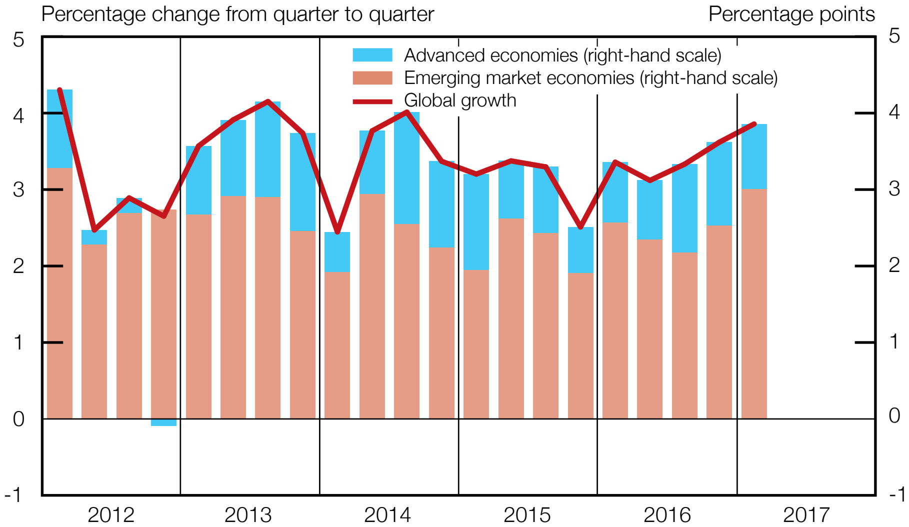
# International economic developments

Global real economic growth accelerated further from 3.6% in the fourth quarter of 2016 to 3.9% in the first quarter of 2017, mainly due to robust output growth in a number of emerging market economies, particularly Brazil, China, India and Russia. By contrast, output growth in advanced economies decelerated to 1.8% in the first quarter of 2017 from 2.3% in the previous quarter, as economic activity in the United States (US) and the United Kingdom (UK) lost some momentum.

### 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 SARB

Sluggish growth in the US and the UK was mainly due to weak consumption expenditure in the first quarter of the year. The disappointing performance in the first quarter also reflected reduced inventory accumulation in the US and the negative contribution of net exports in the UK. Slowing consumer demand is likely to be temporary in the US due to mild winter conditions that limited consumption of utilities. Motor vehicle sales also declined in the first quarter of 2017. In the UK though, the slowdown in consumption expenditure appears to be more persistent, given rising inflation as well as slowing employment and wage growth. By contrast, growth in the euro area remained firm, while the Japanese economy continued to expand at a subdued pace.

### Real output growth in selected advanced economies

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

| | 2015 | | | | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Country/region | Q2 | Q3 | Q4 | Year* | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| United States................ | 2.6 | 2.0 | 0.9 | 2.6 | 0.8 | 1.4 | 3.5 | 2.1 | 1.6 | 1.2 |
| Japan ........................... | -0.3 | 0.7 | -1.0 | 1.1 | 2.5 | 1.6 | 1.0 | 1.4 | 1.0 | 1.0 |
| Euro area...................... | 1.6 | 1.3 | 1.8 | 1.9 | 2.1 | 1.4 | 1.8 | 2.1 | 1.7 | 2.3 |
| United Kingdom ............ | 1.9 | 1.1 | 2.8 | 2.2 | 0.6 | 2.4 | 2.0 | 2.7 | 1.8 | 0.7 |
| Canada ........................ | -0.4 | 2.3 | 0.5 | 0.9 | 2.8 | -1.4 | 4.2 | 2.7 | 1.5 | 3.7 |
| Australia ....................... | 0.8 | 3.4 | 2.1 | 2.4 | 3.8 | 3.0 | -1.6 | 4.5 | 2.5 | 1.1 |
| New Zealand................ | 0.3 | 4.0 | 4.1 | 3.2 | 2.9 | 3.1 | 3.1 | 1.6 | 4.0 | 3.6 |
| Advanced economies... | 1.5 | 1.7 | 1.2 | 2.1 | 1.7 | 1.6 | 2.4 | 2.3 | 1.7 | 1.8 |

* Percentage change over one year

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

Sources: Bloomberg, national statistical offices and SARB

The strong economic performance across a number of emerging market economies led to an acceleration in the pace of output growth for the emerging markets group from 4.9% in the fourth quarter of 2016 to 5.7% in the first quarter of 2017. Brazil exited its protracted recession in the first quarter of 2017, with economic growth of 4.3%, marking the first expansion since the final quarter of 2014. However, the economy continues to operate with a high level of slack as reflected by low rates of industrial capacity utilisation and a high unemployment rate. The Chinese economy accelerated from 6.6% in the fourth quarter of 2016 to 7.3% in the first quarter of 2017, owing to robust government infrastructure and private real estate spending. However, headwinds in the form of tighter monetary conditions, credit risks as well as measures to curb rising property prices could limit growth prospects. India's real economic growth rebounded to 7.2% in the first quarter of 2017 from 4.8% in the fourth quarter of 2016, suggesting that the demonetisation shock towards the end of 2016 was a severe, but only temporary, drag on the economy.

### Real output growth in selected emerging market economies

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

| | 2015 | | | | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Country/region | Q2 | Q3 | Q4 | Year* | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| China | 7.2 | 6.8 | 6.4 | 6.9 | 6.6 | 7.1 | 6.8 | 6.6 | 6.7 | 7.3 |
| India | 12.2 | 8.5 | 4.4 | 7.5 | 12.0 | 6.2 | 6.3 | 4.8 | 8.0 | 7.2 |
| Indonesia | 4.7 | 5.3 | 6.0 | 4.9 | 3.8 | 5.7 | 4.7 | 5.4 | 5.0 | 4.3 |
| **Emerging Asia** | **8.0** | **6.9** | **5.8** | **8.7** | **7.5** | **6.6** | **6.3** | **5.9** | **6.7** | **6.9** |
| Russia | -1.6 | 0.3 | -2.1 | -2.8 | 1.7 | -1.4 | 0.2 | 0.6 | -0.2 | 2.6 |
| Turkey | 6.7 | 4.4 | 3.5 | 6.1 | 1.6 | 5.1 | -6.3 | 14.4 | 2.9 | 5.8 |
| Poland | 2.0 | 4.9 | 3.6 | 3.8 | -0.4 | 4.1 | 1.6 | 7.0 | 2.7 | 4.5 |
| **Emerging Europe** | **1.3** | **2.5** | **0.7** | **0.8** | **1.4** | **1.8** | **-1.1** | **5.5** | **1.5** | **4.1** |
| Brazil | -8.8 | -5.3 | -3.8 | -3.8 | -4.0 | -1.3 | -2.3 | -2.2 | -3.6 | 4.3 |
| Mexico | 3.4 | 2.4 | 1.6 | 2.6 | 1.8 | 0.2 | 4.4 | 2.9 | 2.3 | 2.7 |
| Argentina | 7.0 | 0.5 | -3.8 | 2.7 | -2.9 | -7.7 | 0.2 | 1.9 | -2.3 | 4.1 |
| **Latin America** | **-1.7** | **-0.8** | **-1.1** | **0.1** | **-1.8** | **-1.7** | **0.5** | **0.6** | **-1.0** | **2.6** |
| **Emerging economies** | **5.1** | **4.8** | **3.7** | **5.3** | **5.0** | **4.5** | **4.2** | **4.9** | **4.3** | **5.7** |

* 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 SARB

Output growth in emerging Europe decelerated from 5.5% in the fourth quarter of 2016 to 4.1% in the first quarter of 2017, mainly due to a marked slowdown in Turkey's economic growth from elevated levels in the fourth quarter of 2016. Economic growth in Russia accelerated to 2.6% in the first quarter of 2017, following weak growth in the second half of last year.

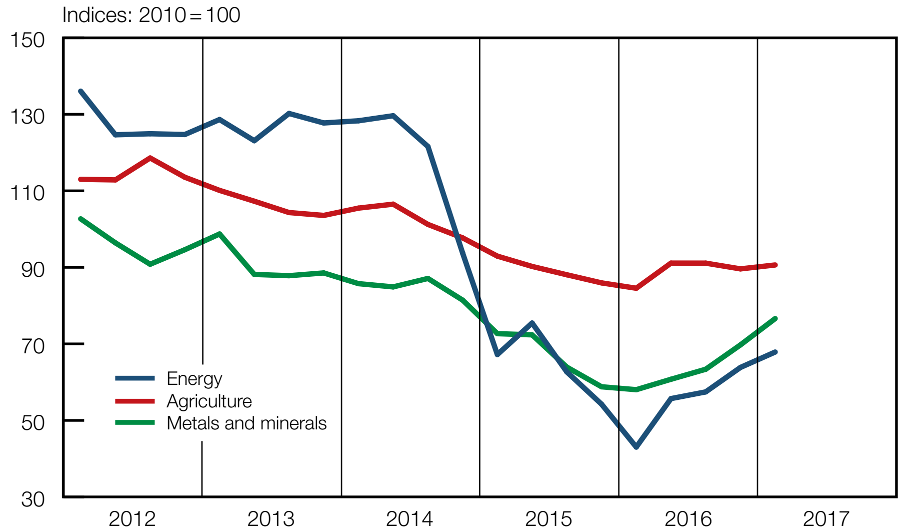
Headline consumer price inflation continued to trend upwards in advanced economies due to higher commodity prices, while core inflation has remained subdued. US headline inflation has accelerated above 2% in recent months, but the deflator for personal consumption expenditure, the Federal Reserve's preferred inflation measure, remained below 2%. Improved economic conditions in the euro area have also not yet translated into higher core inflation.

Consumer price inflation in advanced economies has gradually been moving higher after an extended period of price stagnation. By contrast, inflation in many large emerging market economies has been decelerating, with the exception of Mexico and Turkey. Annual consumer price inflation in Mexico accelerated to 6.2% in May 2017 – its highest level since April 2009 – owing to the depreciation of the peso and a sharp increase in fuel prices. Similarly, inflation in

Turkey accelerated to a nine-year high of 11.9% in April 2017, largely due to the depreciation of the lira and rising energy prices, before slowing somewhat to 11.7% in May.

Most industrial commodity prices increased further during the first quarter of 2017. Metals and minerals prices surged by almost 10% in the first quarter of 2017 due to strong demand from China and various supply constraints, while global agricultural commodity prices remained broadly unchanged. Energy prices increased by 6.3% in the first quarter of 2017, underpinned by higher oil prices.

International commodity prices




Sources: World Bank and SARB

Brent crude oil prices increased sharply after the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC producers agreed at the end of 2016, to reduce output in the first half of 2017. Oil prices averaged US$54 per barrel in the first quarter of 2017, before declining below US$48 per barrel in early May as output from US shale producers exceeded expectations. The prospects of a deal to extend the limits on crude output until March 2018 resulted in prices rebounding above US$53 per barrel towards the end of May 2017. However, oil prices dropped well below US$50 per barrel after the deal was agreed, partly due to disappointment that the cuts had not been deeper or extended for longer.

Growth in global trade moderated in March 2017 after three months of robust expansion. According to the CPB Netherlands Bureau for Economic Policy Analysis, world trade volumes (measured by the three-month moving average of world exports) expanded at an annualised rate of 4.3% in March 2017. In advanced economies, export volumes increased by 1.6% in March, while those in emerging market economies increased by 7.7%. Sluggish growth in trade volumes in March 2017 reflected a slowdown in emerging Asia, Africa and Middle Eastern countries.

# Domestic economic developments

## Domestic output[1]

The South African economy is now technically in a recession, having recorded a second consecutive quarter of contraction in the first quarter of 2017 – the first such occurrence since the first quarter of 2009. *Real gross domestic product* (GDP) declined at an annualised rate of 0.7% in the first quarter of 2017, following a contraction of 0.3% in the fourth quarter of 2016. The decrease reflected a further contraction in the real output of the secondary sector while the real value added by the tertiary sector contracted for the first time since the second quarter of 2009. By contrast, the real output of the primary sector increased at a brisk pace over the period.

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

### Real gross domestic product

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

| Sector | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| Primary sector | -19.0 | 9.1 | 3.2 | -9.0 | -5.4 | 14.9 |
| Agriculture | -8.7 | -7.8 | -0.2 | -0.1 | -7.8 | 22.2 |
| Mining | -21.8 | 14.6 | 4.2 | -11.5 | -4.7 | 12.8 |
| Secondary sector | -0.1 | 4.8 | -2.5 | -1.8 | 0.2 | -3.4 |
| Manufacturing | 0.6 | 7.6 | -3.3 | -3.1 | 0.7 | -3.7 |
| Tertiary sector | 1.4 | 1.9 | 0.8 | 1.6 | 1.4 | -2.0 |
| *Non-primary sector* | *1.0* | *2.5* | *0.1* | *0.8* | *1.1* | *-2.3* |
| Total | -1.5 | 3.1 | 0.4 | -0.3 | 0.3 | -0.7 |

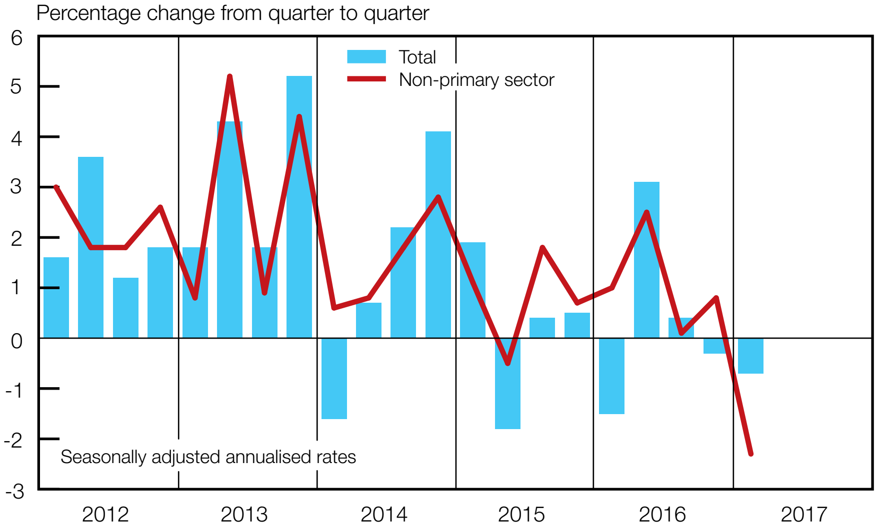
* Percentage change over one year

Source: Stats SA

When excluding the contribution of the more volatile primary sector, growth in real GDP of the non-primary sector slowed notably from 0.8% in the final quarter of 2016 to a contraction of 2.3% in the first quarter of 2017.

### Real gross domestic product

Percentage change from quarter to quarter




Source: Stats SA

The real value added by the *primary sector* advanced at a rate of 14.9% in the first quarter of 2017 after having contracted by 9.0% in the preceding quarter. Improved growth in the first quarter of 2017 reflected robust increases in the real output of both the agricultural and mining sectors.

Growth in the real value added by the *agricultural sector* turned positive in the first quarter of 2017, expanding for the first time since the fourth quarter of 2014. Agricultural production increased markedly at an annualised rate of 22.2% in the first quarter of 2017, following a decline of 0.1% in the fourth quarter of 2016. The rebound largely reflected firm growth in the field crop production of maize and soybeans following increased summer rainfall since the final quarter of 2016. With farmers rebuilding herds, livestock slaughtered decreased.

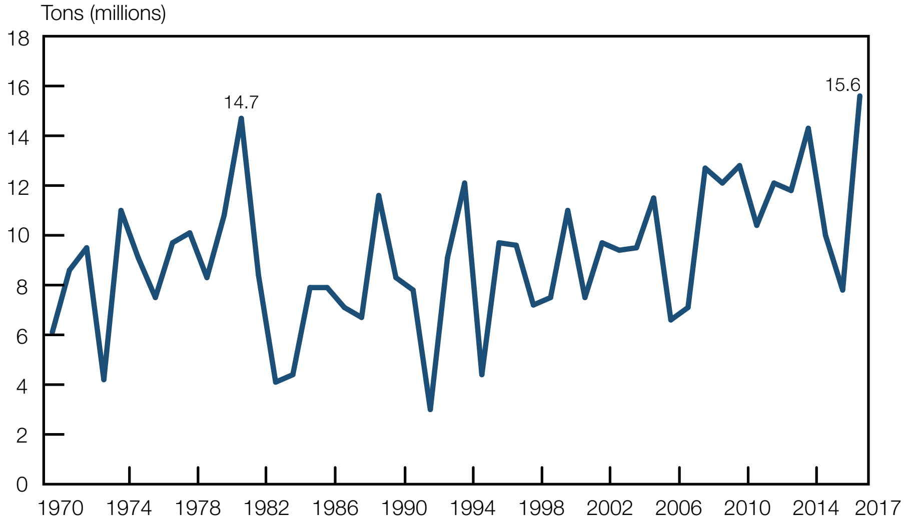
According to the most recent projection by the Crop Estimates Committee, the commercial maize crop for the 2016/17 season is expected to be about double the 7.8 million tons harvested during the previous production season, which was also the smallest crop since 2007. The 2016/17 maize harvest is expected to be the biggest on record, surpassing the record harvest of 14.7 million tons in 1981. Favourable weather conditions supported field crop planting in the Free State, Mpumalanga and North West, with these main maize producing areas expected to contribute around 83% of the total 2016/17 crop.

### Commercial maize crop estimates

| | 2015/16 Final crop | 2016/17 Fourth production forecast | Percentage change |
|---|---|---|---|
| Crop (million tons)................................................ | 7.8 | 15.6 | 101.0 |
| Area planted (million hectares) .............................. | 1.9 | 2.6 | 35.0 |

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

### Commercial maize production



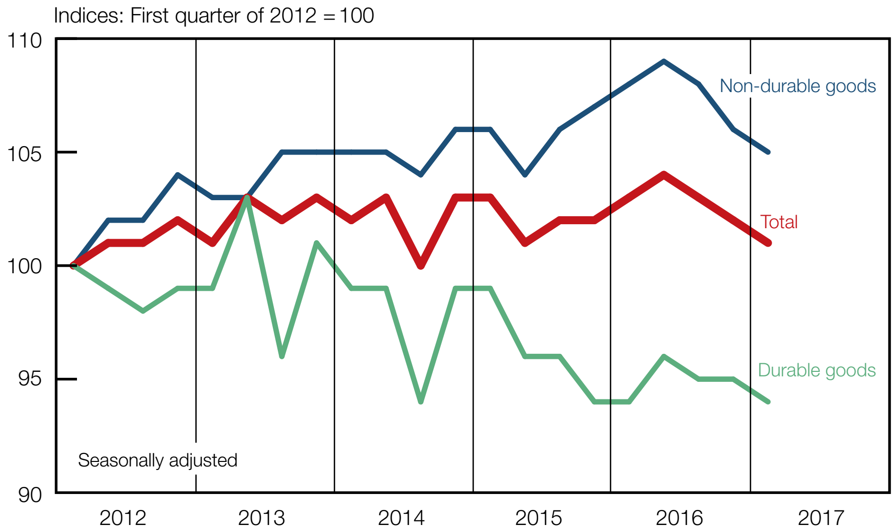

Source: Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries
Note: Calendar year data, e.g. production season 2016/17 = 2017

*Mining* production increased notably in the first quarter of 2017. The real value added by the mining sector rebounded from a sharp contraction of 11.5% in the fourth quarter of 2016 to an expansion of 12.8% in the first quarter of 2017, contributing 0.9 percentage points to overall growth in GDP. The improvement resulted predominantly from a surge in platinum production. Chrome and iron ore production also increased strongly, while gold production rose marginally. By contrast, production of coal and diamonds decreased. A combination of increased demand, higher international commodity prices and stable electricity supply supported domestic mining production in the first quarter of 2017.

The real value added by the *secondary sector* contracted for the third consecutive quarter in the first quarter of 2017, at a slightly faster pace of 3.4%. This was attributable to the disappointing performance of all the secondary subsectors over the period.

Real output of the *manufacturing sector* decreased for the third consecutive quarter and subtracted 0.5 percentage points from overall GDP growth in the first quarter of 2017. The real value added by the manufacturing sector contracted at an annualised rate of 3.7% in the first quarter of 2017, as production of both durable and non-durable goods decreased. Production in 7 of the 10 manufacturing subsectors contracted in the quarter; the most pronounced decreases occurred in clothing and footwear, petroleum and chemical products as well as electrical machinery. By contrast, the manufacturing of motor vehicles, parts and accessories increased notably in the first quarter of 2017, consistent with increased domestic new vehicle sales. Lower manufacturing production of durable goods is reflected by the decrease in the utilisation of production capacity in the manufacturing sector from a seasonally adjusted 82.2% in August 2016 to 81.7% in February 2017. Production activity in the manufacturing sector continued to be restrained by, among other factors, weak domestic demand and sustained low business confidence which are reflected by lacklustre fixed investment.

Physical volume of manufacturing production




Source: Stats SA

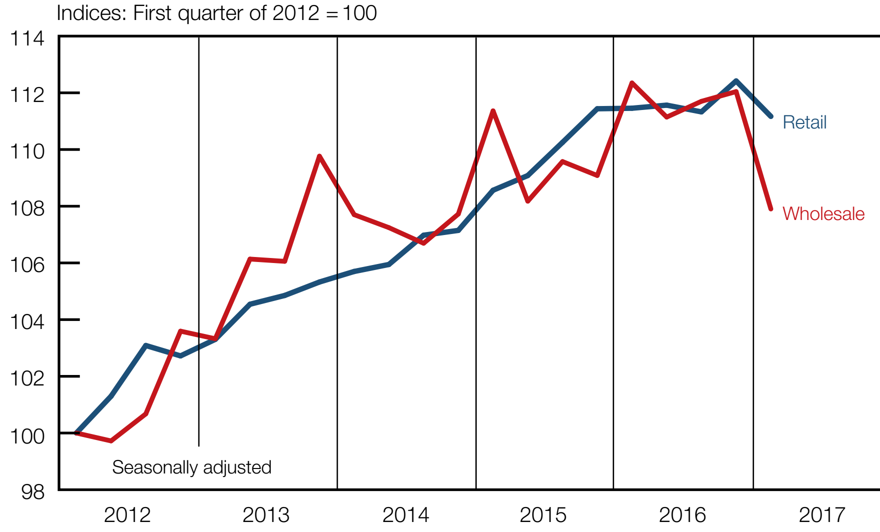
Real economic activity in the sector supplying *electricity, gas and water* shrank at an annualised rate of 4.8% in the first quarter of 2017, following growth of 2.4% in the preceding quarter. The decline in electricity production was compounded by a contraction in the real value added by the gas and water subsectors over the period. In general, the weak demand for electricity may reflect sluggish activity in the electricity-intensive manufacturing sector and the increased usage of alternative energy sources by businesses and households.

Growth in the real value added by the *construction sector* slowed from 0.4% in the fourth quarter of 2016 to a contraction of 1.3% in the first quarter of 2017, the first decline since the first quarter of 2012. Civil construction activity receded alongside a further decline in non-residential building activity. By contrast, residential construction activity increased in the first quarter of 2017.

Growth in the real value added by the *tertiary sector* reverted from an annualised rate of 1.6% in the fourth quarter of 2016 to a decline of 2.0% in the first quarter of 2017. Lower activity in all the tertiary subsectors contributed to the contraction.

Activity in the *commerce sector* contracted notably in the first quarter of 2017, subtracting 0.8 percentage points from overall GDP growth. The sector was adversely affected by, among other factors, subdued business and consumer confidence, weak employment creation as well as a decline in real household disposable income. The real gross value added by the trade sector decreased by 5.9% in the first quarter of 2017 as activity in the wholesale and retail trade as well as in the catering and accommodation subsectors contracted, while motor trade sales turned positive. This was the first substantial simultaneous decline in wholesale and retail trade activity since the first half of 2009. Retail trade activity was weighed down by lower sales of textiles, clothing, leather and footwear products as well as hardware, paint and glass. Wholesale trade activity was impacted by lower sales of solid, liquid and gaseous fuels, machinery and equipment as well as agricultural raw materials and livestock.

Real wholesale and retail trade sales




Source: Stats SA

Real output in the *transport, storage and communication sector* contracted by 1.6% in the first quarter of 2017, following an increase of 2.6% in the fourth quarter of 2016. Reduced activity in the road and rail passenger transport subsector weighed heavily on output over the period. By contrast, the communications subsector benefited from improved network quality and ongoing attractive data promotions.

Growth in real activity in the *finance, insurance, real estate and business services sector* moderated from 1.6% in the fourth quarter of 2016 to -1.2% in the first quarter of 2017. This was the first quarter-to-quarter decline since the third quarter of 2010. Commercial banking activity contracted mainly on account of lower non-interest income while trading activity in the derivatives market decreased.

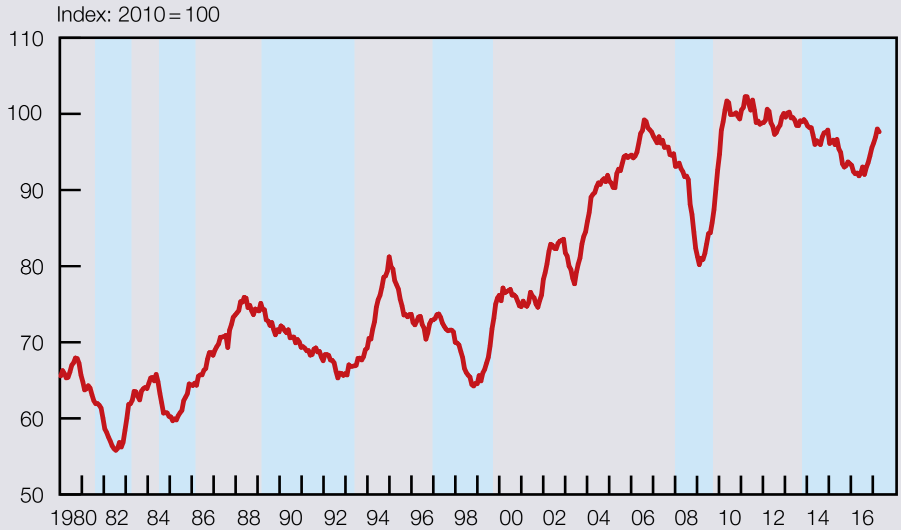
The real value added by the *general government services sector* decreased by 0.6% in the first quarter of 2017, consistent with the lower levels of employment in local and provincial government over the period.

## Box 1 Recent upward trend in the composite leading business cycle indicator

The composite leading business cycle indicator[1] appears to have reached a trough in April 2016 and subsequently increased decisively up to February 2017. Based on past experience, the recent strong upward trend in the leading indicator rightfully led to expectations of an imminent end to the current downward phase in the business cycle. However, domestic economic activity remains subdued as indicated by a contraction in real gross domestic product in recent quarters.

Expectations of a looming end to the current downward phase of the business cycle is based on the established track record of the SARB's composite leading business cycle indicator which has consistently pre-empted turning points in the business cycle. Historically, the leading indicator's median lead time has been 10 months at business cycle peaks and 8.5 months at business cycle troughs. The leading indicator reached its most recent upper turning point in March 2011 – preceding the reference peak in the business cycle by 32 months. The South African economy has been in a downward phase of the business cycle for 42 months up to May 2017.

### Composite leading business cycle indicator




Shaded areas indicate downward phases of the business cycle

Source: SARB

An analysis of the leading indicator's subcomponents indicates that the recent increase has not been very broad-based. The composite leading business cycle indicator combines 11 individual economic indicators whose turning points have historically preceded those in the business cycle. These subcomponents comprise leading indicators of domestic demand, external demand, sentiment and employment, among others.

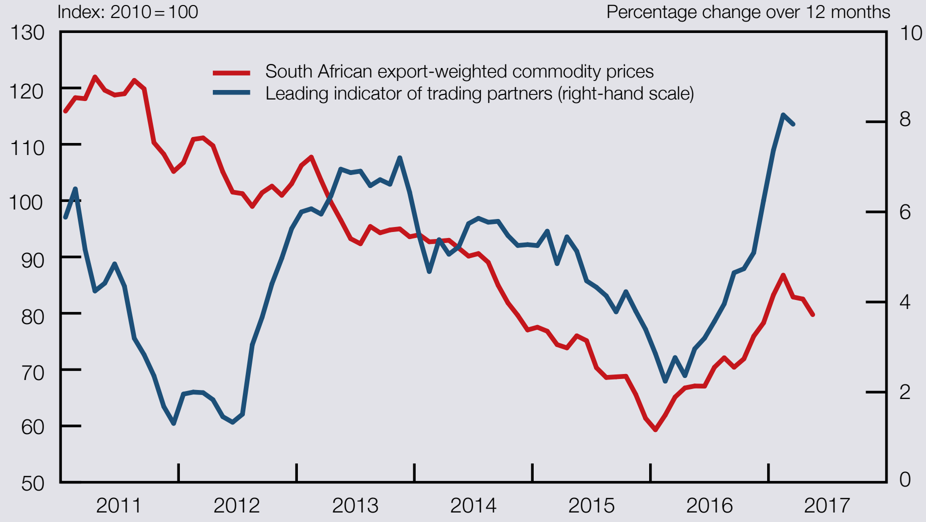
The recent strong upward trend in the leading indicator was largely driven by significant increases in the two subcomponents that measure external demand. These are the South African export-weighted international commodity price index (denominated in US dollar) and the leading indicator of trading partners (an index of the composite leading business cycle indicators of South Africa's main trading partner countries, weighted according to South African exports to those countries)[1]. Most international commodity prices have increased from early 2016 as the global economic outlook improved. This is corroborated by a notable increase in the composite leading indicator of trading partners from March 2016.

1 The *business cycle* can briefly be defined as the fluctuations in aggregate economic activity. The SARB applies the growth cycle definition of business cycles, that is, determining turning points in the deviation of aggregate economic activity from its long term trend.

A *leading indicator* is an economic time series whose turning points consistently precede those in the business cycle by an average of three months or more.

A *composite index* is a time series that is compiled by combining the month-to-month changes in a number of individual economic indicators into one index, reflecting the combined movement of all the individual subcomponents in a single indicator.

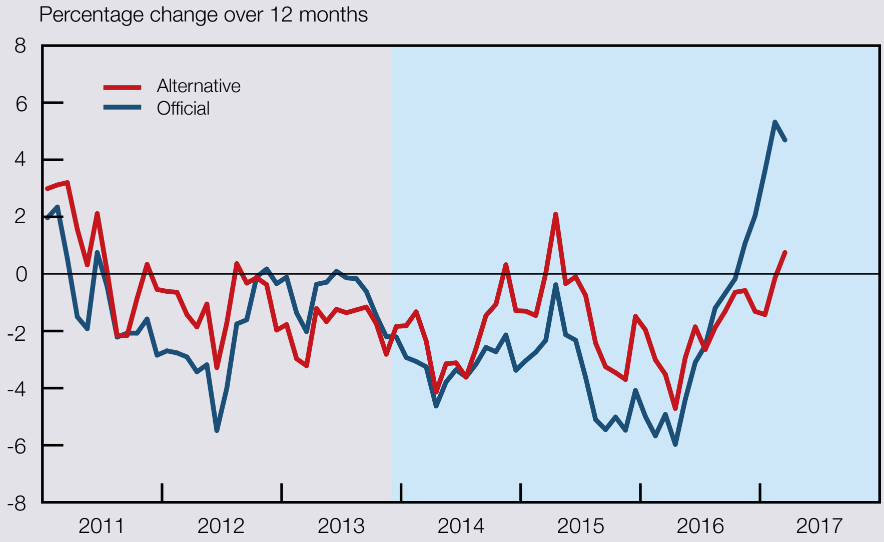
## Drivers of external demand in the composite leading business cycle indicator




Sources: SARB, Foundation for International Business and Economic Research (FIBER) and the Conference Board

An alternative composite leading business cycle indicator that excludes the two subcomponents measuring external demand does not display the same strong upward trend recently observed in the official leading indicator. In recent months, the year-on-year percentage change in the alternative indicator remained subdued, while that in the official indicator accelerated significantly.

## Official and alternative composite leading business cycle indicator




Shaded area indicates downward phase of the business cycle

Source: SARB

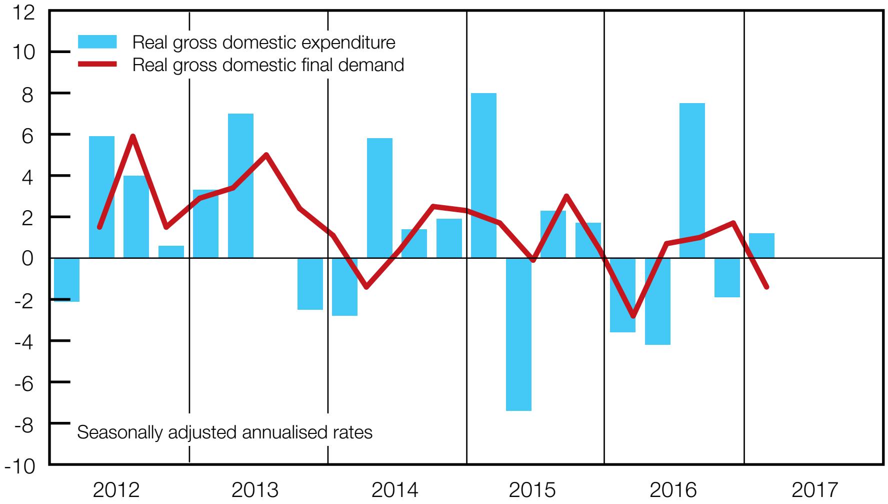
The recent strong upward trend in the official composite leading business cycle indicator therefore appears to have been driven largely by an improved global economic outlook and higher commodity prices. By contrast, leading indicators of domestic demand and employment have not increased much, while business confidence has remained at fairly depressed levels. Furthermore, domestic drivers have recently also been sensitive to political developments, which might restrict further increases in the composite leading business cycle indicator in the short run. In conclusion, the historical relationship between movements in the composite leading business cycle indicator and real economic activity in the domestic economy has been compromised somewhat by domestic growth constraints being more pronounced in the current cycle than in previous episodes.

# Real gross domestic expenditure

*Real gross domestic expenditure* increased by 1.2% in the first quarter of 2017, after having contracted at an annualised rate of 1.9% in the fourth quarter of 2016. This improvement reflected an accumulation in real inventory holdings, alongside an increase in real gross fixed capital formation. By contrast, real gross domestic final demand decreased by 1.4% in the first quarter of 2017 as real final consumption expenditure by households and general government contracted.

### Real gross domestic expenditure and final demand

Percentage change from quarter to quarter




Source: Stats SA

### Real gross domestic expenditure

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

| Component | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| Final consumption expenditure | | | | | | |
| Households | -1.5 | 1.2 | 2.2 | 2.2 | 0.8 | -2.3 |
| General government | 1.5 | 2.8 | 1.9 | 0.3 | 2.0 | -1.0 |
| Gross fixed capital formation | -10.4 | -2.8 | -3.5 | 1.7 | -3.9 | 1.0 |
| **Domestic final demand** | **-2.8** | **0.7** | **1.0** | **1.7** | **0.1** | **-1.4** |
| Change in inventories (R billions)** | -2.2 | -37.0 | 10.8 | -16.4 | -11.2 | 2.7 |
| **Gross domestic expenditure***** | **-3.6** | **-4.2** | **7.5** | **-1.9** | **-0.8** | **1.2** |

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

Sources: Stats SA and SARB

Real net exports subtracted 1.9 percentage points from growth in real GDP in the first quarter of 2017, while the decline in real final consumption expenditure by households shaved off 1.4 percentage points. By contrast, the accumulation in real inventory holdings and the increase in real gross fixed capital formation added 2.5 and 0.2 percentage points respectively to overall economic growth.

Contributions of expenditure components to growth in real gross domestic product

Percentage points

| Component | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year | Q1 |
| Final consumption expenditure | | | | | | |
| Households | -0.9 | 0.7 | 1.3 | 1.3 | 0.5 | -1.4 |
| General government | 0.3 | 0.6 | 0.4 | 0.1 | 0.4 | -0.2 |
| Gross fixed capital formation | -2.2 | -0.6 | -0.7 | 0.3 | -0.8 | 0.2 |
| Change in inventories | -1.1 | -4.6 | 6.2 | -3.5 | -0.8 | 2.5 |
| Net exports | 2.3 | 7.5 | -6.8 | 1.7 | 1.1 | -1.9 |
| Residual | 0.2 | -0.5 | 0.0 | -0.2 | -0.2 | 0.2 |
| Gross domestic product | -1.5 | 3.1 | 0.4 | -0.3 | 0.3 | -0.7 |

Sources: Stats SA and SARB

## Final consumption expenditure by households

*Real final consumption expenditure by households* declined at an annualised rate of 2.3% in the first quarter of 2017 following an increase of 2.2% in the fourth quarter of 2016. Real spending on all three major goods components receded, while growth in real outlays on services slowed.

The decline in real household spending in the first quarter of 2017 occurred within an environment of tight credit conditions, a contraction in the real disposable income of households, and persistent low consumer confidence levels. Growth in household expenditure could remain weak in the wake of South Africa's sovereign credit rating downgrades.

Real final consumption expenditure by households

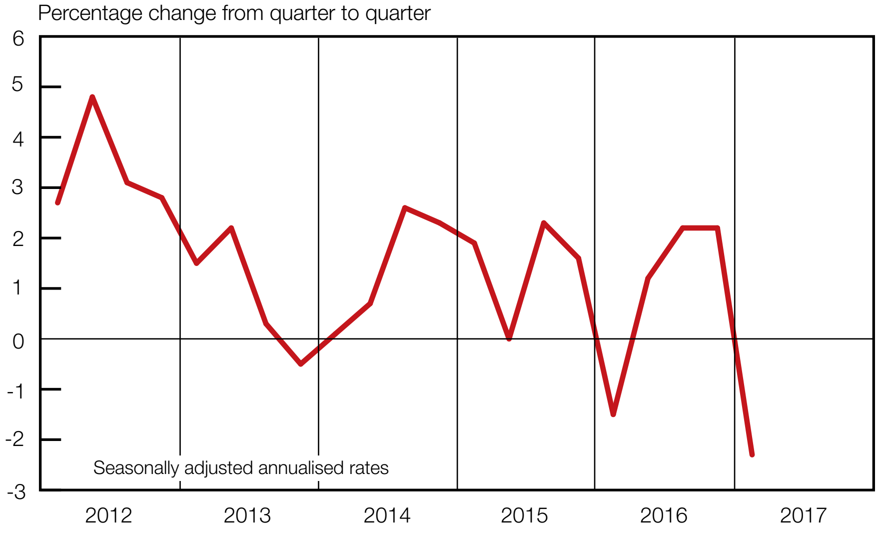
Quarter-to-quarter percentage change at seasonally adjusted annualised rates

| Component | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| Durable goods | -15.3 | -5.4 | -3.2 | 0.2 | -7.3 | -0.2 |
| Semi-durable goods | 2.4 | 1.6 | -0.9 | 6.8 | 3.3 | -10.2 |
| Non-durable goods | -1.1 | 0.4 | 1.1 | 0.3 | 0.9 | -4.6 |
| Services | 0.6 | 3.1 | 5.0 | 3.2 | 2.1 | 1.0 |
| Total | -1.5 | 1.2 | 2.2 | 2.2 | 0.8 | -2.3 |

* Percentage change over one year

Source: Stats SA

## Real final consumption expenditure by households




Source: Stats SA

The moderate increase in households' real expenditure on *durable goods* in the fourth quarter of 2016 was short-lived as real outlays on durable goods contracted anew at an annualised rate of 0.2% in the first quarter of 2017. Spending on all components of durable goods decreased, with the exception of expenditure on personal transport equipment which increased at a brisk pace in the first quarter of 2017. This was the first increase in real outlays on personal transport equipment since the third quarter of 2014.

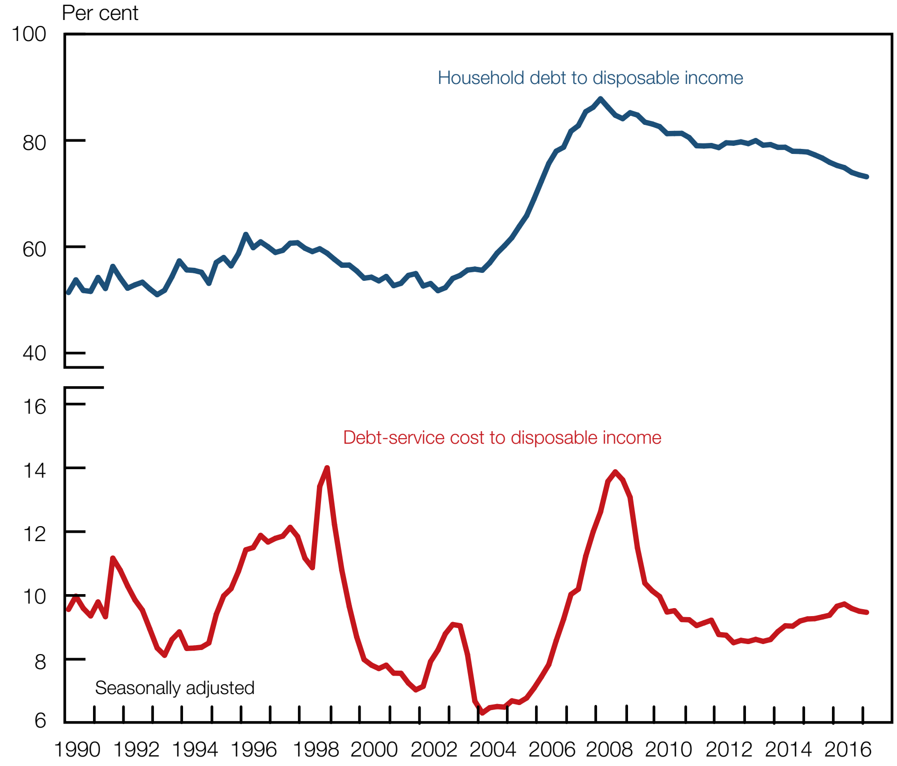
Following an increase of 6.8% in the fourth quarter of 2016, real outlays on *semi-durable goods* declined notably by 10.2% in the first quarter of 2017, the biggest contraction in more than 30 years. The quarter-to-quarter decline was exacerbated by strong semi-durable goods sales in the fourth quarter of 2016 on account of extended Black Friday promotions. Household expenditure on clothing, footwear and textiles declined significantly, while real spending on motorcar tyres and accessories advanced in the first quarter of 2017.

The weakening in households' real expenditure on *non-durable goods* continued, as growth slowed from a moderate increase of 0.3% in the fourth quarter of 2016 to a decline of 4.6% in the first quarter of 2017. Real household spending contracted in most categories of non-durable goods, particularly in food, beverages and tobacco as well as household consumer goods and petroleum products. By contrast, consumer outlays on medical and pharmaceutical products increased further in the first quarter of 2017.

Growth in real expenditure on *services* slowed from an annualised rate of 3.2% in the fourth quarter of 2016 to 1.0% in the first quarter of 2017. Lower spending on transport and recreational services partly outweighed increased real outlays on mostly household and miscellaneous services. The acceleration in spending on miscellaneous services mainly reflected lower net travel receipts from abroad.

Growth in the *real disposable income of households* moderated from an annualised rate of 2.3% in the fourth quarter of 2016 to a contraction of 1.6% in the first quarter of 2017, as prices increased at a faster pace than households' nominal disposable income over the period.

Household debt and debt-service cost




Source: SARB

Households continued to incur debt in the first quarter of 2017. However, household debt as a percentage of annualised disposable income decreased from 73.5% in the fourth quarter of 2016 to 73.2% in the first quarter of 2017, as nominal income increased slightly faster than debt. On balance, the cost of servicing household debt as a ratio of disposable income remained unchanged at 9.5% in the first quarter of 2017.

## Final consumption expenditure by government

*Real final consumption expenditure by general government* reverted from a marginal increase of 0.3% in the fourth quarter of 2016 to a decrease of 1.0% in the first quarter of 2017 and subtracted 0.2 percentage points from overall GDP growth over the period. The decline in real spending by general government reflected lower outlays on both non-wage goods and services and compensation of employees, broadly in line with government's efforts to contain growth in the public-sector wage bill as a means of narrowing the primary budget deficit.

## Fixed capital formation

Growth in *real gross fixed capital formation* slowed from 1.7% in the fourth quarter of 2016 to 1.0% in the first quarter of 2017, reflecting subdued business confidence and policy uncertainty in the South African economy. Growth in real capital outlays by private business enterprises turned positive in the first quarter of 2017, and capital expenditure by general government expanded further, albeit at a slower pace. By contrast, real fixed investment by public corporations contracted further.

### Real gross fixed capital formation

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

| Sector | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year* | Q1 |
| Private business enterprises | -13.7 | -2.0 | -5.6 | -1.7 | -6.0 | 1.2 |
| Public corporations | 3.3 | 0.8 | -5.8 | -3.3 | -1.6 | -2.7 |
| General government | -12.4 | -9.0 | 6.6 | 19.8 | 1.1 | 4.4 |
| **Total** | **-10.4** | **-2.8** | **-3.5** | **1.7** | **-3.9** | **1.0** |

* Percentage change over one year

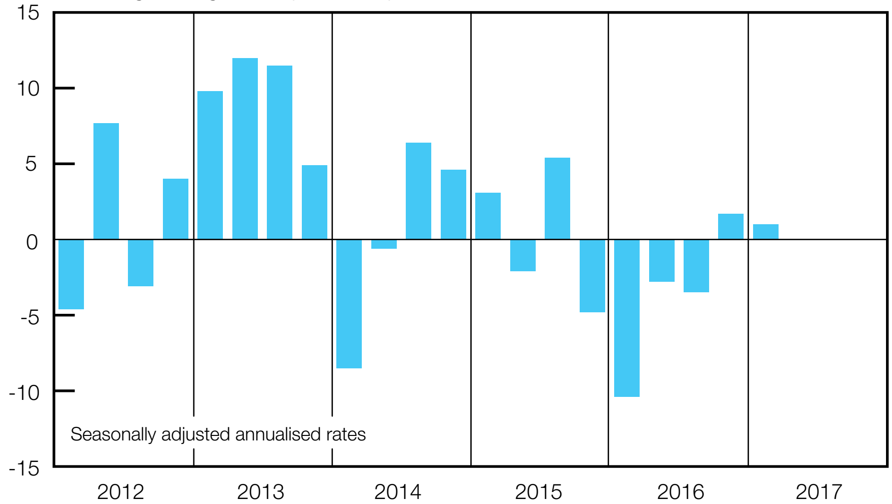
Source: Stats SA

Real gross fixed capital formation by *private business enterprises* increased at an annualised rate of 1.2% in the first quarter of 2017, after having contracted for five consecutive quarters. The marginal increase in private investment spending was mainly driven by increased capital outlays on residential buildings and machinery and other equipment. Real capital outlays by the private electricity sector lost further momentum following the completion of almost half of the projects in Bid Window[2] 3 of the Renewable Energy Independent Power Producer Procurement Programme. The awarding of power purchase contracts for projects in Bid Window 4 has also been further delayed. Real fixed capital investment by *public corporations* declined by 2.7% in the first quarter of 2017, registering the third consecutive quarter of contraction.

2 The Integrated Resource Plan (IRP) 2010 set out to add 17 800 MW of renewable energy sources to the national grid by 2030. With a view of reaching this target, there have been several rounds of private sector bidding for projects, referred to as Bid Windows.

### Real gross fixed capital formation

Percentage change from quarter to quarter



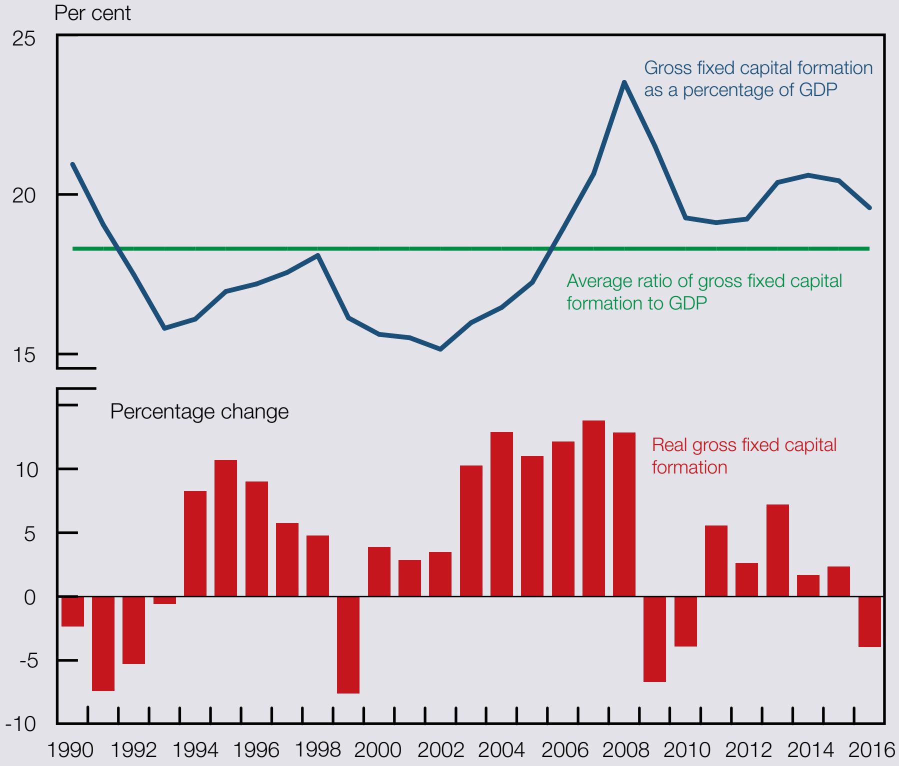

Source: Stats SA

Growth in real gross fixed capital expenditure by *general government* remained fairly brisk, despite slowing from an annualised rate of 19.8% in the fourth quarter of 2016 to 4.4% in the first quarter of 2017. The increase was supported by various ongoing projects undertaken by all levels of general government. Real capital spending by provincial government departments focused on the maintenance of roads and construction projects, while local governments increased expenditure on the rehabilitation of road infrastructure.

## Box 2 The evolution of gross fixed capital formation

Gross fixed capital formation by private business enterprises and public corporations is an important determinant of long term economic growth. The evolution of gross fixed capital formation in South Africa can be analysed from three major perspectives. Firstly, real gross fixed capital formation expanded at a much slower pace in the period following the 2008/09 global financial crisis than in the preceding six years. Secondly, regardless of slower growth in gross fixed capital formation, expressed as a ratio of gross domestic product (GDP), it remained above its long-run average of 18.3% (from 1990 to 2016) since 2006. This ratio was held up by annual growth in investment frequently exceeding that in GDP. Lastly, the structure of capital investment by type of organisation, as reflected by both the kind of economic activity and the type of assets, changed markedly after the global financial crisis.

Real gross fixed capital formation




Sources: Stats SA and SARB

Growth in aggregate real gross fixed capital formation in South Africa averaged 9.2% per annum during the pre-crisis period from 2000 to 2008. Following the financial crisis, growth decelerated to a mere 0.6% per year. Gross fixed capital formation as a ratio of nominal GDP has also fallen from a recent peak of 23.5% in 2008 to 19.6% in 2016. This decline in the ratio occurred alongside the unwinding of boom conditions in global commodity prices from around mid-2008.

Weak global economic growth in recent years supressed the export demand for South African manufactured goods. Persistently low consumer and business confidence in the domestic economy have also resulted in the postponement of a number of key domestic private sector expansion projects. The negative impact of lacklustre growth in the world economy was also experienced by some other emerging market economies. This is evidenced by a similar though stronger decline in capital expenditure in India and to a lesser extent than South Africa in Brazil and Russia. As from 2008, the ratios of gross fixed capital formation to GDP in South Africa, Brazil and Russia averaged around 20%.

## Gross fixed capital formation in selected emerging economies

Percentage of gross domestic product

| Country | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| China | 40.1 | 44.9 | 45.0 | 44.9 | 45.3 | 45.5 | 45.0 | 43.8 | 43.3* |
| India | 35.0 | 33.2 | 33.1 | 34.1 | 32.9 | 32.2 | 30.5 | 29.9 | 27.1 |
| Russia | 21.9 | 19.4 | 18.8 | 19.1 | 20.3 | 20.2 | 20.9 | 20.5 | 20.8 |
| Brazil | 19.3 | 19.1 | 20.5 | 20.6 | 20.7 | 20.9 | 19.9 | 18.1 | 16.4 |
| **South Africa** | **23.5** | **21.5** | **19.3** | **19.1** | **19.2** | **20.4** | **20.6** | **20.4** | **19.6** |

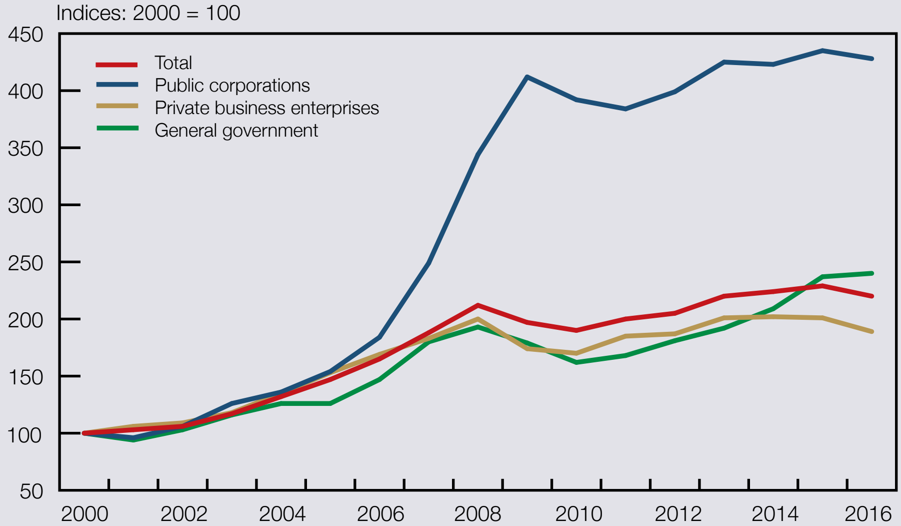
* International Monetary Fund (IMF) projection of gross capital formation

Sources: IMF, Haver Analytics and SARB

The structure of capital investment has changed in terms of the type of organisation driving investment. Weak growth in real fixed capital expenditure since 2009 largely reflected the slower pace of investment by both private business enterprises and public corporations. Real investment by private business enterprises during the period 2009 to 2016 contracted at an average annual rate of 0.5% after having increased by as much as 9.0% during the period 2000 to 2008. Over the same periods, average annual growth in real capital outlays by public corporations also slowed substantially to 2.8% from 11.9%.

### Real gross fixed capital formation

Indices: 2000 = 100

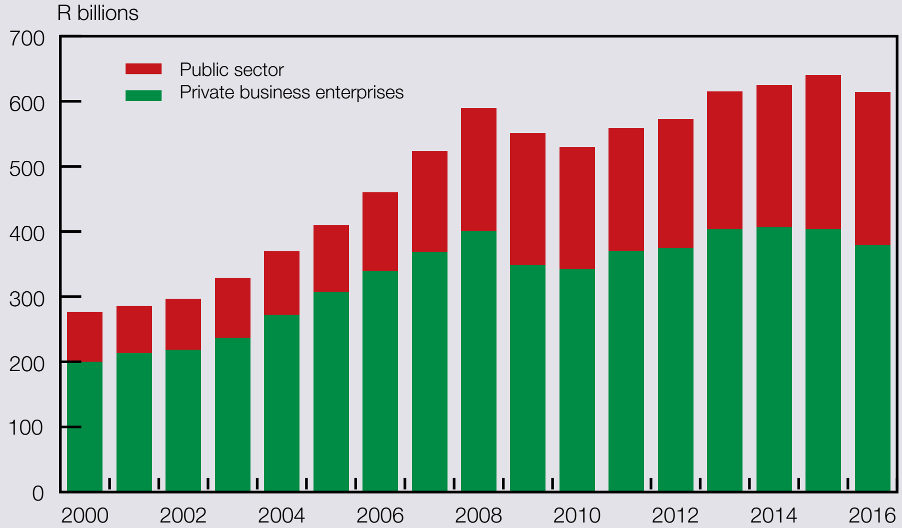



Sources: Stats SA and SARB

The period preceding the global financial crisis was characterised by a strong surge in gross fixed capital formation. The contribution of private business enterprises to total gross fixed capital formation amounted to 72.5% during the period 2000 to 2008, while public corporations contributed 11.5%. Subsequently, the contribution by private business enterprises declined to 61.1% in 2016, while that of public corporations increased to 20.2%.

The structure of capital investment also changed in terms of the kind of economic activity that attracted new investments. The decline in the contribution by private business enterprises to total fixed investment since 2009 was fairly broad-based. Only electricity generation experienced robust growth in gross fixed capital formation, supported especially by the surge in independent renewable energy projects being implemented. Capital investment in mining and exploration activities was, however, to a large extent delayed by a number of high-profile labour strikes as well as policy uncertainty in general, having contributed to the deferment of fixed capital investment. Weak output growth in mining and construction furthermore contributed to a contraction in gross fixed capital formation in manufacturing. Manufacturing was also negatively affected by rapidly rising electricity prices, sporadic labour unrest and loss of international competitiveness.

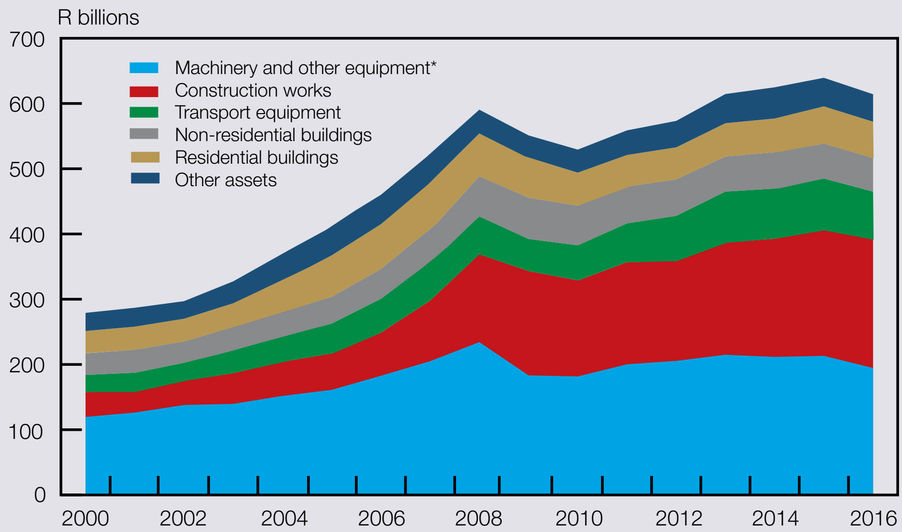
Real gross fixed capital formation




Sources: Stats SA and SARB

The increase in gross fixed capital formation by the public sector since 2009 was largely driven by a robust expansion of capital investment by public corporations, with capital outlays by general government increasing at a more moderate pace. Investment by public corporations occurred primarily in the transport and electricity generation sectors. Consistent with the National Development Plan, economic infrastructure investment relative to total public sector investment increased significantly from an average of 62.9% during the period 2000 to 2008 to 79.4% in 2016.

Real gross fixed capital formation by type of asset




* Including information, computer and telecommunications equipment

Sources: Stats SA and SARB

The structure of gross fixed capital formation also changed in terms of the type of assets being invested in. Since 2009, the contribution of investment in construction works to total capital investment increased meaningfully, largely reflecting capital investment by the public sector. Capital spending on construction works as a share of total fixed investment averaged 14.6% during the period 2000 to 2008, and doubled thereafter to 29.2% during the period 2009 to 2016. By contrast, the share of investment spending on machinery and other equipment declined as investment by private business enterprises waned.

## Inventory investment

*Real inventories* increased by R2.7 billion (at annualised 2010 prices) in the first quarter of 2017 after having declined by R16.4 billion in the fourth quarter of 2016. The higher stock levels could largely be attributed to an accumulation of inventories in the trade sector, particularly in wholesale trade, and in the transport, storage and communication sector. The build-up of inventories in the telecommunication sector was boosted by the growing demand for telecommunication services over time.

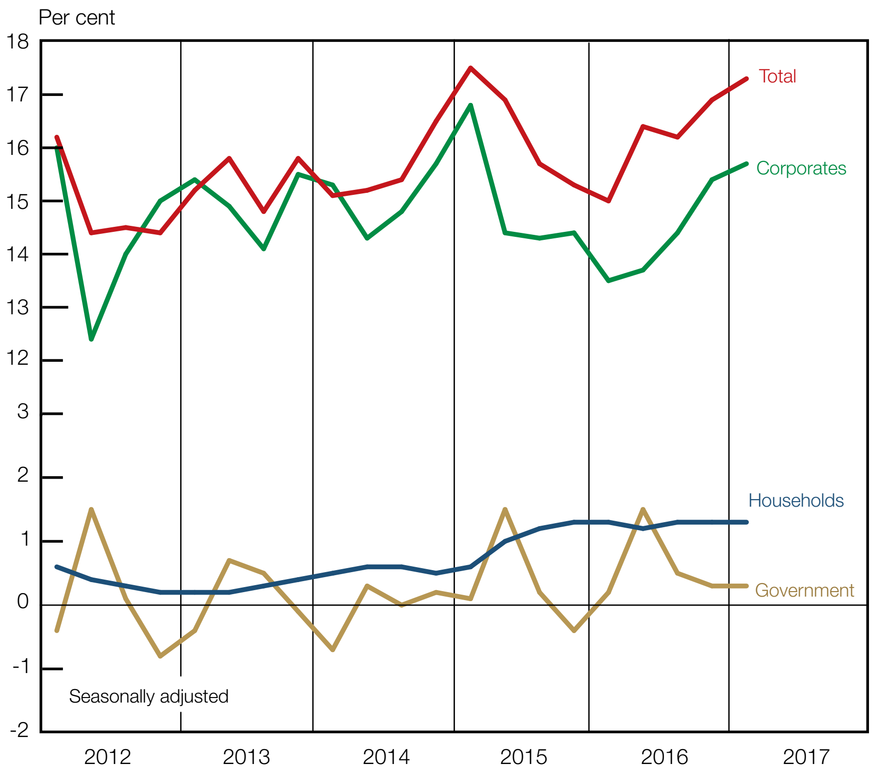
## Gross saving

South Africa's *national saving rate* improved in the first quarter of 2017. Gross saving as a percentage of GDP increased from 16.9% in the fourth quarter of 2016 to 17.3% in the first quarter of 2017. This reflected higher gross saving by both corporate business enterprises and households, while the saving of general government weakened over the period. The foreign financing ratio (the share of total gross capital formation to be financed through foreign capital inflows) increased from 9.2% in the fourth quarter of 2016 to 10.6% in the first quarter of 2017, as the increase in gross capital formation outweighed the increase in national saving over the period.

The saving rate of the *corporate sector* rose from 15.4% in the fourth quarter of 2016 to 15.7% in the first quarter of 2017. The reduction in dividend payments in the first quarter of 2017 more than offset higher corporate tax payments over the period.

Gross saving by *general government* was maintained at 0.3% of GDP in both the fourth quarter of 2016 and the first quarter of 2017. However, the level of gross saving by general government was adversely affected as higher tax revenue, primarily from an increase in personal income tax, was outweighed by a marginal increase in nominal consumption expenditure in the current quarter.

Gross saving as a percentage of gross domestic product




Source: SARB

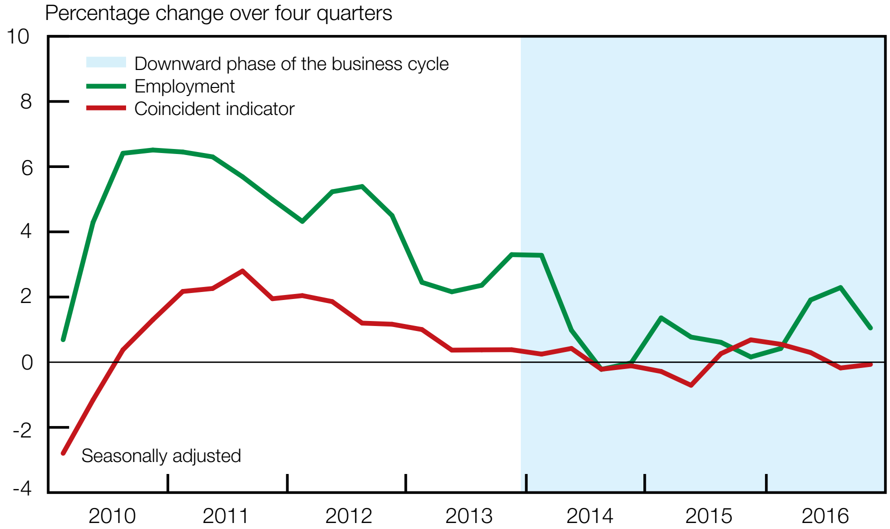
*Household saving* as a percentage of GDP remained at 1.3% in the first quarter of 2017. However, the increase in nominal disposable income marginally outweighed that in nominal consumption expenditure, elevating the saving level of the household sector somewhat.

## Employment[3]

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

Despite an improved global economic growth outlook, unfavourable domestic influences continued to weigh on output growth in the South African economy, limiting meaningful employment creation. According to the *Quarterly Employment Statistics (QES)* survey by Statistics South Africa (Stats SA), formal non-agricultural employment decreased by 0.1% from the third quarter of 2016 to the fourth quarter. This represented a loss of 11 400 job opportunities and lowered the total level of formal non-agricultural employment to an estimated 9.7 million. However, the decrease in employment resulted largely from the termination of temporary employment opportunities by the Independent Electoral Commission (IEC) following the completion of the August 2016 municipal elections.

Growth in formal non-agricultural employment and the coincident business cycle indicator




Sources: Stats SA and SARB

4 All formal non-agricultural employment and earnings time series analysed in this section (and published on pages S–136 and S–137 in the statistical tables section of the *Quarterly Bulletin*) were statistically linked by the SARB, to correct for the structural break caused by the sample change.

Stats SA recently improved the *QES* survey by implementing an upgraded sample drawn from the 2016 Business Sampling Frame. The new sample, which was introduced from the second quarter of 2016, resulted in an upward adjustment of roughly 0.4 million in the level of total formal non-agricultural employment.[4]

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

| Sector | Change over one quarter | | | | Change over four quarters |
|---|---|---|---|---|---|
| | Q1 and Q2 2016 combined | Q3 2016 | Q4 2016 | | |
| | Number | Number | Number | Per cent annualised | Per cent |
| Total mining | -900 | -300 | -2 900 | -2.6 | -0.9 |
| Gold mining | 1 300 | 300 | -1 300 | -4.2 | 0.3 |
| Other mining | -2 200 | -700 | -1 600 | -1.9 | -1.3 |
| Manufacturing | -15 600 | -1 400 | 12 500 | 4.3 | -0.4 |
| Construction | 7 800 | 1 100 | -10 800 | -6.9 | -0.3 |
| Trade, catering and accommodation services | -26 400 | 15 700 | 30 200 | 6.0 | 0.9 |
| Transport, storage and communication services | -9 600 | -100 | 500 | 0.6 | -2.6 |
| Finance, insurance, real estate and business services | -25 900 | -13 500 | 33 700 | 6.4 | -0.3 |
| Community, social and personal services | -2 700 | 9 500 | 9 400 | 7.1 | 3.0 |
| **Private sector** | **-73 300** | **11 000** | **72 600** | **4.0** | **0.1** |
| National departments, provinces and local government | -6 400 | -8 100 | 200 | 0.0 | -0.8 |
| Other public sector enterprises, including electricity and IEC** | -1 800 | 74 300 | -84 200 | -56.0 | -3.1 |
| **Total public sector** | **-8 200** | **66 200** | **-84 000** | **-13.7** | **-1.1** |
| **Grand total** | **-81 500** | **77 200** | **-11 400** | **-0.5** | **-0.2** |

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

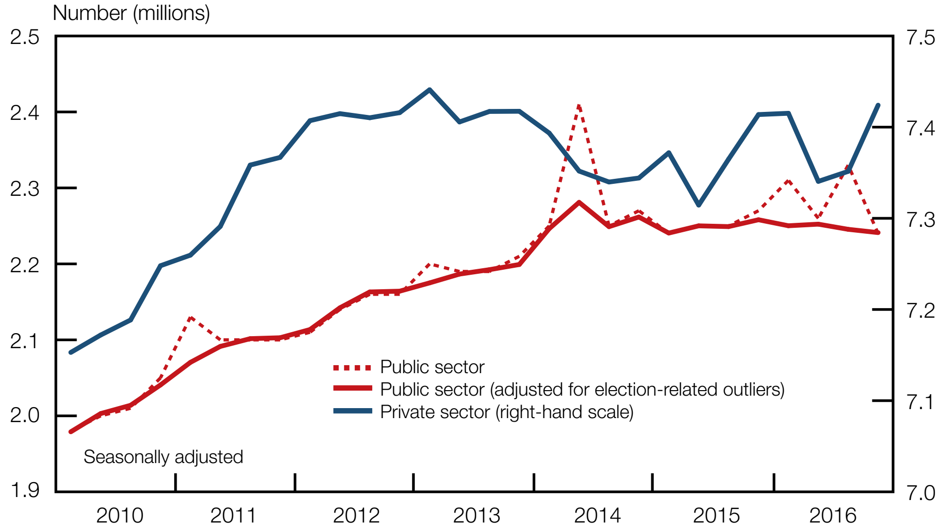
Source: Stats SA

On an annual average basis, formal non-agricultural employment growth accelerated marginally from no growth in 2015 to 0.2% in 2016[5], excluding temporary election-related employment creation. Despite this slight acceleration, annual formal non-agricultural employment growth has been gradually decelerating since reaching a recent peak of 2.5% in 2011, consistent with the current downward phase in the business cycle.

The decrease in total formal non-agricultural employment in the fourth quarter of 2016 resulted entirely from a marked annualised decrease of 13.7% in *public sector* employment, following the termination of roughly 79 000 temporary election-related employment contracts by the IEC. When excluding these temporary employment opportunities, public sector employment decreased moderately by 0.8% in the fourth quarter of 2016. With the exception of local governments, employment levels decreased at all public sector tiers in the fourth quarter of 2016. Following a number of years of solid growth, public sector employment – excluding temporary election-related employment – receded marginally at annual average rates of 0.4% and 0.1% in 2015 and 2016 respectively. This likely reflects the outcome of government's commitment to fiscal consolidation on public sector employment.

5 Annual average growth in formal non-agricultural employment calculated by the SARB differs from that of Stats SA due to different statistical linking methodologies having been applied.

Formal non-agricultural employment

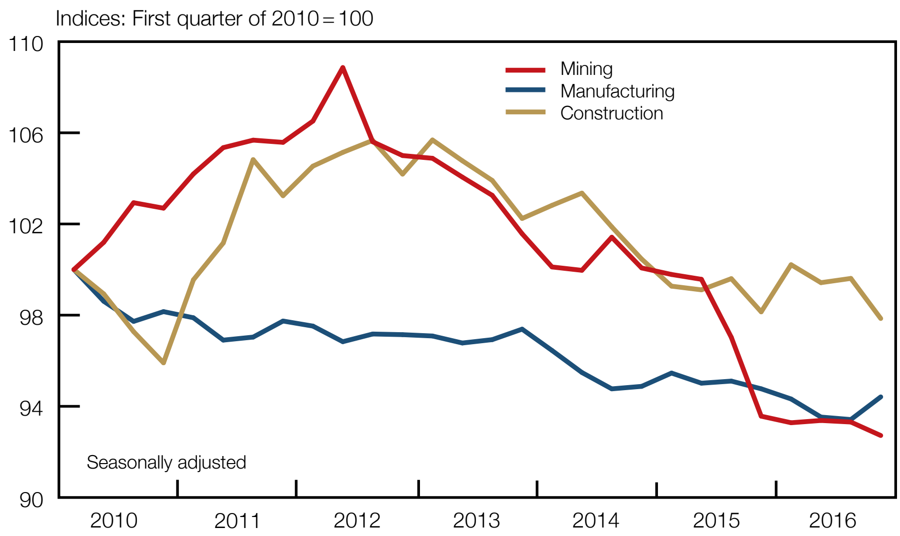



Sources: Stats SA and SARB

By contrast, *private sector employment* increased by an anualised 4.0% in the fourth quarter of 2016. Following a contraction in the first half of 2016, a cumulative 83 600 private sector job opportunities were created in the second half of the year, with the bulk of these job gains recorded in the services subsectors. Employment gains were registered in the private community, social and personal services sector; the finance, insurance, real estate and business services sector; the trade, catering and accommodation services sector; the transport, storage and communication services sector and in the manufacturing sector in the fourth quarter of 2016. However, with the exception of the manufacturing sector, job shedding continued in the goods-producing sectors of the economy, with labour paring occurring in the construction and mining sectors. The level of private sector employment has been trending broadly sideways for the past four years as annual average growth remained lacklustre, picking up only marginally from 0.1% in 2015 to 0.2% in 2016.

The general appreciation in the exchange value of the rand from early 2016 together with an unfavourable domestic economic and political environment likely prevented the *mining sector* from benefiting fully from the rebound in international commodity prices. Although the pace of job shedding in the mining sector has slowed notably over the past year, mining sector employment nevertheless decreased for a second successive quarter in the fourth quarter of 2016. The pace of job shedding was most pronounced in the gold-mining sector, following two quarters of job gains. In addition, employment in the non-gold mining sector contracted for a seventh successive quarter in the final quarter of 2016.

Employment in the goods-producing sectors



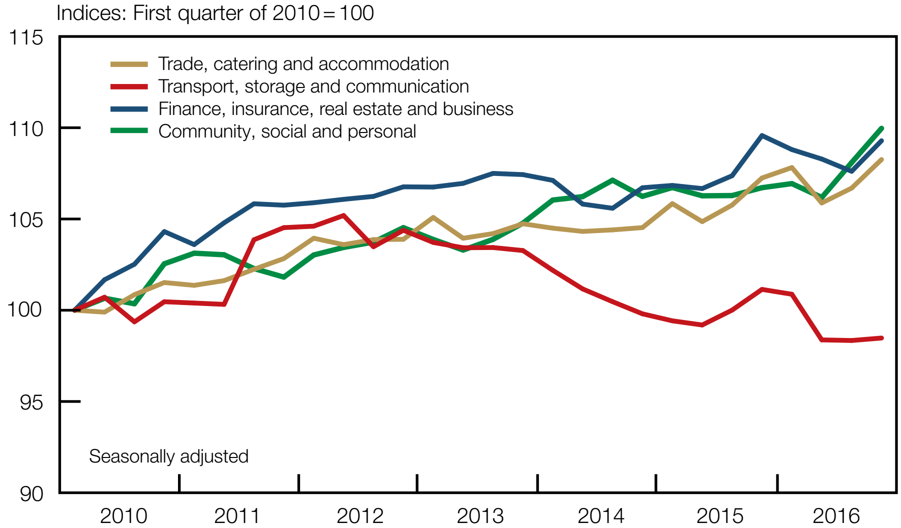

Sources: Stats SA and SARB

Somewhat surprisingly, employment in the *manufacturing sector* increased markedly in the fourth quarter of 2016, following four successive quarters of job losses. Employment creation occurred despite deteriorating sentiment among manufacturers and a contraction in the real gross value added by the manufacturing sector in the second half of 2016. The Absa *Manufacturing Survey* released by Stellenbosch University's Bureau for Economic Research (BER) indicated that business confidence among manufacturers declined to 28 index points in the first quarter of 2017 after registering 30 index points in both the third and fourth quarters of 2016. Although export sales and order volume indicators remained positive in the first quarter of 2017, domestic demand indicators retreated. As such, production and employment indicators also decreased. Furthermore, a net majority of respondents reported a decline in fixed investment levels, with the political climate and the tax structure seriously constraining fixed investment. The BER noted that demand will have to improve on a sustained basis for production, and ultimately fixed investment and employment growth in the manufacturing sector to pick up meaningfully.

Employment in the *construction sector* decreased notably in the fourth quarter of 2016, following a marginal increase in the third quarter. Construction sector employment has trended moderately lower in 2016, consistent with slowing growth in the real gross value added by the sector. Despite recent moderate improvements, confidence levels in the building and construction sector remain subdued. The First National Bank (FNB)/BER Building Confidence Index rose marginally by three index points to a still low 43 index points in the first quarter of 2017. Notwithstanding the slight rise in confidence, respondents reported noticeably weaker building activity, particularly among main building contractors. Likewise, the FNB/BER Civil Confidence Index increased from 35 index points in the fourth quarter of 2016 to 40 index points in the first quarter of 2017. According to FNB, the improvement in sentiment was underpinned by a slight uptick in construction activity due to some investment in the mining sector, while overall profitability in the construction sector continued to weaken.

Employment in the finance, insurance, real estate and business services sector increased significantly in the fourth quarter of 2016, following three successive quarters of job shedding. In addition, the trade, catering and accommodation services sector generated a cumulative 45 900 employment opportunities in the second half of 2016. Employment growth in this sector may have been boosted by the addition of new retail space, following the completion of new shopping centres and the extension of existing malls over the period. Although results from the BER's *Retail Survey* showed that business confidence among retailers, wholesalers and new vehicle traders improved marginally in the first quarter of 2017, confidence remain at fairly low levels. Respondents indicated that despite the uptick in confidence, underlying business conditions deteriorated and sales volumes slumped across the trade sector. Lower input costs owing to the appreciation in the exchange value of the rand led to an improvement in profit margins, which likely contributed to the slight increase in business confidence. With growth in consumer spending expected to slow further in the short run, the pace of service-sector employment growth could moderate in 2017.

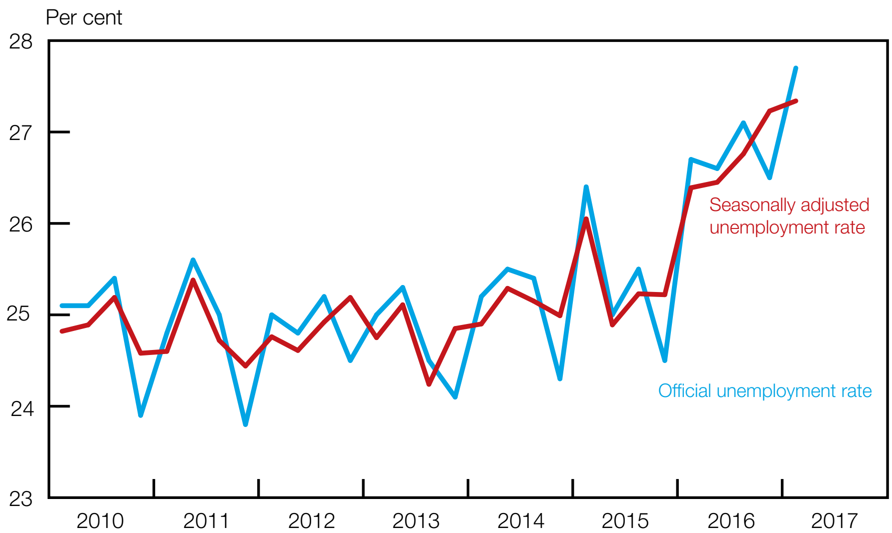
Employment in the private services sectors




Sources: Stats SA and SARB

According to the *Quarterly Labour Force Survey (QLFS)* conducted by Stats SA, the number of persons employed in South Africa increased by 144 000 from the fourth quarter of 2016 to the first quarter of 2017, raising the total level of employment to approximately 16.21 million. Total employment increased more meaningfully, by 538 000, in the year to the first quarter of 2017, with year-on-year growth accelerating from 0.3% in the fourth quarter of 2016 to 3.4% in the first quarter of 2017. Employment gains occurred in the formal non-agricultural sector and in the informal sector, which added 354 000 and 116 000 jobs respectively in the year to the first quarter of 2017. The agricultural sector created a mere 6 000 employment opportunities over this period.

Unemployment rate



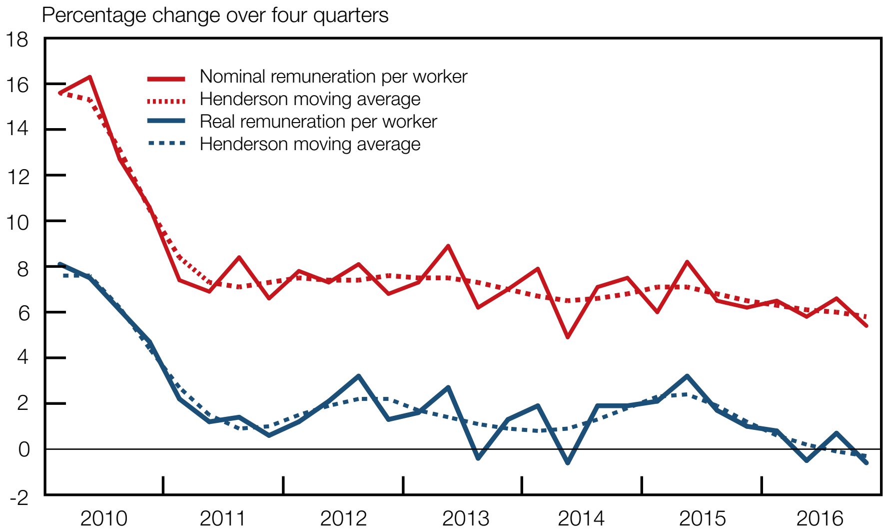

Sources: Stats SA and SARB

The number of unemployed persons increased notably, by 433 000, from the fourth quarter of 2016 to the first quarter of 2017, and by 491 000 over four quarters, lifting the total number of unemployed South Africans to around 6.21 million – the highest number since the inception of the *QLFS* in 2008. However, the number of discouraged job seekers decreased by 156 000 in the year to the first quarter of 2017. The official unemployment rate increased notably from 26.5% in the fourth quarter of 2016 to 27.7% in the first quarter of 2017, reflecting the substantial increase in the number of new entrants into the labour market who failed to find employment. In addition, the seasonally adjusted unemployment rate increased marginally from 27.2% to 27.3% over the same period. Disconcertingly, the youth unemployment rate rose from 50.9% in the fourth quarter of 2016 to 54.3% in the first quarter of 2017, marginally down from 54.5% a year earlier.

## Labour cost and productivity

The pace of wage increases in the domestic economy moderated to below that of consumer prices in 2016, as nominal wage growth slowed while consumer price inflation accelerated. The year-on-year pace of increase in nominal remuneration per worker in the formal non-agricultural sector of the economy slowed from 5.7% in the third quarter of 2016 to 5.5% in the fourth quarter – its sixth consecutive quarter of moderation. Similarly, on an annual average basis, nominal remuneration growth per worker decelerated from 7.0% in 2015 to 5.7% in 2016. In addition, when excluding election-related employment, real wage growth per worker decelerated from 1.9% in 2015 to 0.2% in 2016, largely due to a notable acceleration in consumer price inflation in 2016.

Formal non-agricultural remuneration per worker*




* Adjusted for election-related outliers

Sources: Stats SA and SARB

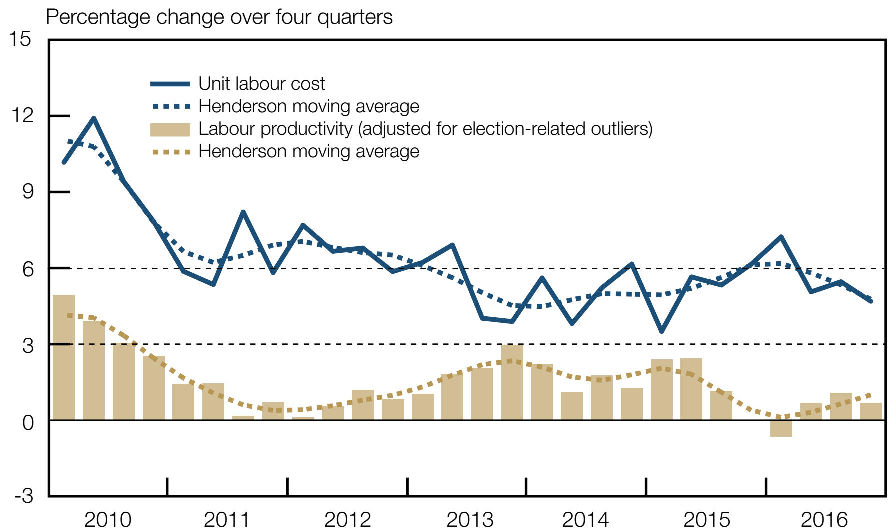
The moderation in nominal remuneration growth per worker in the fourth quarter of 2016 resulted from a deceleration in *private sector* remuneration growth, from a year-on-year rate of 5.7% in the third quarter to 4.5% in the fourth quarter. Apart from lower wage increases, the moderation in private sector wage growth per worker could in part be due to the creation of mostly low earning jobs in the services subsectors, in particular the trade, catering and accommodation services sector and the finance, insurance, real estate and business services sector, in the final quarter of 2016. Year-on-year growth in remuneration per worker moderated in the private community, social and personal services sector (from 5.8% to 5.4%); the finance, insurance, real estate and business services sector (from 5.6% to 3.4%); and in the trade, catering and accommodation services sector (from 6.5% to 3.3%). However, remuneration growth accelerated in the transport, storage and communication services sector (from 4.8% to 7.7%). In the goods-producing sectors remuneration growth accelerated in the manufacturing sector (from 5.6% to 6.7%) and in the construction sector (from 3.3% to 3.6%), while moderating in the mining sector (from 8.5% to 7.0%). On an annual average basis, private sector remuneration growth moderated from 6.5% in 2015 to 5.1% in 2016, indicative of an environment of weak output growth, weak consumer demand and concomitant poor employment prospects.

*Public sector* wage growth per worker accelerated from 5.1% in the third quarter of 2016 to 8.4% in the fourth quarter, pushed up by the termination of a large number of low-earning temporary employment contracts by the IEC. However, when excluding the temporary IEC employees from the calculation, public sector remuneration growth per worker decelerated from 8.8% in the third quarter of 2016 to 7.9% in the fourth quarter. On an annual average basis, public sector remuneration growth – excluding election-related employment – accelerated from 7.2% in 2015 to 8.6% in 2016.

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements moderated from 7.8% in the first quarter of 2016 to 7.6% in the first quarter of 2017, slightly higher than the average of 7.5% for 2016 as a whole. The number of working days lost due to strike action decreased marginally from 90 000 to 85 000 over the same period. Multi-year wage agreements in the steel and engineering sector as well as in the coal mining sector are due for renewal in 2017, which increases the potential for strike action in these sectors later in the year.

Year-on-year growth in *labour productivity* in the formal non-agricultural sector of the economy accelerated from 0.2% in the third quarter of 2016 to 0.8% in the fourth quarter, as the year-on-year contraction in employment outweighed the slight moderation in output growth. However, when adjusting for election-related outliers, labour productivity growth slowed from 1.1% in the third quarter of 2016 to 0.7% in the fourth quarter. For 2016 as a whole, when excluding election-related employment, labour productivity growth slowed to 0.4% from 1.5% in 2015.

Labour productivity and nominal unit labour cost




Sources: Stats SA and SARB

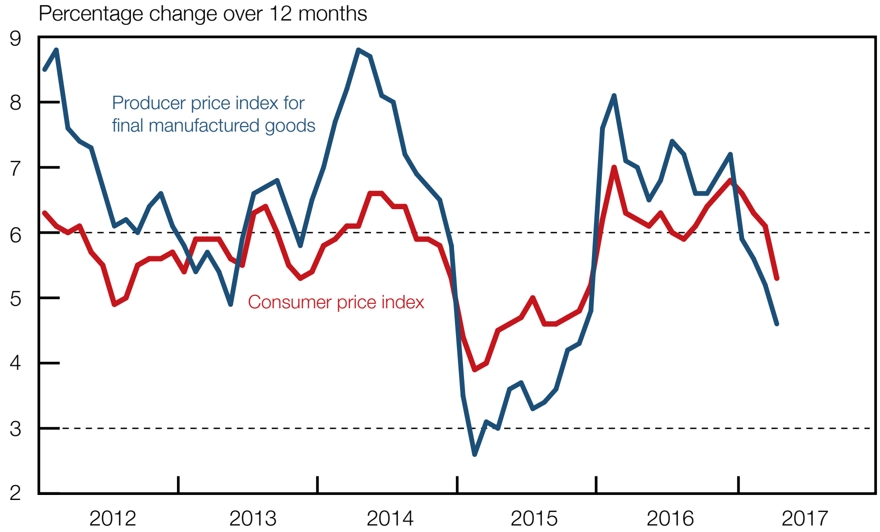
With year-on-year growth in total remuneration slowing at a faster pace than that in output, growth in nominal unit labour cost in the formal non-agricultural sector moderated from 5.5% in the third quarter of 2016 to 4.7% in the fourth quarter. However, growth in nominal unit labour cost accelerated somewhat from an annual average rate of 5.1% in 2015 to 5.6% in 2016, as output growth slowed much more than total remuneration growth in 2016.

## Prices[6]

Domestic inflationary pressures eased somewhat in the opening months of 2017, consistent with continued weak output growth and subdued consumer demand. South Africa's *headline consumer price inflation* slowed from a recent peak of 6.8% in December 2016 to 5.3% in April 2017. Consumer price inflation exceeded the upper limit of the inflation target range for seven consecutive months up to March 2017, before moderating to within the target range in April. The recent moderation in consumer price inflation was fairly broad-based, resulting from a combination of easing food price pressures, the overall appreciating trend in the exchange value of the rand from early 2016 and limited pricing power of domestic firms due to weak domestic demand.

6 Unless stated to the contrary, all rates mentioned in this section reflect year-on-year changes.

### Headline consumer and producer price inflation




Source: Stats SA

Most measures of *producer price inflation* moderated in the opening months of 2017. Producer price inflation for final manufactured goods slowed from 7.2% in December 2016 to 4.6% in April 2017 as price inflation decelerated in four of the nine main categories. Likewise, producer price inflation for intermediate manufactured goods moderated from 7.3% to 5.0% over the same period. Price inflation slowed in the majority of intermediate manufactured goods subcategories, with the exception of glass and glass products.

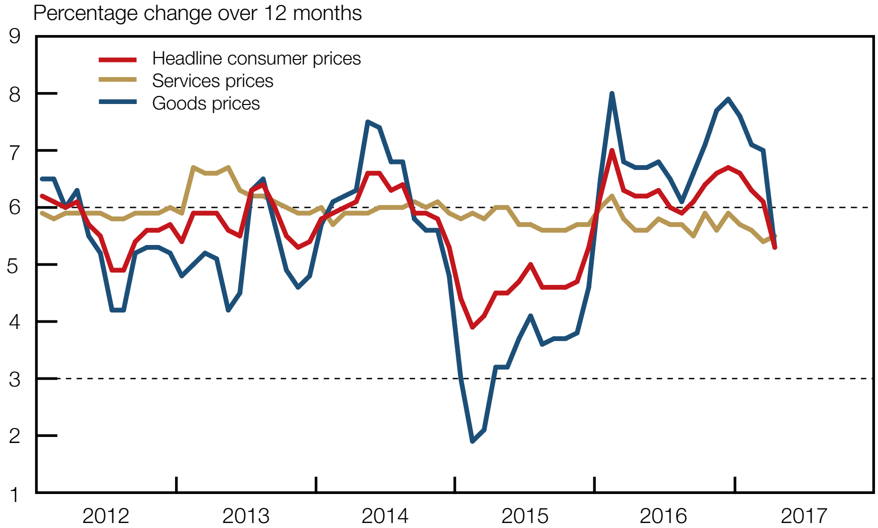
The recovery in international commodity prices from early 2016 contributed to an acceleration in producer price inflation for mining products (prices of domestically produced mining commodities) throughout the year and into 2017. Subsequently, producer price inflation for mining products more than halved from 12.2% in February 2017 to 5.7% in April, as some commodity prices decreased somewhat in the month and as the low base from a year earlier started to dissipate. Producer price inflation for agriculture, forestry and fishing products moderated notably from 6.4% in December 2016 to -4.2% in March 2017, largely due to a marked deceleration in agricultural producer price inflation, before it accelerated again to -1.6% in April. Producer price inflation for electricity and water – both administered prices – remained elevated in the first three months of 2017, but moderated to 5.9% in April as electricity price inflation slowed notably. The moderation in electricity producer price inflation resulted from the decision by the National Energy Regulator of South Africa (NERSA) to award Eskom an annual tariff increase of just 2.2% in 2017 compared with 8.0% in 2016. By contrast, water price inflation accelerated to 12.1% in April 2017.

Consumer *goods price inflation* consistently remained above the upper level of the inflation target range throughout 2016 and into 2017. Goods price inflation quickened notably from 6.1% in August 2016 to 7.8% in December, as price inflation accelerated across a wide range of product categories, possibly reflecting some exchange rate pass-through following the earlier depreciation in the exchange value of the rand prior to 2016. Subsequently, goods price inflation moderated to 5.3% in April 2017. The moderation was equally broad-based and likely reflects an about-turn in exchange rate pass-through following the appreciation in the exchange value of the rand from early 2016.

The recent moderation in consumer goods price inflation was driven largely by slowing durable and semi-durable goods price inflation, probably reflecting some disinflationary effect from the appreciation of the exchange value of the rand. Durable goods price inflation slowed from a recent high of 7.3% in September 2016 to 3.6% in April 2017 as new vehicle price inflation in particular slowed notably. Semi-durable goods price inflation decelerated from 5.9% in December 2016 to 3.9% in April 2017, largely reflecting a moderation in clothing and footwear price inflation. Non-durable goods price inflation initially moderated from 8.2% in November 2016 to 7.7% in February 2017, before accelerating again to 8.1% in March as slowing food price inflation was countered by a marked acceleration in fuel price inflation. Non-durable goods price inflation then moderated again to 5.8% in April 2017 as both food and fuel price inflation slowed.

Consumer price inflation

Percentage change over 12 months



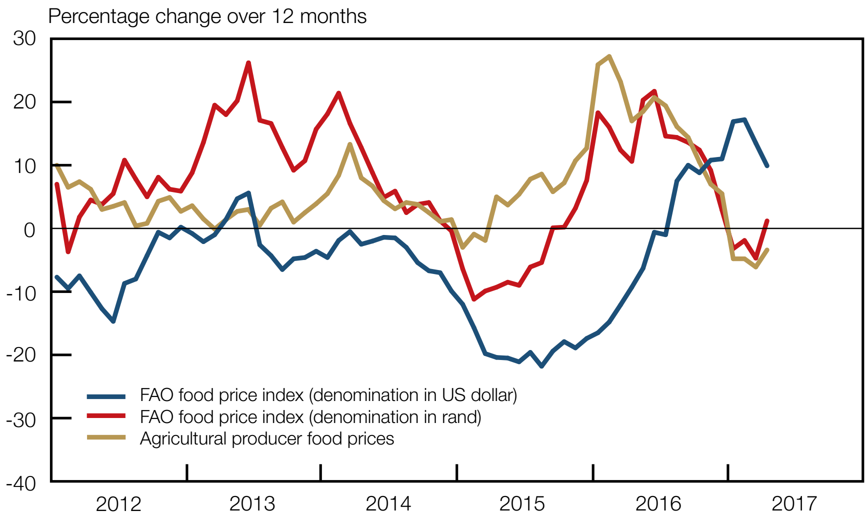

Source: Stats SA

*Consumer services price inflation* remained within the inflation target range from March 2016 onwards and moderated to 5.4% in March 2017 – its lowest level in six years. Price inflation slowed in most consumer services price subcategories in recent months, notably rentals, domestic worker wages, transport services, recreation and culture services, restaurant and hotel services, as well as miscellaneous services. This was countered somewhat by the acceleration in health and education services price inflation, following an increase in tertiary education fees in 2017 after no increase occurred in 2016 due to the 'Fees Must Fall' protest actions that led to a declaration by the state that university fees would not increase in that year. Services price inflation subsequently accelerated marginally to 5.5% in April 2017, mainly as a result of higher hotel services prices.

The international *food price index* of the Food and Agriculture Organization (FAO) of the United Nations (UN), in US dollars, rose to its highest level in 24 months in February 2017 before moderating in March and April as vegetable oil and in particular sugar prices receded. However, the 12-month change in the rand-denominated FAO food price index moderated to -4.5% in March 2017 – supported by the earlier appreciation in the exchange value of the rand – before accelerating to 1.7% in April. International cereal prices decreased somewhat in March and

April 2017 following a moderate upward trend since October 2016. Still, international cereal prices were 2.5% lower in April 2017 than a year earlier, suppressed by ample global supplies and good harvests of wheat in particular. 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 -16.0% in March 2017 before accelerating somewhat to -10.3% in April.

International and domestic food price inflation




Sources: Stats SA and Food and Agriculture Organization (FAO) of the United Nations

Domestic agricultural producer food price inflation slowed significantly in recent months, from 20.7% in June 2016 to -6.1% in March 2017, before accelerating somewhat to -3.4% in April. Producer price inflation of cereals and other crops (with a weight of 21% in the basket) receded markedly from 46.2% to -31.2% over the same period, on account of expected over supply as the impact of the drought dissipated, following expectations at the time that the 2017 domestic maize crop could be the second largest ever. According to the latest forecast by the Department of Agriculture, Forestry and Fishing's Crop Estimates Committee, the yellow maize crop is expected to be 41.0% higher than the final crop of 2016, while the white maize crop is expected to be almost 178.0% higher. In addition, fruit and vegetable producer price inflation also slowed notably to -19.6% in April 2017. By contrast, live animal producer price inflation (with a weight of 38% in the basket) accelerated markedly from 5.2% in November 2016 to 26.2% in April 2017 on account of supply constraints due to the rebuilding of herds by farmers following improved rainfall.

Agricultural producer food prices

Percentage change over 12 months

| | Weight | | 2017 | | | |
|---|---|---|---|---|---|---|
| | In agricultural PPI | In agricultural PPI food basket | Jan | Feb | Mar | Apr |
| Products of crop and horticulture ........................ | 41.05 | 48.0 | -16.9 | -15.9 | -23.5 | -24.8 |
| Cereals and other crops ....... | 17.94 | 21.0 | -18.4 | -23.5 | -31.5 | -31.2 |
| Fruit and vegetables ............ | 23.11 | 27.0 | -14.6 | -9.4 | -17.1 | -19.6 |
| Live animals and animal products.................................. | 44.23 | 52.0 | 11.9 | 10.2 | 14.8 | 20.7 |
| Live animals.......................... | 32.71 | 38.0 | 12.4 | 11.8 | 18.2 | 26.2 |
| Milk and eggs....................... | 10.12 | 12.0 | 12.7 | 6.9 | 7.3 | 7.0 |
| All items.................................. | 85.28 | 100.0 | -4.8 | -4.8 | -6.1 | -3.4 |

Source: Stats SA

In response to the significant deceleration in agricultural producer food price inflation, producer food price inflation at the final manufactured level moderated from a recent peak of 13.4% in August 2016 to 6.4% in April 2017. The moderation resulted largely from lower price inflation of bakery products, grain mill products, starch products and animal feed, while price inflation in the majority of other manufactured producer food price subcategories remained elevated. In addition, substantial pass-through from the acceleration in agricultural 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 13.7% in April 2017.

### Final manufactured producer food prices

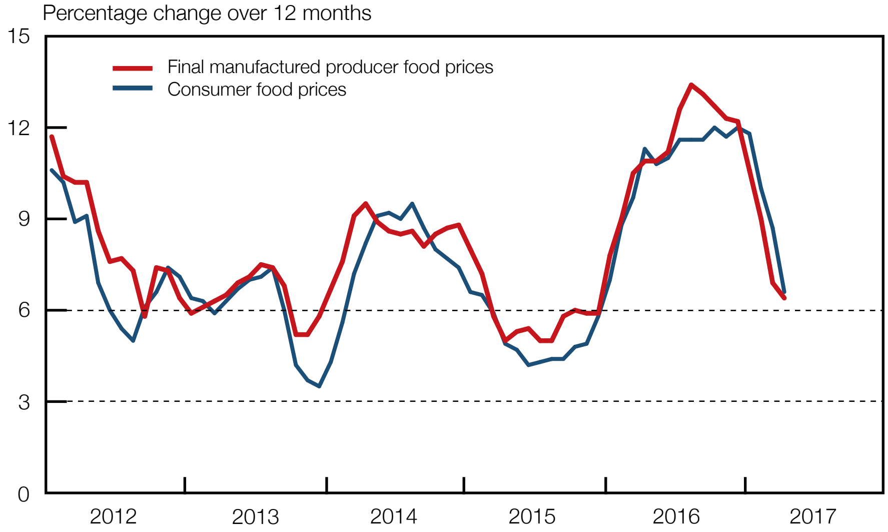
Percentage change over 12 months

| | Weight | | 2017 | | | |
|---|---|---|---|---|---|---|
| | In final manufactured PPI | In final manufactured PPI food basket | Jan | Feb | Mar | Apr |
| Meat, fish, fruit, vegetables, oils and fats | 9.84 | 39.0 | 10.3 | 9.0 | 9.2 | 9.1 |
| Meat and meat products | 5.35 | 21.0 | 12.4 | 11.0 | 12.0 | 13.7 |
| Fish and fish products | 2.04 | 8.0 | 10.8 | 8.4 | 5.4 | 3.4 |
| Fruit and vegetables | 1.58 | 6.0 | 11.2 | 11.7 | 10.6 | 10.0 |
| Oils and fats | 0.87 | 4.0 | -3.4 | -4.3 | -2.0 | -4.8 |
| Dairy products | 2.26 | 9.0 | 13.5 | 12.5 | 10.4 | 8.2 |
| Grain mill, starch and animal feed products | 3.41 | 14.0 | 6.4 | 3.2 | -0.3 | -4.0 |
| Grain mill products | 1.43 | 6.0 | 5.2 | 1.8 | -4.0 | -7.3 |
| Starch and animal feed products | 1.98 | 8.0 | 7.1 | 4.3 | 2.3 | -1.6 |
| Other food products | 9.67 | 38.0 | 11.4 | 10.1 | 6.6 | 7.2 |
| Bakery products | 6.59 | 25.0 | 9.4 | 9.2 | 5.7 | 6.5 |
| Sugar | 1.66 | 7.0 | 21.4 | 14.7 | 9.3 | 8.2 |
| Other food products | 1.42 | 6.0 | 12.5 | 9.1 | 8.9 | 10.5 |
| **All items** | **25.17** | **100.0** | **10.6** | **9.0** | **6.9** | **6.4** |

Source: Stats SA

### Food price inflation

Percentage change over 12 months




Source: Stats SA

Following the moderation in producer food price inflation, food price inflation at the consumer level decelerated thus far in 2017, receding from a recent peak of 12.0% in December 2016 to 6.6% in April 2017. Similar to the slowdown in food price inflation at the producer level, the moderation in consumer food price inflation was largely driven by decelerating bread and cereals price inflation (with a weight of 21% in the consumer food price basket), while slowing fruit and vegetable price inflation also contributed. By contrast, red meat and poultry prices kept consumer meat price inflation elevated due to constrained supply. Slaughtering numbers are notably down from a year earlier as farmers rebuild their herds following improved rainfall and grazing. Rising poultry prices were supported by lower imports (especially from the euro area due to an outbreak of avian flu) as well as the ongoing impact of the adjustments to brine content.

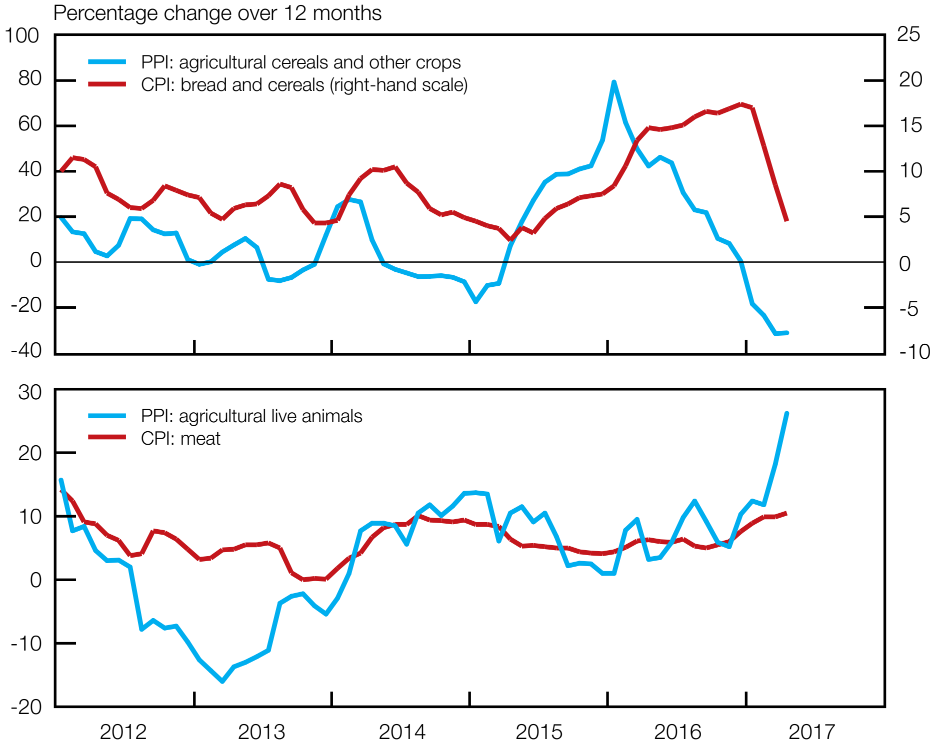
### Consumer food prices

Percentage change over 12 months

| | Weight | | 2017 | | | |
|---|---|---|---|---|---|---|
| | In consumer price index | In consumer food basket | Jan | Feb | Mar | Apr |
| Bread and cereals .................... | 3.21 | 21.0 | 17.0 | 12.8 | 8.5 | 5.4 |
| Meat......................................... | 5.46 | 35.0 | 8.9 | 9.9 | 9.9 | 10.5 |
| Fish ......................................... | 0.40 | 2.0 | 11.1 | 10.7 | 10.5 | 9.7 |
| Milk, eggs and cheese............. | 2.57 | 17.0 | 11.1 | 10.7 | 9.2 | 6.1 |
| Oils and fats ............................ | 0.45 | 3.0 | 7.2 | 4.9 | 1.9 | -0.1 |
| Fruit.......................................... | 0.34 | 2.0 | 11.2 | 11.2 | 4.6 | -1.2 |
| Vegetables............................... | 1.30 | 8.0 | 4.7 | -0.5 | 0.0 | -5.2 |
| Sugar, sweets and desserts ..... | 0.56 | 4.0 | 21.4 | 16.9 | 17.6 | 18.4 |
| Other food products................ | 1.19 | 8.0 | 12.3 | 11.8 | 11.6 | 7.1 |
| **All items**.................................. | **15.48** | **100.0** | **11.8** | **10.0** | **8.7** | **6.6** |

Source: Stats SA

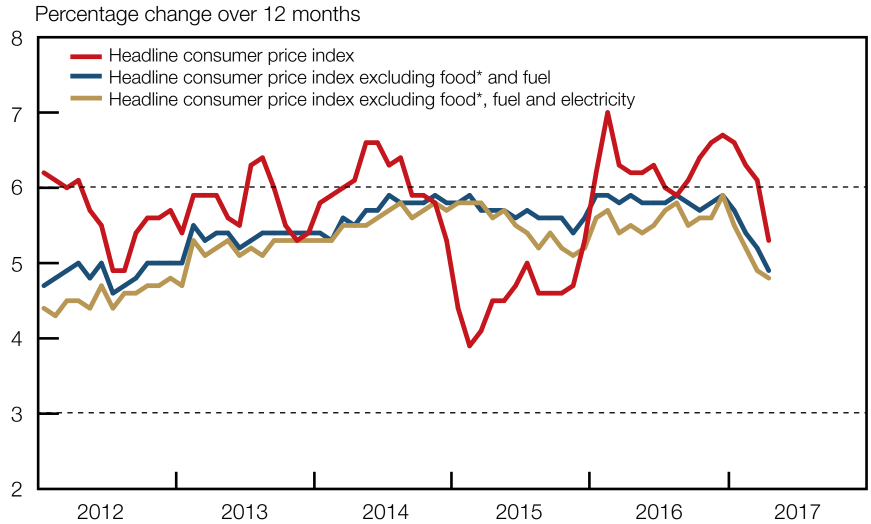
### Food price inflation




Source: Stats SA

Measures of *underlying inflation* indicate a notable easing of inflationary pressures in the opening months of 2017. This reflects subdued domestic demand and probably some disinflationary effects from the appreciation in the exchange value of the rand from early 2016. Subtracting the impact of the more volatile food, non-alcoholic beverages and fuel prices from the calculation of headline CPI inflation, the resultant measure decelerated from 5.9% in December 2016 to 4.9% in April 2017. When also excluding electricity prices, the moderation was even more pronounced, as this measure of underlying inflation (the SARB's preferred measure of core inflation) decelerated from 5.9% to 4.8% over the same period – its lowest level in 51 months.

### Headline and underlying measures of consumer price inflation

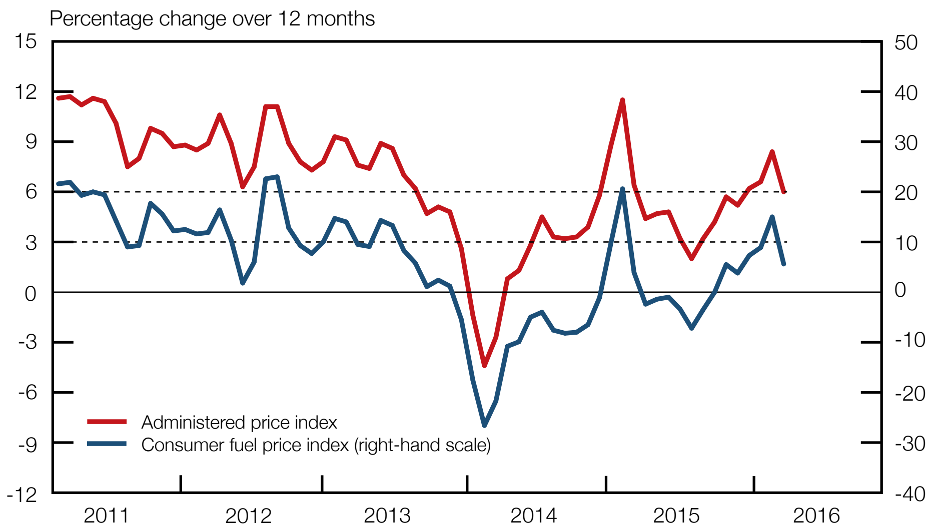



* Food includes non-alcoholic beverages

Source: Stats SA

Movements in *administered price inflation* continued to largely reflect changes in fuel prices. Administered price inflation picked up pace from 2.0% in August 2016 to 8.4% in March 2017, following a marked acceleration in fuel price inflation from -7.2% to 15.0% over the same period. However, when excluding fuel prices, administered price inflation accelerated to 6.1% in March 2017, after having remained unchanged at 5.7% for eight successive months. This rate of change subsequently moderated to 5.9% in April 2017. By contrast, administered price inflation, excluding both fuel and electricity prices moderated from 5.0% in December 2016 to 4.8% in March 2017, before accelerating to 5.7% in April.

### Administered price inflation




Source: Stats SA

Average headline inflation expectations for 2017, as measured with the *Inflation Expectations Survey* conducted by the BER, rebounded from 5.8% in the fourth quarter of 2016 to 6.2% in the first quarter of 2017. Although all surveyed groups adjusted their 2017 inflation expectations upwards since the previous survey, trade union representatives and business representatives made the largest revisions, that is, 0.6 percentage points and 0.4 percentage points respectively. The BER noted that the sharp upward adjustment in inflation expectations of business representatives and trade union representatives could in part be related to the information on historical consumer price inflation provided to respondents on the questionnaire. The annual average headline consumer price inflation rate accelerated notably from 4.6% in 2015 to 6.4% in 2016.

### Headline consumer price inflation expectations

Per cent, as surveyed in the first quarter of 2017

| Average inflation expected for: | Financial analysts | Business representatives | Trade union representatives | All surveyed participants |
|---|---|---|---|---|
| 2017...................................................... | 5.8 | 6.4 | 6.3 | 6.2 |
| 2018...................................................... | 5.4 | 6.4 | 6.1 | 5.9 |
| 2019...................................................... | 5.5 | 6.3 | 6.1 | 6.0 |
| The next five years .............................. | 5.4 | 6.2 | 5.5 | 5.7 |

Source: Bureau for Economic Research, Stellenbosch University

Despite average headline inflation expectations for 2018 having increased marginally from the fourth quarter of 2016 to the first quarter of 2017, on balance, survey participants expect inflation to moderate to 5.9% in 2018. Business representatives expect inflation to be 6.2% five years from now, while analysts and trade unions foresee much lower headline inflation of 5.4% and 5.5% respectively five years from now.

# External economic accounts

## Current account[7]

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

South Africa's trade surplus was sustained for a second consecutive quarter, widening marginally from R56 billion in the fourth quarter of 2016 to R57 billion in the first quarter of 2017. The higher trade surplus resulted from a slight increase in the value of net gold and merchandise exports more than fully offsetting the marginal increase in the value of merchandise imports.

### Balance of payments on current account

R billions, seasonally adjusted and annualised

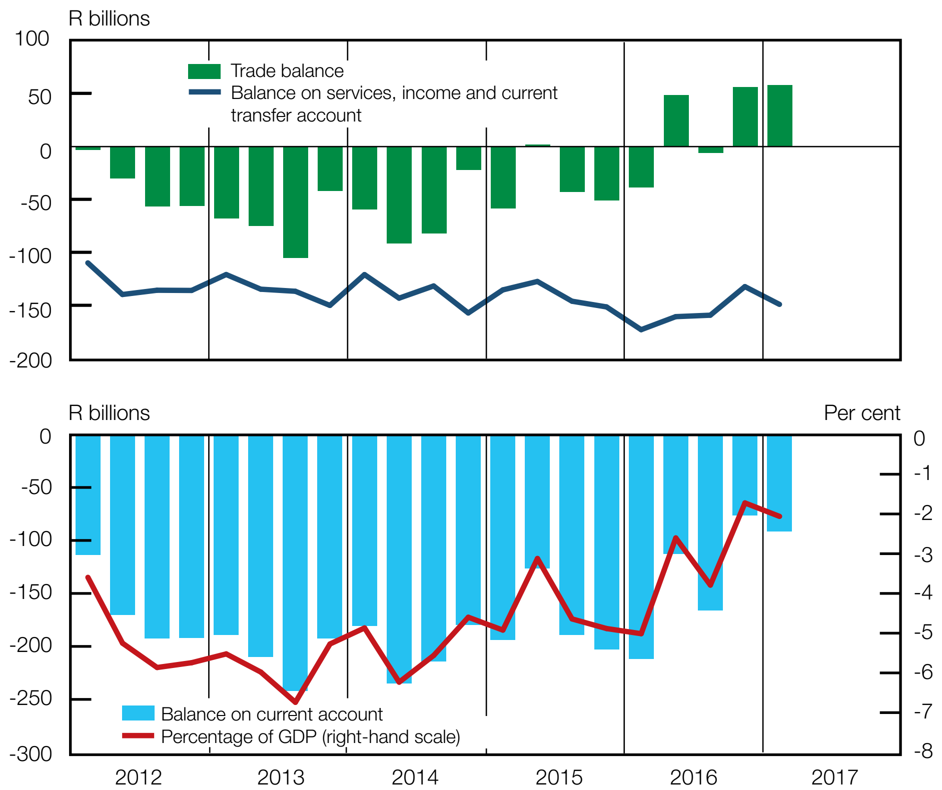
| | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year | Q1 |
| Merchandise exports | 1 006 | 1 104 | 1 033 | 1 071 | 1 054 | 1 069 |
| Net gold exports | 52 | 54 | 47 | 49 | 51 | 55 |
| Merchandise imports | -1 097 | -1 110 | -1 086 | -1 065 | -1 090 | -1 067 |
| **Trade balance** | **-39** | **48** | **-7** | **56** | **15** | **57** |
| Net service, income and current transfer payments | -173 | -160 | -159 | -132 | -156 | -149 |
| **Balance on current account** | **-212** | **-113** | **-166** | **-76** | **-142** | **-92** |
| *As a percentage of GDP* | *-5.0* | *-2.6* | *-3.8* | *-1.7* | *-3.3* | *-2.1* |

Components may not add up to totals due to rounding off

Sources: Stats SA and SARB

The broadly unchanged trade surplus occurred alongside a widening of the shortfall on the services, income and current transfer account, from R132 billion in the fourth quarter of 2016 to R149 billion in the first quarter of 2017. Consequently, the deficit on the current account of the balance of payments widened from R76 billion in the final quarter of 2016 to R92 billion in the first quarter of 2017. As a ratio of GDP, the deficit widened somewhat from 1.7% to 2.1% over this period.

Balance of payments: current account

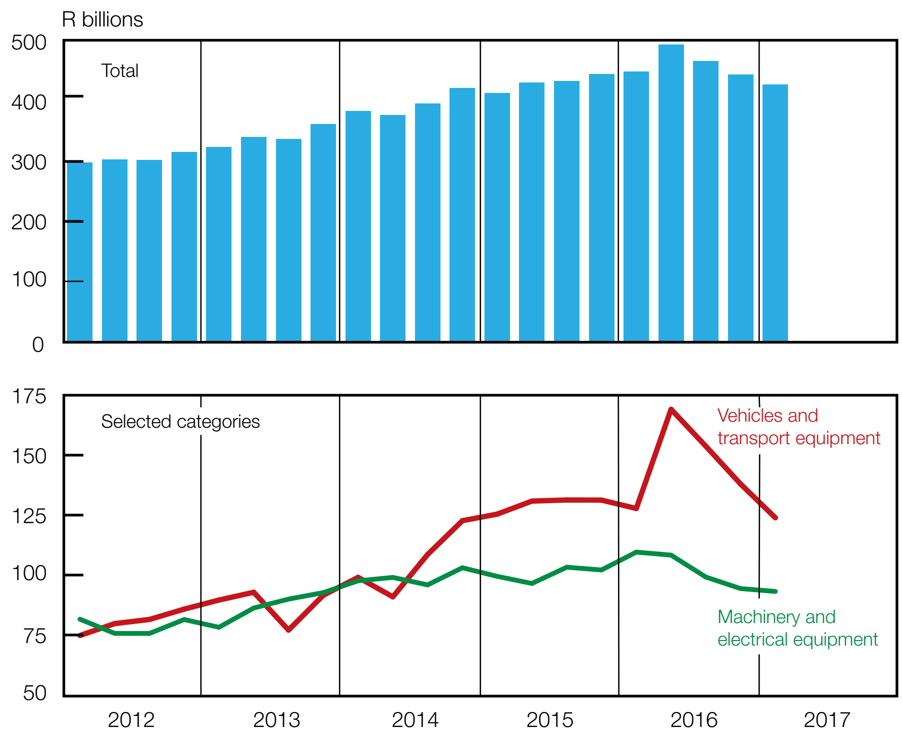



Seasonally adjusted and annualised

Sources: Stats SA and SARB

The value of merchandise exports declined marginally by 0.2% in the first quarter of 2017 following an increase of 3.7% in the final quarter of 2016. An increase in the value of mining exports was fully countered by lower values of exported manufactured and agricultural goods. The decrease in manufactured goods exported coincided with weak domestic manufacturing activity as reflected by the third successive quarterly contraction in real gross value added by the manufacturing sector in the first quarter of 2017. This came about despite a recovery in global demand as evidenced by an improvement in manufacturing purchasing managers' indices and consumer confidence in many economies in the first quarter of 2017. Contractions in the values of exported vehicles and transport equipment, prepared foodstuffs as well as artificial resins and plastics were the main drivers of the decline in the total value of manufactured exports in the first quarter of 2017. The export value of vehicles and transport equipment was negatively affected by a sharp decrease in the number of vehicles exported in the quarter, especially in January. According to the National Association of Automobile Manufacturers of South Africa (NAAMSA), new vehicle exports were negatively affected by extensive factory refurbishment at one of the big manufacturers, in preparation for the production of a new model. However, NAAMSA expects an improvement in vehicle exports later in the year.

Manufactured exports




Seasonally adjusted and annualised

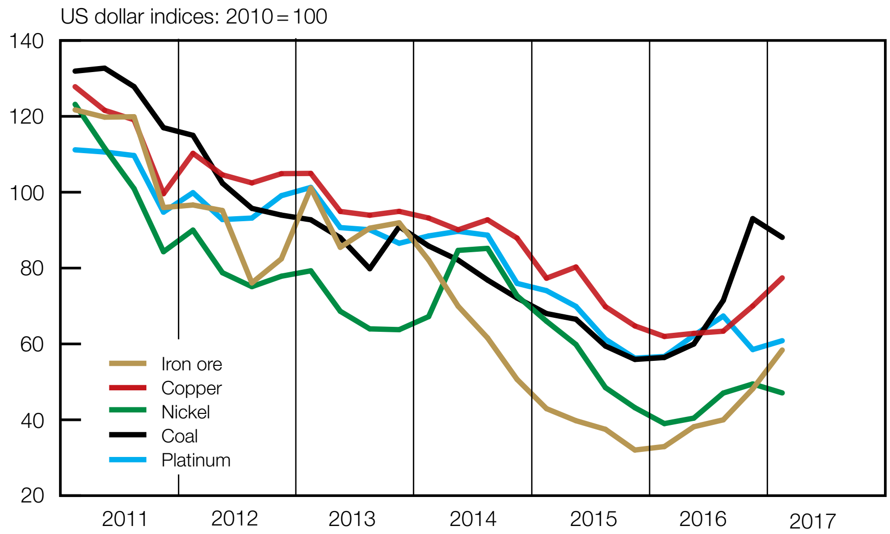
Sources: Stats SA and SARB

The value of non-gold mining exports increased for the second successive quarter in the first quarter of 2017, mainly attributable to higher export proceeds of pearls, precious and semi-precious stones. Reduced international demand for locally produced citrus fruit and maize contributed to the decrease in total agricultural export proceeds in the first quarter of 2017.

The total volume of exported bulk and break bulk cargo handled at national ports in South Africa decreased by 2.8% in the first quarter of 2017, following an increase in the previous quarter. This is also reflected in a decrease in the total volume of merchandise exports, which fell by 0.8% in the first quarter. Significant declines were noted in the physical quantity of exported manufactured goods.

The US dollar price of a basket of South African-produced non-gold export commodities increased by 14.2% in the first quarter of 2017 as it registered gains for a fourth consecutive quarter. However, trends were mixed in the first quarter of 2017, with the international prices of iron ore, copper and platinum increasing and those of nickel and coal decreasing. The sharp increase in the international price of iron ore resulted from a solid demand for steel by China, while the price of copper rose mainly on account of concerns related to supply disruptions caused by striking workers in the world's two largest copper mines, located in Chile and Indonesia. The appreciation in the external value of the rand in the first quarter of 2017 reduced the pace of increase in the rand price of the basket of South African-produced non-gold commodities somewhat. This, together with slight increases in the prices of other exported products, resulted in the overall rand price of merchandise exports increasing by only 0.6% in the first quarter of 2017.

International prices of selected South African export commodities

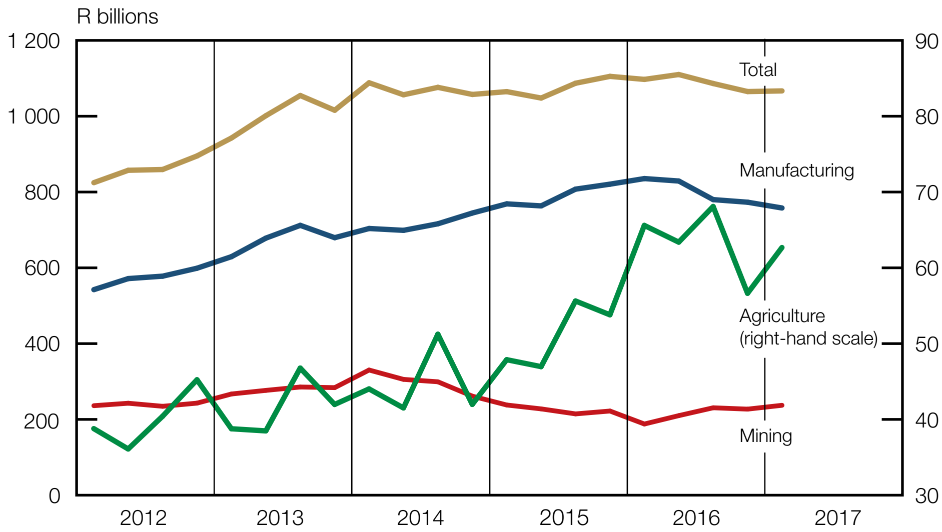



Source: World Bank

On the London market, the US dollar price of gold remained broadly unchanged at US$1 219 per fine ounce in the first quarter of 2017 compared with the previous quarter, despite uncertainty brought about by changing expectations of economic reforms in the US. However, the rand price of gold declined by about 5% in the first quarter 2017 as the external value of the rand appreciated. The impact of the decline in the average realised rand price of gold on local producers was overshadowed by a rise in the volume of net gold exports. Consequently, the value of net gold exports increased noticeably by 11.4% in the first quarter of 2017 following a 6.3% increase in the previous quarter.

The value of merchandise imports increased slightly in the first quarter of 2017 following a contraction in the preceding quarter. The import values of mining and agricultural products increased notably, while that of manufactured goods decreased substantially. Subdued domestic demand for foreign produced cellular telephones and wireless networks contributed largely to the decline in the import value of machinery and electrical equipment. This decrease outweighed increases in the values of imported chemical products as well as vehicles and transport equipment, resulting in a contraction in the total import value of manufactured goods. The value of imported vehicles and transport equipment was boosted by, among others, the importation of an aircraft as well as motor vehicle parts and accessories in anticipation of a new motor vehicle model to be manufactured locally.

Merchandise imports



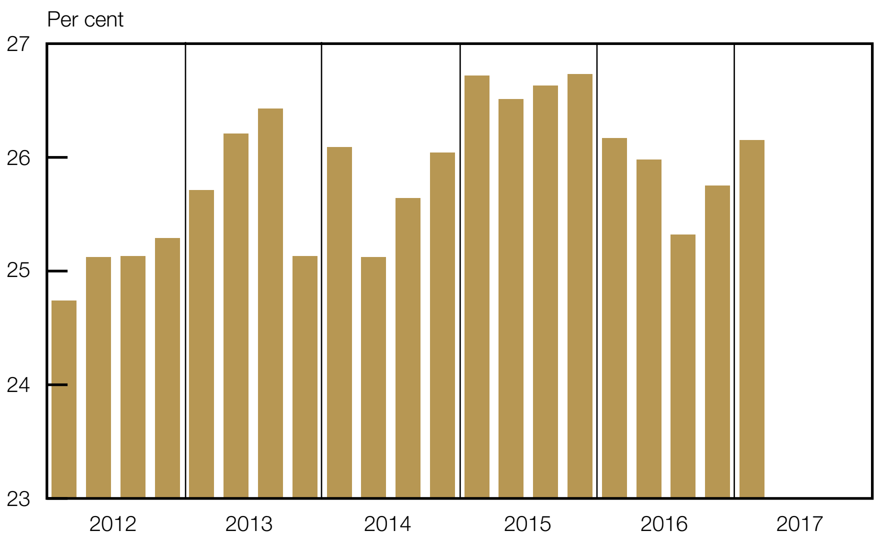

Seasonally adjusted and annualised

Sources: Stats SA and SARB

An increase in the value of imported mineral products in the first quarter of 2017 resulted mainly from a rise in crude and refined oil imports. This, together with an increase in the value of imported base metals and articles of base metals lifted the total value of mining imports in the first quarter. Following a sharp decline in the fourth quarter of 2016, the value of agricultural imports rebounded in the first quarter of 2017, partly due to the importation of live animals and animal products as well as vegetable products.

The rand price of merchandise imports declined further in the first quarter of 2017, though at a slower pace of 1.7% as opposed to the 3.1% in the fourth quarter of 2016. At the same time, the volume of merchandise imports increased further by 1.9% for a second consecutive quarter, mainly on account of increased volumes of imported mining and agricultural goods. Over the same period, real merchandise imports as a ratio of real gross domestic expenditure (the import penetration ratio) increased slightly from 25.7% to 26.1%.

Import penetration ratio

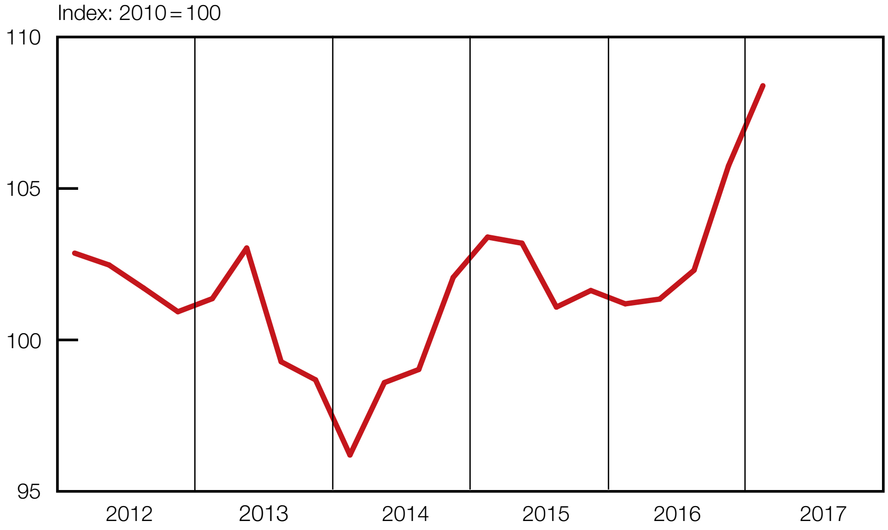



Seasonally adjusted

Sources: Stats SA and SARB

South Africa's terms of trade improved further in the first quarter of 2017 as the rand price of exports increased marginally, while the rand price of imports decreased.

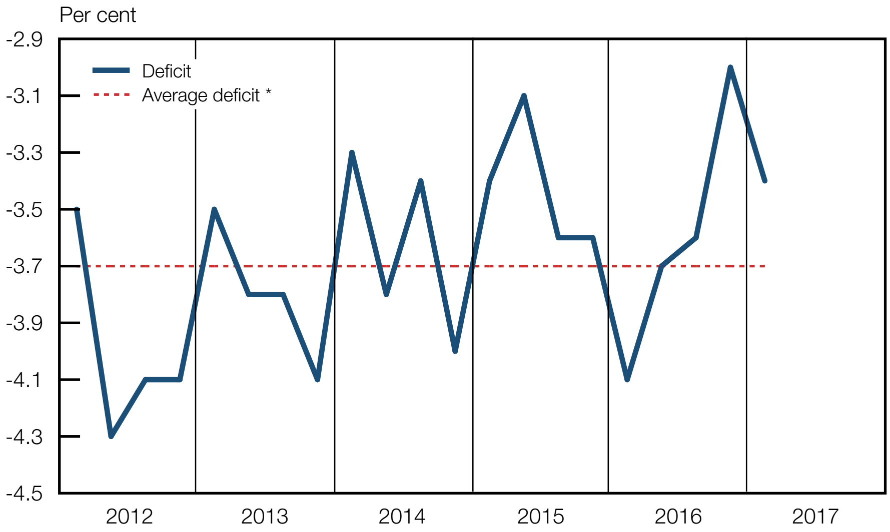
Terms of trade*




* Including gold
Sources: Stats SA and SARB

The deficit on the services, income and current transfer account widened by almost 13% in the first quarter of 2017. Relative to GDP, the deficit increased from 3.0% in the fourth quarter of 2016 to 3.4% in the first quarter of 2017. Despite being larger, the deficit is still less than its medium term average, as indicated in the accompanying figure.

Deficit on the services, income and current transfer account as a ratio of GDP




* Average: 2012/Q1 to 2017/Q1
Source: SARB

The widening in the deficit on the services, income and current transfer account can largely be ascribed to a widening in the net income deficit. This resulted from a significant decline in the level of dividend receipts from abroad though it remained at a fairly high level when compared to a year earlier. The effect of the decline in dividend receipts on the net income deficit was mitigated somewhat by a small decline in dividend payments.

The widening in the deficit on the services, income and current transfer account was softened by a smaller deficit in net payments for services, as the decline in payments for services outweighed the decline in receipts for services. Although the decline in payments for services was relatively widespread, it was most pronounced in the category other services, as payments for intellectual property as well as for technical related services to non-residents decreased. Net current transfer payments increased somewhat in the first quarter of 2017 due to a combination of marginally larger payments and slightly smaller receipts.

## Financial account

The net flow of capital on South Africa's financial account of the balance of payments (including reserve assets but excluding unrecorded transactions) reverted from a revised outflow of R8.7 billion in the fourth quarter of 2016 to an inflow of R37.6 billion in the first quarter of 2017. On a net basis, direct investment and financial derivatives recorded outflows, while all the other functional categories recorded inflows during the first quarter of 2017. Overall financial account inflows amounted to 3.4% of GDP in the first quarter of 2017.

### Net financial transactions

R billions

| | 2016 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year | Q1 |
| Change in liabilities | | | | | | |
| Direct investment | 11.4 | 8.6 | 7.0 | 6.5 | 33.5 | 9.0 |
| Portfolio investment | 31.5 | 51.0 | 55.5 | 1.9 | 139.9 | 25.9 |
| Financial derivatives | -149.6 | -103.8 | -116.1 | -129.8 | -499.3 | -90.9 |
| Other investment | -6.7 | -13.8 | 26.3 | -4.8 | 1.0 | 40.9 |
| Change in assets | | | | | | |
| Direct investment | -22.3 | -6.5 | -1.4 | -19.5 | -49.7 | -9.9 |
| Portfolio investment | 39.3 | 0.1 | -19.2 | 80.5 | 100.7 | -18.4 |
| Financial derivatives | 148.5 | 94.4 | 115.0 | 127.7 | 485.6 | 90.6 |
| Other investment | 14.9 | 2.9 | -22.5 | -17.5 | -22.2 | -22.2 |
| Reserve assets | 4.2 | 1.2 | 7.8 | -53.8 | -40.6 | 12.7 |
| **Total identified financial transactions*** | **71.3** | **34.0** | **52.3** | **-8.7** | **148.9** | **37.6** |
| *As a percentage of GDP* | *6.8* | *3.2* | *4.8* | *-0.8* | *3.4* | *3.4* |

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

Source: SARB

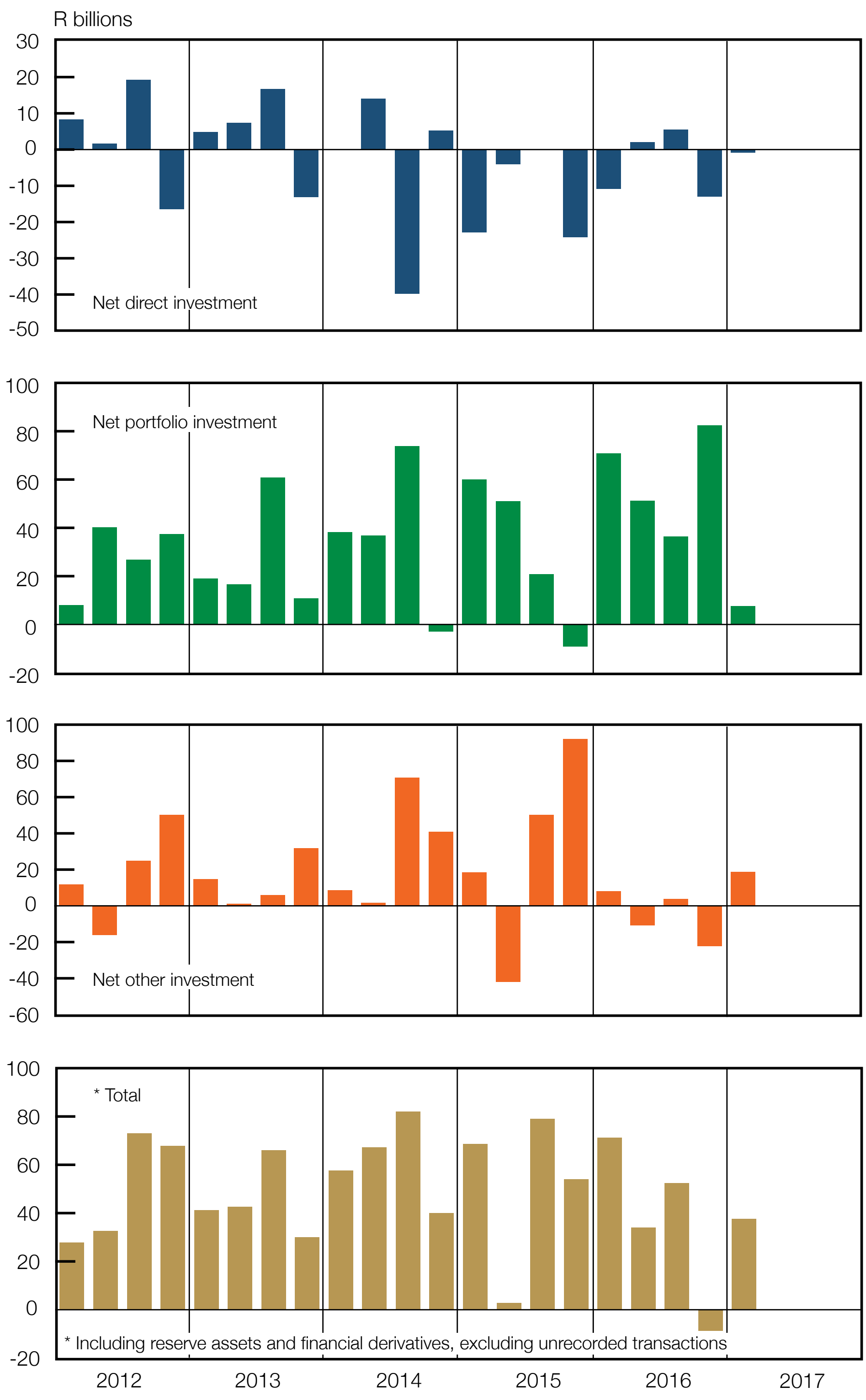
## Foreign-owned assets in South Africa

South Africa's direct investment liabilities increased by R9.0 billion in the first quarter of 2017 following an increase of R6.5 billion in the fourth quarter of 2016. The inflow during the first quarter of 2017 can be attributed to an increase in the share of non-resident equity investment in domestic companies and an increase in loans extended by foreign parent companies to South African subsidiaries.

Inward portfolio investment flows into South Africa amounted to R25.9 billion in the first quarter of 2017, following inflows of R1.9 billion in the fourth quarter of 2016. The capital inflow in the first quarter of 2017 mainly reflected the acquisition of domestic debt securities by foreign investors, as their search for yield continued unabated. Non-resident investors accumulated domestic debt securities to the value of R42.1 billion in the first quarter of 2017 compared with a revised inflow of R14.0 billion in the fourth quarter of 2016. The inflow was partly countered by net sales of domestic equity securities to the value of R16.1 billion in the first quarter of 2017, following net sales of R12.0 billion in the preceding quarter, amid concerns surrounding weak growth prospects for the South African economy and a concomitant subdued outlook for profit growth of listed companies in particular.

Other investment liabilities recorded inflows of R40.9 billion in the first quarter of 2017 following an outflow of R4.8 billion in the preceding quarter. The increase in other investment liabilities can be attributed to drawings on foreign long-term loans by public corporations and short-term borrowing by the domestic private sector.

Balance of payments: financial account




Source: SARB

## South African-owned assets abroad

South African entities' direct investment abroad recorded an outflow of R9.9 billion in the first quarter of 2017 following an outflow of R19.5 billion in the fourth quarter of 2016, as domestic private sector companies increased their equity holdings in, and debt financing to foreign subsidiaries.

South African residents acquired foreign portfolio assets to the value of R18.4 billion in the first quarter of 2017 following the disposal of such assets to the value of R80.5 billion in the fourth quarter of 2016. The resurgence in the acquisition of foreign portfolio assets mainly took the form of an increase in equity securities acquired by the domestic private sector.

Outflows related to other investment assets amounted to R22.2 billion in the first quarter of 2017 following an outflow of R17.5 billion in the preceding quarter, as the domestic banking sector extended short-term loans to non-residents and the domestic private sector increased its deposits abroad.

## Foreign debt

South Africa's total outstanding foreign debt decreased marginally from US$143.0 billion at the end of the third quarter of 2016 to US$142.8 billion at the end of the fourth quarter. The decline in the total foreign debt in the fourth quarter of 2016 resulted largely from non-resident net sales of domestic rand-denominated government bonds, while a strong US dollar against global currencies resulted in a subdued increase in foreign currency-denominated debt over the period. South Africa's gross external debt, expressed in rand terms, decreased notably from R1 998 billion to R1 947 billion over the same period. South Africa's short-term foreign debt (debt with an original maturity of less than one year) decreased from 28.7% of total foreign debt at the end of the third quarter of 2016 to 27.0% at the end of the fourth quarter, as the private non-banking sector repaid short term debt over the period.

Total foreign currency-denominated external debt increased only marginally from US$70.4 billion at the end of September 2016 to US$70.7 billion at the end of December, notwithstanding a US$3 billion international government bond issue. The increase was constrained by repayments of long and short term loan obligations by government, the domestic banking sector and the private non-banking sector.

### Foreign debt of South Africa

US$ billions at end of period

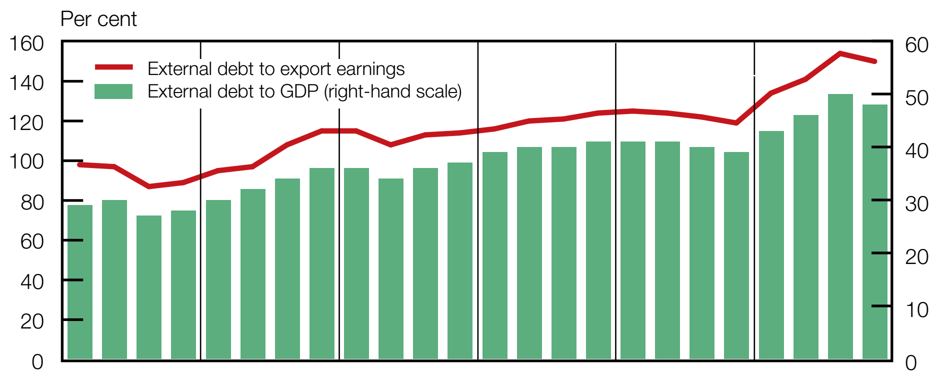
| | 2015 | | 2016 | | | |
|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Foreign currency-denominated debt** | **66.6** | **69.3** | **67.6** | **66.9** | **70.4** | **70.7** |
| Debt securities | 23.9 | 23.3 | 22.7 | 22.5 | 21.9 | 24.1 |
| Other | 42.8 | 46.0 | 45.0 | 44.4 | 48.5 | 46.6 |
| Public sector | 7.8 | 7.7 | 8.1 | 8.0 | 8.1 | 8.1 |
| Deposit-taking institutions | 16.5 | 19.9 | 17.9 | 16.8 | 20.6 | 19.2 |
| Non-monetary private sector | 18.5 | 18.4 | 19.0 | 19.6 | 19.6 | 19.3 |
| **Rand-denominated debt** | **67.9** | **54.8** | **61.7** | **65.5** | **72.6** | **72.1** |
| Debt securities | 34.5 | 28.7 | 32.9 | 36.2 | 42.2 | 41.4 |
| Other | 33.4 | 26.1 | 28.8 | 29.3 | 30.4 | 30.7 |
| **Total foreign debt** | **134.5** | **124.1** | **129.3** | **132.4** | **143.0** | **142.8** |
| *As a percentage of GDP* | *40.5* | *39.1* | *43.2* | *45.8* | *49.6* | *48.4* |
| *As a percentage of total export earnings* | *121.9* | *119.2* | *133.9* | *141.1* | *154.2* | *149.8* |

Source: SARB

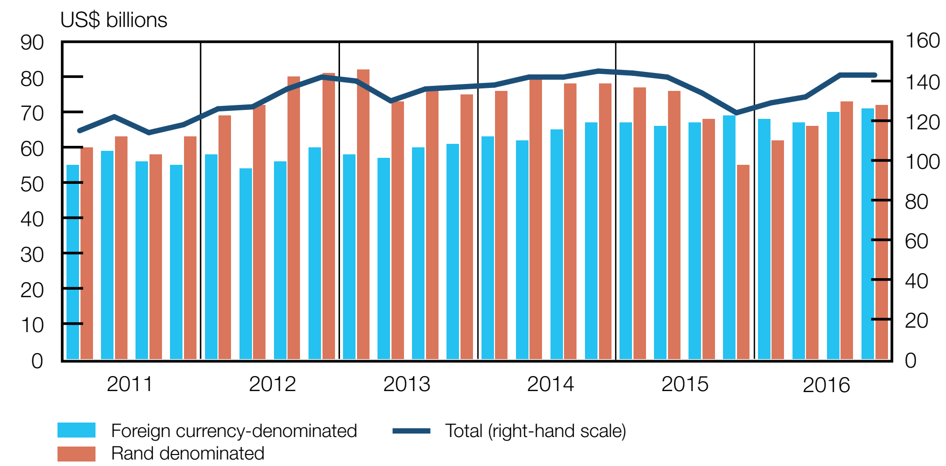
Rand-denominated external debt, expressed in US dollars, decreased moderately from US$72.6 billion at the end of September 2016 to US$72.1 billion at the end of December. The net sales of domestic government bonds by non-residents and, to a lesser extent, the repayment of short term loans by the private non-banking sector contributed to the decrease in rand-denominated debt over the period. The ratio of rand-denominated debt to total external debt decreased marginally from 50.8% at the end of September 2016 to 50.5% at the end of December.

South Africa's external debt as a ratio of annual GDP decreased from 49.6% in September 2016 to 48.4% in December, with the average for the past eight quarters being 43.6%. The ratio of external debt to export earnings also declined, from 154.2% to 149.8%, over the same period.

External debt ratios




External debt

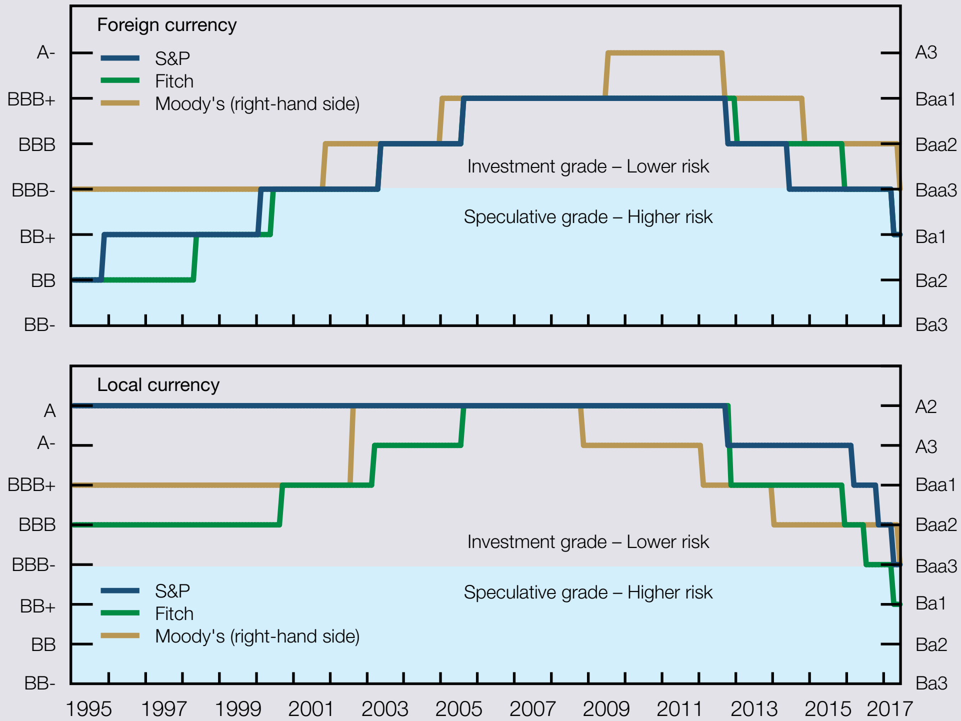



Source: SARB

## Box 3 South Africa's long-term sovereign credit ratings history

Since the inception of democracy in 1994, South Africa has experienced an extended period of successive long-term foreign currency credit rating upgrades from below to well into investment grade. Long-term foreign currency investment grade status was affirmed by three international rating agencies as from 25 February 2000 when Fitch Ratings (Fitch) also upgraded South Africa. Further upgrades followed until 16 July 2009, supported by annual growth in real gross domestic product (GDP) which was positive and mostly in excess of 3% from 2001 to 2011, with the exception of a contraction in 2009 following the global financial crisis. The tide turned in the latter part of 2012, commencing in September, when all three rating agencies downgraded South Africa's long-term foreign currency credit rating.

### Changes in South Africa's long term sovereign credit rating




Sources: Standard & Poors (S&P), Fitch and Moody's Investor Services (Moody's)

Given below is an account of South Africa's credit rating by S&P since 1995.

### Evolution of South Africa's long-term foreign currency credit rating by S&P

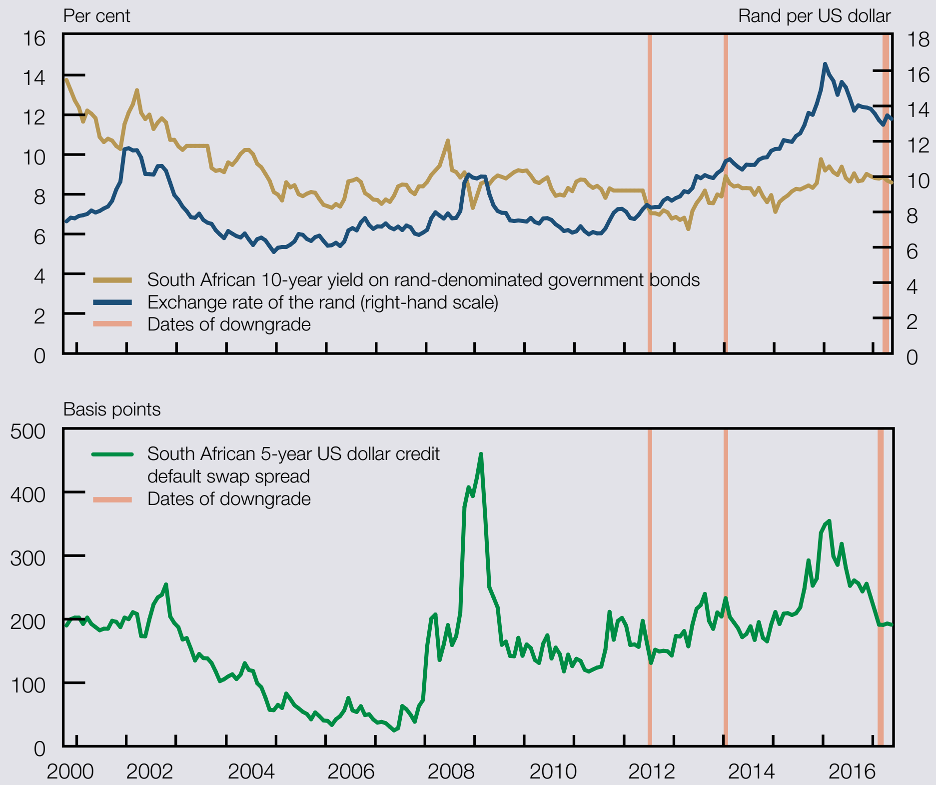
| Rating | Outlook | Date | Announcement |
|---|---|---|---|
| BB+ | Negative | 3 April 2017 | Downgrade |
| BBB- | Negative | 4 December 2015 | Outlook change |
| BBB- | Stable | 13 June 2014 | Downgrade |
| BBB | Negative | 12 October 2012 | Downgrade |
| BBB+ | Negative | 28 March 2012 | Outlook change |
| BBB+ | Stable | 25 January 2011 | Outlook change |
| BBB+ | Negative | 11 November 2008 | Outlook change |
| BBB+ | Stable | 1 August 2005 | Upgrade |
| BBB | Stable | 7 May 2003 | Upgrade |
| BBB- | Positive | 12 November 2002 | Outlook change |
| BBB- | Stable | 25 February 2000 | Upgrade |
| BB+ | Stable | 20 November 1995 | Upgrade |

Source: S&P

Credit rating agencies usually wait for 18 months after changing a country's rating outlook to negative, to properly assess whether concerns that were raised have been adequately addressed by the appropriate authorities, before issuing a downgrade. Unusual events may, however, hasten this process. On 4 December 2015, S&P changed South Africa's long-term foreign currency rating outlook from stable to negative, and subsequently downgraded the country to sub-investment grade on 3 April 2017, within the 18-month period. As from April 2017, South Africa's long-term foreign currency credit rating was also lowered to sub-investment grade by Fitch, with only Moody's Investor Service's (Moody's) investment grade rating remaining intact. These downgrades have taken the country back to its credit rating status that prevailed during the late 1990s.

The impact of the downgrades on financial markets was fairly muted as reflected by movements in domestic government bond yields, the currency and sovereign risk premium. The credit default swap spread did not reflect an event shock and bonds seemed to have already priced-in the downgrade at the time. The subdued response of bond yields should be assessed in the context of already high interest rates and the ongoing search by investors for higher yields in international financial markets. The moderate sovereign credit risk response, in turn, should be gauged relative to recent global experiences in Brazil in Russia.

### Exchange rate and sovereign risk premium indicators



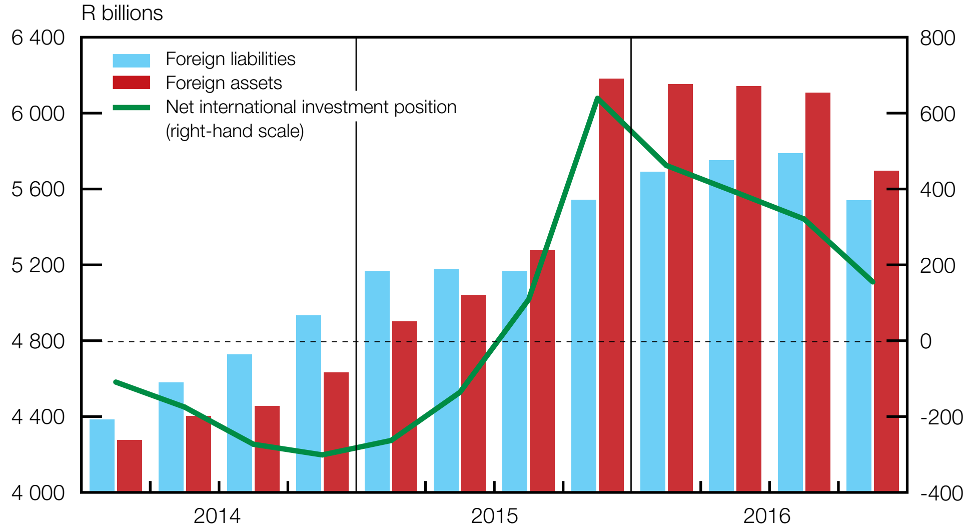

Sources: Bloomberg and SARB

## International investment position

South Africa's positive net international investment position (IIP) narrowed significantly from R321 billion at the end of September 2016 to R155 billion at the end of December, as the country's foreign assets declined at a faster pace than foreign liabilities. The foreign assets and liabilities were both partly weighed down by the 7.4% increase in the weighted average exchange value of the rand from the end of September 2016 to the end of December.

The market value of South Africa's foreign liabilities (inward investment) decreased by 4.3% to R5 541 billion at the end of December 2016 from R5 787 billion at the end of September – its lowest level since the end of December 2015. The decrease in the country's foreign liabilities was broad-based, as all four functional categories recorded declines. The decrease in direct and portfolio investment liabilities reflected lacklustre growth in corporate profits as well as a decline in the JSE All-share index from the end of September 2016 to the end of December. The category for 'other investment' liabilities decreased largely on account of decreases in loan liabilities of the banking and private non-banking sector.

South Africa's international investment position




Source: SARB

The market value of South Africa's foreign assets (outward investment) decreased notably by 6.7% to R5 696 billion at the end of December 2016, from R6 108 billion at the end of September. The decrease occurred in all four functional categories. Although the appreciation in the exchange value of the rand as well as market price valuation adjustments negatively affected the stock of foreign assets, portfolio investment assets were also reduced by the buy-out and delisting of a foreign company in which domestic investors held a substantial investment.

South Africa's positive net IIP declined steadily throughout 2016 as the nominal effective exchange rate of the rand increased. South Africa's foreign liabilities remained broadly unchanged from the end of 2015 to the end of 2016, while the country's foreign assets decreased by nearly 8% over the same period.

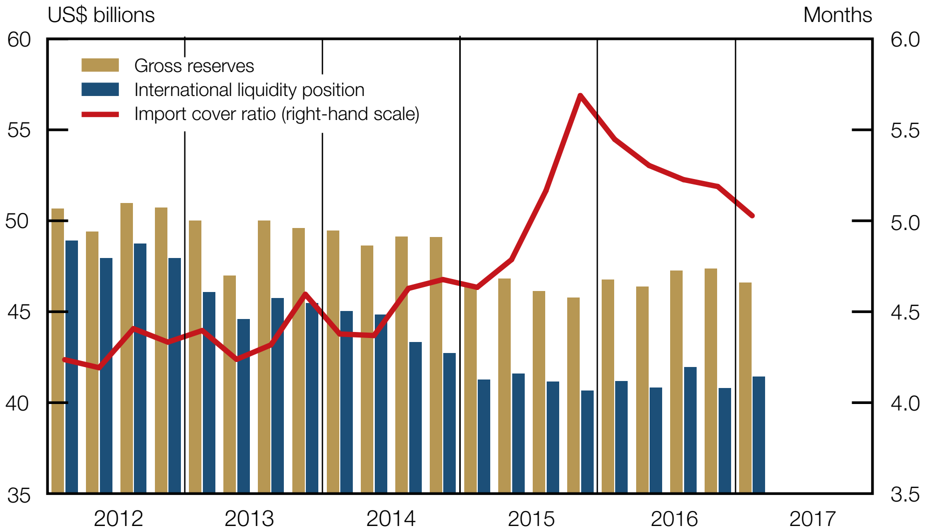
As a ratio of annual GDP, the country's foreign liabilities decreased from 135.7% at the end of September 2016 to 127.7% at the end of December, while the country's foreign assets decreased from 143.2% to 131.3% over the same period. This resulted in the country's positive net IIP retreating further to 3.6% of GDP at the end of December 2016 compared to 7.5% at the end of September.

## International reserves and liquidity

South Africa's international reserves decreased by R12.7 billion in the first quarter of 2017 following a substantial increase of R53.8 billion in the fourth quarter of 2016.

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) decreased from US$47.4 billion at the end of December 2016 to US$46.6 billion at the end of March 2017, before increasing slightly to US$47.2 billion at the end of May 2017. The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services as well as income payments) decreased slightly from 5.2 months at the end of December 2016 to 5.0 months at the end of March 2017.

International reserves




Source: SARB

South Africa's international liquidity position[8] increased from US$40.8 billion at the end of December 2016 to US$41.4 billion at the end of March 2017, and further to US$42.0 billion at the end of May 2017.

8 The SARBs gross gold and foreign exchange reserves minus foreign currency-denominated liabilities against both domestic and foreign counterparties plus/minus the forward position in foreign currency.

## Exchange rates

The nominal effective exchange rate of the rand (NEER) weakened, on balance, by 0.7% in the first quarter of 2017. From the end of December 2016 to the end of February 2017, the NEER increased by 3.2% and by a further 4.0% up to 27 March. During this period the exchange value of the rand was supported by an expectation of improved economic growth prospects for both the global and domestic economy, the continued search for yield by international investors and broad-based US dollar weakness. However, from 27 to 31 March 2017 the NEER declined by 7.4% as the Minister of Finance was recalled from an international investor road show and subsequently relieved of his duties in a cabinet reshuffle. Following these developments, the credit rating agencies Standard & Poor's and Fitch decided to downgrade South Africa's sovereign long-term foreign currency credit rating to sub-investment grade.

### Exchange rates of the rand

Percentage change

| | 30 Jun 2016 to 30 Sep 2016 | 30 Sep 2016 to 31 Dec 2016 | 31 Dec 2016 to 31 Mar 2017 | 31 Mar 2017 to 06 Jun 2017 |
|---|---|---|---|---|
| Weighted average* | 5.6 | 7.4 | -0.7 | 2.8 |
| Euro | 5.0 | 9.0 | -0.4 | 0.2 |
| US dollar | 5.7 | 2.5 | 1.3 | 5.4 |
| Chinese yuan | 6.1 | 6.8 | 0.4 | 4.0 |
| British pound | 9.6 | 8.2 | -0.1 | 1.6 |
| Japanese yen | 3.9 | 18.7 | -3.2 | 3.3 |

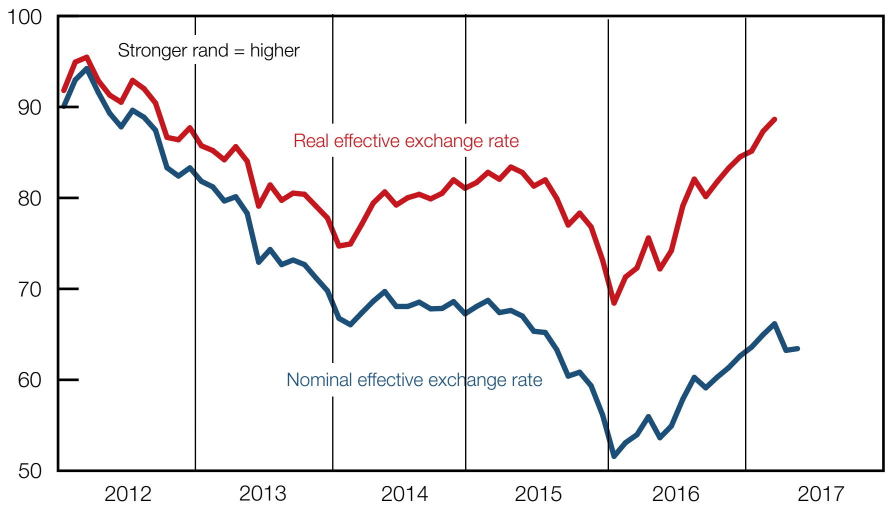
* Trade-weighted exchange rate against a basket of 20 currencies (nominal effective exchange rate)
Depreciation - / Appreciation +

Source: SARB

While the NEER increased by 2.8% from the end of March 2017 to 6 June, the rand also displayed some volatility over this period. During the first three weeks of April, the exchange value of the rand strengthened as foreign investors poured funds into higher yielding domestic debt securities. However, the rand then depreciated as the Federal Open Market Committee (FOMC) in the US indicated that a rise in the target for the federal funds rate was likely in June 2017.

### Effective exchange rates of the rand

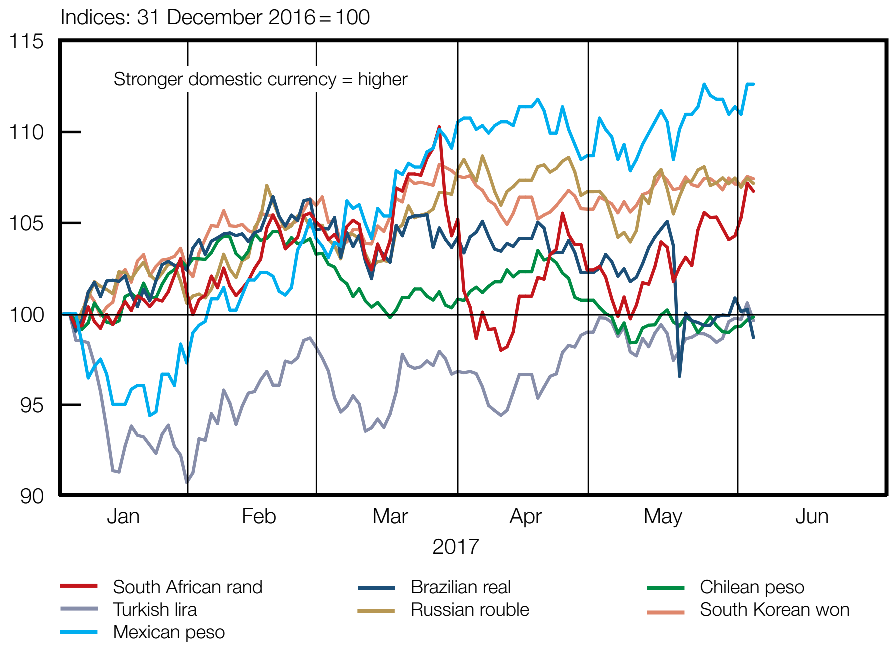
Indices: 2010 = 100




Source: SARB

Emerging market currencies in general appreciated against the weaker US dollar in the first quarter of 2017. The dollar was weighed down largely by uncertainty around the US fiscal policy stance, coupled with expectations of fewer interest rate increases by the FOMC in 2017 than initially expected. Emerging market currencies were further supported by signs of improvement in the Chinese economy and a rebound in the prices of most international commodities.

Selected exchange rates: US dollar per domestic currency unit



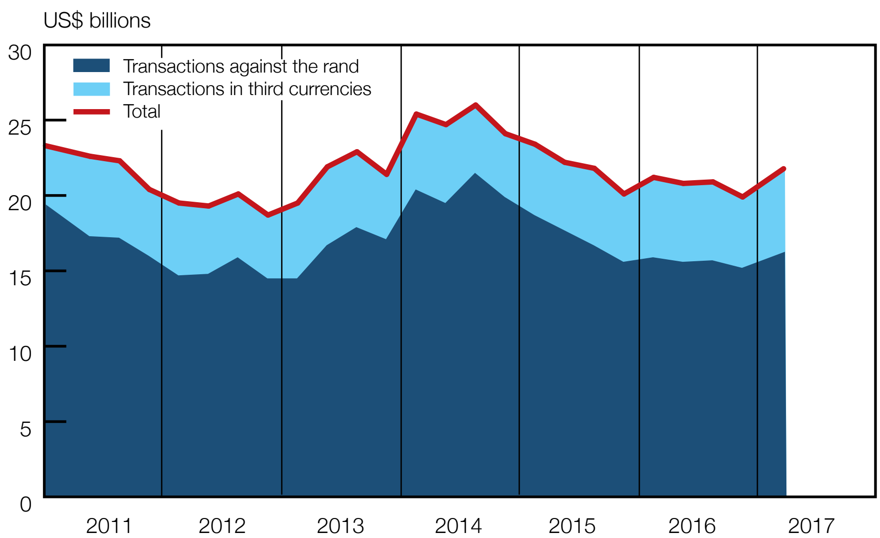

Source: SARB

The real effective exchange rate of the rand strengthened by 22.6% in the 12 months up to March 2017. This eroded much of the competitiveness gained by South African manufacturers in 2015.

## Turnover in the South African foreign exchange market

The net average daily turnover in the South African market for foreign exchange increased by 8.4% from US$19.9 billion in the fourth quarter of 2016 to US$21.6 billion in the first quarter of 2017, largely due to a seasonal pattern of higher turnover volumes in the first quarter of each year. Nevertheless, the net average daily turnover in the first quarter of 2017 was 1.8% higher than that recorded in the first quarter of 2016.

Net average daily turnover in the South African foreign exchange market




Source: SARB

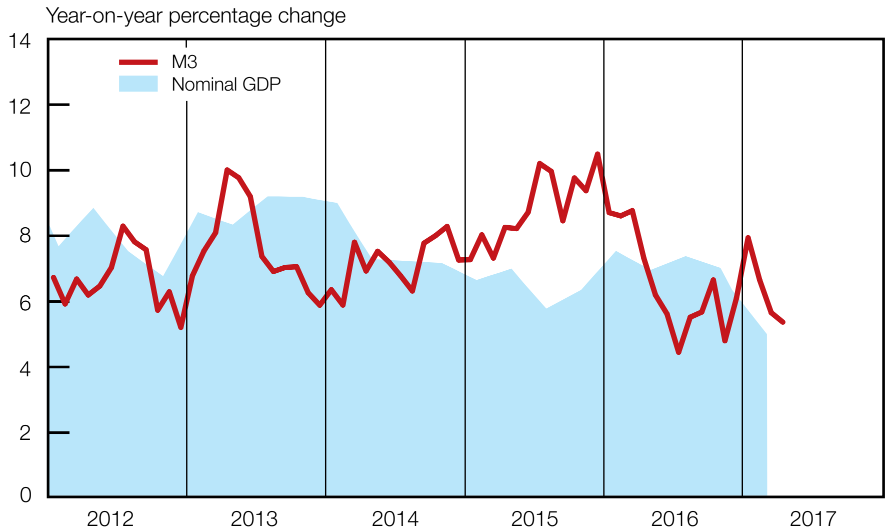
The net average daily turnover in the rand foreign exchange market increased by 5.2% from US$15.2 billion in the fourth quarter of 2016 to US$15.9 billion in the first quarter of 2017, buoyed mainly by increased turnover in the spot and forward markets. Over the same period, the value of transactions in the swap market decreased from US$10.9 billion to US$10.7 billion per day. The net average daily turnover in the market for third currencies increased from US$4.8 billion in the fourth quarter of 2016 to US$5.6 billion in the first quarter of 2017.

# Monetary developments, interest rates and financial markets

## Money supply

The rate of increase in the broadly defined money supply (M3) remained weak thus far in 2017, in line with continued moderate growth in nominal GDP in the first quarter of 2017. Growth in deposit holdings of the household sector continued to exceed that of the corporate sector, although moderating since early 2016. Growth in deposit holdings of the corporate sector recovered somewhat in January 2017, but then moderated up to April. The income velocity of circulation of M3 averaged 1.42 in 2016 and remained broadly unchanged at 1.39 in the first quarter of 2017, confirming alignment between growth in M3 and nominal GDP.

Money supply and gross domestic product




Sources: Stats SA and SARB

Total M3 deposits of the domestic private sector increased by R36.3 billion in the first quarter of 2017, less than the R47.2 billion increase in the first quarter of the previous year and significantly less than the R60.8 billion increase in the fourth quarter of 2016. The corporate sector accounted for most of the increase in the first quarter of 2017, growing their deposit holdings by R25.0 billion. Of this, financial companies contributed R30.0 billion, while non-financial corporates reduced their deposit holdings by R5.0 billion. Household sector deposits increased by R11.3 billion in the first quarter of 2017, similar to the first quarter of 2016, but markedly less than the R25.6 billion in the fourth quarter of 2016 which was buoyed by bonus payments.

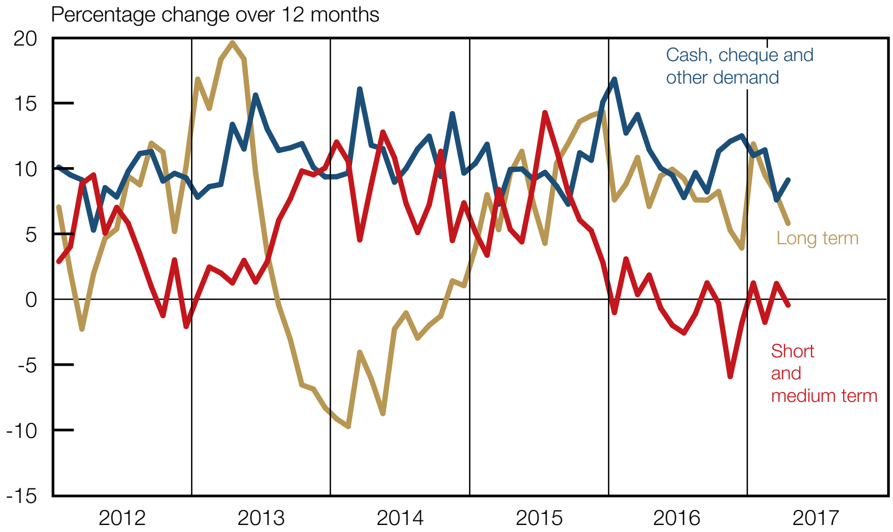
M3 holdings of households and companies

| | Quarterly change (R billions) | | | | | Percentage of total M3 deposit holdings |
|---|---|---|---|---|---|---|
| | 2016 | | | | 2017 | 2017 |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q1 |
| Households | 11.5 | 31.4 | 27.1 | 25.6 | 11.3 | 33.3 |
| Companies | 35.6 | -33.0 | 47.1 | 35.2 | 25.0 | 66.7 |
| *Financial* | *11.3* | *-3.0* | *31.4* | *10.2* | *30.0* | *37.5* |
| *Non-financial* | *24.4* | *-30.0* | *15.7* | *25.0* | *-5.0* | *29.2* |
| Total M3 deposits | 47.2 | -1.6 | 74.3 | 60.8 | 36.3 | 100.0 |

Source: SARB

Growth in deposits continued to favour cash, cheque and other demand deposits even though moderating from 12.5% in December 2016 to 9.1% in April 2017. Depositor preference shifted somewhat to long-term deposits thus far in 2017 as year-on-year growth rebounded strongly to 11.9% in January 2017 from a recent low of 3.9% in December 2016. Subsequently, growth remained fairly elevated although it slowed to 5.8% in April 2017. By contrast, the demand for short- and medium-term deposits remained weak, although improving from a contraction in the second half of 2016 to growth of 1.2% in March 2017. However, these deposits once again contracted by 0.5% in April.

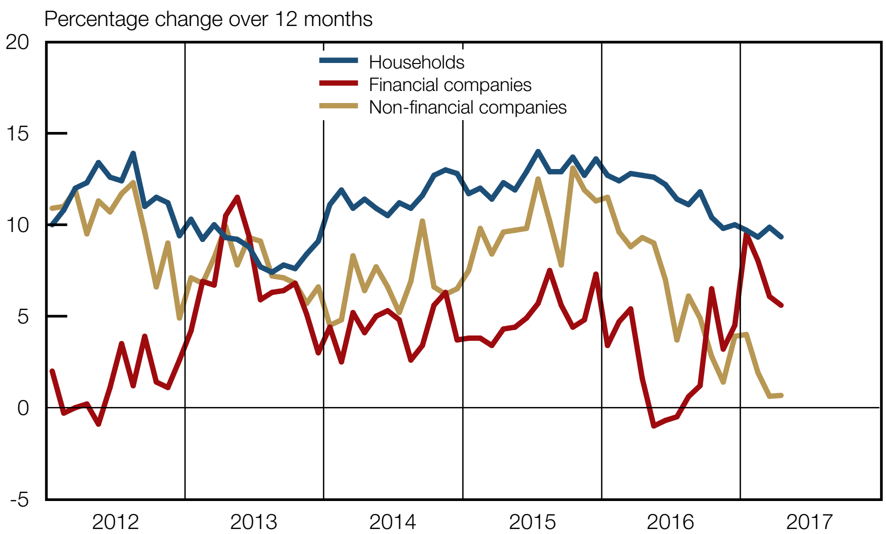
Deposits by maturity




Source: SARB

Twelve-month growth in household deposits surpassed that in corporate deposits, but it maintained its slowing trend and decelerated gradually from a recent high of 14.0% in July 2015 to 9.3% in April 2017. Household deposits account for roughly a third of total private sector M3 deposit holdings, with the corporate sector accounting for the balance. Within the corporate sector, growth in the deposit holdings of financial companies initially firmed to a recent high of 9.5% in January 2017, before decelerating to 5.6% in April. Similarly, the deposit holdings of non-financial companies decelerated from 4.0% to 0.7% over the same period.

Deposit holdings of households and companies




Source: SARB

In a statistical sense, the increase in M3 in the first quarter of 2017 continued to be predominantly attributable to an increase in claims against the private sector. Net claims on the government sector also increased, mainly resulting from a decrease in government deposits with the banking sector. Both net foreign assets as well as net other assets and liabilities decreased in the first quarter of 2017. The decline in net foreign assets resulted from revaluation effects on the gold and foreign exchange assets of the SARB and that of private sector banks due to the appreciation of the exchange value of the rand against the major currencies. The decrease in net other assets and liabilities resulted when the rise in other liabilities exceeded that in other assets.

Statistical counterparts of change in M3

R billions

| | 2016 | | | | 2017 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| Net foreign assets | -24.7 | 7.6 | -73.5 | 10.6 | -38.9 |
| Net claims on the government sector | -0.4 | 8.4 | 75.0 | -17.5 | 17.1 |
| Claims on the private sector | 78.8 | -19.0 | 68.4 | 29.7 | 78.9 |
| Net other assets and liabilities | -6.5 | 1.5 | 4.3 | 38.0 | -20.8 |
| Total change in M3 | 47.2 | -1.6 | 74.3 | 60.8 | 36.3 |

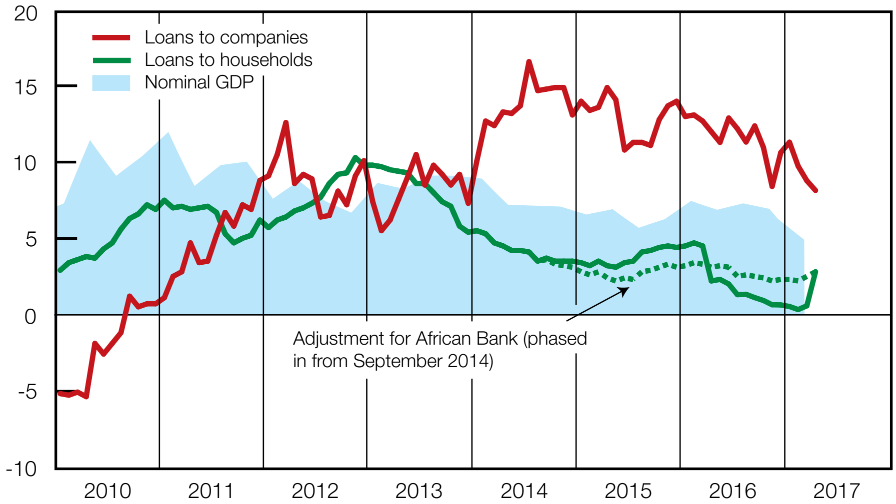
Source: SARB

## Credit extension

Growth in credit extension to the domestic private sector weakened in 2016 and thus far in 2017 largely due to persistent weak growth in credit extension to the household sector. Corporate demand for credit also slowed somewhat during the period. The deceleration in credit growth is reflective of subdued domestic economic activity and partly reflects a technical correction[9] in the data. Some underlying factors that might have contributed to the weakness in credit growth include subdued consumer confidence, slow growth in household disposable income, elevated food price inflation, a weak labour market and continued deleveraging through repayment of existing debt. In the wake of political uncertainty, business confidence levels have also remained depressed for a protracted period.

Bank loans and gross domestic product

Year-on-year percentage change




Sources: Stats SA and SARB

9 In April 2016 the 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. Annual growth rates again converged as from April 2017.

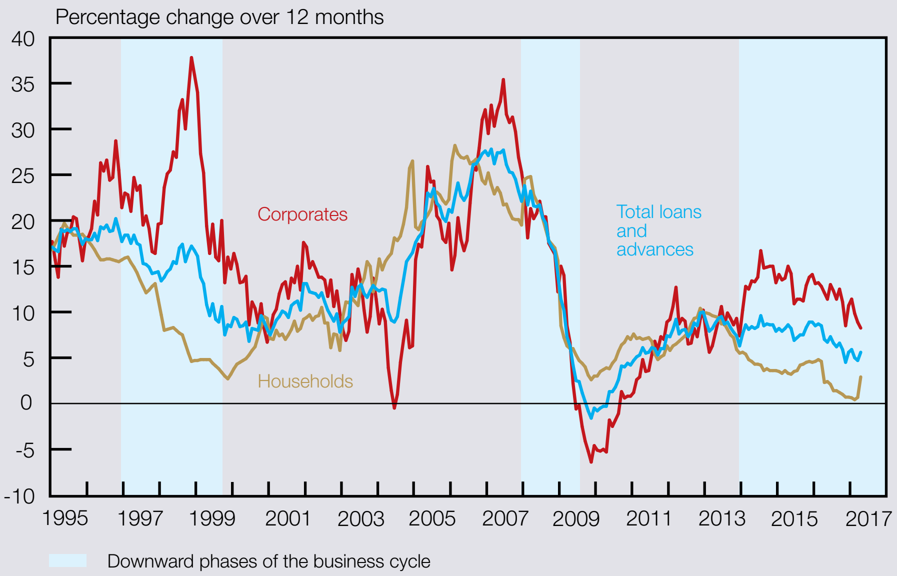
Growth in total loans and advances moderated to a year-on-year rate of 4.5% in November 2016 – its lowest since December 2010. Although growth then accelerated to an average of 5.2% in the first quarter of 2017 and further to 5.6% in April, it remained at historically low levels. Following the downgrade of South Africa's sovereign credit rating, international rating agencies also downgraded the credit rating of domestic banks, impacting the cost of credit going forward.

On a quarter-to-quarter seasonally adjusted and annualised basis, growth in total loans and advances to the private sector accelerated from 6.4% in the fourth quarter of 2016 to 7.0% in the first quarter of 2017. The acceleration in credit growth contrasted the moderation in nominal GDP growth in the first quarter of 2017, resulting in an increase in the ratio of credit to GDP from 68.2% in the fourth quarter of 2016 to 70.1% in the first quarter of 2017.

## Box 4 Long term trends in credit extension to households and corporates

Credit extension to households and corporates experienced several periods of divergent growth over the business cycle. Growth in credit extension to households tends to start decelerating ahead of peaks in the business cycle. By contrast, growth in credit extension to corporates on occasion continues to accelerate beyond peaks in the business cycle into the early stages of the subsequent downward phase. This delayed response indicates that corporates tend to be less sensitive to weak economic conditions than households. Credit growth to corporates also generally displays a higher amplitude than that to households. During the current business cycle (the most recent upward and downward phase) growth in credit extension to both the household and corporate sectors has been significantly more moderate than during previous business cycles.

### Total loans and advances to the household and corporate sectors




Source: SARB

The divergence between growth in credit extension by banks to households and corporates reveals credit standard differentiation among economic sectors, especially during times of slower economic growth. This reflects the more flexible and relatively stronger financial positions of corporates compared to the household sector. Some of the factors that contribute to corporates' ability to obtain credit more easily than households include their ability to:

– pass the effect of rising costs on to consumers;
– retrench staff to cut costs in times of tough trading conditions;
– source income from offshore activities and to benefit from a depreciation in the exchange value of the rand, which may contribute to and support cash flow and savings;
– benefit from a wide range of tax deductions and the write-off of previous losses from taxable income; and
– source funding at lower interest rates than the household sector due to favourable credit risk profiles and relationships with banks.

In the aftermath of the East Asian crisis in 1998, growth in total loans and advances decelerated to an annual average of 8.5% in 2000 from an average of 17% between 1995 and 1998. This period was also marked by disparate growth in credit extension to the household and corporate sectors. The downward phase of the business cycle from late 1996 to 1999 had a marked impact on credit extension to the household sector, while credit extension to the corporate sector maintained strong growth. Growth in loans and advances to the household sector plummeted to rates of below 3% in late 1999, at which stage credit to the corporate sector still grew at around 15%. Year-on-year growth in credit extension to the corporate sector only reached a lower turning point of 6.7% in December 2000.

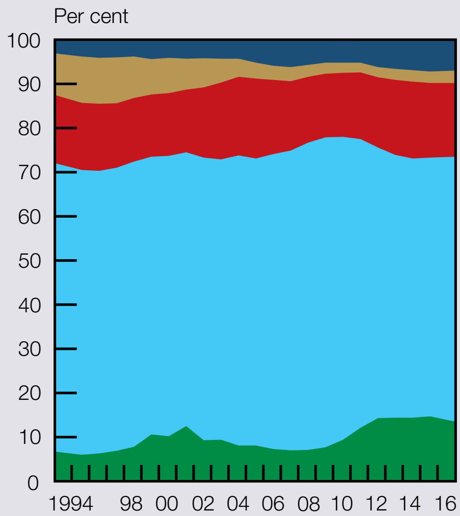
During the subsequent upward phase of the business cycle, growth in credit extension to the household sector accelerated steadily to average 26% in 2006, while growth in credit extension to the corporate sector only peaked in mid-2007. This upward phase was noted for a boom in consumption expenditure and fixed investment. Throughout most of this period, robust growth in loans and advances extended to the private sector was supported by favourable lending and borrowing conditions, rising real disposable income, strong growth in domestic consumption expenditure, high levels of consumer and business confidence, and a buoyant real-estate market. Growth in credit extension was also supported by relatively low interest rates, a rebound in the corporate sector's demand for bank-intermediated funding and wealth effects associated with the rapid rise in domestic real estate prices.

In the wake of the global financial crisis, the end of the pre-2008 property boom saw an almost sudden stop in mortgage advances extended to the corporate sector. Although there was a slowdown in almost all types of corporate credit, demand for general loans by the corporate sector slowed quite sharply. Growth in total loans and advances to the corporate sector slowed from rates in excess of 30% prior to the global financial crisis to negative rates in 2009.

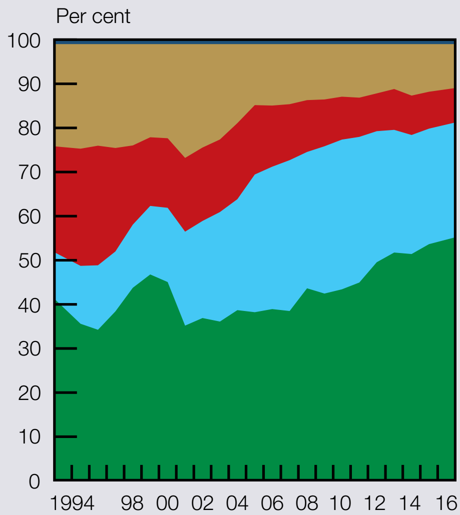
Growth in credit extension to the household sector decelerated to less than 3% by the end of 2009. Household credit growth was further constrained by, among other factors, the introduction of the National Credit Act (NCA) in 2007 which led to tighter lending criteria by banks, increased international regulatory requirements, slower global and domestic economic growth, and weak consumer and business confidence. These factors, together with the progressive tightening of monetary policy up to mid-2008, contributed to a general slowdown in demand for bank credit.

The prolonged period of weak economic conditions following the global financial crisis impacted the credit risk profiles of households to the extent that a credit amnesty was introduced in 2014 to provide relief to many indebted consumers. The difficult economic environment resulted in household consumption expenditure growth moderating to 0.8% in 2016 from 1.7% in 2015, along with a sharp decline in spending on durable goods. In recent years, the balance sheets of households have been quite strained due to rising living costs, high levels of indebtedness limiting access to new credit, higher interest rates as well as insufficient employment creation.

Changing composition of loans and advances to the household sector




Changing composition of loans and advances to the corporate sector



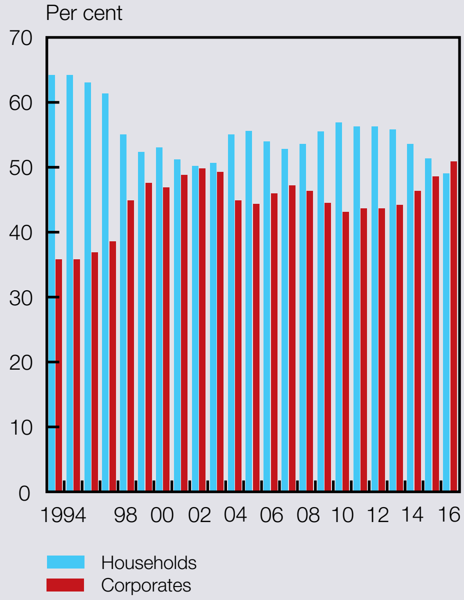

Credit card advances
Overdrafts
Instalment sale credit and leasing finance
Mortgage advances
General loans

Source: SARB

Growth in credit extension to the household sector decelerated across various types of credit from the start of 2013. Mortgage advances, the largest component of household credit, was the main driver behind the subdued growth. General loans to households (mostly unsecured loans) gained in popularity from 2009 with growth accelerating to just less than 40% in 2011, before closer regulatory scrutiny resulted in it decelerating from 2013 onwards. General loans to households currently account for less than 14% of all loans extended to households. Growth in instalment sale credit and leasing finance (predominantly used for the funding of vehicles) also started to decelerate from 2013. This, together with a contraction in new vehicle sales at the time confirmed the effect of challenging economic conditions on consumers and the business sector over a wide front. Growth in credit extension to corporates started to slow gradually from mid-2014, as the increasingly tough economic and trading conditions eventually also impacted the corporate sector.

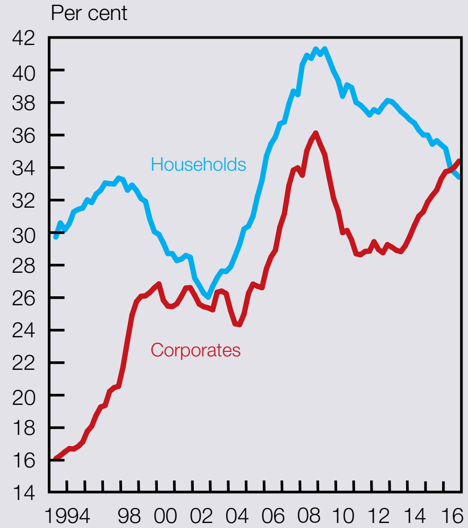
In recent years, growth in credit extension to the corporate sector was supported by firm growth in general loans and mortgage advances on commercial property. General loans are the largest category of credit utilised by corporates and include term loans and structured loan funding. General loans as a ratio of the total outstanding balance on corporate credit have increased from less than 44% in 2009 to more than 55% since early 2016, making it the fastest-growing component of credit extension to the corporate sector. The revival in general loans to companies was supported by an increased number of private-sector companies involved in renewable energy projects making use of this type of finance. Furthermore, the provision of equity bridging finance to assist companies undertaking expansion activities as well as corporate expansions into Africa, boosted this type of finance. The growth in general loans occurred at the expense of mortgage advances to corporates, as its share of total corporate credit diminished in the aftermath of the financial crisis, despite its growth rate accelerating up to 2015.

## Total loans and advances: changing distribution of outstanding balances




Sources: Stats SA and SARB

## Total loans and advances as a ratio of gross domestic product




The importance of the ratio of private sector credit extension to gross domestic product (GDP) was highlighted when the Basel Committee on Banking Supervision proposed that banks hold additional capital at times when the ratio exceeds its long-run trend. By separately displaying the ratio of loans and advances of the household and corporate sectors to GDP, it is possible to distinguish which of these sectors have recorded the strongest relative growth in credit extension.

As a ratio of GDP, credit extended to, and owed by, the household sector has exceeded that of the corporate sector in recent decades. However, the persistent slowdown in credit growth to the household sector, together with robust growth in demand for credit by the corporate sector, is unsettling this historic trend. Subsequent to the global financial crisis, the gap between the ratios of credit extended to households and corporates to GDP widened as the sectoral composition of credit changed. Growth in mortgage advances, the largest component of credit extension and predominantly taken up by the household sector, decelerated notably while the uptake of general loans increased. Initially, this was due to an acceleration in growth of general (unsecured) loans to households, but after 2013 the corporate sector increased their demand for funding through general loans. The brisk growth in general loans to companies that were supported by growth in mortgage loans on commercial property then brought the ratio of credit to GDP of households and corporates closer together. However, on aggregate, the recent trends probably reflect banks' preference to provide credit to the more financially sound corporate clients rather than to households, given subdued economic growth. Credit conditions could remain relatively tight for the household sector in the foreseeable future as unemployment remains high and as a significant proportion of credit active consumers are struggling to service their existing debt.

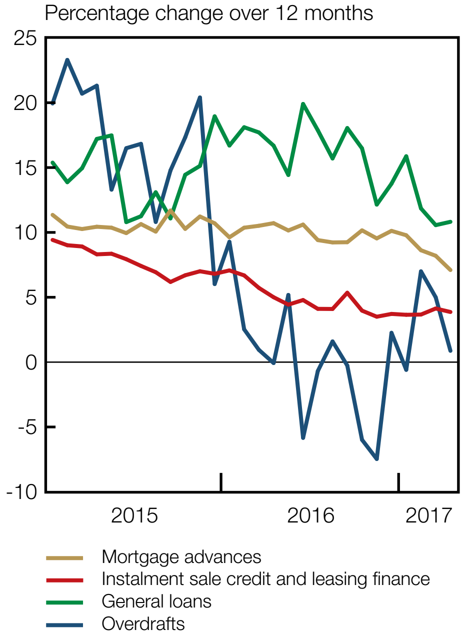
Despite slowing thus far in 2017, year-on-year growth in *loans and advances to corporates* continued to outpace growth in nominal GDP, as it had done since 2014. Corporate credit increased by R55.1 billion in the first quarter of 2017, notably exceeding the increase of R20.0 billion in the fourth quarter of 2016. However, this was much lower than the increase of R74.2 billion in the first quarter of 2016. In particular, general loans to companies moderated from an increase of R58.7 billion in the first quarter of 2016 to R40.6 billion in the first quarter of 2017. General loans to companies 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. The recent slowdown in credit extension to the corporate sector was particularly evident in general loans to companies, which moderated from a recent year-on-year high of 19.9% in June 2016 to 10.8% in April 2017.

Growth in *loans and advances to the household sector* was much weaker than the moderating trend in nominal GDP growth in recent years, with muted household demand for credit continuing in the first quarter of 2017. Credit extension to the household sector increased by R19.9 billion in the first quarter of 2017, up from R12.3 billion in the preceding quarter, but still slightly below the increase of R20.6 billion in the first quarter of 2016. Although mortgage advances represented around half of all credit extended to households over the period, 12-month growth in mortgage advances to households slowed from 4.7% in February 2016 to 3.1% in April 2017.

General loans to households grew by 5.5% year-on-year in April 2017, reflective of a slow but steady improvement in unsecured credit. Despite the recent acceleration, growth remained well below the excessive rates experienced from early 2011 to late 2012. Headwinds in the form of higher personal income tax rates, weak employment prospects and tighter lending criteria will probably continue to dampen growth in unsecured borrowing for an extended period.

**Selected loans and advances to corporate sector**

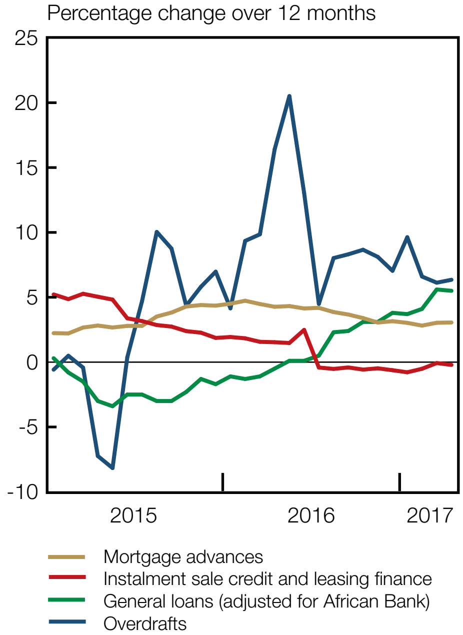
Percentage change over 12 months




Source: SARB

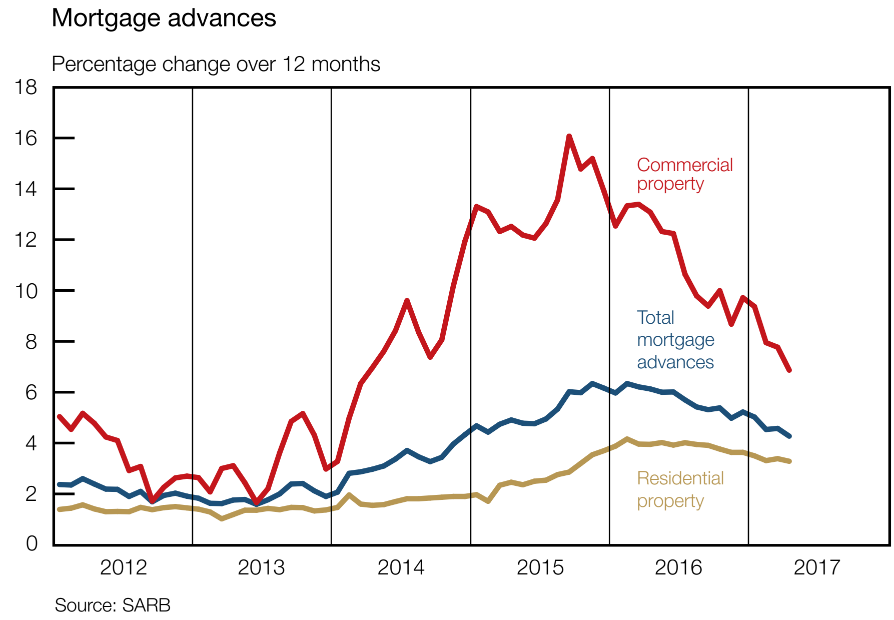
**Selected loans and advances to household sector**

Percentage change over 12 months

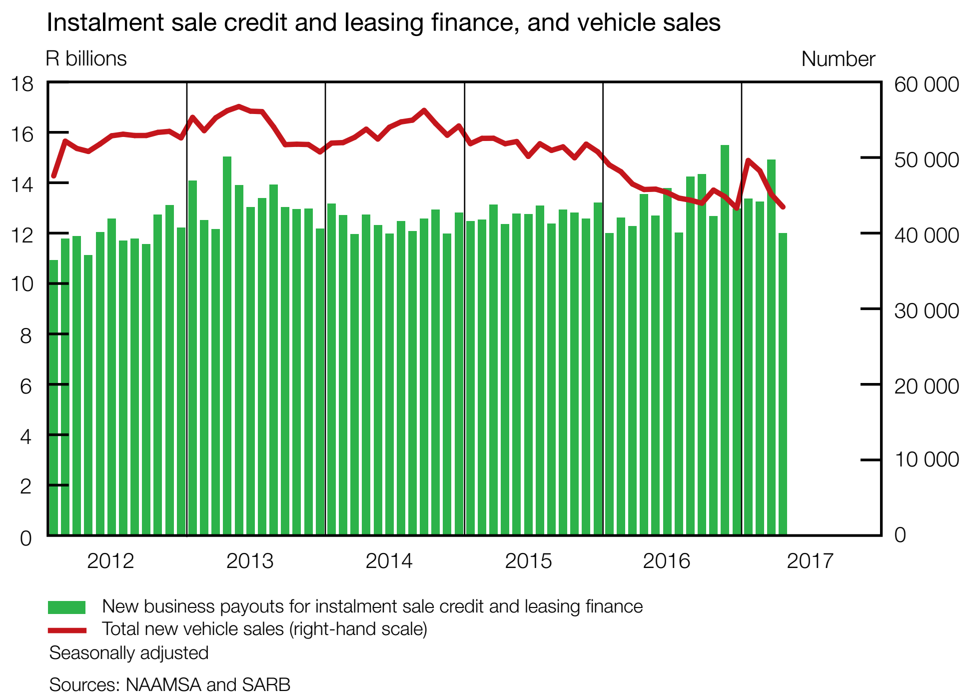



Corporate demand for mortgage advances declined as the outstanding value of such advances increased by only R1.7 billion in the first quarter of 2017 compared to R8.0 billion in the first quarter of 2016 and R10.6 billion in the fourth quarter. The outstanding value of mortgage advances to households increased by R10.2 billion in the first quarter of 2017 compared to an increase of R10.9 billion in the first quarter of 2016 and R4.5 billion in the fourth quarter.

Growth in total *mortgage advances* fluctuated around a year-on-year rate of 6% towards the end of 2015 and early 2016, primarily boosted by solid growth in mortgage advances on commercial property, before moderating to 4.3% in April 2017 when the rate of expansion in mortgage advances on commercial property slowed. Growth in mortgage advances on commercial property peaked at 16.1% in September 2015, before moderating to 6.9% in April 2017. Likewise, growth in mortgage advances on residential property decelerated from a recent peak of 4.2% in February 2016 to 3.3% in April 2017.




*Instalment sale credit and leasing finance* mainly represent the financing of new and second-hand vehicles. Year-on-year growth in this credit category remained muted, slowing from 6.5% in January 2015 to 0.6% two years later, before picking up to 1.3% in March 2017 and 1.1% in April. Instalment sale financing of used passenger vehicles continued to exceed the financing of new vehicles, but was not sufficient to boost credit extension materially. According to the BER, business confidence among new vehicle dealers remained quite low, despite improving somewhat in the first quarter of 2017. However, weak demand and rising costs continued to weigh on confidence in the sector. Furthermore, business confidence among used vehicle and spare part dealers remained around the neutral level, suggesting that consumers are postponing replacement by maintaining their vehicles for longer.



An analysis by economic sector showed that credit demand by the electricity, gas and water sector continued to grow robustly, although growth moderated marginally in the first quarter of 2017. Most sectors recorded slower year-on-year growth in credit extension in the first quarter of 2017, with the exception of the business services and manufacturing sectors, while credit to the community, social and personal services sector also increased. Growth in credit extension to companies involved in real estate development slowed, as did that to transport, mobile telecommunications and network companies. The agricultural sector maintained its reliance on bank funding in the first quarter of 2017, as the sector recovers from the effects of the prolonged drought. Credit demand by the construction sector contracted further in recent quarters, alongside a slowdown in commercial property development. After moderating in the last three quarters of 2016, growth in bank credit to the manufacturing sector remained range-bound in the first quarter of 2017, probably underpinned by weak exports of especially motor vehicles. Credit demand by the mining sector remained weak in the first quarter of 2017, as mining investment remained subdued.

Growth in bank credit by economic sector

| | 2016 | | | | 2017 | Percentage of total credit extension* |
|---|---|---|---|---|---|---|
| Sector | Q1 | Q2 | Q3 | Q4 | Q1 | |
| Electricity, gas and water....... | 25 | 27 | 49 | 41 | 38 | 2.1 |
| Transport, storage and communication..................... | 34 | 29 | 32 | 15 | 2 | 3.3 |
| Agriculture, forestry and fishing............................ | 13 | 11 | 17 | 14 | 12 | 2.3 |
| Real estate ........................... | 42 | 17 | 12 | 11 | 7 | 10.1 |
| Finance and insurance .......... | 19 | 15 | 12 | 4 | 0 | 18.4 |
| Manufacturing ...................... | 20 | 16 | 12 | 8 | 8 | 4.8 |
| Wholesale and retail trade ..... | 12 | 7 | 5 | 4 | 2 | 4.9 |
| Business services................. | 12 | 5 | 4 | 10 | 22 | 3.8 |
| Community, social and personal services.................. | 10 | 7 | 4 | 10 | 14 | 9.1 |
| Construction......................... | 8 | 9 | -9 | -11 | -10 | 0.8 |
| Mining and quarrying............ | -4 | -19 | -23 | -20 | -31 | 1.7 |
| Households .......................... | -3 | 5 | 6 | 7 | 5 | 35.2 |
| Other.................................... | 18 | 3 | -7 | -32 | -28 | 3.4 |
| **Total**..................................... | **10** | **9** | **7** | **5** | **4** | **100.0** |

* Expressed as a percentage of the outstanding balance for March 2017

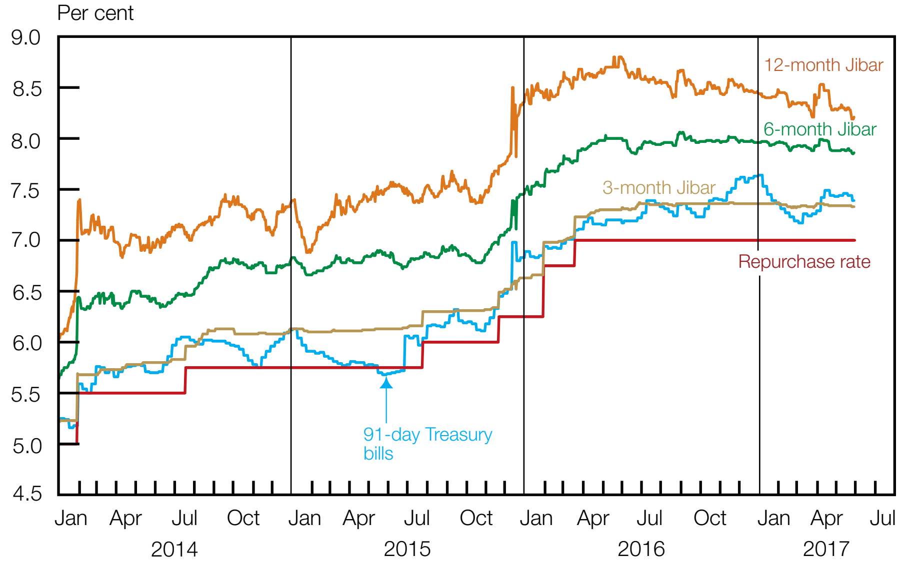
Source: SARB

## Interest rates and yields

The Monetary Policy Committee (MPC) kept the repurchase rate unchanged at 7.0% per annum at their meeting in May 2017. The near-term inflation outlook had improved since January 2017, aided by the further appreciation in the exchange value of the rand following fairly benign market reaction to the monetary policy tightening in the US by the FOMC, as well as the significant narrowing of the deficit on the current account of South Africa's balance of payments. In addition, emerging markets generally benefited from a more positive growth outlook in the advanced economies. The MPC also did not see any evidence of significant demand pressures impacting on inflation. However, the growth outlook remained disappointing along with concern that increased political uncertainty could impact negatively on private sector investment and household consumption expenditure, further undermining employment growth.

Short-term money market rates were relatively stable early in 2017. Subsequently, these rates displayed varied fluctuations towards the end of April alongside a depreciation in the exchange value of the rand, which coincided with domestic political developments and a downgrade of South Africa's sovereign debt by some international rating agencies. The three-month Johannesburg Interbank Average Rate (Jibar) has been range-bound since July 2016, fluctuating by a mere 5 basis points between 7.32% and 7.37% up to 6 June 2017. However, the benchmark 12-month Jibar initially declined from 8.48% on 30 January 2017 to 8.21% on 24 March as the exchange value of the rand appreciated, but then rose abruptly to a high of 8.53% on 6 April, following the domestic political developments. The 12-month Jibar has since fluctuated lower to 8.21% on 6 June alongside the narrowing of the current account deficit and better-than-expected inflation outcomes.

Money market rates

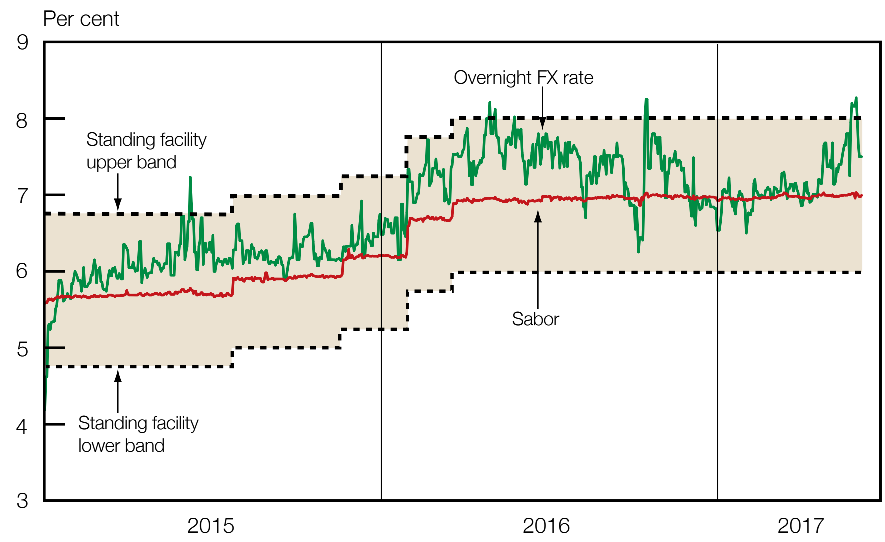



Source: SARB

The tender rate on 91-day Treasury bills decreased by 47 basis points from 7.64% on 5 January 2017 to 7.17% on 3 March, driven by investor demand for liquid assets. However, the rate then increased to 7.49% on 13 April as investors demanded higher yields amid South Africa's sovereign credit rating downgrades, before declining somewhat to 7.36% on 6 June following more stable market conditions.

More recently, funding conditions in the interbank lending market reflected tighter liquidity conditions, although rates remained well within the standing facility limits. During this period, the South African benchmark overnight rate (Sabor) remained relatively stable, closely matching the unchanged repurchase rate. Up to late March 2017, movements in the implied rate on one-day rand funding in the overnight foreign exchange swap market (overnight FX rate) was broadly aligned with the steady Sabor and the unchanged repurchase rate. However, following a rise in demand for liquidity the overnight FX rate increased to a high of 8.20% on 25 May. Towards the end of May the overnight FX rate started to decline, reaching 7.45% in early June.

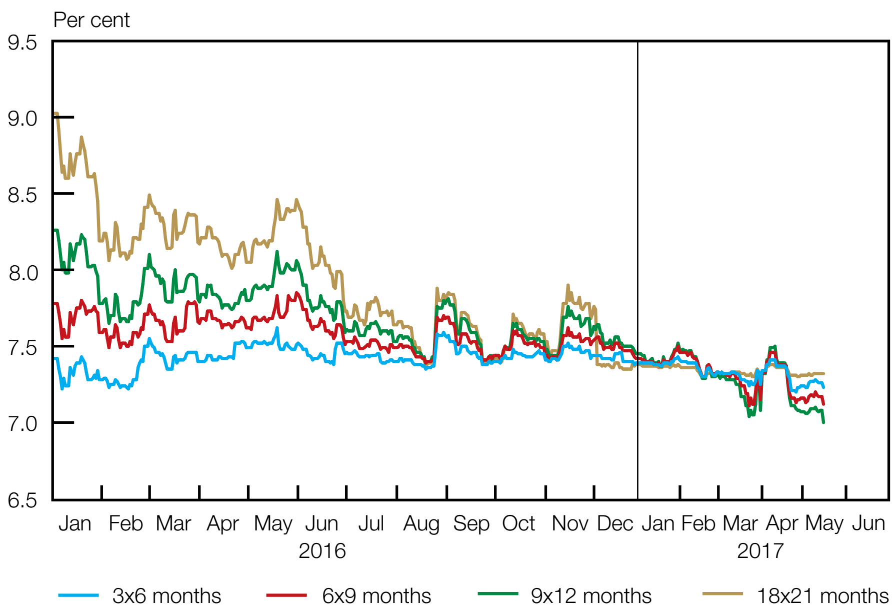
Benchmark overnight rates




Source: SARB

In the opening months of 2017, rates on forward rate agreements (FRAs) trended lower on account of the appreciation in the exchange value of the rand and its expected positive impact on inflation. However, these rates increased sharply in early April, in reaction to the depreciation in the exchange value of the rand and the downgrade of South Africa's sovereign long-term foreign currency-denominated debt to sub-investment grade. Subsequently, the FRA rates declined up to early June, following an improved inflation outlook and more stable financial market conditions. Although FRA rates changed by varying degrees over the different maturity categories, they generally reflected expectations that interest rates will remain unchanged in coming months. On 6 June the rate on the 3x6-month FRA decreased to 7.22%, from 7.41% on 10 April 2017, while the 9x12-month FRA declined from 7.50% to 6.93% over the same period.

Forward rate agreements




Source: SARB

The prime lending rate and the predominant rate on mortgage loans remained unchanged at 10.50% in the first five months of 2017, in line with the stable repurchase rate. Rates on the different loan categories of private sector banks also remained fairly stable during the period. The weighted average overdraft rate on current accounts fluctuated in a narrow range of between 10.47% and 10.52% from January 2017 to April, while the rate on 12-month fixed deposits varied between 7.50% and 7.86% over the same period.

Interest rates on *RSA government fixed-rate retail bonds* moved in line with yields on conventional government bonds thus far in 2017, declining by between 75 and 100 basis points across different maturities in the six months to 1 June 2017. By contrast, the average fixed deposit rate with banks increased over the same period. Furthermore, the pace of increase in the amount in issue of all retail bonds levelled off somewhat in the opening months of 2017, amounting to R9.6 billion in April.

Interest rates on South African government fixed-rate retail bonds

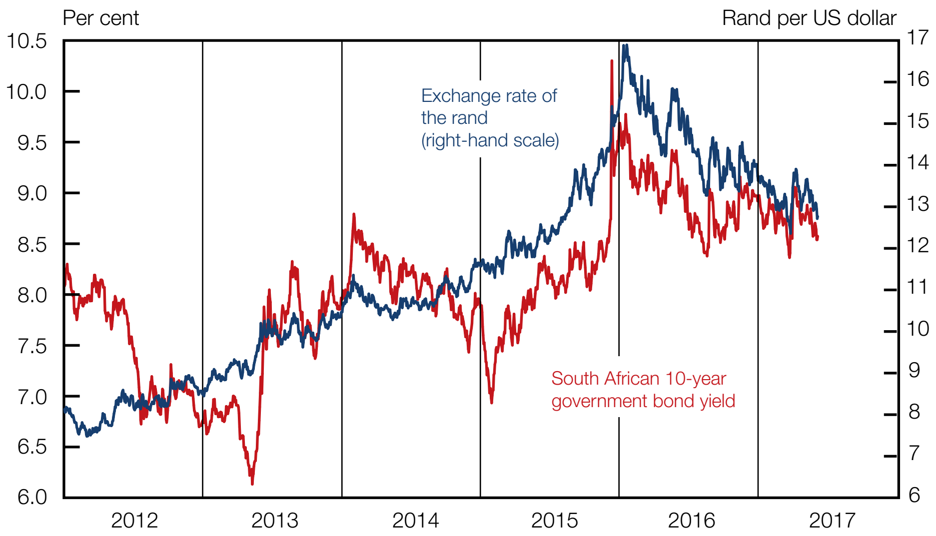
Per cent

| Effective from | Two-year bond | Three-year bond | Five-year bond |
|---|---|---|---|
| 2016 | | | |
| 1 Dec ........ | 8.50 | 9.00 | 9.25 |
| 2017 | | | |
| 1 Jan ........ | 8.50 | 8.75 | 9.00 |
| 1 Feb ........ | 8.25 | 8.50 | 8.75 |
| 1 Mar ........ | 8.00 | 8.25 | 8.75 |
| 1 Apr ........ | 8.00 | 8.25 | 8.75 |
| 1 May ........ | 7.75 | 8.00 | 8.50 |
| 1 Jun ........ | 7.75 | 8.00 | 8.25 |

Source: National Treasury

*Yields on domestic bonds of the South African government* declined from mid-December 2015, exhibiting volatility similar to that of the rand per US dollar exchange rate. The downward trend in bond yields partly suggested expectations of lower future inflation on account of the appreciation in the exchange value of the rand over the period. This is reflected by the decline in the daily closing yield on conventional 10-year South African government bonds by 194 basis points from a high 10.30% on 11 December 2015 to a low 8.36% on 23 March 2017. From late March 2017 bond yields increased to 9.06% on 6 April in response to numerous developments such as the reshuffling of cabinet, currency depreciation, South Africa's sovereign credit rating downgrades and concerns of a possible further credit rating downgrade, of local currency debt in particular, which could exclude South Africa from some prominent global bond indices. The latter might lead to forced sales of domestic government bonds driving yields even higher. However, bond yields again trended lower to 8.57% on 6 June.

Government bond yield and the exchange rate




Sources: INET BFA, JSE and SARB

The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[10] yield spread relative to US government bonds narrowed significantly from 443 basis points at the end of January 2016 to 329 basis points in May 2017, reflecting a notable improvement in investor sentiment towards emerging market debt instruments. The *sovereign risk premium*[11] on South African government US dollar-denominated bonds in the eight-year maturity range similarly narrowed from 349 basis points in January 2016 to 221 basis points in May 2017, with some widening in April 2017 along with South Africa's sovereign credit rating downgrades.

*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 most maturities throughout 2016 and thus far in 2017. The five- and six-year maturity break-even inflation rates were below 6% since early 2017, while the 11-year maturity rate traded below this level from the end of May 2017, reflecting lower inflation expectations in the bond market in line with the general appreciation in the exchange value of the rand. The break-even inflation rate in the six-year maturity range declined by 237 basis points from 18 January 2016 to 5.27% on 6 June 2017, while the 11-year maturity declined by 189 basis points over the same period.

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

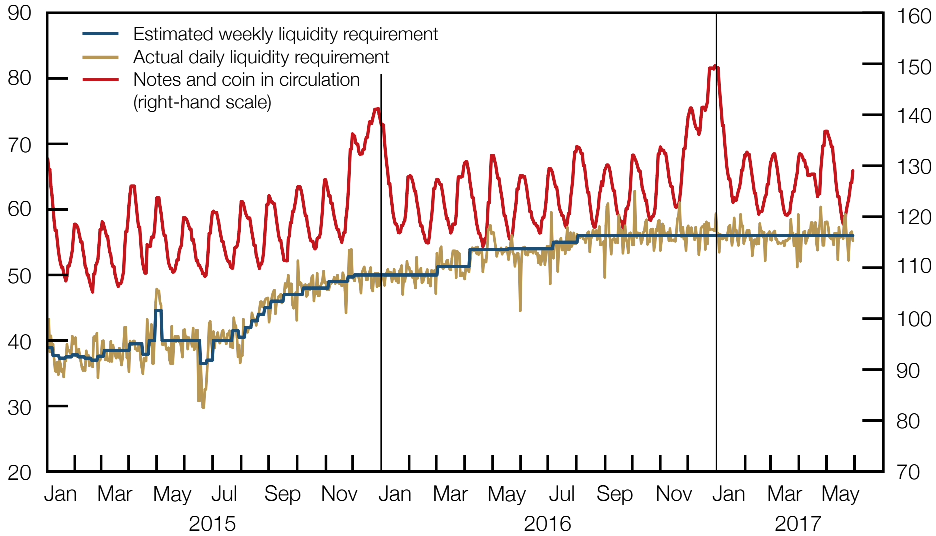
11 The differential between the yield on South African government US dollar-denominated bonds and that on US dollar-denominated bonds of the US government.

## Money market

The actual daily liquidity requirement of private sector banks varied between a low of R51.2 billion and a high of R59.2 billion in the first quarter of 2017. This was lower than the range of between R53.1 billion and R62.8 billion in the fourth quarter of 2016, which was boosted somewhat by seasonal factors. Since the introduction of a new liquidity management strategy in August 2013, the average of the actual daily liquidity requirement has increased from R22.8 billion to levels of around R56 billion from September 2016 onwards. The reforms introduced in recent years essentially served to keep the money market shortage more closely aligned with conditions in the money market, ultimately improving the effectiveness of the transmission of monetary policy. In May 2017 the actual daily liquidity requirement averaged R56.0 billion.

Liquidity requirement

R billions




Source: SARB

The net result of money market liquidity flows was an injection of R3.8 billion during the first quarter of 2017, compared to a net drainage of R1.5 billion in the fourth quarter of 2016. A contraction in notes and coin in circulation outside the SARB served to expand money market liquidity by R16.9 billion in the first quarter of 2017. This was partly neutralised by the money market operations of the SARB which drained R9.3 billion on a net basis, mainly through conducting liquidity-draining foreign exchange swaps, while the SARB also issued debentures and entered into reverse repurchase transactions. This was partly offset by a decrease of R2.6 billion in call deposits of the Corporation for Public Deposits (CPD) with the SARB. Foreign exchange transactions in the spot market by the SARB only had a minor contracting effect on money market liquidity. In April and May 2017, liquidity conditions tightened somewhat alongside an increase in the CPD's deposits with the SARB, which was partly offset when foreign exchange swaps were allowed to mature. In these two months, overall money market conditions were characterised by a net drainage of liquidity of R2.0 billion.

Money market liquidity flows

R billions (easing + tightening –)

| | 2016 | 2017 | |
|---|---|---|---|
| | Oct–Dec | Jan–Mar | Apr–May |
| Notes and coin in circulation | -17.1 | 16.9 | -0.3 |
| Change in cash reserve accounts | -1.8 | -0.2 | -1.5 |
| Money market effect of SARB foreign exchange transactions in spot market | 16.0 | -0.1 | 0.0 |
| Government deposits with SARB | 0.0 | 0.0 | 0.0 |
| Use of liquidity management instruments | 0.1 | -9.3 | -0.6 |
| Reverse repurchase transactions | 2.1 | -1.3 | 0.2 |
| SARB debentures | 1.7 | -0.4 | 0.0 |
| Forward position (swaps) | -4.1 | -10.3 | 6.5 |
| Corporation for Public Deposits' call deposits with SARB | 0.5 | 2.6 | -7.3 |
| Other items net | 1.4 | -3.6 | 0.4 |
| Liquidity provided to banking system | -1.5 | 3.8 | -2.0 |

Source: SARB

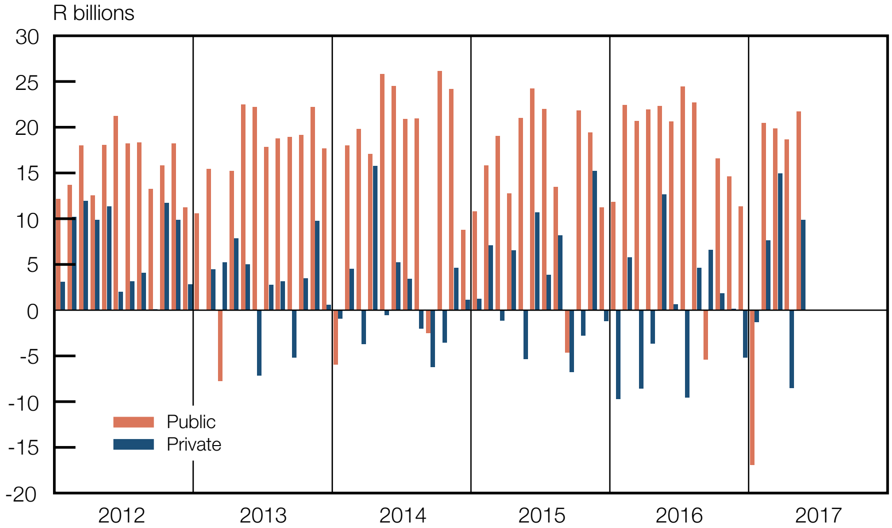
Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R73.8 billion were effected from the government tax and loan accounts from January to May 2017, with only R364 million of this amount accruing to the SARB.

## Bond market

Public sector funding in the domestic *primary bond market* continued briskly up to May 2017. Total net bond issuances by the public sector amounted to R64 billion in the first five months of the year, despite net redemptions in January 2017 when the R211 inflation-linked government bond was redeemed. Net issuances of private sector bonds also increased during this period, amounting to R23 billion compared with net redemptions of R3.5 billion over the same period in 2016.

National government increased its weekly fixed-rate bond auction amount from around R2.4 billion in March 2017 to about R2.7 billion in April. This was the first change in the fixed-rate auction amount since April 2013 and likely reflects the increased borrowing requirement and financing strategy of issuing long term government bonds of R194.5 billion during the 2017/18 fiscal year as tabled in the *2017 Budget Review*. The recent downgrades of South Africa's sovereign credit rating are expected to increase domestic borrowing costs going forward.

Net issuances in the domestic bond market by sector



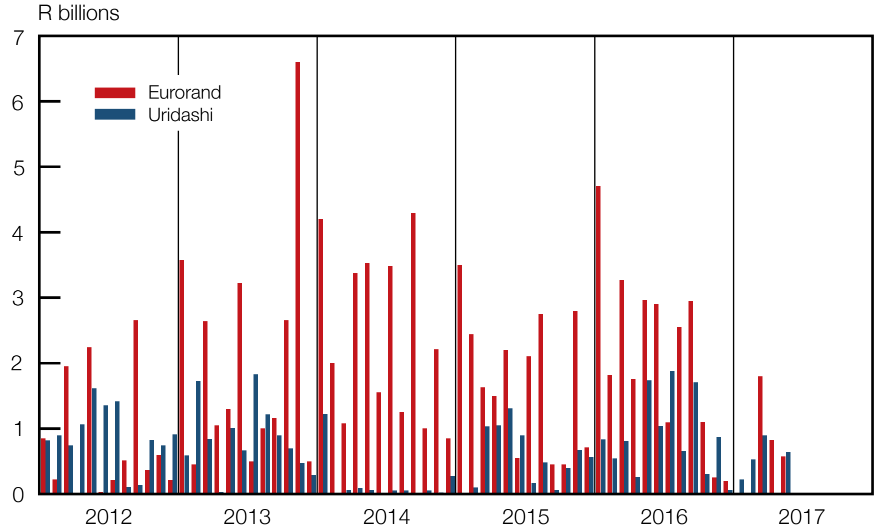

Source: JSE

The volume of bonds traded thus far in 2017 was lower than in the corresponding period in 2016, despite heightened volatility in the exchange value of the rand and domestic bond yields. In addition, the all-time high All-Bond Index in May 2017 was supported by the continued search for yield. Daily average *turnover* in the secondary bond market of R110 billion in the first five months of 2017 was 9% less than in the same period in 2016. Lower turnover led to a decline in the market liquidity ratio[12] in the bond market from 11.1 times in 2016 to an annualised 10.4 times in the first five months of 2017.

The issuance of rand-denominated bonds in the *European and Japanese bond markets* rebounded somewhat thus far in 2017 after a loss of momentum in the final months of 2016. Demand for such rand-denominated debt was most likely supported by a continued search for yield. Despite increased issuance, record-high scheduled redemptions in April 2017 contributed to aggregate net redemptions of R19 billion in the first five months of 2017, in contrast to net issuance of R8.3 billion in the corresponding period of 2016.

12 Measured as the value of bonds traded relative to the market capitalisation of listed bonds.

Rand-denominated bonds issued in international bond markets




Source: Bloomberg

*Non-resident* demand for domestic debt securities increased markedly thus far in 2017, in contrast to JSE reported net sales of R52 billion in the fourth quarter of 2016. Net purchases of domestic bonds by non-residents of R14 billion in the first quarter of 2017 was followed by R24 billion in April and May. Non-resident demand for domestic bonds was most likely buoyed by lower expected domestic inflation and positive sentiment towards emerging markets despite looming uncertainty regarding South Africa's sovereign credit rating.

## Share market

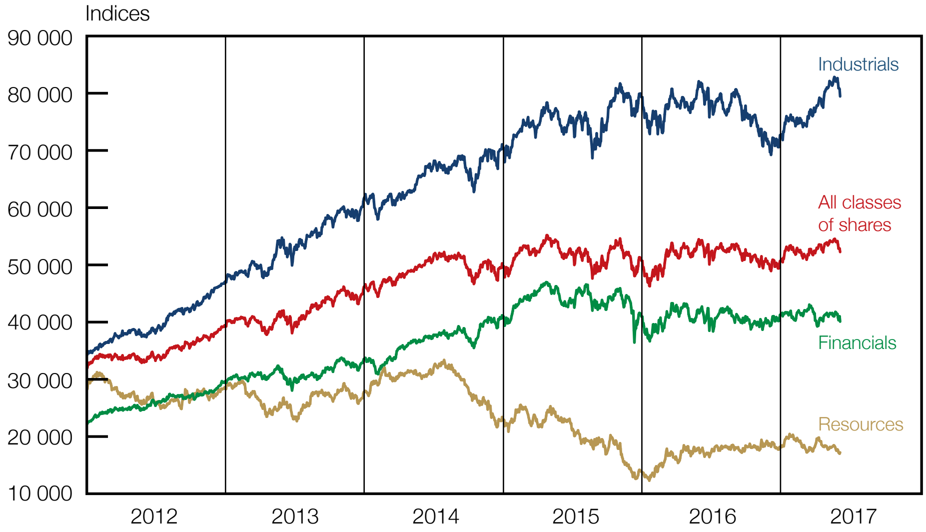
*Equity capital raised* in the domestic and international primary share markets by companies listed on the JSE increased thus far in 2017. Shares to the value of R33 billion were issued in the first five months of 2017 – 21% more than in the same period in 2016. The largest single contribution came from a domestic health care company which used the proceeds from the rights issue to fund the acquisition of a leading provider of medical imaging services in Europe. Companies with primary listings on the JSE, mostly in the industrial sector, raised 70% of the equity capital in the first five months of 2017.

*Turnover* in the JSE's secondary share market was subdued thus far in 2017. Daily average turnover of R20 billion in the first five months of 2017 was 16% less than in the corresponding period in 2016, consistent with the decline in volumes traded. The *market capitalisation* of the JSE increased from R13.3 trillion in October 2016 to R14.2 trillion in May 2017, mainly driven by an increase in share prices.

*Non-resident investors*' negative sentiment towards JSE listed shares persisted in 2017. According to JSE reported data, non-residents were net sellers of JSE listed shares to the value of R55 billion in the first five months of 2017, following significant net sales of R124 billion in 2016. Net sales of JSE listed shares by non-residents in 2017 reflected concerns about economic growth prospects amid domestic political uncertainty and South Africa's sovereign credit rating downgrades. The dearth in non-resident demand for JSE listed shares was also evident in the decline in the portion of JSE listed shares held by non-residents from an average of 23% in 2015 to 21% in the five months to May 2017.

*Share prices* of companies listed on the JSE, on balance, trended higher in recent months. The FTSE/JSE All-Share Price Index (Alsi) increased by 11% from a recent low on 6 December 2016 to 54 549 index points on 23 May 2017, as it surpassed the 54 000 level in May 2017 for the first time in 12 months. The upward trend was predominantly supported by the prices of shares of companies in the industrial sector, the media subsector in particular, and was also in line with higher share prices on international bourses. The Euro Stoxx 50 Index increased by 16% over the same period, while the US S&P 500 Composite Index increased by a lesser 8%. Subsequently, the Alsi declined by 4% to 52 252 index points on 6 June.

Share prices on the JSE




Sources: INET BFA and JSE

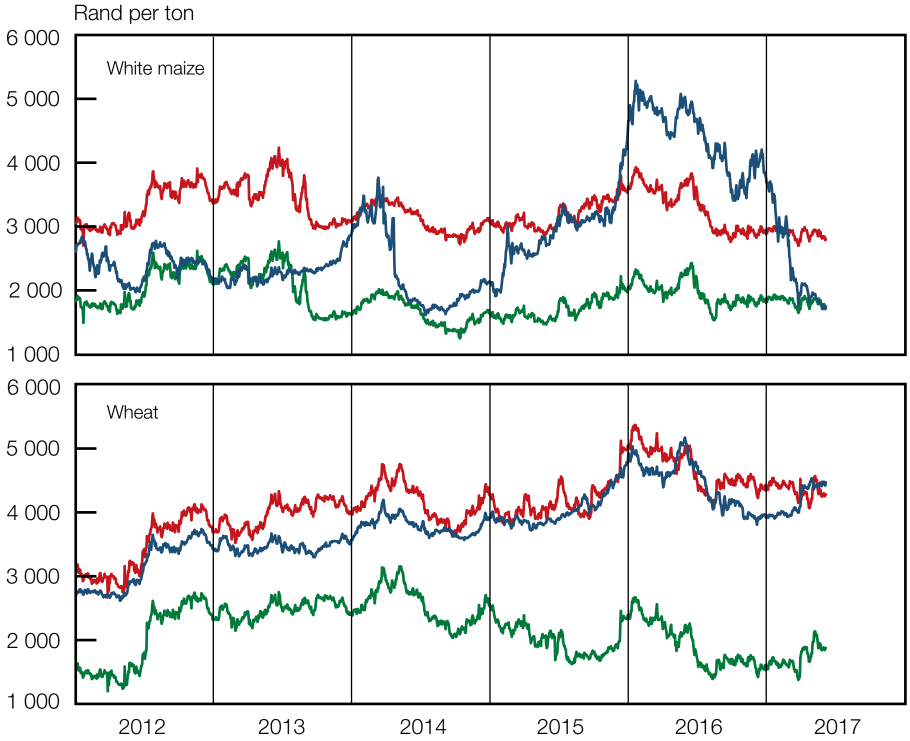
The total earnings of companies listed on the JSE increased by 40% in the first five months of 2017, lowering the historical *price-earnings ratio* of all classes of shares from 32.3 in December 2016 to 24.6 in May 2017. Although dividends declared increased marginally, the *dividend yield* of all classes of shares listed on the JSE decreased somewhat from 2.1% in December 2016 to 2.0% in May 2017, reflecting higher share prices.

## Market for exchange-traded derivatives

The *spot price of maize* contracts listed on the Commodity Derivatives Market (CDM) of the JSE decreased notably thus far in 2017. The decrease was driven by an expected large domestic surplus of maize, given the projections by the Crop Estimates Committee that this season will render the largest ever maize crop. The reasons being an increase in area planted and favourable weather conditions. From a recent high on 19 December 2016, the spot price of white maize declined by 59% and that of yellow maize by 46% up to 6 June 2017. Domestic maize prices could also be affected by an increase in the supply of maize by Malawi, the third largest maize producer in Southern Africa. In addition, South Africa's maize exports to the region may also face increased competition from Zambia, given prospects of a return to the export market following an announcement which lifted the temporary ban on maize exports this year.

By contrast, the *spot price of domestic wheat* increased during the first five months of 2017. This reflected an increase in international wheat prices as fears of extremely cold temperatures prevailed. Consequently, South Africa's wheat import tariff was lowered by 25% to R1 190.2 per ton in March 2017.

Grain prices




Sources: JSE and SARB

*Turnover* in agricultural commodity derivatives and equity derivatives decreased noticeably during the five months to May 2017 compared with the same period of 2016. By contrast, turnover in interest rate and currency derivatives increased briskly as financial market participants hedged against possible adverse movements in bond yields and the exchange value of the rand following *domestic political developments* and fears of a further credit rating downgrade.

Derivatives turnover on the JSE

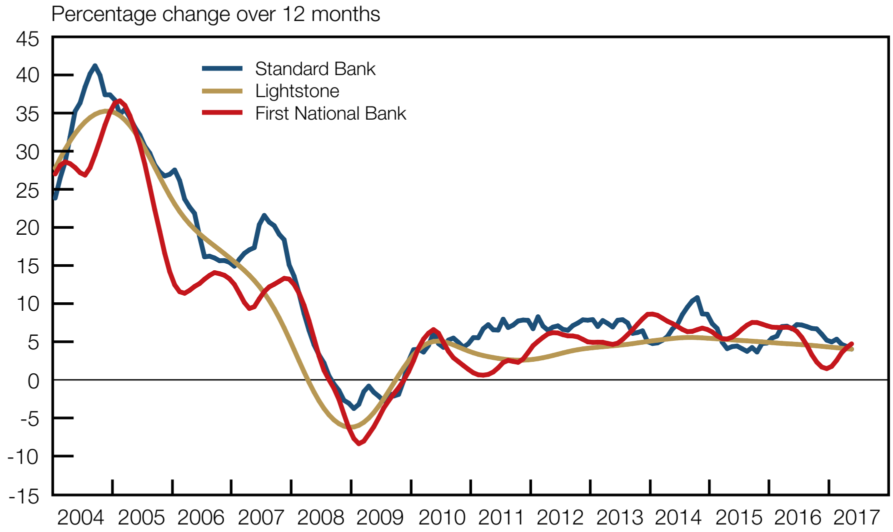
| Type of derivative | Value (R billions) | Change over one year (Per cent) |
|---|---|---|
| | January to May 2017 | |
| Equity | 2 119 | -19 |
| Warrants | 0.1 | -56 |
| Commodity | 221 | -48 |
| Interest rate | 591 | 23 |
| Currency | 324 | 16 |

Source: JSE

## Real estate market

Growth in nominal house prices remained subdued thus far in 2017, reflecting weak demand which is consistent with sluggish economic growth, low consumer confidence and high unemployment. In May 2017 the year-on-year rate of increase across the different indicators varied between 4% and 5%, while house prices declined in real terms.

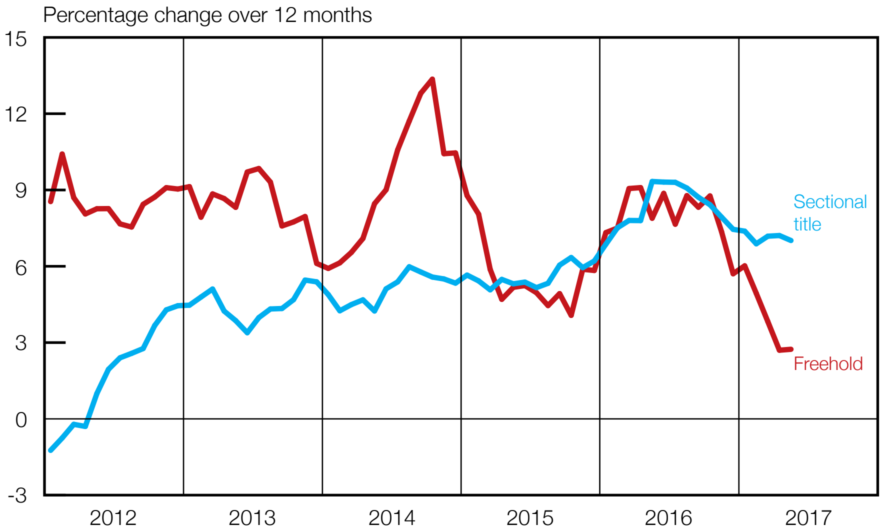
Nominal house prices




Sources: First National Bank, Lightstone and Standard Bank

The subdued trend in residential property prices resulted from a slowdown in the year-on-year rate of increase in the nominal prices of freehold and sectional title properties. Growth in the prices of freehold properties slowed markedly from a year-on-year rate of 8% in May 2016 to 3% in May 2017, while that of sectional title properties moderated more marginally from 9% to 7% over the same period. From a supply perspective, residential building activity weakened in recent months, specifically the real value of residential building plans passed. The average time that residential properties remained on the market nevertheless declined from 15 weeks in the fourth quarter of 2016 to 13.4 weeks in the first quarter of 2017.

Nominal prices of specific types of properties




Source: Standard Bank

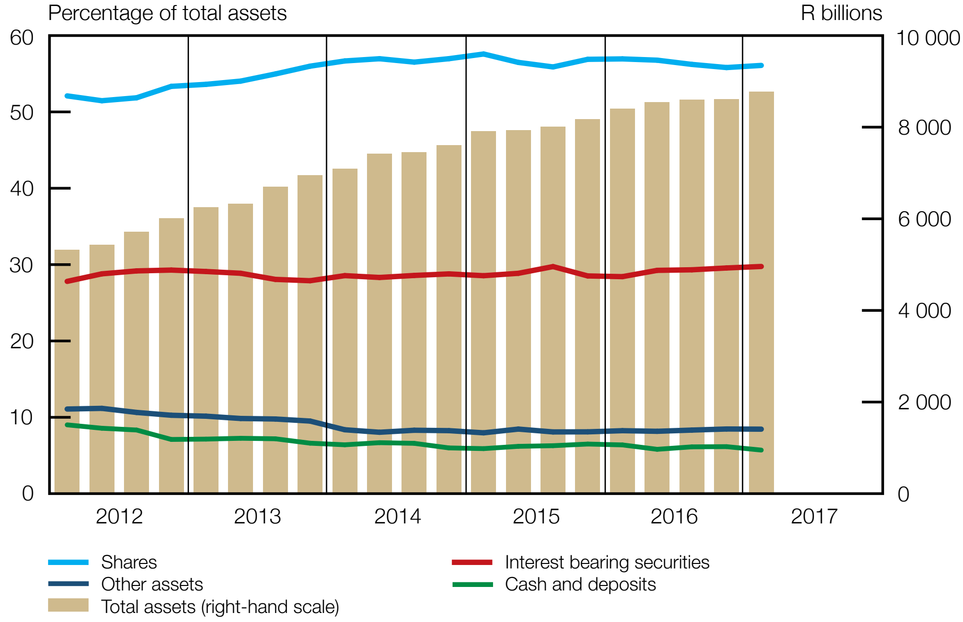
## Non-bank financial intermediaries[13]

Growth in the total value of the consolidated balance sheet of non-bank financial institutions was buoyed by the increase in the prices of financial assets in the first quarter of 2017. The total asset value of these intermediaries increased by 2% from the final quarter of 2016 to R8.8 trillion in the first quarter of 2017. The total value of the balance sheet of these institutions

13 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.

increased year-on-year by 4% in the first quarter of 2017, driven mostly by increases of 9% and 4% respectively in the asset value of unit trusts and the Public Investment Corporation.

Total asset holdings of non-bank financial institutions




Source: SARB

Shares and interest bearing securities remained the preferred asset classes of non-bank financial institutions in the first quarter of 2017. The portion held in shares remained unchanged at 56% of total assets in the final quarter of 2016 and in the first quarter of 2017, despite an increase in share prices. Although exposure to shares in the first quarter of 2017 was 2 percentage points more than the 10-year average, continued weak economic growth might discourage further rotation of funds to this asset class. Similarly, holdings of interest bearing securities as a portion of total assets remained unchanged at 30% in the fourth quarter of 2016 and in the first quarter of 2017, amid the decline in government bond yields over the period.

The part of assets invested in cash and deposits declined by 1 percentage point from the final quarter of 2016 to 6% of total assets in the first quarter of 2017. The steady decline in cash and deposit holdings thus far in 2017 is consistent with fairly low real interest rates. Households still invested in money market unit trusts, which registered net inflows of R5.4 billion in the first quarter of 2017, compared with R10 billion in the fourth quarter of 2016. The value of loans extended by non-bank financial institutions to households and companies remained unchanged at 5% of total assets in both the final quarter of 2016 and the first quarter of 2017.

Weak economic activity and subdued growth in household disposable income had a negative effect on contractual and discretionary savings intermediation through non-bank financial institutions in the first quarter of 2017.

# Public finance[14]

## Non-financial public sector borrowing requirement[15]

The *non-financial public sector borrowing requirement* amounted to R142 billion in fiscal 2016/17, some R12.3 billion less than in the previous fiscal year. The lower non-financial public sector borrowing requirement could mainly be attributed to the improved cash deficit of consolidated general government, following higher cash surpluses of local governments, extra-budgetary institutions and social security funds. National government also recorded a slightly lower cash deficit.

14 Unless stated to the contrary, year-on-year rates of increase in this section compare fiscal 2016/17 to fiscal 2015/16. Data for fiscal 2016/17 are unaudited and remain preliminary.

15 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

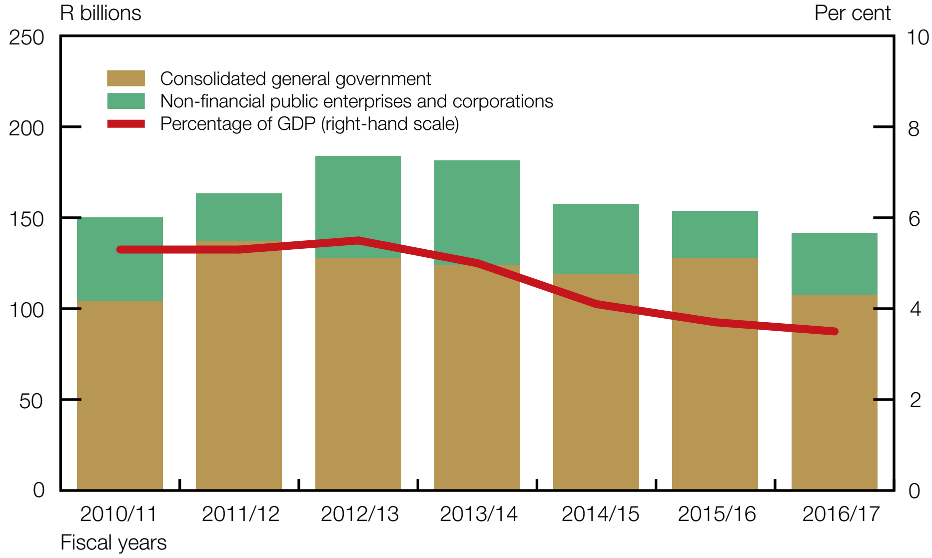
R billions

| Level of government | Fiscal 2015/16* | Fiscal 2016/17* |
|---|---|---|
| Consolidated general government | 127.6 | 107.4 |
| National government | 168.5 | 164.1 |
| Extra-budgetary institutions | -2.4 | -8.5 |
| Social security funds | -13.9 | -15.2 |
| Provincial governments | -2.3 | 1.9 |
| Local governments | -22.4 | -35.1 |
| Non-financial public enterprises and corporations | 26.3 | 34.2 |
| **Total**** | **153.9** | **141.6** |
| *As a percentage of GDP* | *3.7* | *3.2* |

* 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 narrowed further from 3.7% in fiscal 2015/16 to 3.2% in fiscal 2016/17. The borrowing requirement of the *consolidated general government* decreased by R20.2 billion to R107 billion in fiscal 2016/17 and 2.4% of GDP. This was lower than the 3.1% of GDP recorded in fiscal 2015/16.

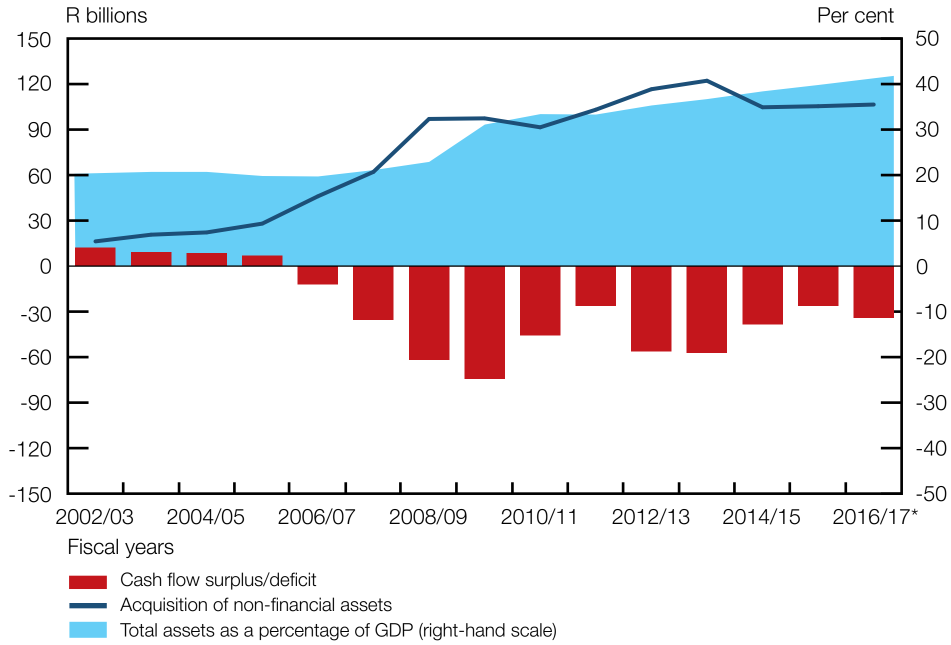
### Non-financial public sector borrowing requirement




Sources: National Treasuary, Stats SA and SARB

The preliminary cash deficit of *non-financial public enterprises and corporations*, also known as state-owned companies (SOCs), amounted to R34.2 billion in fiscal 2016/17. This was R7.9 billion or 30.0% more than the 2015/16 audited outcome. The larger cash deficit could be attributed to the increase in total expenditure outpacing that in total cash receipts from operating activities. Over the past decade the cash deficits of non-financial SOCs have been largely driven by increased acquisitions of non-financial assets which contributed to strong growth in total assets of major SOCs.

Financial activities of non-financial public enterprises and corporations




* Preliminary estimates

Source: SARB

Total cash receipts of non-financial SOCs amounted to R464 billion in fiscal 2016/17, representing a year-on-year increase of 16.9%. The increase resulted mainly from improved operational and financial performance of some major SOCs.

Non-financial SOCs' total current and capital expenditure increased by 17.7% to R498 billion in fiscal 2016/17. Growth in total expenditure was mainly driven by a significant increase in operating expenses, while capital expenditure increased by a moderate R2.4 billion to R106 billion in fiscal 2016/17. According to the *2017 Budget Review*, SOCs are expected to invest more than R432 billion in capital programmes over the medium term. SOCs' capital investment programmes are mainly financed through borrowing against their own balance sheets and in some instances backed by government guarantees.

Total outstanding listed debt of non-financial SOCs amounted to R254 billion as at 31 March 2017 – 4.3% more than a year earlier. The increase was much lower than the annual average increase of about 10.0% over the previous five fiscal years. This may be a reflection of weak domestic economic activity, low investor confidence and rising borrowing costs. The recent sovereign credit rating downgrades may lead to a deterioration in the availability of funding for SOCs and could constrain capital investment programmes.

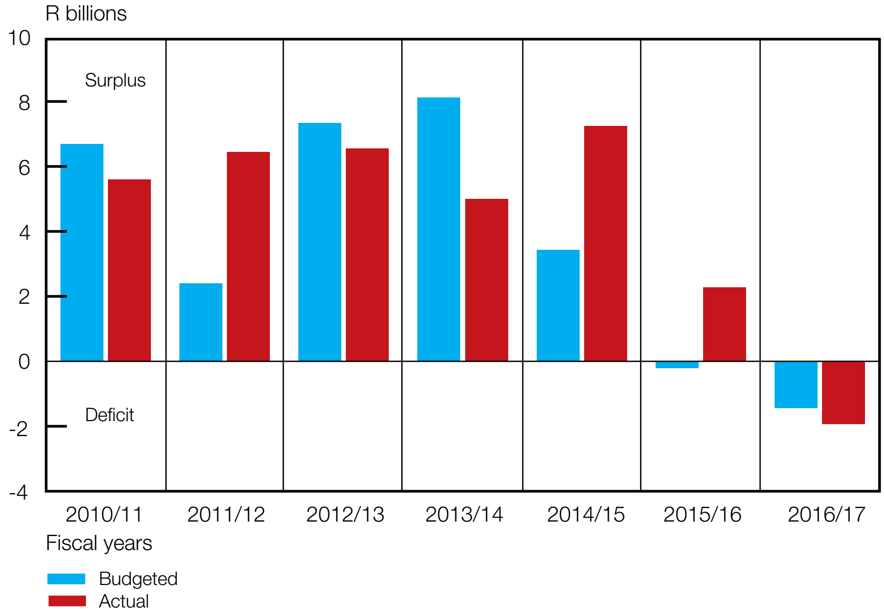
Preliminary financial statistics of *national government* showed cash receipts from operating activities of R1 172 billion in fiscal 2016/17, some 4.5% more than in the preceding fiscal year. The increase in national government's cash receipts could be attributed to higher collections in almost all the main tax categories.

Cash payments for operating activities by national government increased by 4.1% year on year to R1 318 billion in fiscal 2016/17. In fiscal 2016/17, compensation of employees increased by 7.1% to R143 billion, while total grants paid to other levels of general government amounted to R717 billion and contributed 54.4% to total cash payments.

National governments' net cash flow from operating activities and net investment in non-financial assets generated a cash deficit of R164 billion in fiscal 2016/17, which was slightly lower than the cash deficit of R168 billion in the preceding year.

Preliminary financial statistics of *provincial governments* switched from successive cash surpluses in recent years to a cash deficit of R1.9 billion in fiscal 2016/17.

Provincial government finances




Source: National Treasury

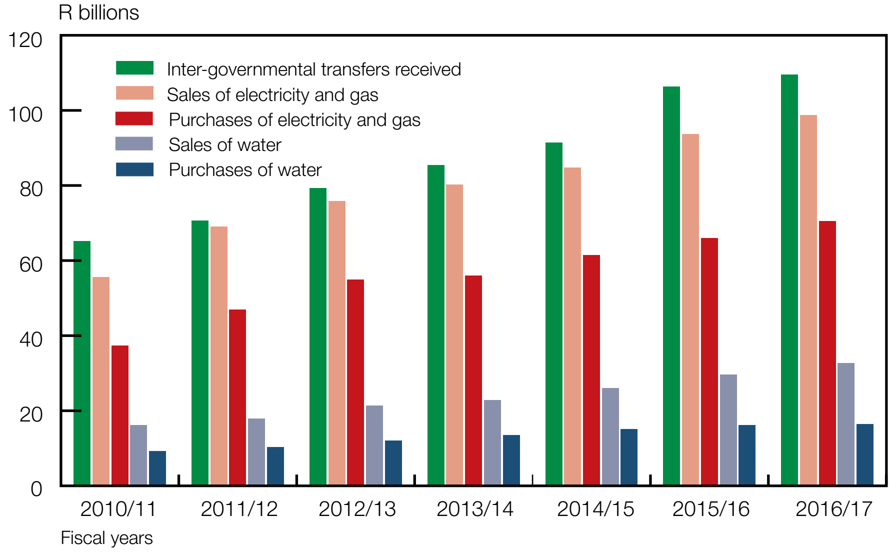
Total cash receipts of provincial governments increased by 6.2% year on year to R518 billion in fiscal 2016/17. Grants received from national government, mainly equitable share transfers and conditional grants, accounted for about 96.6% of provincial governments' total cash receipts. The *2017 Budget Review* estimated that total grants from national government would increase at an average annual rate of 7.5% over the medium term to R621 billion in fiscal 2019/20. KwaZulu-Natal, the Eastern Cape and Gauteng remained the largest provincial recipients of national government grants.

Total cash payments for operating activities by provincial governments increased by 8.1% year on year to R486 billion in fiscal 2016/17. The increase could mainly be attributed to an increase in the provincial compensation bill, in particular that of educators and health practitioners. In fiscal 2016/17, net investment in non-financial assets declined by 5.2% year on year to R33.9 billion.

Provincial governments' deposits with the Corporation for Public Deposits increased from R19.0 billion at the end of March 2016 to R23.7 billion at the end of March 2017. By contrast, deposits with private banks decreased from R17.3 billion to R10.5 billion over the same period. The overall indebtedness of provincial governments to private banks remained unchanged at R0.7 billion.

Preliminary financial statistics of *local governments* showed that growth in total cash receipts from operating activities outpaced that in total expenditure. This resulted in a cash surplus of R35.1 billion in fiscal 2016/17, which was R12.7 billion more than the cash surplus recorded in the previous fiscal year. The notable increase in total cash receipts resulted from higher own-generated cash receipts, mainly through sales of water, electricity and gas.

Municipal own-generated cash receipts* and inter-governmental transfers received




Sources: Stats SA and SARB

* Purchases and sales of water and electricity by municipalities are recorded when invoiced. A purchase is recorded when the municipality receives an invoice from suppliers, and a sale is recorded when the municipality invoices consumers.

Total cash receipts of local governments increased by 7.8% year on year to R364 billion in fiscal 2016/17. Municipalities continued to increase own cash receipts mainly from service charges, property rates and taxes. This amounted to R254 billion or about 70.0% of total cash receipts in the period under review. Inter-governmental transfers, comprising equitable share transfers and conditional grants, inclusive of metropolitan municipalities' share of the general fuel levy, amounted to R109 billion which was 2.9% more than in the preceding fiscal year. Inter-governmental transfers accounted for about 30.0% of total cash receipts in fiscal 2016/17. The *2017 Budget Review* estimated that total transfers from national government would increase at an annual average rate of 8.6%, to average R122 billion per annum over the medium term.

Local governments' cash payments for operating activities and net investment in non-financial assets together amounted to R329 billion in fiscal 2016/17, or R13.7 billion more than in the previous fiscal year. Purchases of goods and services, largely water and electricity, continued to drive growth in municipal operating expenses. Net investment in non-financial assets of R48.5 billion in fiscal 2016/17 was R2.7 billion less than in the previous fiscal year.

Preliminary financial estimates of *extra-budgetary institutions* showed a cash surplus of R8.5 billion in fiscal 2016/17, which was R6.1 billion more than in the previous fiscal year. The higher cash surplus resulted mainly from an increase in total cash receipts from national government transfers, which outpaced a moderate increase in total expenditure. *Social security funds* recorded a preliminary cash surplus of R15.2 billion in fiscal 2016/17, which was slightly more than the R13.9 billion recorded in the previous fiscal year.

## Budget comparable analysis of national government finance

The actual year-on-year rate of increase in both national government expenditure and revenue in fiscal 2016/17 was lower than the original 2016 Budget and the revised 2017 Budget projections. Relative to these projections, actual growth in national government revenue slowed more than that in expenditure, indicative of persistent weak domestic demand, output growth and employment creation. However, this still resulted in a marginally higher cash book deficit in fiscal 2016/17 than the revised 2017 Budget projections, but R3.1 billion less compared with 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 Full 2016/17 |
|---|---|---|---|
| Expenditure | 5.9 | 5.0 | 4.8 |
| Revenue | 8.6 | 6.3 | 5.8 |
| Memo: cash book deficit | R156 billion | R171 billion | R172 billion |

* Fiscal 2015/16 to fiscal 2016/17
** *2016 Budget Review*
*** *2017 Budget Review*

Sources: National Treasury and SARS

National government expenditure amounted to R1 304 billion in fiscal 2016/17, representing an increase of 4.8% compared with the preceding fiscal year. This was R14.6 billion less than the R1 318 billion projected in the *2016 Budget Review*. As a ratio of GDP, national government expenditure amounted to 29.7% in fiscal 2016/17 – slightly lower than the ratio of 30.2% recorded in fiscal 2015/16 and the estimated 30.0% in the original 2016 Budget.

National government expenditure in fiscal 2016/17

| Expenditure item | Originally budgeted Full 2016/17 | | Actual Full 2016/17 | |
|---|---|---|---|---|
| | R billions | Percentage change* | R billions | Percentage change* |
| Voted expenditure | 721.1 | 3.1 | 715.0 | 2.2 |
| *Of which: Current payments* | *208.4* | *7.6* | *207.0* | *6.8* |
| *Transfers and subsidies* | *493.4* | *7.6* | *488.9* | *6.7* |
| *Payments for capital assets* | *14.4* | *-21.1* | *14.2* | *-22.1* |
| *Payments for financial assets* | *4.9* | *-83.2* | *4.8* | *-83.5* |
| Statutory amounts** | 597.2 | 9.6 | 588.7 | 8.0 |
| *Of which: Equitable share transfers* | *410.7* | *6.3* | *410.7* | *6.3* |
| *Interest on debt* | *147.6* | *14.7* | *146.3* | *13.7* |
| Total expenditure | 1 318.3 | 5.9 | 1 303.7 | 4.8 |

* 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

Source: National Treasury

Of the increase in national government expenditure of R59.2 billion relative to fiscal 2015/16, R43.8 billion was due to statutory amounts of which R17.6 billion was interest on debt. On balance, only R15.3 billion was on account of higher voted expenditure. Higher voted expenditure was primarily driven by higher current payments as well as transfers and subsidies. These two spending categories accounted for 97.3% of voted expenditure and 53.4% of total expenditure.

Current payments amounted to R207 billion in fiscal 2016/17 – 6.8% more than in the previous fiscal year. The Justice, Crime Prevention and Security cluster accounted for 72.3% of total current payments.

Transfers and subsidies amounted to R489 billion in fiscal 2016/17 – 6.7% more when compared with fiscal 2015/16. The departments of Education, Social Development, Cooperative Governance and Traditional Affairs, Transport, Health, Human Settlements and National Treasury together accounted for 80.2% of total transfers and subsidies.

Payments for capital assets amounted to R14.2 billion in fiscal 2016/17, or 22.1% less than in the preceding fiscal year, broadly in line with the 2016 Budget projections. Payments for financial assets decreased substantially and amounted to R4.8 billion in fiscal 2016/17, representing a decline of 83.5% on a year-on-year basis. The substantial decline mainly reflected the high base due to the one-off transfer of R25.0 billion to Eskom and the New Development Bank in fiscal 2015/16.

Payments related to statutory amounts, excluding interest payments, pertain mostly to equitable share transfers. Equitable share transfers to provinces, which represent the bulk of provincial governments' cash receipts from operating activities, amounted to R411 billion in fiscal 2016/17, 6.3% more than in the previous fiscal year. Metropolitan municipalities received the last of three equal payments of R3.7 billion in March 2017 as their share of the general fuel levy, bringing their total receipts to R11.2 billion in fiscal 2016/17.

Interest payments on national government debt amounted to R146 billion in fiscal 2016/17 and represented a notable increase of 13.7% on a year-on-year basis, albeit slightly lower than the 14.7% originally budgeted.

After taking cash flow adjustments[16] into account, the cash flow expenditure of national government amounted to R1 275 billion in fiscal 2016/17 – an increase of 4.6% when compared with the previous fiscal year.

National government revenue amounted to R1 132 billion[17] in fiscal 2016/17, or 5.8% more than in fiscal 2015/16. The increase in national government revenue resulted from higher collections in all the major tax categories, although annual growth in most of these tax categories fell below original budgeted projections. The *2016 Budget Review* projected that national government revenue would increase by 8.6% to R1 162 billion in fiscal 2016/17, R30.0 billion more than the final outcome. Relative to GDP, national government revenue amounted to 25.8% in fiscal 2016/17, slightly lower than both the 25.9% recorded in the previous fiscal year and the 26.5% projected in the 2016 Budget.

16 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.

17 In the calculation by the SARB, revenue excludes premiums on debt portfolio restructuring and loan transactions. These came to R3.5 billion in fiscal 2016/17.

National government revenue in fiscal 2016/17

| Revenue source | Originally budgeted Full 2016/17 | | Actual Full 2016/17 | |
|---|---|---|---|---|
| | R billions | Percentage change* | R billions | Percentage change* |
| Taxes on income, profits and capital gains | 668.4 | 10.1 | 664.5 | 9.5 |
| *Income tax on individuals* | *442.2* | *13.6* | *425.9* | *9.4* |
| *Income tax on companies* | *200.9* | *3.9* | *207.0* | *7.1* |
| Payroll taxes | 17.6 | 15.9 | 15.3 | 0.6 |
| Taxes on property | 15.4 | 2.7 | 15.7 | 4.1 |
| Taxes on goods and services | 418.6 | 8.5 | 402.2 | 4.3 |
| *Value-added tax (VAT)* | *301.3* | *7.2* | *289.2* | *2.9* |
| *Domestic VAT* | *322.4* | *8.4* | *321.5* | *8.1* |
| *Import VAT* | *164.0* | *8.8* | *149.3* | *-1.0* |
| *General fuel levy* | 64.5 | 16.0 | 62.8 | 12.9 |
| Taxes on international trade and transactions | 54.5 | 16.2 | 46.1 | -1.8 |
| *Import duties* | *54.0* | *16.8* | *45.6* | *-1.5* |
| Other revenue** | 26.8 | -47.4 | 27.6 | -45.8 |
| Less: SACU*** payments | 39.4 | -22.7 | 39.4 | -22.7 |
| **Total revenue** | **1 162.0** | **8.6** | **1 132.0** | **5.8** |

* Fiscal 2015/16 to fiscal 2016/17
** Including extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions that amounted to R3.5 billion in fiscal 2016/17
*** Southern African Customs Union

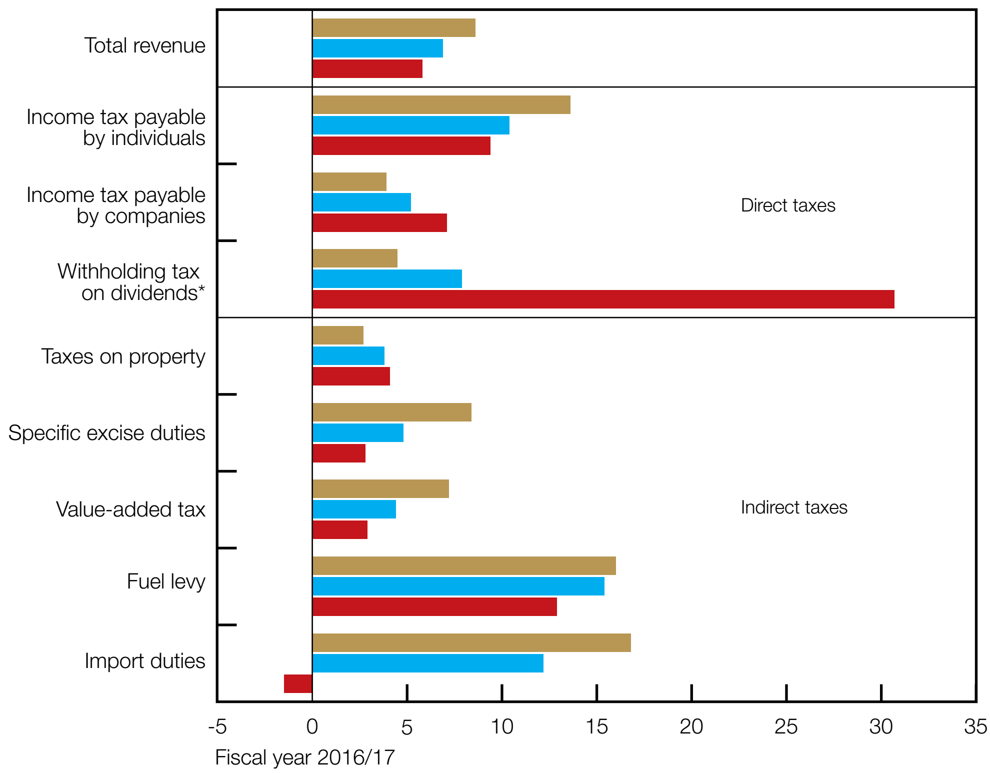
Sources: National Treasury and SARS

Taxes on income, profits and capital gains amounted to R665 billion in fiscal 2016/17 – 9.5% more compared with the previous fiscal year. Collections from this tax category underperformed the 2016 Budget projections, mainly due to lower personal income tax, which resulted from lower pay-as-you-earn receipts, lower bonuses, higher-than-expected personal income tax refunds and lower personal income tax provisional payments. The lack of employment growth could also partly explain the underperformance of this tax category. However, the weaker performance in personal income tax collections was partly offset by sustained corporate income tax receipts, owing to higher provisional tax payments from the mining and quarrying, and the financial sectors, in particular.

Taxes on property amounted to R15.7 billion in fiscal 2016/17, representing a year-on-year increase of 4.1%. Collections of transfer duties contributed R8.2 billion and securities transfer tax R5.6 billion, with the latter reflecting financial market activity. Withholding tax on dividends performed significantly better in fiscal 2016/17 than in the previous fiscal year, although it comprised only about 3% of total revenue. The increase was mainly due to companies distributing profits to shareholders rather than reinvesting, while the dividend tax rate also increased from 15% to 20% as from 22 February 2017.

**Components of national government revenue**

Percentage change over one year



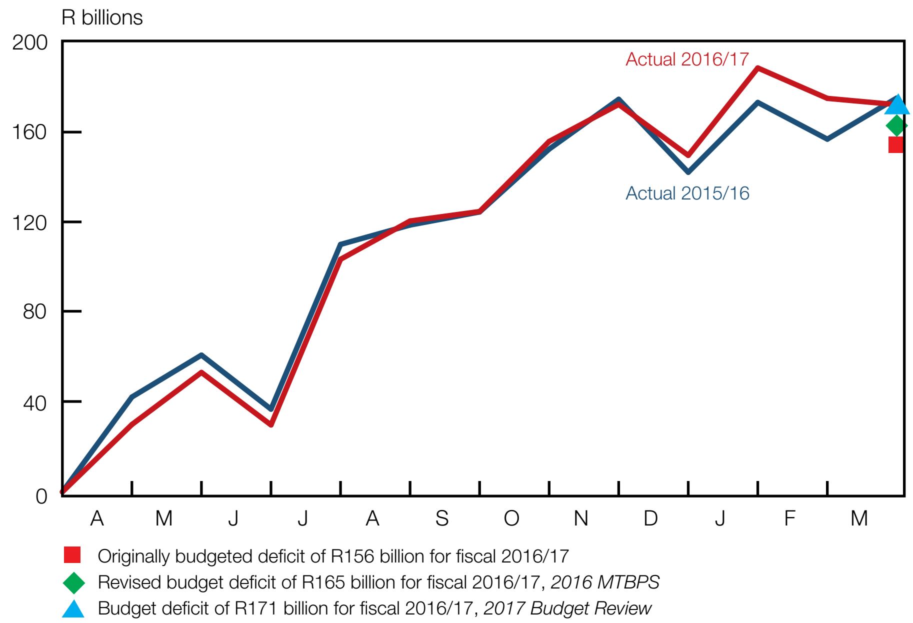

Originally budgeted: *2016 Budget Review*
Revised estimates: *2017 Budget Review*
Actual, Full 2016/17
* Includes secondary tax on companies and withholding tax on interest
Source: National Treasury

Taxes on goods and services amounted to R402 billion in fiscal 2016/17 – 4.3% more than in the previous fiscal year. This tax category underperformed the original budget projections due to the weak performance of import value-added tax (VAT) and excise duties. Weak import VAT collections could mainly be attributed to a slowdown in the importation of vehicles, machinery and electrical machinery. The slow growth in excise duties occurred primarily on account of lower receipts from cigarettes and cigarette tobacco.

Taxes on international trade and transactions amounted to R46.1 billion in fiscal 2016/17, and declined by 1.8% on a year-on-year basis. Although this tax category performed relatively well in the first three months of fiscal 2016/17, receipts from import duties decelerated significantly in subsequent months, partly due to the slowdown in vehicle, electrical machinery and clothing imports as domestic demand waned.

Non-tax revenue amounted to R27.6 billion in fiscal 2016/17 and was broadly in line with the amount originally budgeted. This revenue category decreased notably by 45.8% from a year earlier as a consequence of the high base emanating from the one-off sale of Vodacom shares to the value of R25.0 billion in fiscal 2015/16.

Cumulative deficit of national government




Sources: National Treasury and SARS

Netting national government revenue and expenditure yielded a cash book deficit of R172 billion in fiscal 2016/17, some R3.1 billion lower than the cash book deficit recorded in fiscal 2015/16. However, the deficit was about R16 billion higher than projected in the original 2016 Budget given under-expenditure of R14.6 billion and under-collection of revenue of R30.0 billion. As a ratio of GDP, the cash book deficit amounted to 3.9%, compared with a ratio of 4.2% recorded in the preceding fiscal year. The *2016 Budget Review* projected a cash book deficit of 3.6% of GDP in fiscal 2016/17.

The primary balance of national government (the deficit/surplus recalculated by excluding interest payments from total expenditure) amounted to a deficit of R25.4 billion in fiscal 2016/17 – R20.7 billion less than in the preceding fiscal year. As a ratio of GDP, the primary deficit receded from 1.1% in fiscal 2015/16 to 0.6% in fiscal 2016/17. However, the *2016 Budget Review* projected a primary deficit of only 0.2% of GDP for fiscal 2016/17, while a primary surplus is expected by 2018/19 according to the *2017 Budget Review*.

The cash flow deficit of national government amounted to R137 billion in fiscal 2016/17 – R5.5 billion less than the cash flow deficit recorded in the previous fiscal year. After taking the cost on revaluation of foreign debt at redemption into account, the net borrowing requirement amounted to R150 billion for fiscal 2016/17; this compared with a net borrowing requirement of R144 billion recorded in the preceding fiscal year.

National government financing in fiscal 2016/17

R billions

| Items or instruments | Actual Full 2015/16 | Originally budgeted[1] Full 2016/17 | Revised estimates[2] Full 2016/17 | Actual Full 2016/17 |
|---|---|---|---|---|
| **Cash flow deficit[3]** | **142.9[3]** | **156.3[4]** | **170.5[4]** | **137.4[4]** |
| *Plus:* Cost/profit on revaluation of foreign debt at redemption[5] | 1.5 | 8.1 | 12.6 | 12.6 |
| **Net borrowing requirement** | **144.4** | **164.5** | **183.1** | **150.0** |
| Treasury bills | 13.1 | 25.0 | 41.0 | 40.5 |
| Domestic government bonds[6] | 128.1 | 116.2 | 115.9 | 86.7 |
| Foreign bonds and loans | -2.4 | 15.9 | 49.0 | 49.0 |
| Change in available cash balances[7] | 5.6 | 7.3 | -22.8 | -26.2 |
| **Total net financing[8]** | **144.4** | **164.5** | **183.1** | **150.0** |

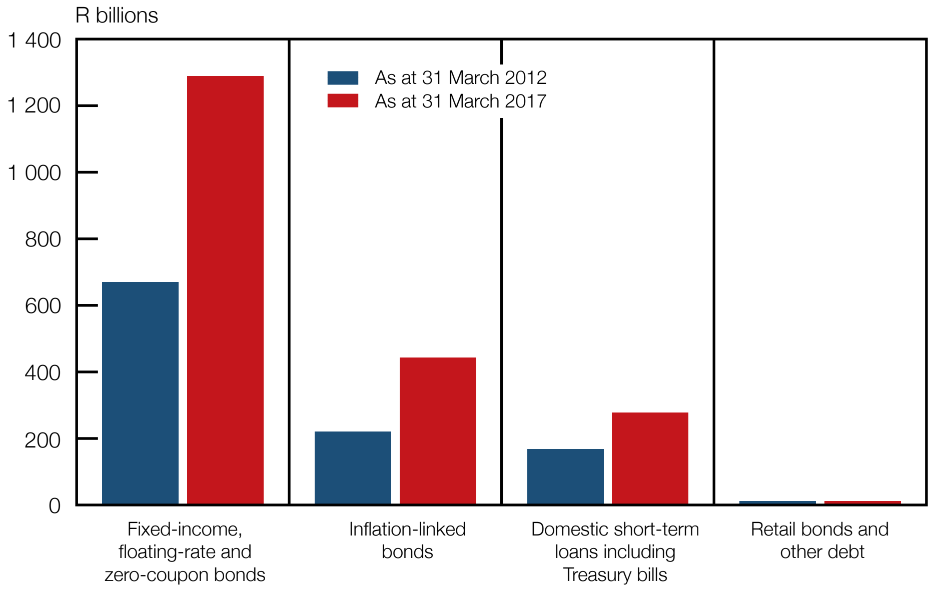
1 *2016 Budget Review*
2 *2017 Budget Review*
3 Cash flow deficit which differs from the cash book deficit; including extraordinary receipts and payments
4 Cash book deficit
5 Cost + profit –
6 Including other financing (non-marketable bonds, RSA money market instruments, and adjusted revaluation on inflation-linked bonds)
7 Increase – decrease +
8 Components may not add up to totals due to rounding off

Sources: National Treasury and SARB

The net borrowing requirement was largely financed through the issuances of domestic government bonds, foreign bonds and loans, and Treasury bills. National government raised R40.5 billion from both Treasury bills and short-term loans from the Corporation for Public Deposits, notably more than in the previous fiscal year. By contrast, domestic government bonds and other financing recorded net issuances worth R86.7 billion in fiscal 2016/17, significantly lower than in the previous fiscal year. In addition, net issuances of foreign bonds and loans to the value of R49.0 billion were recorded in fiscal 2016/17, compared with net redemptions of R2.4 billion in the previous fiscal year. National government's cash balances increased by R26.2 billion in fiscal 2016/17, bringing these balances to R239 billion at the end of March 2017. Of this, deposits with the SARB amounted to R196 billion, or 81.9%, while the remaining balances were held with commercial banks.

National government domestic debt (marketable and non-marketable) increased by R201 billion in fiscal 2016/17 to R2 020 billion as at 31 March 2017. This largely reflected an increase in domestic marketable debt instruments (Treasury bills and bonds) which accounted for 98.1% of total domestic debt as at 31 March 2017. Domestic marketable debt rose from R1 782 billion to R1 982 billion between 31 March 2016 and 31 March 2017, while non-marketable debt rose marginally from R37.2 billion to R38.4 billion over the same period. The total level of outstanding domestic debt was higher than both the original estimate in the *2016 Budget Review* and the revised estimate in the *2017 Budget Review*. National government's domestic debt was originally expected to amount to R2 004 billion (45.7% of GDP) in fiscal 2016/17.

Composition of national government domestic debt

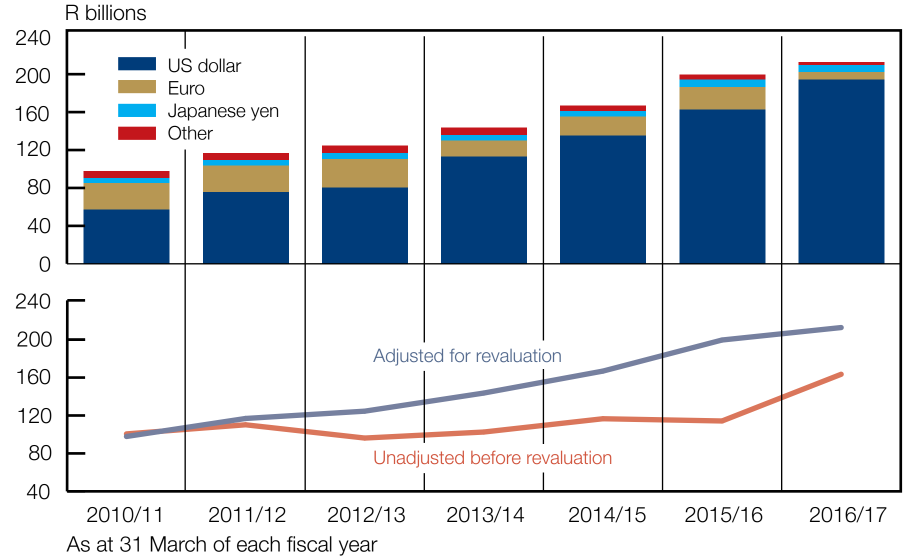



Source: National Treasury

National government's domestic debt largely comprised of fixed-income, floating-rate and zero-coupon bonds, which accounted for 63.8% (R1 289 billion) of total national government domestic debt as at 31 March 2017. This compares with a share of 62.5% (R669 billion) as at 31 March 2012. In the five years between 31 March 2012 and 31 March 2017, the value of outstanding inflation-linked bonds in issue increased from R221 billion to R443 billion, representing an increased share of total national government domestic debt from 20.6% to 21.6% over the same period.

National government's foreign debt (foreign currency-denominated debt) amounted to R213 billion as at 31 March 2017, representing an increase of R13.1 billion in fiscal 2016/17. The increase resulted from two bond issuances of US$1.25 billion and US$3.0 billion in April and October 2016 respectively, along with exchange rate revaluation effects. The foreign debt outcome in fiscal 2016/17 was well below both the original 2016 Budget and the revised 2017 Budget projections. The *2016 Budget Review* originally projected national government's foreign debt to amount to R230 billion (5.2% of GDP) in fiscal 2016/17. However, the *2017 Budget Review* revised this downwards to R222 billion (5.0% of GDP).

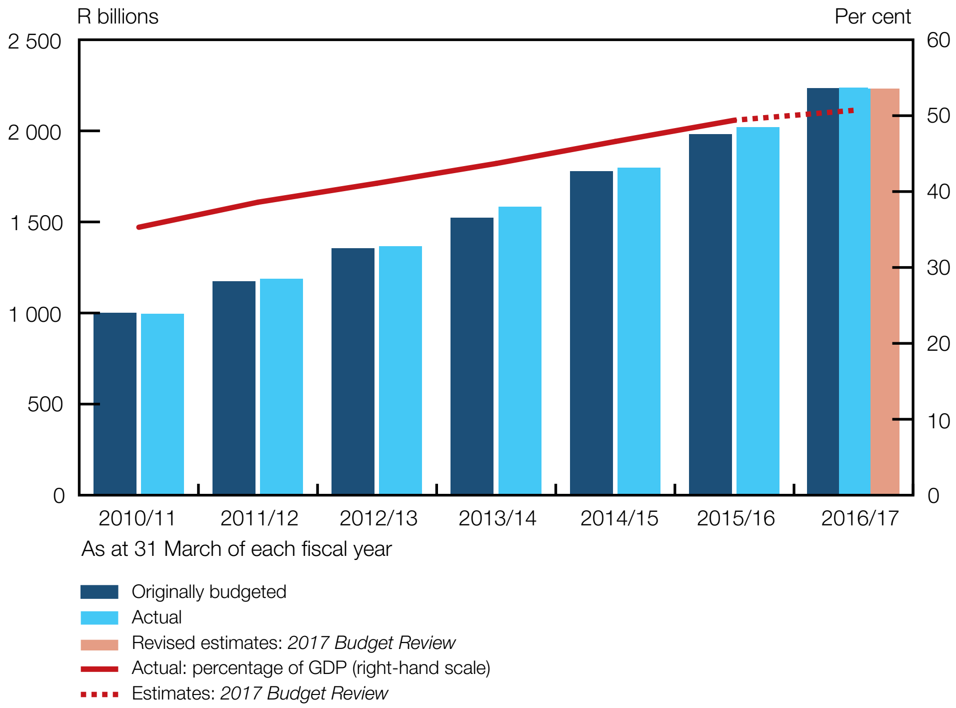
Foreign currency-denominated debt of national government




Source: National Treasury

Before accounting for exchange rate revaluation effects, the foreign currency-denominated debt of national government amounted to R163 billion compared with R213 billion after accounting for exchange rate revaluation as at 31 March 2017 of R49.3 billion. US dollar-denominated debt accounted for 91.2% of total foreign debt as at 31 March 2017, rising from 81.6% as at 31 March 2016. The average outstanding maturity of foreign marketable bonds increased from 102 months as at 31 March 2016 to 123 months a year later.

Total gross loan debt of national government




Source: National Treasury

National government's total gross loan debt (domestic and foreign debt) amounted to R2 233 billion as at the end of fiscal 2016/17, compared with R2 019 billion as at the end of fiscal 2015/16. This was broadly in line with the original 2016 Budget projections of R2 234 billion for the end of fiscal 2016/17. The increase in the stock of total gross loan debt could largely be attributed to a significant increase of 11.0% in the stock of domestic debt compared with an increase of 6.6% in the stock of foreign debt. As such, domestic debt continued to comprise the largest share of gross loan debt, at 90.5%.