the second half of the year. The contraction of 2.0% in the fourth quarter of 2016 largely reflected a decline in the rand price of imported goods which more than offset an increase in the volume. Despite rising inflation in South Africa's trading-partner countries in the fourth quarter of 2016, the average rand price of imported goods dropped further by 3.1% in the quarter after having declined by 1.4% in the third quarter. This could be attributed to the appreciation in the exchange value of the rand over the period which more than neutralised the external inflationary pressures.

The value of imported mining products decreased marginally in the fourth quarter of 2016 as a decrease in the value of imported pearls and semi-precious stones, and base metals and articles of base metals more than countered a rise in the value of imported mineral products. The latter reflected a sharp increase in the import value of refined oil products which rose amid the shutdown of a refinery for maintenance over the period. The decline in mining imports occurred alongside a decrease in the value of manufactured imports, which resulted from lower imports of vehicles and transport equipment as well as textiles and textile articles in the fourth quarter of 2016, although the former included an aircraft to the value of about R600 million. These decreases fully offset a rise in the value of machinery and electrical equipment, which included equipment for the maintenance of a power plant. For 2016 as a whole, the value of merchandise imports increased by 1.2% compared with an increase of 0.6% in 2015.

After three consecutive quarterly declines, the volume of merchandise imports rose by 1.2% in the final quarter of 2016. Although the import penetration ratio increased somewhat in the fourth quarter, domestic demand remained weak throughout 2016, with the ratio declining from 26.6% in 2015 to 25.8% in 2016.

Total merchandise imports

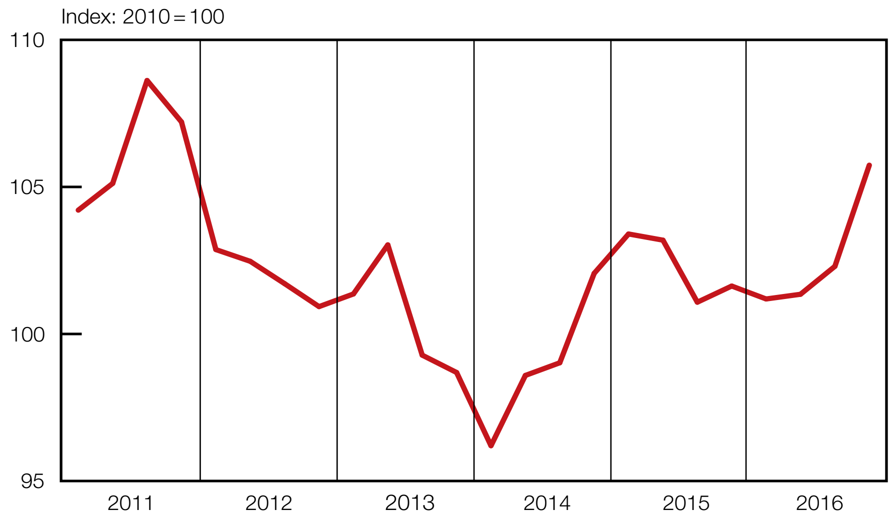


Seasonally adjusted and annualised

Sources: Stats SA and SARB

South Africa's terms of trade improved further in the fourth quarter of 2016 as the rand prices of merchandise exports increased, while that of merchandise imports decreased. The terms of trade also improved for 2016 as a whole.

Terms of trade*



* Including gold

Sources: Stats SA and SARB

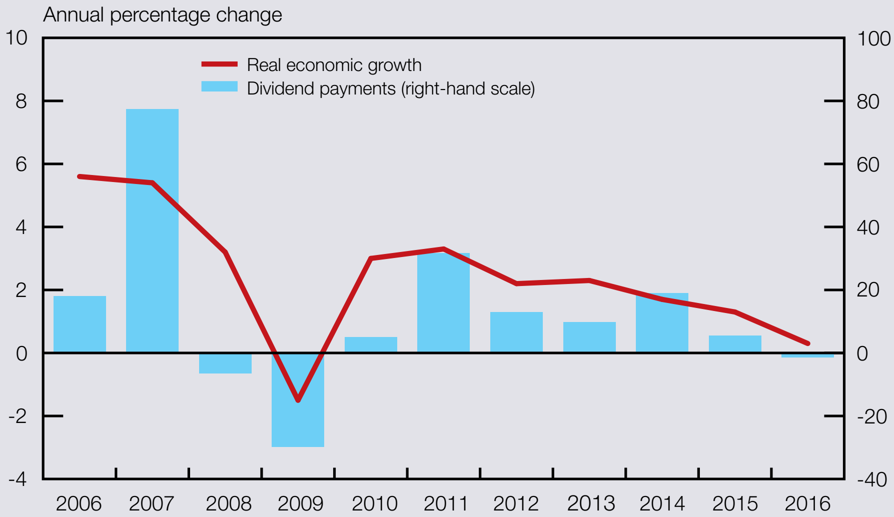
The deficit on the services, income and current transfer account decreased significantly by 17% in the fourth quarter of 2016. Relative to GDP, the deficit improved from 3.6% in the third quarter of 2016 to 3.0% in the fourth quarter. However, on an annual basis, the ratio increased marginally from 3.5% in 2015 to 3.6% in 2016.

The narrowing in the shortfall on the services, income and current transfer account in the fourth quarter of 2016 can largely be ascribed to a distinct improvement in the net income deficit, as dividend receipts from abroad increased rather strongly. Nonetheless, dividend receipts for 2016 as a whole were almost 20% lower than in 2015. The annual decline could largely be attributed to lower dividend receipts from direct investment relationships. This compares with the exceptionally high annual average growth rate in dividends received from abroad of 40% during the previous four calendar years. The upward surge in dividend receipts in the fourth quarter of 2016 was partially countered by an increase in dividend payments to foreign investors, albeit at a slower pace. However, the overall amount of dividend payments to the rest of the world contracted in 2016, marking the first decline since the global financial crisis of 2008–09 (see the accompanying box).

Box 3 Dividend payments to non-residents and real economic growth

Dividend payments to non-residents contracted marginally by almost 1.5% in 2016 following a gradual loss of momentum after 2011. This marked the first annual contraction in dividend payments to non-residents since 2008–09, in the wake of the global financial crisis. Generally, slow (or negative) growth in dividend payments is associated with sluggish growth in real gross domestic product (GDP). As such, the contraction in dividend payments to non-residents alongside weak real GDP growth in 2016 is no exception. Dividend payments can be affected by either 'push' factors where dividends are largely driven by company profits which are determined by economic growth, or 'pull' factors which often reflect the liquidity needs of parent companies or major shareholders abroad.

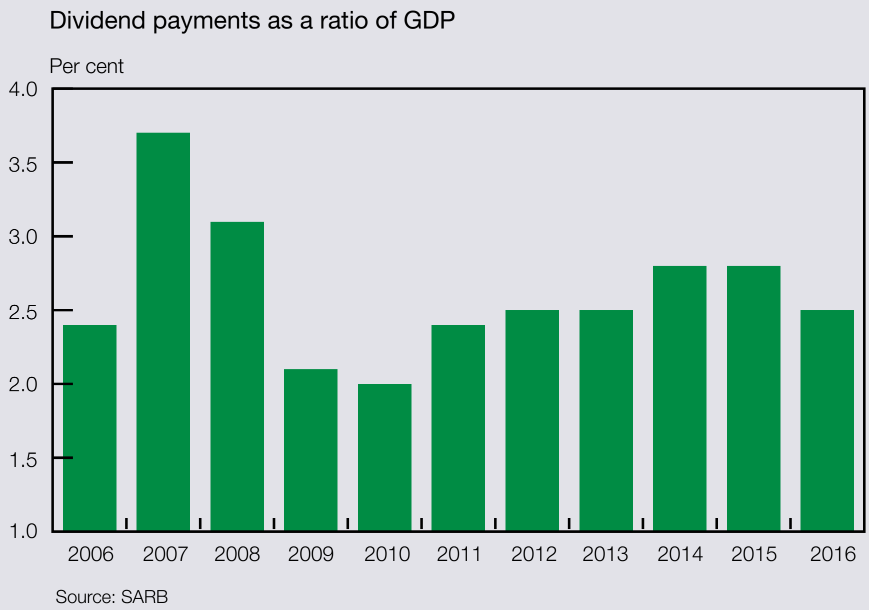
Growth in dividend payments and real economic acitivity



Sources: Stats SA and SARB

Expressed as a share of GDP, dividend payments to non-residents reached an all-time high of 3.7% in 2007 in step with strong real economic growth, but then decreased notably to 2% in 2010 in the aftermath of the global financial crisis. Subsequently, this ratio picked up gradually to 2.8% in 2014 and 2015, before moderating slightly to 2.5% in 2016.

Changes in dividend payments to non-residents have a significant impact on the payments side of the services, income and current transfer account of the balance of payments, representing on average 24% from 2010 to date. Therefore, changes in dividend payments to non-residents are an important determinant of the size of the deficit on the overall current account of the balance of payments. As such, the slower growth in dividend payments to non-residents over the past two years has contributed materially to lowering the deficit on the current account of the balance of payments.



The improvement in the shortfall on the services, income and current transfer account in the fourth quarter of 2016 was further supported by a smaller deficit in net payments for services, which was largely driven by an increase in gross travel receipts. The latter increased by about 11% for 2016 as a whole following a growth rate of only 4% in 2015, signifying growth in the number of foreign tourists that visited South Africa in 2016.

Financial account

The net inflow of capital on South Africa's financial account of the balance of payments (including reserve assets but excluding unrecorded transactions) moderated from a sizeable R52.3 billion in the third quarter of 2016 to R5.6 billion in the fourth quarter.

Net financial transactions

R billions

	2015		2016				
	Q4	Year	Q1	Q2	Q3	Q4	Year
Change in liabilities							
Direct investment	14.3	22.0	11.4	8.6	7.0	6.5	33.5
Portfolio investment	4.2	121.3	31.5	51.0	55.5	16.3	154.3
Financial derivatives	-103.0	-320.9	-149.6	-103.8	-116.1	-129.8	-499.3
Other investment	44.2	72.3	-6.7	-13.8	26.3	-4.8	1.0
Change in assets							
Direct investment	-38.5	-73.2	-22.3	-6.5	-1.4	-19.5	-49.7
Portfolio investment	-13.3	1.3	39.3	0.1	-19.2	80.5	100.7
Financial derivatives	103.3	325.8	148.5	94.4	115.0	127.7	485.6
Other investment	47.9	46.8	14.9	2.9	-22.5	-17.5	-22.2
Reserve assets	-5.1	9.1	4.2	1.2	7.8	-53.8	-40.6
Total identified financial transactions*	54.0	204.4	71.3	34.0	52.3	5.6	163.2
As a percentage of GDP	*5.2*	*5.0*	*6.8*	*3.2*	*4.8*	*0.5*	*3.8*

* Including reserve assets but excluding unrecorded transactions
Inflow (+) outflow (-)
Source: SARB

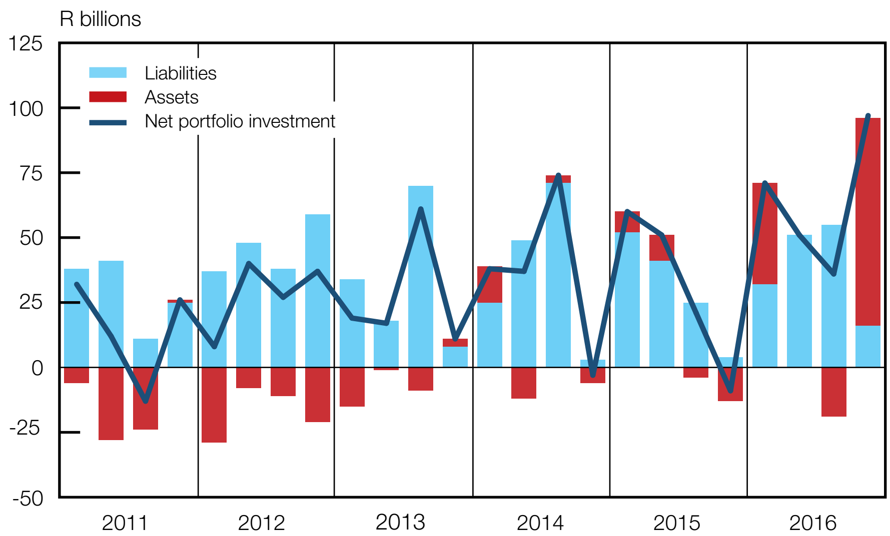
On a net basis, only portfolio investment recorded an inflow, while the other functional categories recorded outflows in the fourth quarter. Nevertheless, the cumulative inflows on the financial account still amounted to R163.2 billion in 2016 compared to R204.4 billion in 2015. Overall, financial account inflows amounted to 0.5% of GDP in the fourth quarter of 2016, down from 4.8% of GDP in the third quarter. For 2016 as a whole, financial account inflows amounted to 3.8% of GDP compared to 5.0% in 2015.

Foreign-owned assets in South Africa

South Africa's direct investment liabilities recorded inflows of R6.5 billion in the fourth quarter of 2016 following an inflow of R7.0 billion in the third quarter. The inflow during the fourth quarter originated primarily from an increase in the share of non-resident equity investment in domestic companies, which was partly offset by the repayment of short-term loans by domestic subsidiaries to foreign parent companies. Cumulative inward direct investment increased by R33.5 billion in 2016 compared to R22.0 billion in 2015.

Inward portfolio investment flows into South Africa amounted to only R16.3 billion in the fourth quarter of 2016, following inflows of R51.0 billion and R55.5 billion in the second and third quarter respectively. Non-resident investors accumulated debt securities to the value of R28.3 billion in the fourth quarter of 2016 compared to an inflow of R44.7 billion in the third quarter. The acquisition of debt securities in the fourth quarter of 2016 largely reflected the issuance of two international bonds to the combined value of US$3 billion by national government, of which approximately US$0.7 billion was offset in a switch and tender offer. In addition, US$1 billion worth of international bonds were issued by a private sector company. These inflows were partly countered by the disposal of domestic rand-denominated debt securities by foreign investors in anticipation of a further rise in US bond yields following expectations of more increases in the federal funds rate. On an annual basis, inward investment into South African debt securities amounted to R128.8 billion in 2016, significantly more than the R16.2 billion in 2015. Non-residents disposed of domestic equity securities to the value of R12.0 billion in the fourth quarter of 2016, compared to an acquisition of R10.7 billion during the third quarter, amid concerns regarding the outcome of South Africa's credit ratings review. On 6 December 2016, Moody's Investors Service and Standard & Poor's kept South Africa's long-term foreign currency credit ratings unchanged with a negative outlook. For 2016 as a whole, non-resident investors acquired equity securities to the value of R25.4 billion, notably less than the R105.1 billion acquired in 2015.

Portfolio investment flows



Source: SARB

South Africa experienced other investment outflows of R4.8 billion in the fourth quarter of 2016 following an inflow of R26.3 billion in the third quarter. Other investment liabilities decreased as the repayment of short-term foreign loans by the domestic banking sector and the private non-banking sector more than countered an increase in deposits of non-residents with domestic banks. Inflows related to other investment liabilities were fairly muted in 2016, amounting to a meagre R1.0 billion compared to inflows of R72.3 billion in 2015. In 2016, other investment inflows were weighed down by the repayment of long-term foreign loans by the domestic banking sector and the repayment of short-term foreign loans by the domestic private non-banking sector.

Box 4 Revision of equity portfolio investment statistics in South Africa's balance of payments

The ever-increasing complexities of the financial markets in South Africa necessitate a frequent review of the South African Reserve Bank's (SARB) approach to collecting and compiling balance of payments statistics. During this process, the SARB validates primary source data and interrogates relevant additional data sources. In addition to using data from the JSE Limited (JSE), the SARB uses supplementary data sources such as stock positions of debt securities (and now also stock positions of equity securities) from South Africa's Central Securities Depository (Strate), to generate its own portfolio investment statistics.

In 2014 the SARB revised its estimates of inward debt portfolio investment flows, which resulted in a significant decline in the value of unrecorded transactions. The current revision is merely a continuation of the review process with a focus on equity portfolio investment flows. The SARB noted the gradual increase in public companies with listings on the JSE as well as on foreign stock exchanges, from less than 50 companies at the end of 2010 to about 90 at the end of February 2017. The SARB then researched the complex nature of trading activities in the shares of these companies in consultation with the relevant data providers, such as the JSE and Strate, for the period 2011 to 2016.

It became apparent that in the case of the movement of shares of public companies between the South African and offshore share registers, arbitrage transactions were not fully recorded; the capital inflows emanating from residents' sales on offshore exchanges were recorded as part of unrecorded transactions. The inflow of capital, in this instance, is reflected as a decline in the foreign assets of residents and is accompanied by an inflow of capital as depicted in the category 'net acquisition of financial assets' of the financial account of the balance of payments (see the table on the next page). The net result is that South Africa attracted more equity portfolio inflows than had previously been reported. Similarly, the positive value of transactions previously classified as 'unrecorded transactions' is now lower and in some instances negative.

The revised trading statistics of shares in public companies with listings on the JSE as well as on foreign stock exchanges are now comprehensively captured and included in the equity portfolio investment flows of the balance of payments. As in the previous revision, the flow and stock data of equity investment are now better aligned as a result of enhanced coverage of the movement of shares between domestic and offshore share registers.

As a result of the availability of more detailed data, the SARB is now also in a position to further disaggregate non-resident purchases and sales of shares listed on the JSE between 'net incurrence of liabilities' and 'net acquisition of financial assets'. Non-resident net portfolio purchases from and sales to residents in companies with a head office in South Africa are classified as 'portfolio investment – net incurrence of liabilities', while resident net portfolio purchases from and sales to non-residents in companies with a head office abroad are classified as 'portfolio investment – net acquisition of financial assets'.

Net equity portfolio investment statistics were revised from the first quarter of 2011 up to the third quarter of 2016. The magnitude of these revisions is shown in the table below.

Selected balance of payments categories

R billions

	Before revision					After revision					
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015	2016
Net portfolio investment................	32.6	84.1	58.0	49.1	69.6	57.0	112.4	107.2	145.7	122.6	255.0
Net incurrence of liabilities..........................	86.4	117.7	69.5	73.4	106.0	114.6	182.1	130.2	146.9	121.3	154.3
Equity and investment fund shares......................	-26.6	-5.2	8.4	26.8	89.8	1.7	59.1	69.1	100.4	105.1	25.4
Net acquisition of financial assets...................	-53.8	-33.6	-11.5	-24.3	-36.4	-57.6	-69.7	-23.0	-1.2	1.3	100.7
Equity and investment fund shares......................	-37.3	-21.0	-10.6	-14.7	-17.8	-41.2	-57.1	-22.1	8.4	20.0	108.8
Balance on financial account	65.9	173.2	130.4	150.2	151.3	90.3	201.5	179.6	246.8	204.4	163.2
Unrecorded transactions........................	0.9	-6.5	77.5	51.3	22.7	-23.5	-34.8	28.3	-44.8	-26.7	-21.8

Source: SARB

South African-owned assets abroad

South African entities' direct investment abroad advanced by R19.5 billion in the fourth quarter of 2016, from R1.4 billion in the third quarter, as domestic private sector companies further increased their equity holdings in foreign subsidiaries and associates. The increase in equity investment resulted largely from the acquisition of a foreign company by a domestic health care group. Notwithstanding the firm increase in outward foreign direct investment flows in the final quarter of 2016, this category recorded outflows of R49.7 billion in 2016 following outflows of R73.2 billion in 2015.

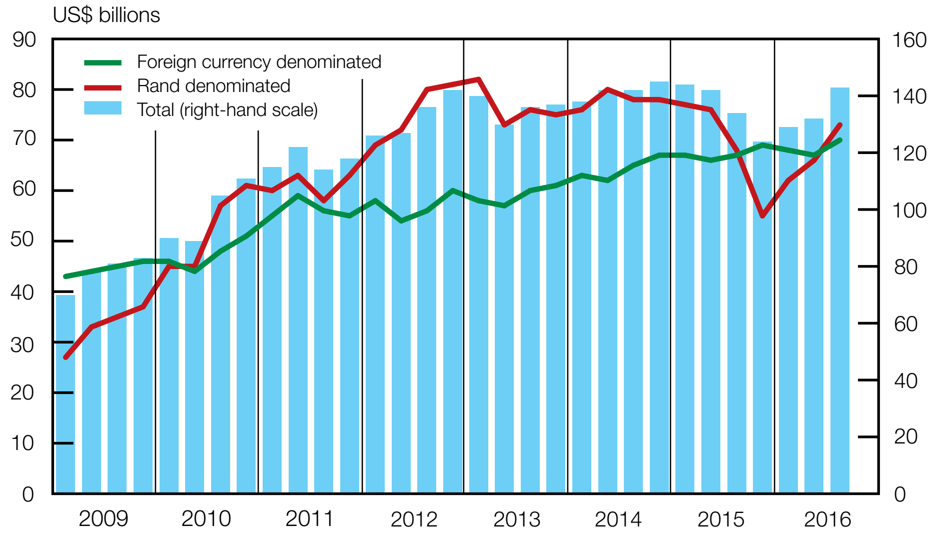
South African residents disposed of foreign portfolio assets to the value of R80.5 billion in the fourth quarter of 2016 following the acquisition of such assets to the value of R19.2 billion in the third quarter. The decline in foreign portfolio assets arose from the payment to domestic shareholders for their share in a company in the alcoholic beverages sector, as the company was acquired by a foreign entity. South African investors sold foreign portfolio assets amounting to R100.7 billion in 2016 compared to a marginal disposal of portfolio assets to the value of R1.3 billion in 2015.

Outflows related to other investment assets amounted to R17.5 billion in the fourth quarter of 2016 following an outflow of R22.5 billion in the third quarter, as the domestic banking sector increased its deposits with banks abroad and the domestic private sector extended loans to non-residents. For 2016 as a whole, other investment outflows amounted to R22.2 billion compared to inflows of R46.8 billion in 2015.

Foreign debt

South Africa's total outstanding foreign debt increased further from US$132.4 billion at the end of the second quarter of 2016 to US$143.0 billion at the end of the third quarter, buoyed by a substantial rise in rand-denominated debt, while foreign currency-denominated debt increased somewhat. In rand terms, however, South Africa's gross external debt rose marginally from R1 955 billion to R1 998 billion over the same period as a result of the strengthening of the rand against the US dollar.

Total external debt



Source: SARB

Foreign currency-denominated external debt increased from US$66.9 billion at the end of the second quarter of 2016 to US$70.4 billion at the end of the third quarter, after having declined for two consecutive quarters. The increase in foreign currency-denominated external debt was mainly driven by short-term loan obligations of 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 12 months) increased markedly from 42.8% of total foreign currency-denominated debt at the end of June 2016 to 47.0% at the end of September.

Foreign debt of South Africa

US$ billions at end of period

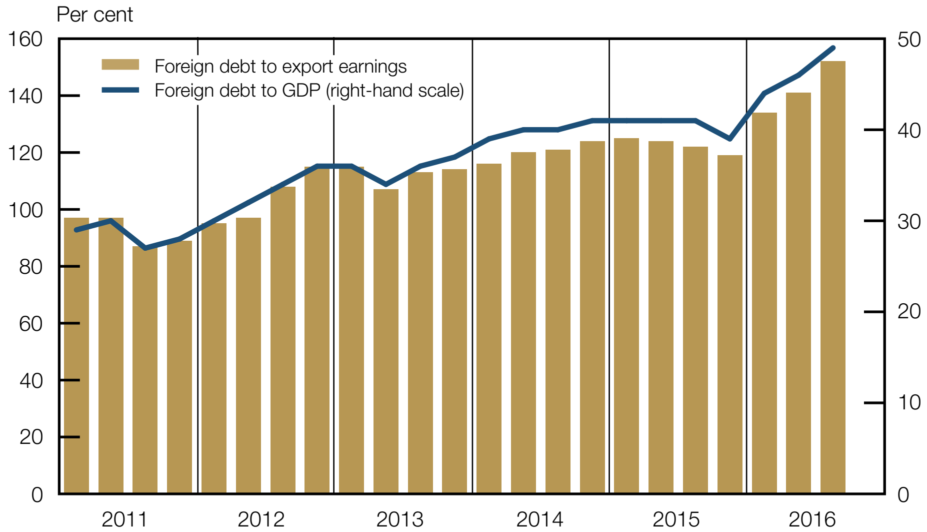
	2015			2016		
	Q2	Q3	Q4	Q1	Q2	Q3
Foreign currency-denominated debt...............	65.7	66.6	69.3	67.6	66.9	70.4
Debt securities	23.9	23.9	23.3	22.7	22.5	21.9
Other...	41.8	42.8	46.0	45.0	44.4	48.5
Public sector	7.7	7.8	7.7	8.1	8.0	8.1
Deposit-taking institutions............................	16.3	16.5	19.9	17.9	16.8	20.6
Non-monetary private sector	17.8	18.5	18.4	19.0	19.6	19.8
Rand-denominated debt	76.0	67.9	54.8	61.7	65.5	72.6
Debt securities...	38.8	34.5	28.7	32.9	36.2	42.2
Other	37.2	33.4	26.1	28.8	29.3	30.4
Total foreign debt	141.7	134.5	124.1	129.3	132.4	143.0
As a percentage of GDP..............................	*41.2*	*40.5*	*39.1*	*43.2*	*45.8*	*49.6*
As a percentage of total export earnings......	*123.9*	*121.9*	*119.2*	*133.9*	*141.1*	*154.2*

Source: SARB

South Africa's rand-denominated external debt, expressed in US dollars, increased substantially to US$72.6 billion at the end of the third quarter of 2016, nearing levels last recorded at the end of June 2015. Net purchases by non-residents of domestic government bonds were mainly responsible for the increase in rand-denominated debt over the period. The ratio of rand-denominated debt to total external debt increased from 49.5% at the end of June 2016 to 50.8% at the end of September, breaching the 50% mark for the first time since the end of September 2015.

South Africa's external debt as a ratio of annualised GDP increased from 45.8% in June 2016 to 49.6% in September, averaging 42.8% for the past eight quarters. Concomitantly, the ratio of the county's external debt to export earnings rose from 141.1% to 154.2% over the same period.

External debt ratios



Source: SARB

International investment position

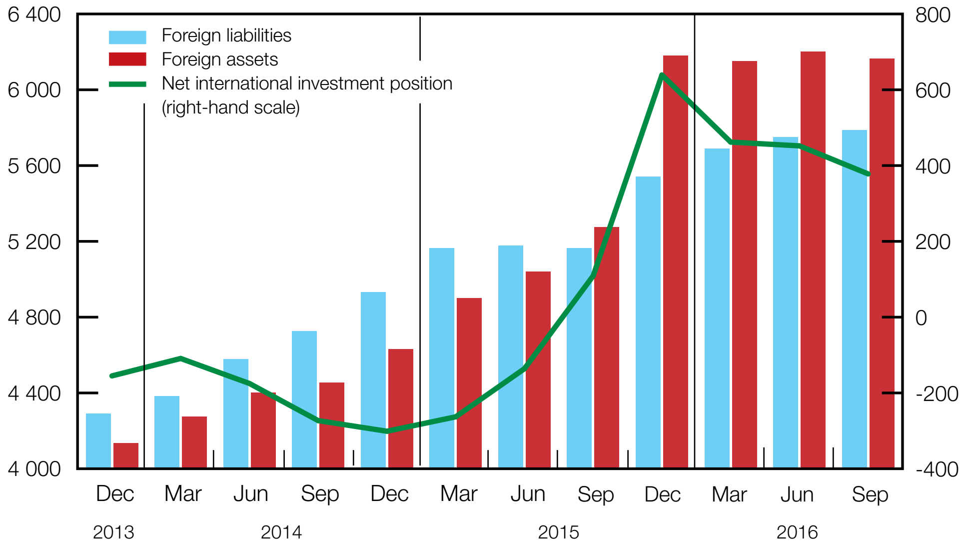
South Africa's positive net international investment position (IIP) narrowed from R452 billion at the end of June 2016 to R378 billion at the end of September, as the country's foreign liabilities increased while foreign assets declined somewhat.

The market value of South Africa's foreign liabilities (inward investment) increased for a fourth consecutive quarter up to the end of September 2016. However, the pace of increase slowed to 0.7% in the third quarter of 2016 as foreign liabilities only increased from R5 750 billion at the end of June 2016 to R5 788 billion at the end of September. The increase reflected marginal increases in the market value of all functional categories, except direct investment. While the JSE All-Share Index declined by 0.5% from the end of June 2016 to the end of September, portfolio investment liabilities increased, mainly on account of non-resident acquisitions of domestic debt securities. 'Other investment' liabilities increased largely on account of an increase in short-term loan liabilities of the banking sector. However, the increase in the country's foreign liabilities was countered by the 5.7% appreciation of the exchange value of the rand against the US dollar.

The market value of South Africa's foreign assets (outward investment) decreased marginally in the third quarter of 2016 to R6 166 billion at the end of September 2016 compared to R6 202 billion at the end of June. The value of foreign assets decreased by 0.5% in the third quarter of 2016 compared to an increase of 0.8% in the preceding quarter. The decrease occurred in all functional categories, except direct investment. Market valuation adjustments reduced the stock of portfolio investment, financial derivatives, 'other investment' and reserve assets, while a further positive valuation of a large direct investment holding increased the country's foreign direct investment asset position.

As a ratio of South Africa's annual GDP, the country's foreign liabilities decreased from 138.2% at the end of June 2016 to 136.7% at the end of September, while the country's foreign assets declined from 149.1% to 145.6% over the same period. This resulted in the country's positive net IIP retreating further to 9.0% of GDP at the end of September 2016 compared to 10.9% at the end of June.

South Africa's international investment position



Source: SARB

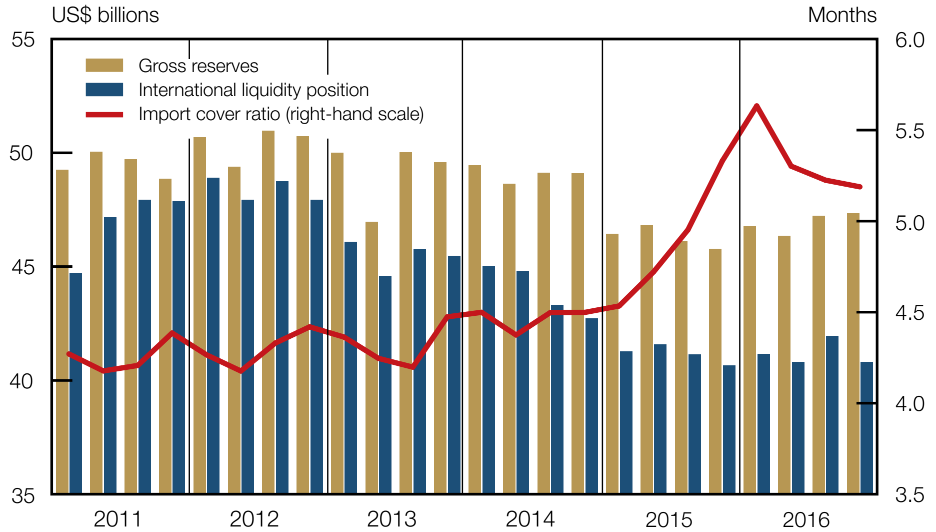
International reserves and liquidity

South Africa's international reserves increased by R53.8 billion in the fourth quarter of 2016 after decreasing by R7.8 billion in third quarter. For 2016 as a whole, the country's reserves increased by R40.6 billion, following a decrease of R9.1 billion in 2015.

The US dollar value of South Africa's gross gold and other foreign reserves (i.e. the international reserves of the SARB before accounting for reserves-related liabilities) increased marginally from US$47.2 billion at the end of September 2016 to US$47.4 billion at the end of December, before decreasing to US$46.7 billion at the end of February 2017. The level of import cover (i.e. the value of gross international reserves relative to the value of the imports of goods and services, and income payments) remained roughly unchanged at 5.2 months from the end of September 2016 to the end of December.

South Africa's international liquidity position decreased from US$42.0 billion at the end of September 2016 to US$40.8 billion at the end of December, before increasing to US$41.5 billion at the end of February 2017.

International reserves



Source: SARB

Exchange rates

The external value of the rand strengthened further in the fourth quarter of 2016, appreciating on balance by 7.4% on a trade-weighted basis. The exchange value of the rand was supported by reduced uncertainty in both global and domestic financial markets. In October and November 2016, the trade-weighted exchange rate of the rand appreciated by 3.5% and 0.2% respectively amid a prudent medium-term budget policy statement. Sentiment towards the South African rand improved in December 2016 as two prominent international credit rating agencies decided to keep South Africa's sovereign credit ratings unchanged. However, further gains in the local currency were limited by a stronger US dollar following a widely anticipated increase in the US federal funds rate in December.

Exchange rates of the rand

Percentage change

	31 Mar 2016 to 30 Jun 2016	30 Jun 2016 to 30 Sep 2016	30 Sep 2016 to 31 Dec 2016	31 Dec 2016 to 14 Mar 2017
Weighted average*	2.1	5.6	7.4	1.9
Euro	2.9	5.0	9.0	1.8
US dollar	0.8	5.7	2.5	3.0
Chinese yuan	3.6	6.1	6.8	2.5
British pound	7.7	9.6	8.2	4.4
Japanese yen	-7.9	3.9	18.7	1.3

* Trade-weighted exchange rate against a basket of 20 currencies (nominal effective exchange rate)
Depreciation– appreciation +

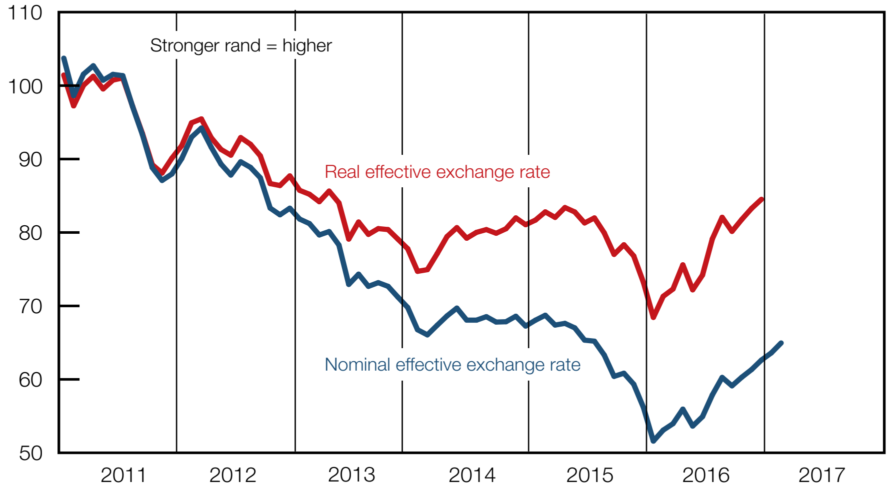
Source: SARB

In January and February 2017 the domestic currency appreciated by 4.7% against the US dollar, mainly due to broad-based US dollar weakness and some indications of improved economic conditions in both developed and emerging market economies. The domestic currency was also supported by positive global risk sentiment and higher international commodity prices.

The nominal effective exchange rate of the rand increased on balance by 18.7% in 2016 compared to a decrease of 19.7% in 2015. While the rand appreciated against the currencies of most advanced economies in 2016 such as the US dollar, the euro and the British pound, it depreciated against those of some emerging market peers such as the Brazilian real and the Russian rouble.

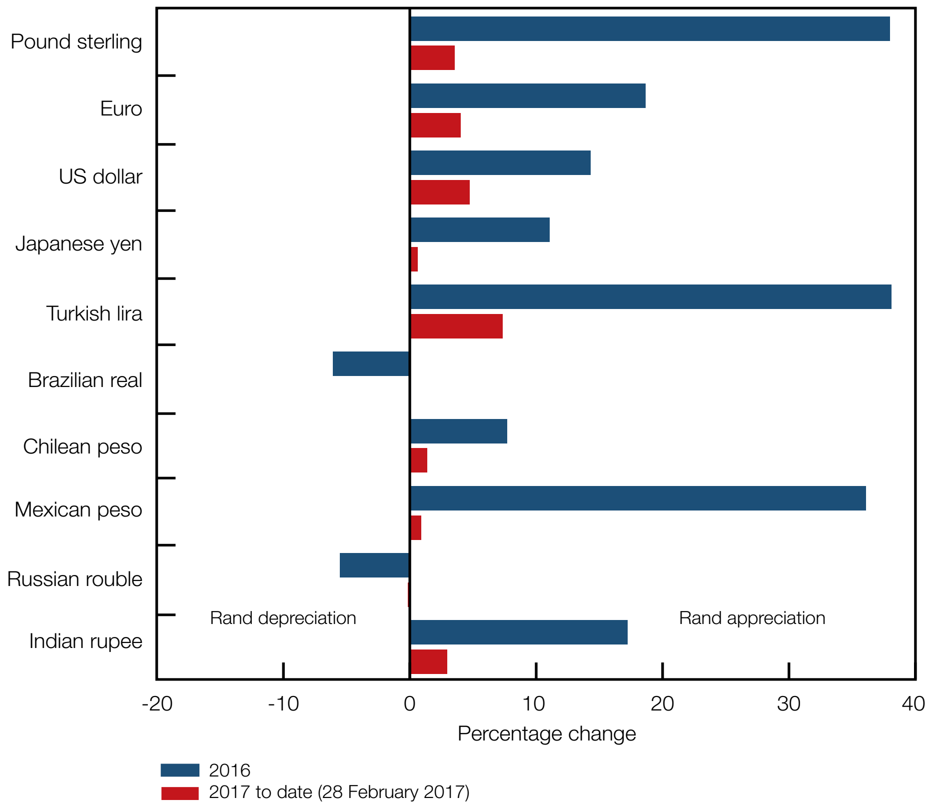
Effective exchange rates of the rand

Indices: 2010 = 100



Source: SARB

Selected exchange rates: South African rand per foreign currency unit



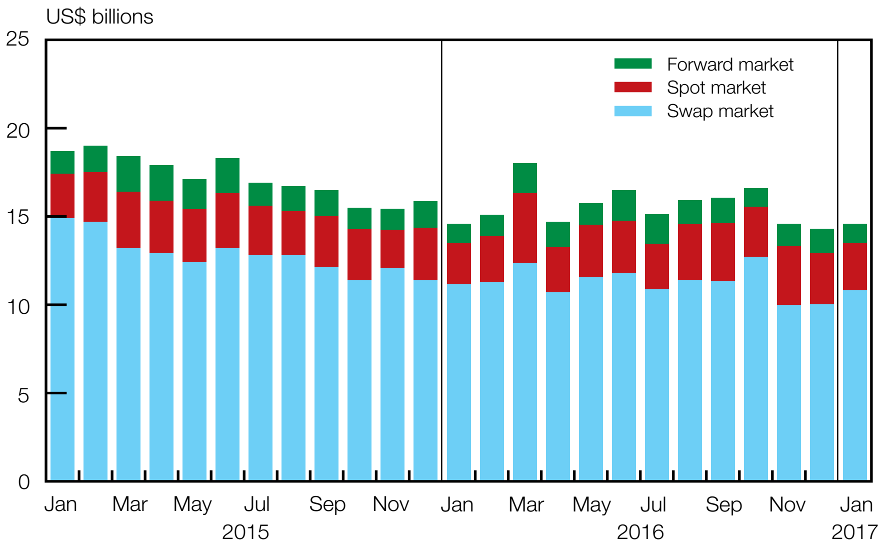
Source: SARB

The real effective exchange rate of the rand increased by 23.6% from January 2016 to December. Part of the strength in the real effective exchange rate of the rand resulted from an increase in the nominal effective exchange rate of the rand.

Turnover in the South African foreign exchange market

The net average daily turnover in the South African market for foreign exchange decreased by 4.6% from US$20.9 billion in the third quarter of 2016 to US$19.9 billion in the fourth quarter, or 0.9% lower than a year earlier. The decline resulted from lower liquidity associated with the year-end holiday season, coupled with cautious trading in the domestic bond market by non-resident investors prior to the credit rating announcements early in December.

Net average daily turnover against the rand



Source: SARB

Turnover in the rand market decreased from a net daily average of US$15.7 billion in the third quarter of 2016 to US$15.2 billion in the fourth quarter, weighed down by decreases of 2.8% and 17.0% in swap and forward transactions respectively. The net daily turnover in the market for third currencies also receded, from an average of US$5.2 billion to US$4.8 billion over the same period.

Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) decelerated significantly in 2016 following a gradual year-on-year acceleration over the preceding two years. Growth in M3 recovered briefly from August 2016 to October but moderated again in November, largely due to a delay in the disbursement of equitable share transfers to local authorities from November to December. On a year-on-year basis, relatively tempered growth in M3 and nominal GDP mirrored one another in the final quarter of 2016. This reflected, among other things:

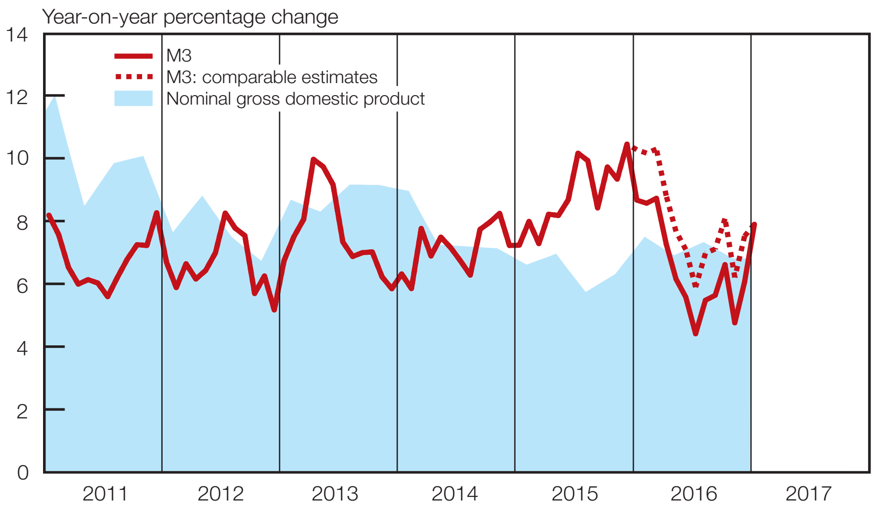
– a methodological change[6] to the monetary statistics which partly affected the value of deposits reported by banks from January 2016; and

– a lower transactions demand for money arising from weak domestic fixed capital expenditure and muted domestic consumption expenditure.

The income velocity of circulation of M3, which increased from 1.40 in the fourth quarter of 2015 to 1.42 in the fourth quarter of 2016, reflected the slower growth in M3 relative to GDP.

6 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 deposits 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*.

Money supply and gross domestic product



Sources: Stats SA and SARB

Developments in the maturity structure of deposits favoured cash, cheque and other demand deposits. Depositors' preference for the aforementioned deposit category is reflected by an acceleration in year-on-year growth, from 7.8% in July 2016 to 11.6% in January 2017. Regardless of the tighter monetary policy stance in early 2016, growth in short- and medium-term deposits fluctuated in negative territory for most of 2016. Despite recovering somewhat towards the end of the year, growth in this deposit category amounted to only 0.4% in January 2017. Growth in long-term deposits also moderated notably, from 10.8% in March 2016 to 3.9% in December, followed by a rebound to 11.9% in January 2017.

Money supply increased by R60.8 billion in the fourth quarter of 2016, slightly down from the increase of R74.3 billion recorded in the third quarter. The increase in the fourth quarter occurred largely on account of an increase of R35.2 billion in deposit holdings of the corporate sector. Non-financial companies and financial companies contributed R25.0 billion and R10.2 billion respectively to this increase. Household sector deposits increased by R25.6 billion over the same period.

Overall, M3 increased by R180.6 billion in 2016, significantly less than the R282.0 billion in 2015. The household sector accounted for 53% of the total increase in deposits in 2016 as households probably took advantage of attractive savings and investment products offered by banks given the somewhat higher interest rates. As a proportion of total M3, household deposits increased steadily from 30.2% in 2014 to 32.8% in 2016. However, 12-month growth in household deposit holdings still moderated from above 12% in the first half of 2016 to 10.1% in January 2017.

M3 holdings of households and companies

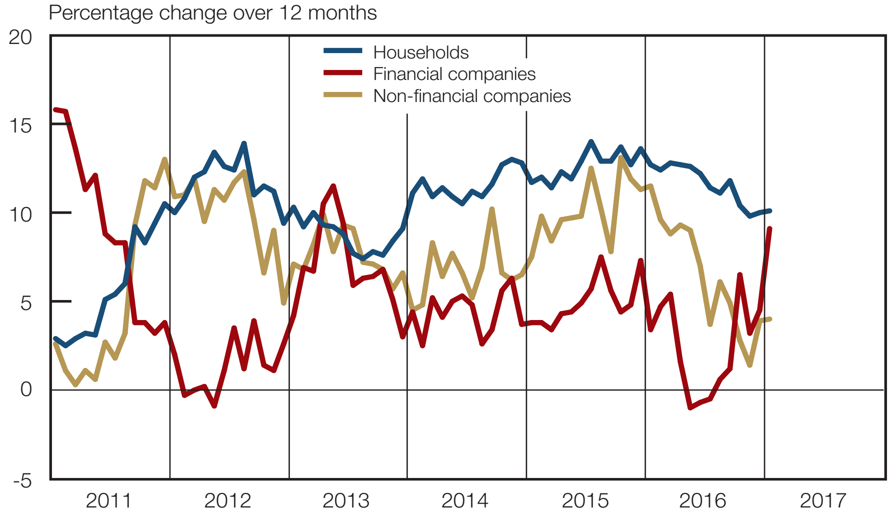
	Year-on-year change (R billions)			Percentage of total M3 deposit holdings		
	2014	2015	2016	2014	2015	2016
Households	95.1	114.6	95.6	30.2	31.2	32.8
Companies	86.5	167.4	85.0	69.8	68.8	67.2
Financial	*36.7*	*75.6*	*49.9*	*40.4*	*39.0*	*37.5*
Non-financial	*49.8*	*91.8*	*35.1*	*29.4*	*29.8*	*29.7*
Total M3 deposits	181.6	282.0	180.6	100.0	100.0	100.0

Source: SARB

Within the corporate sector, year-on-year growth in the deposit holdings of non-financial corporates slowed significantly from 11.5% in January 2016 to only 1.4% in November. Some rebound to 3.9% occurred in December, partly due to the deferred payment of the local government equitable share transfers from November to December. In January 2017, growth remained steady at 4.0%. Although the deposit growth of financial corporates also moderated in 2016, it was partly the result of the earlier-mentioned technical reclassification from deposits to debt securities which mostly impacted the deposits of financial companies. Growth in the deposits of financial corporates decelerated from 7.3% in December 2015 to -1.0% in May 2016, before accelerating to 9.1% in January 2017, partly exacerbated by inflows related to the redemption of a government bond during the month.

Deposit holdings of households and companies

Percentage change over 12 months



Source: SARB

Statistical counterparts of change in M3

R billions

	2016				
	Q1	Q2	Q3	Q4	Year
Net foreign assets	-24.7	7.6	-73.5	10.7	-79.9
Net claims on the government sector	-0.4	8.4	75.0	-17.5	65.4
Claims on the private sector	78.8	-19.0	68.4	29.7	157.9
Net other assets and liabilities	-6.5	1.5	4.3	37.9	37.3
Total change in M3	47.2	-1.6	74.3	60.8	180.6

Source: SARB

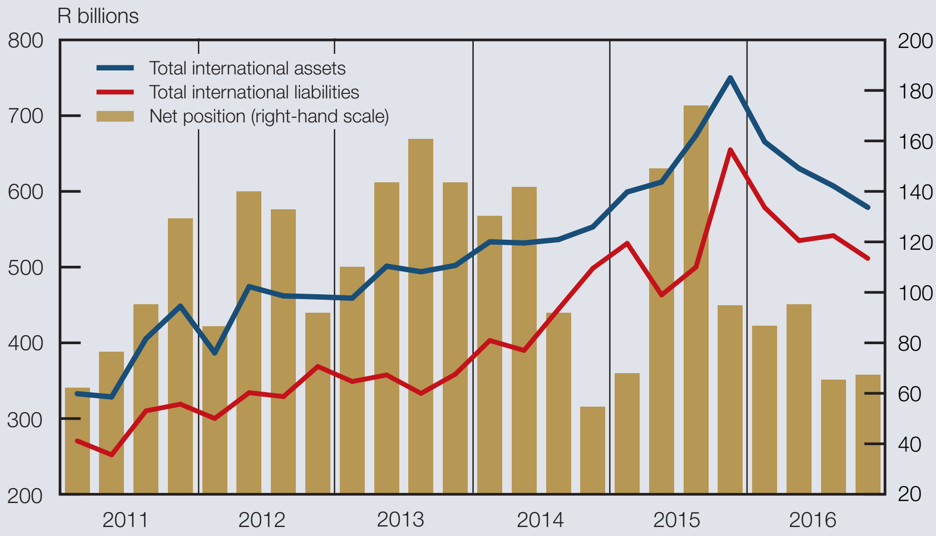
In a statistical sense, the increase in M3 during the fourth quarter of 2016 could be attributed to almost all counterparties, with the exception of net claims on the government sector which decreased as an increase in deposits of the government sector exceeded investments in government securities by the banking sector. The increase in net foreign assets resulted when a decline in the foreign liabilities of the monetary sector exceeded the decline in their foreign assets. The accompanying box provides further insight into the foreign and cross-border activity of South African banks. The revaluation effect on foreign assets was balanced through a rise in other domestic liabilities which contributed to the decline in net other assets of the monetary sector. The moderation in claims on the private sector in the fourth quarter of 2016 reflected the slowdown in demand for credit.

Box 5 Cross-border activity of South African banks[1]

South African banks' balance sheets include both domestic and foreign assets and liabilities. The foreign activities of domestic banks represent transactions with non-residents and the creation of foreign asset and liability positions denominated in foreign currencies. Traditionally, the focus of South African banks has predominately been on domestic activity, with a lesser prevalence of international exposure. As a result, the cross-border banking activity of South African banks is relatively small compared to some other countries. Nonetheless, cross-border activity remains an important focus area, both locally and internationally. Granular stock and flow data of domestic banks' cross-border exposure provides a benchmark in relation to other countries in terms of both overall market share/exposure and categorisation – such as counterparty lending and borrowing institutional sectors, and currency composition. The data can also be utilised to assess changes in country and geographical preferences.

The value of cross-border assets and liabilities of South African banks increased noticeably in recent years. However, South Africa's private sector banks experienced a substantial reduction in outstanding international asset and liability balances during 2016. In rand terms, part of this reduction reflects the appreciation in the exchange value of the rand during the year. The balance of international assets fell by R171 billion, from a peak of R750 billion at the end of December 2015 to R579 billion at the end of December 2016. Over the same period, the balance of international liabilities decreased by R143 billion to R512 billion. This resulted in a narrowing of the net foreign asset position of domestic banks from R95 billion at the end of December 2015 to R67 billion at the end of December 2016. Nonetheless, South African banks total holdings of foreign assets continue to exceed foreign liabilities by a substantial margin. This net lending position indicates an absence of reliance on foreign funding for the domestic banking sector as a whole.

Total external position of South African banks

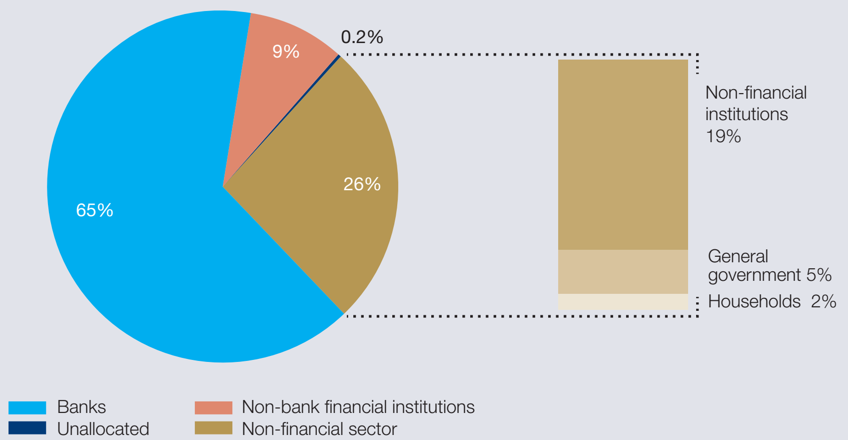


Source: SARB

1 South African banks, also referred to as *domestic banks* in this box, denote all registered, local or foreign controlled domestic private sector banks and South African branches of foreign banks.

The external sector accounted for 10.3% of the total financing obtained by South African banks at the end of December 2016 compared with 13.3% at the end of 2015. Similarly, domestic banks' holdings of non-resident assets as a percentage of total assets were 11.9% at the end of 2016, down from 15.5% a year earlier. As at December 2016, the majority of domestic banks' international assets were holdings of financial instruments issued by foreign banks, at about 65%, followed by non-financial and non-bank financial institutions.

Total international assets by institutional sector as at December 2016



Source: SARB

The bulk of cross-border assets of South African registered banks are held in developed countries. At the end of 2016, the exposure of South African banks to a single counterparty country continued to be dominated by the United Kingdom (UK), followed by the Isle of Man, the United States and Nigeria. As a group, exposure to Africa (excluding South Africa) and the Middle East was also significant.

Similar to international assets, the bulk of the external liabilities of South African registered banks are dominated by developed countries, in particular the UK. South Africa has a well-developed and regulated banking system with multiple links to the UK. Some of the country's largest banking groups either have headquarters or parent companies located in the UK. In addition, various South African banks obtain offshore funding from the UK. As a result, significant changes to the UK's financial services sector will inevitably have spillover effects on South Africa's financial services sector. However, it should be noted that exposure to the UK represents only a small portion of the aggregate balance sheet positions of domestic banks. While the UK represented around 37% and 35% of domestic banks' international assets and liabilities respectively at the end of December 2016, it comprised only 4% of their total assets.

International assets of South African banks by largest counterparty country, including Africa* and the Middle East

R billions

	Amount outstanding as at the end of:		Percentage of total foreign assets for 2016
	Dec 2015 (R billions)	Dec 2016 (R billions)	
United Kingdom	310.5	212.1	36.6
Isle of Man	63.3	58.7	10.1
United States	73.7	52.1	9.0
Nigeria	31.3	27.4	4.7
Germany	20.7	21.0	3.6
Africa* and the Middle East	119.9	106.1	18.3
All countries	749.9	578.9	100.0

* Excluding South Africa

Source: SARB

Positions of South African banks in relation to the United Kingdom

R billions

	Amount outstanding as at the end of:		
	Jun 2016	Dec 2016	Change
Assets versus United Kingdom..................	267.6	212.1	-55.5
Liabilities versus United Kingdom	223.6	181.6	-42.0

Source: SARB

Available data for the second half of 2016 may provide some early insight into the impact that the UK's decision in June 2016 to exit from the European Union (also referred to as 'Brexit') may have had on offshore activity of the South African banking sector. Between 30 June 2016 and 31 December 2016, domestic banks' assets and liabilities with respect to the UK decreased by R55.5 billion and R42.0 billion respectively. However, it is probably still too early to predict the overall impact of Brexit on the balance sheets of domestic banks. Furthermore, Brexit will most likely remain an important focus area in the months to come as it is widely expected that London will lose its prominence as a financial gateway to Europe.

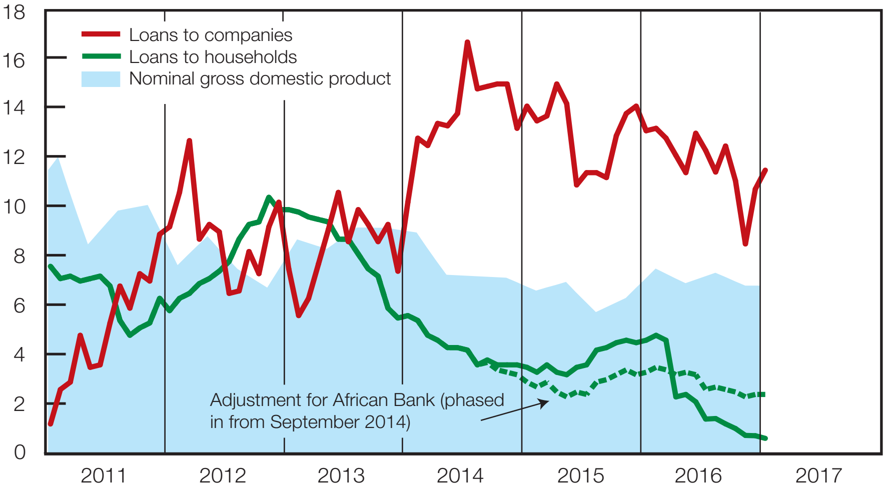
Credit extension

Growth in bank credit extended to the domestic private sector declined steadily to an annual average of 6.8% in 2016, following four consecutive years of average growth of around 8%. The deceleration in credit growth is reflective of the subdued state of domestic economic activity and was also partly affected by a technical correction[7] in the data. Year-on-year growth in total loans and advances reached a post-recession low of 4.5% in November 2016 – its lowest rate since December 2010. If an adjustment is made for the technical effect, growth in total loans and advances would have averaged 7.2% in 2016, and would have been slightly higher at 5.4% in November 2016, which is still a multi-year low. Continuing the trend of the past two years, the corporate sector remained the driving force behind growth in credit extension in 2016. The uptake of bank credit by households remained lacklustre as consumers faced rising interest rates and tighter credit conditions. Subsequent to November 2016, 12-month growth in total loans and advances improved moderately to 5.9% in January 2017.

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

Bank loans and gross domestic product

Year-on-year percentage change



Sources: Stats SA and SARB

Quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances to the private sector accelerated from 4.1% in the third quarter of 2016 to 6.4% in the fourth quarter. The ratio of credit to GDP decreased in the final quarter of 2016 on account of the moderate expansion in nominal GDP growth relative to the moderation in total loans and advances. There has been a notable resilience in loans to corporates in recent years, with their growth outpacing that of nominal GDP since 2014. However, year-on-year growth in corporate credit moderated in

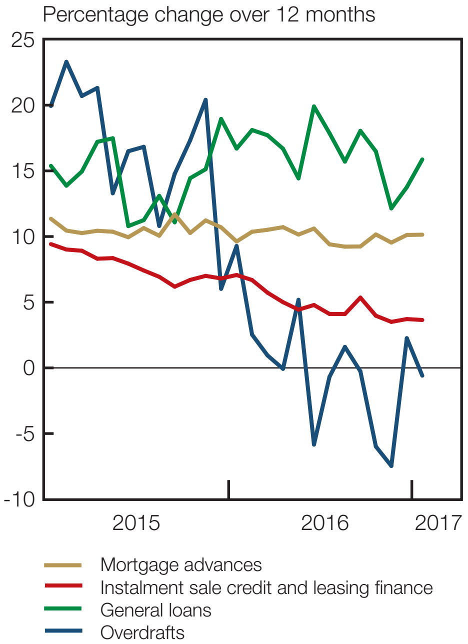
2016, most notably in November. This reflected weak demand by corporates for their preferred credit category, namely *general loans*. Corporate demand for general loans moderated in the second half of 2016 and dampened the overall expansion in credit extension. This probably reflected lower demand for working capital requirements. General loans to companies rose by a moderate R15.7 billion in the fourth quarter of 2016 compared to an increase of R30.8 billion in the previous quarter. Such loans include term loans and structured loan funding to non-financial companies, and to financial companies involved in, among other things, securities trading, life insurance, fund management and vehicle financing. Persistent weak business confidence could continue to suppress corporate credit demand in coming months. In January 2017, growth in general loans to companies improved to 15.9%.

On an aggregate level, total loans and advances increased by R32.3 billion in the fourth quarter of 2016, markedly less than the increase of R56.6 billion in the third quarter and the increase of R58.6 billion in the fourth quarter of 2015. This brought the increase in loans and advances for 2016 as a whole to only R160.1 billion compared to the increase of R235.1 billion in 2015. This moderation was partly influenced by the technical adjustment mentioned earlier, which had its largest impact on credit extension to the household sector.

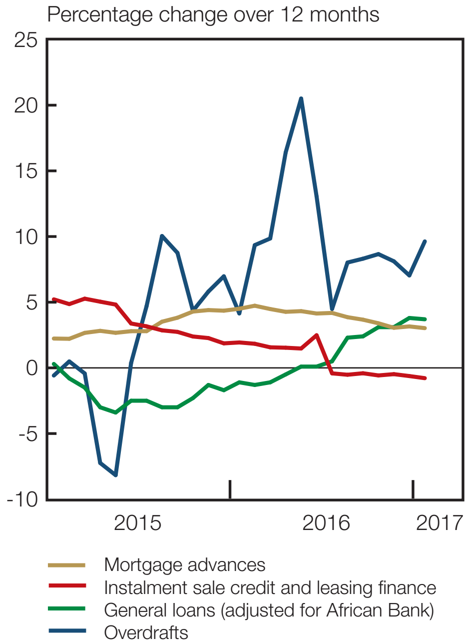
Growth in loans and advances to the household sector generally followed the moderating trend in nominal GDP growth in recent years. However, demand for credit by households remained weak in 2016 even though growth in nominal GDP showed signs of improvement. The gradual rise in interest rates, increased inflationary pressures, muted economic growth and weak employment prospects probably heightened the financial strain of consumers. As such, credit extension to the household sector increased by only R10.7 billion in 2016, a significant moderation from the increase of R63.2 billion in 2015. Although the slowdown was exacerbated by the technical adjustment mentioned earlier, it resulted largely from a general moderation in credit extension to households over the period, including weaker demand for instalment sale financing and mortgage advances.

After adjusting for the technical effect caused by the restructured African Bank, year-on-year growth in general loans to households (also referred to as unsecured loans) measured 3.7% in January 2017, representing a steady improvement from negative growth for most of 2015 and the opening months of 2016. The decline in the ratio of households' general loans to total loans and advances from a high of 8.5% in July 2013 to 6.7% in January 2017 reflects the waning significance of such loans in recent years.

Selected loans and advances extended to corporate sector



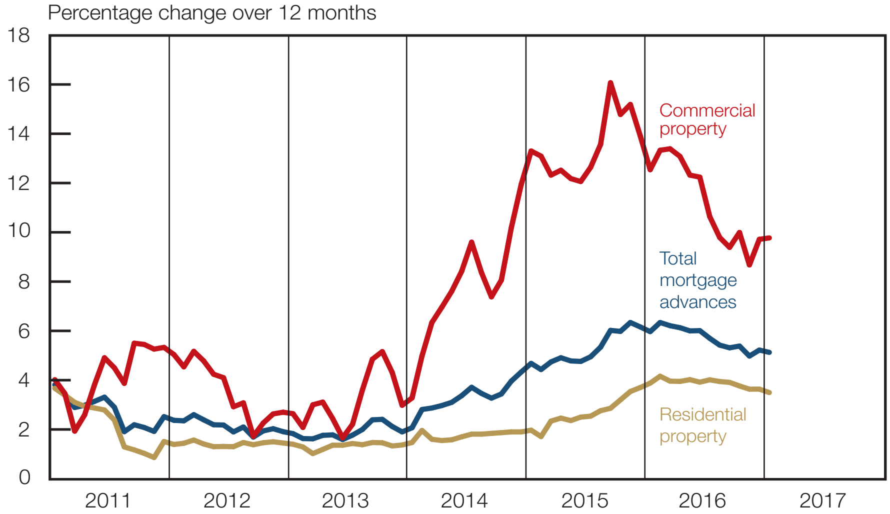
Selected loans and advances extended to household sector



Source: SARB

The prominence of *mortgage advances*, the largest category of credit extension, diminished somewhat in recent years. As a ratio of total loans and advances, total mortgage advances declined from a peak of around 54% in 2010 to slightly less than 43% in 2016. The value of total mortgage advances increased less significantly by only R64.2 billion in 2016, following relatively buoyant growth of R71.3 billion in 2015. From pedestrian year-on-year growth of less than 2% in 2013, growth in total mortgage advances initially accelerated to more than 6% towards the end of 2015 and in early 2016. Growth then moderated to 5.2% in December 2016 and 5.1% in January 2017. This reflected a slowdown in household demand for residential mortgage advances and also a weaker rate of expansion in corporate demand for mortgage advances to finance commercial property. Growth in mortgage advances on commercial property accelerated markedly from subdued rates in 2013 and peaked at 16.1% in September 2015 before moderating to 9.8% in January 2017. While growth in mortgage advances on residential property also initially gained some momentum, the pace moderated gradually throughout the year, averaging 3.8% in 2016. In January 2017, 12-month growth in mortgage advances on residential property amounted to 3.5%.

Mortgage advances

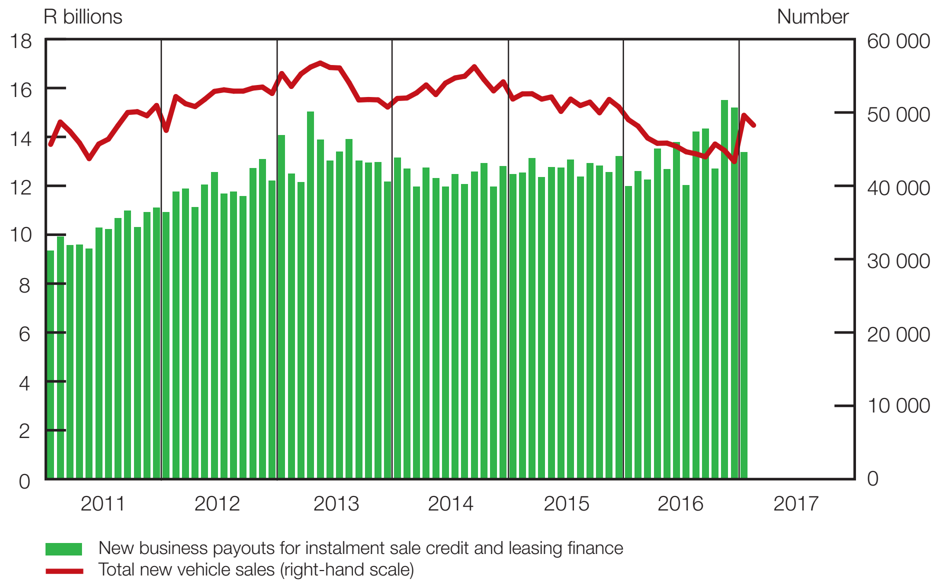


Source: SARB

The rate of expansion in *instalment sale credit and leasing finance*, mainly representing the financing of new and second-hand vehicles, slowed further in 2016 to lows previously reached in 2010. Despite sporadic monthly increases in new business payouts, year-on-year growth in instalment sale credit and leasing finance slowed from 6.5% in January 2015 to 0.6% in January 2017. Instalment sale financing of new passenger vehicles in particular has been contracting since the second half of 2015, while the financing of used passenger vehicles maintained positive, albeit broadly sideways growth over the same period. According to the BER, business confidence among new vehicle dealers remained at depressed levels in the fourth quarter of 2016, while confidence among used vehicle dealers and spare parts dealers increased to above the neutral level. This indicates that consumers are maintaining their vehicles for longer while postponing the purchase of new vehicles. Nonetheless, the demand for used vehicles has not been sufficient to boost credit extension significantly.

A sectoral analysis indicated that credit demand by the electricity, gas and water sector increased significantly in the third and fourth quarter of 2016, despite a slowdown in renewable energy projects initiated by government. Demand for loans by rail and transport companies, together with companies involved in mobile telecommunications and networks, also continued to increase briskly. The agricultural sector increased its reliance on bank funding in 2016, probably partly due to the effects of the prolonged drought. The moderation in mortgage advances towards residential and commercial property is evident in the recent slowdown in credit extension to the real estate sector. Credit demand by the construction sector also contracted most recently. Growth in bank credit to the manufacturing sector edged higher towards the end

Instalment sale credit and leasing finance, and vehicle sales



Seasonally adjusted

Sources: NAAMSA and SARB

of 2015 and early 2016, probably indicating the emergence of more lucrative export opportunities, higher selling prices and expectations of an improvement in domestic demand for manufactured goods at the time. However, growth once again moderated in the last three quarters of 2016 as these expectations disappointed. Credit demand by the mining sector contracted throughout 2016 as mining output remained subdued.

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

Sector	Percentage change	Percentage of total credit extension*
Electricity, gas and water	41	2.2
Transport, storage and communication	15	3.3
Agriculture, forestry and fishing	14	2.2
Real estate	11	10.1
Business services	10	3.5
Community, social and personal services	10	8.7
Manufacturing	8	4.7
Households	7	35.3
Finance and insurance	4	18.9
Wholesale and retail trade	4	4.9
Construction	-11	0.8
Mining and quarrying	-20	2.0
Other	-32	3.3
Total	5	100.0

* Expressed as a percentage of the outstanding balance

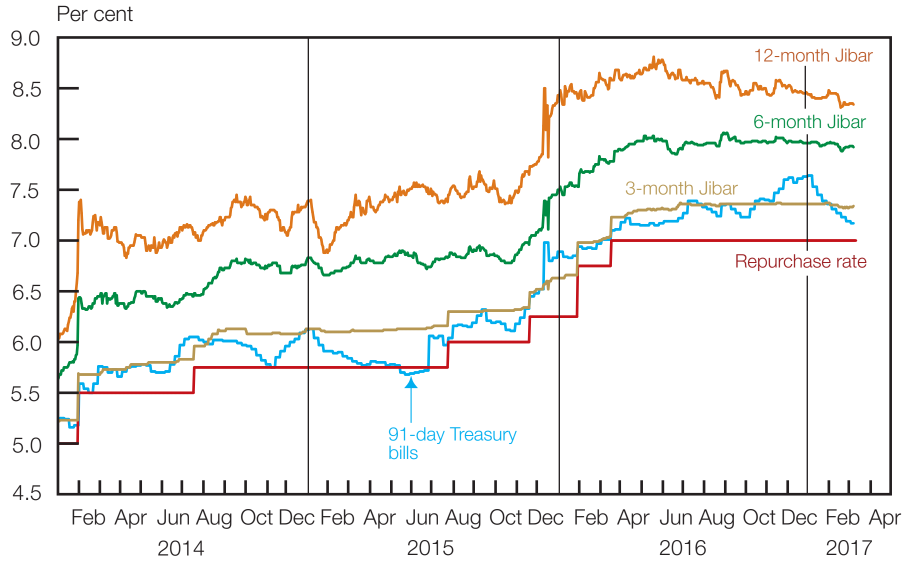
Source: SARB

Interest rates and yields

In January 2017 the Monetary Policy Committee (MPC) decided to keep the repurchase rate unchanged at 7.0% per annum. The MPC retained the view of being near the end of the tightening cycle, despite some deterioration in the near-term inflation outlook. The expected inflation profile has been negatively affected by higher international oil prices and elevated domestic food price inflation. At the same time, the exchange value of the rand displayed some degree of resilience. Global economic growth prospects remained mixed amid policy uncertainty, while the domestic growth outlook remained challenging with only a modest improvement expected over the forecast period.

Movements in short-term money market rates mimicked the unchanged repurchase rate in recent months. The three-month Johannesburg Interbank Average Rate (Jibar) remained range-bound in a relatively narrow range of 7.32%–7.37% between July 2016 and early March 2017, and amounted to 7.34% on 13 March 2017. The benchmark 12-month Jibar displayed a sideways to downward trend, fluctuating from a recent high of 8.81% on 19 May 2016 to a low of 8.31% on 16 February 2017. The decline occurred alongside an appreciating exchange value of the rand. Subsequently, the 12-month Jibar increased moderately to 8.45% in early February 2017, partly affected by sociopolitical and global uncertainty, before fluctuating lower to 8.35% on 13 March when conditions stabilised.

Money market rates

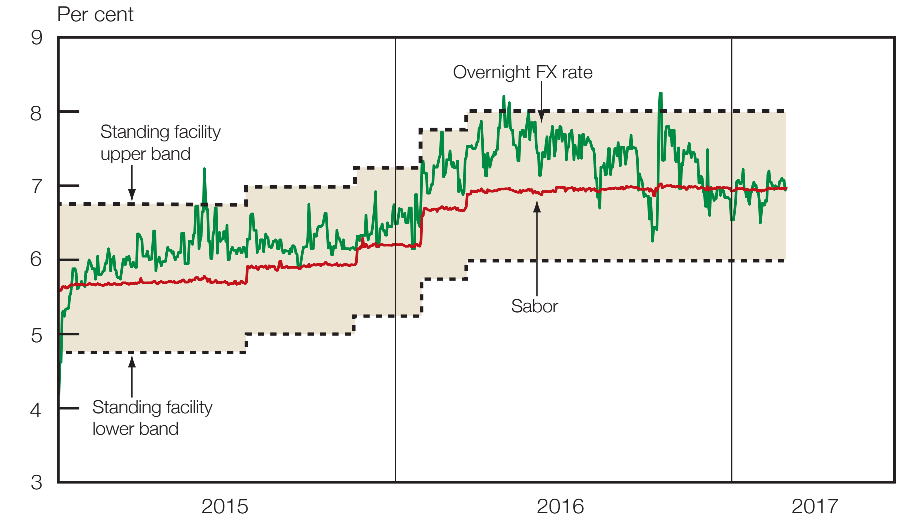


Source: SARB

Initially, the tender rate on 91-day Treasury bills increased by 41 basis points from 7.23% on 6 October 2016 to 7.64% on 30 December. However, the rate declined rapidly thereafter to a low of 7.17% on 3 March 2017 following heightened demand for short-term government paper before rising to 7.26% on 13 March.

The implied rate on one-day rand funding in the foreign exchange swap market (overnight FX rate) was characterised by periods of high volatility due to the strong demand for rand alongside fluctuations in the exchange value of the rand in the fourth quarter of 2016. This was opposed to the more subdued fluctuations displayed by the South African Benchmark Overnight Rate (Sabor) over the same period. In early 2017 up to 13 March, the overnight FX rate moved more in line with the stable Sabor and the unchanged repurchase rate, remaining well within the standing facility limits. Since October 2016, the Sabor rate has moved between 6.86% and 7.03%, and amounted to 7.03% on 13 March. The overnight FX rate declined from a recent high of 8.25% on 14 October 2016 to a low of 6.50% on 31 January 2017, following some normalisation of market conditions after a large international merger transaction temporarily affected liquidity. The rate then fluctuated higher to 7.30% in early March 2017.

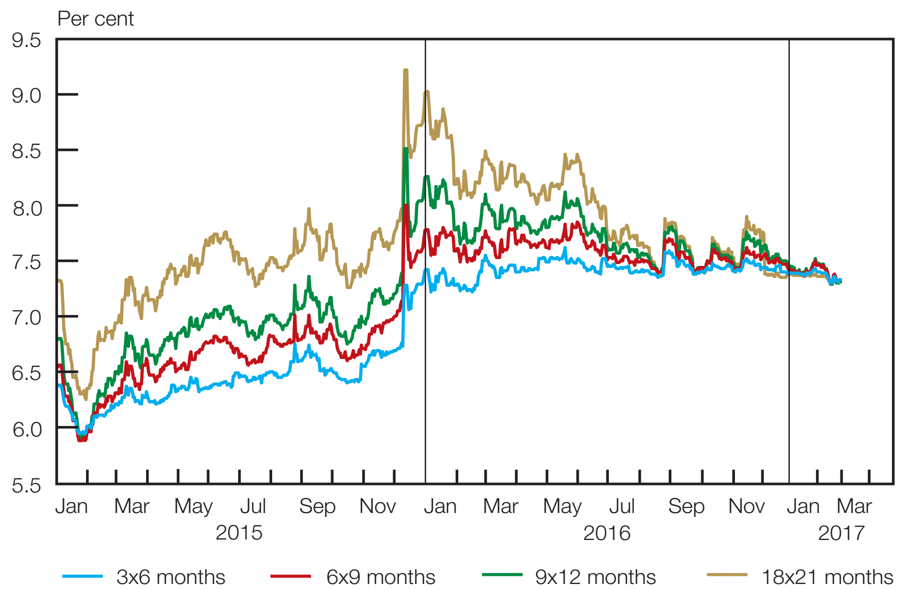
Benchmark overnight rates



Source: SARB

Despite some short-term fluctuations, rates on forward rate agreements (FRAs) trended sideways from late August 2016 into the opening months of 2017. These rates depict market expectations of future interest rate movements. The longer-term FRAs increased in November 2016 but once again declined during December 2016 and into early 2017. The decline reflected the appreciation of the exchange value of the rand and its expected positive impact on inflation, while market participants were also encouraged by indications by the SARB that it may be near the end of the interest rate tightening cycle. The rate on the 3x6-month FRA has been range-bound at around 7.40% since early December 2016, with a moderate decline to 7.32% on 13 March. By contrast, the 9x12-month FRA rate declined from 7.64% on 2 December 2016 to 7.25% on 13 March. The current level of FRA rates is possibly a reflection that market conditions are expected to remain relatively stable over the short to medium term.

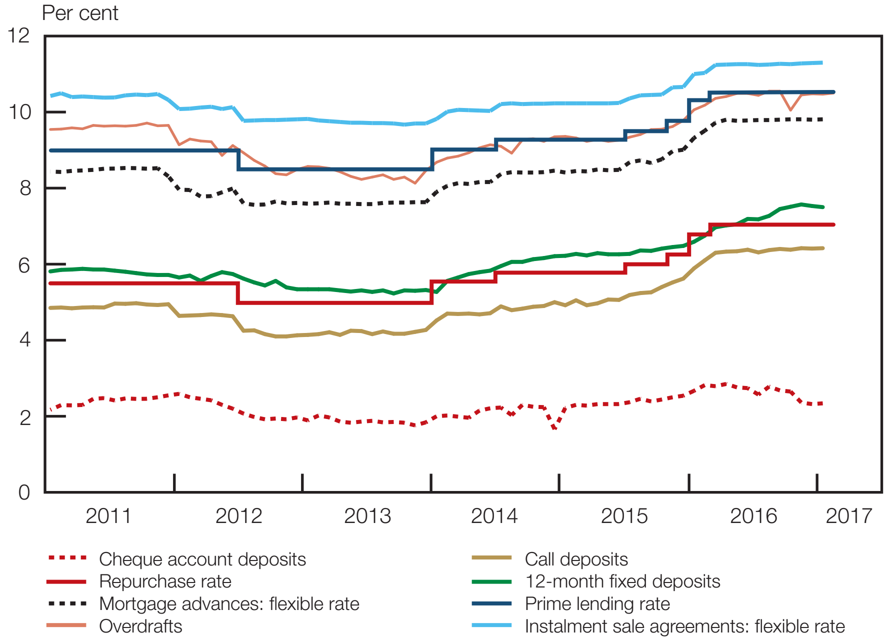
Forward rate agreements



Source: SARB

The prime lending rate and the predominant rate on mortgage loans have remained at 10.50% since March 2016, in line with the unchanged repurchase rate. Rates on the different loan categories of private sector banks also remained fairly stable during the period. In January 2017 the weighted average overdraft rate on current accounts amounted to 10.47%, while banks offered 7.50% on 12-month fixed deposits.

Selected bank deposit and lending rates



Source: SARB

South African government bond yields experienced volatility while generally trending lower in 2016 and the opening months of 2017. Domestic bond yields were influenced by both domestic and international factors. From mid-August to November 2016 the downward trend was interrupted, in part in response to higher actual and expected domestic consumer price inflation, domestic political tensions, higher international oil prices, policy uncertainty after the US presidential election, net sales of domestic bonds by non-residents from October 2016, and concerns about a possible downgrade of South Africa's long-term foreign currency credit rating. Nevertheless, positive developments such as the appreciation in the exchange value of the rand, unchanged sovereign credit ratings, lower bond yields in some emerging market economies, and a narrower budget deficit over the medium term provided for in the *2017 Budget Review* supported a continuation of the downward trend in bond yields.

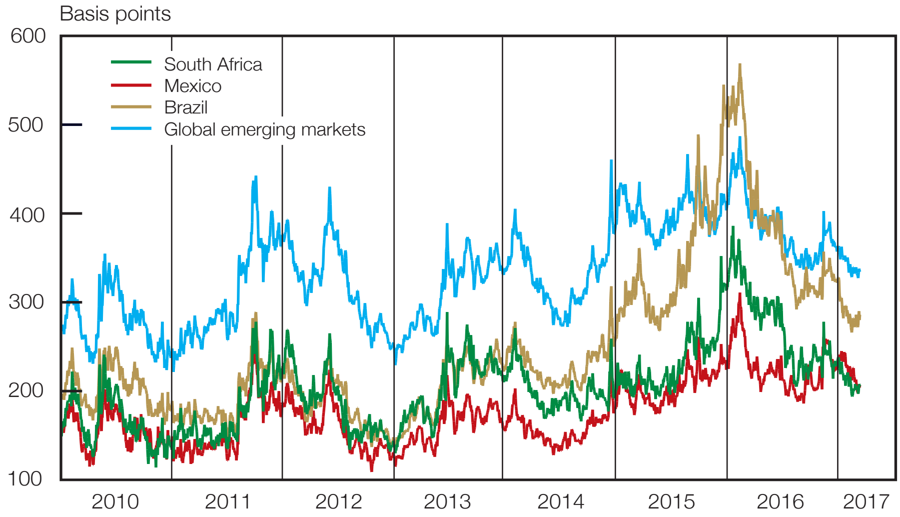
The daily closing yield of conventional 10-year South African government bonds increased by 78 basis points, from a low of 8.38% on 18 August 2016 to a high of 9.16% on 14 November, before declining to 8.70% on 13 March 2017. Globally, bond yields of some emerging market economies also fluctuated lower, with the daily closing yield on the Russian 10-year government bond declining by 61 basis points from the end of November 2016 to 13 March 2017.

The yield spread of emerging market economies, as measured by the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[8] relative to US government bonds, narrowed significantly between February 2016 and February 2017. This reflected a noticeable improvement in emerging market sovereign risk perceptions. Bond yields in most emerging economies trended generally lower throughout 2016, but increased towards the end of 2016 when the US federal funds rate increased and risk appetite for emerging market government bonds deteriorated. South Africa's spread was consistently below the global spread of emerging market economies and in line with its peers, with the exception of Brazil which experienced an economic recession. Similarly, the *sovereign risk premium*[9] on South African government US dollar-denominated bonds in the eight-year maturity range trading in international markets narrowed by 141 basis points over the same period.

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

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

Sovereign spreads*



* JPMorgan Emerging Markets Bond Index Plus

Source: Bloomberg

These developments in domestic bond yields caused the *yield curve* in South Africa to move progressively higher from mid-August to November 2016 as underlying inflationary pressures intensified. Subsequently, the yield curve moved lower across most of the maturity spectrum as it displayed the recent decline in bond yields, except at the extreme short end of the curve. Consequently, the *yield gap*, measured as the difference between yields at the extreme long and short ends of the curve, narrowed by 46 basis points from 14 November 2016 to 13 March 2017.

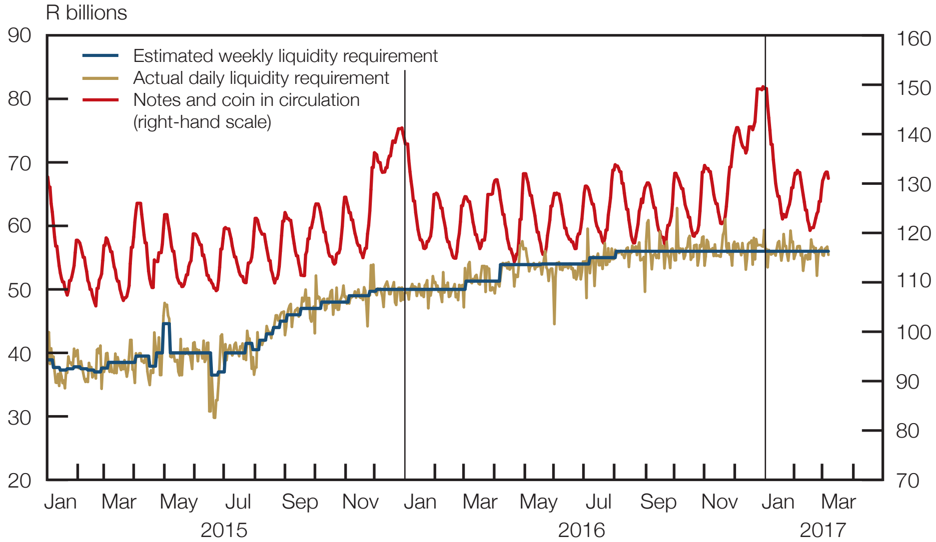
Break-even inflation rates, measured as the difference between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds, fluctuated lower across all maturities during most of 2016. For some shorter-term maturity bonds, break-even inflation declined to less than 6% from early 2017. This reflected lower inflation expectations on account of the appreciation in the exchange value of the rand and the dissipation of the prolonged drought. The real yield on the 11-year R210 inflation-linked government bond increased by 11 basis points from 14 November 2016 to 13 March 2017, while the nominal yield on the conventional R186 government bond declined by 53 basis points over the same period. Accordingly, the break-even inflation rate in the 11-year maturity range declined notably by 63 basis points from 7.05% on 14 November 2016 to 6.42% on 13 March 2017.

Money market

The actual daily liquidity requirement of private sector banks varied between a low of R53.1 billion and a high of R62.8 billion in the fourth quarter of 2016. This was slightly higher than the range of between R48.6 billion and R60.9 billion in the previous quarter. The gradual longer-term increase in the daily liquidity requirement of private sector banks reflected the strategy introduced in recent years to improve the broad alignment of the money market shortage with underlying conditions in the money market. This is intended to ultimately improve the effectiveness of the monetary policy transmission mechanism. Since the introduction of the new liquidity management strategy in August 2013, the actual average liquidity requirement has increased steadily from R22.8 billion and settled at levels of around R56 billion since September 2016. In February 2017 the actual daily liquidity requirement averaged R55.7 billion.

Liquidity to the net amount of R1.5 billion was drained from the money market during the fourth quarter of 2016 compared to a net drainage of R1.8 billion in the third quarter. A seasonal increase in notes and coin in circulation contributed to tighter conditions and contracted money market liquidity by R17.1 billion. Notes and coin in circulation grew by 8.1% over the past year to R149.2 billion at the end of December 2016. Spot purchases of foreign exchange by the SARB of R16.0 billion largely alleviated the contracting impact of the expansion in notes and coin in circulation. Other daily liquidity disparities were intermittently addressed through, among other things, commercial banks placing funds in their cash reserve accounts with the SARB which contracted money market liquidity by R1.8 billion.

Liquidity requirement



Source: SARB

The overall net impact on money market liquidity of the various liquidity management instruments utilised by the SARB in the final quarter of 2016 was relatively neutral. A decrease of R4.1 billion in the forward position reflected maturing foreign exchange swaps previously entered into to sterilise foreign exchange purchases related to an exceptionally large international merger transaction during 2016. The liquidity impact of the maturing swaps was neutralised through R2.1 billion in reverse repurchase transactions, the issuance of SARB debentures and a rise of R0.5 billion in deposits by the Corporation for Public Deposits at the SARB.

Money market liquidity flows

R billions (easing + tightening –)

	2016		2017
	Jul–Sep	Oct–Dec	Jan–Feb
Notes and coin in circulation	-4.0	-17.1	18.6
Change in cash reserve accounts	-3.5	-1.8	-0.7
Money market effect of SARB foreign exchange transactions in spot market	5.9	16.0	-0.0
Government deposits with SARB	0.0	0.0	0.0
Use of liquidity management instruments	-0.1	0.1	-12.4
Reverse repurchase transactions	1.7	2.1	-0.6
SARB debentures	0.3	1.7	-1.0
Forward position (swaps)	1.0	-4.1	-12.2
Corporation for Public Deposits' call deposits with SARB	-3.1	0.5	1.3
Other items net	-0.2	1.4	-3.7
Liquidity provided to banking system	**-1.8**	**-1.5**	**1.9**

Source: SARB

Liquidity conditions eased somewhat in the first two months of 2017 following a decrease in notes and coin in circulation outside the SARB, which allowed for the unwinding of some previous liquidity management operations. In these two months, overall money market conditions were characterised by a net injection of liquidity of R1.9 billion.

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R61.8 billion were effected from the government tax and loan accounts from October 2016 to January 2017, with only R53 million of this amount accruing to the SARB.

Bond market

Public sector funding in the domestic *primary bond market* remained robust in 2016, with the total nominal value of public sector bonds in issue accounting for 81% of the total amount of all bonds in issue as at the end of December 2016. Within the public sector, national government accounted for 84% of bonds in issue as at the end of 2016; for the listed bond market as a whole it accounted for 68%. This is reflective of the funding requirement brought about by national government's sizeable budget deficit.

By contrast, the net issuances of private sector bonds – securitised bonds in particular – declined significantly in 2016 on account of sizeable net redemptions. In 2016, non-bank private companies' net redemptions slightly decreased their nominal amount of bonds in issue. Banks had less net issuances in 2016 than in 2015. This was probably due to a combination of the weak demand for credit and because the allowance for national discretion with regard to Basel III's net stable funding ratio (NSFR) requirement had reduced banks' need to issue long-term debt before the NSFR's implementation in January 2018. In second place, after national government, banks accounted for 13% of the outstanding nominal value of bonds in issue as at the end of December 2016.

For all institutional sectors, net issuances of R199 billion in 2016 and R6.7 billion in the first two months of 2017 (inclusive of the redemption of the R211 inflation-linked government bond) increased the total outstanding nominal value of all debt securities listed on the JSE Limited (JSE) from R2.3 trillion at the end of 2015 to R2.5 trillion at the end of February 2017.

Funding in the domestic primary bond market

R billions

	Net issues	Net issues	Nominal amount in issue
	2015	2016	As at 31 December 2016
Public sector	186	204	2 025
National government	168	183	1 709
Public corporations: Financial	2	0	42
Non-financial	17	20	256
Local governments	-1	1	18
Private sector	36	-5	481
Banks	33	10	315
Non-bank private companies: Financial	0	6	57
Non-financial	0	-7	57
Securitisation	3	-14	52
Non-residents	1	0	8
Total	223	199	2 514

Source: JSE

Given the downward trend in bond yields, the All-Bond Index increased by 15% in 2016 following a decline of 4% in 2015. The recovery in returns on domestic bonds buoyed trading volumes in 2016. Daily average *turnover* in the secondary bond market reached an annual record high of R111 billion in 2016, representing a 16% increase compared with 2015. However, bond turnover slowed somewhat in the latter months of 2016 on account of higher local bond yields from August 2016. This also spilled over to lower turnover in the first two months of 2017, at an average of R103 billion per day.

Net issuances of rand-denominated debt by non-residents in the *European and Japanese bond markets* amounted to R9.8 billion in 2016, representing an annual increase of 23%. Increased issuances of rand-denominated debt occurred alongside higher yields offered by emerging market economies, as opposed to lower returns in developed economies. However, demand for rand-denominated debt has waned since September 2016. This is reflected by cumulative net redemptions of R3.2 billion from September 2016 to February 2017. This slowdown in the issuance of rand-denominated debt may have been affected by, among other things, international rating agencies' continued negative outlook for South Africa and expectations of further increases in the US federal funds rate.

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

R millions

	Eurorand		Uridashi		Total	
	2015	2016	2015	2016	2015	2016
Issues	21 073	25 563	6 725	10 705	27 798	36 269
Redemptions	11 612	12 941	8 206	13 514	19 817	26 455
Net	9 461	12 622	-1 480	-2 808	7 981	9 814

Source: Bloomberg

Non-residents significantly reduced their holdings of domestic bonds by an all-time record quarterly amount of R52 billion in the fourth quarter of 2016. This followed JSE exchange-reported net purchases of domestic debt securities by non-residents to the value of R17 billion in the first three quarters of the year. Accordingly, non-residents were net sellers of domestic bonds to the value of R35 billion in 2016 compared to net sales of R30 billion in 2015. Factors contributing to non-resident net sales in 2016 included, among other things, cautious investor behaviour due to uncertainty regarding the timing and magnitude of the new US administration's economic policies, investor fears over the pace of the US Federal Reserve's monetary policy tightening, a shift in global demand away from emerging market debt securities, and uncertainty regarding the domestic political environment. Net sales of domestic bonds by non-resident investors continued in the first two months of 2017, amounting to R4.8 billion.

Share market

Equity capital-raising activity by companies listed on the JSE in the domestic and international primary share markets was subdued in 2016. Equity funding on the JSE more than halved from an all-time annual high of R250 billion in 2015 to R116 billion in 2016 – the lowest annual amount since 2013. Contributing to the decline was weak domestic economic growth, volatility in share prices globally, and a decrease in the number of companies listed on the JSE. The number of listed companies decreased in 2016 as delistings exceeded new listings for the first time since 2013.

Number of listings on the various boards of the JSE

	Alt^x	Venure and development capital boards	Main board	Total	New listings	Delistings
31 December 2013	60	5	324	389	13	26
31 December 2014	58	3	330	391	24	22
31 December 2015	64	3	328	395	23	19
31 December 2016	60	2	326	388	18	25
28 February 2017	57	2	324	383	0	5

Source: JSE

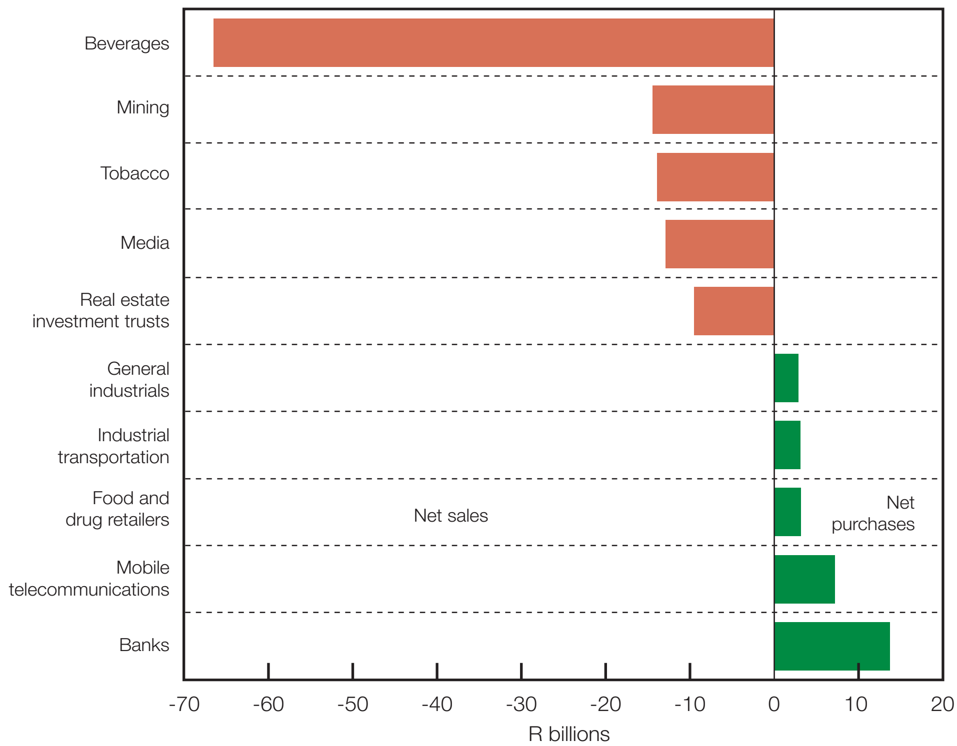
The proceeds of the 10 largest share issuances by companies listed on the JSE in 2016 were mostly utilised for acquisitions abroad accounting for 54%, and were raised by secondary listed companies. The remaining 46% was used for financial business operations. In the first two months of 2017, the value of shares issued amounted to R4.1 billion.

Turnover in the secondary share market of the JSE was 18% more in 2016 compared with 2015, at a daily average of R24 billion – the highest daily average turnover on record in a calendar year. This was supported by an increase in the number of transactions and higher volumes traded. The market capitalisation of the JSE averaged around R15 trillion in the first nine months of 2016 before receding to around R13 trillion in October along with the delisting of a large UK beer company, and remained around this level up to February 2017.

According to JSE exchange-reported data, *non-residents* were net sellers of shares listed on the JSE, with an all-time high value of R124 billion in 2016; net sales in 2016 by far surpassed net sales of only R1 billion in 2015. The factors that contributed to the record value of net sales by non-residents of JSE-listed shares were mostly similar to those contributing to developments in bond yields and non-resident net sales of bonds.

In 2016 significant net sales of JSE-listed shares by non-residents in the domestic secondary share market occurred mainly in the beverages, mining, tobacco and media sectors. The beverages sector had the highest value of net sales of R67 billion. The notable sell-off in the beverages sector could be ascribed to acquisition activity, which resulted in the delisting of a large UK beer company from domestic and international share markets. By contrast, the banking and mobile telecommunications sectors experienced the highest net purchases of JSE-listed shares by non-residents in 2016. Non-residents purchased banking shares, on a net basis, to the value of R14 billion. Subsequently, non-residents continued to offload JSE-listed shares to the value of R26 billion in the first two months of 2017.

Selection of non-resident net purchases and sales of JSE-listed shares in 2016*

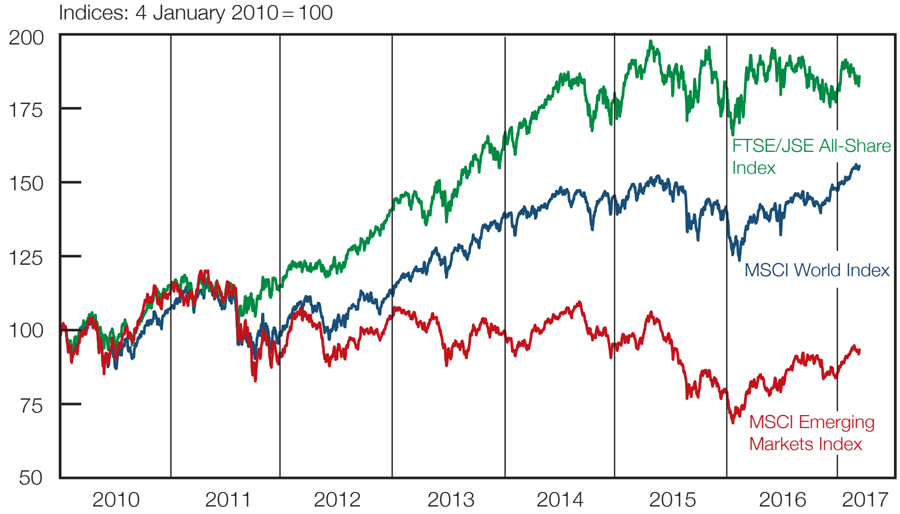


* Largest net sales and purchases

Source: JSE

The prices of shares listed on the JSE rebounded in the opening month of 2017, recovering from a poor performance in the final quarter of 2016. The *FTSE/JSE All-Share Price Index* (Alsi) increased by 9% from a recent low of 48 936 index points on 6 December 2016 to 53 406 index points on 26 January 2017. The Alsi followed the MSCI Emerging Markets Index and the MSCI World Index higher, supported by signs of improved global economic growth and expectations of US fiscal stimulus following the outcome of the US presidential election. An increase in international commodity prices and expectations of improved domestic economic growth in 2017, among other things, also provided some impetus to the prices of shares listed on the JSE over the period. Subsequently, the Alsi declined by 3% to 51 855 index points on 13 March.

Global share prices



Sources: INET BFA, Bloomberg and own calculations

The total earnings of companies listed on the JSE increased by 6% in 2016. With earnings increasing more than share prices, the historical *price-earnings ratio* of all classes of shares declined from a record high of 56.8 in June 2016 to 26.5 in February 2017. The *dividend yield* declined from an annual average of 2.4% in 2015 to an all-time annual low of 2.0% in 2016, in line with a decrease in dividends declared. The dividend yield of all classes of shares listed on the JSE averaged 1.9% in the first two months of 2017.

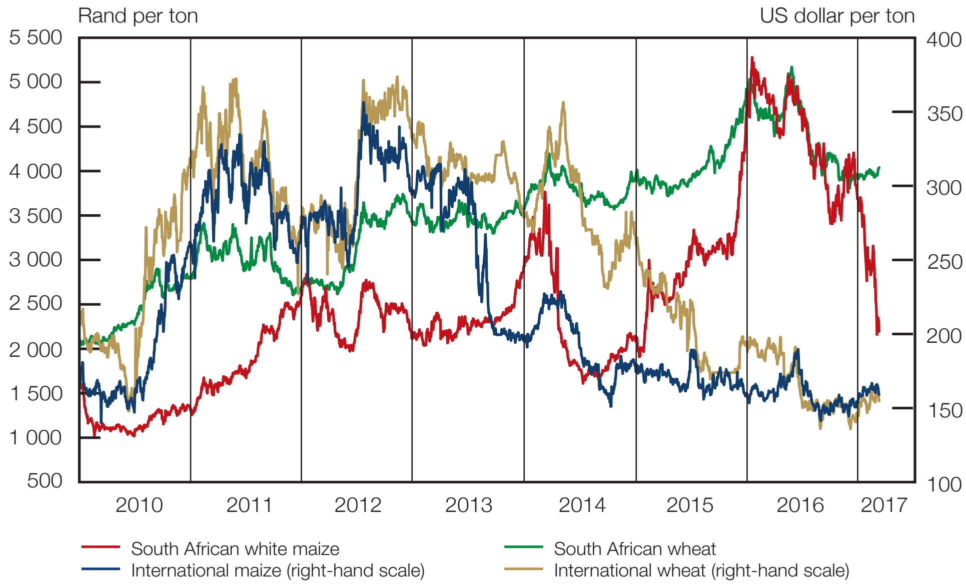
Market for exchange-traded derivatives

The *prices of agricultural commodities* listed on the Commodity Derivatives Market (CDM) of the JSE, in particular grains, trended downwards throughout most of 2016 and early 2017 following record-high levels in the first half of 2016 amid the persistent drought. A number of factors, including the approved importation of genetically modified maize from the US, the improvement in rainfall which encouraged increased summer crop plantings, and the appreciation in the exchange value of the rand exerted downward pressure on domestic agricultural commodity prices over the period. This downward trend in agricultural commodity prices was reflected by the year-on-year growth rate in the monthly average spot price of white maize which moderated significantly from 89% in December 2015 to 0.3% in December 2016. The spot price of white maize maintained a downward trajectory, declining by 26% from December 2016 to February 2017. Despite the production cost implications due to fuel price increases, this trend is expected to continue, mainly on account of the favourable weather outlook and estimates of a much higher 2017 maize crop, as released by the Crop Estimates Committee. However, these estimates could be lowered somewhat due to the invasion of armyworm in some domestic maize planting areas.

Following record highs in May 2016, domestic wheat prices decreased notably up to December. Subsequently, domestic wheat prices increased somewhat in January and February 2017, largely driven by higher international wheat prices which gained momentum on account of smaller-than-expected global supply following unfavourable weather conditions.

The CDM of the JSE introduced the Soya Bean Crush Can-do (CRSH) and the Quanto White Maize (QWMZ) futures contracts in January 2017, denominated in rand. The underlying products of the CRSH comprise Chicago Mercantile Exchange soybean meal and oil contracts as well as JSE soya bean contracts, while the QWMZ comprises JSE white maize contracts. Furthermore, an inflation-linked bond contract on the I2029 government bond was introduced on the interest rate derivatives market of the JSE in January 2017.

Grain prices



Source: JSE

Trading activity in *interest rate derivatives* on the JSE increased briskly in 2016 and early 2017 as participants continued to hedge against adverse movements in bond yields.

Derivatives turnover on the JSE Limited

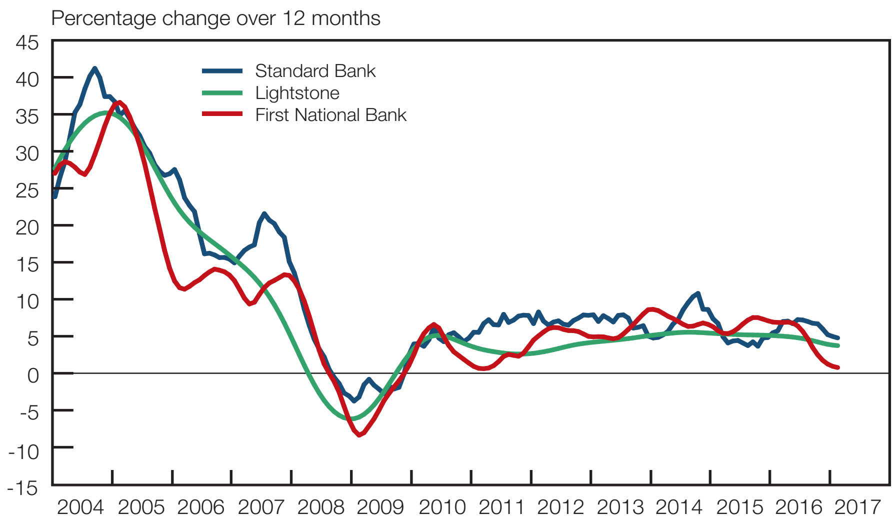
Type of derivative	Value (R billions)	Value (R billions)	Change over one year (Per cent)	Change over one year (Per cent)
	2016	Jan–Feb 2017	2016	Jan–Feb 2017
Equity	6 943	672	4	-23
Warrants	1	0.04	12	-62
Commodity	958	97	28	-50
Interest rate	1 095	288	49	45
Currency	734	56	22	-46

Source: JSE

Real estate market

Residential property prices in South Africa increased at a fairly subdued pace in 2016 and early 2017. The year-on-year rate of increase in nominal house prices slowed to between 1% and 5% across the different indicators in February 2017. In real terms (adjusting for consumer price inflation), house prices declined in the year to February 2017. The lacklustre growth in nominal house prices reflected weak demand consistent with slow economic growth, high unemployment levels, weak consumer confidence, an acceleration in consumer price inflation (particularly food price inflation), tighter credit conditions, higher interest rates, and rising municipal property taxes and utility tariffs. According to Lightstone, the slowdown in nominal house price growth was more apparent for higher-value houses.

Nominal house prices



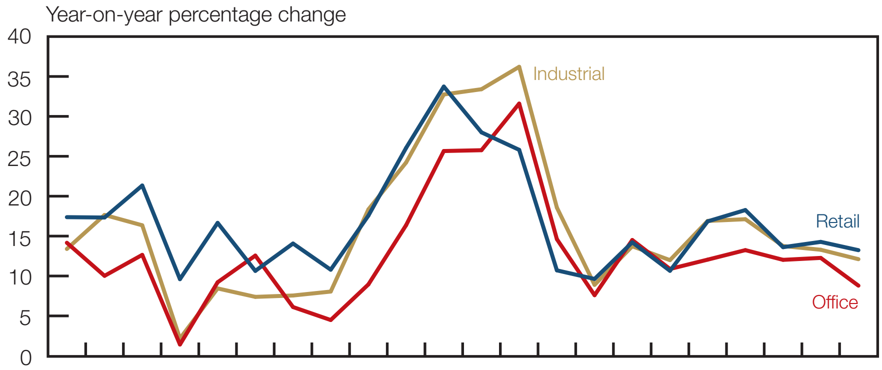
Sources: First National Bank, Lightstone and Standard Bank

Income return[10] on commercial property generally held up in 2016, but total return[11] has slowed gradually since 2014. This should be seen in the context of a challenging economic environment which has impacted adversely on annual capital growth. In terms of total return, retail property was the top performer and outperformed industrial property by a small margin in recent years. The commercial office sector has underperformed since 2012.

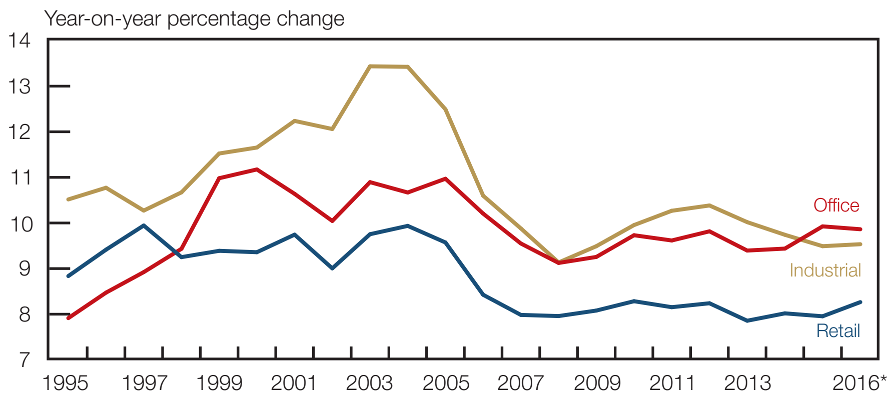
10 Income return is calculated as net income divided by market value plus capital expenditure.

11 Total return is calculated as the change in market value less capital expenditure plus the value of sales of capital plus net income divided by market value plus capital expenditure.

Total return of commercial property by sector



Income return of commercial property by sector



* June 2016

Source: MSCI

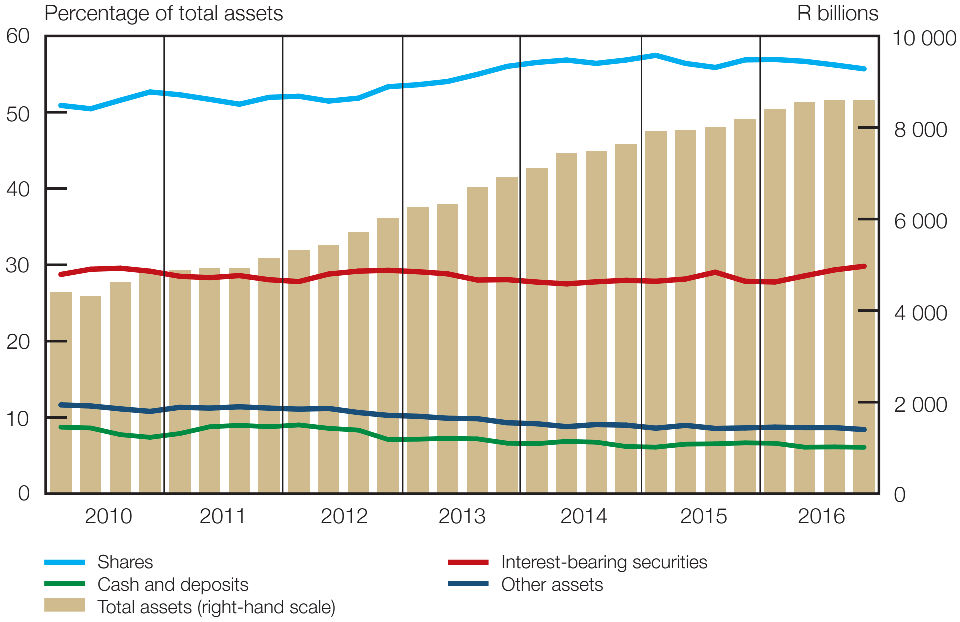
Non-bank financial intermediaries

The consolidated balance sheet of non-bank financial institutions[12] contracted slightly from the third quarter of 2016 to R8.6 trillion in the fourth quarter. On an annual basis, the total assets of these institutions increased by only 5% in 2016 – the slowest increase since 2008. Weak domestic economic growth and volatility in financial asset prices appear to have had a negative effect on the market value of financial assets held by non-bank financial institutions in 2016. A change in non-bank financial institutions' asset allocation shows that the proportion of shareholdings declined by 1 percentage point from the third quarter of 2016 to 56% of total assets in the fourth quarter. Shareholdings declined by 1 percentage point in 2016, alongside lower share prices in the final quarter of the year. The rebound in share prices thus far in 2017 might encourage the reallocation of some funds to shares.

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

Holdings of interest-bearing securities as a proportion of total assets increased by 1 percentage point from the third quarter of 2016 to 30% in the fourth quarter. Consistent with the strong performance of the bond market, as evidenced by a 15% nominal increase in the All-Bond Index in 2016, the proportion of assets held in interest-bearing securities increased by 2 percentage points from 2015 to 2016. The reallocation of funds into this asset class is likely to be influenced by, among other things, the inflation outlook, exchange rate developments and the expected returns of shares relative to bonds.

Total asset holdings of non-bank financial institutions



Source: SARB

Non-bank financial institutions' holdings of cash and deposits remained unchanged at 6% of total assets in both the third and fourth quarters of 2016. Holdings of cash and deposits declined by 1 percentage point from 2015 to 2016, to a level of 2 percentage points below the 10-year average. The value of loans extended by these institutions to households and companies remained unchanged at 5% of total assets in both the third and fourth quarters of 2016. Surprisingly, credit extended by finance companies remained relatively robust, registering annual growth of 8% in the final quarter of 2016.

Weak economic growth, job losses and a moderation in households' disposable income adversely affected the amount of savings intermediated through non-bank financial institutions in 2016. The absence of meaningful economic growth suggests that the balance sheet of these institutions is likely to be largely dependent on changes in asset prices.

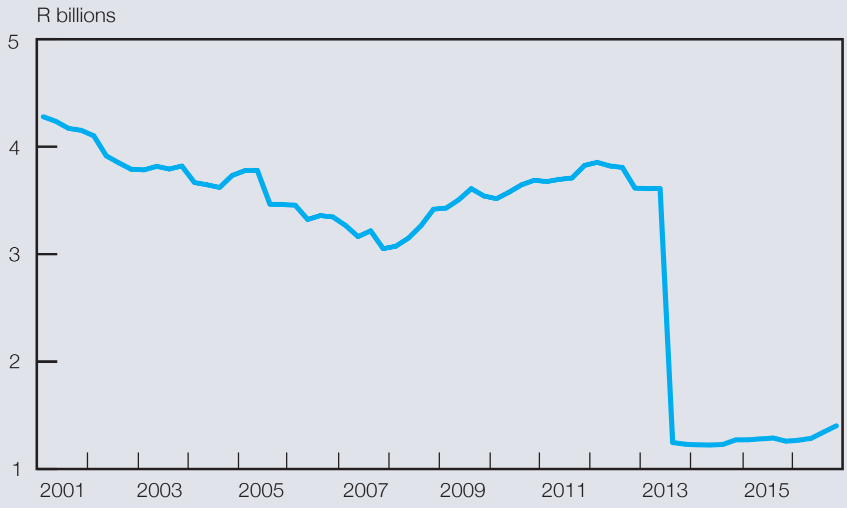
Box 6 Shrinking participation bond scheme intermediation

Participation bond schemes (PBSs) are collective investment vehicles that pool funds received from investors and mainly provide loans to commercial and industrial real estate developers. The investment term is five years, with investors receiving interest linked to the prime lending rate. PBSs in turn extend mortgage bonds on various properties within their portfolio. This industry channels household savings and other funds for property development. These schemes conduct intermediation in the so-called 'shadow banking' sphere by facilitating maturity transformation from short-term funding to long-term financing.

Property financing by the PBS industry declined from R4.2 billion in 2001 to R3.1 billion in 2007. However, lending activity rebounded somewhat, following the global financial crisis which constrained such financing by banks, and PBSs' investments increased to R3.8 billion in 2011. Subsequently, PBSs' intermediation decreased significantly to only R1.2 billion in 2013 and then remained broadly around this level, reaching R1.4 billion in 2016. The dearth of intermediation by PBSs resulted from a notable decline in the number of such schemes, from 14 in 2001 to only 3 in the fourth quarter of 2016, as some were consolidated into banks and insurance companies while others closed. The biggest capital redemption occurred in 2013 when the largest scheme dissolved.

PBS intermediation appears to have been negatively affected on the funds received side by increased competition from other low-risk investment products such as fixed deposits, with interest rates offered by banks exceeding that of PBSs since mid-2009. Other alternative investments include retail government bonds and money market funds.

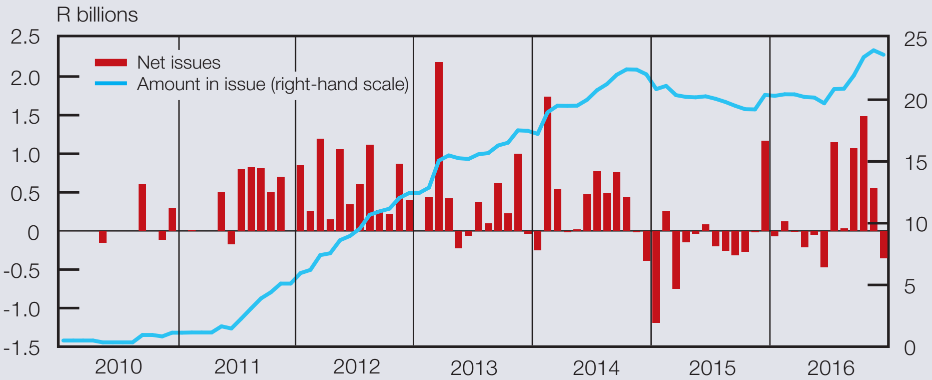
Funds invested by participation bond schemes on behalf of participants



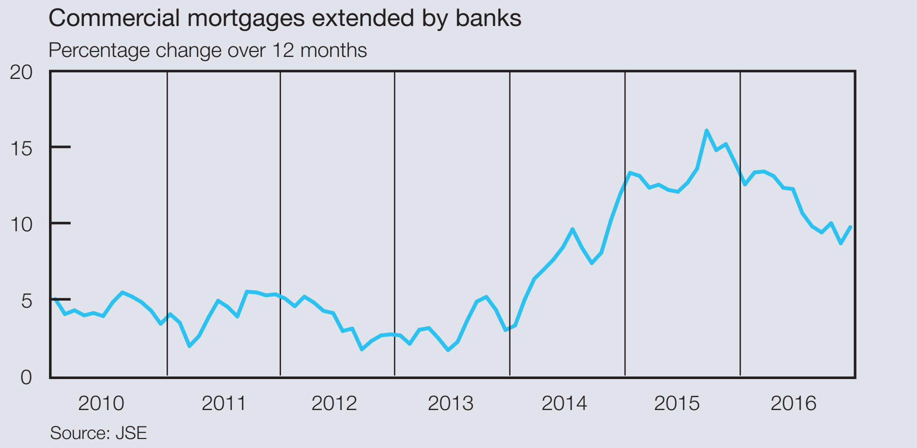
Source: SARB

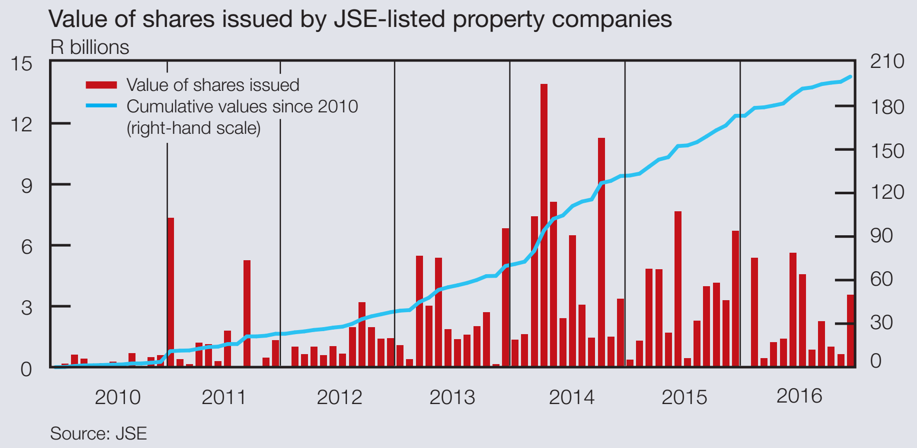
On the funding side, companies in the real estate sector started to utilise the bond market from the end of 2009. Their outstanding nominal value of bonds in issue in the primary bond market increased from R0.5 billion in November 2009 to R24 billion at the end of 2016. Growth in credit extended by banks for mortgages on commercial property increased significantly from a year-on-year rate of 2% in June 2013 to 16% in September 2015, before slowing in subsequent months. Share issuances on the JSE Limited by listed property companies as a means of raising capital have also increased significantly since 2014. Despite these developments, PBSs continue to be the preferred investment vehicle of some investors.

Bond issuances by JSE-listed property companies



Source: JSE





Flow of funds[13]

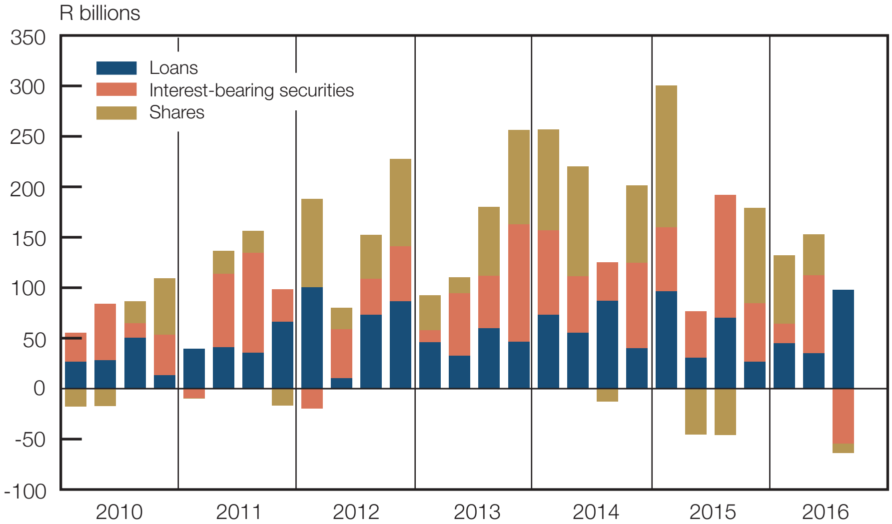
13 For more detail, refer to the matrix on pages S–46 and S–47.

The domestic economy received more net foreign investment inflows in the third quarter of 2016 than in the preceding quarter, despite volatility in financial asset prices globally. This was due to, among other things, continued demand for high-yielding emerging market assets, including those of South Africa. Non-residents' net purchases of interest-bearing securities amounted to R44 billion in the third quarter of 2016, while loans of R40 billion were extended. Similarly, investment in domestic shares by non-residents registered an inflow of R12 billion.

Financial intermediation through loans improved during the third quarter of 2016 as bank loans and advances increased. Total loans extended by financial intermediaries more than doubled from R35 billion in the second quarter of 2016 to R98 billion in the third quarter, spurred by credit demand from central government and non-financial private corporate businesses. By contrast, financial intermediaries reduced their holding of shares and interest-bearing securities in the third quarter of 2016. Shares equivalent to R9.1 billion were sold during the third quarter of 2016 along with the decline in the JSE's share prices. Correspondingly, sales of interest-bearing securities worth R55 billion occurred during the review period.

The *general government sector's* finances remained under pressure in the third quarter of 2016 in an environment of weak economic growth, notwithstanding signs of a gradual deceleration in expenditure. The deceleration in expenditure followed the pronouncement by the Minister of Finance in the *Medium Term Budget Policy Statement* in October 2016 of measured fiscal consolidation by gradually contracting spending, while prioritising capital investment. Meanwhile the revenue collection base continued to weaken during the third quarter of 2016, increasing the general government's financing shortfall to R65 billion from R54 billion in the preceding quarter. The shortfall was financed through the issuance of R32 billion in government bonds, R10 billion in Treasury bills and by acquiring bank loans and advances of R26 billion. Non-residents purchased R53 billion worth of long-term government bonds while the monetary sector acquired R13 billion, taking advantage of attractive yields in an environment of muted corporate earnings.

Financial intermediation by main instruments



Source: SARB

Non-financial corporate business enterprises' economic activity slowed during the third quarter of 2016, amid lower business confidence levels. The slowdown was reflected in lower gross saving[14] to the value of R121 billion in the third quarter of 2016 – 8% lower than in the second quarter – along with subdued profits. Notwithstanding the lower level of saving and muted economic conditions, non-financial business enterprises' gross fixed capital formation accelerated from R149 billion in the second quarter of 2016 to R170 billion in the third quarter. Capital outlays were related to, among other things, the acquisition of coaches, machinery and equipment, and the construction of vehicle assembly plants. These outlays were financed by various sources of funds, including internal funds and loans amounting to R55 billion over the review period. Non-financial corporate business enterprises had a financing shortfall of R44 billion in the third quarter of 2016 compared with R16 billion in the second quarter.

14 The sum of net saving and consumption of fixed capital.

The *household sector's* financial flows moderated during the third quarter of 2016, reflecting low consumer confidence levels, tighter financial conditions, high debt levels, rising living costs, and slowing real income growth. While the household sector's real asset flows increased by 6% in the second quarter of 2016, a decline was registered in the financial asset component. The latter receded from R78 billion in the second quarter of 2016 to R63 billion in the third quarter, as deposits at banks increased by a smaller amount. Similarly, credit to households remained weak during the third quarter of 2016 as the combined value of mortgage loans and bank loans and advances amounted to a paltry R5.4 billion. The household sector's financing surplus of R25 billion in the third quarter of 2016 was lower than the R29 billion recorded a quarter earlier.

Public finance[15]

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

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

Non-financial public sector borrowing requirement[16]

The *non-financial public sector borrowing requirement* amounted to R138 billion in the first nine months (April–December 2016) of fiscal 2016/17, some R34.1 billion less than in the same period of the previous fiscal year. The lower non-financial public sector borrowing requirement was mainly attributable to the lower cash deficit of non-financial public enterprises and corporations, alongside higher cash surpluses of local governments. In addition, the cash surpluses of provincial governments, extra-budgetary institutions and social security funds contributed further to the lower overall borrowing requirement of the non-financial public sector.

Non-financial public sector borrowing requirement

R billions

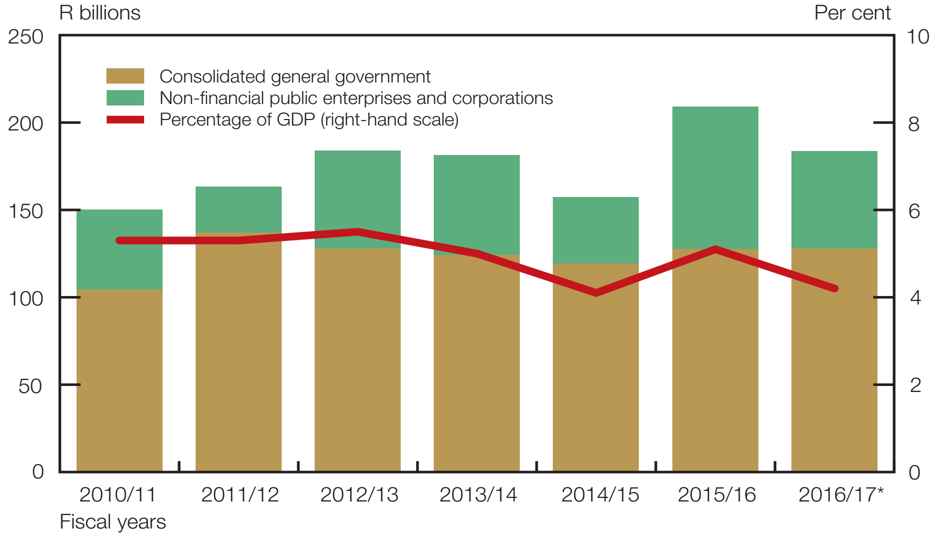
Level of government	Apr–Dec 2015*	Apr–Dec 2016*
Consolidated general government	106.0	95.8
National government	133.8	142.1
Extra-budgetary institutions	-5.6	-6.9
Social security funds	-10.8	-11.9
Provincial governments	-3.6	-0.6
Local governments	-7.9	-26.9
Non-financial public enterprises and corporations	65.8	41.9
Total**	**171.8**	**137.7**
As a percentage of GDP	*5.6*	*4.2*

* Deficit + surplus –
** Components may not add up to totals due to rounding off
Sources: National Treasury, Stats SA and SARB

As a ratio of GDP, the non-financial public sector borrowing requirement amounted to 4.2% in the first nine months of fiscal 2016/17. This was lower than the ratio of 5.6% recorded in the same period of the previous fiscal year.

The borrowing requirement of the *consolidated general government* amounted to R95.8 billion in the first nine months of fiscal 2016/17, some R10.2 billion less than in the corresponding period of fiscal 2015/16. As a ratio of GDP, the borrowing requirement of the consolidated general government was 2.9% in the first nine months of fiscal 2016/17 – less than the 3.4% in the corresponding period of fiscal 2015/16.

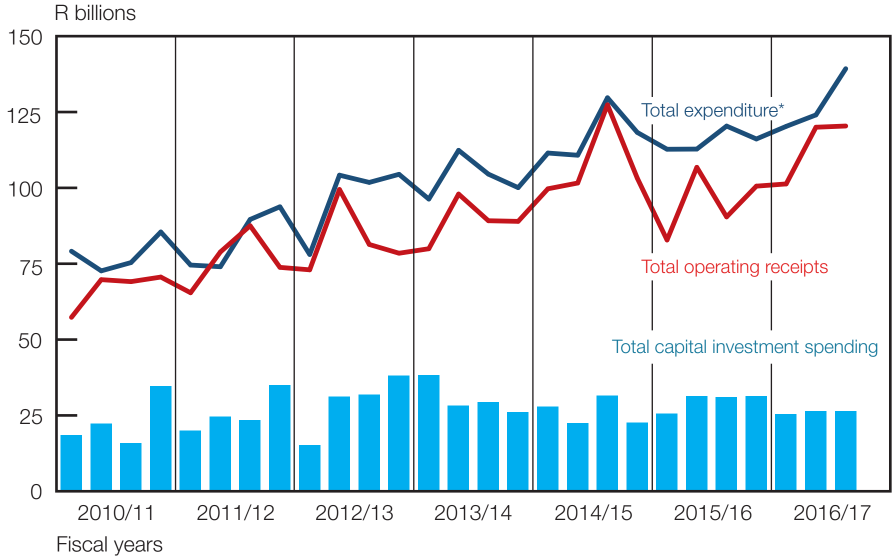
Non-financial public sector borrowing requirement



* April–December 2016, annualised
Sources: National Treasuary, Stats SA and SARB

The *non-financial public enterprises and corporations'* estimated cash deficit of R18.9 billion in the fourth quarter of 2016 resulted in a preliminary cumulative cash deficit of R41.9 billion in the first nine months of fiscal 2016/17. This cumulative cash deficit was R23.9 billion less than in the same period of the preceding fiscal year. The significant improvement in the cash deficit could be attributed to relatively higher operating cash receipts, notably in the July–September quarter, and a moderation in capital investment spending by some major state-owned companies (SOCs).

Financial activities of non-financial public enterprises and corporations



* Including both current and capital spending

Source: SARB

Total cash receipts of non-financial public enterprises and corporations amounted to R342 billion in the first nine months of fiscal 2016/17, representing a year-on-year increase of 22.0%. This increase resulted primarily from improved operational performance reported by some major SOCs. Over the same period, total expenditure, both current and capital, amounted to R384 billion, reflecting an annual increase of 10.9%. Total expenditure growth was driven by operating expenses as growth in net investment in non-financial assets continued to slow.

Capital investment by SOCs remained fairly subdued and below budgeted targets for capital infrastructure spending against the backdrop of subdued economic growth, uncertainty and low business confidence. The acquisition of non-financial assets by non-financial public enterprises and corporations amounted to R78.4 billion in the first nine months of fiscal 2016/17, or 10.8% less than in the corresponding period of the previous fiscal year. The moderation in capital spending resulted mainly from general delays in, or the postponement of, some capital investment programmes, particularly in the transport sector. In addition, borrowing costs continued to exacerbate already constrained financial positions and to deter capital investment spending plans of the SOCs. The total outstanding listed debt of non-financial SOCs amounted to R253 billion at 31 December 2016, or 4.2% more than at 31 March 2016.

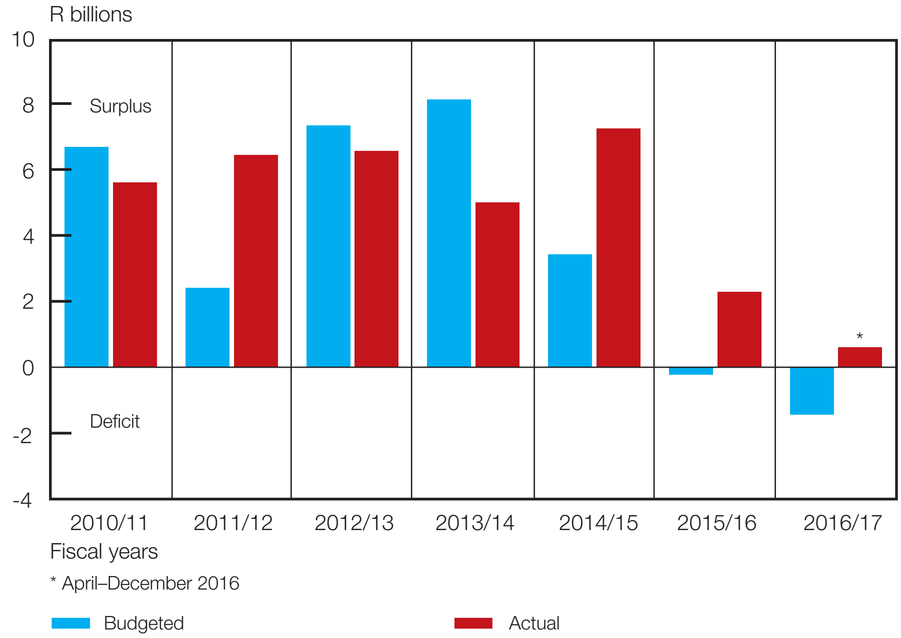
The preliminary financial statistics of *national government* showed a moderate improvement in cash receipts from operating activities to R842 billion in the first nine months of fiscal 2016/17 – 4.9% more than in the same period of the preceding fiscal year. The increase in national government cash receipts resulted from higher collections in all the main tax categories, despite most of these tax categories having performed below budgeted projections.

National government's cash payments for operating activities amounted to R972 billion in the first nine months of fiscal 2016/17, reflecting a year-on-year increase of 5.4%. Total grants paid by national government to other levels of general government amounted to R551 billion over the period, representing 56.7% of total cash payments. Compensation of employees amounted to R107 billion over the period, representing a year-on-year increase of 9.0%.

Net cash flow from operating activities of national government, together with net investment in non-financial assets, generated a cash deficit of R142 billion in the first nine months of fiscal 2016/17, up from a cash deficit of R134 billion in the same period of the previous fiscal year.

Provincial governments' financial activities resulted in a cash surplus of R0.6 billion in the first nine months of fiscal 2016/17. This was R3.0 billion less than the cash surplus in the corresponding period in fiscal 2015/16. The lower cash surplus resulted from higher growth in cash payments which outpaced the rate of increase in total operating cash receipts.

Provincial government finances



Source: National Treasury

Cash receipts from operating activities of provincial governments amounted to R392 billion in the first nine months of fiscal 2016/17, representing a year-on-year increase of 7.2%. Grants from national government (equitable share transfers and conditional grants) amounted to almost R379 billion and remained the largest component of provincial government cash receipts. Of this, equitable share transfers amounted to R308 billion and reflected year-on-year growth of 7.3%, while conditional grants earmarked for specific purposes totalled R70.7 billion and represented a year-on-year increase of 6.1%.

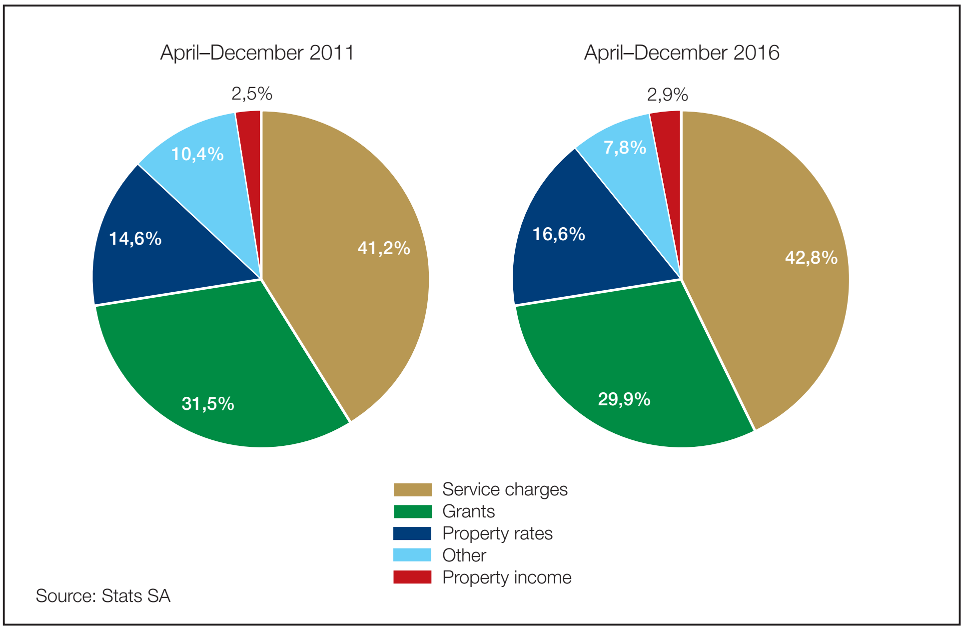
Netting cash payments for operating activities and net investment in non-financial assets amounted to R391 billion in the first nine months of fiscal 2016/17, or about R29.4 billion more than in the same period of the previous fiscal year. The increase in provincial governments' cash payments for operating activities could largely be attributed to the compensation of employees, which amounted to R234 billion and reflected year-on-year growth of 8.3%.

Provincial governments' deposits with the Corporation for Public Deposits decreased from R19.0 billion at the end of March 2016 to R17.9 billion at the end of December. Over the same period, provincial government deposits with private banks increased marginally from R17.3 billion to R17.9 billion, while their overall indebtedness to banks decreased slightly from R0.7 billion to R0.5 billion.

Preliminary *local government* financial statistics showed an estimated cash surplus of R26.9 billion in the first nine months of fiscal 2016/17, significantly higher than the cash surplus of R7.9 billion recorded in the same period of fiscal 2015/16. The pronounced increase in the cash surplus of local government resulted mainly from the increase in total cash receipts, particularly in equitable share receipts from the national government earmarked for the provision of basic services to households, which outpaced growth in total expenditure.

Local governments' cash receipts from operating activities amounted to R277 billion in the first nine months of fiscal 2016/17, or a year-on-year increase of 11.9%. Sales of water, electricity and gas as well as inter-governmental transfers continued to be the primary sources of local government cash receipts. Inter-governmental transfers rose by 12.3% from the previous fiscal year and were comprised mainly of equitable share transfers from national government.

Composition of municipal operating cash receipts



Local governments' cash payments for operating activities amounted to R213 billion in the first nine months of fiscal 2016/17, representing a year-on-year increase of 6.5%. Purchases of goods and services (largely water and electricity) continued to drive growth in local government operating expenses. Net investment in non-financial assets amounted to R36.4 billion in the first nine months of fiscal 2016/17 – a decrease of R2.6 billion compared with the same period of the previous fiscal year.

Preliminary financial statistics for *extra-budgetary institutions* indicated a cash surplus of R6.9 billion in the first nine months of fiscal 2016/17, which was slightly higher than the cash surplus of R5.6 billion in the corresponding period of fiscal 2015/16. The higher cash surplus could be attributed to grants received from national government which amounted to R94.0 billion in April–December 2016, representing a year-on-year increase of 7.4%. *Social security funds* showed a preliminary cash surplus of R11.9 billion in the first nine months of fiscal 2016/17, somewhat higher than the cash surplus of R10.8 billion in the same period of the preceding fiscal year.

Budget comparable analysis of national government finance

The year-on-year rate of increase in national government revenue fell short, while that of expenditure exceeded original 2016 Budget projections in the first nine months of fiscal 2016/17. Therefore, the level of expenditure exceeded national government revenue by a larger margin than originally budgeted, resulting in a higher cash-book deficit for the first nine months of fiscal 2016/17 when compared with the same period of the previous fiscal year.

National government finances: key statistics, 2016/17

Year-on-year percentage change*

	Originally budgeted** Full 2016/17	Revised estimates*** Full 2016/17	Actual Apr–Dec 2016
Expenditure	5.9	5.2	6.2
Revenue	8.6	6.9	6.4
Memo: cash book deficit	**R156 billion**	**R165 billion**	**R149 billion**

* Fiscal 2015/16 to fiscal 2016/17
** *2016 Budget Review*
*** *2016 Medium Term Budget Policy Statement*

Sources: National Treasury and SARS

National government expenditure amounted to R961 billion in the first nine months of fiscal 2016/17, or 6.2% more than in the corresponding period a year earlier. The ratio of national government expenditure to GDP of 29.2% for the period April–December 2016 remained broadly the same as for the corresponding interval a year earlier. The *2016 Budget Review* projected that national government expenditure would amount to R1 318 billion in fiscal 2016/17, representing a year-on-year increase of 5.9%. However, in the *2016 Medium Term Budget Policy Statement (MTBPS)*, national government expenditure was revised downwards by about R9.0 billion to a year-on-year increase of 5.2%. This reinforces government's commitment to fiscal consolidation.

National government expenditure in fiscal 2016/17

Expenditure item	Originally budgeted Full 2016/17		Actual Apr–Dec 2016	
	R billions	Percentage change*	R billions	Percentage change*
Voted amounts	721.1	3.1	536.6	4.4
Of which: Current payments	*208.4*	*7.6*	*152.5*	*7.8*
Transfers and subsidies	*493.4*	*7.6*	*371.0*	*7.3*
Payments for capital assets	*14.4*	*-21.1*	*8.4*	*-9.4*
Payments for financial assets	*4.9*	*-83.2*	*4.7*	*-72.5*
Statutory amounts**	597.2	9.6	424.8	8.6
Of which: Interest on debt	*147.6*	*14.7*	*94.4*	*13.6*
Total expenditure	**1 318.3**	**5.9**	**961.4**	**6.2**

* Fiscal 2015/16 to fiscal 2016/17. Note that numbers might differ from previous editions of the *Quarterly Bulletin* due to the audited outcome of fiscal 2015/16
** Including extraordinary payments

Sources: National Treasury

The increase in national government expenditure was mainly due to higher voted expenditure and an increase in interest payments. Voted expenditure consists of current payments, transfers and subsidies, and payments for capital and financial assets. Current payments, and transfers and subsidies contributed 97.6% to total voted expenditure in the first nine months of fiscal 2016/17.

Current payments amounted to R152 billion in the first nine months of fiscal 2016/17, or 7.8% more than in the same period of the previous fiscal year. The Justice, Crime Prevention and Security cluster accounted for 72.6% of total current payments, with the departments of Correctional Services, Police, and Defence and Military Veterans contributing the most to this cluster.

Transfers and subsidies amounted to R371 billion in the first nine months of fiscal 2016/17, or 7.3% more than in the same period of the previous fiscal year. The departments of Education, Social Development, Cooperative Governance and Traditional Affairs, Transport, Health and Human Settlements together accounted for 80.2% of total transfers and subsidies.

Payments for capital assets are usually distributed unevenly, distorting year-on-year comparisons. These payments decreased by only 9.4% during the period under review compared with a projected decline of 21.1% in the *2016 Budget Review*. Payments for financial assets also declined in the first nine months of fiscal 2016/17 compared with the same period a year earlier. These payments amounted to R4.7 billion from April 2016 to December – 72.5% less than in the corresponding period of the previous fiscal year. The significant year-on-year decline in payments for financial assets is attributable to the high base created by a one-off transfer of R25.0 billion to Eskom and the New Development Bank in fiscal 2015/16.

Interest payments on national government debt totalled R94.4 billion in the first nine months of fiscal 2016/17, and increased by 13.6% on a year-on-year basis. The *2016 Budget Review* expected this spending category to increase by 14.7% in the current fiscal year to R148 billion.

Equitable share transfers to provinces, which represent the bulk of provincial government's total cash receipts, amounted to R308 billion in the first nine months of fiscal 2016/17 – some 7.3% more than in the same period of fiscal 2015/16. The *2016 Budget Review* projected this spending item to amount to R411 billion in fiscal 2016/17, reflecting a year-on-year increase of 6.3%.

Metropolitan municipalities received R3.7 billion in December 2016 as their share of the general fuel levy. This brought these payments to R7.5 billion during the current fiscal year. This was the second of three equal payments in the current fiscal year, with the final payment expected in March 2017.

After taking cash flow adjustments[17] into account, the cash flow expenditure of national government amounted to R940 billion in the first nine months of fiscal 2016/17 – some 5.2% more than in the same period of the previous fiscal year.

National government revenue amounted to R812 billion[18] in the first nine months of fiscal 2016/17, representing an increase of 6.4% compared with the same period of the previous year. This increase reflected higher tax collections in all the main tax categories, except payroll. However, most of the revenue sources performed below budgeted projections. As a ratio of GDP, national government revenue amounted to 24.7% in the first nine months of fiscal 2016/17 compared with 24.8% in the corresponding period of the previous fiscal year. The *2016 Budget Review* envisaged that national government revenue would increase by 8.6% to R1 162 billion. However, the *2016 MTBPS* revised national government revenue projections lower by about R18.0 billion to a year-on-year increase of 6.9% and gross tax revenue lower by R23.0 billion. This was partly offset by an upward revision in non-tax revenue.

17 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.

18 In the calculation by the South African Reserve Bank, revenue excludes premiums on debt portfolio restructuring and loan transactions. These came to R2.8 billion in the period April–December 2016.

National government revenue in fiscal 2016/17

Revenue source	Originally budgeted Full 2016/17		Actual Apr–Dec 2016	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	668.4	10.1	469.7	8.4
Income tax on individuals	*442.2*	*13.6*	*298.8*	*9.4*
Income tax on companies	*200.9*	*3.9*	*151.4*	*6.8*
Payroll taxes	17.6	15.9	11.0	-1.2
Taxes on property	15.5	2.7	11.7	7.7
Taxes on goods and services	418.6	8.5	292.9	7.3
Value-added tax (VAT)	*301.3*	*7.2*	*210.7*	*6.9*
Domestic VAT	*322.4*	*8.4*	*237.6*	*7.9*
Import VAT	*164.0*	*8.8*	*106.4*	*0.2*
Taxes on international trade and transactions	54.5	16.2	33.1	2.8
Import duties	*54.0*	*16.8*	*32.8*	*3.7*
Other revenue**	26.8	-47.4	23.2	-43.9
Less: SACU*** payments	39.4	-22.7	29.6	-23.0
Total revenue	1 162.0	8.6	812.1	6.4

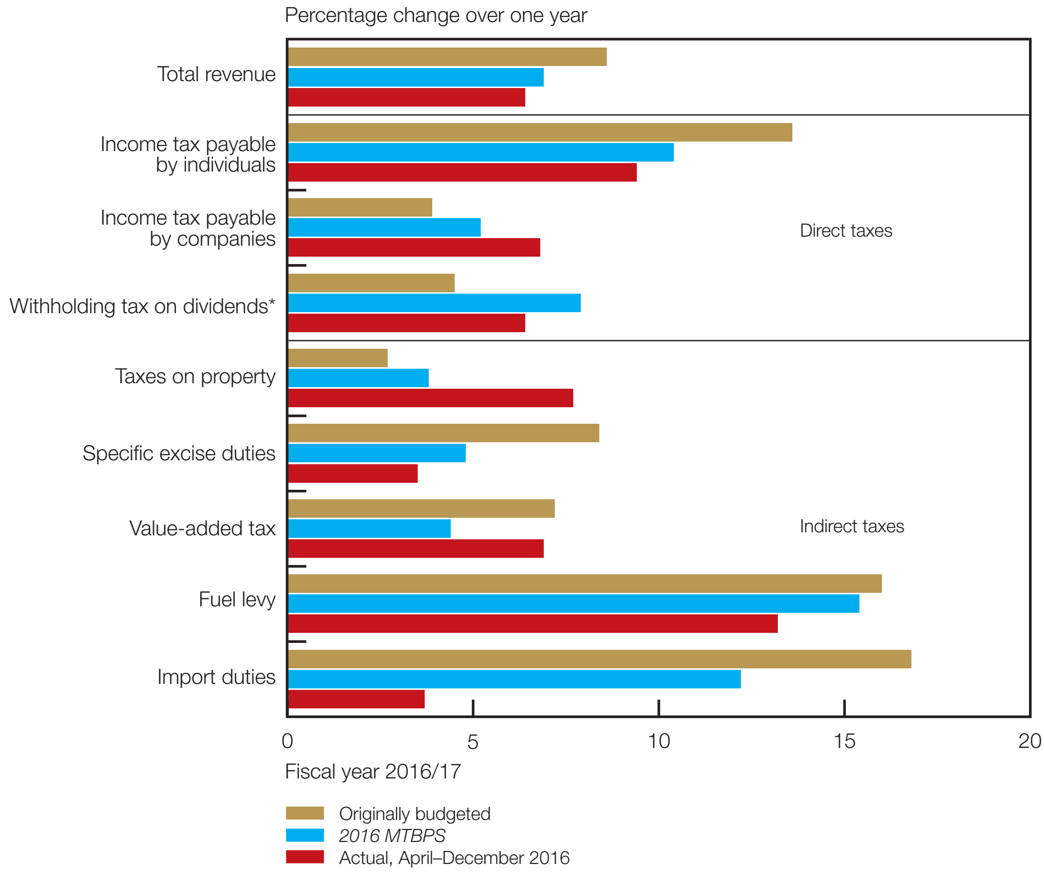
* Fiscal 2015/16 to fiscal 2016/17
** Including extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions that amounted to R2.5 billion in April–December 2016
*** Southern African Customs Union

Sources: National Treasury and SARS

Taxes on income, profits and capital gains amounted to R470 billion in the first nine months of fiscal 2016/17, or 8.4% more compared with the same period of the previous fiscal year. However, this tax category underperformed the 2016 Budget projections, primarily due to a combination of lower pay-as-you-earn receipts, lower bonuses, higher-than-expected personal income tax refunds, and lower provisional personal income tax payments. Revenue collection in this category may also have been adversely affected by a lack of formal sector employment growth. Conversely, corporate income tax recorded a significant increase well above budgeted projections during the period under review due to higher provisional tax payments from the mining and quarrying, and the financial sectors, in particular.

Taxes on property amounted to R11.7 billion in the first nine months of fiscal 2016/17, or 7.7% more than in the same period of fiscal 2015/16. Higher tax receipts emanated from buoyant collections of both transfer duties and security transfer tax. This mirrored some improved economic activity in the property and financial markets.

Components of national government revenue



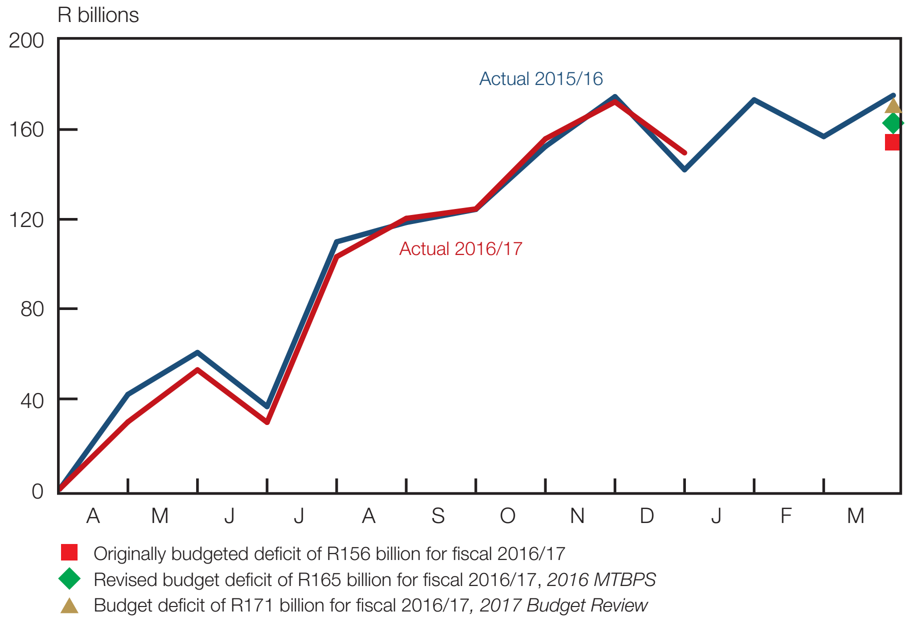
* Includes secondary tax on companies and withholding tax on interest

Sources: National Treasury and SARS

Taxes on goods and services amounted to R293 billion in the first nine months of fiscal 2016/17, or 7.3% more than in the same period of the previous fiscal year. Although this tax category fell short of the original 2016 Budget projections, it improved somewhat in December 2016. This tax category underperformed due to slower growth in import value-added tax (VAT) and excise duties. Lower collections from import VAT could mainly be attributed to a significant slowdown in the importation of vehicles, machinery and electrical machinery. Weak growth in excise duties occurred primarily on account of lower receipts from cigarettes, cigarette tobacco and beer. The recovery in taxes on goods and services during December 2016 resulted largely from stronger collections of domestic VAT, alongside lower VAT refunds.

Taxes on international trade and transactions amounted to R33.1 billion in the first nine months of fiscal 2016/17. The year-on-year increase of 2.8% was well below the originally budgeted growth rate for the full fiscal year. In the first quarter of fiscal 2016/17, this tax category increased at a brisk pace before slowing down in the subsequent two quarters. The slowdown resulted primarily from a decline in receipts of import duties (the largest component of the international trade and transactions category), partly due to a moderation in the importation of vehicles, electrical machinery and clothing.

Cumulative deficit of national government



Sources: National Treasury and SARS

Netting national government revenue and expenditure yielded a cash book deficit of R149 billion in the first nine months of fiscal 2016/17. This was R7.5 billion more than the cash-book deficit recorded in the corresponding period of the previous fiscal year. As a ratio of GDP, the cash book deficit amounted to 4.5% in the first nine months of fiscal 2016/17, slightly lower than the 4.6% recorded in the first nine months of fiscal 2015/16. The *2016 Budget Review* projected a cash book deficit of R156 billion (3.6% of GDP) in fiscal 2016/17. However, the *2016 MTBPS* revised the cash book deficit upwards to R165 billion (3.8% of GDP).

The primary balance of national government (the deficit/surplus recalculated by excluding interest payments from total expenditure) recorded a deficit of R54.9 billion in the first nine months of fiscal 2016/17, or R3.8 billion less than in the same period of the preceding fiscal year. The ratio of the primary balance to GDP of 1.7% in the first nine months of fiscal 2016/17 compares with the 1.9% recorded in the same period of the previous fiscal year. The *2016 Budget Review* projected a primary deficit of only 0.2% of GDP for the current fiscal year as a whole. This was subsequently revised to 0.4% in the *2016 MTBPS.*

The cash flow deficit of national government remained broadly unchanged at R122 billion in the first nine months of fiscal 2016/17 when compared with the same period of the previous fiscal year. After taking the cost on revaluation of foreign debt at redemption into account, the net borrowing requirement amounted to R134 billion. This was R10.9 billion more than in the first nine months of fiscal 2015/16.

National government financing in fiscal 2016/17

R billions

Item or instrument	Actual Apr–Dec 2015	Originally budgeted Full 2016/17[1]	Actual Apr–Dec 2016
Cash flow deficit[2]	122.2[3]	156.3[4]	121.9[3]
Plus: Cost/profit on revaluation of foreign debt at redemption[5]	1.2	8.1	12.6
Net borrowing requirement	123.5	164.5	134.4
Treasury bills	29.3	25.0	67.4
Domestic government bonds	89.9	116.2	80.2
Foreign bonds and loans	-2.1	15.9	49.1
Change in available cash balances[6]	6.5	7.3	-62.4
Total net financing[7]	123.5	164.5	134.4

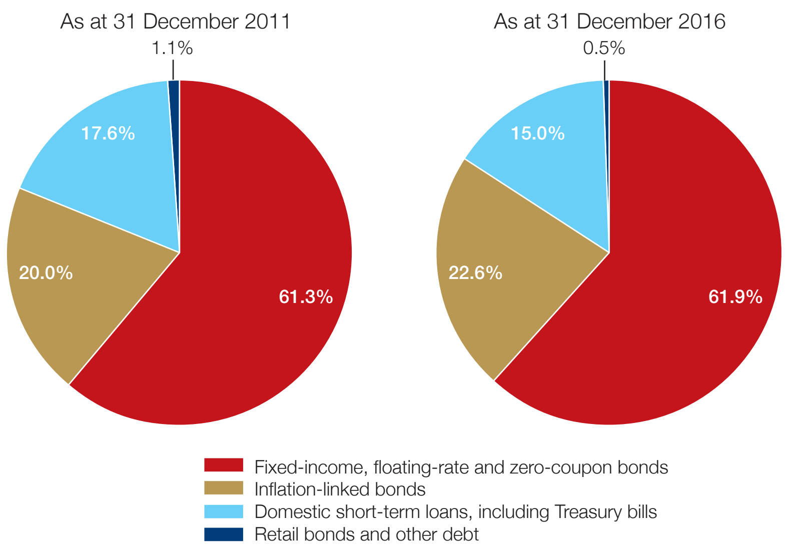
1 *2016 Budget Review*
2 Including extraordinary receipts and payments
3 Cash flow deficit which differs from the cash book deficit
4 Cash book deficit
5 Cost + profit –
6 Increase – decrease +
7 Components may not add up to totals due to rounding

Sources: National Treasury and own calculations

The net borrowing requirement was largely financed through the issuances of Treasury bills and domestic government bonds. National government raised R67.4 billion from both Treasury bills and short-term loans from the Corporation for Public Deposits, notably more than in the corresponding period of fiscal 2015/16. The net issuance of domestic government bonds amounted to R80.2 billion in the first nine months of fiscal 2016/17, while the net issuance of foreign bonds and loans amounted to R49.1 billion during the period under review – more than three times the amount originally budgeted for in the full fiscal year. National government's cash balances increased by R62.4 billion in the first nine months of fiscal 2016/17 to R275 billion at the end of December 2016. Of this, deposits with the SARB amounted to R200 billion, or 72.8%, while the remaining balances were held with commercial banks.

National government's domestic debt (marketable and non-marketable) increased by R205 billion in the first nine months of fiscal 2016/17 to R2 024 billion at the end of December 2016. This increase resulted largely from an increase of R175 billion in domestic marketable debt instruments (Treasury bills and bonds), accounting for about 97% of the outstanding balance as at 31 December 2016. Inflation-linked bonds accounted for 27.4% of the domestic marketable debt, bringing the outstanding balance of these instruments to R457 billion at the end of December 2016.

Composition of national government domestic debt



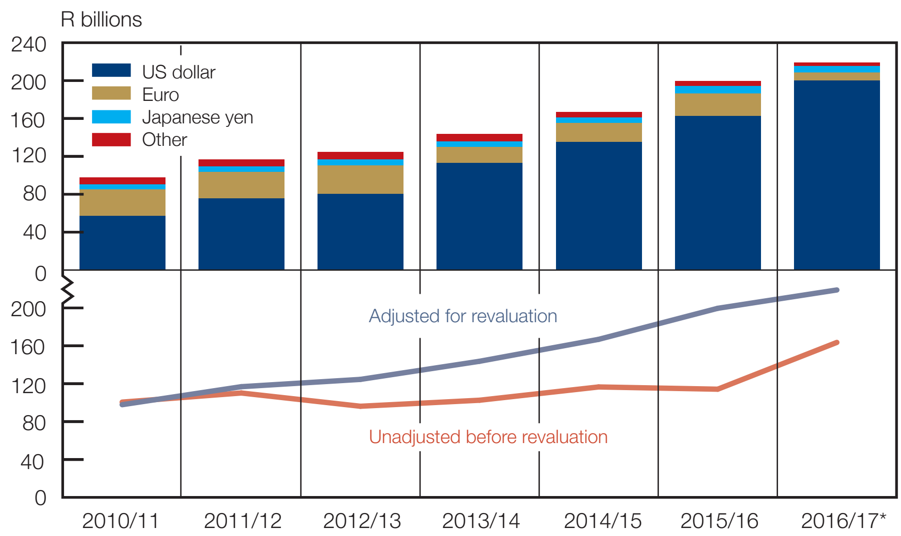
Source: National Treasury

The composition of national government's domestic debt remained broadly unchanged over the past five years, with fixed-income, floating-rate and zero-coupon bonds representing the largest share at almost 62%. The share of inflation-linked bonds increased from 20.0% to 22.6%, whereas the share of domestic short-term loans, including Treasury bills, declined from 17.6% to 15.0%. At the same time, the share of retail bonds and other debt instruments more than halved from 1.1% to 0.5%.

The *2016 Budget Review* projected national government's domestic debt to amount to R2 004 billion (45.7% of GDP) for the 2016/17 fiscal year as a whole. However, in the *2016 MTBPS* this was revised upwards to R2 008 billion (45.9% of GDP). The average unexpired maturity of national government's domestic marketable bonds increased from 179 months as at 31 March 2016 to 183 months as at 31 December 2016.

Foreign debt of national government increased by R19.4 billion in the first nine months of fiscal 2016/17 to R219 billion as at 31 December 2016. This increase resulted from a combination of exchange rate revaluation effects and net issuances of foreign bonds and loans. Government successfully issued three offshore bonds. The first was a US$1.25 billion 10-year bond priced at a coupon of 4.875% in April 2016, and the other two in October have a combined value of US$3 billion and mature in 2028 (12-year bond) and 2046 (30-year bond).

Foreign currency-denominated debt of national government



As at 31 March of each fiscal year

* As at 31 December 2016

Source: National Treasury

Before accounting for exchange rate revaluation effects, national government's total foreign debt amounted to R164 billion compared with R219 billion after revaluation effects as at 31 December 2016 – a revaluation of R55.4 billion. National government's foreign debt-to-GDP ratio increased from 4.8% as at 31 March 2016 to 5.0% as at 31 December 2016. The *2016 Budget Review* estimated that national government's foreign debt would amount to R230 billion (5.2% of GDP) for the full 2016/17 fiscal year. However, in the *2016 MTBPS*, foreign debt was revised upwards to R238 billion (5.4% of GDP) for the same period. The average outstanding maturity of foreign marketable bonds increased from 102 months as at 31 March 2016 to 126 months as at 31 December.

National government's total gross loan debt (domestic and foreign debt) increased by R224 billion in the first nine months of fiscal 2016/17 to R2 243 billion as at 31 December 2016. The increase could largely be attributed to a rise in domestic debt, which also accounted for the largest share of the outstanding balance. In the first nine months of fiscal 2016/17, total gross loan debt of national government represented 51.7% of GDP. According to the *2016 Budget Review*, national government's gross loan debt was expected to amount to R2 234 billion (50.9% of GDP) in fiscal 2016/17. However, in the *2016 MTBPS* this was revised upwards by about R12.8 billion to R2 246 billion (51.3% of GDP).

The Budget for fiscal 2017/18 to 2019/20

The National Budget for fiscal 2017/18 was presented by the Minister of Finance on 22 February 2017 against an economic landscape characterised by significant domestic political and transformational challenges.

The fiscal space continued to be constrained by, among other factors, slow economic growth, higher debt levels and debt-service costs, mounting spending pressures and revenue underperformance. The 2017 Budget reaffirmed government's continued commitment to a measured and prudent consolidation path, aimed at maintaining fiscal discipline through a reduction in the budget deficit and by slowing the pace of national debt accumulation to safeguard fiscal sustainability.

Macroeconomic projections*

	2014	2015	2016		2017	2018	2019
Percentage change	Outcome		Originally budgeted**	Revised estimates***	Medium-term estimates		
Real GDP growth	1.6	1.3	0.9	0.5	1.3	2.0	2.2
CPI	6.1	4.6	6.8	6.4	6.4	5.7	5.6
Current account balance (percentage of GDP)	-5.3	-4.3	-4.0	-4.0	-3.9	-3.7	-3.8
GDP at current prices (R billions)	3 813	4 014	4 306	4 322	4 658	5 030	5 441

* Calendar years
** *2016 Budget Review*
*** *2017 Budget Review*
Source: National Treasury

The 2017 Budget reflected macroeconomic projections that remained broadly unchanged from the projections in the *2016 MTBPS*. After successive downward revisions to GDP growth forecasts in recent years, government now expects the South African economy to grow moderately by 0.5% in 2016, and to accelerate to 1.3% and 2.0% in 2017 and 2018 respectively.

The 2017 Budget recognised that the projected pace of economic growth is still substantially lower than the targets set out in the National Development Plan, and is therefore insufficient to address the triple challenge of unemployment, poverty and inequality. In addition, government recognised that prevailing weak economic growth could also be a function of underlying structural impediments. The 2017 Budget thus advocated an accelerated broad-based economic transformation.

The fiscal framework presented in the 2017 Budget did not deviate much from the consolidation targets set out in the *2016 MTBPS*. Consistent with the *2016 MTBPS*, the 2017 Budget proposed raising additional tax revenue of R28 billion in fiscal 2017/18. The additional revenue would come from increases in various taxes, in particular personal income tax. The most notable income tax proposal was the introduction, as from 1 March 2017, of a new top personal income tax bracket of 45.0% for individuals with taxable incomes above R1.5 million per year. This is expected to affect an estimated 103 000 tax payers. The primary, secondary and tertiary rebates, and the levels of all taxable income brackets would increase by only 1%, with the minimum tax-free threshold increasing from R75 000 to R75 750. These increases are well below expected inflation and thus only provide very limited relief for bracket creep.

Other selected tax proposals include the following:

– *Fuel levy:* The general fuel levy would increase by 30 cents per litre from 5 April 2017, lifting the levy to R3.15 per litre of petrol and R3.00 per litre of diesel.
– *Transfer duties:* Government proposed to raise the duty-free threshold on purchases of residential property from R750 000 to R900 000, with effect from 1 March 2017.
– *Dividend withholding tax:* The dividend withholding tax would increase from 15% to 20%, with effect from 22 February 2017.
– *Tax-free savings:* The annual limit on contributions to tax-free savings accounts would increase from R30 000 to R33 000.
– *Medical tax credits:* Medical tax credits would be increased for the first two beneficiaries from R286 to R303 per month, and would increase from R192 to R204 per month for all remaining beneficiaries.

The new top individual marginal income tax bracket, combined with the partial relief for bracket creep, is expected to contribute an additional R16.5 billion in revenue in 2017/18. The increase in the dividend withholding tax is expected to contribute an additional R6.8 billion.

Total national gross tax revenue for fiscal 2016/17 is estimated at R1.1 trillion, increasing to R1.5 trillion over the medium term. The tax burden would increase from 26.0% of GDP in fiscal 2016/17 to 26.7% in fiscal 2017/18 as a result of the proposed tax increases.

19 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 framework.

Government's revised consolidated expenditure[19] is expected to increase, but within the context of a proposed expenditure ceiling which will be reduced by R26 billion over the next two years – R10 billion in fiscal 2017/18 and R16 billion in fiscal 2018/19. This would be achieved by trimming expenditure on non-core goods and services and compensation budgets, together with some funding reallocations.

Debt-service costs, the fastest-growing expenditure category, is expected to be R1.4 billion lower in 2016/17 than the 2016 Budget estimate of R148 billion. This decline could be attributed to favourable exchange rate movements and adjustments to domestic and foreign debt issuance plans. However, debt-service costs have been revised substantially higher over the medium term due to growth in the outstanding stock of debt, and are expected to amount to R197 billion in fiscal 2019/20, or 3.6% of GDP. Excluding debt-service costs and the contingency reserve, allocated expenditure shared between the three spheres of government amounted to R1.2 trillion, R1.3 trillion and R1.4 trillion over each of the respective Medium Term Expenditure Framework (MTEF) years. These allocations took into account government's spending priorities and each government sphere's revenue-raising capacity and responsibilities.

Government proposed to mobilise additional resources to fund further allocations to higher education budgets and other spending obligations. These additional resources include drawing down on the contingency reserve, the removal of provisional allocations from the MTEF, and using the National Skills Fund's reserves to fund shortfalls in university education in fiscal 2017/18. The 2017 Budget also prioritised support to health and social protection. Spending allocation on social protection was expected to increase from R165 billion in fiscal 2016/17 to R209 billion by 2019/20. Social protection proposals announced in the 2017 Budget include:

– an increase of R90 in the old age grant to R1 600 for pensioners over the age of 60, and to R1 620 for those over 75;
– an increase of R90 in the disability and care dependency grants to R1 600 per month;
– an increase of R30 in the foster care grant to R920 per month; and
– an increase of R20 in the child support grant to R380 per month.

The number of social grant beneficiaries is expected to reach 18.1 million by the end of fiscal 2019/20, with child support grant beneficiaries accounting for the lion's share.

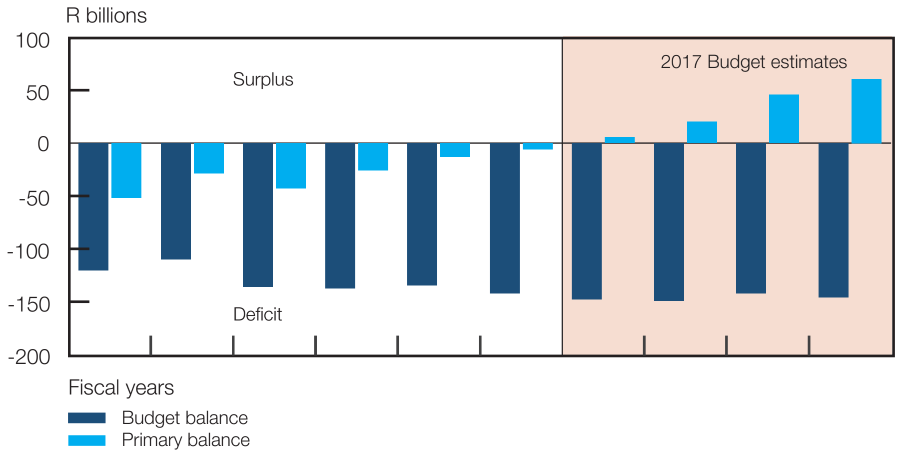
The proposed spending measures are expected to increase consolidated expenditure from R1.4 trillion in fiscal 2016/17 to R1.8 trillion by fiscal 2019/20. This represents a modest upward revision in government spending over the medium term, from annual average growth of 7.6% in the *2016 MTBPS* to 7.9% in the 2017 Budget. For fiscal 2017/18, budgeted consolidated expenditure amounted to R1.6 trillion (almost 33.0% of GDP), while consolidated revenue amounted to R1.4 trillion (29.8% of GDP), resulting in a consolidated deficit of R149 billion, or 3.1% of GDP. The consolidated deficit is expected to decline to 2.6% of GDP by 2019/20.

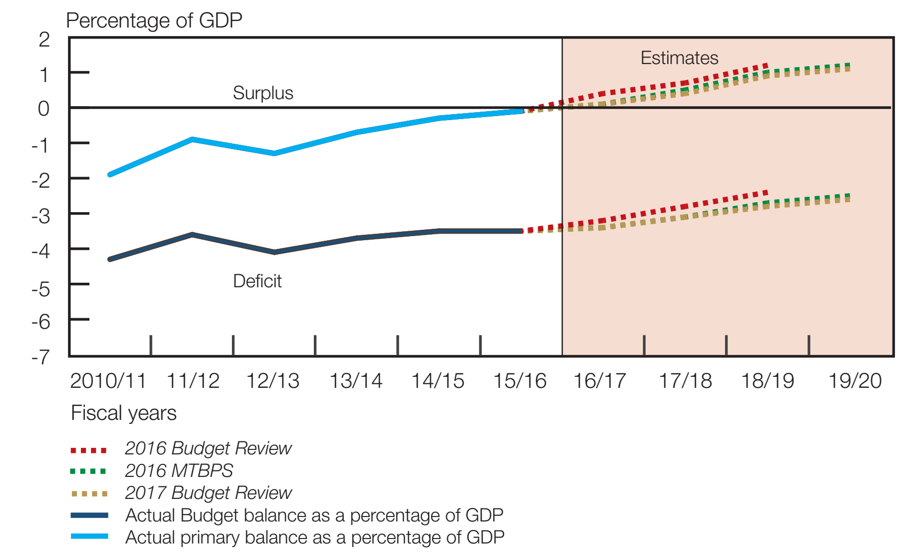
Consolidated fiscal framework indicators

R billions	2014/15 Outcome	2015/16 Outcome	2016/17 Originally budgeted*	2016/17 Revised estimate**	2017/18 Medium-term estimates	2018/19 Medium-term estimates	2019/20 Medium-term estimates
Total consolidated revenue	1 098.9	1 222.0	1 324.3	1 297.3	1 414.1	1 535.2	1 668.5
(percentage of GDP)	(28.4%)	(29.9%)	(30.2%)	(29.4%)	(29.8%)	(29.9%)	(30.1%)
Total consolidated expenditure	1 233.5	1 364.2	1 463.3	1 445.2	1 563.1	1 677.1	1 814.3
(percentage of GDP)	(31.9%)	(33.4%)	(33.3%)	(32.8%)	(33.0%)	(32.7%)	(32.7%)
Primary balance......................	-13.2	-5.9	15.4	5.5	20.3	45.7	60.6
(percentage of GDP)	(-0.3%)	(-0.1%)	(0.4%)	(0.1%)	(0.4%)	(0.9%)	(1.1%)
Budget deficit (fiscal balance)	- 134.6	-142.2	-139.0	-147.9	-149.0	-141.9	-145.8
(percentage of GDP)	(- 3.5%)	(-3.5%)	(-3.2%)	(-3.4%)	(-3.1%)	(-2.8%)	(-2.6%)
Gross loan debt	1 798.9	2 019.0	2 233.6	2 237.7	2 477.6	2 713.2	2 904.6
(percentage of GDP)	(46.6%)	(49.4%)	(50.9%)	(50.7%)	(52.3%)	(52.9%)	(52.4%)
Net loan debt	1 584.2	1 804.6	2 003.4	2 006.2	2 226.3	2 442.4	2 670.0
(percentage of GDP)	(41.0%)	(44.2%)	(45.7%)	(45.5%)	(47.0%)	(47.6%)	(48.1%)

* *2016 Budget Review*
** *2017 Budget Review*
Source: National Treasury

Consolidated government budget balances





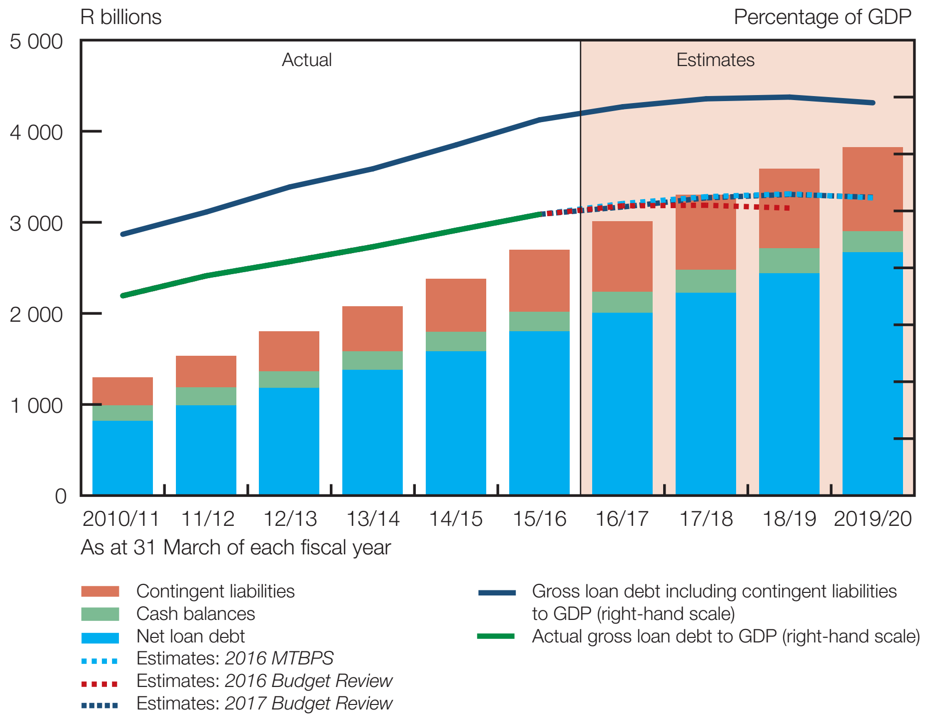
Source: National Treasury

Fiscal policy measures appear to have stabilised the budget deficit in recent years, with government expecting to achieve a primary surplus as from fiscal 2016/17 and over the medium term. This implies that revenue will exceed non-interest expenditure, which is a positive outcome for debt stabilisation.

Government's net borrowing requirement was revised higher to R170 billion in fiscal 2016/17, or R14.2 billion more than the 2016 Budget projections. It was further projected to stabilise at R181 billion in fiscal 2019/20. Domestic capital markets remain the primary source of financing government's borrowing requirement. Government increased the net issuance of Treasury bills by R16 billion to R41 billion in fiscal 2016/17 in response to short-term funding pressures and the higher borrowing requirement. The bond-switch programme (exchanging short-term debt for longer-term debt) progressed well and should continue to ease refinancing pressure in targeted areas of domestic and foreign redemptions.

Total gross loan debt of national government is projected at R2.5 trillion (R2.2 trillion on a net basis) by the end of fiscal 2017/18. As a ratio of GDP, gross loan debt is set to increase from 50.7% in the current fiscal year to 52.3% in fiscal 2017/18. Gross loan debt is projected to edge upwards to 52.9% of GDP in fiscal 2018/19, before receding to 52.4% in fiscal 2019/20.

National government debt



Source: National Treasury

After accounting for available cash balances, government net loan debt is expected to stabilise at 48.1% of GDP in fiscal 2018/19, revised upwards from 46.2% in the 2016 Budget. The revised projections resulted from revenue shortfalls and the build-up of cash reserves for large debt redemptions over the period ahead.