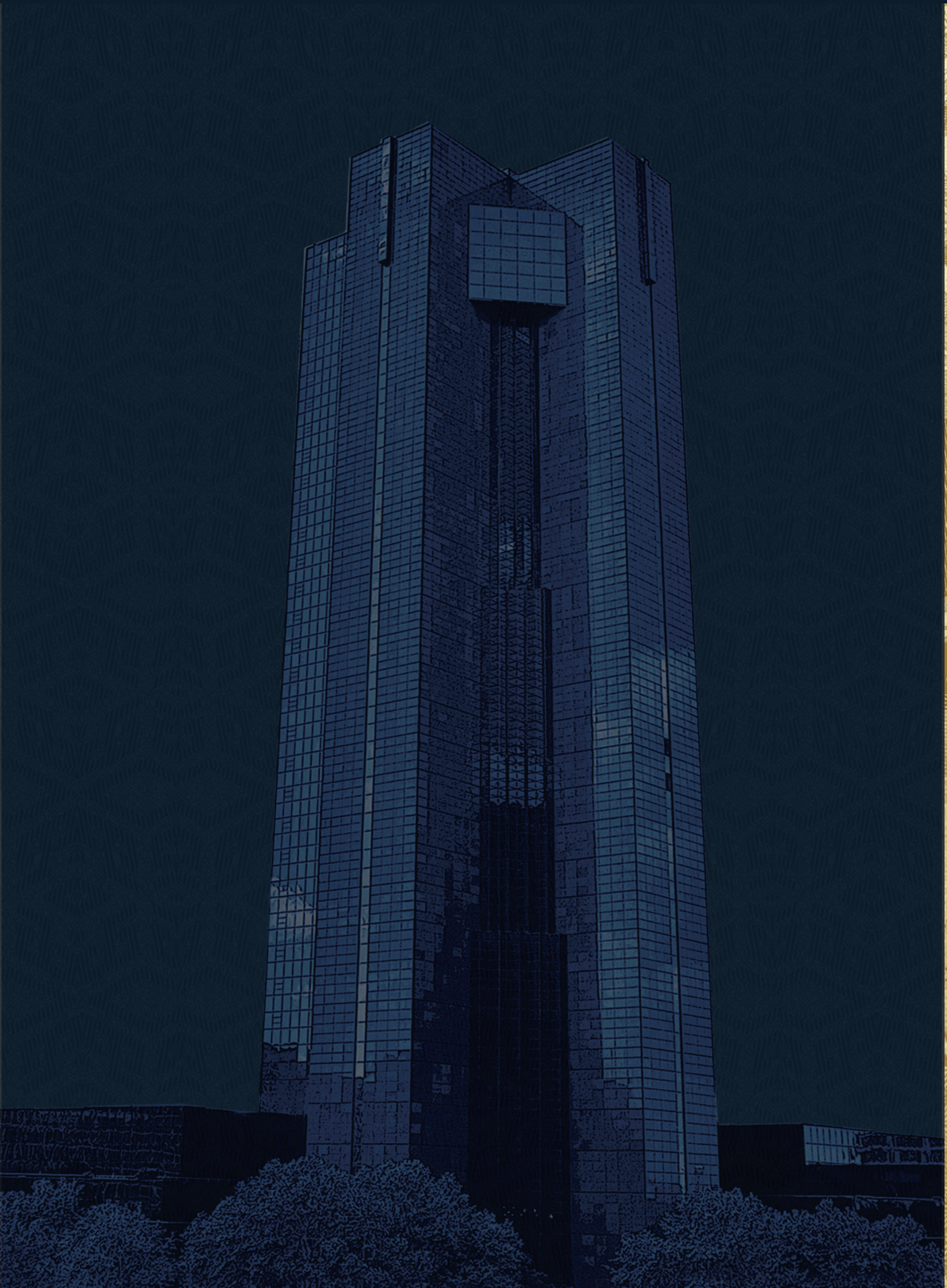
Quarterly Bulletin

December 2017



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South African Reserve Bank

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Introduction

Global economic growth remained fairly robust in the third quarter of 2017. Real output growth in the advanced economies accelerated marginally, while economic activity expanded at a slightly slower pace in the emerging market economies. Slower economic growth in emerging Europe marginally outweighed faster output growth in emerging Asia. World trade volumes gathered pace in the third quarter of 2017, led by higher export volumes in the emerging market economies.

The prices of most international commodities increased in the third quarter of 2017, in particular those of metals and minerals and, to a lesser extent, energy. Despite the higher commodity prices, global inflationary pressures remained quite subdued. The outcomes of consumer price inflation in the advanced economies were generally below both expectations and central bank targets, with the United Kingdom the notable exception.

In South Africa, growth in real gross domestic product (GDP) slowed to an annualised rate of 2.0% in the third quarter of 2017. This is the first time since 2014 that real GDP has expanded at a rate of 2.0% or more for two consecutive quarters. The moderation in the third quarter of 2017 was brought about by a deceleration in real output growth of the tertiary sector, while economic activity expanded at a slightly faster pace in both the primary and secondary sectors.

An acceleration in the real output growth of the agricultural sector, underpinned by the 2017 bumper maize crop, drove the acceleration in growth in the real gross value added (GVA) by the primary sector in the third quarter of 2017. Mining production increased for a third successive quarter, albeit at a slower pace than in the second quarter. Growth in the real output of the secondary sector accelerated marginally in the third quarter of 2017, reflecting the faster pace of expansion in the manufacturing sector. By contrast, the real GVA by the electricity, gas and water sector as well as the construction sector contracted.

The real output of the tertiary sector advanced at a notably slower pace in the third quarter of 2017, suppressed by contractions in the real GVA by the commerce and the general government services sectors. The contraction in the commerce sector resulted from a significant decrease in real wholesale trade sales. By contrast, real economic activity in both the transport and finance sectors advanced further in the third quarter of 2017.

Growth in real gross domestic expenditure (GDE) moderated to 0.7% in the third quarter of 2017. The deceleration resulted from a contraction in the real final consumption by general government, a rundown of real inventory holdings, and slower growth in real household consumption expenditure. Conversely, real gross fixed capital formation increased in the third quarter of 2017 following a contraction in the previous quarter. Viewed from the expenditure side, real final consumption expenditure by households and net exports both contributed significantly to real GDP growth in the third quarter of 2017, while the change in inventories subtracted the most.

Real final consumption expenditure by households increased further in the third quarter of 2017, albeit at a slightly slower pace than in the second quarter. Growth in households' real spending on semi-durable and non-durable goods moderated markedly, while spending on durable goods accelerated sharply on account of a significant increase in motor vehicle purchases. Following a slight contraction in the second quarter of 2017, households' real spending on services increased in the third quarter. The increase in real household consumption expenditure was supported by a further increase in households' real disposable income in the third quarter of 2017, albeit at a slightly slower pace than in the previous quarter.

Real gross fixed capital formation rebounded in the third quarter of 2017 following a contraction in the second quarter. Fixed investment spending by the private sector in particular reverted from a fairly sharp contraction in the second quarter of 2017 to a steady increase in the third quarter, supported by notable increases in real outlays on machinery and transport equipment. In addition, growth in real capital outlays by public corporations accelerated while that by general government slowed notably in the third quarter of 2017.

Employment growth in the domestic economy remained insufficient to fully absorb new entrants into the labour market, resulting in the official unemployment rate remaining unchanged at 27.6% for a third successive quarter in the third quarter of 2017. Public sector employment contracted for a third successive quarter in the second quarter of 2017, reflecting the impact of government's attempts to contain the public sector wage bill on employee headcount through a freeze on new appointments as well as natural attrition.

Year-on-year growth in labour productivity in the formal non-agricultural sector of the economy slowed further in the second quarter of 2017, while growth in nominal unit labour cost accelerated to 6.0% – the upper limit of the inflation target range. Despite the acceleration in unit labour cost, domestic inflationary pressures remained fairly subdued in the first 10 months of 2017. With the exception of meat prices, food price inflation slowed across a broad range of food product categories. Consumer price inflation nevertheless accelerated marginally in recent months, largely due to higher fuel and housing rental prices. However, core inflation receded further to its lowest rate in five years in October 2017, reflecting subdued domestic demand and the still disinflationary effect of the appreciation in the exchange value of the rand throughout most of 2016.

South Africa's trade surplus with the rest of the world improved for a fourth successive quarter in the third quarter of 2017, as the value of merchandise imports decreased more than the value of net gold and merchandise exports. Both export and import volumes also decreased over the period. Contrary to the larger trade surplus, the shortfall on the services, income and current transfer account widened further in the third quarter of 2017, resulting in the deficit on the current account of the balance of payments improving marginally to 2.3% of GDP. The terms of trade remained broadly unchanged in the third quarter of 2017, as the increase in export prices was almost fully offset by the increase in import prices.

The net inflow of capital on South Africa's financial account of the balance of payments increased from the second to the third quarter of 2017, with the shortfall on the current account mainly financed through net portfolio investment inflows. This largely reflected the acquisition of domestic debt securities and, to a lesser extent, domestic equity securities by foreign investors as the global search for higher investment returns continued. South Africa's positive net international investment position (IIP) improved significantly up to the end of June 2017, as the market value of the country's foreign assets increased substantially while the value of foreign liabilities remained broadly unchanged.

Twelve-month growth in the broadly defined money supply accelerated somewhat in the third quarter of 2017, reflecting a notable recovery in the deposit holdings of financial companies, a sustained increase in household deposits, and a marginal improvement in those of non-financial companies. Bank credit extended to the domestic private sector remained subdued in the third quarter of 2017. Growth in loans and advances to the household sector accelerated marginally but remained weak, while corporate credit growth continued to slow.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) lowered the repurchase rate by 25 basis points to 6.75% with effect from 21 July 2017, but kept the rate unchanged at its September and November 2017 meetings due to increased upside risk to the inflation outlook. Other money market rates initially followed the reduction in the repurchase rate, but fluctuated higher after the September 2017 MPC meeting.

On a trade-weighted basis, the external value of the rand depreciated at a much faster pace in the third quarter of 2017 than in the second quarter, weighed down by, among other things, a prominent international credit rating agency's warning that political pressure around the central bank posed a key credit risk, and rising expectations of a tightening in United States (US) monetary policy in December 2017. The exchange value of the rand weakened further in October and during most of November as sentiment continued to be depressed by domestic political uncertainty following another surprise cabinet reshuffle, the presentation of the October 2017 *Medium Term Budget Policy Statement* (*2017 MTBPS*) which showed much wider projected government deficits and higher debt levels, and increased expectations of a credit rating downgrade. However, the exchange value of the rand appreciated after only S&P Global Ratings downgraded South Africa's local-currency debt on 24 November 2017, while Moody's Investors Service put the country's credit rating on review instead of an immediate downgrade, resulting in South African government bonds remaining part of some key international bond indices. These developments also affected South African government bond yields, which remained closely aligned to movements in the exchange value of the rand.

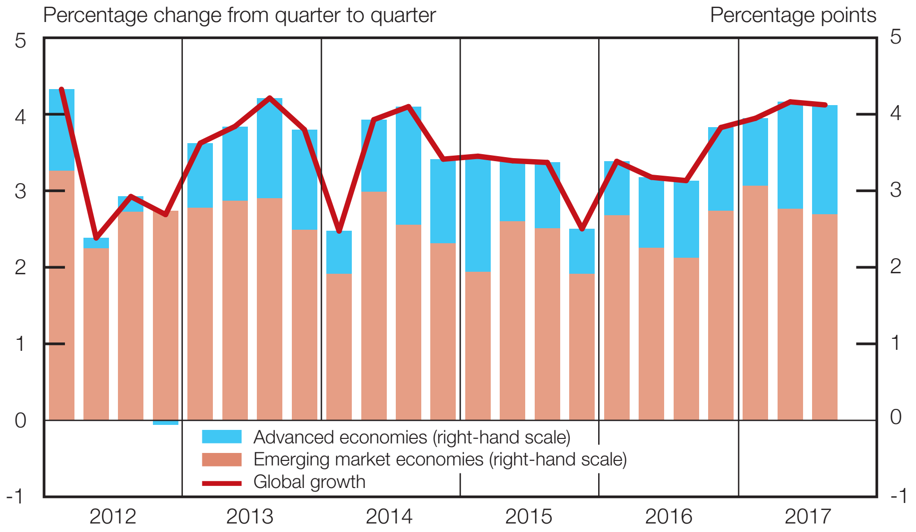
The share prices of companies listed on the JSE Limited (JSE) increased notably from a recent low in June 2017 to an all-time high in November, led by industrial and resource companies. Share prices were supported by the depreciation in the exchange value of the rand, higher international commodity prices, and higher share prices of companies listed on international bourses following an improved global economic outlook.

Although growth in both national government revenue and expenditure fell short of the original 2017 Budget projections, expenditure increased at a much faster pace than revenue in the first half of fiscal 2017/18. Year-on-year growth in most of the main tax categories was well below budgeted estimates. The revenue under-collection, together with weaker economic growth projections and a decline in tax buoyancy, prompted a significant review of the fiscal framework as put forth in the *2017 MTBPS*. The consolidated government budget deficit is now expected to be much wider in the current fiscal year as well as over the medium term than projected in the February 2017 Budget. As a result of the higher projected deficits, projections for government debt have also been adjusted upwards, with the total gross loan debt of national government now expected to reach almost 60% of GDP.

International economic developments

Global economic growth decelerated marginally from an annualised rate of 4.2% in the second quarter of 2017 to a still robust 4.1% in the third quarter. The mild slowdown in world output growth resulted from slightly weaker economic performances in emerging market economies, which decelerated from 5.3% to 5.1% over the period. By contrast, real output growth in advanced economies accelerated marginally from 2.9% in the second quarter of 2017 to 3.0% in the third quarter.

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



Seasonally adjusted annualised rates

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

The United States (US) economy expanded by 3.3% in the third quarter of 2017 – the fastest pace since the third quarter of 2014. Growth in personal consumption expenditure, although weaker than in the second quarter of 2017, remained the core driver of overall growth. Private inventory investment, non-residential fixed investment and net exports also supported real gross domestic product (GDP) growth in the third quarter.

Real economic growth in the euro area moderated to 2.4% in the third quarter of 2017 from 2.8% in the second quarter. Private consumption expenditure was underpinned by rising employment and increasing household wealth. Fixed investment growth remained strong in an environment of favourable financing conditions and improved corporate profitability. Moreover, exports benefitted from the global recovery. Output growth in the United Kingdom (UK) maintained its recent upward trend, accelerating from 1.2% in the second quarter of 2017 to 1.6% in the third quarter. Uncertainty about the impact of Brexit remains a key factor in the outlook for the UK economy. Meanwhile, Japanese real GDP growth slowed in the third quarter of 2017 due to contractions in private consumption expenditure as well as residential and public investment. Output growth nonetheless remained above its potential.

Real economic growth in emerging Asia accelerated from 6.0% in the second quarter of 2017 to 6.8% in the third quarter. This was mainly due to a rebound in India, where growth picked up significantly from 4.2% in the second quarter to 8.7% in the third quarter. China's real GDP growth slowed moderately to 6.5% in the third quarter of 2017, despite significant decelerations in output growth in the construction and real estate sectors.

Real output growth in emerging Europe fell sharply to 1.7% in the third quarter of 2017 from 6.0% in the previous quarter, mainly due to a contraction in Russia and notably weaker growth in Turkey. Real GDP in Russia contracted by 2.0% in the third quarter as fixed investment decreased, although consumption spending continued to gain momentum.

Real output growth in selected advanced economies

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

	2015		2016					2017		
Country/region	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
United States................	0.5	2.9	0.6	2.2	2.8	1.8	1.5	1.2	3.1	3.3
Japan...........................	-0.9	1.4	2.2	1.6	0.9	1.4	0.9	1.5	2.9	2.5
Euro area.......................	1.9	2.1	2.0	1.4	1.7	2.6	1.8	2.5	2.8	2.4
United Kingdom	2.9	2.3	0.6	2.1	1.5	2.3	1.8	1.0	1.2	1.6
Canada	0.4	1.0	2.5	-1.0	4.3	2.2	1.4	3.7	4.3	1.7
Australia	2.0	2.5	4.3	3.4	-1.3	3.5	2.6	1.7	3.8	2.4
New Zealand	4.4	3.2	2.8	3.2	2.8	1.5	3.5	2.5	3.3	3.4
Advanced economies...	**1.2**	**2.3**	**1.5**	**1.9**	**2.1**	**2.3**	**1.7**	**1.9**	2.9	3.0

* Percentage change over one year

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

Sources: Bloomberg, JPMorgan, national statistical offices and SARB

Output growth in Latin America decelerated somewhat from 1.8% in the second quarter of 2017 to 1.2% in the third quarter. Mexico's real GDP contracted for the first time since the fourth quarter of 2015. However, the contraction is likely to be short-lived as it was mainly due to the natural disasters that impacted the country during the quarter. Although output growth in Brazil moderated sharply to 0.6% in the third quarter of 2017, the economy still expanded for a third consecutive quarter after two years of recession.

Real output growth in selected emerging market economies

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

	2015		2016					2017		
Country/region	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
China..........................	6.4	6.9	6.6	7.1	6.8	6.6	6.7	7.3	6.7	6.5
India	4.4	8.0	12.0	6.2	6.3	4.8	7.1	7.2	4.2	8.7
Indonesia....................	6.0	4.9	3.8	5.7	4.7	5.4	5.0	4.3	5.6	4.9
Emerging Asia	**5.8**	**9.0**	**7.5**	**6.6**	**6.3**	**5.9**	**6.5**	**6.9**	**6.0**	**6.8**
Russia	-1.3	-2.8	1.6	-2.7	0.5	1.9	-0.2	2.5	4.9	-2.0
Turkey	4.2	6.1	2.5	5.0	-10.2	21.0	2.9	6.7	9.1	4.8
Poland........................	3.6	3.8	0.0	4.5	1.2	7.4	2.9	4.5	3.6	4.9
Emerging Europe........	**1.4**	**0.8**	**1.7**	**1.1**	**-2.1**	**8.0**	**1.6**	**4.3**	**6.0**	**1.7**
Brazil	-3.7	-3.5	-2.8	-2.3	-2.0	-2.7	-3.5	5.3	2.7	0.6
Mexico	-0.2	2.6	4.0	0.0	5.0	4.2	2.3	2.2	1.1	-1.2
Argentina....................	-3.1	3.5	-3.6	-7.8	0.2	4.0	-1.4	4.8	2.8	6.0
Latin America	**-1.6**	**0.2**	**-0.9**	**-2.1**	**0.7**	**0.8**	**-0.9**	**2.9**	**1.8**	1.2
Emerging economies..	**3.7**	**5.5**	**5.2**	4.4	4.1	5.3	4.3	5.8	5.3	5.1

* Percentage change over one year

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

Sources: Bloomberg, Barclays, Haver Analytics, JPMorgan, national statistical offices and SARB

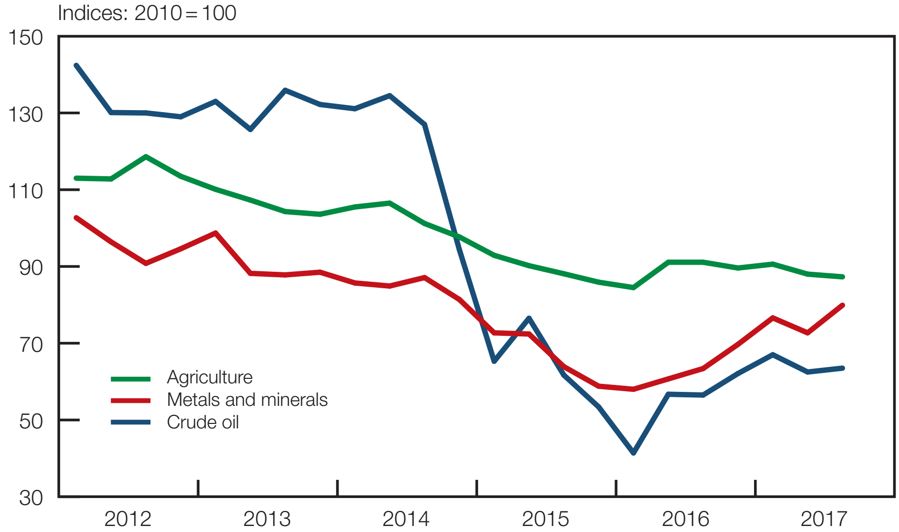
Consumer price inflation outcomes in advanced economies have generally fallen short of expectations in recent quarters. In the US, various measures of core inflation slowed to below year-ago levels, despite the strong economic momentum. Inflation outcomes in the euro area were also below market expectations and the central bank's inflation target.

The exception to this pattern was the UK, where headline and core inflation picked up to 3.0% and 2.7% respectively. These inflationary pressures prompted the Bank of England to raise the policy rate by 25 basis points in November 2017 – the first increase in 11 years. Meanwhile, inflation in emerging market economies remained subdued, with the exception of Turkey, where inflation accelerated to 13.0% in November.

The prices of international commodities generally increased in the third quarter of 2017. The exception was agricultural commodity prices, which decreased by 0.8% in the third quarter, reflecting lower prices for maize, rice and sugar. By contrast, metals and minerals prices increased by 9.9% during this period, mainly due to strong demand and various supply bottlenecks, including initiatives by the Chinese government to eliminate surplus capacity in that economy. Similarly, energy prices (which include oil, natural gas and coal) increased by 2.0% in the third quarter of 2017.

Brent crude oil prices have more than doubled since January 2016, reaching levels of around US$62 per barrel in early December 2017. The sharp increase in oil prices reflected a combination of factors, including stronger global demand and supply disruptions (on account of the referendum in Iraqi Kurdistan as well as hurricanes in the US). The Organization of the Petroleum Exporting Countries (OPEC) and other non-OPEC producers have also reduced output since January 2017, removing about 1.8 million barrels per day from the global market, which has drawn down inventories. OPEC and the other non-OPEC producers, led by Russia, recently agreed to maintain the oil production cuts until the end of 2018.

International commodity prices



Sources: World Bank and SARB

According to the CPB Netherlands Bureau for Economic Policy Analysis, growth in global trade (using world exports as a proxy) picked up in the third quarter of 2017 after moderating somewhat in the second quarter. World trade volumes increased at an annualised rate of 4.3% in the third quarter of 2017. Export volumes in advanced economies rose by 3.5%, while those in emerging market economies increased by 5.6%.

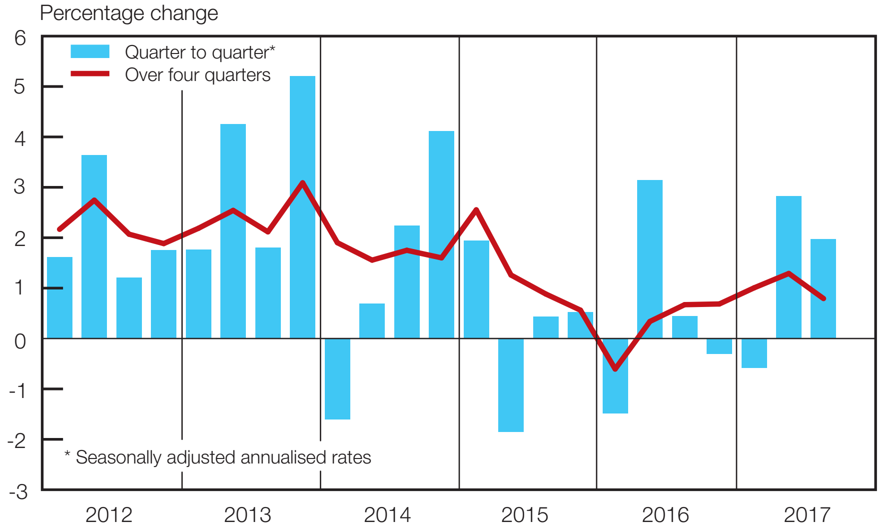
Domestic economic developments

Domestic output[1]

Growth in real *gross domestic product* (GDP) moderated to an annualised rate of 2.0% in the third quarter of 2017 following a revised rebound to 2.8% in the second quarter. The moderation in the third quarter of 2017 was brought about by a deceleration in real output growth of the tertiary sector, while economic activity expanded at a slightly faster pace in both the primary and secondary sectors. This is the first time since 2014 that real GDP has expanded at a rate of 2.0% or more for two consecutive quarters.

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

Real gross domestic product



Source: Stats SA

The level of real output in the first three quarters of 2017 was 1.0% higher than in the corresponding period of 2016. The Minister of Finance, in his October 2017 *Medium Term Budget Policy Statement (2017 MTBPS)*, lowered South Africa's economic growth projection for 2017 to 0.7%, similar to that of the International Monetary Fund (IMF) in its October 2017 *World Economic Outlook (WEO).* The SARB's forecast for real GDP growth in 2017 was revised marginally upwards in November, also to 0.7%.

When excluding the contribution of the generally more volatile primary sector, growth in the real GDP of the non-primary sector slowed from 1.2% in the second quarter of 2017 to 0.7% in the third quarter.

Real gross domestic product

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

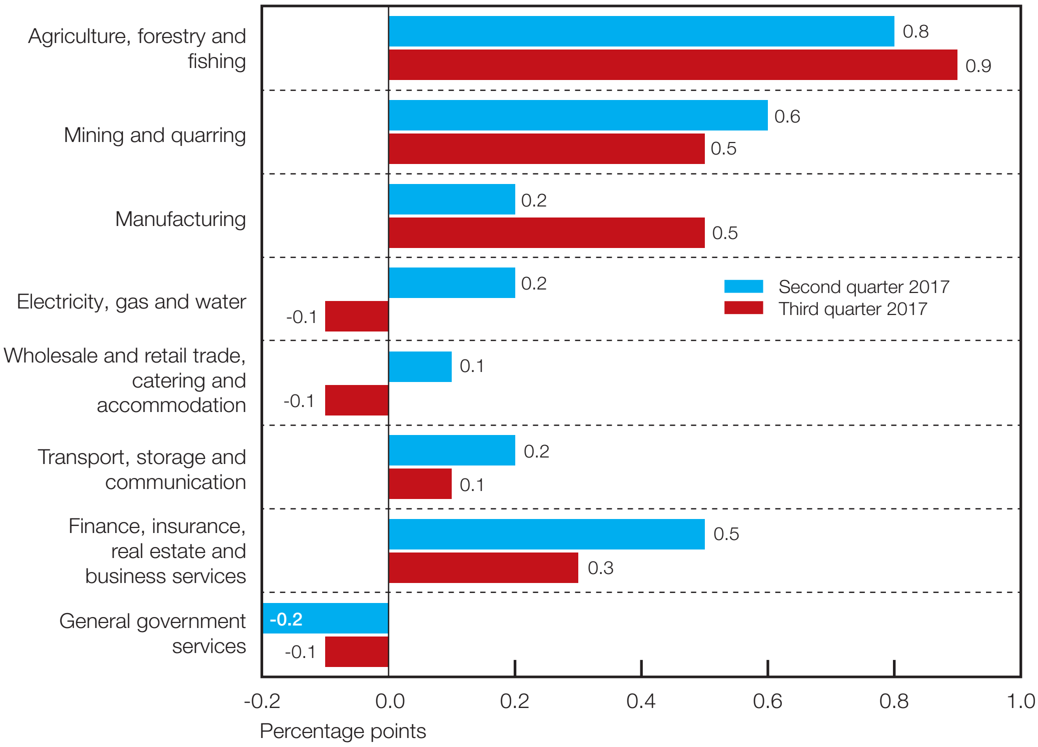
Sector	2016					2017		
	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
Primary sector	-19.0	9.1	3.2	-9.0	-5.4	15.3	14.8	14.9
Agriculture	-8.7	-7.8	-0.2	-0.1	-7.8	23.1	38.7	44.2
Mining	-21.8	14.6	4.2	-11.5	-4.7	13.1	8.2	6.6
Secondary sector	-0.1	4.8	-2.5	-1.8	0.2	-3.3	1.9	2.1
Manufacturing	0.6	7.6	-3.3	-3.1	0.7	-3.7	1.5	4.3
Tertiary sector	1.4	1.9	0.8	1.6	1.4	-2.1	1.1	0.3
Non-primary sector	*1.0*	*2.5*	*0.1*	*0.8*	*1.1*	*-2.3*	*1.2*	*0.7*
Total	**-1.5**	**3.1**	**0.4**	**-0.3**	**0.3**	**-0.6**	**2.8**	**2.0**

* Percentage change over one year

Source: Stats SA

The real output of the *primary sector* increased further by 14.9% in the third quarter of 2017 following an increase of 14.8% in the second quarter. The slight acceleration in the third quarter resulted from increased activity in the agricultural sector, while real output growth in the mining sector moderated somewhat.

Selected contributions to growth in real gross domestic product



Source: Stats SA

The *agricultural sector* was the largest contributor (0.9 percentage points) to growth in real GDP in the third quarter of 2017. Growth in the real value added by the agricultural sector accelerated further, from an already brisk rate of 38.7% in the second quarter of 2017 to an even higher 44.2% in the third quarter. Increased production of field crops was supported by the 2017 bumper maize crop, while increased production of horticultural products was reflected in higher volumes of vegetable exports. However, although bearing a small weight, wheat crop production continued to be adversely affected by drought conditions in the Western Cape.

Commercial wheat crop estimates

	Crop (million tons)	Area planted (million hectares)
2016/17: final estimate	1.9	508
2017/18: third production forecast	1.6	492
Percentage change	-17.2	-3.3

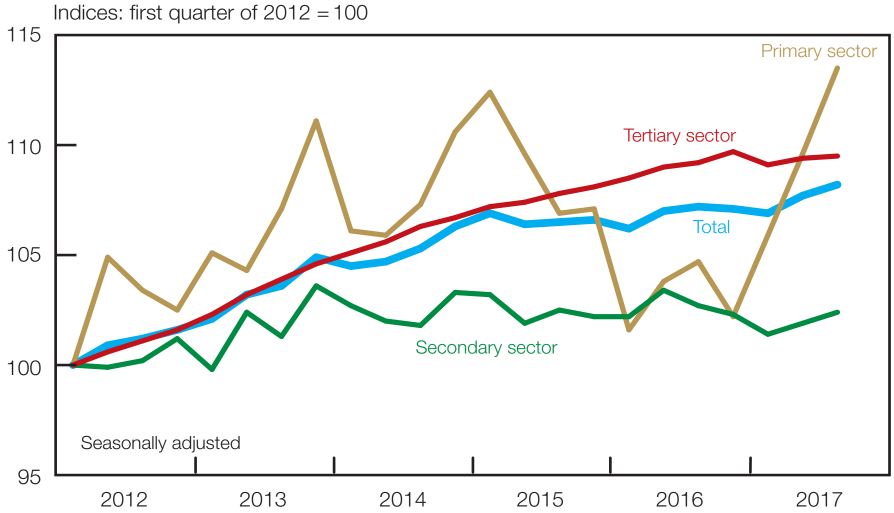
Source: Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries

The real value added by the *mining sector* advanced for a third consecutive quarter, underpinned by improved global economic activity, higher international commodity prices, the depreciation in the exchange value of the rand, and an increased demand for processed minerals from South Africa. Following a revised increase of 8.2% in the second quarter of 2017, growth in mining production decelerated to a still high 6.6% in the third quarter, adding 0.5 percentage points to overall GDP growth. Firm increases in the production of platinum group metals, chrome, copper, diamonds and other metallic minerals, together with the marginally higher output of nickel and gold, outweighed declines in other mining production.

The level of mining production was 4.3% higher in the first three quarters of 2017 than in the corresponding period of 2016. Although mining output has trended higher in 2017 thus far, the sector continues to face a difficult operating environment, compounded by ongoing regulatory uncertainty and restructuring initiatives in an attempt to cut loss-making operations.

Real output growth in the *secondary sector* accelerated marginally to 2.1% in the third quarter of 2017 following an increase of 1.9% in the second quarter, as activity in the manufacturing subsector expanded at a faster pace. By contrast, the real output of the construction and the electricity, gas and water subsectors contracted.

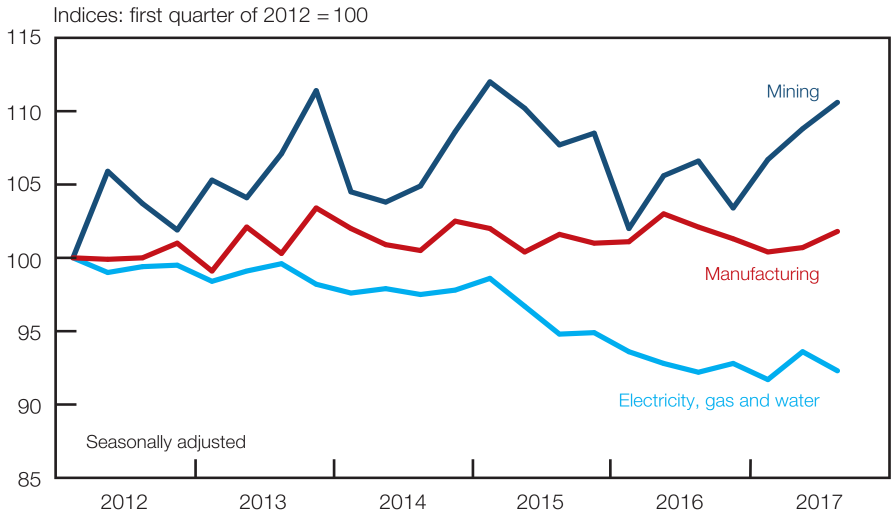
Real gross domestic product of main sectors



Source: Stats SA

Following an increase of 1.5% in the second quarter of 2017, real output growth in the *manufacturing sector* accelerated to 4.3% in the third quarter, contributing 0.5 percentage points to overall GDP growth. Increased production mainly occurred in the subsectors supplying petroleum and chemical products; basic iron and steel, non-ferrous metal products and machinery; and motor vehicle parts and accessories. Owing to lower demand, production shrank somewhat in the subsectors producing food and beverages; radio, television and communication apparatus; and wood and wood products. Consistent with the acceleration in output growth, the utilisation of production capacity in the manufacturing sector increased from 81.3% in the second quarter of 2017 to 81.5% in the third quarter.

Real gross value added by selected subsectors



Source: Stats SA

The real value added by the sector supplying *electricity, gas and water* resumed its downward trend when its output contracted by 5.5% in the third quarter of 2017 following a brisk, albeit brief, increase of 8.8% in the second quarter. The decline in activity could partly be linked to a high base in the preceding quarter and a decrease in the volume of water available for distribution, but stands in contrast to the increased production in the mining and manufacturing sectors – the two large energy-intensive sectors – in the third quarter. It may be that these industries sought alternative sources of energy during the periods of high electricity tariff increases and load shedding.

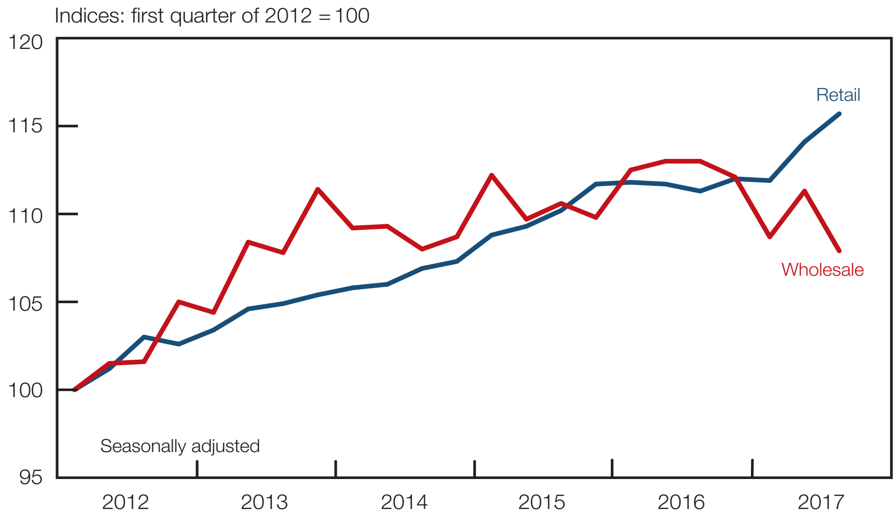
The real output of the *construction sector* declined marginally further by 1.1% in the third quarter of 2017 after having contracted by 0.3% in the preceding quarter. Activity in the non-residential and residential building subsectors as well as in construction works remained subdued in the third quarter of 2017 due to insufficient demand for the construction of new buildings. Civil construction activity contracted over the period, consistent with the notable decrease in confidence among civil contractors who were adversely impacted by broader policy uncertainty, especially relating to the mining charter and key renewable energy programmes.

Growth in the real output of the *tertiary sector* slowed from 1.1% in the second quarter of 2017 to 0.3% in the third quarter. Lower activity in the trade and general government services subsectors more than offset increases in the real output of the transport, storage and communication as well as the finance, insurance, real estate and business services subsectors.

Growth in the real value added by the *trade sector* reverted from an increase of 0.6% in the second quarter of 2017 to a contraction of 0.4% in the third quarter. Real activity in the wholesale trade subsector decreased markedly in the third quarter, weighed down by lower sales of food, beverages and tobacco as well as precious stones, jewellery and silverware. Sales of used vehicles as well as vehicle parts and accessories declined in the third quarter of 2017, adversely impacted by, among other factors, the subdued economic environment, compounded by political uncertainty. The real value added by the catering and accommodation sector also receded over the period.

Retail trade activity remained firm in the third quarter of 2017, driven mainly by lower consumer price inflation, the earlier appreciation in the exchange value of the rand, and the marginal interest rate reduction in July. The sales of general dealers as well as retailers of food, beverages and tobacco and retailers of household furniture, appliances and equipment increased over the period. Real retail trade sales were also supported by retailers narrowing their profit margins in a difficult trading environment.

Real wholesale and retail trade sales



Source: Stats SA

Growth in the real output of the *transport, storage and communication sector* slowed from a rate of 2.2% in the second quarter of 2017 to 0.6% in the third quarter. Activity in the transport sector, in particular land freight transport, increased at a slower pace, consistent with the declines in export and import volumes over the period. Passenger air transport benefitted from continued competition among airlines, while the volume of South African coal destined for export markets and delivered by rail to ports increased slightly. Growth in the communication subsector gathered further pace over the period.

Growth in the real value added by the *finance, insurance, real estate and business services sector* decelerated from 2.5% in the second quarter of 2017 to 1.2% in the third quarter, contributing 0.3 percentage points to overall GDP growth. The moderation resulted from slower output growth by the banking sector and a decrease in trading activity in the equity market over the period.

The real value added by the *general government services sector* contracted by a further 0.7% in the third quarter of 2017, reflecting a modest reduction in the number of employees in the sector, in part due to the ongoing moratorium on new appointments in the government sector.

Real gross domestic expenditure

Growth in real *gross domestic expenditure* (GDE) moderated to 0.7% in the third quarter of 2017 following an increase of 2.6% in the second quarter. Real final consumption expenditure by general government contracted alongside a rundown of real inventory holdings in the third quarter of 2017. By contrast, real final consumption expenditure by households and gross fixed capital formation increased over the period. The level of real GDE was 1.4% higher in the first three quarters of 2017 than in the corresponding period of 2016.

Real gross domestic expenditure

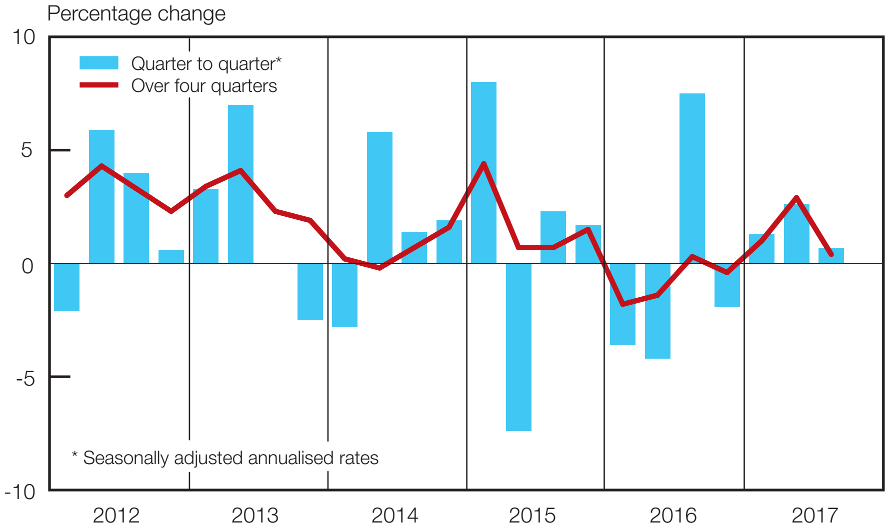
Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Component	2016					2017		
	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
Final consumption expenditure								
Households	-1.5	1.2	2.2	2.2	0.8	-2.7	4.7	2.6
General government	1.5	2.8	1.9	0.3	2.0	-1.7	1.4	-0.5
Gross fixed capital formation	-10.4	-2.8	-3.5	1.7	-3.9	1.3	-2.0	4.3
Domestic final demand	**-2.8**	**0.7**	**1.0**	**1.7**	**0.1**	**-1.7**	**2.7**	**2.3**
Change in inventories (R billions)**	-2.2	-37.0	10.8	-16.4	-11.2	6.8	5.8	-5.5
Gross domestic expenditure* **	**-3.6**	**-4.2**	**7.5**	**-1.9**	**-0.8**	**1.3**	**2.6**	**0.7**

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

Sources: Stats SA and SARB

Real gross domestic expenditure



Sources: Stats SA and SARB

Contributions of expenditure components to growth in real gross domestic product

Percentage points

Component	2016					2017		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Final consumption expenditure								
Households	-0.9	0.7	1.3	1.3	0.5	-1.7	2.8	1.6
General government	0.3	0.6	0.4	0.1	0.4	-0.4	0.3	-0.1
Gross fixed capital formation	-2.2	-0.6	-0.7	0.3	-0.8	0.3	-0.4	0.8
Change in inventories	-1.1	-4.6	6.2	-3.5	-0.8	3.0	-0.1	-1.5
Net exports	2.3	7.5	-6.8	1.7	1.1	-1.9	0.2	1.3
Residual	0.2	-0.5	0.0	-0.2	-0.2	0.1	0.1	-0.2
Gross domestic product	-1.5	3.1	0.4	-0.3	0.3	-0.6	2.8	2.0

Sources: Stats SA and SARB

Real final consumption expenditure by households and net exports contributed 1.6 and 1.3 percentage points respectively to growth in real GDP in the third quarter of 2017, while the change in inventories subtracted 1.5 percentage points.

Growth in real *final consumption expenditure by households* decelerated to 2.6% in the third quarter of 2017 following a revised rebound to 4.7% in the second quarter. Real outlays on all three major goods components advanced further, while real spending on services also increased after contracting in the second quarter of 2017. Real household spending in the first three quarters of 2017 was 1.4% higher than in the corresponding period of 2016, supported by robust growth in the second quarter of 2017. The improvement in household spending occurred despite an environment of persistent weak consumer confidence, uncertainty about employment prospects and tight credit conditions.

Real outlays by households on *durable goods* increased at a brisk 19.9% in the third quarter of 2017 following an increase of 6.4% in the preceding quarter. Spending on personal transport equipment – the largest component in the durable goods basket – surged by 17.8% in the third quarter of 2017 after having contracted for the better part of three years. Expenditure on all other components of durable goods also advanced at a buoyant pace. The rebound in spending on new passenger vehicles could likely be attributed to the replacement of ageing vehicles, low vehicle price inflation, and attractive sales incentives in a relatively low interest rate environment.

Real final consumption expenditure by households

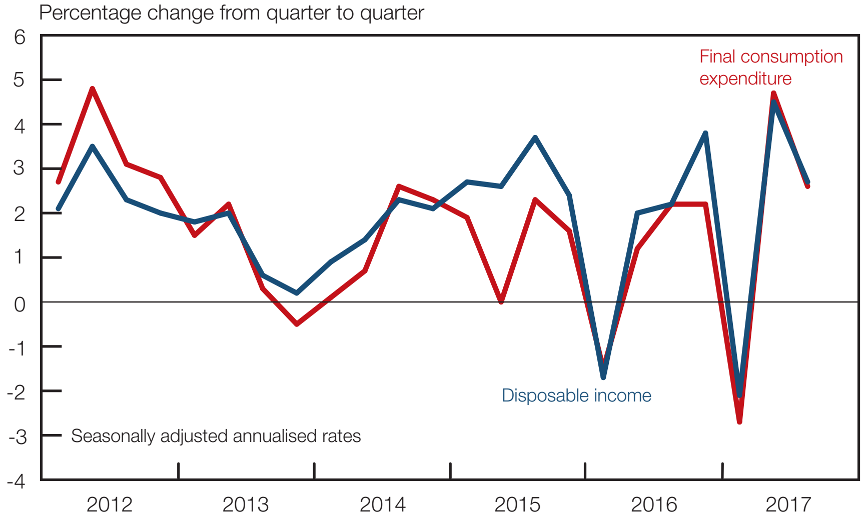
Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Category	2016					2017		
	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
Durable goods	-15.3	-5.4	-3.2	0.2	-7.3	-8.6	6.4	19.9
Semi-durable goods	2.4	1.6	-0.9	6.8	3.3	-13.0	22.1	4.4
Non-durable goods	-1.1	0.4	1.1	0.3	0.9	-3.7	6.2	0.3
Services	0.6	3.1	5.0	3.2	2.1	1.8	-0.2	1.0
Total	-1.5	1.2	2.2	2.2	0.8	-2.7	4.7	2.6

* Percentage change over one year

Source: Stats SA

Real final consumption expenditure by, and disposable income of, households



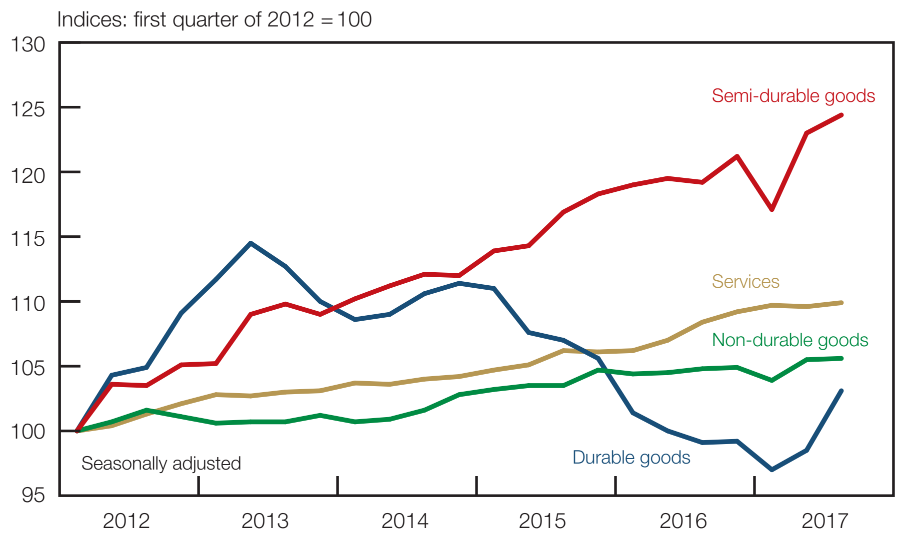
Sources: Stats SA and SARB

Growth in real spending by households on *semi-durable goods* moderated to 4.4% in the third quarter of 2017 following a robust increase of 22.1% in the preceding quarter. Real outlays on motorcar tyres, parts and accessories declined further in the third quarter of 2017, while purchases of most other components of semi-durable goods increased at a slower pace.

Real expenditure by households on *non-durable goods* increased at a slower pace of 0.3% in the third quarter of 2017. Growth in spending on food and beverages – the largest non-durable goods component – as well as petroleum products, and recreational and entertainment goods slowed in the third quarter of 2017, while real outlays on household fuel, power and water as well as consumer goods contracted. By contrast, households' purchases of medical and pharmaceutical products reverted from a decline in the second quarter to an increase in the third quarter of 2017.

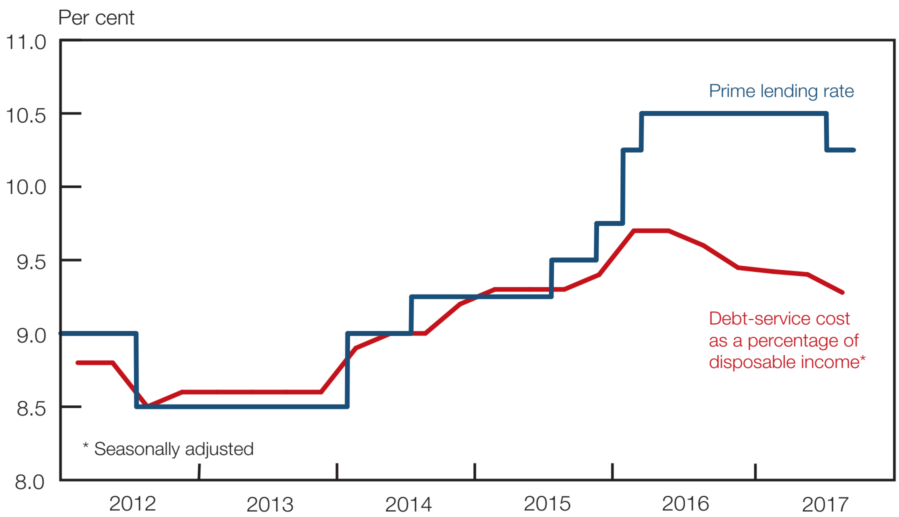
The decline in households' real expenditure on *services* in the second quarter of 2017 was short-lived, as real services outlays increased anew by 1.0% in the third quarter. Following two consecutive quarters of contraction, spending on transport and communication services rebounded in the third quarter alongside increased real outlays on most other services components.

Components of real final consumption expenditure by households



Growth in the real *disposable income of households* moderated from 4.5% in the second quarter of 2017 to 2.7% in the third quarter. Growth in most categories of household debt remained subdued, except for instalment sale credit, in line with increased household spending on motor vehicles. With nominal disposable income increasing slightly faster than debt, household debt as a percentage of disposable income receded further to 72.5% in the third quarter of 2017 – its lowest level since the first quarter of 2006. Following the reduction in the prime lending rate in July 2017, households' cost of servicing debt as a percentage of disposable income also decreased from 9.4% in the second quarter of 2017 to 9.3% in the third quarter.

Household debt-service cost and the prime lending rate



Source: SARB

Real *final consumption expenditure by general government* reverted from an increase of 1.4% in the second quarter of 2017 to a contraction of 0.5% in the third quarter. Spending on the compensation of employees contracted for a third consecutive quarter alongside slower growth in real outlays on non-wage goods and services. Expenditure by general government on compensation of employees was 0.4% lower in the first three quarters of 2017 than in the corresponding period of 2016, consistent with government's intention to curb expenditure in order to prevent government debt from rising to fast.

Growth in real *gross fixed capital formation* rebounded to 4.3% in the third quarter of 2017 following a contraction of 2.0% in the second quarter. Private business enterprises, public corporations and general government all recorded growth in real capital spending in excess of 4.0%. As a percentage of GDP, gross fixed capital formation increased to 18.7% in the third quarter of 2017, still well below a recent high of 21.0% in the fourth quarter of 2013.

Real gross fixed capital formation

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

Sector	2016					2017		
	Q1	Q2	Q3	Q4	Year*	Q1	Q2	Q3
Private business enterprises	-13.8	-3.7	-5.0	-1.6	-6.8	2.9	-8.4	4.1
Public corporations	2.5	6.0	-7.4	-3.4	0.7	-1.0	0.7	4.8
General government	-12.4	-9.0	6.6	19.8	1.1	-1.1	17.3	4.4
Total	-10.4	-2.8	-3.5	1.7	-3.9	1.3	-2.0	4.3

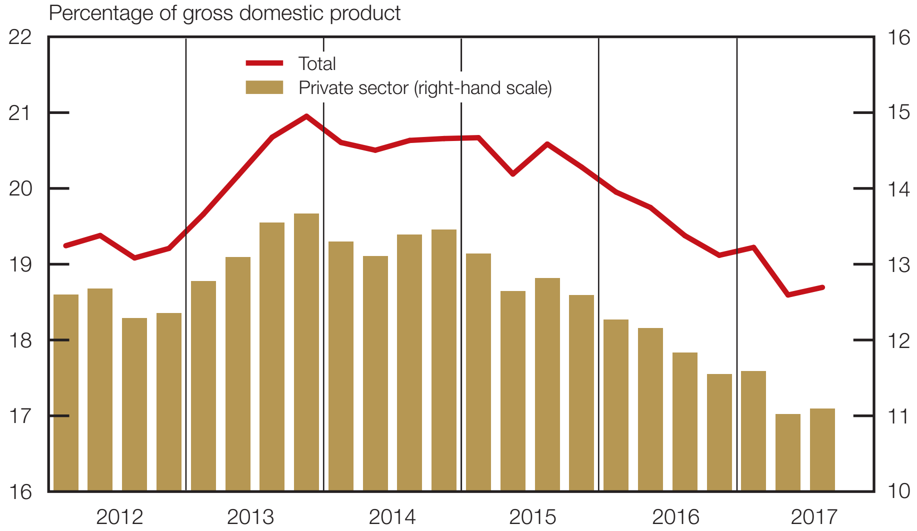
* Percentage change over one year

Source: Stats SA

Real gross fixed capital formation by *private business enterprises* increased by 4.1% in the third quarter of 2017, clawing back part of the 8.4% contraction in the preceding quarter. Capital outlays on machinery and equipment as well as transport equipment increased strongly in the third quarter of 2017, while capital expenditure on non-residential construction remained weak. As a percentage of GDP, capital investment by private business enterprises picked up to 11.1% in the third quarter of 2017 – still lower than a recent high of 13.7% in the fourth quarter of 2013. Gross fixed investment by private business enterprises was 2.1% lower in the first three quarters of 2017 than in the corresponding period of the preceding year, despite the better performance in the third quarter of 2017. Weak business confidence, subdued domestic demand, and the preference of firms to maintain and replace fixed capital goods rather than to expand capacity contributed to lacklustre fixed investment in the private sector.

Real gross fixed capital formation

Percentage of gross domestic product



Seasonally adjusted annualised rates

Source: Stats SA

Growth in real fixed capital spending by *public corporations* accelerated from a revised increase of 0.7% in the second quarter of 2017 to 4.8% in the third quarter. A considerable increase in capital outlays on transport equipment as well as machinery and equipment outweighed the lack of investment in other types of assets over the period.

Growth in real investment spending by *general government* slowed to a rate of 4.4% in the third quarter of 2017, though still supported by ongoing road rehabilitation projects by provinces and local governments.

Real *inventory holdings* decreased by R5.5 billion (at annualised 2010 prices) in the third quarter of 2017 following two quarters of inventory build-up. The rundown in stock levels largely reflected a decrease in agricultural stocks-in-trade, impacted by an increase in the exports of agricultural products. In the manufacturing sector, the slower pace of increase occurred in the petroleum subsector as less crude oil was imported due to scheduled maintenance of some refineries over the period. As a result, industrial and commercial inventories as a percentage of non-agricultural GDP declined marginally from 12.3% in the second quarter of 2017 to 12.1% in the third quarter.

Gross saving

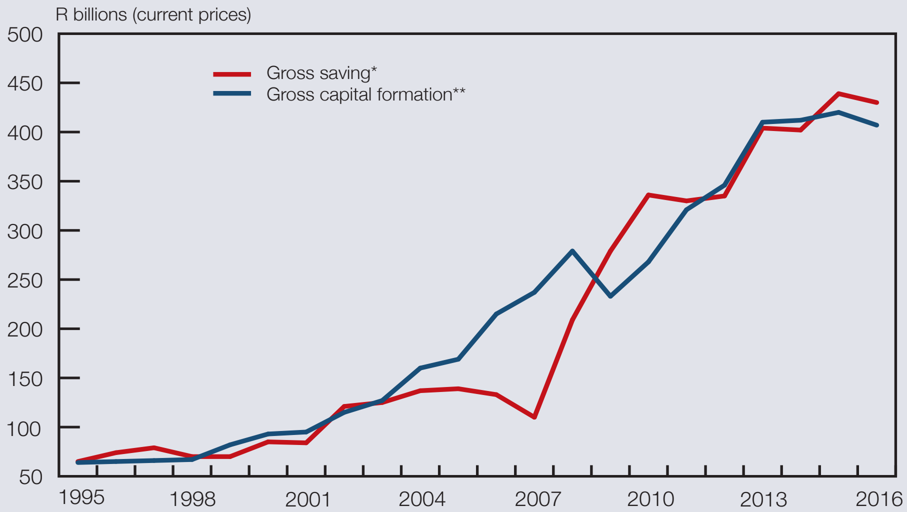
Gross saving as a percentage of GDP (i.e. the *national saving rate*)) rose slightly to 16.3% in the third quarter of 2017 from 16.2% in the preceding quarter. Lower gross saving by the general government sector was more than offset by advances in corporate saving, while saving by households remained stable. The share of total gross capital formation to be financed by foreign capital inflows – the foreign financing ratio – decreased from 12.9% in the second quarter of 2017 to 12.5% in the third quarter.

Gross saving by the *corporate sector* as a percentage of GDP increased from 13.8% in the second quarter of 2017 to 14.8% in the third quarter as a result of higher operating surpluses along with a reduction in corporate tax payments.

Box 1 Are corporates saving too much and investing too little?

The corporate sector, or more specifically *private non-financial corporate business enterprises* excluding both financial institutions and state-owned enterprises, has been in the spotlight of late. The increase in corporate saving globally should not be viewed separately from how these savings were used. This analysis uses national accounting conventions to guide the interpretation of saving in the economy, particularly in relation to investment, with a focus on the corporate sector in South Africa.

Saving and investment of private non-financial corporate business enterprises



* Gross saving equals net saving plus consumption of fixed capital
** Gross capital formation equals gross fixed capital formation and change in inventories

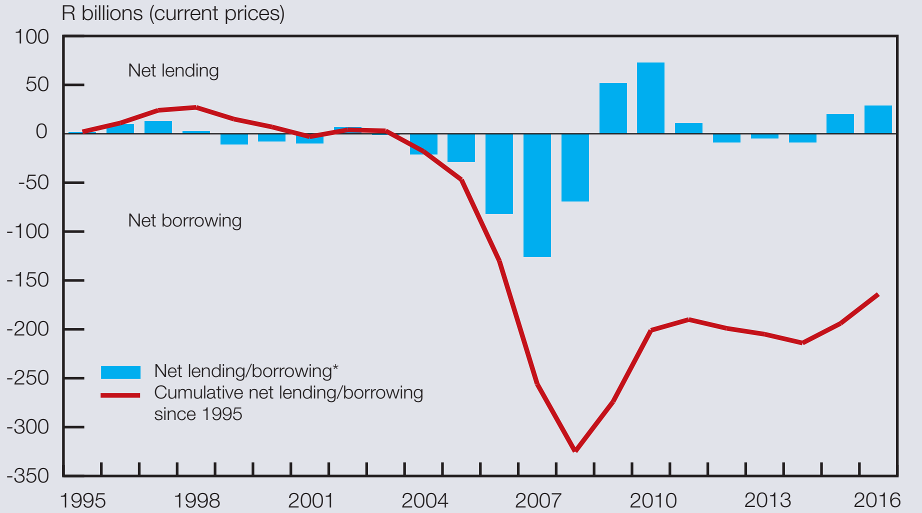
Sources: Stats SA and SARB

Notwithstanding the increase in corporate saving in the country, corporate investment mostly kept up with saving and at times even exceeded saving, as shown in the figure above. An important qualification is that an increase in investment at broadly the same pace as saving does not necessarily mean that the economy is performing adequately. This suggests that investment would have been growing at a faster pace if economic growth was more robust, in which case firms could also have saved more.

Not surprisingly, despite maintaining an average corporate savings ratio of 9.8% to gross domestic product (GDP) since 1995, compared to 16.4% for the domestic economy as a whole, the corporate sector has, on balance, been a net borrower from other sectors in the domestic economy and the rest of the world as its investments exceeded its savings in some years. One way of interpreting this is that although the bulk of South Africa's savings come from the corporate sector, their investments required funding in excess of their savings.

As shown in the accompanying figure, for several years the private non-financial corporate sector was a net borrower despite maintaining its savings as a ratio of GDP. More recently, the corporate sector has been a small net lender but, by and large, has drawn more resources from other parts of the domestic economy, in particular from domestic financial intermediaries and from foreign savings. The cumulative effect of the corporate sector's net lending and borrowing portrays an even starker picture. This implies that the corporate sector has supplemented its savings with credit to fund investment. Consequently, financial liabilities increased on the corporate sector's balance sheet.

Net lending/borrowing by private non-financial corporate business enterprises



* Net lending/borrowing is the difference between goss saving, capital transfers and gross capital formation

Source: SARB

Ironically, this analysis shows that if the corporate sector saved less in the current economic environment, it would have required more foreign funding which would have increased South Africa's external debt. The interplay between the incurrence of foreign financial liabilities and assets by the corporate sector would have put more pressure on the funding of the current account deficit.

The saving rate of *general government* weakened from 0.9% in the second quarter of 2017 to -0.1% in the third quarter as the net effect of less tax revenue received from corporations and increased transfers to households resulted in a lower gross saving level.

Gross saving by *households* was maintained at 1.6% of GDP in both the second and third quarters of 2017 as nominal disposable income and nominal final consumption expenditure increased at the same pace.

Employment[2]

Employment growth remained insufficient to fully absorb new entrants into the South African labour market, partly due to the underperformance of domestic output growth in contrast to the synchronised global economic recovery. The total number of persons employed in South Africa increased by 92 000 from the second to the third quarter of 2017, raising the total level of

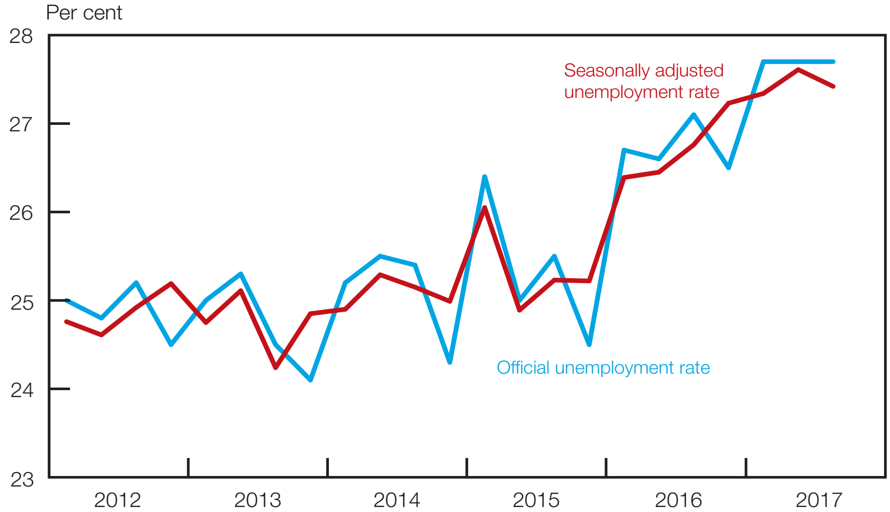
2 Unless stated to the contrary, the *QES* data reported in this section are seasonally adjusted.

employment to approximately 16.2 million as measured by Statistics South Africa's (Stats SA) *Quarterly Labour Force Survey*. Likewise, total employment increased by 358 000 in the year to the third quarter of 2017. However, year-on-year growth in total employment slowed from 3.6% in the second quarter of 2017 to 2.3% in the third quarter.

Household-surveyed formal non-agricultural employment increased by 187 000 (or 3.2%) in the year to the third quarter of 2017, while informal sector employment advanced by a mere 48 000 over the same period, representing a significant slowdown to a year-on-year growth rate of 1.8%. The most notable annual employment gains were observed in the finance (140 000), community (117 000) and trade (88 000) sectors. Encouragingly, permanent or medium-term contracts (296 000) accounted for the bulk of these job gains, followed by unspecified-duration contracts (213 000). The number of employees with limited duration contracts decreased by 72 000.

The number of unemployed persons increased by 33 000 from the second to the third quarter of 2017, raising the total number of unemployed South Africans to 6.21 million. Unemployment increased by a notable 337 000, or 5.7%, when measured over four quarters. Disconcertingly, the number of discouraged job seekers increased by 145 000 (6.3%) in the year to the third quarter of 2017. The official unemployment rate remained unchanged at 27.7% for a third successive quarter in the third quarter of 2017, but was higher than the 27.1% recorded a year earlier. The seasonally adjusted unemployment rate decreased marginally from 27.6% in the second quarter of 2017 to 27.4% in the third quarter, following six consecutive quarterly increases. The youth unemployment rate fell from 55.9% in the second quarter of 2017 to 52.2% in the third quarter, down from 54.2% a year earlier.

Unemployment rate

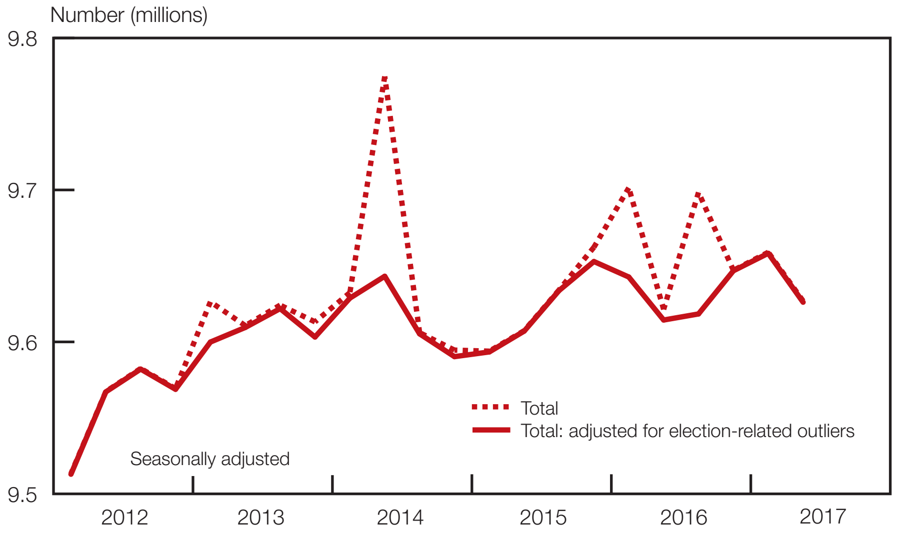


Sources: Stats SA and SARB

According to the *Quarterly Employment Statistics (QES)* survey by Stats SA, enterprise-surveyed formal non-agricultural employment decreased by 0.3% (not seasonally adjusted) from the first to the second quarter of 2017 as both public and private sector employment declined. Roughly 32 000 jobs were lost over the period, lowering the level of total formal non-agricultural employment to an estimated 9.6 million in the second quarter of 2017 – virtually unchanged from a year earlier.

Public sector employment decreased for a third successive quarter in the second quarter of 2017. Provinces accounted for the largest number of job losses, followed by national departments and the public transport, storage and communication services sector. When measured over four quarters, employment at provincial level and in the public transport, storage and communication services sector has declined continuously since 2015. By contrast, local governments and other public sector enterprises increased their staff complement in the second quarter of 2017. Year-on-year growth in public sector employment slowed significantly in recent years, reflecting the impact of government's commitment to fiscal consolidation on employee headcount.

Formal non-agricultural employment

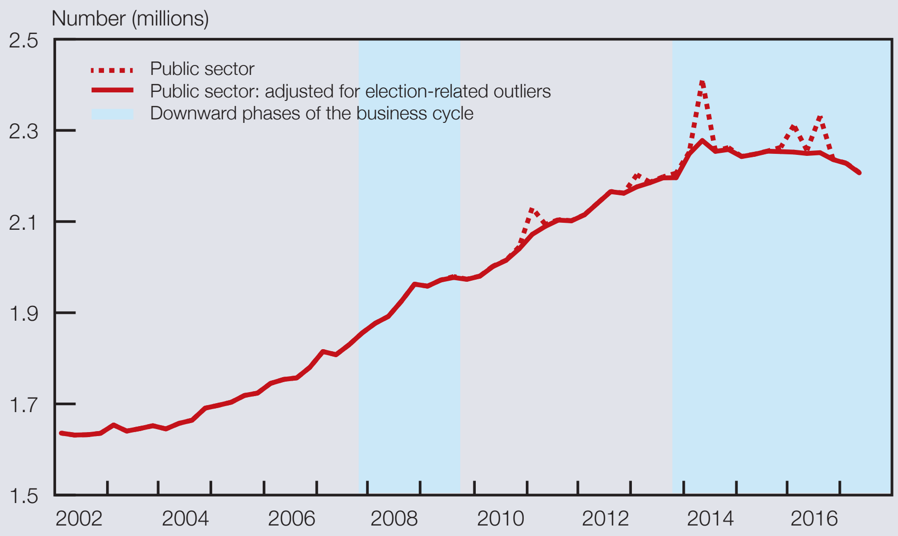


Sources: Stats SA and SARB

Box 2 Recent trends in public sector employment

The public sector is a significant contributor to employment in the South African economy, comprising 23% of total formal non-agricultural employment in the second quarter of 2017. The public sector's contribution to job creation is evidenced by the notable increase in employees, from around 1.6 million in 2002 to a record high of almost 2.3 million in the second quarter of 2014. However, fiscal consolidation has contributed to a contraction in public sector employment in recent years.

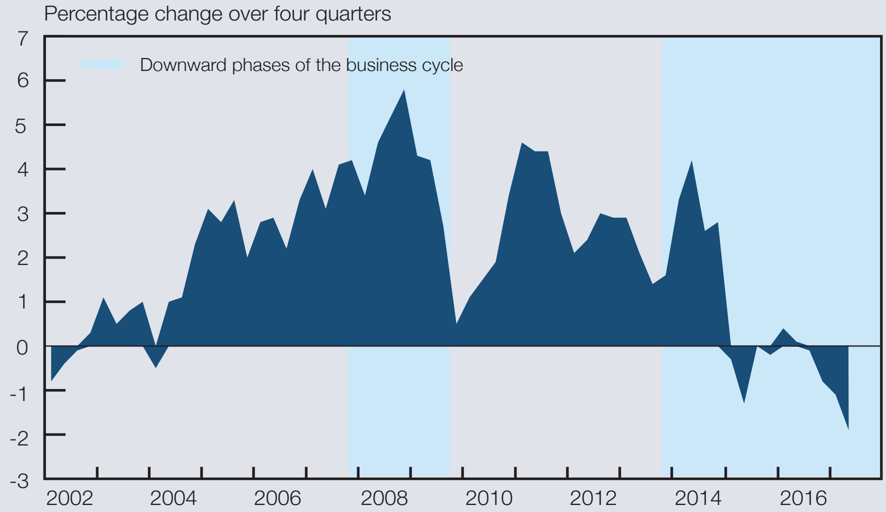
Public sector employment



Sources: Stats SA and SARB

Following the 2008–09 global financial crisis, South Africa, similar to many other countries, followed countercyclical fiscal policies to stimulate economic activity and minimise the impact of the recession. Although public sector employment growth slowed briefly in 2009, a cumulative 261 700 new public sector employment opportunities were created between the second quarter of 2010 and the first quarter of 2014. Against this backdrop, public sector debt rose substantially and the national government budget deficit widened, exacerbated by the rapidly rising wage bill and slower-than-expected real economic growth.

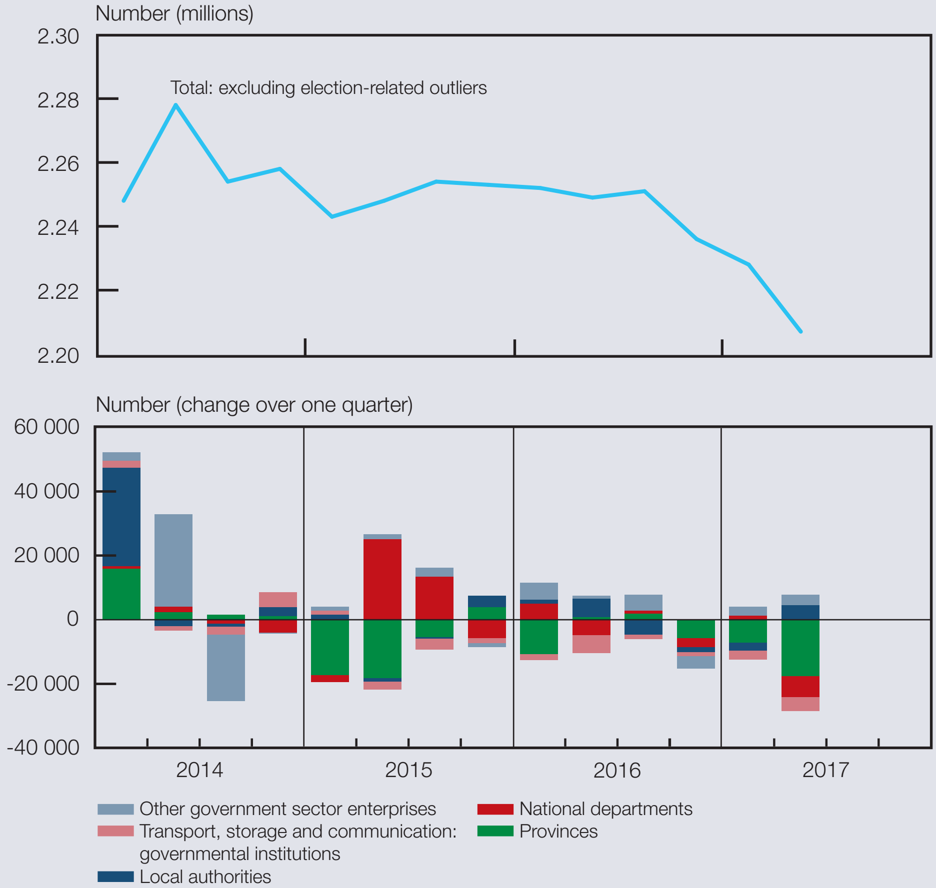
Growth in public sector employment



Sources: Stats SA and SARB

To reduce the fiscal deficit and stabilise debt levels, measures such as a freeze on headcount and the permanent withdrawal of funded vacancies were introduced in 2014 to contain the public sector's wage bill, along with natural attrition. These measures gradually reduced the number of employees; this resulted in public sector employment contracting in a procyclical fashion during the current downward phase of the business cycle. When adjusting for election-related outliers, the public sector reduced its staff complement by a cumulative 44 400 between the second quarter of 2014 and the second quarter of 2017.

Public sector employment

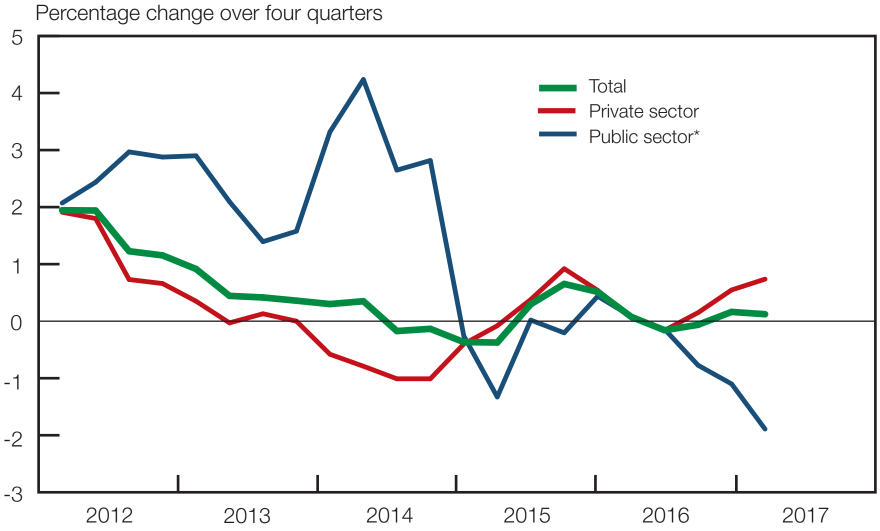


Seasonally adjusted

Sources: Stats SA and SARB

Provinces account for the largest share of public sector employment, currently 47%, followed by national departments (22%); local authorities (14%); other public sector enterprises (11.8%); and the public transport, storage and communication services sector (4.9%). The recent decline in public sector employment was most pronounced at the provincial level and in the public transport, storage and communication services sector. Around 70 600 provincial government jobs were shed between the second quarter of 2014 and the second quarter of 2017, while 22 900 jobs were lost in the public transport, storage and communication services sector. National departments also shed jobs over this period, but the decrease was masked somewhat by the transfer of employees at technical and vocational education and training colleges (formerly known as further education and training colleges) and community and education training colleges (CETCs) from provincial governments to the National Department of Higher Education and Training between the second and third quarter of 2015. This resulted in a concomitant decrease in employment levels at provincial level in the second quarter of 2015, exacerbating the overall decrease in provincial government employment somewhat since the second quarter of 2014. By contrast, employment increased at local government level, largely due to an increase in the employment of workers by various municipalities for projects under government's Expanded Public Works Programme.

Formal non-agricultural employment



* Adjusted for election-related outliers

Sources: Stats SA and SARB

Private sector employment decreased marginally in the second quarter of 2017 following three consecutive quarters of moderate job gains, mostly in the services sectors of the economy. Labour paring occurred in the construction; gold-mining; manufacturing; trade, catering and accommodation services; and in the private transport, storage and communication services sectors in the second quarter of 2017. By contrast, employment gains were recorded in the non-gold mining; finance, insurance, real estate and business services; and in the private community, social and personal services sectors.

Mining sector employment increased further in the second quarter of 2017, in line with an increase in this sector's real gross value added (GVA) in the first half of 2017. The non-gold mining sector created a cumulative 13 400 new job opportunities in the first half of 2017, as coal and platinum mines continued to engage in labour-intensive projects. By contrast, the pace of job shedding accelerated in the gold-mining sector in the second quarter of 2017. Although higher international commodity prices have supported mining sector employment thus far in 2017, prospects for job growth remain subdued as several mining companies have announced retrenchment and restructuring plans since the start of the year. In addition, operating conditions remain challenging amid continued policy uncertainty.

Employment in the manufacturing sector decreased in the second quarter of 2017 following two consecutive quarters of job growth, while the sector's real output increased. The increase in the manufacturing sector's real output in the second quarter of 2017 was supported by improved global demand and the recovery in domestic mining and agricultural output despite continued subdued sentiment. Business confidence among manufacturers improved from 16 index points in the second quarter of 2017 to 27 index points in the third quarter, according to the *Absa Manufacturing Survey* by Stellenbosch University's Bureau for Economic Research (BER). Despite the increase, manufacturers remained generally pessimistic, with confidence in all but one manufacturing subsector remaining below the neutral level of 50 in the third quarter. Furthermore, respondents indicated that domestic demand remained subdued while export indicators, on balance, displayed a slightly more positive picture. The weak domestic demand environment resulted in production volume and employment indicators remaining depressed.

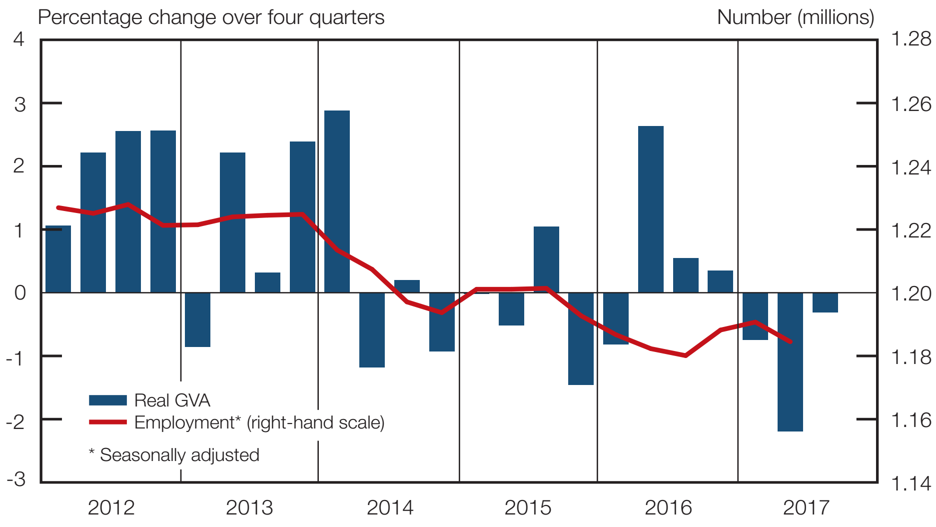
Change in enterprise-surveyed formal non-agricultural employment by sector*

Sector	Change over one quarter: Q2 2017		Change over four quarters to Q2 2017		Cumulative job losses(-)/ gains(+)**	
	Number	Per cent annualised	Number	Per cent	Q2 2010 to Q1 2014	Q2 2014 to Q2 2017
Total mining	3 600	3.2	9 100	2.0	600	-23 900
Gold mining	-1 300	-4.5	-3 500	-3.0	-41 100	-4 800
Other mining	5 000	5.8	12 600	3.7	41 700	-19 200
Manufacturing	-6 100	-2.0	2 300	0.2	-44 400	-22 800
Construction	-11 400	-7.3	-8 800	-1.4	17 700	-18 900
Trade, catering and accommodation services	-5 800	-1.1	40 500	2.0	84 000	91 800
Private transport, storage and communication services	- 700	-0.8	-1 200	-0.3	7 600	-14 500
Finance, insurance, real estate and business services	8 000	1.5	-3 500	-0.2	135 900	28 200
Community, social and personal services	900	0.7	15 900	3.0	30 200	16 600
Private sector	-11 500	-0.6	54 300	0.7	231 600	50 400
National departments	-6 500	-5.3	-7 000	-1.5	44 000	20 100
Provinces	-17 500	-6.4	-28 600	-2.7	109 600	-70 600
Local governments	4 400	5.8	-4 400	-1.4	71 600	6 100
Public transport, storage and communication services	-4 400	-15.0	-9 800	-8.4	26 700	-22 900
Other public sector enterprises, including electricity and IEC***	3 400	5.4	1 200	0.4	19 700	22 900
Public sector	-20 600	-3.6	-48 700	-2.2	271 600	-44 400
Grand total	-32 100	-1.3	5 600	0.1	503 200	26 600

* Seasonally adjusted. Components may not add up to totals due to rounding off.
** These reflect the two most recent phases in the formal non-agricultural employment cycle
*** Independent Electoral Commission

Sources: Stats SA and SARB

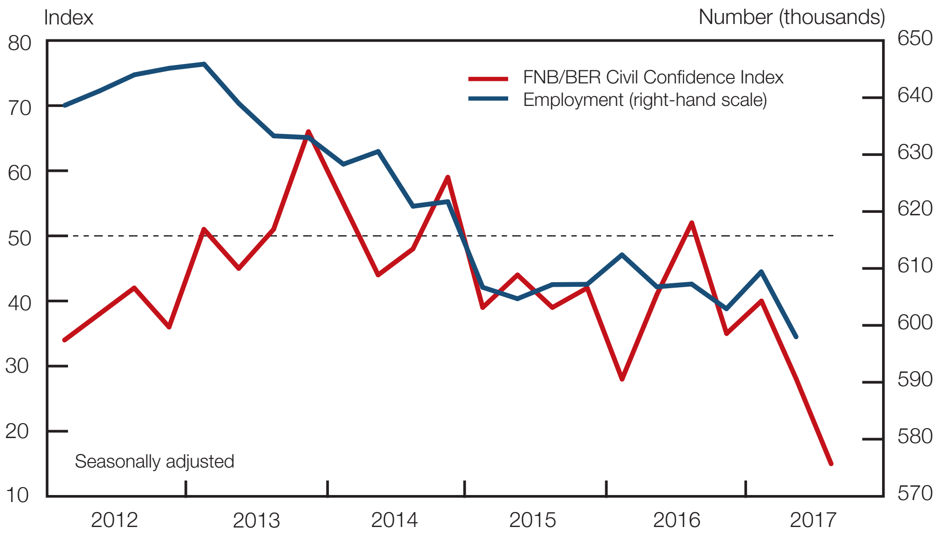
Manufacturing sector employment and output



Sources: Stats SA and SARB

Construction sector employment decreased notably in the second quarter of 2017. Since reaching a peak in the first quarter of 2013, a cumulative 47 900 formal construction jobs were lost up to the second quarter of 2017. This is consistent with the slowdown in real gross fixed capital formation growth over the period, particularly by the private sector. Discouragingly, sentiment in the construction sector deteriorated further, with the First National Bank/Bureau for Economic Research (FNB/BER) Civil Confidence Index falling to a 17-year low of 15 index points in the third quarter of 2017, from 28 index points in the second quarter, as respondents reported slower growth in construction activity. The FNB/BER Building Confidence Index regained three index points to a still low level of 35 in the third quarter of 2017. However, underlying activity indicators suggest that conditions in the building sector continued to deteriorate as growth in residential building activity appeared to be waning, while non-residential building activity remained subdued.

Construction sector employment and civil construction confidence



Sources: Stats SA, BER and SARB

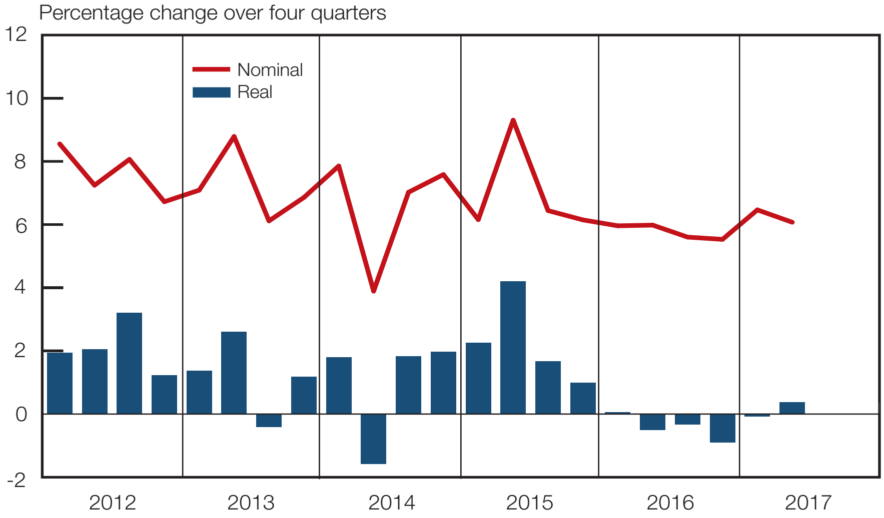
Employment increased somewhat in the *finance, insurance, real estate and business services sector* in the second quarter of 2017, but the number of people formally employed in the sector was marginally less than a year earlier. By contrast, employment in the *trade, catering and accommodation services sector* decreased in the second quarter of 2017, following three successive quarters of job gains. The BER's *Retail Survey* showed that business confidence among retailers and new vehicle dealers improved somewhat in the third quarter of 2017, while remaining virtually unchanged among wholesalers. However, confidence remained below the neutral level of 50 for all three trade subsectors. Respondents indicated that trading conditions had deteriorated in the retail and wholesale sectors as lower volume growth, combined with sustained input-cost pressure, resulted in a further deterioration in overall profitability. The BER noted that the underlying economic environment remained unsupportive of strong growth in consumer spending, suggesting moderate trade sector employment growth at best.

Labour cost and productivity

The year-on-year pace of increase in the nominal remuneration per worker in the formal non-agricultural sector of the economy decelerated only slightly from 6.5% in the first quarter of 2017 to 6.1% in the second quarter. This resulted primarily from slower remuneration growth in the public sector as private sector remuneration growth accelerated somewhat. However, following four successive quarters of year-on-year decreases, real wage growth per worker accelerated from -0.1% to 0.4% over the same period, as consumer price inflation slowed more than nominal wage growth.

Public sector remuneration growth per worker moderated from 11.0% in the first quarter of 2017 to 9.2% in the second quarter. However, when adjusted for election-related outliers, remuneration growth accelerated from 8.2% in the first quarter of 2017 to 8.9% in the second quarter, continuing the upward trend in public sector wage growth per worker since the third quarter of 2013. Nominal wage growth per worker decelerated at national departments and local government, while quickening at provinces and in the public transport, storage and communication services sector.

Formal non-agricultural remuneration per worker



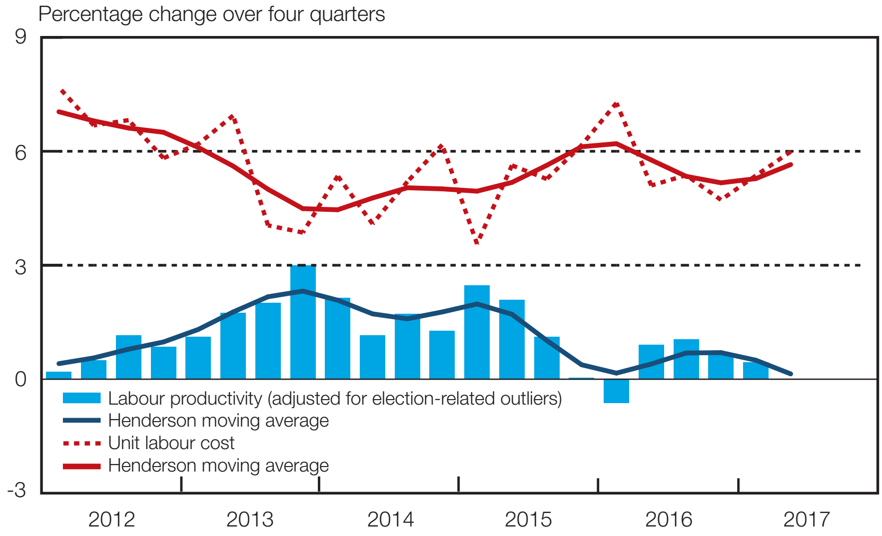
Sources: Stats SA and SARB

Remuneration growth per worker in the private sector accelerated marginally from 5.0% in the first quarter of 2017 to 5.1% in the second quarter. Year-on-year growth in remuneration per worker accelerated in the following sectors: construction (from 4.2% to 8.1%); trade, catering and accommodation services (from 4.5% to 5.4%); and finance, insurance, real estate and business services (from 4.7% to 5.3%). By contrast, remuneration growth moderated in the following sectors: mining (from 8.2% to 4.9%); private transport, storage and communication services (from 5.9% to 4.8%); manufacturing (from 5.8% to 4.7%); and private community, social and personal services (from 6.1% to 3.2%).

According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements amounted to 7.6% in the first nine months of 2017, marginally up from 7.5% in the first nine months of 2016. Encouragingly, the number of working days lost due to industrial action fell from 500 000 to 370 000 over the same period.

Labour productivity growth in the formal non-agricultural sector of the economy decelerated from a year-on-year rate of 1.0% in the first quarter of 2017 to 0.1% in the second quarter, as year-on-year employment growth accelerated while output growth decelerated. When adjusted for election-related outliers, labour productivity growth slowed from 0.4% in the first quarter of 2017 to no change in the second quarter. Conversely, with year-on-year growth in total remuneration accelerating while year-on-year output growth slowed, growth in *nominal unit labour cost* in the formal non-agricultural sector of the economy accelerated from 5.4% in the first quarter of 2017 to 6.0% in the second quarter.

Labour productivity and nominal unit labour cost



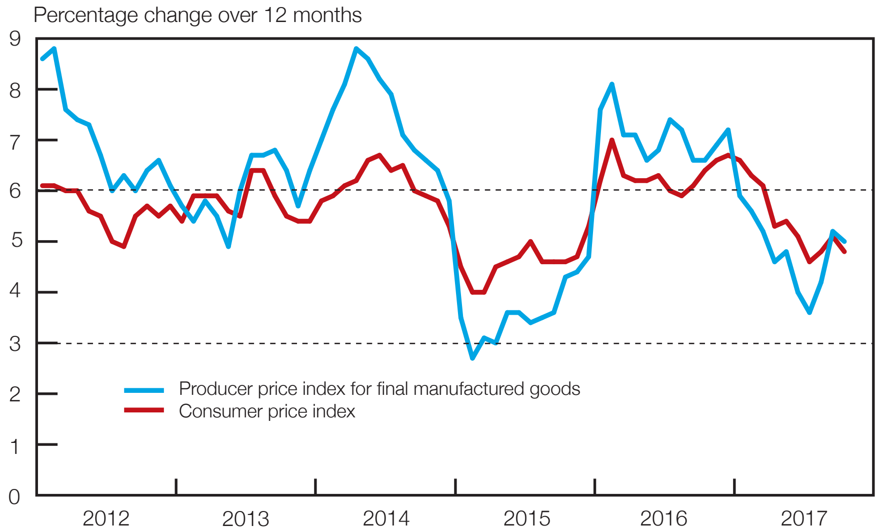
Sources: Stats SA and SARB

Prices[3]

Domestic inflationary pressures subsided in the first half of 2017. Headline consumer price inflation moderated from a recent peak of 6.8% in December 2016 to 4.6% in July 2017 – close to the midpoint of the inflation target range. Consumer price inflation subsequently accelerated to 5.1% in September 2017, largely due to higher fuel and housing rental prices, before it moderated again to 4.8% in October. As an indication of the short-term momentum in inflation, the annualised rate of increase in the three-month moving average seasonally adjusted headline consumer price index accelerated from 2.6% in July 2017 to 5.3% in October.

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

Headline consumer and producer price inflation



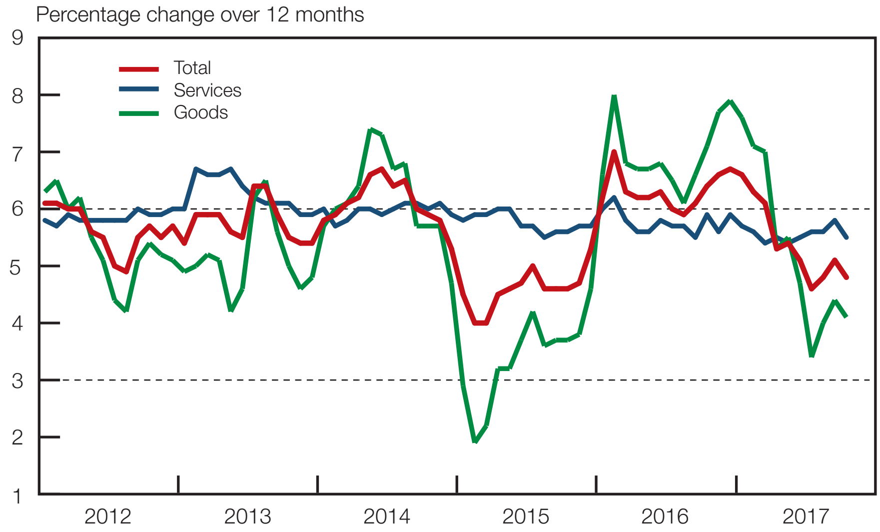
Source: Stats SA

Most measures of *producer price inflation* accelerated somewhat in recent months, mostly due to higher energy and metal prices. Producer price inflation for final manufactured goods accelerated from a recent low of 3.6% in July 2017 to 5.0% in October, driven primarily by higher prices of coal and petroleum products, metal products and motor vehicles. Similarly, producer price inflation for intermediate manufactured goods quickened somewhat from 1.5% to 4.1% over the same period, mainly on account of higher basic iron and steel as well as chemical prices.

The recent increase in most international commodity prices, and the depreciation in the exchange value of the rand this year, contributed to a significant acceleration in producer price inflation for mining products from -3.0% in May 2017 to 9.0% in October. Although fairly broad-based, the acceleration was most pronounced in coal and gas price inflation. Producer price inflation for electricity moderated significantly from 10.7% in March 2017 to 1.3% in August, but then accelerated to 2.3% in October. Producer price inflation for water also moderated somewhat from 12.1% in June 2017 to a still high of 10.5% in July, and subsequently remained at that level up to October.

Consumer goods price inflation accelerated from 3.4% in July 2017 to 4.4% in September on account of higher fuel and, to a lesser extent, alcoholic beverages and tobacco prices. Consequently, non-durable goods price inflation (comprising 72% of the consumer goods basket) accelerated from 4.0% to 5.8% over the same period. By contrast, durable and semi-durable goods price inflation decelerated further to 0.7% and 1.5% respectively in October 2017, reflecting the lagged effect of the earlier appreciation in the exchange value of the rand since early 2016 and current weak consumer demand.

Consumer price inflation



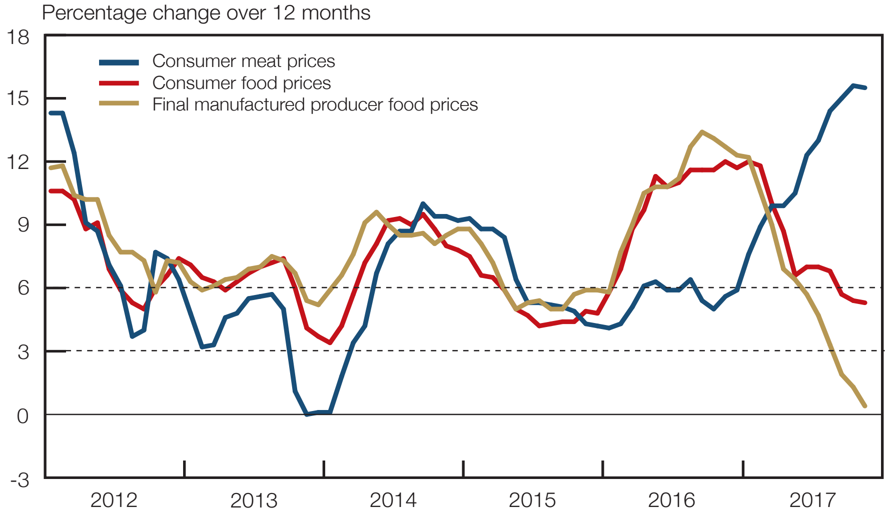
Source: Stats SA

Consumer services price inflation accelerated from 5.4% in May 2017 – its lowest rate in six years – to 5.8% in September 2017. The acceleration was largely due to a marked quickening in rental price inflation (with a weight of almost 17% in the total consumer price basket). Higher prices for taxi fares, transport insurance and funeral services also contributed to the acceleration in consumer services price inflation in recent months. In October 2017, consumer services price inflation moderated again to 5.5% following a deceleration in hotel and funeral services price inflation, in particular.

US dollar-denominated international food prices, as measured by the index of the Food and Agriculture Organization (FAO) of the United Nations, receded somewhat in the three months to October 2017 after rising steadily from a recent low in January 2016. However, base effects resulted in a moderation in the 12-month growth rate from 17.2% in February 2017 to 2.4% in October. The year-on-year rate of change in the rand-denominated FAO food price index moderated to -8.4% in June 2017 before reverting to an increase of 0.5% in October as the impact of the appreciation in the exchange value of the rand a year earlier started to diminish. US dollar international cereals prices rose in the first half of 2017 before receding slightly in recent months, but were still 7.4% higher in October 2017 than a year earlier. Similarly, the year-on-year rate of change in the rand-denominated international cereals price index accelerated from -18.5% in January 2017 to 5.3% in October.

Domestic *food price inflation* has decelerated significantly thus far in 2017. The prices of most food products at both the producer and consumer level decreased following the end of the two-year drought in most parts of the country, particularly in the maize producing areas. The notable exception remained meat prices, which continued to increase as farmers rebuilt herds while avian flu impacted poultry prices.

Food price inflation



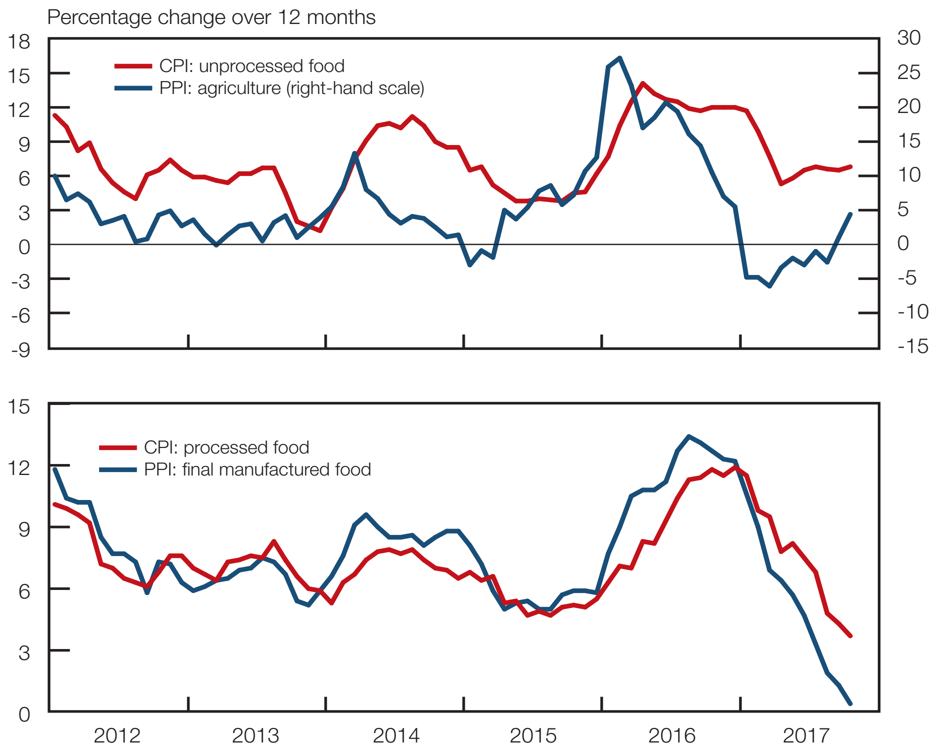
Source: Stats SA

Agricultural producer food price inflation remained very subdued in recent months, but nonetheless accelerated somewhat from -6.1% in March 2017 to 4.4% in October, reflecting the dissipation of the low base in the prices of crops and horticulture products as well as the continued elevated price inflation of live animals. Likewise, unprocessed consumer food price inflation quickened slightly from 5.3% in April 2017 to 6.8% in October following a marked moderation from 14.1% in April 2016. Producer food price inflation at the final manufactured level moderated significantly from 13.4% in August 2016 to 0.4% in October 2017, resulting in processed consumer food price inflation more than halving from 11.9% in December 2016 to 3.7% in October 2017.

Consumer food price inflation slowed to 5.3% in October 2017 – its lowest rate of increase in 23 months, despite the continued acceleration in consumer meat price inflation. Following the outbreak of avian flu in eight of the nine provinces in South Africa, millions of birds had to be culled, which led to a shortage of poultry and also had spillover effects on egg prices. Apart from meat, price inflation in the other eight consumer food subcategories has receded notably thus far in 2017. The annualised rate of increase in the three-month moving average seasonally adjusted consumer food price index moderated for seven consecutive months to 2.4% in October 2017, confirming the loss of short-term momentum in food price inflation.

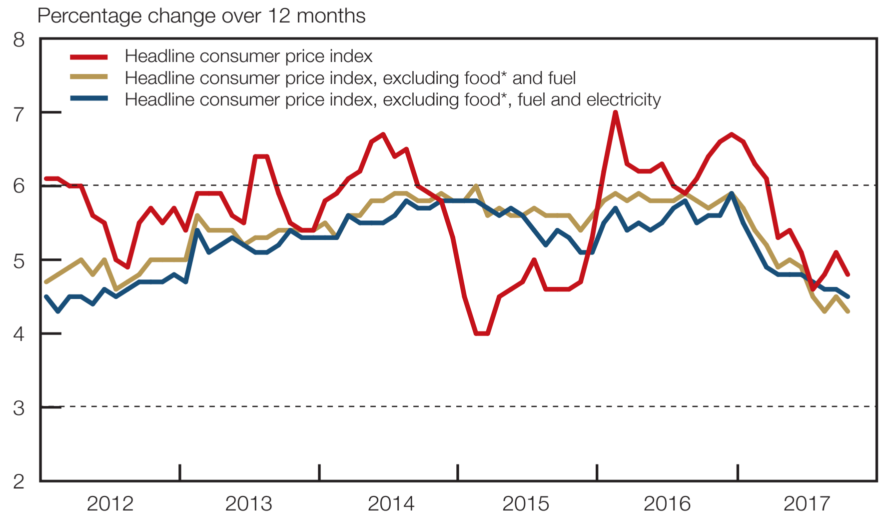
All measures of *underlying inflation* receded notably during the first ten months of 2017, reflecting subdued domestic demand and the still disinflationary effect of the earlier appreciation in the exchange value of the rand since early 2016. Subtracting the impact of the usually more volatile food, non-alcoholic beverages and fuel prices from the calculation of headline consumer price inflation, this measure of underlying inflation decelerated from 5.0% in May 2017 to 4.3% in October. Likewise, the SARB's preferred measure of core inflation, also excluding electricity prices, slowed to 4.5% in October 2017 – the midpoint of the inflation target range and its lowest rate in five years. After accelerating slightly up to September 2017, the annualised rate of increase in the three-month moving average core consumer price index moderated to 5.1% in October 2017.

Food price inflation



Source: Stats SA

Headline and underlying measures of consumer price inflation



* Food includes non-alcoholic beverages

Source: Stats SA

Administered price inflation quickened from a recent trough of 1.8% in July 2017 to 6.1% in September, driven by a marked acceleration in fuel price inflation which accounts for 28.3% of the total administered price basket. Fuel price inflation accelerated abruptly from -3.6% in July 2017 to 12.2% in September on account of a sharp increase in international crude oil prices and, more recently, a further depreciation in the exchange value of the rand. Subsequently, fuel price inflation moderated to 10.8% in October 2017. Excluding this main driver, administered price inflation remained unchanged at 4.0% for a fourth consecutive month in October 2017. When also excluding electricity prices from the calculation, the rate of increase accelerated from 4.3% in September 2017 to 4.6% in October.

Administered prices

Percentage change over 12 months

	Weight					
	In the overall consumer price index	In the administered price basket	Jul 2017	Aug 2017	Sep 2017	Oct 2017
Housing and utilities	6.17	38.2	4.5	4.6	4.6	4.6
Assessment rates	1.30	8.0	5.8	5.8	5.8	5.8
Water	1.08	6.7	11.5	11.5	11.5	11.5
Electricity	3.75	23.2	2.1	2.1	2.1	2.1
Paraffin	0.04	0.3	4.1	5.9	8.6	9.7
Transport	5.06	31.3	-3.1	5.5	11.4	10.1
Fuel	4.58	28.3	-3.6	5.7	12.2	10.8
Public transport: trains	0.13	0.8	2.4	2.4	2.4	2.4
Motor licence and registration	0.13	0.8	3.2	3.2	3.2	3.2
Communication	2.31	14.3	-0.6	-0.6	-0.6	-0.6
Telephone fees	0.09	0.6	0.7	0.7	0.7	0.7
Cellphone calls	2.22	13.7	-0.7	-0.7	-0.7	-0.7
Recreation and culture	0.04	0.2	0.0	0.0	0.0	0.0
Television licences	0.04	0.2	0.0	0.0	0.0	0.0
Education	2.53	15.6	7.0	7.0	7.0	7.0
Primary school fees	0.76	4.7	7.8	7.8	7.8	7.8
Secondary school fees	0.78	4.8	7.4	7.4	7.4	7.4
Tertiary education fees	0.99	6.1	6.2	6.2	6.2	6.2
Restaurants and hotels	0.06	0.4	8.5	8.5	8.5	8.5
Universities and colleges	0.06	0.4	8.5	8.5	8.5	8.5
Total administered prices	**16.17**	**100.0**	**1.8**	**4.4**	**6.1**	**5.8**
Total administered prices (excluding fuel)	**11.55**	**71.4**	**4.0**	**4.0**	**4.0**	**4.0**

Source: Stats SA

In October 2017 the 12-month rate of increase in three of the six administered price categories, with a combined weight of 47% in the total administered price basket, exceeded the upper limit of the inflation target range of 6%, while that of one category was within the inflation target range and the other two below the lower limit of the inflation target range of 3%. Furthermore, the year-on-year rate of increase in only one of the six categories, namely transport, moderated in October 2017, while that in the remaining five categories remained unchanged when compared to the previous month.

Average headline consumer price inflation expectations of financial analysts, business and trade union representatives for the current year declined slightly from 5.9% in the second quarter of 2017 to 5.7% in the third quarter, as measured by the BER *Inflation Expectations Survey.* However, average headline CPI inflation expectations for the outer years (i.e. 2018 and 2019) remained unchanged at 5.8% and 5.9% respectively.

Headline consumer price inflation expectations

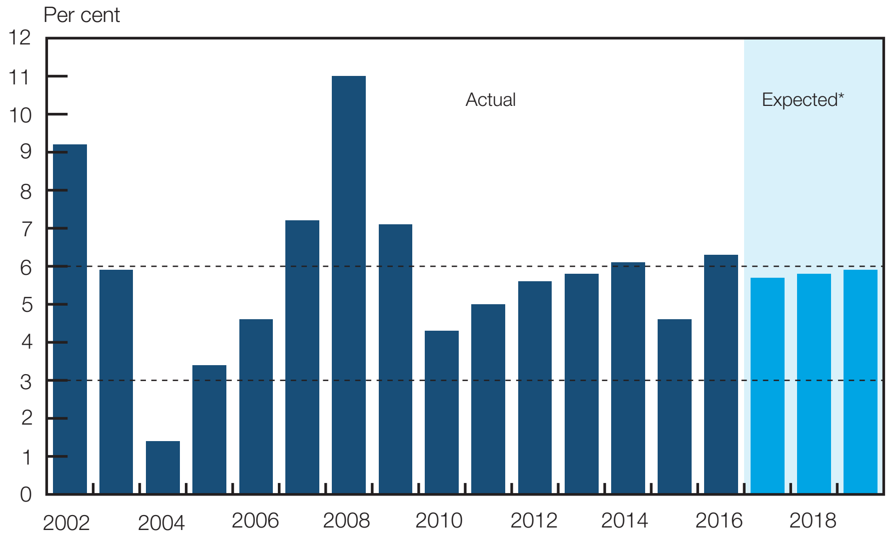
Per cent, as surveyed in the third quarter of 2017

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2017	5.3	6.1	5.8	5.7
2018	5.0	6.1	6.1	5.8
2019	5.3	6.3	6.0	5.9
The next five years	5.4	6.0	5.5	5.6

Source: BER

In the third quarter of 2017, financial analysts and business representatives lowered their forecasts, while trade union representatives revised their projections upwards since the previous survey. Financial analysts expect inflation to moderate from 5.3% in 2017 to 5.0% in 2018, and then to accelerate to 5.3% in 2019. Business representatives expect inflation to be 6.1% in both 2017 and 2018, before accelerating to 6.3% (down from 6.5% previously) in 2019. Trade union representatives lowered their 2017 inflation expectation from 6.0% to 5.8%, but increased their 2018 and 2019 projections marginally to 6.1% and 6.0% respectively.

Annual headline consumer price inflation and expectations



* As surveyed in the third quarter of 2017

Sources: Stats SA and BER

All three surveyed groups lowered their five-year inflation expectations from the second to the third quarter of 2017: financial analysts from 5.5% to 5.4%; business representatives from 6.3% to 6.0%; and trade union representatives from 5.8% to 5.5%. Consequently, average five-year inflation expectations declined from 5.9% in the second quarter of 2017 to 5.6% in the third quarter, which is the lowest level since the third quarter of 2011 when the five-year expectations were first surveyed.

External economic accounts

Current account[4]

South Africa's trade surplus improved for the fourth consecutive quarter in the third quarter of 2017. The further widening in the trade balance from R64 billion in the second quarter of 2017 to R71 billion in the third quarter came about as the value of merchandise imports decreased more than that of net gold and merchandise exports. These declines in the value of both imported and exported goods were largely driven by lower volumes.

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

Balance of payments on current account

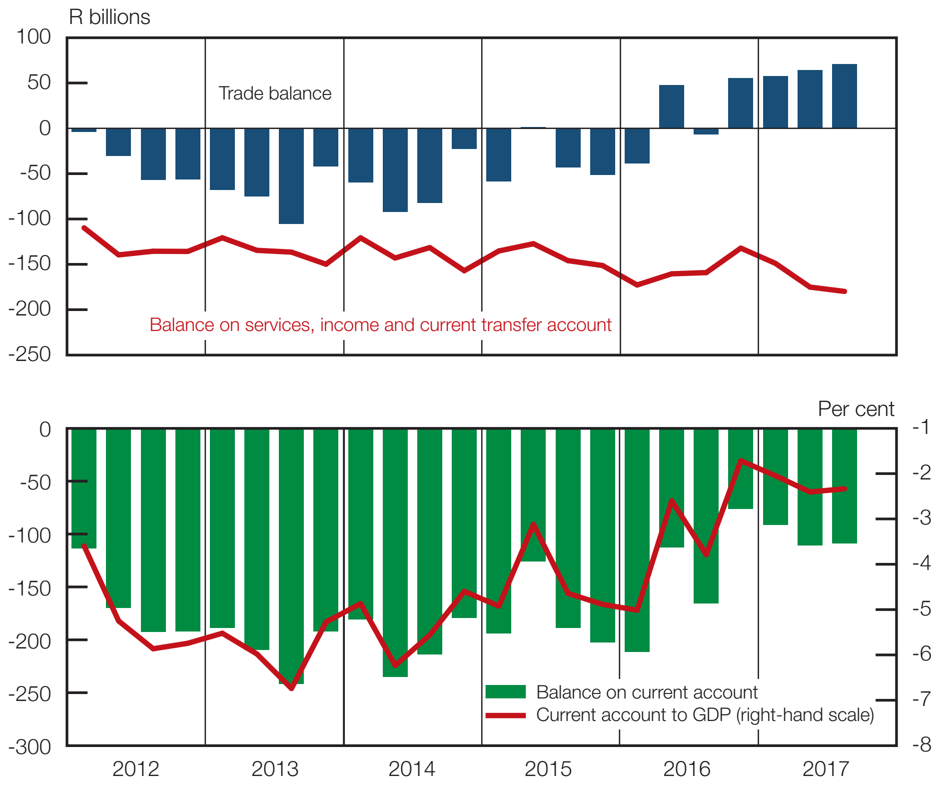
R billions, seasonally adjusted and annualised

	2016			2017		
	Q3	Q4	Year	Q1	Q2	Q3
Merchandise exports	1 033	1 071	1 054	1 069	1 102	1 086
Net gold exports	47	49	51	55	74	62
Merchandise imports	-1 086	-1 065	-1 090	-1 067	-1 112	-1 077
Trade balance	-7	56	15	57	64	71
Net service, income and current transfer payments	-159	-132	-156	-149	-175	-180
Balance on current account	-166	-76	-142	-91	-111	-109
As a percentage of gross domestic product	*-3.8*	*-1.7*	*-3.3*	*-2.0*	*-2.4*	*-2.3*

Components may not add up to totals due to rounding off

Sources: Stats SA and SARB

Balance of payments: current account

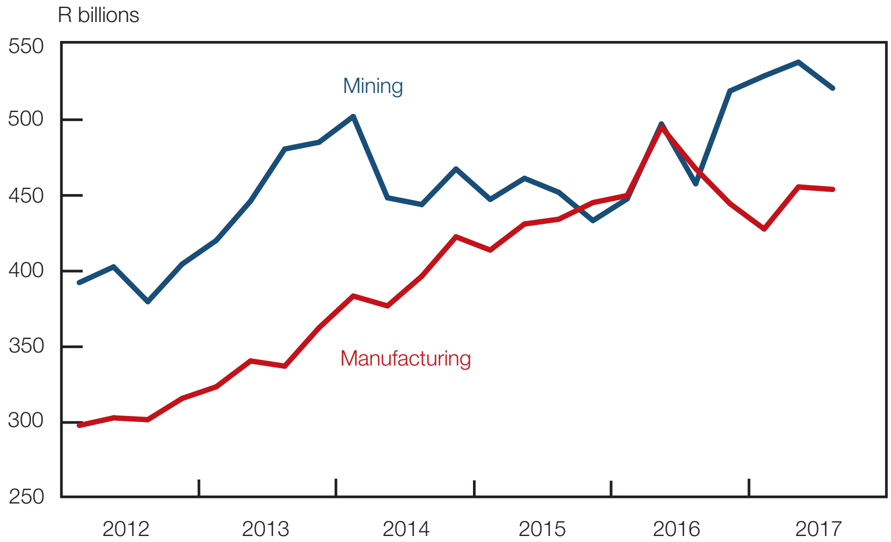


Seasonally adjusted and annualised
Sources: Stats SA and SARB

Contrary to the larger trade surplus, the shortfall on the services, income and current transfer account widened for the third consecutive quarter by a further marginal increase to R180 billion in the third quarter of 2017. This resulted in the deficit on the current account of the balance of payments improving somewhat to R109 billion in the third quarter of 2017, or 2.3% of GDP.

The value of total merchandise exports lost some of its recent momentum when it declined marginally in the third quarter of 2017 as the increase in agricultural exports was insufficient to offset the declines in mining and manufactured goods. The value of mining exports was pushed lower by the declines in base metals and articles of base metals as substantially higher exports of ferro-chromium to China was more than offset by lower mining exports to other destinations, including a decline in the exports of pearls, precious and semi-precious stones due to the lower demand for diamonds. These declines outweighed increases in the exports of mineral products and platinum group metals. The value of manufactured exports remained broadly unchanged in the third quarter of 2017 as declines in vehicles and transport equipment as well as chemical products were almost fully countered by higher exports of artificial resins and plastics as well as textiles and textile articles. The value of agricultural exports increased in the third quarter of 2017 as a sharp rise in citrus fruit, in particular, more than countered declines in the other agricultural subcategories.

Merchandise exports

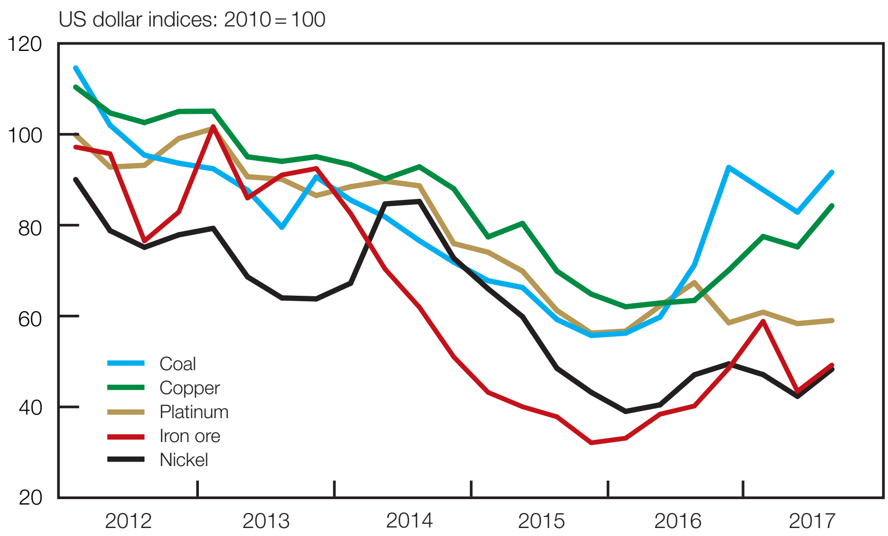


Seasonally adjusted and annualised

Sources: Stats SA and SARB

The rand price of merchandise exports increased further in the third quarter of 2017, supported by increases in the international prices of most of South Africa's major export commodities. The US dollar price of a basket of South African-produced non-gold export commodities increased by 6.6% from the second to the third quarter of 2017, underpinned by sharp increases in the prices of nickel, iron ore, copper and coal. After two consecutive quarterly declines, nickel prices increased by more than 14% in the third quarter of 2017 due to supply concerns and declining global stockpiles. The turnaround in the price of iron ore was given impetus by increased import demand from China for higher-grade material in the interest of a cleaner environment.

International prices of selected South African export commodities



Source: World Bank

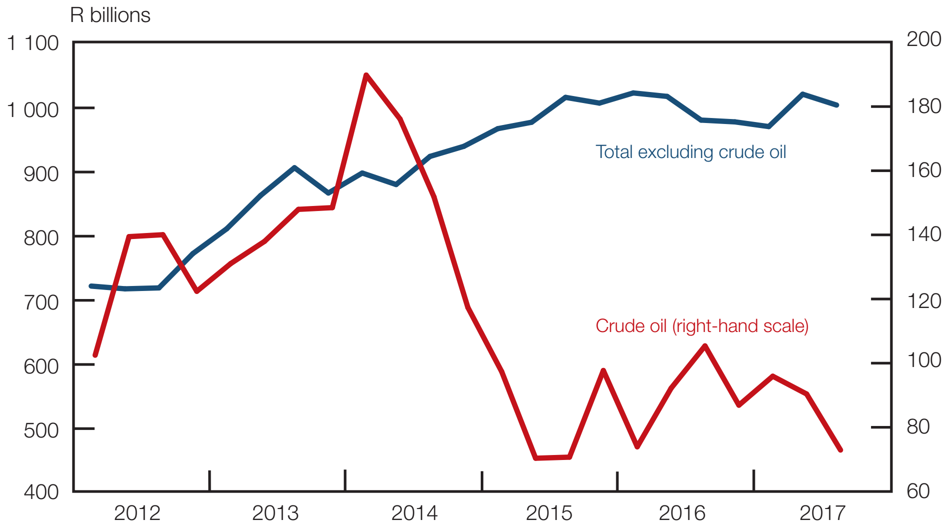
The volume of merchandise exports decreased in the third quarter of 2017 as the quantity of both mining and manufactured goods declined. Lower bulk export volumes handled at South Africa's national ports also reflected the decline in mining exports. As a ratio of GDP, the volume of merchandise exports declined marginally from 24.6% in the second quarter of 2017 to 23.9% in the third quarter.

The US dollar price of gold per fine ounce on the London market increased from an average of US$1 258 in the second quarter of 2017 to US$1 278 in the third quarter, or by 1.6%, as geopolitical tensions continued to support gold's appeal as a safe haven. However, the average realised rand price of gold remained broadly unchanged, while the volume of gold exported by South Africa declined by 16.9% in the third quarter of 2017. The decline in volume could partly be attributed to customers in India being deterred from buying gold due to a new tax regime and tighter regulations around jewellery transactions. As a consequence, the value of South Africa's net gold exports declined by almost 17% in the third quarter of 2017.

Following two consecutive quarterly increases, the value of total merchandise imports declined by 3.1% in the third quarter of 2017 and by 1.1% for the first three quarters of 2017 compared to the same period in 2016, reflecting subdued domestic demand. In the third quarter of 2017, the decline in the value of imported mining and manufactured products lowered overall import values as it outweighed the increase in the import value of agricultural products. Lower import values in all the mining subcategories contributed to a sharp decline in mining imports, and the value of imported mineral products in particular fell significantly as the shutdown of some refineries for maintenance reduced crude oil imports. The import value of base metals and articles of base metals also declined noticeably, together with that of pearls, precious and semi-precious stones.

The value of manufactured imports decreased in the third quarter of 2017 on account of a decline in the value of imported passenger vehicles, vehicle parts and accessories, machinery and electrical equipment as well as miscellaneous manufactured equipment. These declines more than offset the higher import value of agricultural products as imports of vegetable products, and live animals and animal products outweighed lower imports of raw hides and skins.

Merchandise imports

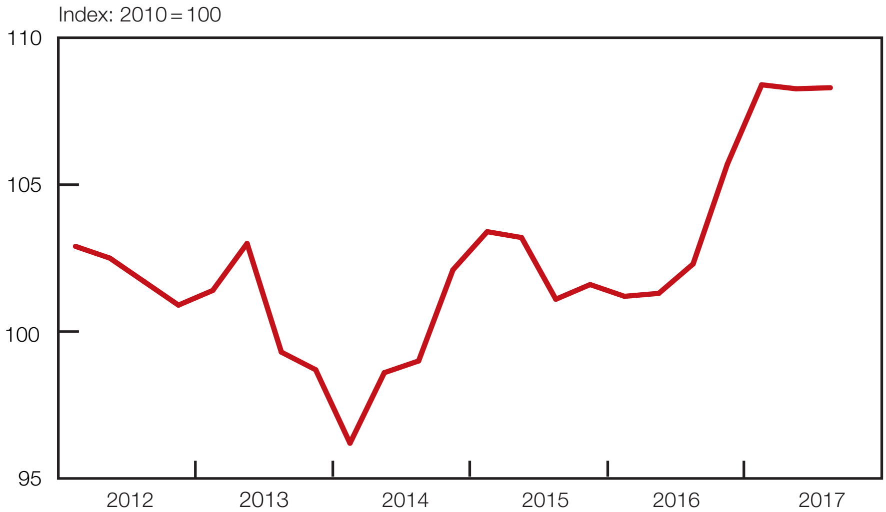


Seasonally adjusted and annualised
Sources: Stats SA and SARB

Despite the increase in the price of imported goods, the volume of total merchandise imports declined by 3.7% in the third quarter of 2017. Much lower import volumes of mining and manufactured goods resulted in a noticeable contraction in the total volume of imported merchandise. The import penetration ratio (real merchandise imports as a ratio of real gross domestic expenditure) declined from 26.9% to 25.9% over the corresponding period.

South Africa's terms of trade remained broadly unchanged at very elevated levels in the third quarter of 2017, as the increase in export prices was almost fully offset by the increase in the price of imports.

Terms of trade*



* Including gold
Sources: Stats SA and SARB

The shortfall on the services, income and current transfer account widened marginally by R5 billion in the third quarter of 2017, while the deficit relative to GDP increased fractionally from 3.8% in the second quarter to 3.9% in the third quarter. The slightly larger shortfall resulted mainly from an increase in net income payments which were partially offset by a decrease in net payments for services and net current transfer payments.

The larger income deficit resulted from increases in both net dividend and interest payments. Following two consecutive quarters of decline, gross dividend payments to non-resident investors increased fairly strongly in the third quarter of 2017, with the resumption of dividend payments by companies after abstaining from regular dividend payments during the recent past. Gross dividend receipts from abroad also increased, albeit less than dividend payments, resulting in a small increase in net dividend payments in the third quarter of 2017. In addition, gross interest payments increased relatively firmly and contributed more to the widening in the income deficit than net dividend payments.

The narrower deficit on net payments for services can largely be ascribed to an increase in gross travel receipts, which contributed just more than half of the total services receipts. The deficit on net current transfer payments narrowed marginally in the third quarter of 2017, following a notable increase in the previous quarter.

Box 3 Current transfers and the current account of the balance of payments

'Current transfers' comprises both receipts from, and payments to, non-resident counterparties without a quid pro quo. On average, about 80% of gross current transfer payments are related to central government transfer payments to trading-partner countries in the Southern African Customs Union (SACU). SACU transfers to the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) affect the balance on the current account of the balance of payments.

The net current transfer deficit remained stable at a ratio of about 0.9% of gross domestic product (GDP) between 2012 and 2015. However, in 2016 the ratio declined to 0.6% of GDP and consequently reduced the overall deficit on the current account of the balance of payments. The lower ratio was sustained in the first quarter of 2017 before increasing to around 1.0% of GDP in the second and third quarters. The increase in net current transfer payments in the second quarter of 2017 could mainly be attributed to an increase in SACU payments. Changes in the size of such payments originate from the National Budget at the beginning of each fiscal year (see memorandum item in the table below) and impact the balance of payments as from the second quarter of each calendar year. The rand value of SACU payments in each fiscal year is based on projections, which often require adjustments to the estimates of previous years. As such, the smaller SACU payment for the 2016/17 fiscal year can partly be attributed to a technical correction relating to the import component of the fuel levy in earlier years (see the *2017 Budget Review* for more detail). Hence, coming from a low base, this has, inter alia, resulted in the upward adjustment in the value of SACU payments in the 2017/18 fiscal year and a return of the ratio of net current transfers to GDP to levels experienced in the 2012 to 2015 period.

Current account of the balance of payments

Components as a percentage of GDP

	2012	2013	2014	2015	2016	2017		
						Q1	Q2	Q3
Trade balance*	-1.1	-2.1	-1.7	-0.9	0.3	1.3	1.4	1.5
Net service payments**	-0.3	-0.3	-0.1	-0.1	-0.2	-0.1	-0.2	0.0
Net income payments**	-2.7	-2.6	-2.7	-2.5	-2.8	-2.6	-2.7	-3.0
Net current transfers **	*-1.0*	*-0.9*	*-0.9*	*-0.8*	*-0.6*	*-0.6*	*-1.0*	*-0.9*
Balance on current account	-5.1	-5.9	-5.3	-4.4	-3.3	-2.0	-2.4	-2.3

Components may not add up to totals due to rounding off

Memorandum item***

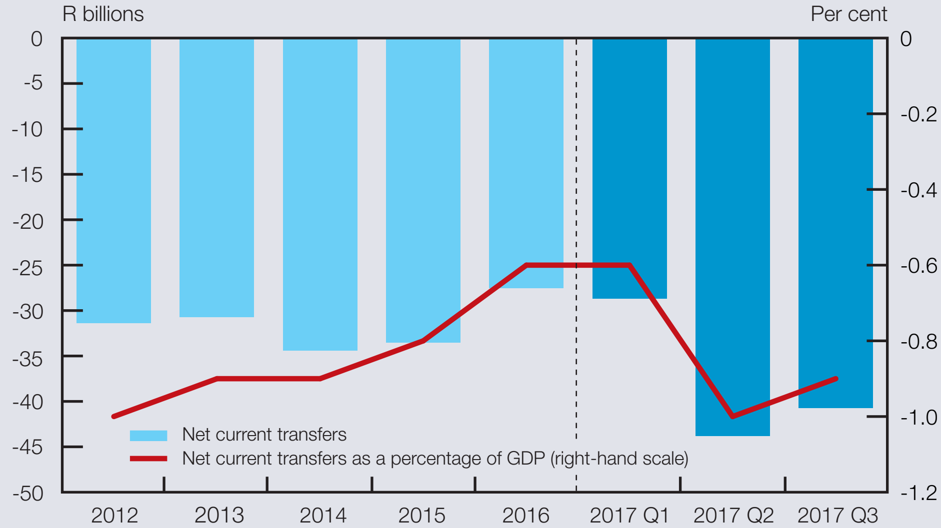
R billions	Fiscal years				
	2013/14	2014/15	2015/16	2016/17	2017/18
SACU payments	43.4	51.7	51.0	39.4	56.0

* Net merchandise exports and imports, and net gold exports
** Receipts less payments
*** *2017 Budget Review* and *2017 Medium Term Budget Policy Statement*

Sources: Stats SA, National Treasury and SARB

Net current transfers are one of the four main components of the current account of the balance of payments, together with the trade balance, net service payments and net income payments. The aggregate of the net inflows and outflows of these four components constitutes the balance on the current account of the balance of payments. Collectively, net service payments, net income payments and net current transfers are known as the services, income and current transfer account, and in South Africa, as in many other emerging market economies, the latter tends to be in a persistent deficit.

Net current transfers*



* Quarterly data are seasonally adjusted and annualised

Sources: Stats SA, National Treasury and SARB

Net current transfers account for a relatively large part of the current account of the balance of payments, but are usually fairly stable and not a major driver of changes in the ratio of the balance on the current account of the balance of payments to GDP. However, in 2016 and 2017, SACU payments impacted net current transfers and the balance on the current account of the balance of payments more significantly.

Financial account

The net flow of capital on South Africa's financial account of the balance of payments (excluding unrecorded transactions) amounted to an inflow of R17.4 billion in the third quarter of 2017 following an inflow of R3.2 billion in the second quarter. On a net basis, direct investment and financial derivatives recorded outflows, while portfolio investment and other investment recorded inflows during the third quarter of 2017. Overall, financial account inflows amounted to 1.5% of GDP in the third quarter of 2017.

Net financial transactions

R billions

	2016			2017		
	Q3	Q4	Year	Q1	Q2	Q3
Change in liabilities						
Direct investment	7.0	6.5	33.5	9.0	3.9	19.2
Portfolio investment	55.5	1.9	139.9	25.9	74.7	88.4
Financial derivatives	-116.1	-129.8	-499.3	-90.9	-59.6	-39.3
Other investment	26.3	-4.8	1.0	40.9	-29.4	54.3
Change in assets						
Direct investment	-1.4	-19.5	-49.7	-9.9	-30.4	-57.0
Portfolio investment	-19.2	80.5	100.7	-18.4	-9.4	-16.8
Financial derivatives	115.0	127.7	485.6	90.6	58.4	35.2
Other investment	-22.5	-17.5	-22.2	-22.2	-3.1	-33.2
Reserve assets	7.8	-53.8	-40.6	12.7	-1.9	-33.3
Total identified financial transactions*	52.3	-8.7	148.9	37.6	3.2	17.4
As a percentage of gross domestic product	*4.8*	*-0.8*	*3.4*	*3.4*	*0.3*	*1.5*

* Excluding unrecorded transactions
Inflow + outflow –

Source: SARB

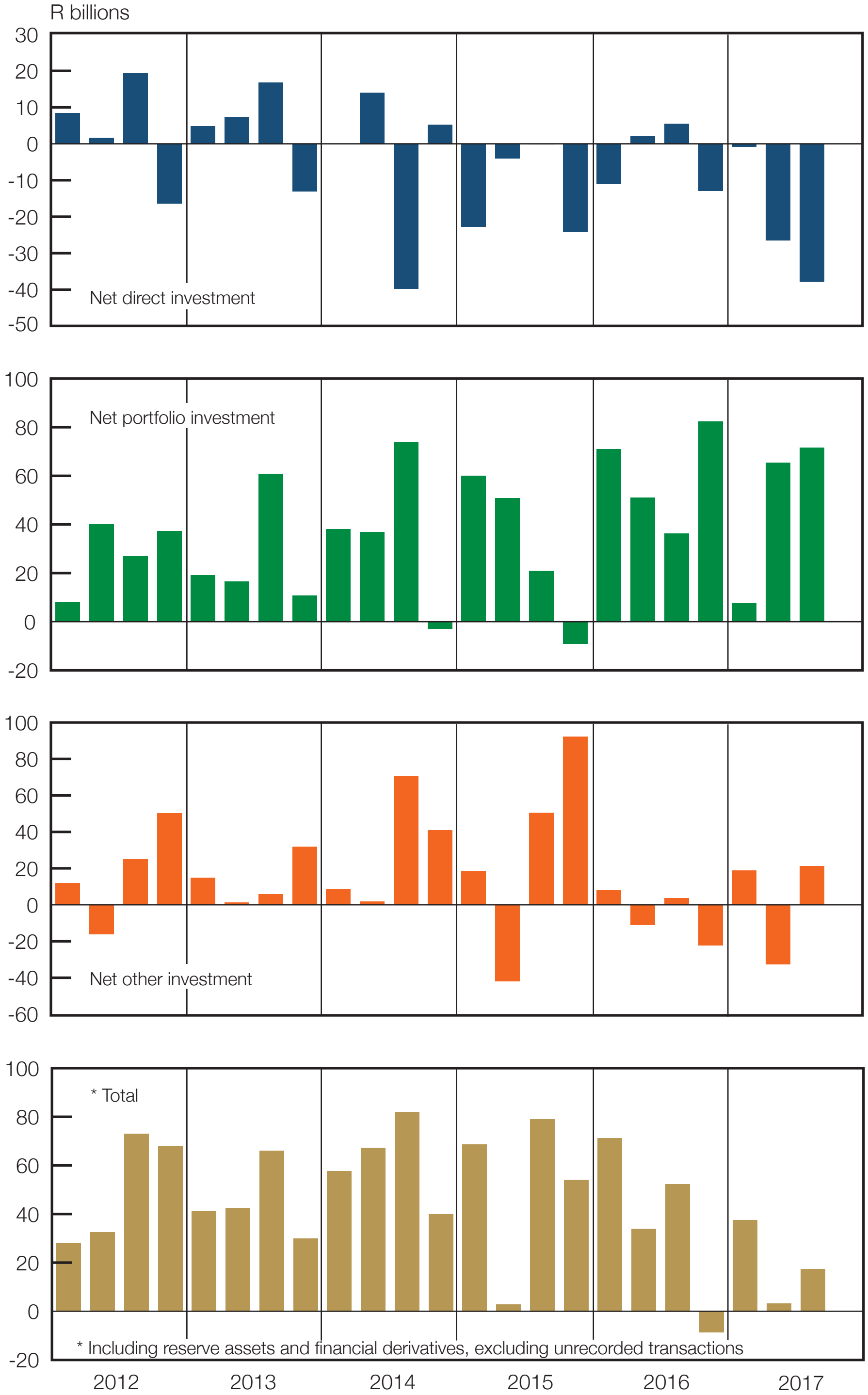
Foreign-owned assets in South Africa

South Africa's direct investment liabilities recorded an inflow of R19.2 billion in the third quarter of 2017 following an inflow of R3.9 billion in the second quarter. The inflow during the third quarter could be attributed to proceeds from non-residents selling shares of a company in the domestic retail sector and share issuance by a domestic company in the telecommunications sector to its parent company abroad.

Portfolio investment liability inflows of R88.4 billion in the third quarter of 2017 followed an inflow of R74.7 billion in the previous quarter. Driven mostly by foreign investors' continued search for yield, capital inflows in the third quarter mainly reflected the acquisition of domestic debt securities and, to a lesser extent, domestic equity securities. Non-resident investors acquired debt securities to the value of R62.2 billion in the third quarter of 2017 following an inflow of R49.2 billion in the second quarter. The acquisition of domestic debt securities was further supported by the issuance of two international bonds by National Treasury to the combined value of US$2.5 billion. Non-residents acquired equity securities to the value of R26.2 billion in the third quarter of 2017 following R25.5 billion in the second quarter.

Other investment liability flows switched from an outflow of R29.4 billion in the second quarter of 2017 to an inflow of R54.3 billion in the third quarter. The increase in other investment liabilities resulted from short-term borrowing by the domestic private and banking sectors, and drawings on foreign long-term loans by public corporations.

Balance of payments: financial account



Source: SARB

South African-owned assets abroad

South African entities' direct investment abroad increased by R57.0 billion in the third quarter of 2017 following an outflow of R30.4 billion in the preceding quarter. In the third quarter, a domestic company acquired a significant stake in a telecommunications company abroad. In addition, a South African company in the retail sector acquired a company abroad and a domestic resources company extended debt financing to its subsidiary abroad.

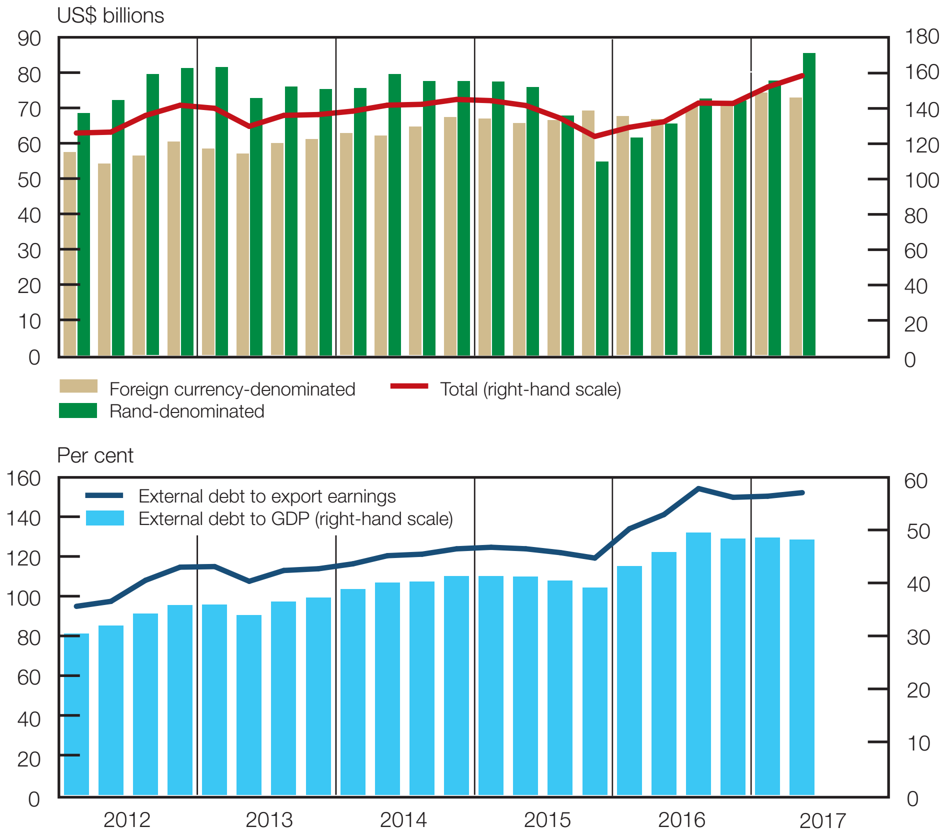
South African residents acquired foreign portfolio assets to the value of R16.8 billion in the third quarter of 2017 following an outflow of R9.4 billion in the second quarter. The acquisition of foreign portfolio assets was supported by an increase in the acquisition of both foreign debt and equity securities by the domestic private sector.

Outflows related to other investment assets amounted to R33.2 billion in the third quarter of 2017 following a small outflow of R3.1 billion in the second quarter, as the domestic private sector repaid short-term loans to non-residents and the domestic banking sector increased its deposits abroad.

Foreign debt

South Africa's total external debt increased from US$152.1 billion at the end of March 2017 to US$158.5 billion at the end of June, mainly as a result of non-resident net purchases of domestic rand-denominated government bonds, while foreign currency-denominated external debt declined over the same period. South Africa's gross external debt, expressed in rand terms, increased from R2 048 billion at the end of March 2017 to R2 074 billion at the end of June.

External debt



Source: SARB

Foreign currency-denominated external debt decreased marginally from US$74.3 billion at the end of March 2017 to US$73.0 billion at the end of June, largely as a result of repayments on short-term loans by the domestic banking sector. The foreign currency-denominated external debt balance of the public sector remained broadly unchanged, while the external debt of the non-banking private sector increased over the period. In the private sector an international convertible bond issuance of US$250 million was partly countered by the redemption of US$170 million by the same company, while the national government redeemed an international bond amounting to US$141 million.

Foreign debt of South Africa

US$ billions at end of period

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Foreign currency-denominated debt	67.6	66.9	70.4	70.7	74.3	73.0
Debt securities	22.7	22.5	21.9	24.1	24.1	24.3
Other	45.0	44.4	48.5	46.6	50.2	48.7
Public sector	8.1	8.0	8.1	8.1	9.1	9.2
Deposit-taking institutions	17.9	16.8	20.6	19.2	19.2	16.6
Non-monetary private sector	19.0	19.6	19.6	19.3	21.9	22.9
Rand-denominated debt	61.7	65.5	72.6	72.1	77.8	85.5
Debt securities	32.9	36.2	42.2	41.4	45.0	50.3
Other	28.8	29.3	30.4	30.7	32.8	35.2
Total foreign debt	129.3	132.4	143.0	142.8	152.1	158.5
As a percentage of gross domestic product	*43.2*	*45.8*	*49.5*	*48.3*	*48.5*	*48.2*
As a percentage of total export earnings	*133.9*	*141.1*	*154.2*	*149.8*	*150.3*	*152.1*

Source: SARB

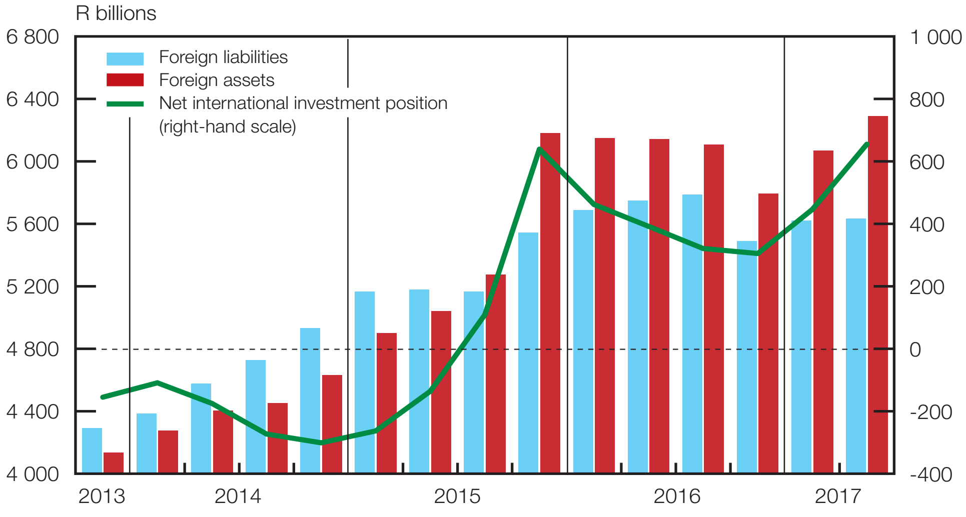
Rand-denominated external debt, expressed in US dollars, increased substantially from US$77.8 billion at the end of March 2017 to US$85.5 billion at the end of June, largely due to net purchases of domestic government bonds by non-residents. As at the end of June 2017, rand-denominated domestic bonds held by non-resident investors comprised 59% of total rand-denominated external debt, up from 55% a year earlier.

South Africa's total external debt as a ratio of annual GDP decreased slightly from 48.5% at the end of March 2017 to 48.2% at the end of June 2017 – the average for the past eight quarters was 45.4%. By contrast, the ratio of external debt to export earnings increased from 150.3% to 152.1% over the same period.

International investment position

South Africa's positive net international investment position (IIP) increased significantly from a revised R446 billion at the end of March 2017 to R656 billion at the end of June, as the value of South Africa's foreign assets increased substantially while the value of foreign liabilities remained broadly unchanged over the period.

South Africa's international investment position



Source: SARB

The market value of South Africa's foreign assets (outward investment) increased from a revised R6 068 billion at the end of March 2017 to R6 290 billion at the end of June. This 3.6% increase in foreign assets resulted mainly from an increase in direct investment and, to a lesser extent, from portfolio investment, while both financial derivatives and 'other' investment declined marginally. The market value of direct investment increased mainly on account of a further increase in the share price of a large foreign subsidiary of a South African company. The increase in foreign portfolio assets mainly took the form of a rise in the value of equity securities as the US Standard & Poor's 500 Index rose by 2.6% in the second quarter of 2017. The increase in foreign assets occurred despite an appreciation of 2.9% in the value of the rand against the US dollar in the second quarter of 2017.

The market value of South Africa's foreign liabilities (inward investment) increased marginally from a revised R5 622 billion at the end of March 2017 to R5 634 billion at the end of June. This 0.2% increase in foreign liabilities reflected a subdued increase in the market value of portfolio investment, while that of all other functional categories declined marginally. The decline in direct investment can partly be attributed to the sale of a significant stake in a company in the banking sector by a foreign direct investor. Price changes did not materially impact the market value of portfolio investment liabilities as the JSE All-Share Index (Alsi) declined only marginally by 0.9% from the end of March 2017 to the end of June. The increase in portfolio investment liabilities was mainly due to the acquisition of domestic debt securities by foreign investors as their search for yield continued.

As a ratio of annual GDP, South Africa's foreign liabilities decreased from 127.6% at the end of March 2017 to 125.9% at the end of June, while foreign assets increased from 137.8% to 140.6% over the same period. This resulted in the country's positive net IIP rising to 14.7% of GDP at the end of June 2017 – the highest since 31 December 2015 when the IIP was 15.7% of GDP.

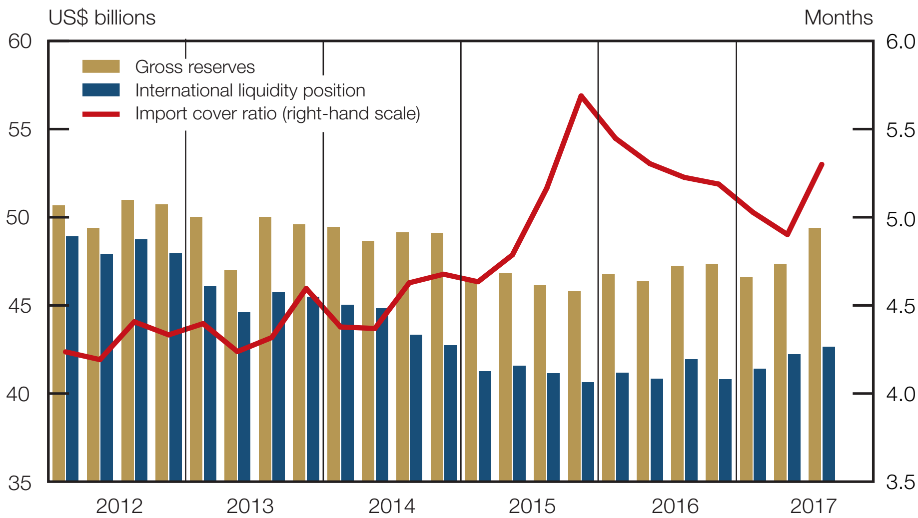
International reserves and liquidity

South Africa's international reserve assets increased further by R33.3 billion in the third quarter of 2017 following an increase of R1.9 billion in the second quarter.

The US dollar value of South Africa's gross gold and other foreign reserves (i.e. the international reserves of the SARB before accounting for reserves-related liabilities) increased from US$47.4 billion at the end of June 2017 to US$49.4 billion at the end of September, mainly reflecting proceeds from foreign debt issuance by government.

The country's gross gold and other foreign reserves subsequently increased to US$50.3 billion at the end of November 2017. The level of import cover (i.e. the value of gross international reserves relative to the value of the imports of goods and services as well as income payments) increased from 4.9 months at the end of June 2017 to 5.3 months at the end of September.

International reserves



Source: SARB

5 This is calculated as the SARB's 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.

South Africa's international liquidity position[5] increased from US$42.2 billion at the end of June 2017 to US$42.7 billion at the end of September, and remained unchanged at the end of November.

Exchange rates

The nominal effective exchange rate of the rand (NEER) declined, on balance, by 4.6% in the third quarter of 2017 compared with a marginal decline of 0.1% in the second quarter. The NEER declined by 1.2%, 0.5% and 3.0% in July, August and September 2017 respectively. Factors weighing on the rand in the third quarter included a warning by credit rating agency Moody's Investors Service (Moody's) that political pressure around the central bank posed a key credit risk, and rising expectations that the US Federal Reserve would increase the target for the federal funds rate in December 2017. However, the domestic currency was supported by better-than-expected GDP data for the second quarter of 2017 and higher international commodity prices.

Exchange rates of the rand

Percentage change

	30 Dec 2016 to 31 Mar 2017	31 Mar 2017 to 30 Jun 2017	30 Jun 2017 to 29 Sep 2017	29 Sep 2017 to 30 Nov 2017
Weighted average*	-0.7	-0.1	-4.6	-1.4
Euro	-0.4	-3.6	-6.2	-1.5
US dollar	1.3	2.9	-3.1	-1.1
Chinese yuan	0.4	1.2	-5.0	-1.6
British pound	-0.1	-1.4	-5.9	-1.6
Japanese yen	-3.2	3.0	-2.7	-1.1

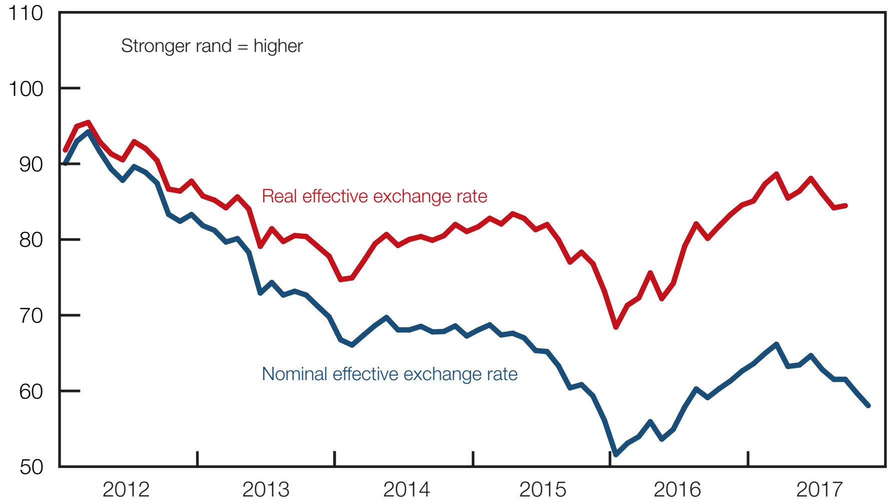
* Trade-weighted exchange rate against a basket of 20 currencies (nominal effective exchange rate)
Depreciation – appreciation +

Source: SARB

The exchange value of the rand weakened further in October 2017 as sentiment continued to be weighed down by domestic political uncertainty following another cabinet reshuffle and the release of the *2017 MTBPS,* which projected much wider government deficits and higher debt levels.

Effective exchange rates of the rand

Indices: 2010 = 100



Source: SARB

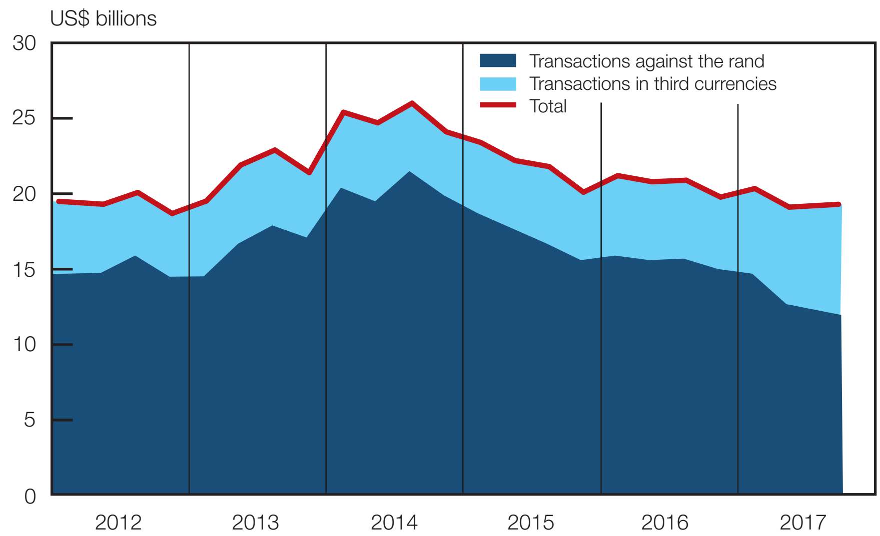
The exchange value of the rand initially depreciated further in November as market participants priced in a rating downgrade of South Africa's local-currency debt by prominent international rating agencies. However, the exchange value of the rand appreciated after only S&P Global Ratings downgraded the country's local-currency debt, while Moody's put South Africa's credit rating on review instead of an immediate downgrade. As a result, South African government bonds remained part of key international bond indices, such as the Citigroup World Government Bond Index (WGBI).

The real effective exchange rate of the rand (REER) decreased marginally by 0.1% from December 2016 to September 2017, implying a broadly unchanged competitive position for South African manufacturers in international markets thus far in 2017.

Turnover in the South African foreign exchange market

The net average daily turnover in the South African foreign exchange market increased slightly by 1.0% from US$19.1 billion in the second quarter of 2017 to US$19.3 billion in the third quarter. This increase can be attributed to an increase in the value of transactions in third currencies, from US$6.4 billion to US$7.3 billion over the period, as domestic banks increased their trading with non-resident counterparties in currencies other than the rand. However, the net average daily turnover in foreign currency against the rand decreased from US$12.7 billion to US$12.0 billion over the same period.

Net average daily turnover in the South African foreign exchange market



Source: SARB

Monetary developments, interest rates and financial markets

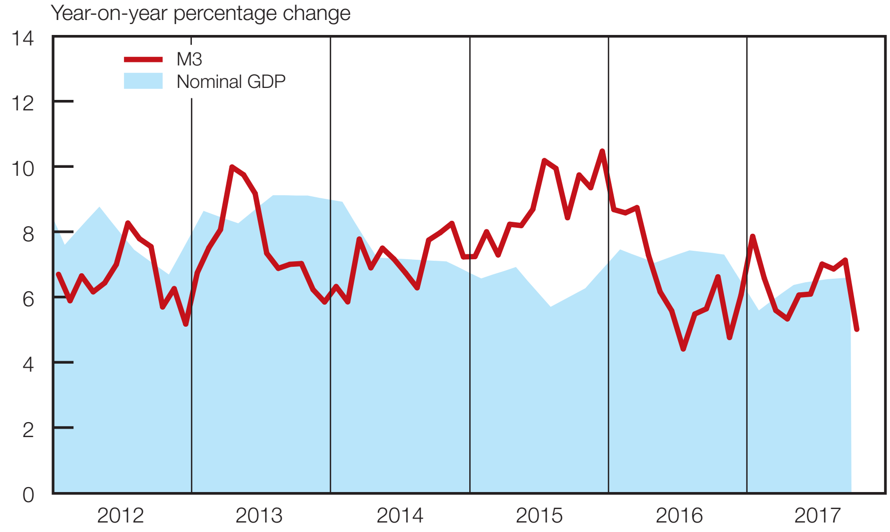
Money supply

Growth in the broadly defined money supply (M3) trended higher as from mid-2016, and occasionally exceeded the weak expansion in nominal GDP. Quarter-to-quarter seasonally adjusted and annualised growth in M3 rebounded from zero per cent in the second quarter of 2017 to 8.3% in the third quarter. The acceleration in M3 growth relative to that in nominal GDP lowered the income velocity of circulation of M3 slightly from 1.44 in the second quarter of 2017 to 1.43 in the third quarter. The upward momentum in money supply growth reflected a notable recovery in the growth of deposit holdings of financial companies, supported by sustained growth in household deposits and a marginal improvement in the deposits of non-financial companies.

Factors that contributed to the higher growth in M3 in the third quarter of 2017 included:

- equitable share transfers from national government to local authorities in July 2017;
- institutional investor receipts of proceeds from the redemption of the R203 government bond in September, which shifted deposits from government to deposit holders, being included in the calculation of money supply; and
- banks' drive, in the context of Basel III liquidity requirements, to attract and maintain stable longer-term deposits, especially of the household sector.

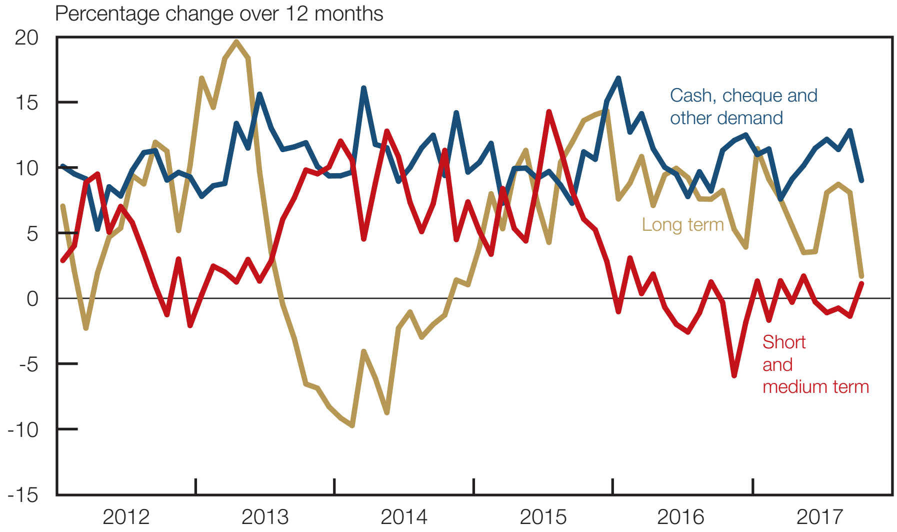
Money supply and gross domestic product



Sources: Stats SA and SARB

The most liquid deposit category – cash, cheque and other demand deposits – continued to dominate private sector deposits, both in terms of absolute size and growth. This category expanded at an average year-on-year rate of 10.6% in the first 10 months of 2017. Despite private sector banks' efforts to attract stable funding, growth in long-term deposits only averaged 6.7% over this period, down from 8.0% in 2016. By contrast, growth in short- and medium-term deposits fluctuated below zero per cent during most of 2016 and 2017, although the contraction moderated in recent months. The contribution of long-term deposits to total deposit balances remained at around 19% for most of 2017, with cash, cheque and other demand deposits accounting for 50%.

Deposits by maturity



Source: SARB

M3 holdings of households and companies

	Quarter-to-quarter change R billions					Percentage of total M3 deposit holdings
	2016		2017			2017
	Q3	Q4	Q1	Q2	Q3	Q2
Households	27.1	25.6	13.0	29.1	31.4	33.9
Companies: Total.................................	47.1	35.2	22.5	-15.8	79.8	66.1
Of which: Financial	31.4	10.2	27.0	14.0	42.4	37.7
Non-financial....................	15.7	25.0	-4.5	-29.8	37.4	28.4
Total M3 deposits...............................	**74.3**	**60.8**	**35.6**	**13.3**	**111.2**	**100.0**

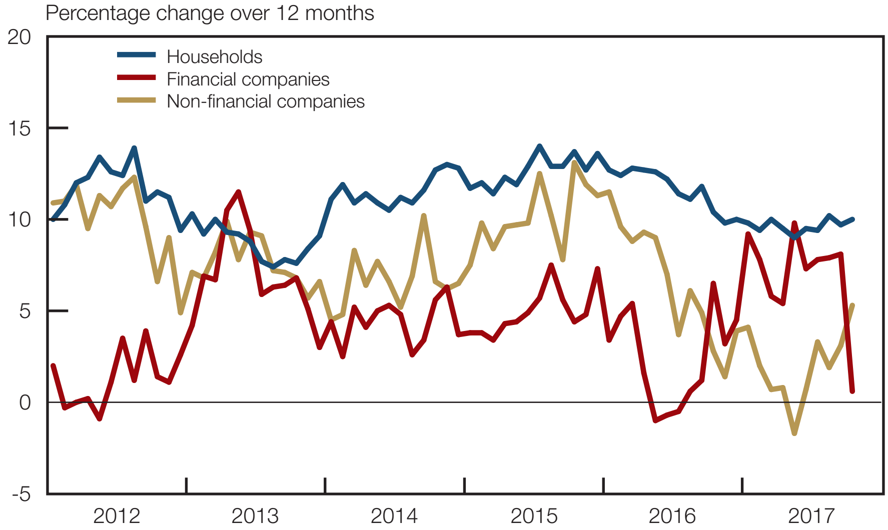
Source: SARB

Total M3 deposit holdings increased significantly by R111.2 billion in the third quarter of 2017. The deposit holdings of the corporate sector increased by R79.8 billion, more than fully reversing the decline of R15.8 billion in the second quarter. Non-financial company deposit holdings reverted from a sharp contraction in the second quarter of 2017 to a notable increase in the third quarter, while financial companies and households also recorded strong increases.

Despite the recent switch in the quarter-to-quarter change in the deposit holdings of non-financial companies, their year-on-year deposit growth remained muted at 5.3% in October 2017. Growth in household deposits, although trending gradually lower from a high of 14.0% in July 2015, remained resilient and accelerated somewhat from a recent low of 9.0% in May 2017 to 10.0% in October. Growth in financial company deposits accelerated from -1.0% in May 2016 to 8.1% in September 2017, before decelerating again to 0.6% in October. The deceleration in October was partly affected by a high base value in the same period a year ago.

Statistically, the change in M3 in the third quarter of 2017 is explained by significant developments related to both domestic and foreign counterparts. Net foreign assets increased significantly, partly boosted when National Treasury's deposits at the SARB increased as a result of inflows related to foreign bond issuances. Foreign assets were also affected by an increase in the rand value of the SARB's gold and foreign exchange reserves due to a depreciation in the exchange value of the rand. In addition, private sector banks increased their foreign currency loans to non-resident counterparties. The significant increase in net claims against the government sector

Deposit holdings of households and companies



Source: SARB

was mainly as a result of an increase in government securities held by the banking sector as well as an increase in claims by the Corporation for Public Deposits (CPD) against the government. The decrease in net other assets and liabilities can be attributed to an increase in other liabilities, which was partly related to an increase in the foreign exchange adjustment account of the SARB and an increase in the liabilities of banks in respect of derivative instruments.

Statistical counterparts of change in M3

R billions

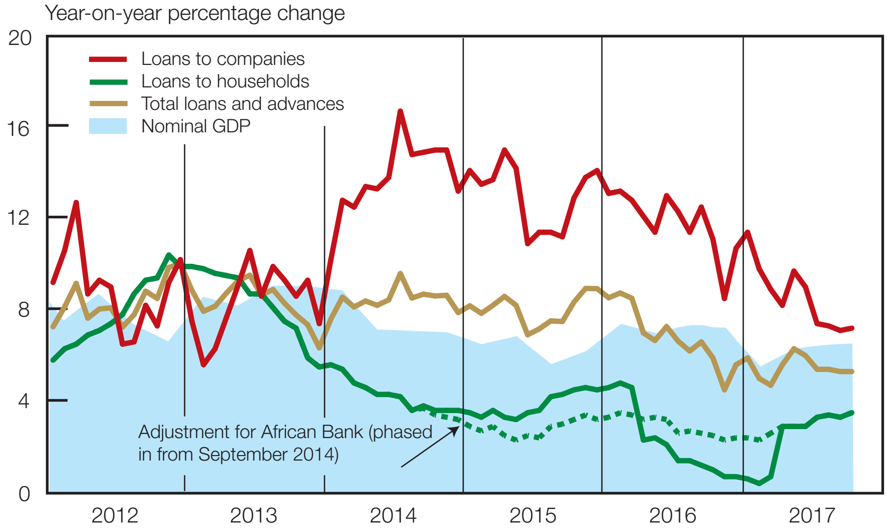
	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Net foreign assets	-73.5	10.6	-38.9	29.5	68.1
Net claims on the government sector	75.0	-17.5	17.0	-6.1	40.7
Claims on the private sector	68.4	29.7	78.7	17.3	51.5
Net other assets and liabilities	4.3	38.0	-21.3	-27.4	-49.1
Total change in M3	**74.3**	**60.8**	**35.6**	**13.3**	**111.2**

Source: SARB

Credit extension

Twelve-month growth in total loans and advances extended to the domestic private sector accelerated marginally in 2017. Thus far in 2017, a moderate but uninspiring increase in loans and advances to the household sector narrowly outweighed a deceleration in loans and advances to the corporate sector. Growth in credit extension to companies was likely weighed down by subdued corporate investment amid protracted weak domestic demand and low business confidence in an environment of heightened political uncertainty. Domestic demand for goods and services was affected by household income concerns related to employment prospects, which together with low consumer confidence contributed to weak household demand for bank credit. Year-on-year growth in total loans and advances initially rebounded from a five-year low of 4.5% in November 2016 to 6.3% in May 2017; it then decelerated to 5.3% in October.

Bank loans and gross domestic product

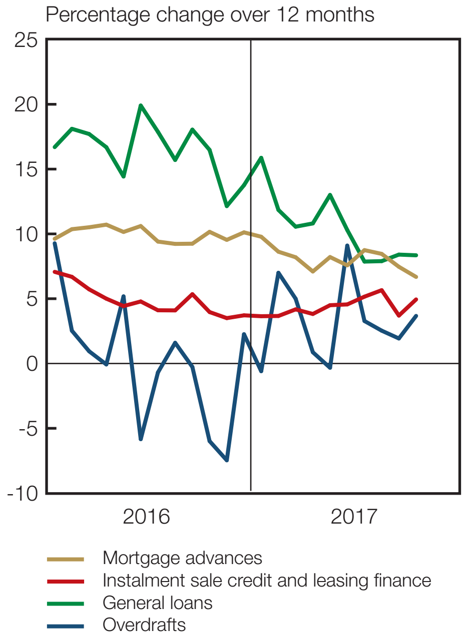


Sources: Stats SA and SARB

By contrast, quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances to the private sector decelerated from 7.0% in the first quarter of 2017 to 3.0% in the third quarter, suggesting a renewed loss of momentum. The slower growth in credit relative to nominal GDP resulted in a further decrease in the ratio of credit to GDP, from 73.5% in the first quarter of 2017 to 72.3% in the third quarter.

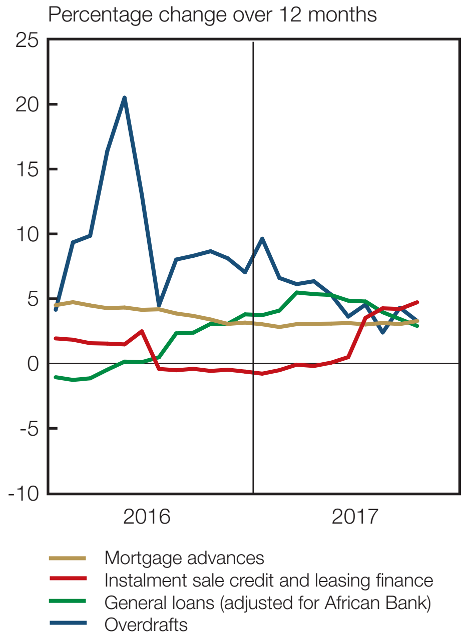
Credit extension to the corporate sector increased by R28.2 billion in the third quarter of 2017, much more than the increase of R4.9 billion in the second quarter, but significantly less than the increase of R52.1 billion in the same quarter of 2016. The weaker increases in loans and advances to companies was also evident in the year-on-year growth rate, which moderated fairly consistently from a recent high of 14.1% in December 2015 to 7.2% in October 2017. Both

Selected loans and advances to corporate sector



Source: SARB

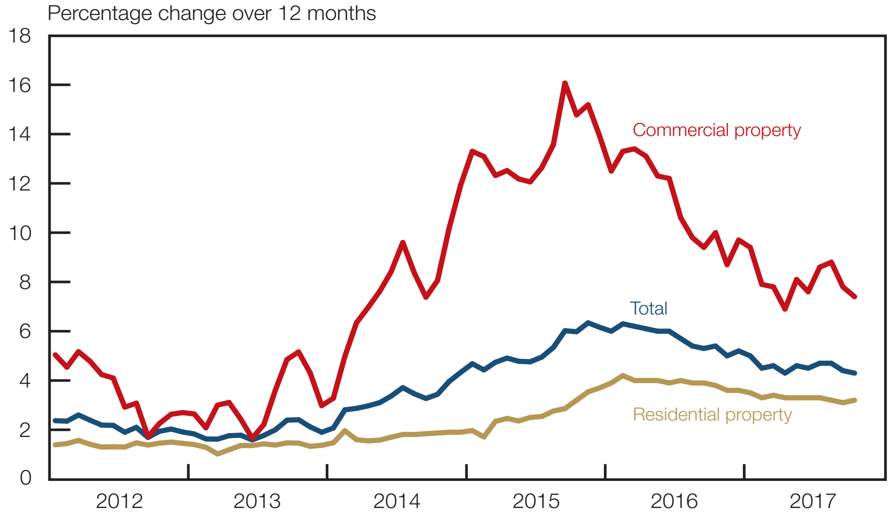
Selected loans and advances to household sector



financial and non-financial companies reduced their demand for bank funding over this period. This is reflected by the sharp deceleration in year-on-year growth in general loans to companies – their preferred source of credit – from a recent high of 19.9% in June 2016 to 8.3% in October 2017. The issuance of corporate bonds as an alternative to bank credit for some companies increased in 2017, but moderated again in recent months. The total outstanding value of bonds issued by non-bank companies on the JSE Limited (JSE) remained small compared to the outstanding balance of loans and advances to companies by banks.

Growth in *loans and advances to the household sector* improved moderately during 2017, but still remained quite weak. Credit extension to the household sector increased by R10.8 billion in the third quarter of 2017, up from an increase of R6.4 billion in the preceding quarter, supported by mortgage advances as well as instalment sale credit and leasing finance. Mortgage advances – households' preferred source of credit – increased by R6.7 billion in the third quarter of 2017 compared to an increase of R10.2 billion in the first quarter. Twelve-month growth in mortgage advances to households averaged at around 3.1% in the first 10 months of 2017.

Mortgage advances



Source: SARB

Growth in *mortgage advances* on commercial property slowed significantly from the end of 2015 to the beginning of 2017, but accelerated moderately from a low of 6.9% in April 2017 to 7.4% in October. Growth in mortgage advances on residential property remained muted, fluctuating around an average of 3.3% in the first 10 months of 2017, moderately down from a recent peak of 4.2% in February 2016. Consequently, year-on-year growth in total mortgage advances decelerated from 6.3% in February 2016 to 4.3% in October 2017.

Instalment sale credit and leasing finance, mostly used for the financing of new and second-hand vehicles, increased by R15.0 billion in the first 10 months of 2017 – more than double the increase of R6.8 billion in the same period of 2016. Year-on-year growth in this type of credit picked up moderately from 2.4% in May 2016 to 4.8% in October 2017, in line with stronger new vehicle sales. According to the BER, a slight acceleration in sales volumes resulted in a moderate rebound in business confidence among new vehicle dealers in the third quarter of 2017.

An analysis of credit demand by economic sector in the third quarter of 2017 showed that credit demand by the electricity, gas and water sector receded sharply, probably reflecting a slowdown in the renewable energy procurement programme. Growth in credit extension to finance and insurance companies picked up pace, as did that to community, social and personal services (mostly government). Credit demand by the agricultural sector slowed somewhat due to a recovery in proceeds realised from bumper maize crops. Credit demand by the real estate sector remained relatively muted alongside stagnant conditions in the property market, while growth in credit extension to the construction sector accelerated and that to the mining sector contracted further.

Growth in bank credit by economic sector

Percentage change over four quarters

Economic sector	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	Percentage of total credit extension*
Households	6	7	5	5	6	34.5
Finance and insurance	12	4	0	1	13	20.5
Real estate	12	11	7	9	9	10.2
Community, social and personal services	4	10	14	9	18	8.9
Wholesale and retail trade	5	4	2	2	1	4.7
Manufacturing	12	8	8	3	4	4.5
Business services	4	10	22	21	12	3.6
Transport, storage and communication	32	15	2	5	1	3.3
Electricity, gas and water	49	41	38	39	16	2.3
Agriculture, forestry and fishing	17	14	12	10	6	2.2
Mining and quarrying	-23	-20	-31	-19	-16	1.6
Construction	-9	-11	-10	-8	11	0.9
Other	-7	-32	-28	-29	-26	3.1
Total	7	5	4	4	7	100.0

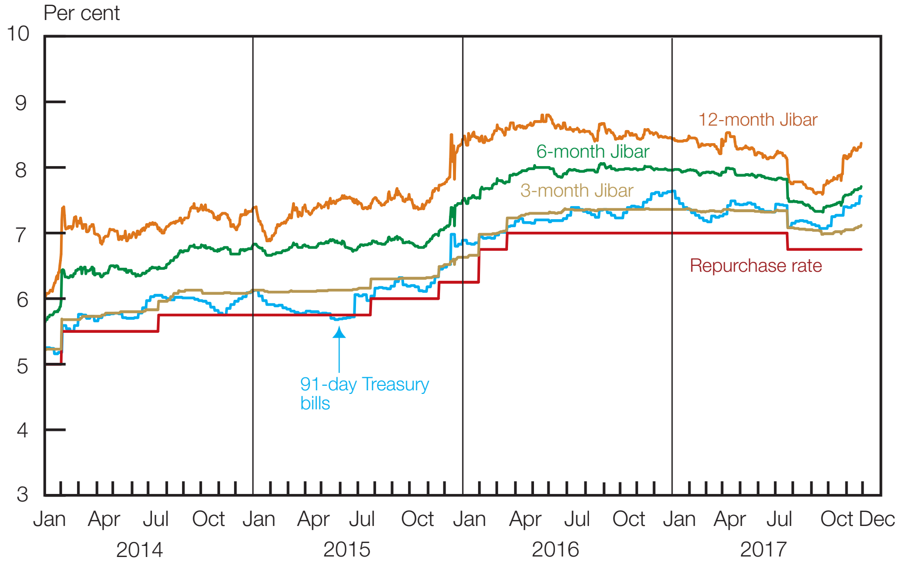
* Expressed as a percentage of the total outstanding balance for September 2017

Source: SARB

Interest rates and yields

Following a decision by the Monetary Policy Committee (MPC) to lower the repurchase rate by 25 basis points with effect from 21 July 2017, the MPC decided to keep the rate unchanged at the September and November 2017 MPC meetings due to increased upside risk to the inflation outlook. The deterioration in the inflation outlook resulted from, among other factors, the depreciation in the exchange value of the rand in recent months, higher international oil prices, heightened political uncertainty, and persistent elevated inflation expectations of business and trade union representatives.

Money market rates

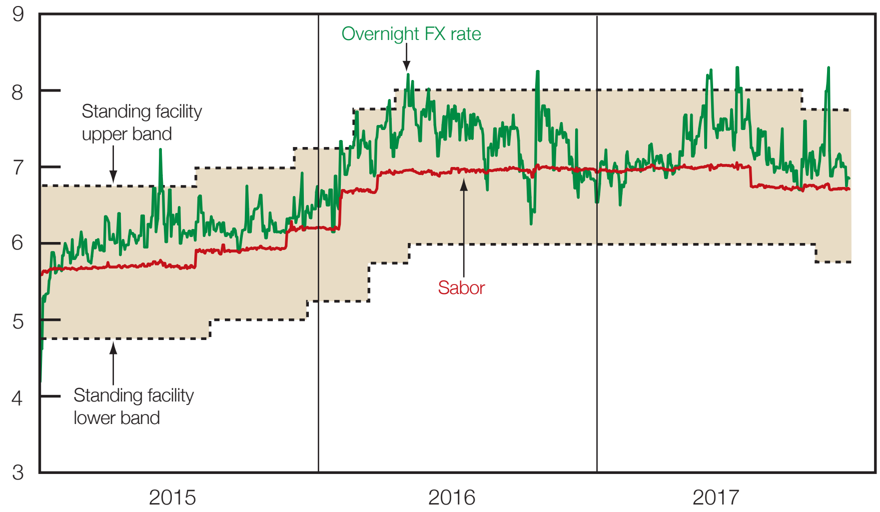


Source: SARB

Domestic money market rates initially edged lower after the reduction in the repurchase rate in July 2017, in line with moderate inflation outcomes and the appreciation in the exchange value of the rand at the time. However, the downward momentum in money market rates was reversed when the MPC kept the policy rate unchanged in September 2017. Subsequently, short-term interest rates across the various maturities fluctuated higher alongside a surprise reshuffling of cabinet ministers, concerns about national government revenue under-collection and rising debt levels in the *2017 MTBPS*, and the recent depreciation in the exchange value of the rand. In November 2017, money market interest rates rose further alongside a further depreciation in the exchange value of the rand, the possibility of a tightening of US monetary policy in December, and concerns of a then possible credit rating downgrade of South African government debt by some international rating agencies.

In the wake of the July 2017 reduction in the repurchase rate, the 12-month Johannesburg Interbank Average Rate (Jibar) declined by 66 basis points from 8.25% on 4 July 2017 to 7.59% on 20 September. However, after market conditions deteriorated, the 12-month Jibar increased to 8.37% on 27 November before moderating slightly to 8.32% on 30 November. Fluctuations in the three-month Jibar were more subdued, as it declined by 37 basis points from 7.35% on 4 July 2017 to 6.98% on 19 September, before increasing marginally to 7.12% at the end of November. Similarly, the tender rate on 91-day Treasury bills declined from a recent high of 7.44% on 6 July 2017 to 7.07% on 15 September. Subsequently, lower demand for these instruments saw the rate increasing to 7.56% at the end of November.

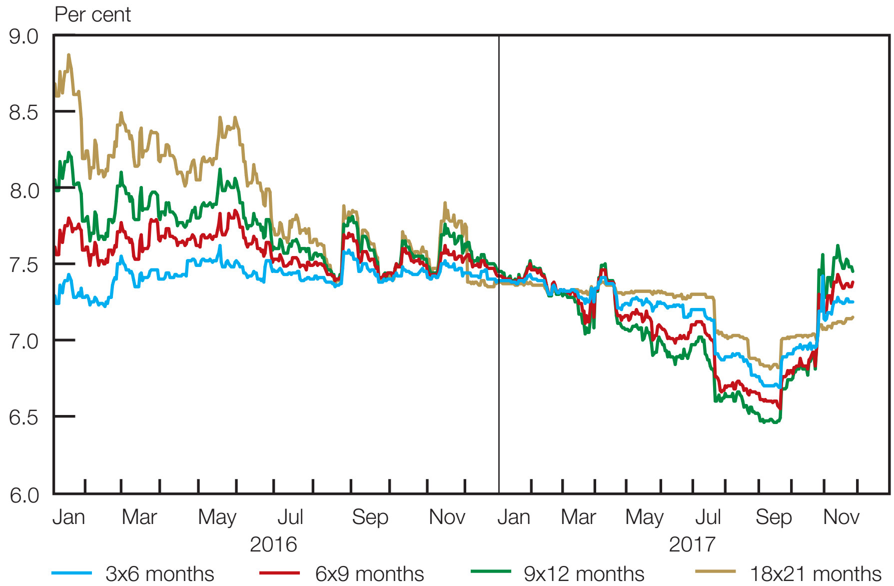
Benchmark overnight rates



Source: SARB

Overall funding conditions in the market for interbank lending remained fairly stable in the second half of 2017, with rates only occasionally exceeding the standing facility limits. The South African Benchmark Overnight Rate (Sabor) closely emulated the 25 basis point reduction in the policy rate in mid-July 2017 and stood at 6.72% on 30 November 2017. The close alignment of the Sabor with the repurchase rate is reflected in the difference between the two rates averaging around 2 basis points since the start of 2017, slightly narrower than the average of 5 basis points for 2016 as a whole. By contrast, the implied rate on one-day rand funding in the foreign exchange swap market (overnight FX rate) displayed more volatility, declining by 160 basis points from 8.30% on 3 July 2017 to 6.70% on 22 September. Subsequently, this rate increased to 8.30% on 31 October, affected by the high demand for liquidity towards month-end. The overnight FX rate fluctuated moderately lower during November, ending the month at 6.75% when liquidity conditions stabilised.

Forward rate agreements



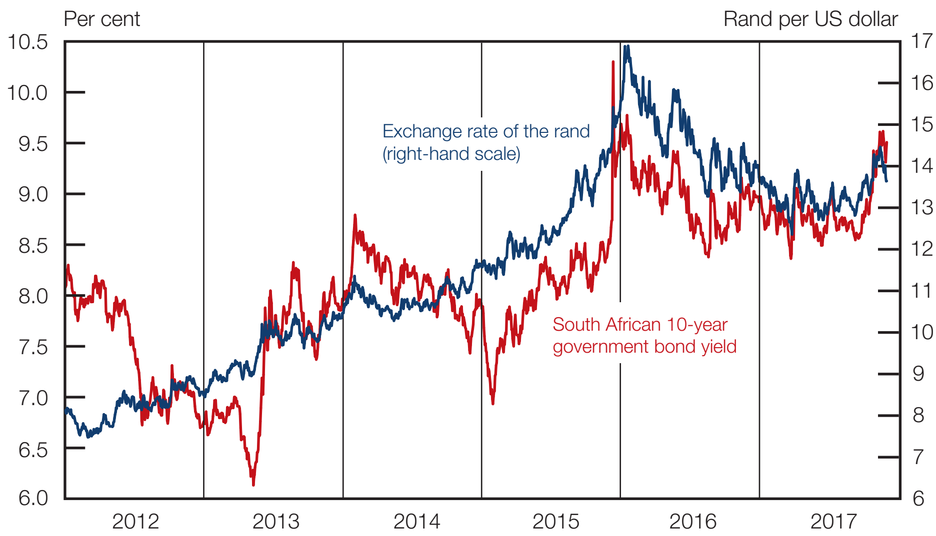
Source: SARB

Rates on forward rate agreements (FRAs) trended lower during most of the third quarter of 2017, initially affected by the July MPC decision to reduce the policy rate and later by the appreciation in the exchange value of the rand and lower-than-expected inflation outcomes. For example, the 9x12-month FRA declined by 56 basis points from 7.02% on 8 July to 6.46% on 16 September. However, the downward momentum was reversed after the September MPC decision to keep the policy rate unchanged in light of a less favourable inflation outlook. Subsequently, FRA rates moved higher, with the 9x12-month FRA increasing to as high as 7.62% on 13 November before moderating to 7.48% on 30 November. Similarly, the 3x6-month FRA increased by 73 basis points from 6.69% on 20 September 2017 to a recent high of 7.42% on 30 October, before declining slightly to 7.25% at the end of November when market conditions stabilised. At these levels FRA rates are discounting the possibility of policy rate increases during 2018.

The prime lending rate and the predominant rate on mortgage loans both decreased to 10.25% following the July 2017 MPC decision to lower the repurchase rate. Private sector banks subsequently held their various deposit and lending rates relatively stable alongside the unchanged policy rate.

Yields on rand-denominated bonds of the South African government issued in the domestic market declined significantly during most of 2016, before fluctuating broadly sideways until the beginning of September 2017. During this period, bond yields closely followed, and continued to follow, movements in the exchange value of the rand. The daily closing yield on the conventional 10-year South African government bond declined, on balance, by 175 basis points from a high of 10.30% on 11 December 2015 to 8.55% on 8 September 2017. Subsequently, bond yields increased noticeably to 9.51% on 30 November in response to rising government debt levels projected in the *2017 MTBPS* and increased expectations of a credit rating downgrade, followed by S&P Global Ratings downgrading South Africa's short- and long-term local currency ratings to sub-investment grade on 24 November, although ascribing a stable outlook amid continued elevated political uncertainty. Meanwhile, in international bond markets the daily closing yield on the US and euro area 10-year bonds of foreign governments also increased somewhat by 33 basis points and 7 basis points respectively from 8 September 2017 to 30 November, reflecting monetary tightening in some advanced economies.

Government bond yield and the exchange rate



Sources: IRESS, JSE and SARB

The level of the *yield curve* moved higher and the slope steepened from the beginning of September 2017 as bond yields increased across most of the maturity spectrum. The longer end of the curve was driven by expectations of higher domestic inflation following the depreciation in the exchange value of the rand and expectations of a sovereign credit rating downgrade, which eventually materialised. By contrast, the short end of the curve remained anchored to the unchanged repurchase rate. Consequently, the yield gap, measured as the difference between yields at the extreme long and short ends of the curve, widened from 300 basis points on 8 September 2017 to 367 basis points on 30 November.

Emerging markets continued to attract foreign bond inflows despite the significant narrowing of the yield spread offered by global emerging markets relative to US government bonds, from 383 basis points at the end of November 2016 to 336 basis points in November 2017, as measured by the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[6]. On a relative basis, the *sovereign risk premium*[7] on South African government US dollar-denominated bonds in the seven-year maturity range narrowed by a much smaller margin, from 208 basis points to 201 basis points over the same period, due to idiosyncratic South African developments.

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

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

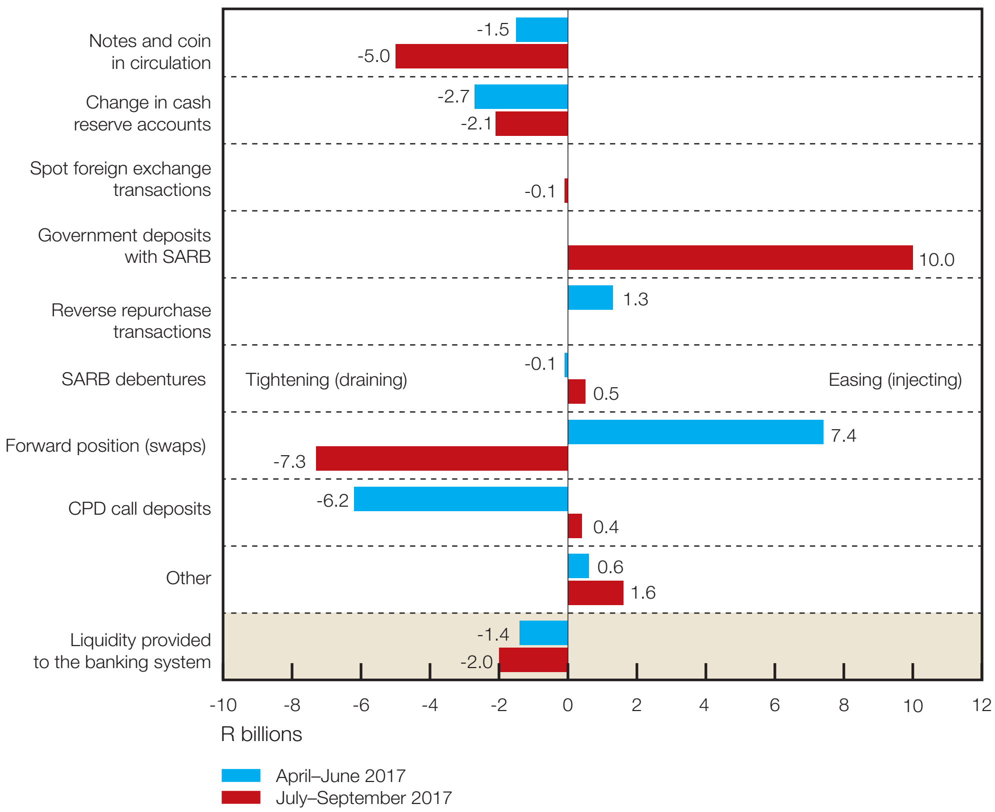
Money market

The liquidity management operations of the SARB aim to ensure broad alignment between the money market shortage and underlying conditions in the money market. Since September 2016, the SARB has maintained the average actual daily liquidity requirement of private sector banks at a level of around R56 billion, after allowing for a gradual increase in the money market shortage in order to align it with the growth trend in notes and coin in circulation outside the SARB. The third quarter of 2017 was no exception, with the average actual daily liquidity requirement amounting to R56.1 billion, varying between a low of R50.5 billion and a high of R60.9 billion. This was marginally wider than the range of between R52.1 billion and R60.4 billion recorded in the preceding quarter.

Liquidity to the net amount of R2.0 billion was drained from the money market in the third quarter of 2017, slightly more than the R1.4 billion during the previous quarter. In the three months to September 2017, the net result of the change in the amount of notes and coin in circulation outside the SARB as well as banks' required cash reserve deposits contracted money market liquidity by R7.2 billion. Forward position foreign exchange swap transactions contracted market liquidity by a further R7.3 billion. However, in the 'other' category, this was partly neutralised by a National Treasury Sterilisation Deposit Account foreign exchange swap transaction, conducted on behalf of National Treasury for bridging financing purposes, while the

CPD decreased its deposit holdings at the SARB by R0.4 billion. In October and November 2017 overall money market liquidity conditions were characterised by a net injection of R3.3 billion, with liquidity management operations by the SARB injecting R9.4 billion into the market.

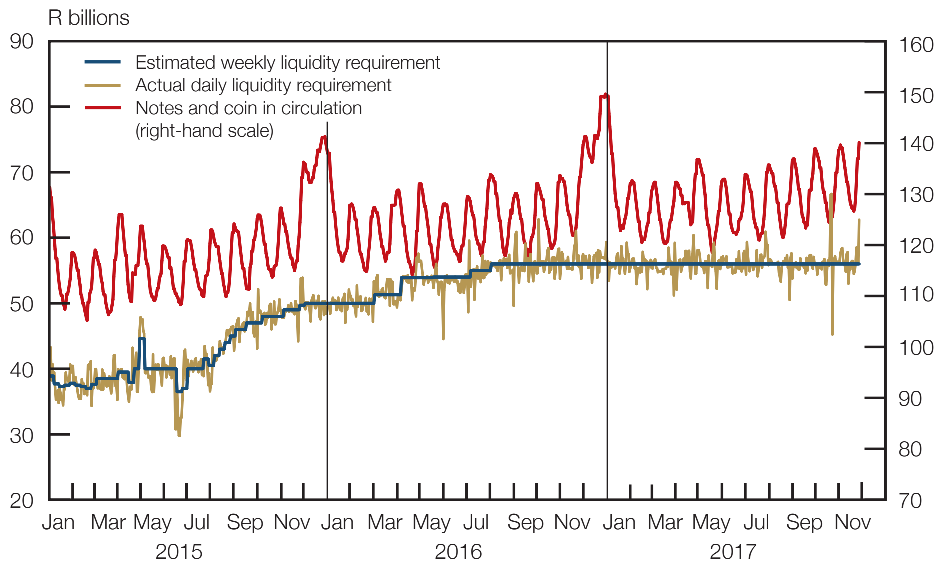
Factors influencing money market liquidity flows



Source: SARB

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R67.8 billion were effected from the government tax and loan accounts from July to September 2017. Of this, only R148 million accrued to the SARB.

Liquidity requirement



Source: SARB

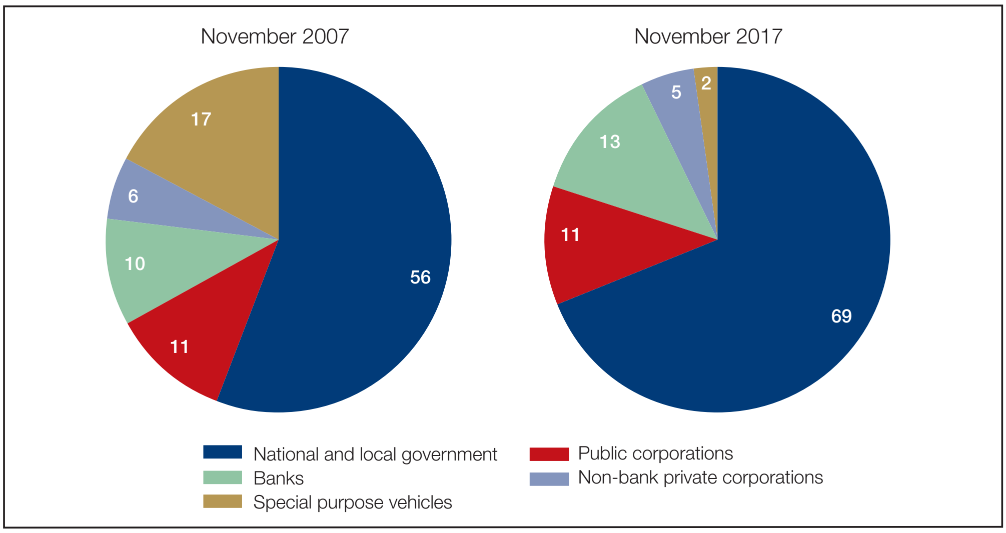
Bond market

8 Only national and local government issue bonds.

Over a period of 10 years, net debt issuance in the domestic *primary bond market* translated into an increase of 246% in the total outstanding nominal value of listed debt securities in issue on the JSE to R2.7 trillion as at the end of November 2017. The general government[8] sector increased its dominance due to national government's need to finance sizeable budget deficits. Banks, non-bank private corporations and public corporations maintained their contribution, while that of private sector securitised bonds declined significantly following the global financial crisis.

Change in the structure of the total outstanding nominal value of listed debt securities

Per cent



Sources: JSE and SARB

The private sector's net bond issuance increased significantly from only R0.7 billion in the first 11 months of 2016 to R51.8 billion in the corresponding period of 2017, driven by both banks and non-bank companies in an environment where strong investor demand provided issuers with the opportunity to place debt at attractive interest rates. The redemption of the R203 government bond to the value of R21.3 billion on 15 September 2017 reduced the net issuances of public sector bonds to R156 billion during the first 11 months of 2017, compared with R190 billion in the corresponding period of 2016.

9 This ratio is measured as the value of bonds traded relative to the market capitalisation of bonds listed.

In the secondary bond market the R186 bond replaced the now redeemed R203 bond as the most liquid government bond. Despite the lower value of turnover of all listed bonds in the secondary bond market in the first 11 months of 2017, the bond market liquidity ratio[9] remained at around 11.1 times per annum in 2016 and thus far in 2017. For the year to November 2017, the daily average turnover of R114 billion was 2.0% less than in the corresponding period of 2016, despite the all-time high in October 2017.

The South African government raised US$2.5 billion in the international capital markets in September 2017 through the placement of two bonds to the equivalent value of R33.9 billion. The 10-year US$1 billion was priced at a coupon rate of 4.85%, while the 30-year US$1.5 billion bond carries a coupon rate of 5.65%. The strategic issuance of these longer-dated bonds is aligned to financing plans as projected in the *2017 Budget Review*.

The outstanding amount in issue of rand-denominated bonds in the *European and Japanese bond markets* continued to decrease throughout 2017. Net issuances of R11.8 billion in the period January to November 2016 reverted to net redemptions of R20.4 billion in the corresponding period of 2017. These net redemptions of rand-denominated debt in 2017 occurred despite the attractive yields.

Primary market activity in rand-denominated bonds in international bond markets from January to November

R millions

	Eurorand		Uridashi		Total	
	2016	2017	2016	2017	2016	2017
Issuances	26 513	15 614	10 642	3 159	37 156	18 773
Redemptions	12 941	30 999	12 387	8 203	25 328	39 202
Net	13 572	-15 385	-1 744	-5 044	11 828	-20 429

Source: Bloomberg

Non-resident holdings of domestic bonds increased by a further R25.4 billion in the third quarter of 2017 following net purchases of R17.1 billion in the second quarter, according to the JSE. However, non-residents were net sellers of domestic bonds to the value of R13.1 billion in October 2017 – the highest monthly net sales since December 2016 – followed by net sales of R12.8 billion in November. The sell-off resulted primarily from increased concerns over South Africa's credit rating, persistent domestic political uncertainty, the depreciation in the exchange value of the rand, and the higher-than-expected consumer price inflation outcome in October. Nonetheless, the continued global search for yield still resulted in cumulative non-resident net purchases of domestic bonds of R30.3 billion in the first 11 months of 2017, compared with net sales of R18.6 billion over the same period of 2016. Non-residents' participation rate[10] averaged 8.1% in the first 11 months of 2017, marginally higher than in 2016.

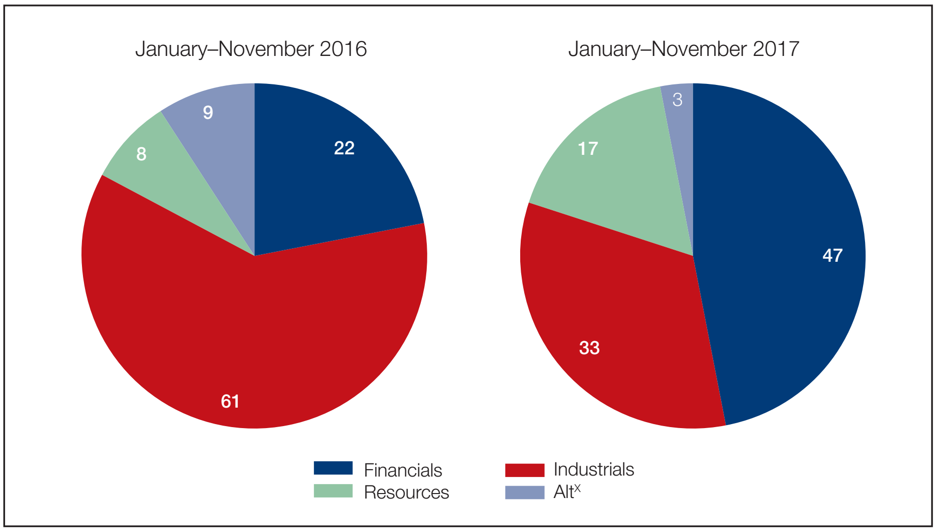
10 The non-resident participation rate in the bond market is measured as the gross value of bonds traded by non-residents as a percentage of the total value of bonds traded on the JSE.

Share market

Companies listed on the JSE raised less *equity capital* in the domestic and international primary share markets in the first 11 months of 2017 than in the same period of 2016. The value of shares issued by JSE-listed companies decreased by 15.2% from R108 billion in the first 11 months of 2016 to R91.8 billion in the corresponding period of 2017, partly due to a decline in the number of companies listed on the JSE following numerous delistings. From January to November 2017, companies in the financial sector contributed most to the total value of shares issued at 47.3% of total equity capital raised, compared with 22.1% in the corresponding period of 2016.

Equity capital raised by sector

Per cent



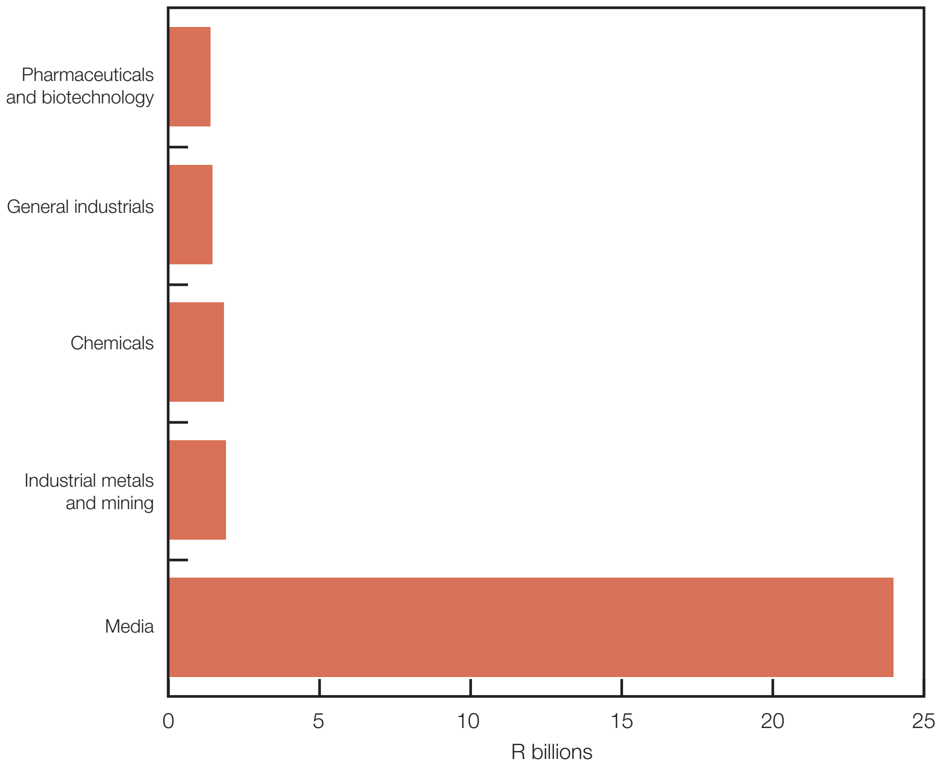
Sources: JSE and SARB

The *value of turnover* in the secondary share market of the JSE was subdued in the first 11 months of 2017 compared with the same period of 2016, despite higher share prices. Daily average turnover of R21.4 billion in the 11 months to November 2017 was 11.1% less than in the corresponding period of 2016. Record high share prices boosted the market capitalisation of the JSE from a most recent low of R13.5 trillion in February 2017 to an all-time high of R16.2 trillion in October, before declining somewhat to R15.9 trillion in November.

Non-residents were net buyers of listed shares to the value of R10.8 billion in October and November 2017, following net sales in the preceding two months, according to the JSE. Non-residents' net purchases in the domestic share market in October and November 2017 could be attributed to, among other things, investors moving out of debt securities and into equities in anticipation of a credit rating downgrade of bonds and the spillover effect of higher global prices of dual-listed company shares. These net purchases were mostly in the media, industrial metals and mining, chemicals, general industrial as well as the pharmaceutical and biotechnology sectors. The media sector attracted the largest net purchases of R24.0 billion in October and November 2017. For the first 11 months of 2017, non-residents' net sales of JSE-listed shares amounted to R79.1 billion compared with net sales of R120 billion during the corresponding period of 2016. The non-resident participation rate[11] averaged 18.3% in the first 11 months of 2017, similar to the level recorded in 2016.

11 The non-resident participation rate in the share market is measured as the combined value of non-residents' purchases and sales as a percentage of the total value of shares traded on the JSE.

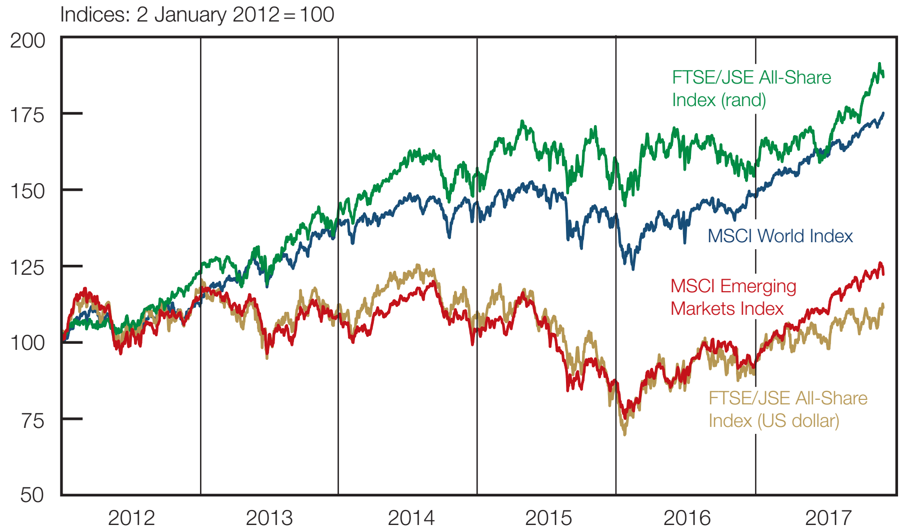
Selected non-resident net purchases of listed shares in October and November 2017



Source: JSE

Share prices of companies listed on the JSE generally increased during 2017 despite some brief interruptions. The FTSE/JSE All-Share Price Index (Alsi) increased by 20.4% from a recent low of 50 832 index points on 15 June 2017 to an all-time high of 61 212 index points on 21 November, breaking the 60 000 mark for the first time. The surge in share prices was led by industrial and resources companies. The drivers of share prices included the depreciation in the exchange value of the rand, higher international commodity prices and higher share prices of companies listed on international bourses following, among other things, a more optimistic global economic growth outlook as reflected by the co-movement of the Alsi, the MSCI Emerging Markets Index and the MSCI World Index.

Share price indices



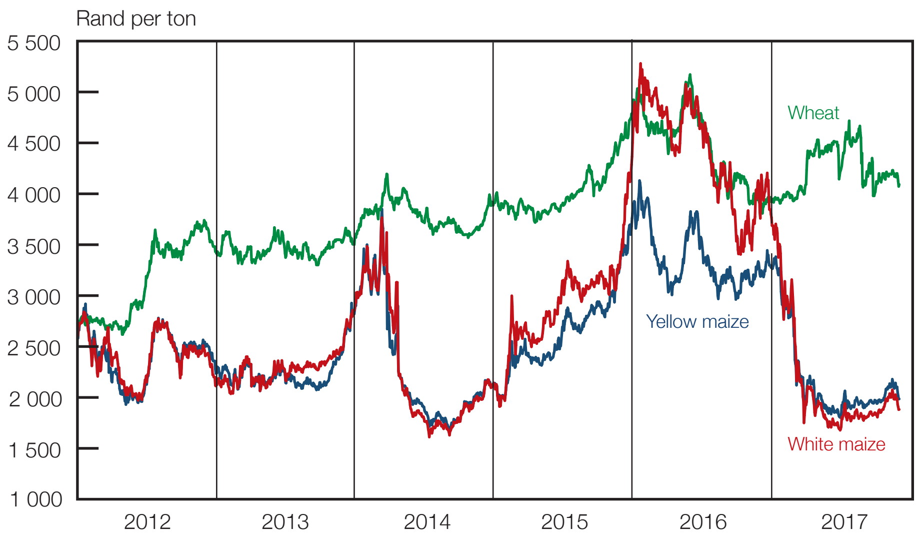
Sources: IRESS, Bloomberg, JSE and SARB

The historical *price-earnings ratio* of all classes of ordinary shares listed across all sectors and boards on the JSE receded from a recent high of 33.1 in January 2017 to 22.1 in October, largely on account of significant earnings growth.

Market for exchange-traded derivatives

During the first half of 2017, the *spot prices of white and yellow maize* contracts listed on the JSE Commodity Derivatives Market (CDM) fell sharply along with the then appreciation in the exchange value of the rand, lower international maize prices and the record domestic harvest. However, the decline in the spot prices of white and yellow maize was arrested when the price of white maize increased by 12.2% from a recent low of R1 678 per ton on 28 June 2017 to R1 882 per ton on 30 November, and that of yellow maize by 10.0% over the same period. These increases were directly influenced by the depreciation in the exchange value of the rand. The increase in international crude oil prices pushed up domestic fuel prices and also affected domestic grain prices by raising agricultural input costs. In addition, South Africa's Crop Estimates Committee also indicated farmers' intention to plant less white maize along with a switch to other crops, such as oilseeds, following the 2017 bumper maize crop and depressed maize prices.

South African grain prices



Source: JSE

By contrast, the *spot price of domestic wheat* contracts increased during most of 2017 to a recent high of R4 717 per ton on 21 July along with higher international wheat prices. This necessitated a reduction in South Africa's wheat import tariff of 60% to R379.3 per ton in early September 2017. Subsequently, the spot price of domestic wheat fell by 13.2% to R4 092 per ton on 30 November when international wheat prices declined. This led to an increase in the wheat import tariff of 140% to R910 per ton in November. However, persistent drought in the Western Cape continues to pose a serious risk for domestic wheat supplies and prices.

The JSE listed a rand-denominated Quanto Gold Can-do contract on the CDM in September 2017, with an underlying gold contract traded on COMEX. This new contract provides pure commodity exposure without associated exchange rate risk.

Turnover on the CDM of the JSE decreased markedly by 41.4% in the 11 months to November 2017 compared with the corresponding period of 2016. This decline in turnover reflected volatile currency and domestic agricultural commodity price movements.

Derivatives turnover on the JSE, January to November 2017

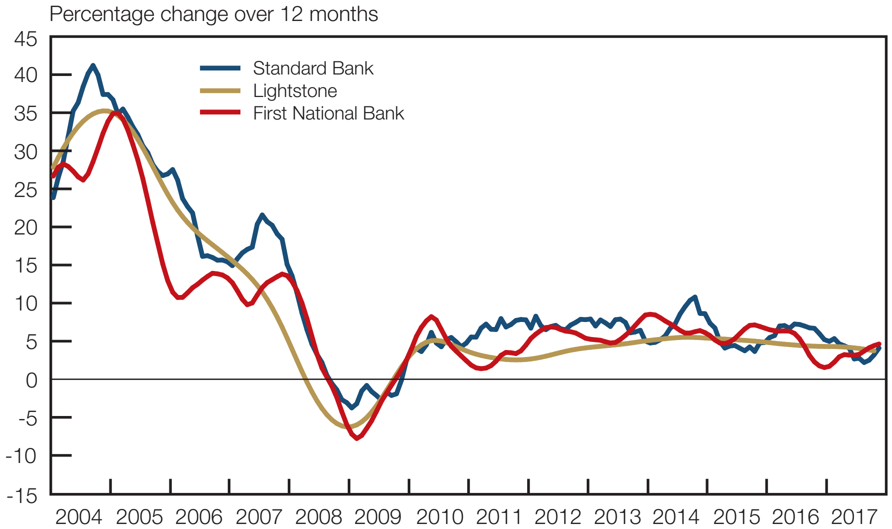
Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity	5 320	-12
Warrants	0.6	3
Commodity	535	-41
Interest rate	1 333	23
Currency	785	14

Source: JSE

Real estate market

Growth in nominal residential property prices remained subdued and noticeably below consumer price inflation in the 11 months to November 2017. In an environment of weak domestic economic growth, sluggish employment growth, tight credit conditions, weak consumer confidence and financially constrained households, the average time that residential properties remained on the market rose slightly from 15.4 weeks in the second quarter of 2017 to 15.6 weeks in the third quarter. This depressed year-on-year growth in nominal house prices to a range of between 3.7% and 4.6% across the various indicators in November 2017.

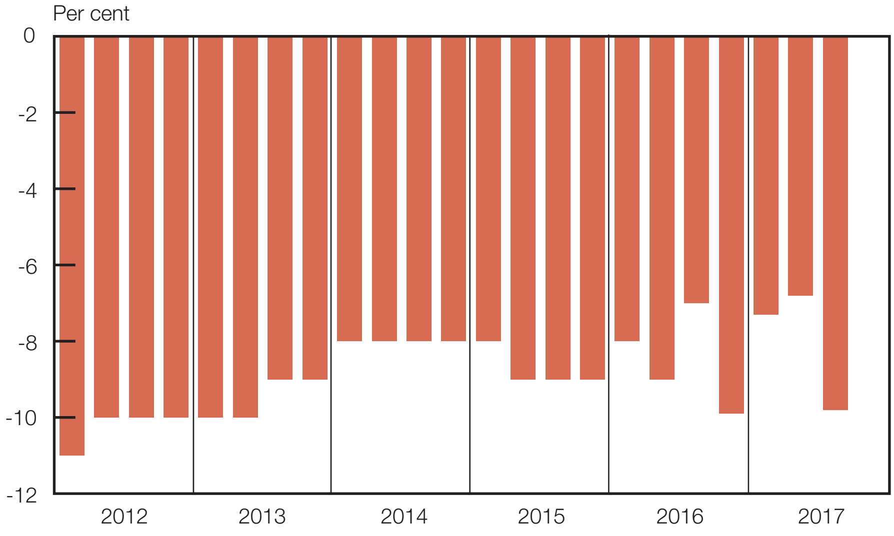
Nominal house prices



Sources: FNB, Lightstone and Standard Bank

According to the latest FNB Estate Agent Survey, the time that properties remained on the market also increased the proportion of sellers who reduced asking prices, from a low of 78% in the second quarter of 2014 to 93% in the third quarter of 2017. In addition, the lack of demand led to an increase in the average percentage reduction in asking prices from 6.8% in the second quarter of 2017 to 9.8% in the third quarter.

Average reduction in residential property asking prices



Source: FNB

Non-bank financial intermediaries[12]

The consolidated assets of non-bank financial institutions increased by 3.2% from the second quarter of 2017 to R9.1 trillion in the third quarter, supported by an increase in financial asset prices. The assets of long-term insurance companies and unit trusts increased the most, by 4.0% to R2.9 trillion and 3.7% to R2.5 trillion respectively in the third quarter of 2017. The assets of non-bank financial institutions grew by 6.3% over the first three quarters of 2017 compared with 5.1% over the same period of 2016.

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

Total assets of non-bank financial institutions

Source: SARB

The value of shares held by non-bank financial institutions increased by 0.3 percentage points from the second quarter of 2017 to 56.7% of total assets in the third quarter. The steady increase in exposure to this asset class in 2017 was largely driven by the steep increase in share prices. The proportion of interest-bearing securities remained unchanged at 29.8% of total assets in the third quarter of 2017.

Holdings of cash and deposits remained unchanged at 5.5% of total assets in the third quarter of 2017, but declined by 0.7 percentage points in the first three quarters of 2017. The value of loans extended by non-bank financial institutions to households and companies declined by 0.2 percentage points from the second quarter of 2017 to 4.9% of total assets in the third quarter.

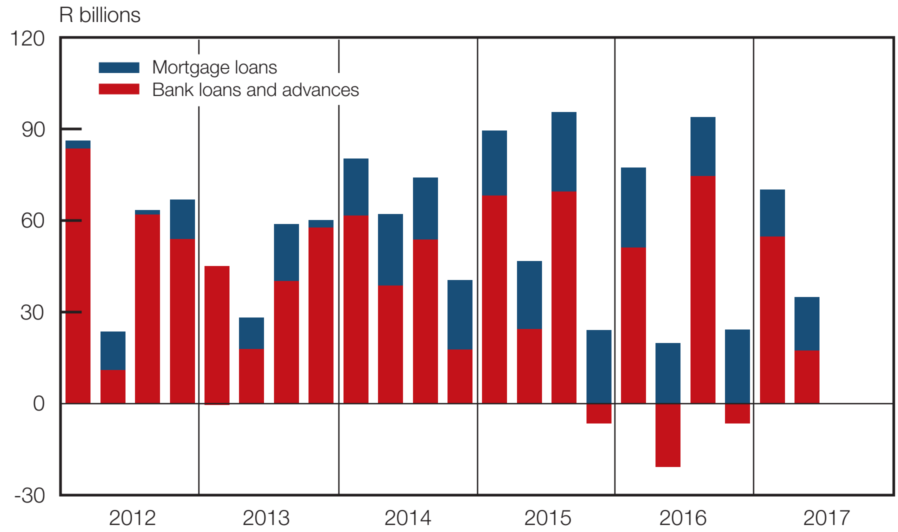
Flow of funds

The South African economy received net capital inflows of R18.1 billion from the *rest of the world* in the second quarter of 2017, less than the R31.2 billion in the first quarter. The lower net capital inflows in the second quarter were mostly related to the decline in the extension of loans to R0.1 billion from R37.1 billion in the first quarter. Non-residents continued to acquire long-term government bonds of R48.2 billion in the second quarter of 2017 as yields remained comparatively attractive. Non-residents' net purchases of equity amounted to R15.4 billion over the same period.

Financial intermediaries' net inflows in the second quarter of 2017 largely reflected deposits with banks by general government and households, which contributed R29.1 billion and R21.8 billion respectively. Meanwhile, public and private non-financial corporate business enterprises reduced their deposit balances by R13.5 billion in the second quarter of 2017. Other inflows to financial intermediaries included R24.0 billion related to interest in retirement and life funds, and R33.3 billion placed with other financial institutions for further investment in various assets.

In the second quarter of 2017, funds received by financial intermediaries were mostly redirected into the domestic economy through the extension of loans amounting to R47.1 billion. However, the combined value of bank loans and advances and mortgage loans was R34.8 billion, much less than the R70.1 billion during the first quarter of 2017, in an environment of low business and consumer confidence and constrained domestic demand. Financial intermediaries also recorded net purchases of equities of R17.3 billion and fixed-interest securities of R10.2 billion.

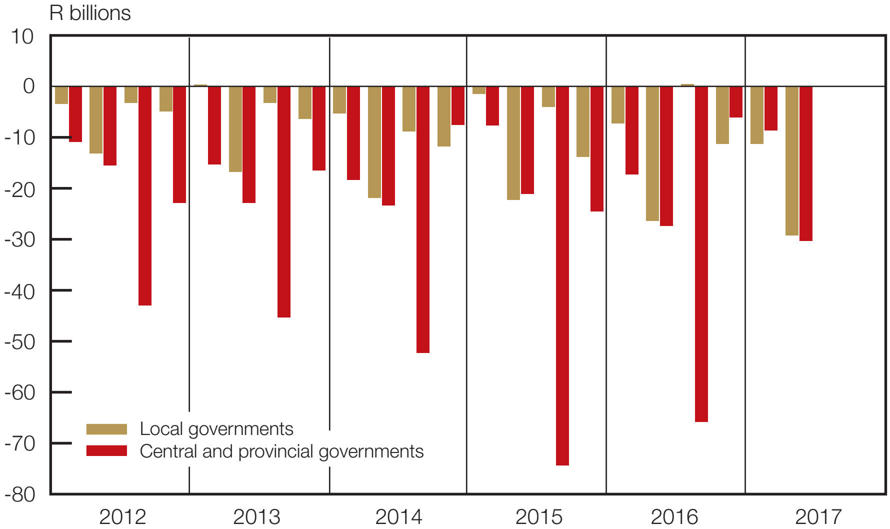
Financial intermediation by main credit extension instruments



Source: SARB

The *general government sector's* revenue collection declined at a faster pace than expenditure in the second quarter of 2017, resulting in net borrowing of R59.5 billion, which was substantially more than the R22.3 billion in the preceding quarter. This shortfall comprised R29.3 billion from local governments and R30.3 billion from central and provincial governments. In addition to the funding needs, national government redeemed an international bond in the second quarter of 2017. The shortfall was mainly funded through the net issuance of Treasury bills of R7.5 billion and long-term government bonds of R51.1 billion, as well as bank loans and advances of R14.4 billion.

General government's net borrowing



Source: SARB

Public and private non-financial corporate business enterprises' gross capital formation increased to R153 billion in the second quarter of 2017 from R124 billion in the preceding quarter. This sector contributed 68.5% to total gross capital formation in the economy and 13.3% relative to GDP. Among other things, the increase in capital spending resulted in overall net borrowing of R21.6 billion during the review period, which was funded through loans of R52.5 billion and equity issuances of R20.6 billion.

During the second quarter of 2017, the *household sector* recorded net lending of R38.7 billion following two quarters of net borrowing. This surplus was intermediated into the economy through increased deposits and interest in retirement and life funds. Meanwhile, credit to households amounted to R10.1 billion in the second quarter of 2017, significantly less than the R21.2 billion in the first quarter.

13 Unless stated to the contrary, the year-on-year rates of increase in this section compare April–September 2017 to April–September 2016. Data for fiscal 2016/17 are unaudited and remain preliminary.

14 The non-financial public sector borrowing requirement is calculated as the cash deficit/surplus of the consolidated central, provincial and local governments as well as non-financial public enterprises and corporations.

Public finance[13]

Non-financial public sector borrowing requirement[14]

The *non-financial public sector borrowing requirement* of R158 billion in the first half of fiscal 2017/18 (April–September 2017) was R35.9 billion more than in the same period a year earlier. This increase could mainly be attributed to the higher cash deficits of national government as well as of non-financial public enterprises and corporations. Furthermore, the cash surpluses of local governments and extra-budgetary institutions decreased over the period, whereas provincial governments and social security funds recorded increases in cash surpluses.

Non-financial public sector borrowing requirement

R billions

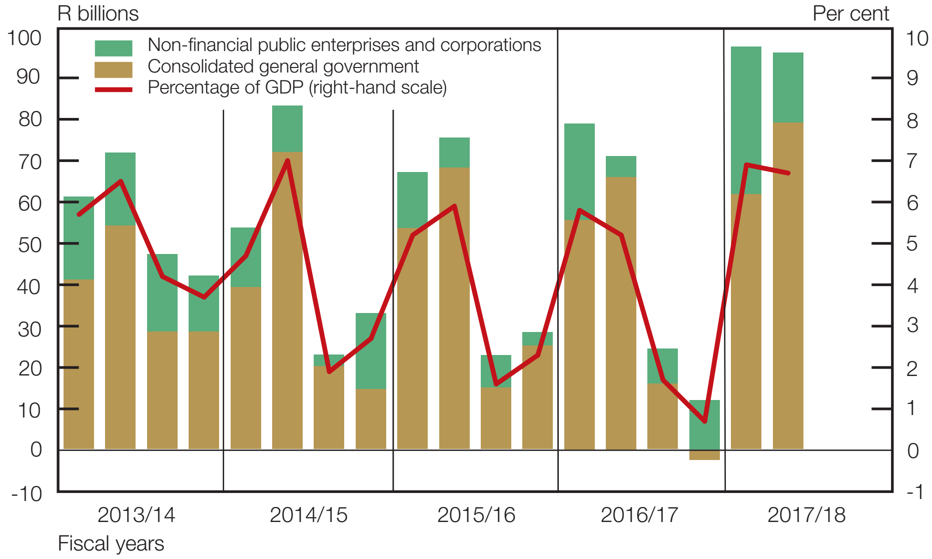
Level of government	April–September 2016*	April–September 2017*
Consolidated general government	99.1	114.9
National government	123.3	140.2
Extra-budgetary institutions	-6.0	-4.3
Social security funds	-5.0	-10.1
Provincial governments	-4.0	-8.7
Local governments	-9.1	-2.1
Non-financial public enterprises and corporations	23.0	43.1
Total**	122.2	158.0
As a percentage of gross domestic product	*5.6*	*6.8*

* 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 increased from 5.6% in April–September 2016 to 6.8% in April–September 2017. In addition, the borrowing requirement of consolidated general government widened from R99.1 billion (4.6% of GDP) to R115 billion (5.0% of GDP) over the same period.

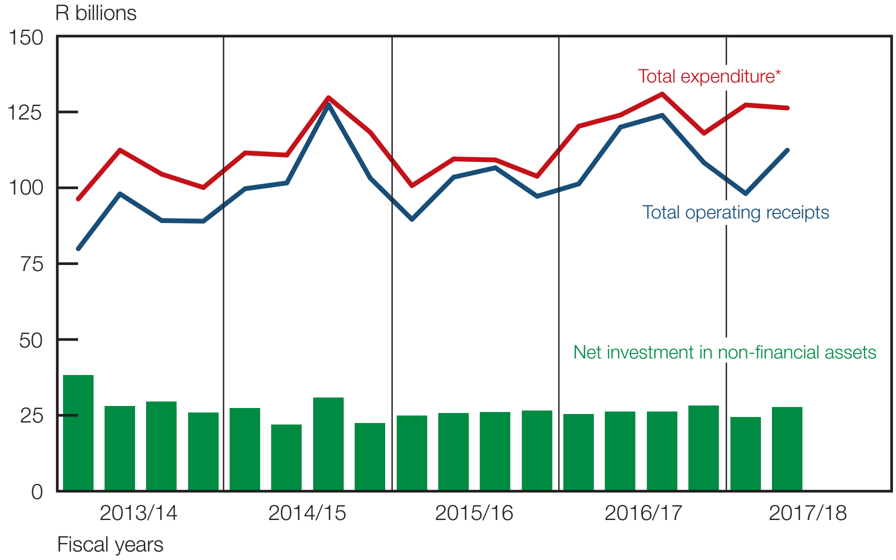
Non-financial public sector borrowing requirement



Sources: National Treasury, Stats SA and SARB

The preliminary cash deficit of *non-financial public enterprises* and corporations, or *non-financial state-owned companies* (SOCs), was R43.1 billion in the first half of fiscal 2017/18 – R20.1 billion more than in the same period of the previous fiscal year. This higher cash deficit could be attributed to lower operating cash receipts together with increased operating expenses. Total cash receipts from operating activities amounted to R211 billion in April–September 2017, or 4.9% less than in April–September 2016.

Financial activities of non-financial public enterprises and corporations



* Including both operating cash payments and net investment in non-financial assets
Source: SARB

Total expenditure (including both operating cash payments and net investment in non-financial assets) by non-financial SOCs was R254 billion in the first half of fiscal 2017/18, representing a year-on-year increase of 3.8%. This growth in total expenditure was mainly driven by a year-on-year increase of 4.6% in operating cash payments, which amounted to R201 billion. Over the same period, SOCs' net investment in non-financial assets came to R52.3 billion.

The total outstanding listed debt of non-financial SOCs was R260 billion as at 30 September 2017 – 0.3% more than a year earlier. Borrowing by SOCs for infrastructure financing remained constrained in an environment of rising borrowing costs, low investor confidence, credit rating downgrades and weak domestic economic activity.

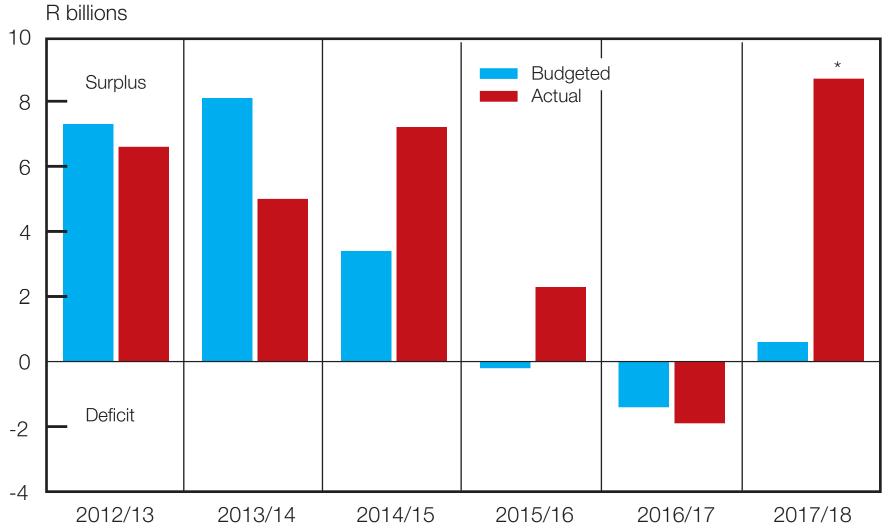
The *national government's* preliminary total cash receipts from operating activities amounted to R568 billion in the first half of fiscal 2017/18 – some 5.1% more than in the same period of the previous year. Growth in total cash receipts from operating activities of national government resulted mainly from higher revenue collections from taxes on income, profits and capital gains as well as taxes on goods and services. By contrast, taxes on international trade and transactions as well as non-tax revenue decreased in the first half of fiscal 2017/18 compared to the first half of fiscal 2016/17.

Cash payments for operating activities of national government amounted to R701 billion in April–September 2017, representing an annual increase of 7.0%. Over this period, spending on the compensation of employees came to R77.8 billion – 10.9% more than in April–September 2016. Grants (equitable and conditional transfers) to other levels of general government amounted to R385 billion, accounting for 54.8% of total cash payments for operating activities of national government over the period.

National government's net cash flow from operating activities, together with its net investment in non-financial assets, resulted in a cash deficit of R140 billion in the first half of fiscal 2017/18 – some R16.9 billion more than in the same period of the previous fiscal year.

Preliminary financial statistics of *provincial governments* revealed a cash surplus of R8.7 billion for April–September 2017 – some R4.7 billion more than in April–September 2016 – as growth in total cash receipts outpaced that in total cash payments from operating activities. The *2017 Budget Review* estimated a cash surplus of R0.6 billion for provincial governments for fiscal 2017/18 as a whole, which was revised marginally upwards to R0.8 billion in the *2017 MTBPS*.

Provincial government finances



* April–September 2017

Source: National Treasury

Total cash receipts from operating activities of provincial governments increased by a year-on-year rate of 7.2% to R280 billion in the first half of fiscal 2017/18. Grants received from national government of R271 billion, mainly in the form of equitable share transfers and conditional grants, accounted for 96.7% of provincial governments' total cash receipts. KwaZulu-Natal, the Eastern Cape and Gauteng remained the largest recipients of national government transfers.

Provincial governments' total expenditure (i.e. cash payments for operating activities, including net investment in non-financial assets) of R271 billion in April–September 2017 was 5.5% more than in the same period of the previous year. This increase could mainly be attributed to a higher provincial compensation bill, in particular for educators and health practitioners, which represented about 60% of total provincial government spending over the six-month period.

Provincial governments' deposits with the CPD decreased from R23.7 billion at the end of March 2017 to R21.9 billion at the end of September 2017. However, deposits with private banks more than doubled from R10.5 billion to R21.9 billion, whereas provincial governments' overall indebtedness to banks decreased slightly from R0.7 billion to R0.2 billion over the period.

The estimated cash surplus of *local governments (municipalities)* of R2.1 billion in April–September 2017 was significantly lower than the R9.1 billion in April–September 2016. This lower cash surplus resulted from higher cash payments for operating activities, mainly purchases of water and electricity.

Total cash receipts of local governments amounted to R176 billion in April–September 2017, representing an increase of R3.0 billion from April–September 2016. This increase resulted from growth in self-generated revenue – predominantly from service charges, and property rates and taxes.

Municipalities' total expenditure – cash payments for operating activities and net investment in non-financial assets – increased to R174 billion in April–September 2017 compared with R164 billion in April–September 2016. Purchases of goods and services, mainly water and electricity, continued to be the largest municipal operating expense. Capital investment by municipalities increased slightly by 0.5%, resulting in net investment in non-financial assets of R24.7 billion in April–September 2017.

The preliminary cash surplus of *extra-budgetary institutions* of R4.3 billion in the first half of fiscal 2017/18 was R1.7 billion less than in April–September 2016. The lower cash surplus was due to increased total expenditure, driven largely by net investment in non-financial assets that outweighed higher cash receipts from operating activities.

The preliminary cash surplus of *social security funds* increased by R5.1 billion year on year to R10.1 billion in April–September 2017.

Budget comparable analysis of national government finance

National government expenditure increased at a much faster pace than national government revenue in the first six months of fiscal 2017/18, resulting in a wider cash book deficit than originally budgeted. Growth in both national government revenue and expenditure fell short of the original 2017 Budget projections.

National government finances: key statistics, 2017/18

Year-on-year percentage change*

	Originally budgeted** Full 2017/18	Actual Apr–Sep 2017
Expenditure	7.9	6.6
Revenue	9.5	3.8
Memo: cash book deficit	R167 billion	R147 billion

* Fiscal 2016/17 to fiscal 2017/18
** *2017 Budget Review*

Sources: National Treasury and SARS

National government expenditure amounted to R687 billion in April–September 2017 – 6.6% more than in the same period of the previous fiscal year. This increase was mainly due to voted expenditure (current payments, transfers and subsidies as well as payments for capital and financial assets) of R374 billion – the largest contributor to national government expenditure. As a ratio of GDP, national government expenditure remained unchanged at 29.7% in April–September 2017 compared with the same period a year earlier. The *2017 MTBPS* revised national government expenditure slightly higher to R1 413 billion for fiscal 2017/18 as a whole, compared to R1 409 billion projected in the *2017 Budget Review.*

Higher voted expenditure could mainly be attributed to a significant increase in transfers and subsidies, along with an increase in current payments. Transfers and subsidies of R261 billion represented an annual increase of 7.2%, and mostly related to increased spending by the departments of Social Development, Education, Health, Transport, Human Settlements, National Treasury, and Cooperative Governance and Traditional Affairs (COGTA). COGTA transferred R23.5 billion to municipalities in July 2017.

Current payments of R102 billion in April–September 2017 reflected a marginal increase of only 1.1%. The departments of Correctional Services, Police, and Defence and Military Veterans together accounted for 67.5% of these payments.

National government expenditure in fiscal 2017/18

Expenditure item	Originally budgeted Full 2017/18		Actual Apr–Sep 2017	
	R billions	Percentage change*	R billions	Percentage change*
Voted expenditure	767.0	7.0	374.2	5.4
Of which: Current payments	*216.9*	*5.0*	*102.1*	*1.1*
Transfers and subsidies	*529.2*	*8.1*	*261.1*	*7.2*
Payments for capital assets	*15.8*	*1.5*	*5.6*	*0.3*
Payments for financial assets	*5.0*	*3.2*	*5.4*	*13.2*
Statutory amounts**	642.2	9.1	261.0	9.4
Of which: Interest on debt	*162.2*	*10.9*	*78.6*	*9.8*
Equitable share transfers	*441.3*	*7.5*	*220.7*	*7.5*
Total expenditure	1 409.2	7.9	687.3	6.6

* Fiscal 2016/17 to fiscal 2017/18. Note that numbers might differ from previous editions of the *Quarterly Bulletin* due to the audited outcome of fiscal 2016/17.
** Including extraordinary payments

Source: National Treasury

Payments for financial assets of R5.4 billion in the first six months of fiscal 2017/18 was 13.2% more than in the same period of fiscal 2016/17. The marked increase mainly reflected the emergency transfer of R5.4 billion from the National Revenue Fund to South African Airways to settle debt that fell due.

Interest paid on national government debt of R78.6 billion in April–September 2017 was 9.8% more than in the same period a year ago. Interest payments continued to increase in line with the rising stock of outstanding national government debt. The *2017 MTBPS* projected debt-service cost in fiscal 2017/18 to be R1.0 billion more than the R162 billion projected in the *2017 Budget Review.*

Equitable share transfers of R221 billion to provinces in April–September 2017 – their main source of revenue – was 7.5% more than in the same period a year earlier. Metropolitan municipalities received the first transfer of R3.9 billion in August 2017 as their share of the general fuel levy, with the next payment due in December 2017.

15 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.

After taking into account cash flow adjustments[15], the cash flow expenditure of national government amounted to R672 billion in the first six months of fiscal 2017/18, representing an increase of 7.0% relative to the same period of the previous fiscal year.

National government revenue of R540 billion in April–September 2017 was only 3.8% more than in April–September 2016, and R34.1 billion less than the cumulative monthly budgeted estimates. Although positive, year-on-year growth in most main tax categories was well below budgeted estimates. Relative to GDP, national government revenue was 23.3% in the first six months of fiscal 2017/18 – less than the 23.9% in the same period of the previous fiscal year. The *2017 Budget Review* projected national government revenue to increase by 9.5% year on year to R1 242 billion in the current fiscal year. The *2017 MTBPS* lowered total revenue by R48.9 billion to R1 194 billion for fiscal 2017/18 due to lower collections in all the tax categories, notably personal income tax (PIT), corporate income tax (CIT), value-added tax (VAT) and customs duties.

National government revenue in fiscal 2017/18

Revenue source	Originally budgeted Full 2017/18		Actual Apr–Sep 2017	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	739.2	11.2	322.7	6.4
Income tax on individuals	*483.3*	*13.5*	*213.7*	*7.9*
Income tax on companies	*221.1*	*6.8*	*96.7*	*3.8*
Payroll taxes	16.6	8.7	7.5	4.8
Taxes on property	16.5	5.4	7.9	4.5
Taxes on goods and services	439.3	9.2	194.1	5.8
Value-added tax (VAT)	*312.8*	*8.2*	*136.3*	*4.7*
Domestic VAT	*344.8*	*7.3*	*164.6*	*6.1*
Import VAT	*162.3*	*8.7*	*66.8*	*-0.7*
VAT refunds	*194.4*	*7.1*	*95.2*	*3.0*
General fuel levy	*70.9*	*12.1*	*34.0*	*11.8*
Excise duties	*43.5*	*11.1*	*17.8*	*2.2*
Taxes on international trade and transactions	53.6	16.4	21.2	0.2
Import duties	*52.6*	*15.4*	*20.9*	*-0.9*
Other revenue**	33.1	11.1	14.8	-15.1
Less: SACU*** payments	56.0	41.8	28.0	41.8
Total revenue	1 242.4	9.5	540.3	3.8

* Fiscal 2016/17 to fiscal 2017/18
** Including non-tax revenue and extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions amounting to R2.2 billion in April–September 2017
*** Southern African Customs Union

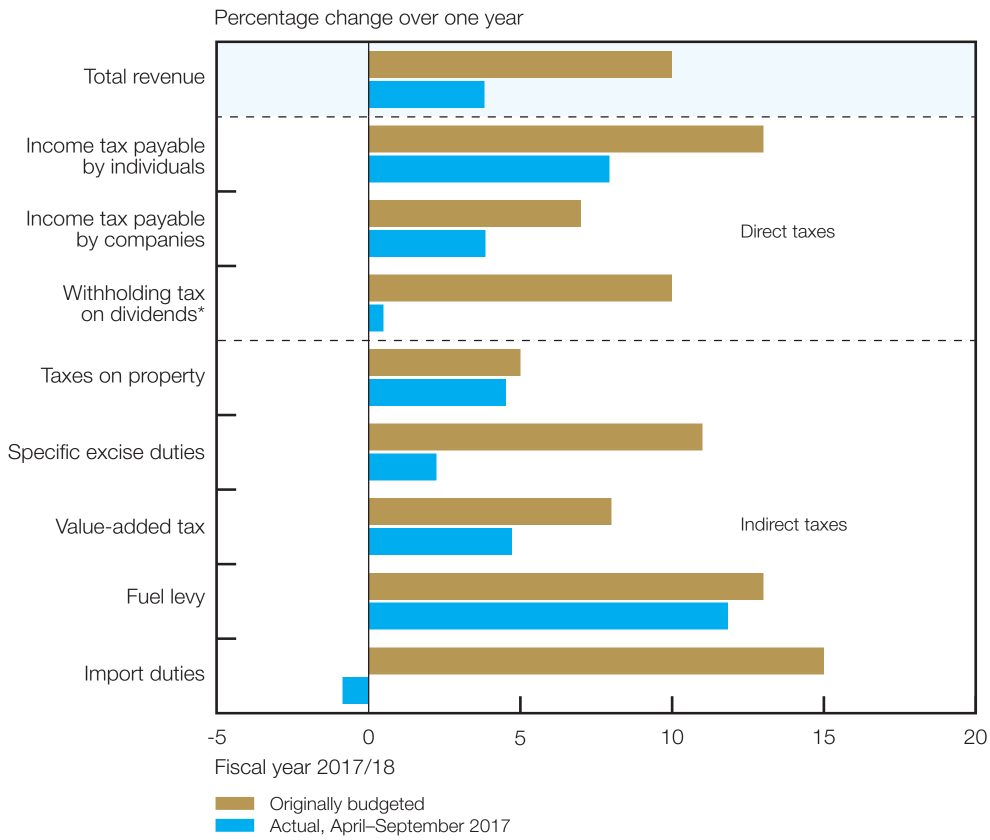
Sources: National Treasury and SARS

Taxes on income, profits and capital gains of R323 billion in the first six months of fiscal 2017/18 was 6.4% more than in the corresponding period of the previous fiscal year. Higher collections in this tax category could be attributed to increases in PIT and CIT, with PIT being the main anchor of tax revenue. However, growth in PIT was below budgeted projections, partly due to job losses, a moderation in wage settlements and a contraction in bonus payments. In addition, legislative changes which allowed for higher tax deductions for retirement contributions resulted in higher-than-expected refunds as well as lower pay-as-you-earn collections. Receipts from CIT also increased at a much slower pace than originally estimated in the 2017 Budget, mainly due to subdued provisional tax and assessment payments.

The taxes on property category was boosted to R7.9 billion in the first six months of fiscal 2017/18, representing a year-on-year increase of 4.5%, as a result of a one-off estate duty payment related to a deceased estate.

Taxes on goods and services amounted to R194 billion in April–September 2017 – 5.8% more than in the same period a year earlier. Annual growth in this tax category underperformed relative to budgeted projections due to slower growth in all the subcategories, namely VAT, the general fuel levy and other excise duties. VAT collections were negatively affected by import VAT collections in particular, which declined year on year.

Components of national government revenue



* Includes secondary tax on companies and withholding tax on interest

Sources: National Treasury and SARS

Taxes on international trade and transactions increased by a marginal 0.2% year on year in the first six months of fiscal 2017/18. The sluggish performance emanated from a year-on-year decline in import duties due to lower imports of key products such as cereals, clothing and footwear.

Non-tax revenue declined by 15.1% year on year to R14.8 billion in the first six months of fiscal 2017/18, mostly due to a decrease in revaluation profits on foreign currency transactions. The *2017 Budget Review* allocated R56.0 billion to the Southern African Customs Union (SACU). Payments totalling R28.0 billion were made to SACU in April and July 2017, with further payments scheduled to be made in October 2017 and January 2018.

Box 4 The *2017 Medium Term Budget Policy Statement*[1]

Government's measured fiscal consolidation, as pronounced in the 2017 Budget, is being threatened by slow domestic economic growth and concomitant large revenue shortfalls. The latter have contributed to a significant deterioration in the fiscal position since the February 2017 Budget. The revenue shortfalls contributed to the fiscal deficit which, together with government debt, continues to increase relative to gross domestic product (GDP), as economic growth remains weak.

The impact of slower domestic economic growth on fiscal consolidation is expected to persist, as reflected by the downward revision of annual growth in real GDP to only 0.7% in 2017 from an originally estimated 1.3%, followed by a slow recovery to 1.9% in 2020.

Macroeconomic projections*

Percentage

	2016			2017		2018		2019		2020
				Medium-term estimates						
	Budget	*MTBPS*	Outcome	Budget	*MTBPS*	Budget	*MTBPS*	Budget	*MTBPS*	*MTBPS*
Real GDP growth	0.9	0.5	0.3	1.3	0.7	2.0	1.1	2.2	1.5	1.9
CPI.............................	6.8	6.4	6.3	6.4	5.4	5.7	5.2	5.6	5.5	5.5
Current account balance (as a percentage of GDP)	-4.0	-3.9	-3.3	-3.9	-2.3	-3.7	-2.6	-3.8	-2.9	-3.1
GDP at current prices (R billions)....................	4 306	4 300	4 339	4 658	4 602	5 030	4 889	5 441	5 222	5 612

* February 2017 *Budget Review* and October 2017 *MTBPS* (calendar years)

Source: National Treasury

Although partly a consequence of weak economic activity, both the outlook for consumer price inflation and the deficit on the current account of the balance of payments (due to lower imports) as a ratio of GDP were expected to improve over the medium term compared to previous estimates.

The significantly revised macroeconomic projections informed a review of the fi scal framework, reflective of the complex challenge of dealing with the revenue shortfalls while containing borrowing. This will be partly offset by a budgeted reduction in the contingency reserve over the next three years and the disposal of a portion of government's Telkom shares to prevent a breach of the expenditure ceiling. More specific and detailed measures to reduce spending and raise revenue are expected to be announced in the *2018 Budget Review.* The original and revised fiscal projections are summarised in the accompanying table.

The *2017 MTBPS* projected a consolidated government revenue shortfall of R50.8 billion compared to the February 2017 Budget estimate for fiscal 2017/18 as a whole – the largest expected revenue under-collection since 2009. The shortfall could be attributed to slowdowns in all the main tax components (i.e. personal and corporate income tax, value-added tax (VAT) and customs duties).

1 The *Medium Term Budget Policy Statement (MTBPS)* was presented to Parliament by the Minister of Finance on 25 October 2017.

Fiscal framework*

R billions/percentage of GDP

	2016/17			2017/18		2018/19		2019/20		2020/21
				Medium-term estimates						
	Budget	*MTBPS*	Outcome	Budget	*MTBPS*	Budget	*MTBPS*	Budget	*MTBPS*	*MTBPS*
Total consolidated revenue	1 324	1 301	1 298	1 414	1 364	1 535	1 478	1 669	1 594	1 709
Personal income tax....	441	429	425	482	461	527	500	582	545	596
Corporate income tax	198	201	204	219	214	233	224	252	236	251
Value-added tax..........	301	293	289	313	301	338	325	365	352	383
Total consolidated expenditure	1 463	1 452	1 446	1 563	1 567	1 677	1 671	1 814	1 802	1 935
Compensation............	517	515	510	550	549	589	588	631	630	678
Goods and services	205	205	208	222	220	237	236	254	256	270
Grants, transfers and subsidies....................	476	470	473	509	505	544	543	590	585	627
Debt-service cost........	148	148	147	162	163	181	183	197	203	223
Consolidated Budget deficit (fiscal balance).....	-139.0	-150.5	-147.5	-149.0	-203.0	-141.9	-193.1	-145.8	-208.1	-225.8
Percentage of GDP	-3.2%	-3.4%	-3.3%	-3.1%	-4.3%	-2.8%	-3.9%	-2.6%	-3.9%	-3.9%
Primary balance (national government)	-8.6	17.3	-21.3	-4.4	-56.3	9.5	-39.0	16.6	-39.8	-42.0
Percentage of GDP	-0.2%	-0.4%	-0.5%	-0.1%	-1.2%	0.2%	-0.8%	0.3%	-0.7%	-0.7%
Gross loan debt (national government)	2 233	2 246	2 478	2 478	2 531	2 713	2 830	2 905	3 094	3 416
Percentage of GDP	50.9%	51.3%	52.3%	52.3%	54.2%	52.9%	57.0%	52.4%	58.2%	59.7%
Net loan debt (national government)	2 003	2 004	2 226	2 226	2 294	2 442	2 569	2 670	2 864	3 179
Percentage of GDP	45.7%	45.8%	47.0%	47.0%	49.1%	47.6%	51.7%	48.1%	53.9%	55.6%

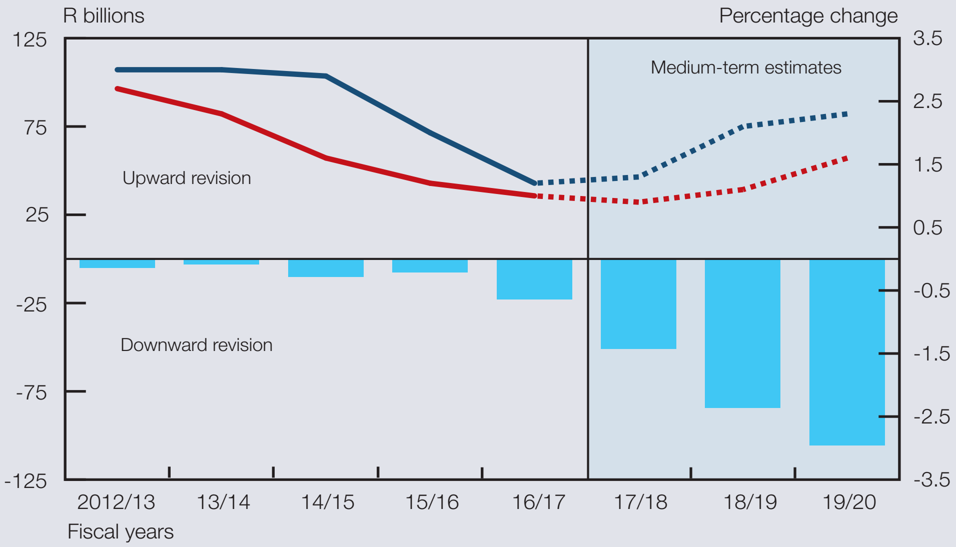
* February 2017 *Budget Review* and October 2017 *MTBPS* (fiscal years)

Source: National Treasury

Disconcertingly, the revenue shortfalls are expected to extend to the outer years, with gross tax revenue projected to fall short of the 2017 Budget estimates by R84.3 billion in 2018/19 and by R106 billion in 2019/20. This mostly reflects weaker economic growth projections and a decline in tax buoyancy due to a change in the relationship between revenue and economic growth. The current and expected weak revenue collections are exacerbated by a number of economic factors, including slower output growth in key sectors that have supported buoyant revenue collection, such as finance, retail trade and telecommunications; the moderation in wage settlement rates; slower growth in aggregate household income due to job losses; weak household consumption that negatively affects VAT collections; and the notable slowdown in the growth rate of imported goods.

Consolidated government expenditure was revised slightly upwards to R1 567 billion for fiscal 2017/18 in the *2017 MTBPS*. Expenditure related to the recapitalisation of South African Airways and the South African Post Office put the expenditure ceiling at risk of a breach of R3.9 billion.

Gross tax revenue and GDP forecasting differences*



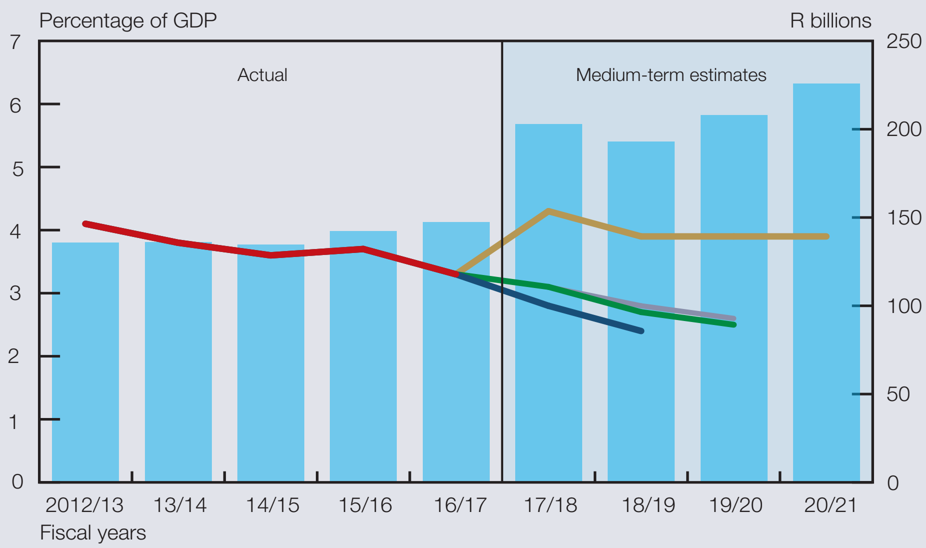
- Gross tax revenue forecasting difference
- Real GDP growth: *Budget Reviews* (right-hand scale)
- Revised real GDP growth: *MTBPSs* (right-hand scale)

* Calculated as the difference between original estimates in the *Budget Review* and the revised estimates in the *MTBPS*

Source: National Treasury

The revenue shortfall and the upward revision in expenditure resulted in a much wider consolidated government budget deficit of 4.3% of GDP in fiscal 2017/18 – up from 3.1% in the February 2017 Budget. The consolidated budget deficit was estimated to remain stable at 3.9% of GDP over the medium term, compared with the gradual improvement expected in the February 2017 Budget. The main national government budget deficit was expected to stabilise at a higher 4.6% of GDP over the same period. Whereas the February 2017 Budget envisaged a primary surplus over the medium term, the *2017 MTBPS* expected the primary deficit to widen in fiscal 2017/18 and to narrow only marginally over the medium term.

Consolidated government budget deficit

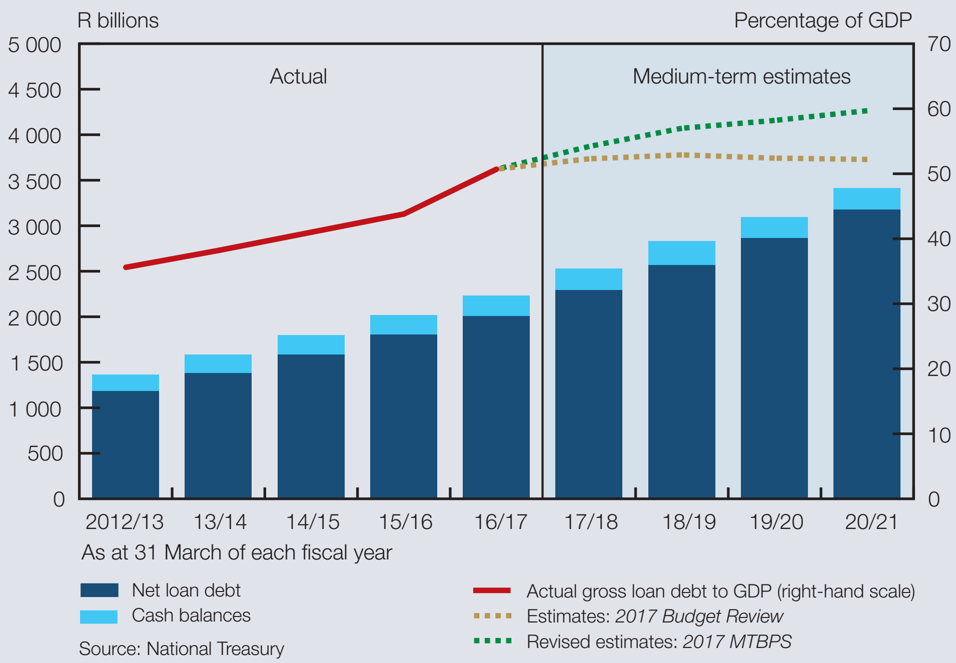


- Budget deficit (right-hand scale)
- Actual budget deficit
- Estimates: *2016 Budget Review*
- Revised estimates: *2016 MTBPS*
- Estimates: *2017 Budget Review*
- Revised estimates: *2017 MTBPS*

Source: National Treasury

The higher consolidated government budget deficit envisaged by the *2017 MTBPS* resulted in much higher projections of government debt. Total gross loan debt of national government has been revised higher by R53.0 billion to R2 531 billion (54.2% of GDP) at the end of fiscal 2017/18, and is expected to reach almost 60% of GDP in fiscal 2020/21, with debt-service costs approaching 15% of the main budget revenue. In the absence of higher economic growth or additional steps to narrow the budget deficit, the debt-to-GDP ratio is not projected to stabilise over the medium term. Total net loan debt of national government (gross loan debt minus cash balances) was estimated at R3.2 trillion, or 55.6% of GDP, in fiscal 2020/21.

National government debt



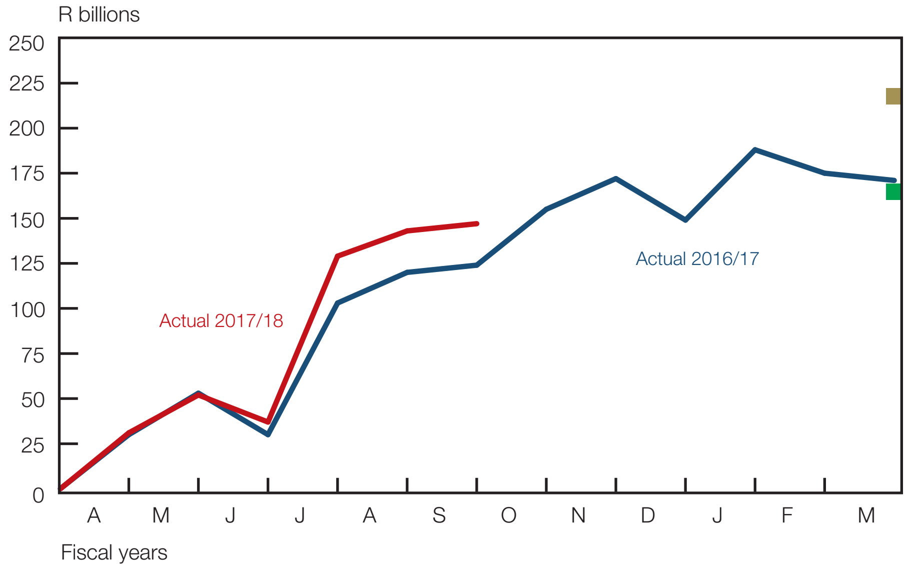
Source: National Treasury

Risks to the already weak fiscal position depicted by the *2017 MTBPS* remain elevated. These risks include increased financial demands from state-owned companies, pressures related to public servant compensation, and new spending commitments associated with higher education. In the absence of an acceleration in real economic growth, government debt seems to be steadily approaching the International Monetary Fund's Debt Sustainability Assessment high-risk benchmark. In light of the deteriorating fiscal position, a team of Cabinet ministers that reports directly to the President would consider a range of proposals to return South Africa's public finances onto a sustainable path.

With growth in expenditure outpacing that in revenue, a cash book deficit of R147 billion was generated in the first six months of fiscal 2017/18. This was some R22.7 billion more than in the first six months of fiscal 2016/17. As a ratio of GDP, the cash book deficit of 6.4% in the first six months of fiscal 2017/18 was higher than the 5.7% in the same period a year earlier. The *2017 Budget Review* expected a cash book deficit of R167 billion for fiscal 2017/18 as a whole but this was revised sharply higher to R220 billion in the *2017 MTBPS*.

The primary balance of national government recorded a deficit of R68.5 billion in the first six months of fiscal 2017/18 – some R15.7 billion more than in the same period a year earlier. However, a primary surplus of R16.5 billion was recorded in the most recent two months (August and September 2017). As a percentage of GDP, the primary deficit amounted to 3.0% in April–September 2017 compared to 2.4% in the same period of the previous fiscal year. The *2017 MTBPS* materially revised the projected primary deficit at the end of fiscal 2017/18 to R56.3 billion (1.2% of GDP) from only R4.4 billion (0.1% of GDP) projected in the *2017 Budget Review*.

Cumulative deficit of national government



Originally budgeted deficit of R167 billion for fiscal 2017/18, in *2017 Budget Review*
Revised budget deficit of R220 billion for fiscal 2017/18, in *2017 MTBPS*
Sources: National Treasury and SARS

National government financing

R billions

Items or instruments	Actual Apr–Sep 2016	Originally budgeted[1] Full 2017/18	Actual Apr–Sep 2017
Cash flow deficit[2]	105.5[3]	166.8[4]	133.2[3]
Plus: Cost/profit on revaluation of foreign debt at redemption[5]	7.9	2.5	1.7
Net borrowing requirement	112.9	169.3	134.9
Treasury bills	48.8	21.0	55.0
Domestic government bonds	49.4	142.0	58.4
Foreign bonds and loans	11.4	27.5	32.5
Change in available cash balances[6]	3.3	-21.2	-11.0
Total net financing[7]	112.9	169.3	134.9

1 *2017 Budget Review*
2 Including extraordinary receipts and payments
3 Cash-flow deficit which differs from the cash-book deficit
4 Cash-book deficit
5 Cost + profit –
6 Increase – decrease +
7 Components may not add up to totals due to rounding off

Sources: National Treasury and SARB

The cash flow deficit of national government of R133 billion in April–September 2017 was R28.2 billion more than in the same period a year ago. After taking the cost on the revaluation of foreign debt at redemption into account, the net borrowing requirement amounted to R135 billion in April–September 2017 compared to R113 billion in April–September 2016.

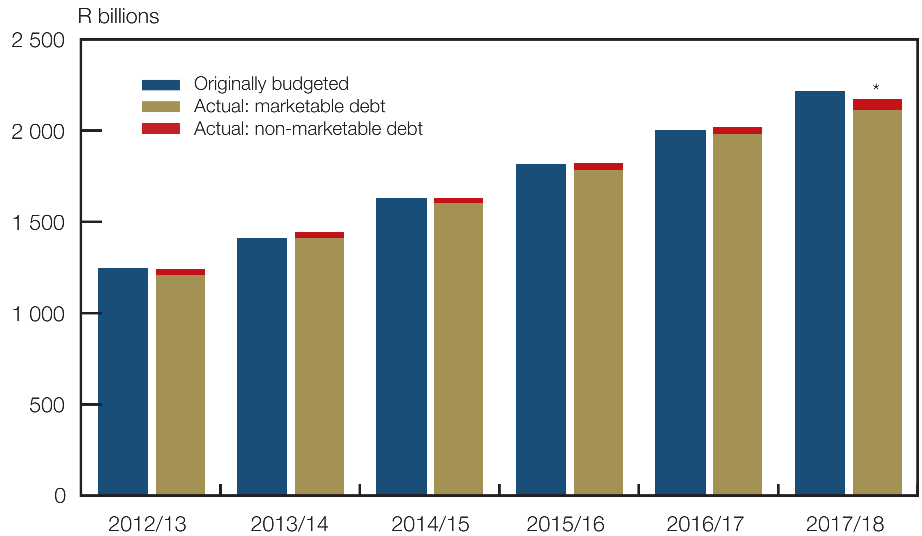
National government's net borrowing requirement was largely financed in the domestic capital market through the net issuance of domestic government bonds as well as Treasury bills and short-term loans of R58.4 billion and R55.0 billion respectively from April to September 2017.

The net issuance of foreign bonds and loans of R32.5 billion in April–September 2017 was notably higher compared with that of R11.4 billion in the same period of the previous fiscal year. The change in national government's available cash balances reverted from a decrease of R3.3 billion in April–September 2016 to an increase of R11.0 billion in April–September 2017.

Total domestic marketable and non-marketable national government debt of R2 171 billion as at the end of September 2017 was R151 billion more than as at the end of March 2017. This increase could largely be attributed to increases in domestic marketable debt instruments (Treasury bills and bonds), which accounted for 97.3% of total domestic debt as at the end of September 2017. Domestic non-marketable debt, namely bonds and short-term loans, accounted for the balance and rose by R20.1 billion to R58.5 billion in the first six months of fiscal 2017/18. As a ratio of total gross loan debt, domestic debt accounted for 89.7% at the end of September 2017. The *2017 MTBPS* revised national government domestic debt higher by R66.1 billion from the amount projected in the *2017 Budget Review* to R2 281 billion for fiscal 2017/18 as a whole (i.e. from 46.7% to 48.8% of GDP).

The total gross domestic debt of national government largely comprises fixed-income, floating-rate and zero-coupon bonds, including retail bonds and other debt. Combined, these instruments had a value of R1 371 billion and accounted for 63.6% of total domestic debt as at 30 September 2017. Government redeemed the R203 fixed-income bond to the value of R22.2 billion in September 2017. The outstanding value of inflation-linked bonds, which account for about 21.8% of total domestic debt, was R474 billion as at 30 September 2017 – some R31.1 billion more than as at 31 March 2017. Domestic short-term loans, including Treasury bills, increased by R55.0 billion in the first six months of fiscal 2017/18, taking the balance of these instruments to a cumulative total of R332 billion as at 30 September 2017.

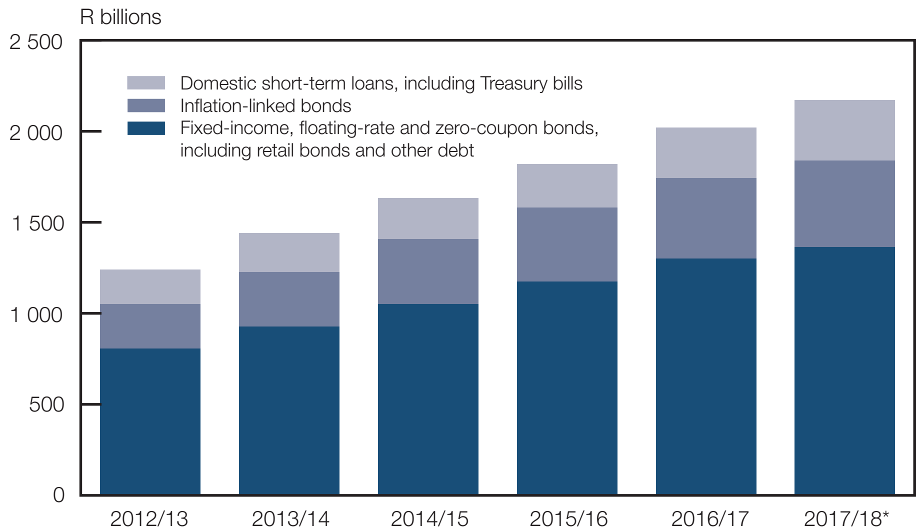
Domestic debt of national government



As at 31 March of each fiscal year
* As at 30 September 2017

Source: National Treasury

Composition of national government domestic debt



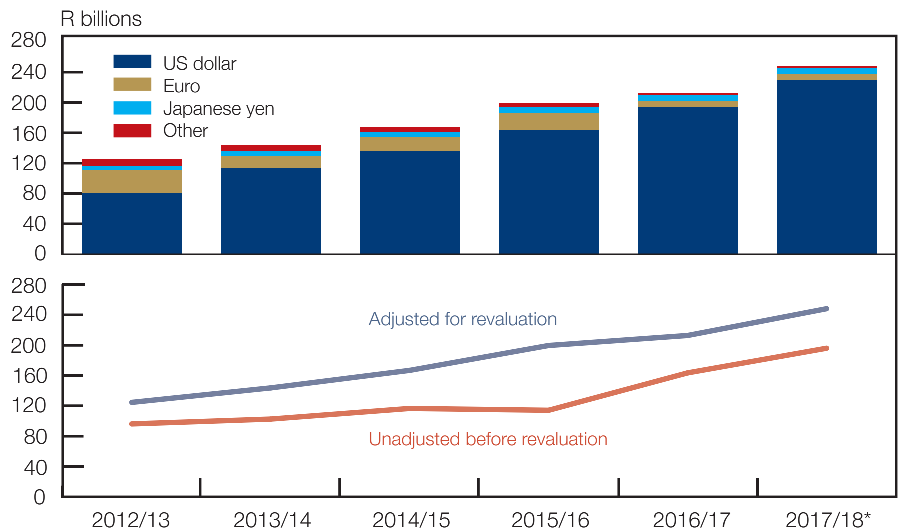
As at 31 March of each fiscal year

* As at 30 September 2017

Source: National Treasury

National government's foreign currency-denominated debt (marketable and non-marketable) of R248 billion as at 30 September 2017 was R35.4 billion more than as at 31 March 2017. The significant increase resulted largely from the issuance of US$2.5 billion worth of bonds in September 2017, along with currency-related revaluation effects. The issuance of the foreign bonds was in line with government's intention to borrow an average of US$2 billion per year in global markets over the medium term. Foreign currency-denominated debt as a ratio of GDP was 5.5% as at 30 September 2017, compared with 4.8% as at 31 March 2017. The *2017 Budget Review* projected national government's foreign currency-denominated debt to amount to R262 billion (5.5% of GDP) in fiscal 2017/18. This was revised lower to R249 billion (5.3% of GDP) in the *2017 MTBPS*.

Foreign currency-denominated debt of national government



As at 31 March of each fiscal year

* As at 30 September 2017

Source: National Treasury

The foreign currency-denominated debt of national government amounted to R196 billion as at 30 September 2017 compared with R248 billion after adjusting for exchange rate revaluation – a revaluation effect of about R52 billion. The bulk of national government's foreign currency-denominated debt was denominated in US dollars (92.3%), followed by euros (3.5%) as at 30 September 2017. The average outstanding maturity of foreign marketable bonds increased from 104 months as at 30 September 2016 to 138 months a year later, largely due to the issuance of a US$3.0 billion bond in October 2016 and two bonds with a combined value of US$2.5 billion in September 2017.

In September 2017 national government successfully placed US$2.5 billion in new notes maturing in 2027 (10-year) and 2047 (30-year) in the international capital market. The 10-year bond of US$1.0 billion was priced at a coupon rate of 4.85% (at par value) at a spread of 260.5 basis points above 10-year US Treasuries, while the 30-year bond of US$1.5 billion was priced at a coupon rate of 5.65% (at par value) at a spread of 283.7 basis points above 30-year US Treasuries. The proceeds from these bond issuances will be used to finance government's foreign currency commitments as indicated in the *2017 Budget Review*.

Total gross loan debt (domestic and foreign currency-denominated debt) of national government amounted to R2 419 billion as at 30 September 2017 compared with R2 233 billion as at 31 March 2017. The increase was primarily driven by increases in domestic debt which accounted for about 90% of total gross loan debt. Total gross loan debt was 53.2% of GDP as at 30 September 2017 compared with 50.7% as at 31 March 2017. The *2017 Budget Review* projected a total gross loan debt-to-GDP ratio of 52.3% for fiscal 2017/18 as a whole, which was revised higher to 54.2% in the *2017 MTBPS*.

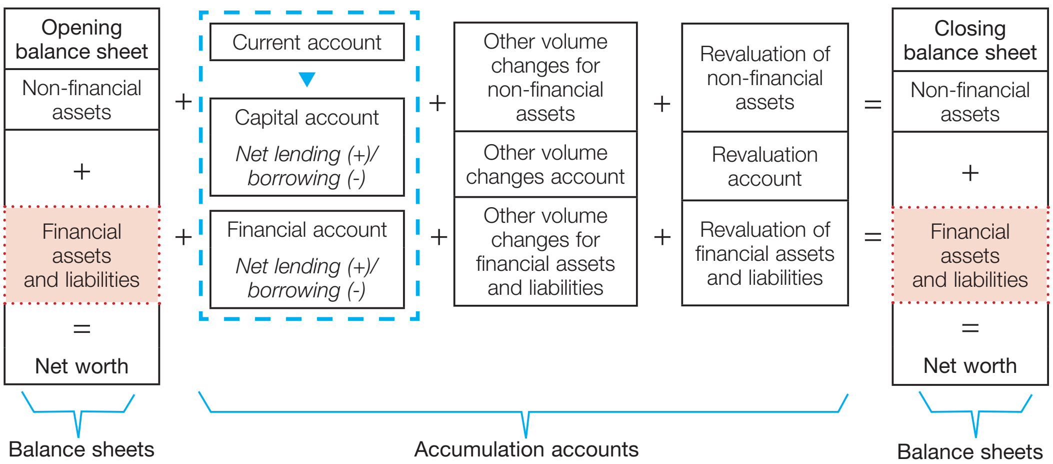
The further development of sectoral financial balance sheets for South Africa's integrated economic accounts[1]

by B de Beer and M Kock[2]

1. Introduction

The South African Reserve Bank (SARB) has been advancing the development of sectoral balance sheet statistics for the South African economy within the context of the integrated economic accounts (IEA) framework. These statistics will extend the range of macroeconomic aggregates available for national policy formulation and contribute towards the fulfillment of South Africa's international statistical commitments. The methodological approach used is aligned with the Group of Twenty (G20)[3] Data Gaps Initiative (DGI), in particular recommendation 8 of the second phase of the DGI (DGI-2), which specifically focuses on sectoral balance sheets, flows, and a from-whom-to-whom analysis of stocks and transactions. The goal is to compile a complete and integrated set of sectoral balance sheets and accumulation accounts for South Africa covering the main institutional sectors and financial instrument categories[4] as proposed in the *System of National Accounts, 2008* (SNA 2008). This note focuses on the progress made with the sectoral financial balance sheet component of the IEA as indicated by the red dotted lines in Figure 1.

Figure 1 Integrated economic accounts*



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

Source: System of National Accounts, 2008

1 This note is the second in a series highlighting the development of sectoral financial balance sheets as part of South Africa's integrated economic accounts. The first note titled 'The further development of integrated economic accounts for South Africa – institutional sector balance sheets' was published in the December 2016 *Quarterly Bulletin*. This note provides the inter-sectoral balanced view of the estimated size of harmonised sectoral financial balance sheets. The intention is to compile and publish IEA data on a quarterly basis at some future date. At this stage, the data published and discussed in this note should be treated as preliminary and provisional.

2 The views expressed are those of the authors and do not necessarily reflect the views of the SARB.

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

4 Please refer to the first note in the series for a full delineation of institutional sector and financial instrument coverage.

2. Methodology

The expansive nature of sectoral financial balance sheets demands a systematic and methodological compilation approach that can be broken down into two major components, comprising *data sourcing* and *data harmonisation*.

The *data sourcing* component firstly comprises the identification, sourcing and collation of all the basic asset and liability information pertaining to the various financial instruments for all the institutional sectors, and secondly data validation through analysis to uncover and rectify (where necessary) any anomalies and classification issues related to both financial instruments and sectors to ensure integrity and consistency. These processes then serve as input for all further calculations in order to render harmonised stock positions and accumulation account flows for financial assets and liabilities. To ensure a consistent methodological approach and coherent outcomes, the data processing uses IEA templates based on those proposed by the International Monetary Fund (IMF) and the G20 DGI-2 working group, subject to adjustment for country-specific circumstances. Source data are mapped per institutional sector into these templates, rendering counterparty information, inter-sectoral stock positions and flow linkages between the different domestic sectors of the economy as well as the rest of the world (ROW) at detailed financial instrument asset and liability level. In addition to the requirement of harmonised inter-sectoral stock positions, there is also the very demanding requirement to generate disaggregated accumulation account data that entails accounting for changes in balance sheet stock positions from one period to the next. The accumulation account requires a detailed breakdown into transactions, other volume changes and revaluations. In the case of South Africa, this is particularly demanding as most of the available sectoral data only covers stock positions. Thus, in the absence of actual transaction data, this needs to be derived after estimating revaluations and accounting for other volume changes.

The *harmonisation component* in the IEA framework refers to the horizontal harmonisation of financial asset and liability instruments across sectors as well as the vertical harmonisation between the real and the financial components of the IEA.

The vertical harmonisation covers two areas. The first area is the vertical harmonisation of stocks, which aims to integrate the non-financial assets with the financial assets to obtain total assets. Thereafter, net worth is derived as the difference between total assets and financial liabilities. The second area relates to the integration or harmonisation of net lending/borrowing as derived from the current and capital account, with the net lending/borrowing as derived from the financial account. In this note, the provisional results of the first area are shown in Table 1 after harmonising the sectoral financial balance sheets horizontally for all financial asset and liability instruments across all sectors in the prescribed international templates. The second area will be addressed in future work when the complete IEA is published, integrating the current and capital account with the financial account.

In order to generate harmonised sectoral financial balance sheet positions, the process commences with unharmonised sectoral financial balance sheets of all sectors, with the matrices per sector representing the data of the specific sector as obtained through data sourcing. These unharmonised sector financial balance sheet positions are then integrated and harmonised with one another to form a cohesive and harmonised set of sectoral financial balance sheets for the South African economy as a whole. Key issues in progressing from unharmonised to harmonised sectoral financial balance sheets relates to achieving inter-sector coherence. The anchoring principle of inter-sector coherence is satisfied when the financial assets of sector A vis-à-vis sector B equate the financial liabilities of sector B vis-à-vis sector A.

The horizontal harmonisation entails two different but interlinked steps: firstly harmonising financial stocks and thereafter ensuring that the flows equate to the difference between opening and closing stock positions. A hierarchy of sources is used to harmonise stock positions whereafter a revaluation process is used to harmonise and disaggregate the flows.

The hierarchy of sources is based on aspects such as coverage, data quality and data reliability of each sector's data at the detailed 32 financial instrument levels, and each sector-by-sector financial asset and liability position is evaluated before rendering the harmonised outcome. Owing to the dynamic properties of financial instruments as well as improvements in data sourcing, the hierarchy of sources and equations to generate harmonised stock positions is reviewed each quarter. These harmonised stock positions, together with detailed price indices, facilitate the revaluation process which renders two key components of the accumulation accounts, namely estimated revaluations of financial assets and liabilities, and thereafter derived transactions.

3. Analysis of preliminary sectoral financial balance sheet asset and liability stock positions[5]

5 These are experimental results subject to adjustment.

An overview of total assets, broken down between non-financial and financial assets as well as total liabilities for the total domestic economy by institutional sector and the ROW 'sector', as at 31 December 2011 is provided in Table 1.

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

R trillions

	Non-financial corpo-rations*		Financial corpo-rations		General government		House-holds		Total domestic economy		Rest of the world	
	A	L	A	L	A	L	A	L	A	L	A	L
Non-financial assets**	4.1		0.5		1.9		2.8		9.3			
Financial assets and liabilities	1.9	6.4	11.2	11.2	1.4	1.5	5.7	1.5	20.2	20.6	3.2	2.7
Net worth***		-0.4		0.5		1.8		7.0		8.9		
Total assets and liabilities	6.0	6.0	11.7	11.7	3.3	3.3	8.5	8.5	29.5	29.5	3.2	2.7

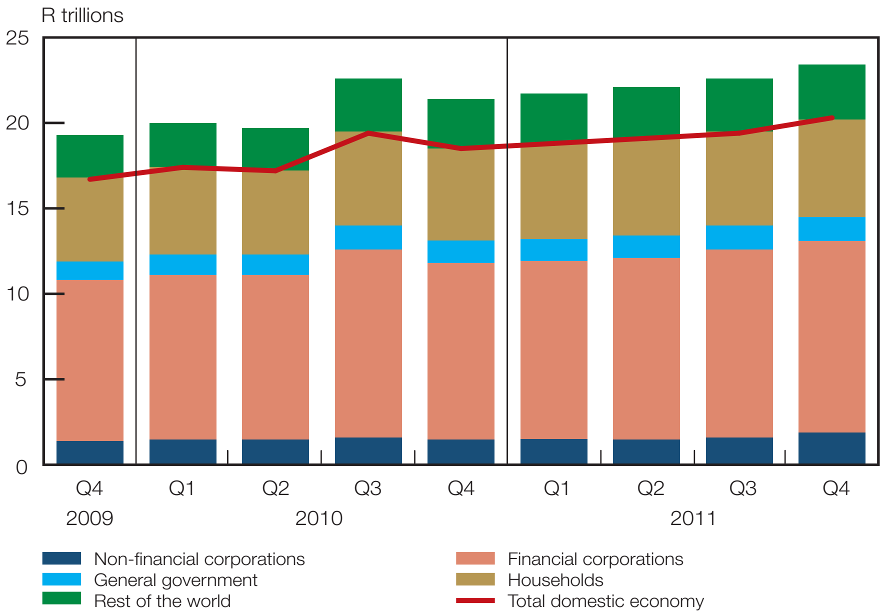
A = assets
L = liabilities
* Private non-financial corporations' data are not directly sourced but derived from counterparty positions. This should therefore be treated as preliminary as it will be revised when administrative data sources are incorporated.
** Total produced assets, including underlying land
*** Total assets minus total liabilities

Source: SARB

Total assets of the domestic economy of R29.5 trillion comprised non-financial assets of R9.3 trillion and financial assets of R20.2 trillion, which rendered a net worth of R8.9 trillion, given total financial liabilities of R20.6 trillion as at 31 December 2011. Furthermore, the non-financial corporations sector held 44% of South Africa's non-financial assets and only 9% of its financial assets. The financial corporations sector held 56% of the financial assets, with almost an equal financial liability exposure – this is to be expected given their role as financial intermediaries. The household sector accounted for 79% of the net worth in the economy at R7.0 trillion. The ROW had a positive net financial asset position of R0,5 trillion vis-à-vis the domestic sector's. The remainder of this section focuses on the analysis of the harmonised quarterly financial asset and liability stock positions as referenced in Figure 1 by the red dotted blocks for the period 2010–2011.

The market value of the stock of total financial assets of the South African economy increased from R16.7 trillion from the end of December 2009 to R20.2 trillion at the end of December 2011, as shown in Figure 2. This represents an increase of R3.5 trillion. Financial corporations contributed R1.9 trillion to the increase, while on average accounting for 56% of total financial assets. The second-largest contribution to the change in total financial assets came from the household sector at R0.9 trillion – this sector on average accounted for 29% of total financial assets. Non-financial corporations and general government on average accounted for 8% and 7% respectively of total financial assets.

Figure 2 Market value of total financial assets per institutional sector

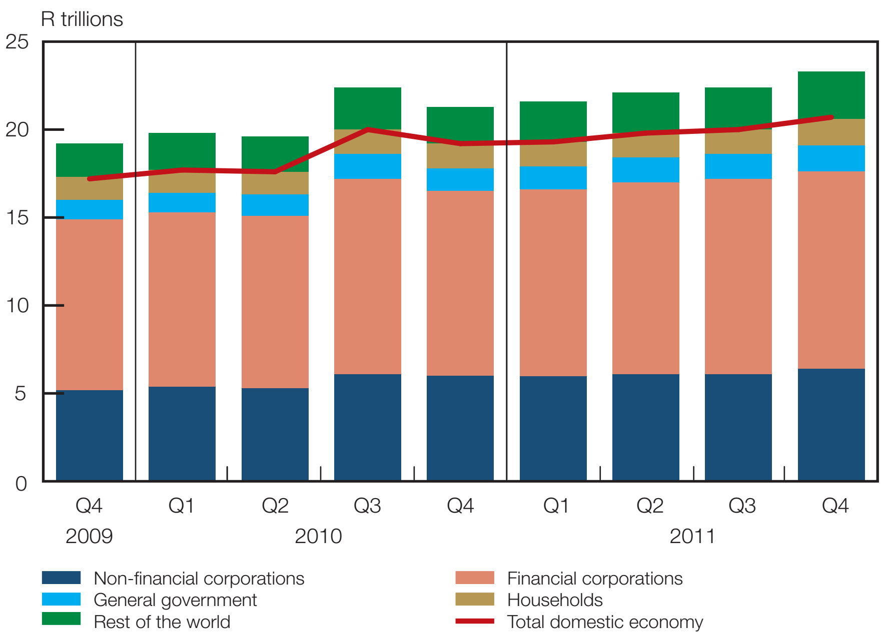


Source: SARB

The financial assets of the ROW vis-à-vis the domestic sectors of the economy increased from R2.5 trillion at the end of December 2009 to R3.2 trillion at the end of December 2011.

The market value of the stock of total financial liabilities of the South African economy similarly increased by R3.4 trillion, from R17.2 trillion at the end of December 2009 to R20.6 trillion at the end of December 2011, as shown in Figure 3. The financial asset and liability positions of financial corporations were of fairly similar magnitude over the period. The household sector's contribution to total financial liabilities on average only amounted to 7.3%, significantly less than their contribution to total financial assets, as is to be expected given their significant retirement assets. Non-financial corporations' contribution to total financial liabilities, on average 30.6%, dwarfed their contribution to total financial assets. This divergence between their financial assets and liabilities reflect their reliance on leveraged funding to finance real economic activity and non-financial assets.

Figure 3 Market value of total financial liabilities per institutional sector

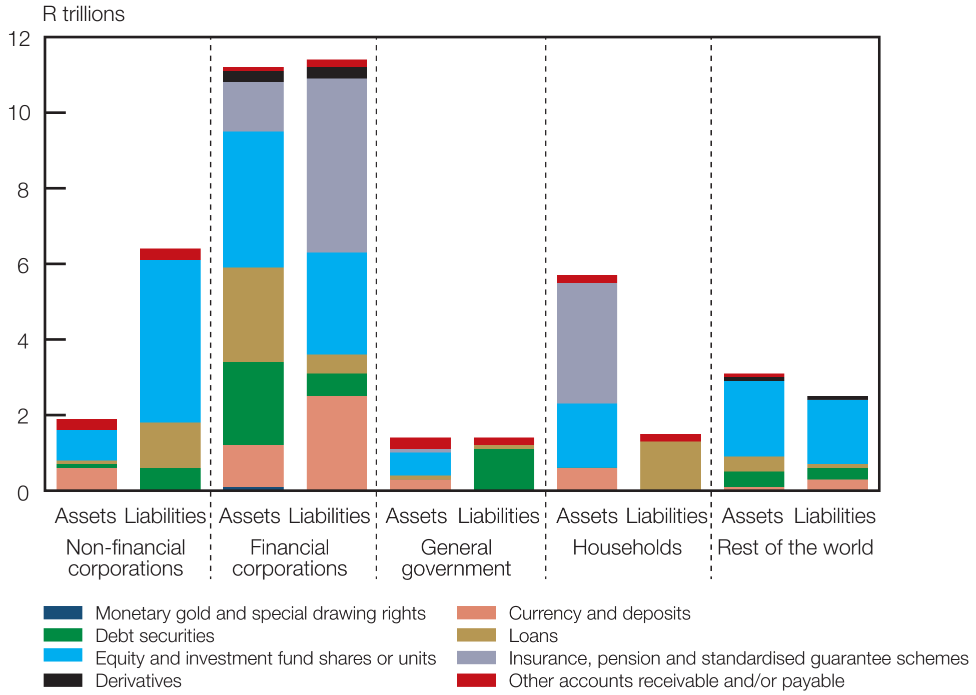


Source: SARB

The analysis now shifts to a more detailed breakdown of financial instruments included in the financial asset and liability positions of the different institutional sectors as at 31 December 2011, as shown in Figure 4. The contribution of different financial instruments to the individual sectors' overall financial asset and/or liability position provides some insights specific to each institutional sector.

Equity and investment fund shares or units featured prominently in the non-financial corporations sector's financial liabilities, with a large exposure of R4.3 trillion at the end of December 2011 that accounted for approximately 67% of this sector's financial liabilities. The ROW had the second-largest proportional financial liability exposure in this instrument, at 64%. Financial corporations, which include subsectors such as non-money market fund investment funds, had the largest counterparty financial asset position in this financial instrument at 32% of total financial assets. *Loan* assets also featured prominently in the financial corporations sector and contributed approximately 23% to its total financial assets. As financial corporations include pension funds and insurers, the financial instrument *insurance, pension and standardised guarantees* constituted a significant part of this sector's financial liability position, at 41%. Most of the financial asset positions in this financial instrument resided with the household sector where it accounted for 55% of households' total financial asset position. With general government financing its deficit through the issuance of debt securities, this sector's financial liability position had a 74% exposure to *debt securities*.

Figure 4 Market value of total financial assets and liabilities by institutional sector and financial instrument, 31 December 2011

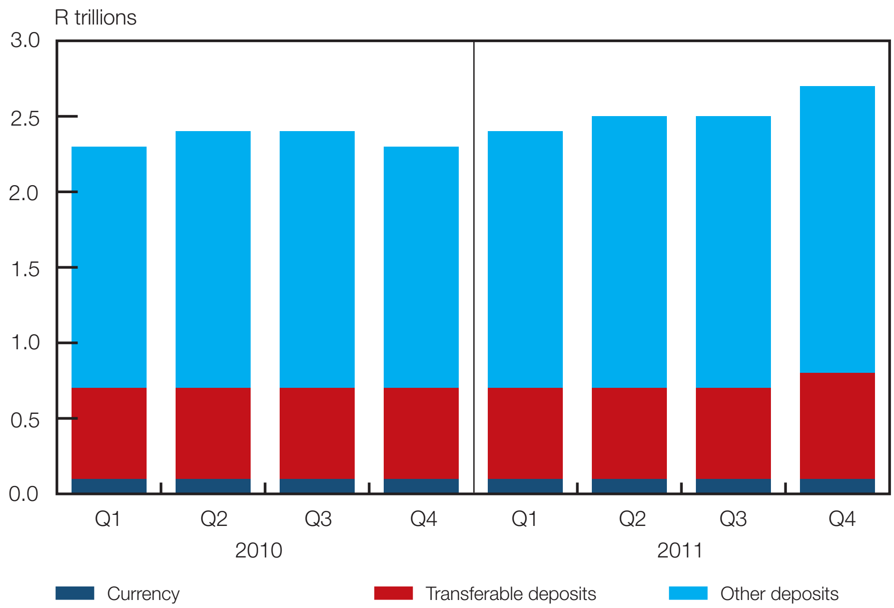


Source: SARB

In order to highlight the level of detail contained within the sectoral financial balance sheets, the analysis now focuses on two of the financial instruments, namely currency and deposits as well as debt securities.

A breakdown of the financial instrument *currency and deposits* into its constituent parts, as shown in Figure 5, reveals that *other deposits* contributed on average 71% to the total from the first quarter of 2010 to the fourth quarter of 2011. *Transferable deposits* and *currency* contributed 26% and 3% respectively.

Figure 5 Components of currency and deposits



Source: SARB

The financial instrument *other deposits* is shown on a from-whom-to-whom basis in Table 2. The horizontal view (rows) provides the total asset positions in other deposits of the relevant institutional sector vis-à-vis the institutional sector against which the claims are held, that is, the vertical view (columns) provides the equivalent liability position. The total financial asset and liability positions of other deposits amounted to R1.9 trillion as at 31 December 2011. For example, of the R1.8 trillion for other deposit liabilities of financial corporations, the same sector held other deposit assets of R700 billion and the household sector held R440 billion. As is to be expected, the only two sectors recording liabilities in this financial instrument are financial corporations and the ROW.

Table 2 From-whom-to-whom market value of other deposit assets and liabilities between resident institutional sectors as well as the rest of the world, 31 December 2011

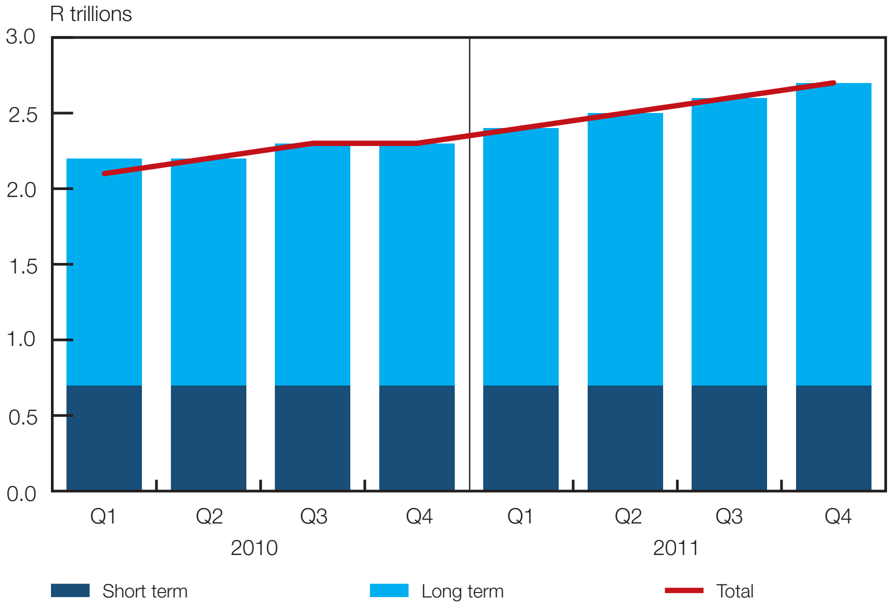
R billions

Institutional sectors		Other deposit liabilities per institutional sector						
		Non-financial corporations	Financial corporations	General government	House-holds	Rest of the world	Total	
Other deposit assets per institutional sector	Non-financial corporations	–	407	–	–	1	408	1 911
	Financial corporations	–	700	–	–	88	788	
	General government	–	197	–	–	–	197	
	Households	–	440	–	–	–	440	
	Rest of the world	–	78	–	–	–	78	
	Total	–	1 822	–	–	89		
		1 911						

Source: SARB

A longitudinal view of the financial instrument *debt securities* by short- and long-term maturity is presented in Figure 6. The stock of debt securities at market value increased from just over R2 trillion at the end of March 2010 to approximately R2.7 trillion at the end of December 2011. Over the period under review, long-term debt securities contributed on average 71% and short-term debt securities the remaining 29%.

Figure 6 Maturity split of debt security stock



Source: SARB

A from-whom-to-whom analysis of stock positions at market value of debt securities as at 31 December 2011 is presented in Table 3. The horizontal view (rows) provides asset positions in this instrument and the vertical view (columns) the liability positions. The main contributor to the R2.7 trillion liability position was the general government sector at R1.1 trillion, which represented approximately 42% of the total debt securities liability position.

Table 3 From-whom-to-whom market value of debt security assets and liabilities between resident institutional sectors as well as the rest of the world, 31 December 2011

R millions

Institutional sectors		Debt security liabilities per institutional sector: Non-financial corporations	Financial corporations	General government	Households	Rest of the world	Total	
Debt security assets per institutional sector	Non-financial corporations	–	52 806	11 199	–	0	64 005	2 671 350
	Financial corporations	535 718	514 071	785 348	–	337 444	2 172 580	
	General government	280	1 525	68	–	–	1 873	
	Households	445	325	11 539	–	3 604	15 913	
	Rest of the world	77 884	25 622	313 472	–	–	416 978	
	Total	614 327	594 349	1 121 626	–	341 048		
		2 671 350						

Given their intermediary function, the main investors in debt securities were financial corporations which held R2.2 trillion, or 81%, of the issued debt. Of this total, the financial corporations' holdings of general government debt securities amounted to R785 billion. The ROW invested R417 billion in debt securities, of which R313 billion was in general government debt.

4. Conclusion

The preliminary experimental results presented in this note reflect the progress made with the sectoral financial balance sheet component of the IEA. The methodological approach followed to compile sectoral financial balance sheets is based on international best practices subject to South African circumstances, and has been validated by international experts. Future work will focus on the development of accumulation accounts and linking the respective balance sheet stock positions between quarters as well as the vertical harmonisation of the complete IEA. Once completed, the IEA will provide a rich set of information facilitating analysis from various new vantage points.

Notes to tables

Non-resident and real estate transactions – Table S–30

In the non-resident and real estate transactions table KB204, the data under 'transfer duty' have been revised, based on a review of the seasonal adjustment methodology.

Participation bond schemes – Table S–43

The participation bond schemes table KB226 has been discontinued as from this issue of the *Quarterly Bulletin*. This aggregated industry data set can no longer be published as the decrease in the number of such registered schemes does not sufficiently mask individual institutions.

Gross fixed capital formation – Tables S–120 and S–121

Gross fixed capital formation data published in tables KB615 and KB616 are now aligned with those published by Statistics South Africa. The publication of gross fixed capital formation by kind of economic activity, as previously published in these tables, has been discontinued. Gross fixed capital formation by type of organisation at current and constant 2010 prices, for both seasonally adjusted and unadjusted data, are now provided for a longer period.