Quarterly Economic Review

Introduction

Global economic growth accelerated to a robust 4.3% in the first quarter of 2018. However, the global economic expansion became less synchronised as output growth accelerated in the emerging market economies while slowing notably in the major advanced economies. Similarly, export volumes in the emerging market economies increased strongly while those in the advanced economies remained broadly unchanged. Global inflationary pressures remained fairly benign in the first quarter of 2018, notwithstanding the significant increase in international crude oil prices since mid-2017.

South Africa's real gross domestic product (GDP) contracted by an annualised 2.2% in the first quarter of 2018 despite a notable improvement in domestic business and consumer confidence. The contraction was fairly broad-based, with economic activity shrinking in both the primary and secondary sectors while advancing at a slower pace in the tertiary sector.

The real output of the primary sector contracted markedly in the first quarter of 2018 as both agricultural and mining output decreased sharply. When excluding the usually more volatile primary sector, the real output of the non-primary sector still contracted by 0.8% in the first quarter.

The real gross value added (GVA) by the secondary sector reverted from a fairly brisk increase in the fourth quarter of 2017 to a contraction in the first quarter of 2018, as output declined in all three of the subsectors. Manufacturing production decreased notably in the first quarter of 2018, led by a sharp contraction in non-durable goods production, while the seasonally adjusted utilisation of manufacturing production capacity also receded over the period. The real output of the sector supplying electricity, gas and water decreased marginally, likely suppressed by lower demand from the electricity-intensive mining and manufacturing sectors. The real GVA by the construction sector also contracted further, marking the 12th consecutive quarter in which this sector has not contributed to overall economic growth.

The slowdown in real output growth of the tertiary sector in the first quarter of 2018 could largely be attributed to a contraction in the real GVA by the commerce sector, while output growth moderated in both the finance and transport sectors. By contrast, the real output of the government services sector accelerated slightly. The contraction in the real GVA by the commerce sector resulted from lower activity in the wholesale, retail and motor trade subsectors.

Growth in real gross domestic expenditure (GDE) slowed significantly from 6.9% in the final quarter of 2017 to 1.0% in the first quarter of 2018, as growth moderated across all of the expenditure components. Net exports and real gross fixed capital formation subtracted from real GDP growth in the first quarter of 2018, while real final consumption expenditure by households made the largest positive contribution.

Growth in real final consumption expenditure by households moderated significantly in the first quarter of 2018. Base effects partly exacerbated the contraction in households' real spending on durable and semi-durable goods following robust increases in the fourth quarter of 2017 which were supported by substantial 'Black Friday' promotions. Real outlays by households on non-durable goods increased at a slower pace, while real spending on services – the largest component of household consumption expenditure – increased fairly briskly. Growth in household consumption expenditure was inhibited by notably slower growth in households' real disposable income.

Real gross fixed capital formation contracted anew in the first quarter of 2018 as capital spending by both the private sector and general government decreased. Fixed capital outlays by public corporations increased for a second successive quarter, albeit at a very moderate pace. Fixed investment spending continued to be hampered by the constrained fiscal space, policy uncertainty (in the mining sector in particular), and very weak civil construction confidence.

Employment growth slowed further in the year to the first quarter of 2018, with most of the limited job creation occurring in the informal sector. The decrease in South Africa's seasonally adjusted unemployment rate to 26.3% in the first quarter of 2018 was largely due to a marked increase in the number of discouraged job seekers. Enterprise-surveyed formal non-agricultural employment decreased marginally in the fourth quarter of 2017 due to job losses in the private sector.

Year-on-year growth in labour productivity in the formal non-agricultural sector of the economy accelerated further in the fourth quarter of 2017 when excluding the temporary election-related outliers. This improvement in labour productivity growth assisted in the further moderation in the rate of increase in nominal unit labour cost to 4.9% over the same period. Annual average growth in formal non-agricultural nominal unit labour cost has fluctuated in a very narrow range since 2013 and slowed marginally to 5.2% in 2017.

Domestic consumer price inflation slowed further in the first quarter of 2018 to a low of 3.8% in March. The earlier appreciation in the exchange value of the rand continued to exert downward pressure on goods prices, while food and services price inflation also moderated. Core inflation slowed further to a six-year low of 4.1% in March 2018. However, consumer price inflation accelerated in April following the increase in the value-added tax (VAT) rate and higher fuel prices. Encouragingly, average headline inflation expectations receded to multi-year lows in the first quarter of 2018 – the first time since 2007 that expectations across all four time horizons fell below the 6% upper limit of the inflation target range.

Following seven consecutive quarterly surpluses, South Africa's trade balance with the rest of the world switched to a deficit in the first quarter of 2018 as the value of net gold and merchandise exports decreased much more than that of merchandise imports. The value of mining exports in particular receded notably, weighed down by a sharp decline in the rand price of mining commodities which contributed to a significant deterioration in South Africa's terms of trade. Despite a slight narrowing of the shortfall on the services, income and current transfer account, the worsening of the trade balance resulted in a marked deterioration of the deficit on the current account of the balance of payments, to 4.8% of GDP in the first quarter of 2018.

The net inflow of capital on South Africa's financial account of the balance of payments increased further from the fourth quarter of 2017 to the first quarter of 2018, driven largely by continued sizable net portfolio investment inflows. Non-residents' net purchases of domestic debt securities were slightly more than their net purchases of domestic equity securities over the period. South Africa's positive net international investment position (IIP) almost halved from the end of September 2017 to the end of December, as the value of foreign liabilities increased while that of foreign assets decreased. The decline in the value of foreign assets was exacerbated by the sharp appreciation in the exchange value of the rand in the fourth quarter of 2017, as South Africa's foreign assets have a fairly large foreign-currency exposure.

The external value of the rand increased by a further 1.8% on a trade-weighted basis in the first quarter of 2018, supported by government's renewed commitment to fiscal consolidation in the February Budget, the marked improvement in domestic business and consumer confidence, and the confirmation of South Africa's investment-grade credit rating by Moody's Investor Services, which also revised the credit outlook from negative to stable. Domestic money market rates and South African government bond yields also declined over this period, in step with the appreciation in the exchange value of the rand and lower realised and expected consumer price inflation.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) reduced the repurchase rate by 25 basis points to 6.50% with effect from 29 March 2018 as the inflation outlook improved and risks to the forecast diminished. This narrowed the interest rate differential between South Africa and the advanced economies, while the United States (US)-China trade dispute, higher international crude oil prices, and the concomitant increase in global inflation expectations, as well as an interest rate increase by the US Federal Reserve (Fed), all led to decreased appetite for emerging market assets in general. Consequently, the rand depreciated against most currencies in April and May 2018 while South African government bond yields increased. After reaching an all-time high in January 2018, the share prices of companies listed on the JSE Limited (JSE) declined notably in subsequent months, mainly impacted by the appreciation in the exchange value of the rand in January and February as well as lower international share prices. Share prices have, however, recovered somewhat since the beginning of April.

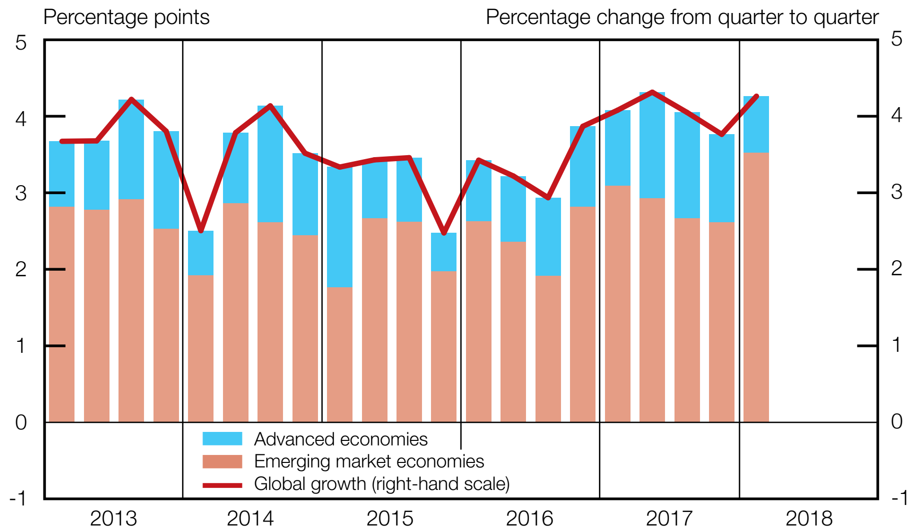
Growth in the broadly defined money supply remained subdued in the first quarter of 2018, and closely aligned to growth in nominal GDP. Although growth in the deposit holdings of the household sector moved sideways in the first four months of the year, it remained above that of the corporate sector. Year-on-year growth in long-term deposits decelerated markedly since November 2017, driven by heightened political uncertainty at the time. Concurrently, growth in short- and medium-term deposits accelerated significantly and remained fairly brisk up to April 2018. Growth in bank credit extended to the domestic private sector moderated somewhat in the first four months of 2018. Credit extension to the corporate sector slowed notably over this period, partly impacted by the implementation of International Financial Reporting Standard (IFRS) 9 from January 2018. Growth in loans and advances to the household sector remained subdued but continued to trend gradually upwards thus far in 2018.

The cash book deficit of national government was significantly larger in fiscal 2017/18 than originally budgeted, as annual growth in revenue was much lower than expenditure. The revenue shortfall was R50.7 billion for the full fiscal year; it resulted mainly from lower-than-expected personal income tax (PIT) and VAT collections. The non-financial public sector borrowing requirement increased considerably in fiscal 2017/18, primarily due to the larger cash deficits of both national government and the non-financial public enterprises and corporations. In order to finance the larger borrowing requirement, the total gross loan debt of national government increased to 52.7% of GDP as at 31 March 2018, with domestic debt accounting for 98% of the total.

International economic developments

Global economic growth accelerated from an annualised 3.8% in the fourth quarter of 2017 to a solid 4.3% in the first quarter of 2018, buoyed by real output growth in the emerging market economies which quickened from 5.0% to 6.6% over the period. However, the synchronised global economic expansion experienced during 2017 faded somewhat as output growth in the United States (US), Japan, the euro area and the United Kingdom (UK) slowed significantly in the first quarter of 2018.

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



Seasonally adjusted annualised rates

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

In the US, growth in real gross domestic product (GDP) moderated to 2.2% in the first quarter of 2018. Growth in consumer spending slowed to a five-year low of 1.0% after increasing by a robust 4.0% in the previous quarter. The euro area also started 2018 on a weaker footing, with real output growth slowing to 1.5% in the first quarter, mainly due to temporary factors associated with unusually cold weather and strike-related disruptions in some countries.

Real output growth in selected advanced economies

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

	2016				2017					2018
Country/region	Q2	Q3	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1
United States.................	2.2	2.8	1.8	1.5	1.2	3.1	3.2	2.9	2.3	2.2
Japan	0.9	0.8	1.0	0.9	2.7	2.1	2.0	1.0	1.6	-0.6
Euro area.......................	1.3	1.7	2.7	1.8	2.7	3.0	2.9	2.8	2.5	1.5
United Kingdom	1.9	2.2	3.0	1.9	1.3	1.0	1.9	1.6	1.7	0.4
Canada	-1.0	4.3	2.2	1.4	4.0	4.6	1.7	1.7	3.0	1.3
Australia	3.6	-1.0	3.6	2.6	1.2	4.1	2.2	2.1	2.3	4.2
New Zealand	4.7	2.9	1.7	4.2	2.9	3.7	2.4	2.6	2.7	<u>2.7</u>
Advanced economies...	**1.8**	**2.1**	**2.2**	**1.7**	**2.1**	**2.9**	**2.9**	2.4	**2.3**	**<u>1.7</u>**

* 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

In the UK, quarterly growth slowed sharply to 0.4% in the first quarter of 2018 – the lowest growth rate in over five years. The slowdown was due to sluggish consumer spending and a decline in business investment. Meanwhile, real GDP in Japan contracted by 0.6% in the first quarter of 2018, ending an unusually extended period of uninterrupted growth (the longest in almost three decades). The contraction was driven by a rundown in real inventories and a decline in private investment.

Global economic growth benefitted from a broad-based acceleration in emerging markets in the first quarter of 2018. In Emerging Asia, growth picked up from 6.3% in the fourth quarter of 2017 to 7.7% in the first quarter of 2018 as Chinese real GDP expanded at a faster pace of 7.2%, mainly underpinned by strong consumer demand and robust property investment. Furthermore, real economic growth in India rebounded to 10.1% in the first quarter of 2018 due to a strong pick-up in household consumption expenditure and private investment.

Real output growth in selected emerging market economies

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

	2016				2017					2018
Country/region	Q2	Q3	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1
China	7.1	6.9	6.8	6.7	6.9	7.0	6.7	6.4	6.9	7.2
India	7.5	5.3	3.8	7.1	7.5	5.8	7.8	7.2	6.7	10.1
Indonesia	5.6	4.8	5.1	5.0	4.7	5.4	5.1	5.4	5.1	4.4
Emerging Asia	**6.9**	**6.1**	**5.8**	**6.5**	**6.8**	**6.5**	**6.8**	**6.3**	**6.6**	**7.7**
Russia	-2.7	-3.2	3.4	-0.2	4.7	4.4	-3.1	-1.8	1.5	5.8
Turkey	4.9	-9.7	20.0	3.2	8.3	9.1	5.0	7.0	6.8	8.0
Poland	4.9	0.8	8.2	2.9	4.5	3.6	5.7	4.1	4.5	6.6
Emerging Europe	**1.1**	**-4.0**	**8.7**	**1.6**	**6.0**	**5.7**	**1.3**	**1.8**	**3.6**	**6.1**
Brazil	-2.8	-1.5	-2.1	-3.5	4.4	2.4	1.1	0.9	1.0	1.8
Mexico	1.3	5.0	4.2	2.3	1.5	1.4	-0.2	3.6	2.1	4.6
Argentina	-8.2	1.1	3.0	-1.0	6.7	2.3	3.1	3.9	3.7	4.2
Latin America	**-2.1**	**0.6**	**1.6**	**-0.7**	**2.4**	**1.9**	**1.5**	**2.1**	**1.5**	**3.1**
Emerging economies	**4.6**	**3.7**	**5.4**	**4.3**	**5.9**	**5.6**	**5.1**	**5.0**	**4.8**	**6.6**

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

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

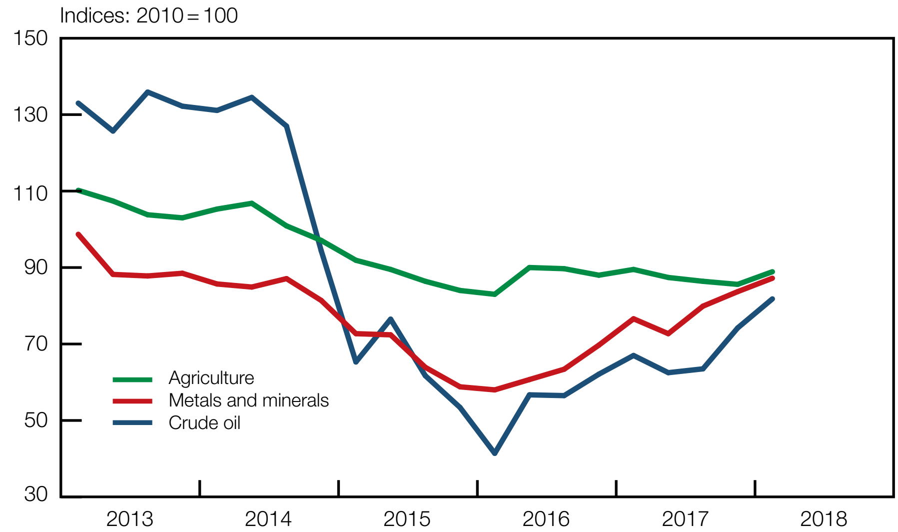
Economic growth in Latin America accelerated from 2.1% in the fourth quarter of 2017 to 3.1% in the first quarter of 2018. The acceleration was mainly driven by a rebound in Brazilian growth, from 0.9% to 1.8%, on account of improved household consumption. Mexico's economy maintained a firm pace of growth, expanding by 4.6% in the first quarter of 2018.

Real output growth in Emerging Europe accelerated sharply to 6.1% in the first quarter of 2018 from 1.8% in the previous quarter. The rebound was largely attributable to Russia, where output expanded by 5.8% following a technical recession in the second half of 2017. Output growth in Turkey was stronger than expected, accelerating from 7.0% in the fourth quarter of 2017 to 8.0% in the first quarter of 2018.

Headline inflation in the advanced economies trended moderately upwards following the recent increase in crude oil prices, but remained relatively benign. For instance, consumer price inflation in the US accelerated to 2.8% in May 2018, and the deflator for personal consumption expenditure, the Federal Reserve's (Fed) preferred inflation measure, reached the 2.0% inflation target in March and April, for the first time since early 2017. Inflationary pressures in most of the emerging markets remained subdued, with the exception of double-digit inflation in both Argentina and Turkey and hyperinflation in Venezuela.

International commodity prices increased in the first quarter of 2018, underpinned by increased demand (due to strong global growth) and supply constraints. Agricultural product prices rose by 3.8%, mainly due to lower wheat and maize plantings in the US and weather-related supply disruptions in South America. Metals and minerals prices maintained an upward trend, rising by 4.3% owing to higher iron ore, tin and nickel prices. Energy prices strengthened significantly, rising by 9.8% in the first quarter of 2018, led by natural gas and oil.

International commodity prices



Sources: World Bank and SARB

The price of Brent crude oil increased by almost 80% between mid-2017 and May 2018. In November 2017, the Organization of the Petroleum Exporting Countries (OPEC) and other non-OPEC producers agreed to extend production cuts of 1.8 million barrels per day until the end of 2018. Attempts to reduce supply have also benefitted from collapsing oil production in Venezuela and the threat of renewed US sanctions on Iranian oil exports. The combination of solid growth in world oil consumption, major producers complying with agreed production targets, and geopolitical tensions pushed crude oil prices to almost US$80 per barrel at the end of May 2018, despite increased US shale production. However, oil prices declined to around US$75 per barrel in mid-June following speculation that OPEC could increase production to offset the sharper-than-expected decline in Venezuela's output.

World trade volumes (using world exports as a proxy) increased at an annualised three-months-to-three-months rate of 4.5% in March 2018, according to the Netherlands Central Planning Bureau. Export volumes in the emerging markets rose sharply (by 10.8%), mainly due to robust export growth in Emerging Asia and Emerging Europe, while those in the advanced economies decreased by 0.2%.

Domestic economic developments

Domestic output[1]

Real economic activity in South Africa contracted sharply in the first quarter of 2018 despite the notable improvement in business and consumer confidence. Following real output growth in excess of 2.0% for three consecutive quarters, real *gross domestic product* (GDP) shrank at an annualised rate of 2.2% in the first quarter of 2018. This was the largest contraction since the global financial crisis. The real output of both the primary and secondary sectors contracted, while the tertiary sector grew at a much slower pace. Despite the quarter-on-quarter contraction, real GDP still grew by 0.8% on an annual basis in the first quarter of 2018.

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

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

Sector	2017					2018
	Q1	Q2	Q3	Q4	Year*	Q1
Primary sector	15.5	13.9	13.7	4.9	7.5	-13.8
Agriculture	26.2	36.8	41.1	37.5	17.7	-24.2
Mining	12.6	7.8	6.2	-4.4	4.6	-9.9
Secondary sector	-3.7	2.8	1.5	3.1	-0.1	-4.9
Manufacturing	-4.1	2.9	3.7	4.3	-0.2	-6.4
Tertiary sector	-1.7	1.2	1.1	2.7	0.8	0.3
Non-primary sector	*-2.1*	*1.6*	*1.2*	*2.7*	*0.6*	*-0.8*
Total	**-0.5**	**2.9**	**2.3**	**3.1**	**1.3**	**-2.2**

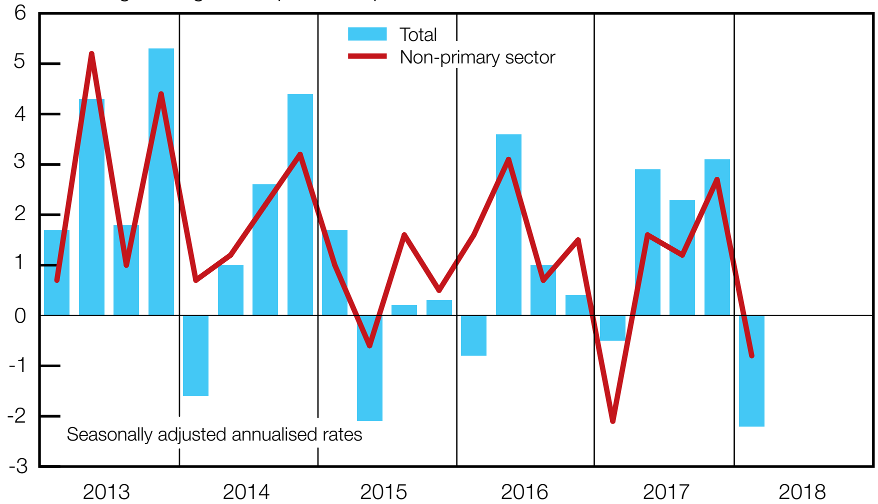
* Percentage change over one year

Source: Stats SA

When excluding the contribution of the generally more volatile primary sector, the real output growth of the non-primary sector contracted by 0.8% in the first quarter of 2018, compared with an increase of 2.7% in the previous quarter.

Real gross domestic product

Percentage change from quarter to quarter

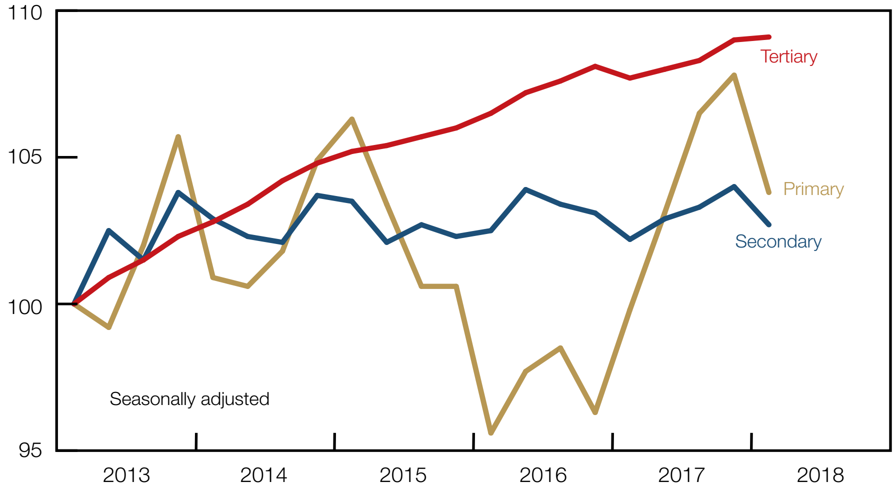


Source: Stats SA

The real gross value added (GVA) by the *primary sector* contracted by 13.8% in the first quarter of 2018 after expanding by 4.9% in the fourth quarter of 2017. Real output contracted in both the agricultural and mining sectors.

Real gross domestic product by main sector

Indices: first quarter of 2013 = 100



Source: Stats SA

Lower field crop and horticultural production largely led to the contraction in the real GVA by the *agricultural sector* in the first quarter of 2018, subtracting 0.7 percentage points from real GDP growth. The commercial maize crop for the 2017/18 production season is expected to be 23.3% less than the record 16.8 million tons harvested in 2016/17, while the area planted is expected to be 11.8% smaller. Despite the notable decrease, the 2017/18 maize crop should be sufficient for domestic consumption.

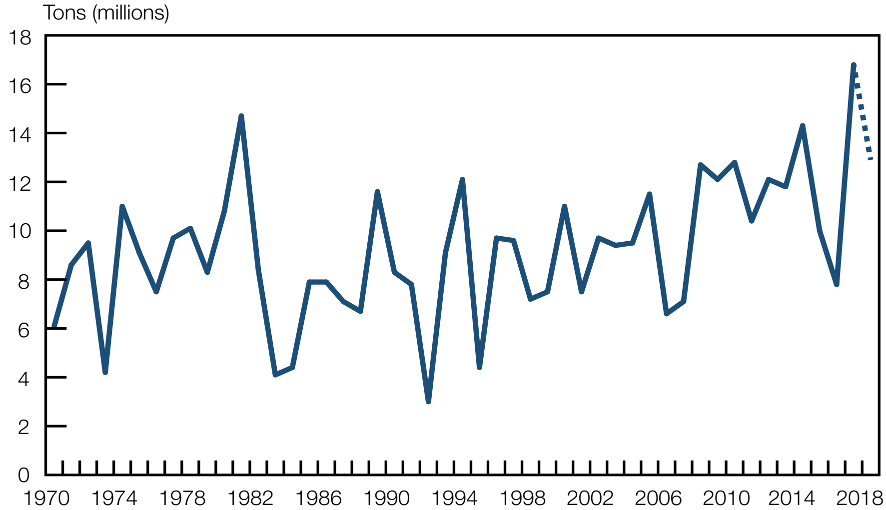
Commercial maize crop estimates

	Crop (million tons)	Area planted (million hectares)
2016/17: final estimate	16.8	2.6
2017/18: fourth production forecast	12.9	2.3

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

Commercial maize production

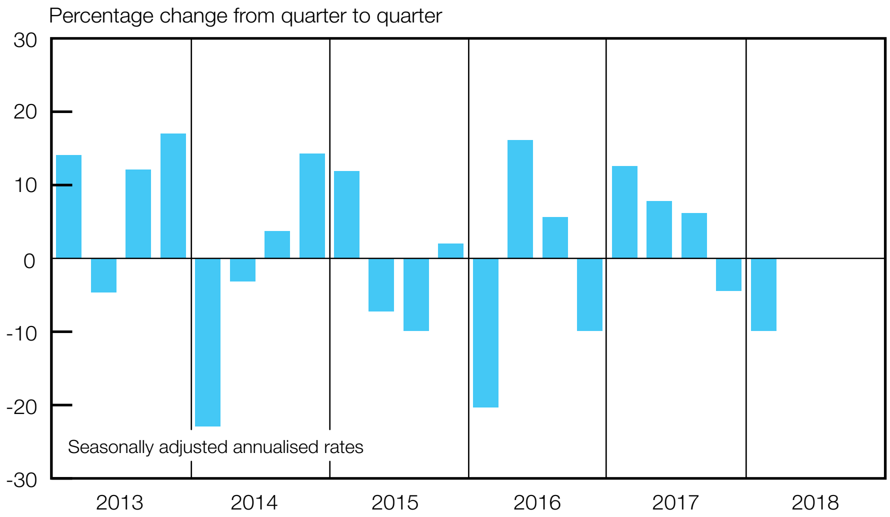
Tons (millions)



Calendar-year data, e.g. production season 2017/18 = 2018
Source: Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries

Mining production contracted further at a rate of 9.9% in the first quarter of 2018, subtracting 0.8 percentage points from overall real GDP growth. The decrease in mining output was broad-based, with lower production in 10 of the 12 mineral groups. Platinum group metals, iron ore, copper, nickel, other non-metallic minerals and gold contributed most to the contraction. Gold mining production was adversely affected by the closure of some loss-making operations, exacerbated by the lower rand price of gold. Despite higher international commodity prices, domestic mining output contracted for two consecutive quarters, weighed down by ageing infrastructure, reserve depletion, regulatory and policy uncertainty, mining accidents, and the imposition of import tariffs on steel by the US.

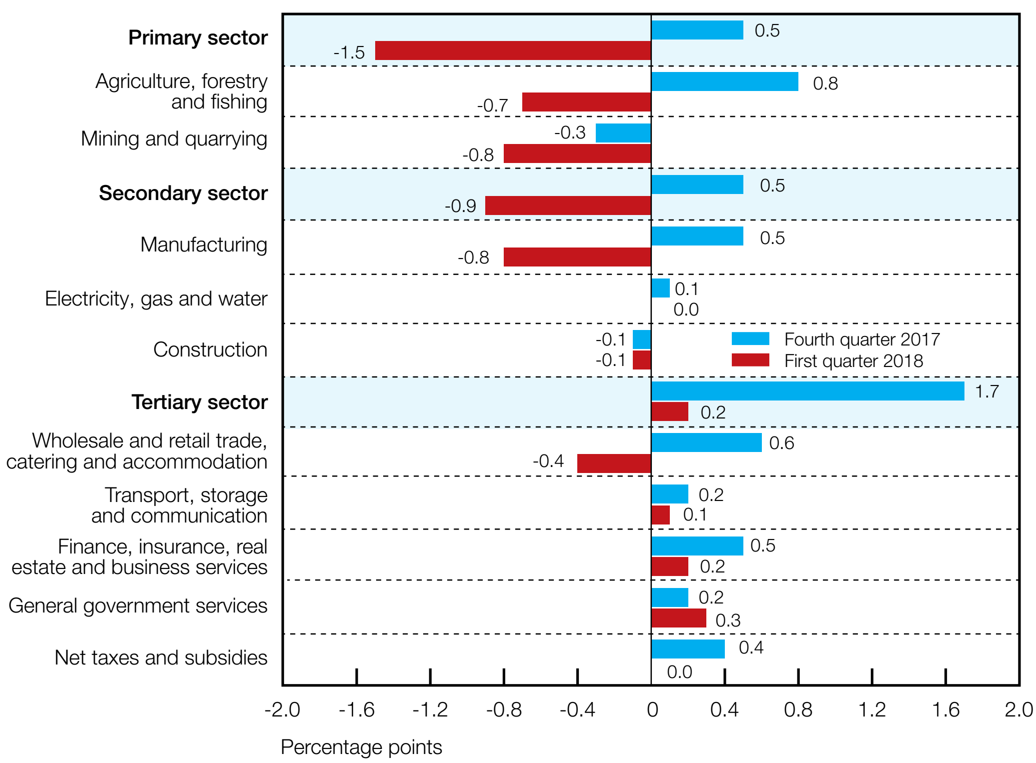
Real gross value added by the mining sector



Source: Stats SA

The real GVA by the *secondary sector* contracted by 4.9% in the first quarter of 2018 following an increase of 3.1% in the preceding quarter. Real output shrank in all three of the subsectors, i.e. manufacturing, electricity, gas and water as well as construction.

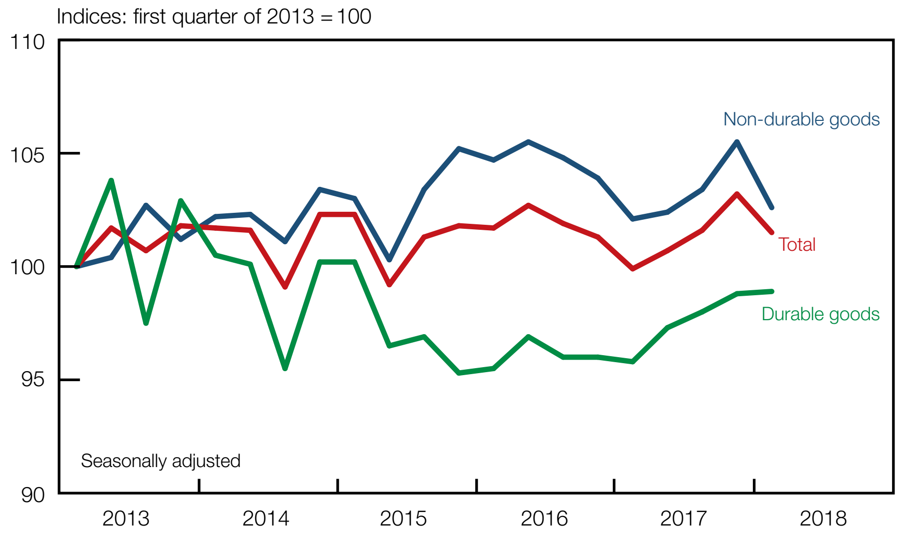
Contributions to growth in real gross domestic product



Source: Stats SA

Fairly brisk real economic activity for three successive quarters in the *manufacturing sector* was followed by a contraction of 6.4% in the first quarter of 2018, subtracting 0.8 percentage points from overall real economic growth. Production decreased in 6 of the 10 manufacturing subsectors, with the most pronounced decline in the subsector supplying petroleum, chemical products, rubber and plastic products. In the first quarter of 2018, non-durable manufacturing goods production decreased sharply while durable goods production increased marginally. Overall manufacturing production was constrained by slower business activity, lower sales orders, continued domestic cost pressures, and lower manufactured export earnings following the appreciation in the exchange value of the rand in the first quarter of 2018. Consistent with the decrease in manufacturing production, the seasonally adjusted utilisation of production capacity in the manufacturing sector fell from 81.8% in the fourth quarter of 2017 to 81.1% in the first quarter of 2018.

Physical volume of manufacturing production



Source: Stats SA

Growth in the real output of the sector supplying *electricity, gas and water* reverted from an annualised rate of 3.3% in the fourth quarter of 2017 to a contraction of 0.5% in the first quarter of 2018. Electricity production declined while the distribution of water increased. Reduced demand from the electricity-intensive manufacturing and mining subsectors likely affected activity in this sector.

The real GVA by the *construction sector* declined further by 1.9% in the first quarter of 2018, weighed down by weaker residential and civil construction activity. By contrast, non-residential building activity rebounded, increasing for the first time since the third quarter of 2015. The real output of the construction sector has made no contribution to overall economic growth since the first quarter of 2015 due to persistent weak building and construction confidence and the absence of meaningful fixed capital investment.

Growth in the real GVA by the *tertiary sector* slowed significantly to 0.3% in the first quarter of 2018 from 2.7% in the preceding quarter. The slower pace of increase reflected a contraction in the real output of the trade sector while output growth decelerated in both the transport, storage and communication as well as the finance sectors. The real value added by the general government services sector accelerated slightly.

The real output of the *trade sector* contracted by 3.1% in the first quarter of 2018, subtracting 0.4 percentage points from overall GDP growth. Activity in the retail, wholesale and motor trade subsectors declined. Real activity in the wholesale trade subsector was mainly impacted by weaker sales of food, beverages and tobacco. Real retail trade activity also shrank, affected by lower sales by retailers of textiles, clothing, footwear and leather goods, general dealers and the 'all other' retailers category. Retail sales were likely impacted by the high base due to strong 'Black Friday' sales in the fourth quarter of 2017, the listeria outbreak, weak formal sector employment, and subdued growth in household credit extension. The real GVA by the motor trade subsector declined in the first quarter of 2018, despite improved business confidence among vehicle dealers.

Real output growth in the *transport, storage and communication sector* slowed to 0.9% in the first quarter of 2018. Lower activity in most of the categories in the transport subsector was offset by increases in land freight transportation and transport support services. Real activity in the telecommunications subsector maintained its upward momentum.

Growth in the real GVA by the *finance, insurance, real estate and business services sector* moderated from 2.5% in the fourth quarter of 2017 to 1.1% in the first quarter of 2018, mainly reflecting a slowdown in non-bank financial activity and business services. Although growth in the fee income of commercial banks decelerated, the value added by commercial banks increased at a faster pace as operating costs remained well contained. Activity in the equity market continued to expand over the period.

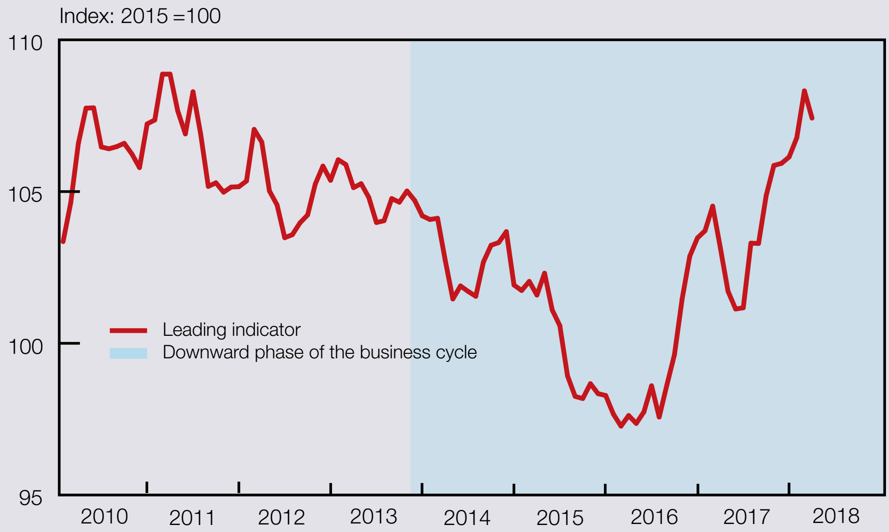
Growth in the real GVA by the *general government services sector* accelerated from 1.4% in the fourth quarter of 2017 to 1.8% in the first quarter of 2018, reflecting a slight increase in the number of employees in the sector over the period.

Box 1 The improvement in confidence in the South African economy

Business, consumer and foreign-investor confidence in the South African economy improved significantly in the first quarter of 2018. This followed a gradual and protracted weakening in confidence due to, among other factors, unfavourable domestic political events during the current downward phase of the business cycle which had commenced in December 2013.

The notable advance in various measures of confidence followed the African National Congress' elective conference in December 2017, and supported the further increase in the South African Reserve Bank's (SARB) composite leading business cycle indicator[1] in the opening months of 2018. The revival in confidence was also supported by the marked appreciation in the exchange value of the rand since mid-November 2017, the absence of any further sovereign credit rating downgrades, the return to fiscal consolidation proposed in the national Budget, and a Cabinet reshuffle. However, confidence would need to improve even further, and be sustained, to materially raise the rate of economic growth and fixed capital investment in South Africa.

Composite leading business cycle indicator for South Africa

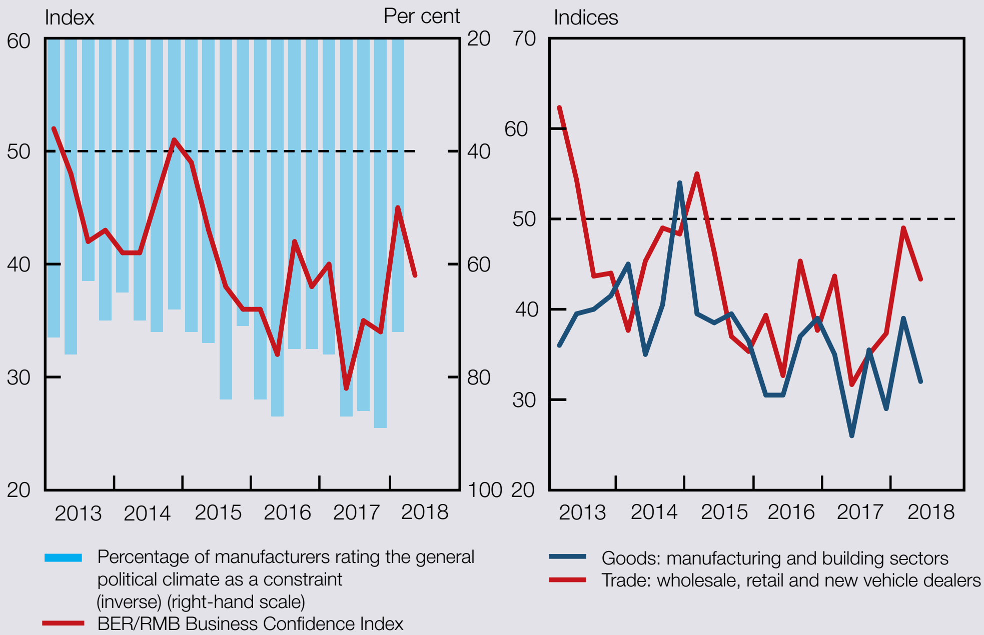


Source: SARB

1 The RMB/BER Business Confidence Index is a component series of the SARB's composite leading business cycle indicator.

Business confidence in the South African economy, as measured by the Rand Merchant Bank (RMB)/ Bureau for Economic Research (BER) Business Confidence Index (BCI), declined gradually from a high of 51 index points in the fourth quarter of 2014 to a low of 29 index points in the second quarter of 2017, while the percentage of manufacturers rating the general political climate as a constraint increased to an all-time high of 89% in the fourth quarter of 2017. Although the weakness was broad-based, confidence was generally lower in the goods-producing sectors (manufacturing and building) than in the trade sector. In the first quarter of 2018, the factors already mentioned contributed to a significant increase of 11 index points in the BCI to a level of 45, while the percentage of manufacturers rating the general political climate as a constraint fell markedly by 17 percentage points to 72%. Business confidence improved much more in the trade sector than in the goods-producing sectors in the first quarter of 2018, but despite the marked improvement the BCI is still below the neutral level of 50. Business confidence fell back slightly in the second quarter of 2018.

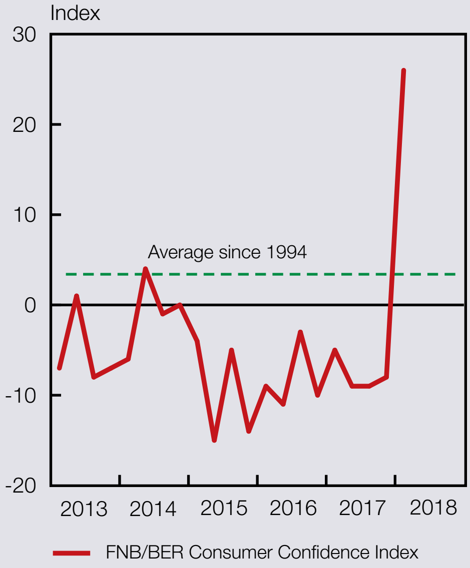
Business confidence



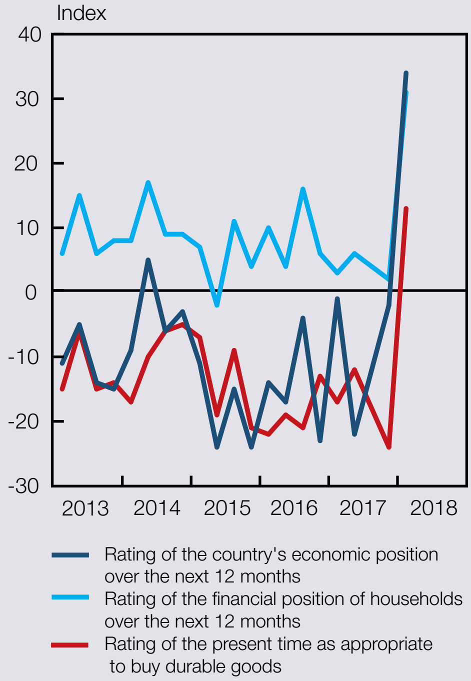
Sources: BER and RMB

Domestic consumer confidence, as measured by the First National Bank (FNB)/BER Consumer Confidence Index (CCI), also remained fairly depressed throughout the most recent downward phase of the business cycle, and well below its democratic-era average of 3.4 index points. The CCI was dragged down by consumers' weak rating of the appropriateness of the present time to buy durable goods and their unfavourable rating of the economic position of the country in 12 months' time. By contrast, consumers' rating of their own financial position over the next 12 months held up relatively well in an environment of above-inflation wage and social grant increases, while employment growth only slowed instead of contracting outright. Following the events described above, the CCI increased markedly by a record 34 index points to 26 index points in the first quarter of 2018 as all three sub-indices increased significantly. Consumer confidence was also boosted by three consecutive fuel price decreases from January to March 2018 and the further moderation in consumer price inflation. However, the previously observed volatility in the CCI, the value-added tax increase in April 2018, and the recent increases in fuel prices could weaken consumer confidence in the short run. Nevertheless, the strong recovery in consumers' willingness to spend on durable goods augurs well for household consumption expenditure in 2018.

Consumer confidence

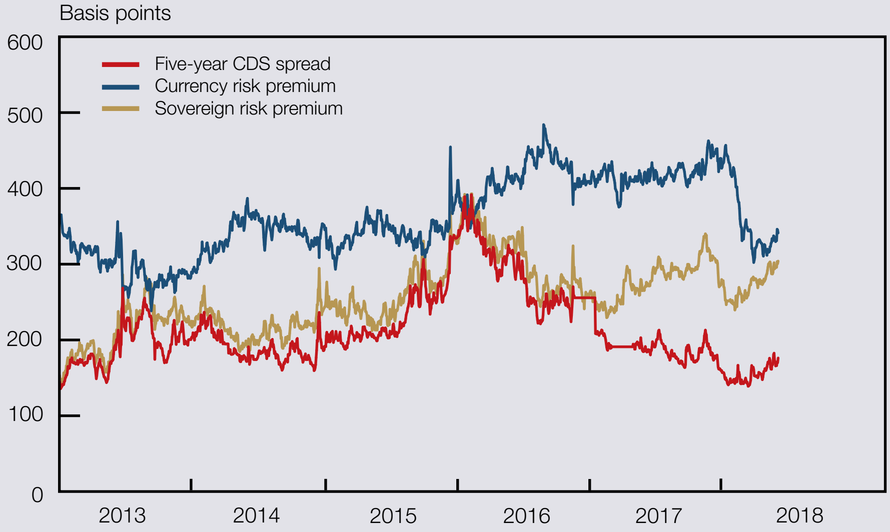


Sources: BER and FNB



Foreign-investor confidence in South Africa, as measured by a number of risk premiums, has improved notably since mid-November 2017. Following the developments mentioned above, South Africa's sovereign risk premium[2], currency risk premium[3] and five-year credit default swap (CDS) spread[4] all narrowed significantly. However, further improvements in these indicators will also depend on external factors such as the pace and extent of increases in global interest rates.

Foreign-investor confidence



Source: Bloomberg

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

3 The differential between the yield on South African government rand-denominated bonds and South African government US dollar-denominated bonds.

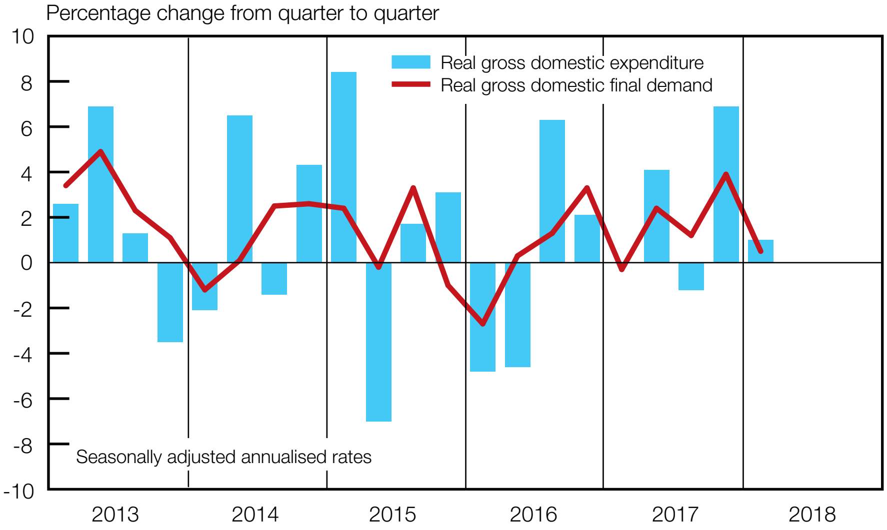
4 The South African five-year credit default swap spread reflects the price of insuring against a default on five-year bonds of the South African government.

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

Real gross domestic expenditure[2]

Growth in real *gross domestic expenditure* (GDE) moderated to 1.0% in the first quarter of 2018 from 6.9% in the final quarter of 2017. Gross fixed capital formation contracted anew, while the other two components of real gross domestic final demand – i.e. final consumption expenditure by households and general government – increased at a slower pace. By contrast, the pace of real inventory accumulation was slightly faster.

Real gross domestic expenditure and final demand



Source: Stats SA

Real gross domestic expenditure

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

Component	2017					2018
	Q1	Q2	Q3	Q4	Year*	Q1
Final consumption expenditure						
Households	0.9	3.8	2.4	3.6	2.2	1.5
General government	-1.2	0.6	1.3	1.6	0.6	1.2
Gross fixed capital formation	-3.1	-0.2	-2.7	7.4	0.4	-3.2
Domestic final demand	**-0.3**	**2.4**	**1.2**	**3.9**	**1.5**	**0.5**
Change in inventories (R billions)**	-6.1	6.3	-12.0	10.5	-0.3	11.6
Gross domestic expenditure* **	**0.0**	**4.1**	**-1.2**	**6.9**	**1.9**	**1.0**

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

Sources: Stats SA and SARB

Real net exports and gross fixed capital formation subtracted 3.2 and 0.6 percentage points respectively from real GDP growth in the first quarter of 2018. The largest positive contribution came from final consumption expenditure by households, contributing 0.9 percentage points.

Contributions of expenditure components to growth in real gross domestic product

Percentage points

Component	2017					2018
	Q1	Q2	Q3	Q4	Year	Q1
Final consumption expenditure						
Households	0.5	2.3	1.5	2.2	1.4	0.9
General government	-0.3	0.1	0.3	0.3	0.1	0.2
Gross fixed capital formation	-0.6	0.0	-0.5	1.4	0.1	-0.6
Change in inventories	0.1	1.6	-2.4	2.9	0.2	0.1
Net exports	-0.5	-1.3	3.5	-3.8	-0.6	-3.2
Residual	0.3	0.1	0.0	0.0	0.1	0.3
Gross domestic product	**-0.5**	**2.9**	**2.3**	**3.1**	**1.3**	**-2.2**

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

Sources: Stats SA and SARB

Growth in real *final consumption expenditure by households* moderated to 1.5% in the first quarter of 2018 from 3.6% in the fourth quarter of 2017. Real spending on durable and semi-durable goods contracted while real outlays on non-durable goods increased at a slower pace. By contrast, real expenditure on services reverted from a mild contraction in the fourth quarter of 2017 to a fairly robust increase in the first quarter of 2018. The slowdown in real household consumption expenditure growth occurred despite a marked improvement in consumer confidence in the first quarter of 2018, which was largely related to domestic political developments.

Real final consumption expenditure by households

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

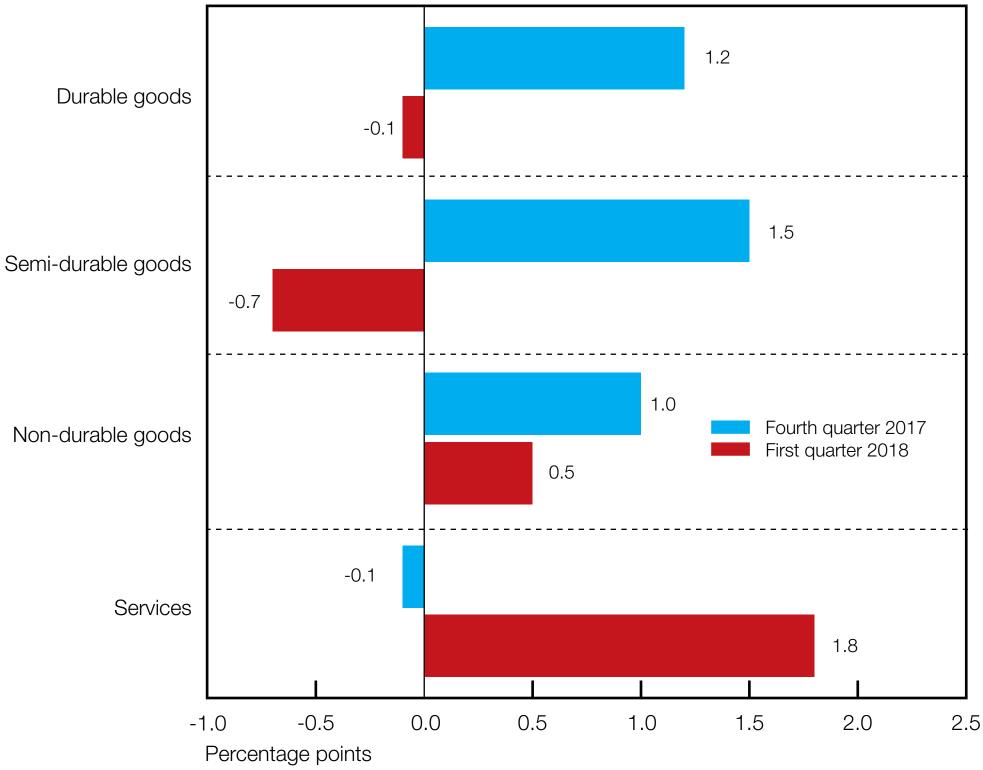
Category	2017					2018
	Q1	Q2	Q3	Q4	Year*	Q1
Durable goods	4.4	11.2	15.2	13.1	6.0	-0.6
Semi-durable goods	-2.2	10.9	4.8	16.7	3.1	-6.7
Non-durable goods	-0.1	4.0	-1.2	2.6	1.1	1.2
Services	1.6	0.7	2.4	-0.3	2.3	4.2
Total	**0.9**	**3.8**	**2.4**	**3.6**	**2.2**	**1.5**

* Percentage change over one year

Source: Stats SA

Real spending on *durable goods* contracted by 0.6% in the first quarter of 2018 following three successive double-digit quarterly increases. Real outlays on personal transport equipment, recreational and entertainment goods, and other durable goods contracted while those on furniture and household appliances as well as computers and related equipment increased at a slower pace. Household expenditure on personal transport equipment, which represents roughly 50% of durable goods expenditure, contracted despite some pre-emptive vehicle purchases to avoid the value-added tax (VAT) increase from 1 April 2018.

Contributions to growth in real final consumption expenditure by households



Source: Stats SA

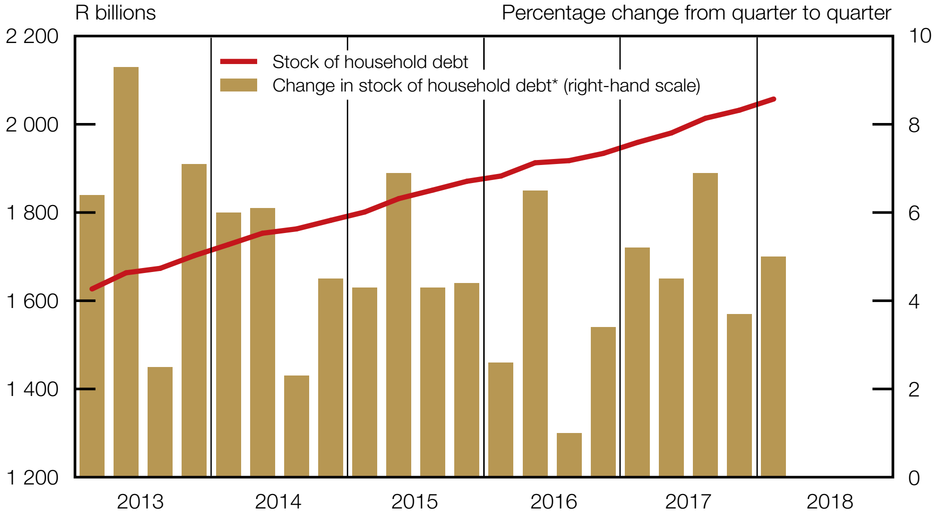
Following a robust increase of 16.7% in the fourth quarter of 2017, real outlays on *semi-durable goods* decreased by 6.7% in the first quarter of 2018, subtracting 0.7 percentage points from growth in total final consumption expenditure by households. Spending on all of the semi-durable subcategories contracted, particularly in clothing and footwear; motorcar tyres, parts and accessories; and recreational and entertainment goods. The contraction in real outlays on semi-durable goods can partly be ascribed to the high base set in the previous quarter on account of the 'Black Friday' promotions in November 2017.

Growth in real spending on *non-durable goods* moderated to 1.2% in the first quarter of 2018 from 2.6% in the previous quarter. The slowdown resulted from a contraction in real household spending on food, beverages and tobacco as well as recreational and entertainment goods, while spending on consumer goods as well as medical and pharmaceutical products increased at a slower pace. Lower fuel price inflation in the first quarter of 2018 contributed to an increase in real outlays on household fuel, power and water as well as petroleum products.

Real household spending on *services* – the largest component of household consumption expenditure – rebounded from a marginal decline of 0.3% in the fourth quarter of 2017 to an increase of 4.2% in the first quarter of 2018. Real spending on all of the services categories increased over the period.

Growth in the real *disposable income* of households slowed from 2.7% in the fourth quarter of 2017 to 0.2% in the first quarter of 2018 as growth in the real compensation of employees moderated marginally. Notwithstanding the slower pace of increase in consumer spending (on a seasonally adjusted basis), growth in household debt accelerated in the first quarter of 2018 as overdrafts and other loans and advances increased notably. Growth in both mortgage advances extended to households – the largest component of household debt – and instalment sale credit and leasing finance increased at a marginally slower pace. The ratio of household debt to nominal disposable income inched higher to 71.7% in the first quarter of 2018 from 71.2% in the preceding quarter as household debt increased at a faster pace than nominal disposable income. Similarly, the ratio of debt-service cost to nominal disposable income increased from 9.1% to 9.2% over the period.

Household debt

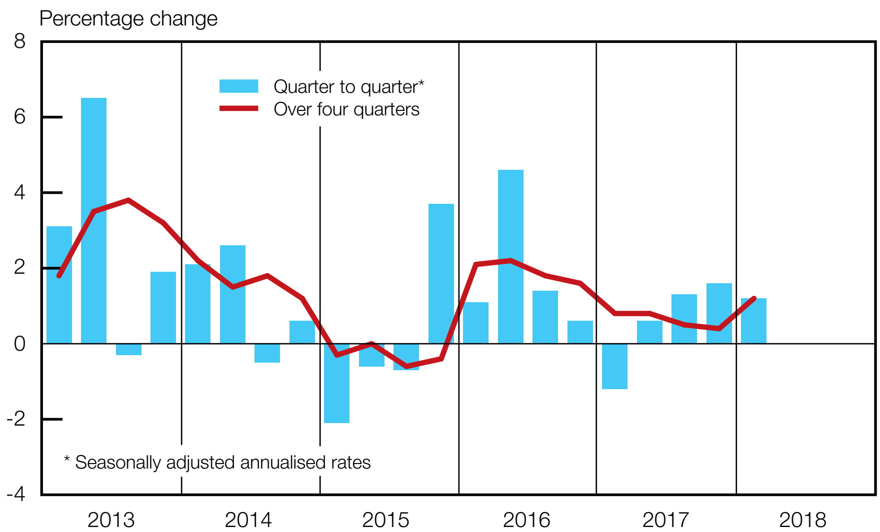


Seasonally adjusted
* Seasonally adjusted annualised rates

Source: SARB

Growth in real *final consumption expenditure by general government* moderated to 1.2% in the first quarter of 2018 from 1.6% in the fourth quarter of 2017. The slowdown could mainly be attributed to weaker growth in spending on non-wage goods and services. The compensation of employees increased following temporary appointments by the Electoral Commission of South Africa over the period. Measured over four quarters, growth in real final consumption expenditure by general government accelerated slightly to 1.2% in the first quarter of 2018 after four quarters of growth below 1.0%. Government spending remained constrained by limited fiscal space and the high public sector wage bill.

Real final consumption expenditure by general government



Source: Stats SA

Real *gross fixed capital formation* contracted anew in the first quarter of 2018 following a robust increase in the final quarter of 2017. Capital spending by private business enterprises and general government contracted, while fixed capital outlays by public corporations increased for a second consecutive quarter, albeit at a far slower pace than in the previous quarter.

Real gross fixed capital formation

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

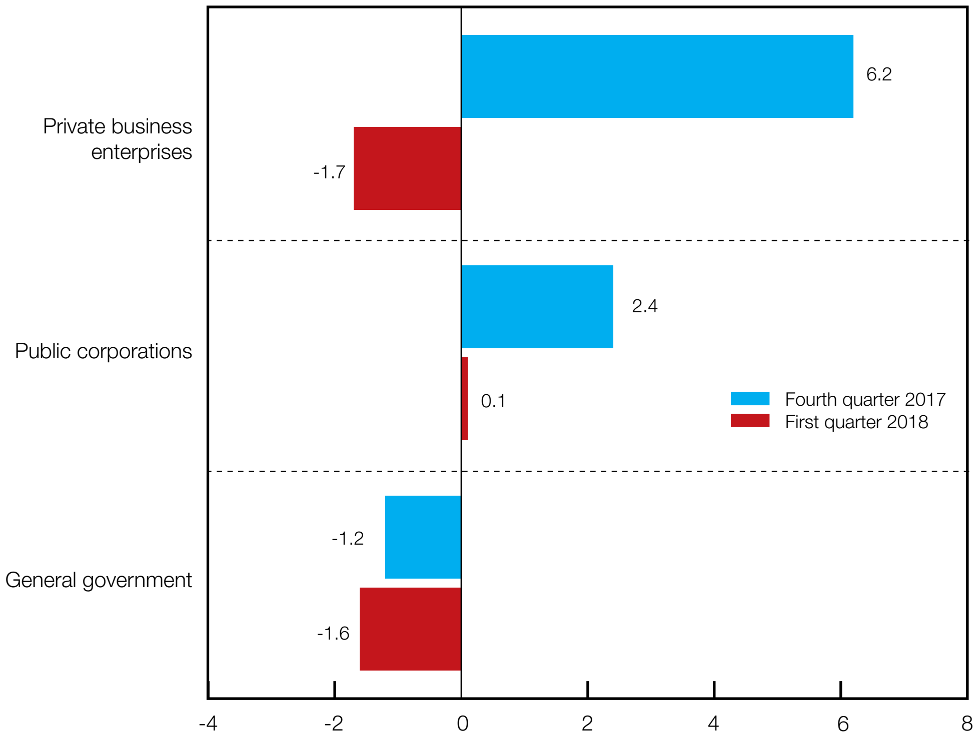
Sector	2017					2018
	Q1	Q2	Q3	Q4	Year*	Q1
Private business enterprises	1.3	-0.2	-4.9	9.9	1.2	-2.7
Public corporations	-16.5	-0.7	-2.6	12.2	-1.3	0.6
General government	-1.9	0.4	6.0	-6.4	-0.7	-9.3
Total	-3.1	-0.2	-2.7	7.4	0.4	-3.2

* Percentage change over one year

Source: Stats SA

Growth in real gross fixed capital outlays by *private business enterprises* receded from 9.9% in the fourth quarter of 2017 to -2.7% in the first quarter of 2018, subtracting 1.7 percentage points from overall growth in real gross fixed capital formation. Capital spending on transport equipment, residential buildings as well as machinery and equipment decreased in the first quarter. However, non-residential construction activity increased for the first time in more than two years. Power purchasing agreements for the next round of independent renewable energy projects were recently signed but it will take some time before capital spending on these projects takes effect.

Contributions to growth in real gross fixed capital formation



Percentage points

Source: Stats SA

Growth in real fixed capital expenditure by *public corporations* slowed notably from 12.2% in the final quarter of 2017 to only 0.6% in the first quarter of 2018, largely due to reduced spending on construction works.

Real fixed capital spending by *general government* contracted further by 9.3% in the first quarter of 2018 following a decrease of 6.4% in the preceding quarter. Although all three tiers of general government reduced capital expenditure in the first quarter of 2018, lower spending on construction works by local government contributed most to the contraction.

Real *inventory holdings* increased further by R11.6 billion (at annualised 2010 prices) in the first quarter of 2018. The higher stock levels could mainly be attributed to a build-up of inventories in the manufacturing sector, associated with a large contraction in the exportation of manufactured goods. This was partly offset by a run-down of inventories in the mining sector, particularly of platinum group metals. Industrial and commercial inventories, as a percentage of non-agricultural nominal GDP, edged lower from 11.1% in the fourth quarter of 2017 to 11.0% in the first quarter of 2018.

Gross saving

Gross saving as a percentage of GDP (South Africa's *national saving rate*) deteriorated further in the first quarter of 2018 to 13.8% from 15.8% in the fourth quarter of 2017. Lower gross saving by the household and corporate sectors outweighed the slightly reduced dissaving by general government. As a result, the portion of total gross capital formation to be financed through foreign capital increased from 15.3% in the fourth quarter of 2017 to 25.8% in the first quarter of 2018.

As a percentage of GDP, gross saving by the *corporate sector* decreased from 14.5% in the fourth quarter of 2017 to 12.6% in the first quarter of 2018. This was mainly on account of higher dividend payments and a decrease in the gross operating surplus. The corporate saving rate has trended lower since the fourth quarter of 2016.

Gross dissaving by *general government* as a percentage of GDP improved marginally from 0.2% in the fourth quarter of 2017 to 0.1% in the first quarter of 2018. The increase in revenue outweighed that in expenditure over the period. Tax revenue was mainly underpinned by higher tax payments by individuals while lower final consumption expenditure and subsidies paid moderated the increase in total expenditure.

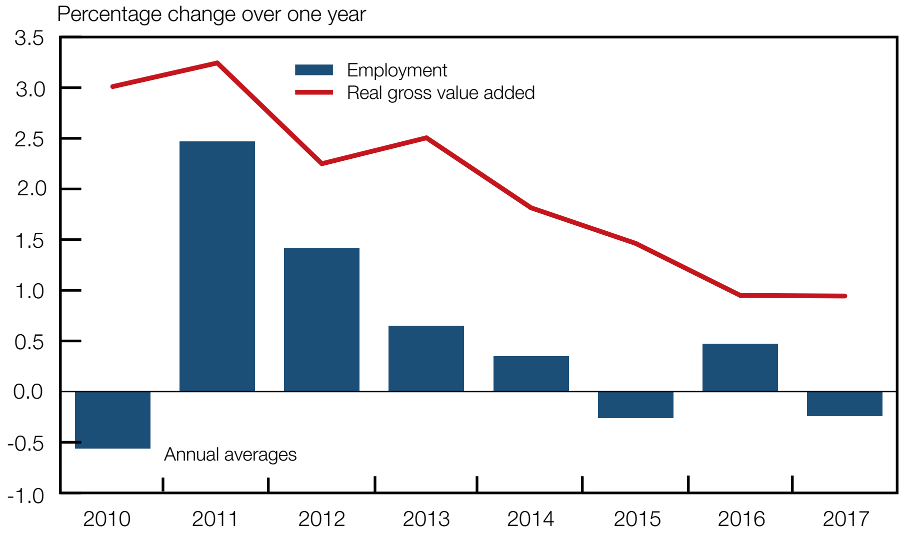
The saving rate of the *household sector* edged marginally lower from 1.5% in the fourth quarter of 2017 to 1.3% in the first quarter of 2018, as nominal consumption expenditure increased at a faster pace than nominal disposable income.

Employment[3]

The acceleration in domestic economic growth in 2017 was insufficient to support meaningful employment creation. On an annual average basis, growth in enterprise-surveyed formal non-agricultural employment slowed continuously from a peak of 2.5% in 2011 to -0.2% in 2017. This slowdown in employment growth is consistent with the current downward phase of the business cycle that commenced in December 2013. In 2017, the level of employment was almost the same as in 2014. According to the *Quarterly Employment Statistics (QES)* survey of Statistics South Africa (Stats SA), total enterprise-surveyed formal non-agricultural employment decreased marginally in the fourth quarter of 2017, with the level of employment remaining broadly unchanged at 9.7 million.

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

Formal non-agricultural employment and real gross value added

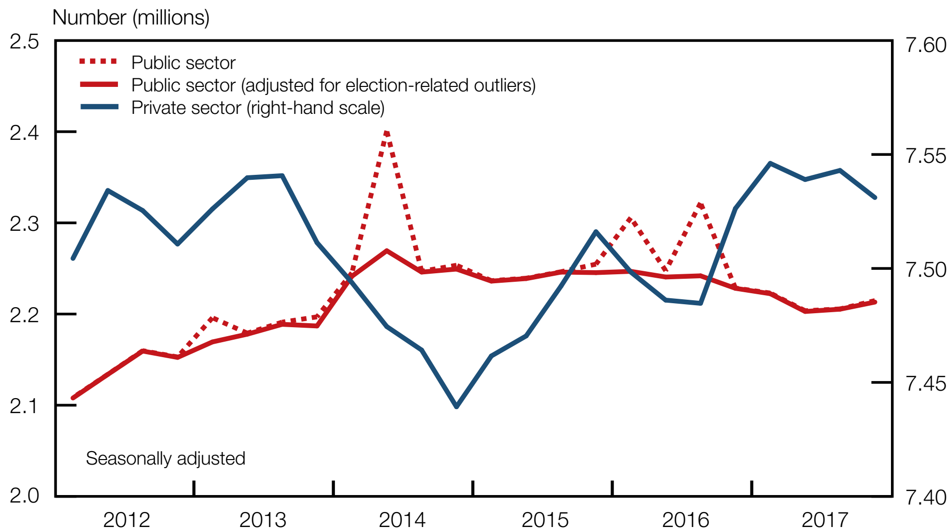


Sources: Stats SA and SARB

4 The *QES* data analysed in this section were statistically linked by the SARB to remove the level shift.

Stats SA implemented a new sample drawn from the 2017 Business Sampling Frame in the second quarter of 2017. This resulted in an upward adjustment of roughly 114 000 in the level of total formal non-agricultural employment.[4]

Formal non-agricultural employment



Sources: Stats SA and SARB

The marginal decrease in formal non-agricultural employment in the fourth quarter of 2017 resulted entirely from an annualised decrease of 0.6% in *private sector employment*. Labour paring occurred in all of the goods-producing private subsectors, which collectively shed around 53 200 jobs in the second half of 2017. However, besides in the private transport, storage and communication services sector, additional employment opportunities were created in the services subsectors in the fourth quarter of 2017. These included private community, social and personal services; finance, insurance, real estate and business services; and trade, catering and accommodation services. Annual average growth in private sector employment remained lacklustre, picking up only marginally from 0.2% in 2016 to 0.5% in 2017.

Change in seasonally adjusted enterprise-surveyed formal non-agricultural employment by sector

Sector	Change over one quarter: Q4 2017		Change over four quarters to Q4 2017		Cumulative job losses(-)/ gains(+)*	
	Number	Per cent annualised	Number	Per cent	Q2 2010 to Q1 2014	Q2 2014 to Q4 2017
Total goods-producing	*-29 700*	*-5.1*	*-31 400*	*-1.4*	*-16 900*	*-123 300*
Total services..................................	*17 800*	*1.4*	*36 100*	*0.7*	*273 600*	*160 600*
Private sector	-11 900	-0.6	4 700	0.1	256 700	37 300
National departments	-2 400	-2.0	-8 800	-1.8	44 000	16 500
Provinces	14 300	5.6	-10 100	-1.0	108 000	-56 200
Local governments..........................	-1 800	-2.2	- 100	0.0	71 600	4 800
Transport, storage and communication services	-1 300	-4.9	-8 600	-7.5	26 700	-24 300
Other public sector enterprises, including electricity and IEC**	300	0.5	13 800	5.4	20 400	28 800
Public sector	9 100	1.7	-13 800	-0.6	270 700	-30 400
Grand total	-2 800	-0.1	-9 100	-0.1	527 400	6 900

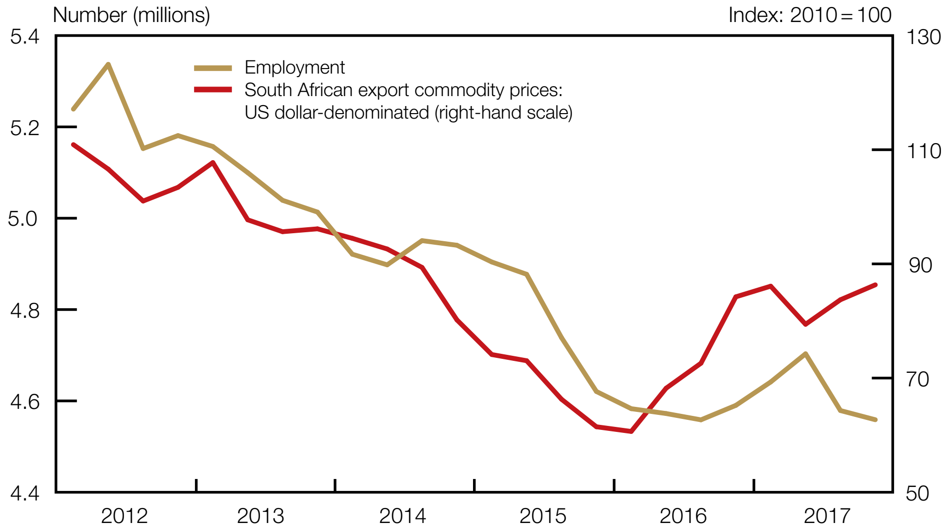
* These reflect the two most recent phases in the formal non-agricultural employment cycle.
** Electoral Commission of South Africa

Sources: Stats SA and SARB

By contrast, the *public sector* created an additional 9 100 jobs in the fourth quarter of 2017. The increased employment by provincial governments was partially offset by job losses at national departments, local government as well as the public transport, storage and communication services sector. The level of public sector employment, excluding election-related employment, has trended gradually lower after reaching a peak in the second quarter of 2014, as government remained committed to fiscal consolidation. Consequently, public sector employment growth receded notably from an annual average rate of 3.2% in 2014 to -1.3% in 2017.

Mining sector employment decreased for a second successive quarter in the fourth quarter of 2017, as job losses continued unabated in the gold-mining sector. Gold-mining employment contracted for a fifth successive quarter, as retrenchments due to shaft closures and maintenance continued.

Mining-sector employment and commodity prices

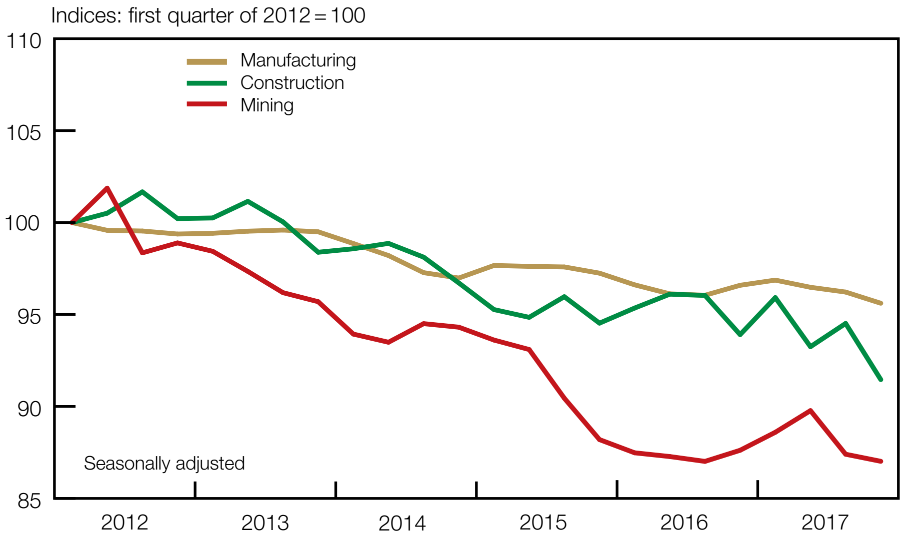


Sources: Stats SA and SARB

Conversely, employment in the non-gold mining sector increased in the fourth quarter of 2017, following a loss of roughly 10 500 job opportunities in the previous quarter. However, annual average mining sector employment increased somewhat in 2017 – the first annual increase since 2013 – aided by the sustained global economic recovery and higher international commodity prices. The recent constructive engagements between mining industry stakeholders to resolve the impasse on the revised 2017 Mining Charter and the acquisition of mineral rights bodes well for much-needed policy certainty in the sector.

Employment in the *manufacturing sector* decreased for a third successive quarter in the fourth quarter of 2017 despite an acceleration in the sector's real GVA over the same period. Disconcertingly, annual average manufacturing sector employment has contracted since 2007, albeit at a much slower pace in 2017. According to the *Absa Manufacturing Survey* by Stellenbosch University's Bureau for Economic Research (BER), manufacturing business confidence jumped by 13 index points to a still low 37 in the first quarter of 2018, driven by expectations of improved economic conditions and a notable waning of the political climate as a key constraint on business. However, the increase in business confidence was not supported by underlying activity indicators. Domestic demand remained under pressure while respondents indicated that their export performance held up relatively well. As a result, production volumes dipped slightly lower but remained positive. The domestic manufacturing sector remains vulnerable to international trade tensions (particularly between the US and China), movements in the exchange value of the rand, and domestic demand conditions.

Employment in the private goods-producing sectors

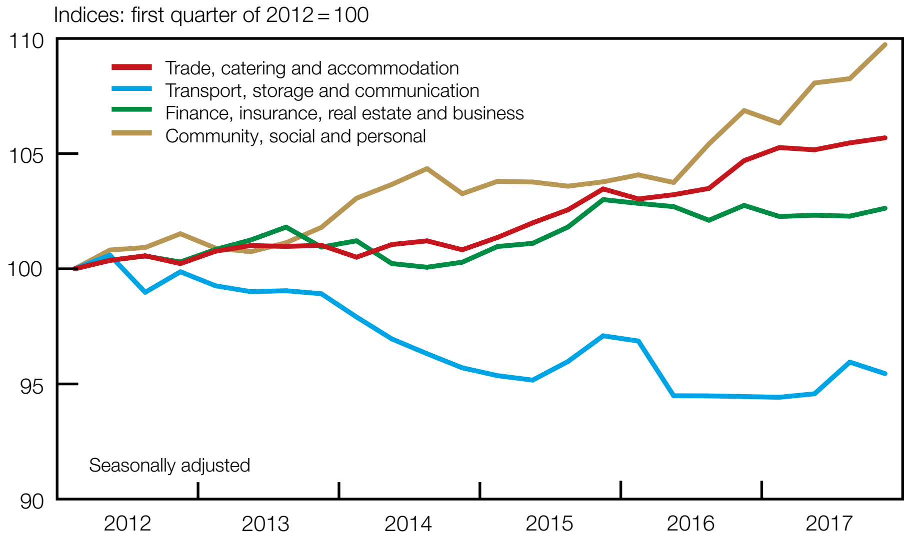


Sources: Stats SA and SARB

Following an increase in the third quarter of 2017, *construction sector employment* contracted at an annualised rate of 12.3% in the fourth quarter, weighed down by retrenchments and the termination of contracts in the following construction subsectors: the building of complete constructions or parts thereof; civil engineering; and building completions. Around 20 100 formal construction jobs were lost in the fourth quarter, consistent with the contraction in the real GVA by the sector for four successive quarters. Sentiment in the sector remained depressed, as the First National Bank (FNB)/BER Civil Confidence Index fell by 7 index points to a record low of 12 in the first quarter of 2018, weighed down by increased competitive tendering, which lowered profitability. The BER noted that, given the strained fiscus, construction activity remained under pressure as public sector capital expenditure accounts for the bulk of civil construction. Encouragingly, the FNB/BER Building Confidence Index rose from 31 to 43 index points in the first quarter of 2018, underpinned by an improvement in non-residential building activity, while residential activity remained largely flat.

Contrary to the goods-producing sectors of the economy, employment picked up pace in the services sectors, with roughly 38 100 jobs having been added in the three quarters up to the fourth quarter of 2017. Employment in the *finance, insurance, real estate and business services sector* increased in the fourth quarter of 2017, reversing the losses sustained in the previous quarter. Employment in the *trade, catering and accommodation services sector* increased for a second successive quarter in the fourth quarter of 2017. In line with this increase in employment, business confidence improved meaningfully in the trade sector in the first quarter of 2018, while the BER's *Retail Survey* reported improved conditions in the trade sector despite the underlying activity indicators remaining relatively subdued. Furthermore, the FNB/BER Consumer Confidence Index increased dramatically from -8 in the fourth quarter of 2017 to a record 26 in the first quarter of 2018, as the change in the country's leadership lifted sentiment significantly. However, the BER noted that while retail survey participants were optimistic that trading conditions would improve meaningfully during 2018, this would largely depend on the sustainability of the recovery in business and consumer confidence.

Employment in the private services sectors



Sources: Stats SA and SARB

According to the *Quarterly Labour Force Survey* conducted by Stats SA, the total number of people employed in South Africa increased by 207 000 from the fourth quarter of 2017 to the first quarter of 2018, raising the level of employment to approximately 16.4 million. However, total employment increased by only 165 000 in the year to the first quarter of 2018, with year-on-year growth slowing from 2.3% in the fourth quarter of 2017 to a mere 0.6% in the first quarter of 2018. Household-surveyed formal non-agricultural employment increased by only 18 000 (or 0.2%) in the year to the first quarter of 2018. Conversely, employment in the *informal sector* increased by as much as 8.2%, or 220 000, in the year to the first quarter of 2018. The largest annual employment gains were observed in the community (216 000), trade (69 000) and manufacturing (59 000) sectors. The bulk of these job gains occurred on an unspecified-duration contract basis (129 000) followed by limited-duration contracts (79 000), while permanent or medium-term contracts decreased marginally (by 2 000).

Labour market statistics

Thousands

	2017				2018
	Q1	Q2	Q3	Q4	Q1
a. Total employment..	16 212	16 100	16 192	16 171	16 378
b. Total unemployment (official definition)*....................	6 214	6 177	6 210	5 880	5 980
c. Total economically active (a + b).............................	22 426	22 277	22 402	22 051	22 358
d. Total not economically active..................................	14 634	14 941	14 971	15 474	15 320
e. Total aged 15-64 years (c + d)................................	37 061	37 217	37 373	37 525	37 678
f. Official unemployment rate in per cent (b*100/c)	27.7	27.7	27.7	26.7	26.7

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

* Unemployed persons are persons aged 15–64 years who:
- were not employed in the reference week;
- actively looked for work or tried to start a business in the four weeks preceding the survey interview;
- were available for work, i.e. would have been able to start work or a business in the reference week; or
- had not actively looked for work in the past four weeks but had a job or a business to start at a definite date in the future and were available.

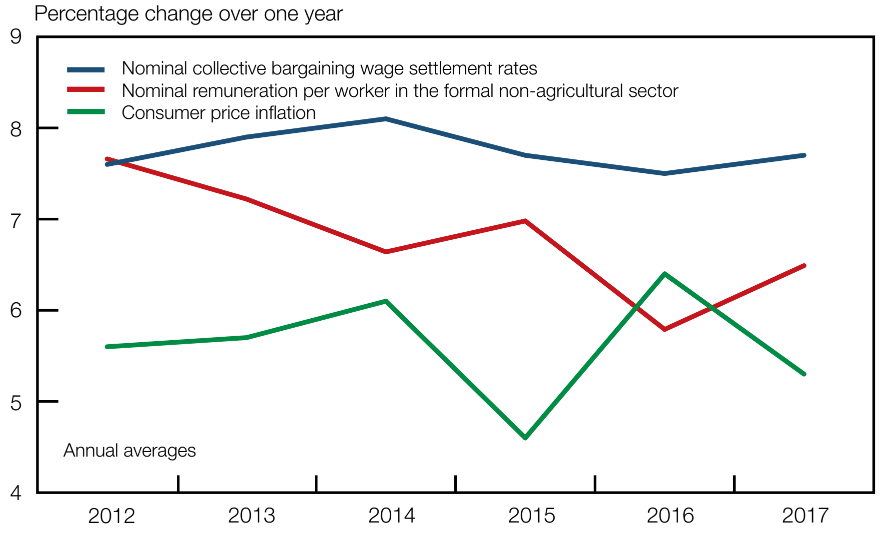
Source: Stats SA

The number of unemployed persons increased by 100 000 from the fourth quarter of 2017 to the first quarter of 2018, raising the total number of unemployed South Africans to 5.98 million. However, unemployment decreased markedly by 234 000, or 3.8%, when measured over four quarters. Disconcertingly, the number of discouraged job seekers increased notably by 510 000 (or 22.4%) over the same period. Given these developments, the official unemployment rate remained unchanged at 26.7% in the first quarter of 2018 but was much lower than the 27.7% of a year earlier. The seasonally adjusted unemployment rate decreased from 27.5% in the fourth quarter of 2017 to 26.3% in the first quarter of 2018. However, the youth unemployment rate rose notably from 51.1% to 54.3% over the same period, up from 52.4% a year earlier.

Labour cost and productivity

The year-on-year pace of increase in *nominal remuneration per worker* in the formal non-agricultural sector of the economy moderated from 6.6% in the third quarter of 2017 to 6.3% in the fourth quarter, as growth in public sector remuneration slowed while private sector remuneration quickened marginally.

Remuneration, wage settlements and inflation

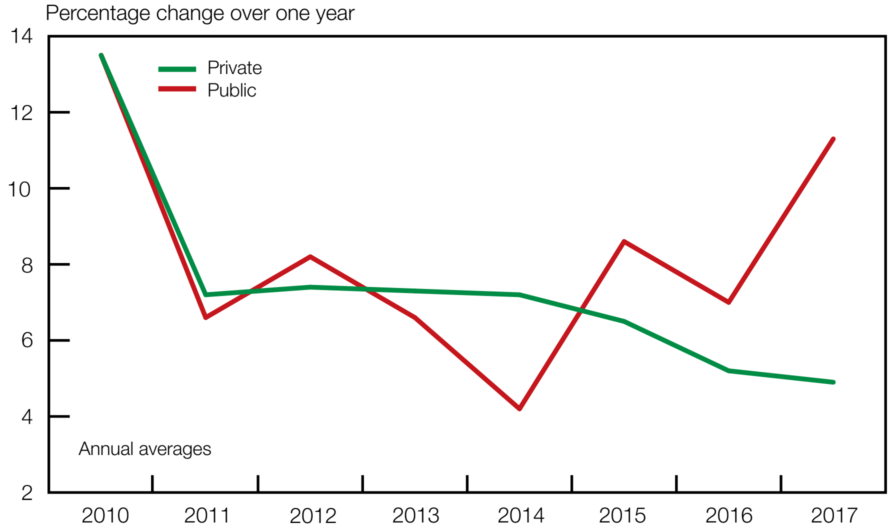


Sources: Andrew Levy Employment Publications, Stats SA and SARB

However, on an annual average basis, the pace of increase in nominal remuneration per worker accelerated from 5.8% in 2016 to 6.5% in 2017 due to an acceleration in public sector wage growth. Wage growth per worker exceeded annual average consumer price inflation in 2017 but remained below the average wage settlement rate in collective bargaining agreements. This suggests lower annual remuneration increases in 2017 for employees who were not part of collective bargaining units.

Growth in *public sector remuneration per worker* moderated from a year-on-year rate of 13.6% in the third quarter of 2017 to a still high 10.6% in the fourth quarter. Despite the moderation in public sector wage growth, year-on-year increases in nominal remuneration per worker remained above the upper limit of the inflation target range at all tiers of the public sector. On an annual average basis, public sector remuneration growth per worker accelerated notably from 7.0% in 2016 to 11.3% in 2017.

Remuneration per worker in the formal non-agricultural sector



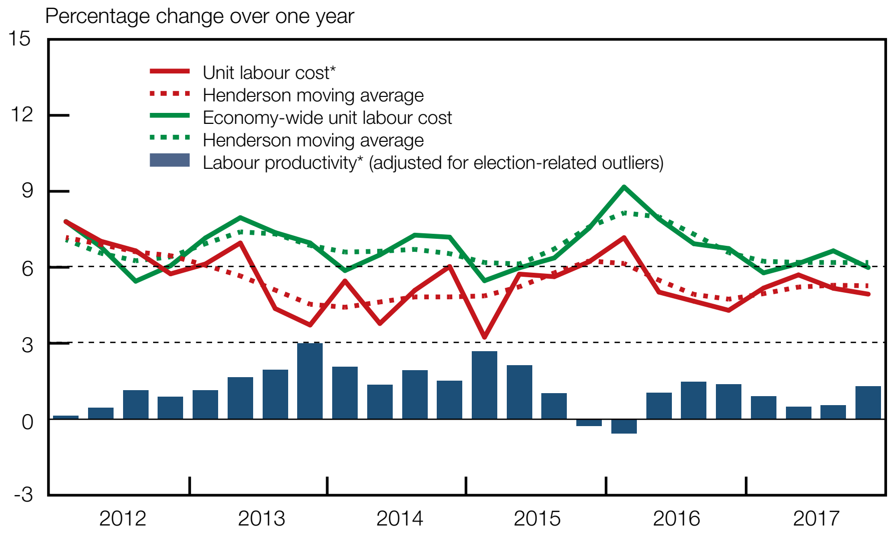
Sources: Stats SA and SARB

Private sector remuneration growth per worker quickened slightly from 4.4% in the third quarter of 2017 to 4.6% in the fourth quarter. Remuneration growth per worker accelerated in the following subsectors: gold mining (from 4.7% to 7.7%); finance, insurance, real estate and business services (from 4.7% to 5.9%); manufacturing (from 3.2% to 4.3%); and construction (from 1.7% to 3.5%). Moderations in wage growth were registered in community, social and personal services (from 6.7% to 5.2%); transport, storage and communication services (from 6.1% to 3.7%); trade, catering and accommodation services (from 4.2% to 3.4%); and non-gold mining (from 5.5% to 2.4%). Annual average growth in private sector remuneration per worker has slowed gradually for five successive years, from 7.4% in 2012 to 4.9% in 2017, as job losses in a subdued economic environment exerted downward pressure on wage growth.

According to Andrew Levy Employment Publications, the *average wage settlement rate* in collective bargaining agreements was 7.4% in the first quarter of 2018, marginally down from the 7.6% in the first quarter of 2017 as well as for 2017 as a whole. The number of working days lost due to strike action rose slightly from 85 000 to a still low 122 000 over the same period. Encouragingly, the protracted public sector wage negotiations were recently concluded without any working days having been lost due to industrial action. The current three-year public sector wage agreement expired on 31 March 2018.

Year-on-year growth in *labour productivity* in the formal non-agricultural sector of the economy slowed marginally from 1.4% in the third quarter of 2017 to 1.3% in the fourth quarter, as year-on-year growth in employment accelerated at a slightly faster pace than output growth. When adjusting for election-related outliers, labour productivity growth accelerated from 0.6% in the third quarter of 2017 to 1.3% in the fourth quarter. For the year as a whole, labour productivity growth quickened from 0.5% in 2016 to 1.2% in 2017.

Labour productivity and unit labour cost



* Formal non-agricultural sector

Sources: Stats SA and SARB

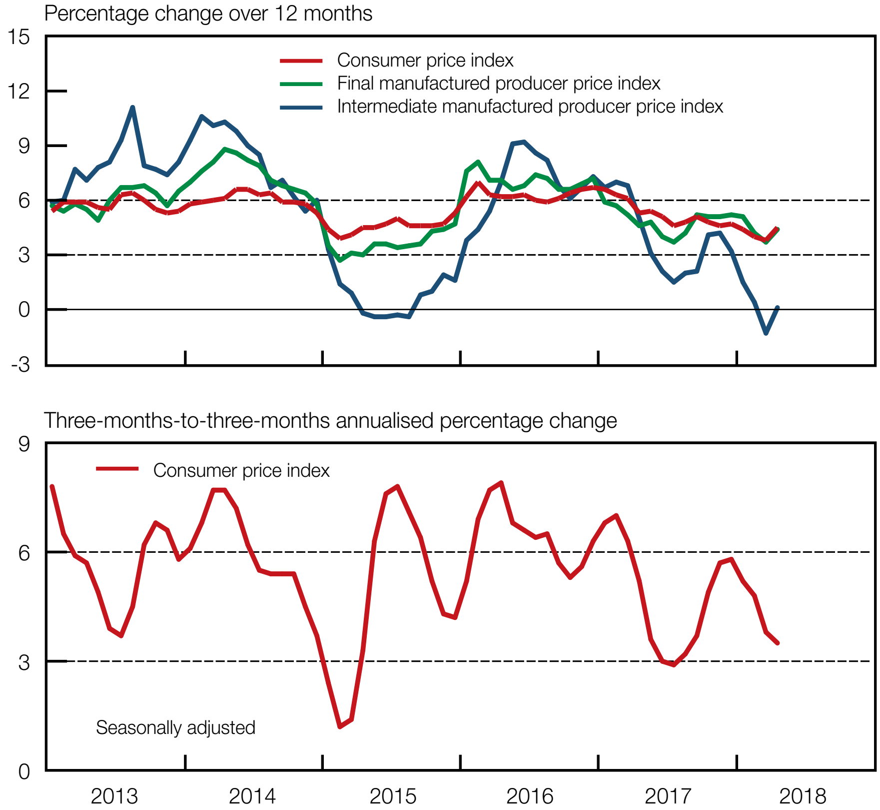
With year-on-year output growth accelerating at a faster pace than year-on-year growth in total remuneration, growth in *nominal unit labour cost in the formal non-agricultural sector* moderated from 5.2% in the third quarter of 2017 to 4.9% in the fourth quarter. Similarly, growth in nominal unit labour cost slowed marginally from an annual average rate of 5.3% in 2016 to 5.2% in 2017. Annual average growth in nominal unit labour cost has fluctuated in a narrow range of between 5.1% and 5.3% since 2013, as total wage growth and output growth slowed over most of this period. Likewise, year-on-year growth in *economy-wide unit labour cost* moderated from 6.6% in the third quarter of 2017 to 6.0% in the fourth quarter, as year-on-year output growth outpaced growth in the compensation of employees.

Prices[5]

Headline consumer price inflation fell below the upper limit of the inflation target range in April 2017 and moderated further to 3.8% in March 2018. The earlier appreciation in the exchange value of the rand continued to exert downward pressure on domestic goods price inflation in particular, while food and services price inflation also moderated over the period. Consumer price inflation subsequently accelerated to 4.5% in April 2018, mainly due to the 1% increase in the VAT rate as well as higher fuel prices. The seasonally adjusted annualised three-months-to-three-months rate of change in the headline consumer price index (CPI) slowed from 5.8% in December 2017 to 3.5% in April 2018, confirming the loss of short-term momentum in domestic consumer price inflation.

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

Consumer and producer price inflation



Sources: Stats SA and SARB

Similar to headline consumer price inflation, most measures of *producer price inflation* decelerated further in the opening months of 2018, largely driven lower by food price inflation and the renewed appreciation in the exchange value of the rand in the closing months of 2017 and early in 2018. Producer price inflation for final manufactured goods decelerated from a recent high of 5.2% in December 2017 to 3.7% in March 2018 due to lower coal, petroleum, chemical, metal and food product price inflation in particular. Likewise, producer price inflation for intermediate manufactured goods slowed from 5.2% in November 2017 to -1.3% in March 2018, mainly on account of falling chemical, rubber and metal prices. Subsequently, both final and intermediate manufactured producer goods price inflation accelerated to 4.4% and 0.1% respectively in April 2018, largely due to the VAT increase as well as the surge in fuel prices following the increase in domestic fuel levies and higher international oil prices.

The appreciation in the exchange value of the rand from November 2017 to March 2018 caused producer price inflation for mining products to decelerate markedly from 11.3% in that month to -2.6% in April 2018. Producer price inflation for agriculture, forestry and fishing also slowed from 8.7% in January 2018 to 0.4% in April, as agricultural price inflation in particular moderated significantly. Producer price inflation for electricity accelerated somewhat to 4.2% in April 2018, reflecting the higher electricity tariff awarded by the National Energy Regulator of South Africa (NERSA). Producer price inflation for water remained elevated but dipped into single digits for the first time in 30 months, at 9.3% in April 2018.

Consumer price inflation

Percentage change over 12 months

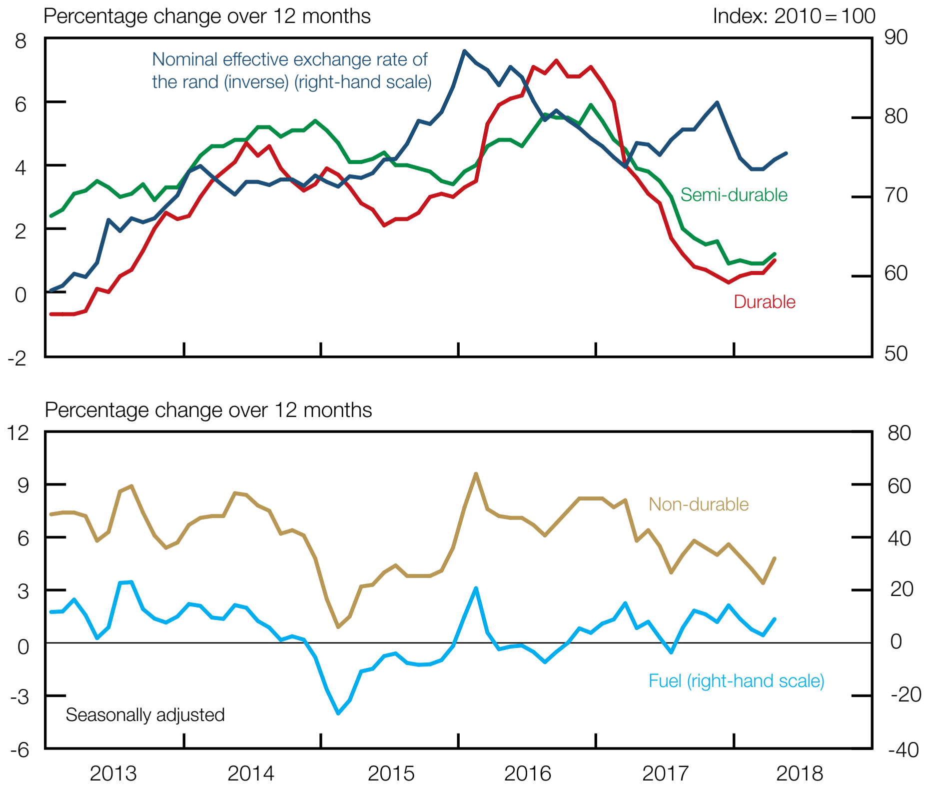
	Weight		2018			
	In the overall index	In the subcategory	Jan	Feb	Mar	Apr
Headline consumer prices	100.00	–	4.4	4.0	3.8	4.5
Goods	48.70	100.0	3.7	3.2	2.6	3.5
Non-durable	35.21	72.3	4.9	4.2	3.4	4.8
Food	15.48	31.8	4.6	4.0	3.6	3.7
Fuel	4.58	9.4	9.1	5.1	2.9	9.0
Semi-durable	5.68	11.7	1.0	0.9	0.9	1.2
Clothing	2.71	5.6	2.0	1.8	1.7	1.8
Footwear	1.12	2.3	1.2	1.2	1.2	1.2
Durable	7.81	16.0	0.5	0.6	0.6	1.0
New motor vehicles	5.62	11.5	2.5	2.5	2.5	3.0
Appliances	0.83	1.7	-6.5	-4.5	-4.7	-4.1
Computers	0.31	0.6	-7.8	-8.0	-10.3	-10.5
Services	51.30	100.0	5.1	4.9	5.1	5.3
Housing and utilities	20.30	39.6	4.9	4.9	5.0	5.1
Health	0.87	1.7	6.4	5.5	5.5	5.7
Medical services	0.75	1.5	6.5	5.6	5.6	5.9
Education	2.53	4.9	7.0	7.0	6.7	6.7
Tertiary education	0.99	1.9	6.2	6.2	5.3	5.3
Restaurants and hotels	3.09	6.0	3.6	3.0	2.8	4.3
Hotels	1.11	2.2	-1.3	-2.3	-3.7	-2.2
Miscellaneous	13.26	25.8	7.8	6.9	7.0	6.9
Insurance	10.06	19.6	8.1	6.9	7.1	7.1

Source: Stats SA

The broad-based moderation in *consumer goods price inflation* was the main driver of lower overall consumer price inflation in the first quarter of 2018. Durable and semi-durable goods price inflation, which is sensitive to the exchange rate, has remained muted since about mid-2017 and amounted to 1.2% and 1.0% respectively in April 2018. Non-durable goods price inflation slowed from 5.6% in December 2017 to 3.4% in March 2018, largely due to a deceleration in food price inflation and, in particular, fuel price inflation. Domestic fuel price inflation slowed markedly from 14.2% in December 2017 to 2.9% in March 2018 due to a combination of the appreciation in the exchange value of the rand against the US dollar and base effects. However, consumer fuel price inflation accelerated markedly to 9.0% in April 2018 due to higher international crude oil prices and the increase in fuel levies announced in the national Budget, resulting in non-durable goods price inflation picking up pace to 4.8% in that month.

Consumer services price inflation moderated from a recent high of 5.8% in September 2017 to a seven-year low of 4.9% in February 2018, aiding the moderation in overall consumer price inflation. Services categories with a combined weight of almost 60% in the consumer services price basket grew at or below the 4.5% midpoint of the inflation target range in February.

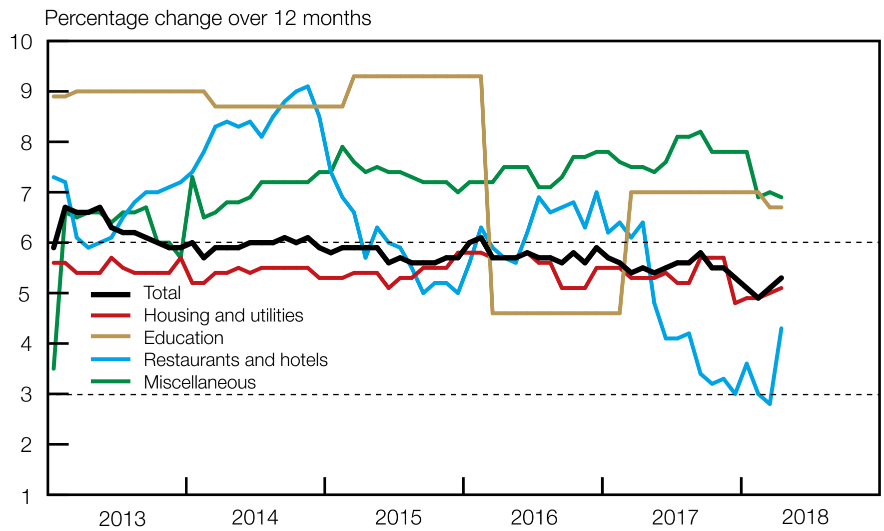
Consumer goods price inflation and the exchange rate



Sources: Stats SA and SARB

Restaurant and hotel services price inflation decelerated from 6.4% in April 2017 to 2.8% in March 2018 – its lowest year-on-year rate on record – due to a decrease in hotel services prices in the Western Cape in particular following the water shortage in that province. Driven by an acceleration in five of the nine services categories, overall consumer services price inflation subsequently accelerated somewhat to 5.3% in April 2018. The seasonally adjusted annualised three-months-to-three-months percentage change in consumer services price inflation moderated to 4.5% in February and March 2018 before accelerating to 5.3% in April.

Consumer services price inflation

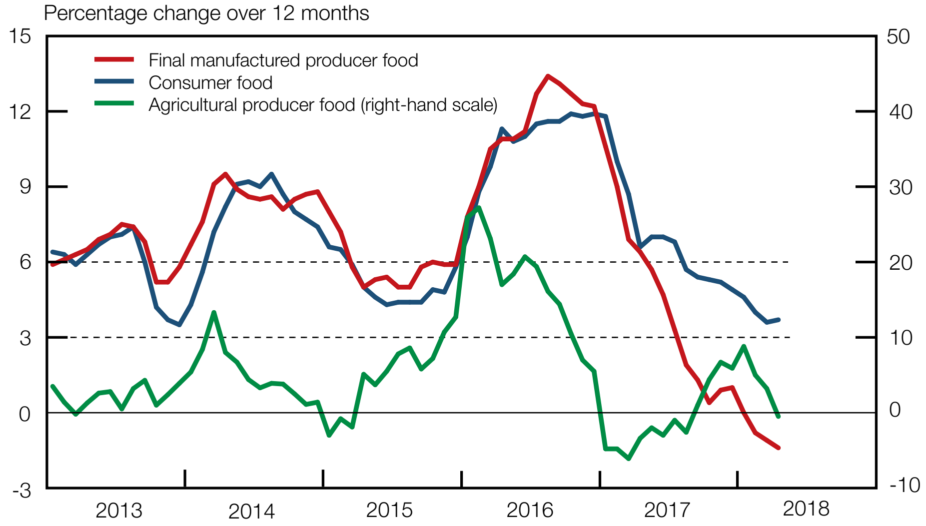


Source: Stats SA

The US dollar-denominated international food price index of the Food and Agriculture Organization (FAO) of the United Nations increased for four consecutive months up to May 2018, driven largely by higher dairy and cereal prices. However, international food prices were only 1.9% higher in May 2018 than a year earlier. The rand-denominated FAO food price index declined by 3.8% in the year to May 2018, driven lower by the earlier appreciation in the exchange value of the rand. International US dollar-denominated cereals prices rose notably in the first five months of 2018 as weather-related risks, robust trade and expectations of lower plantings in especially the US pushed up wheat prices. Drought-related lower production in Argentina continued to lift international maize prices. Consequently, international cereals prices were 16.8% higher in May 2018 than a year earlier. The year-on-year rate of increase in the rand-denominated international cereals price index was 10.3% in May 2018, as the earlier appreciation in the exchange value of the rand cushioned the increase in international cereal prices.

Domestic *food price inflation* eased notably over the past year and a half. Final manufactured producer food price inflation decelerated markedly from 13.4% in August 2016 to -1.4% in April 2018. The moderation was broad-based, with price inflation for meat and meat products, grain mill and bakery products as well as sugar slowing sharply. Following a marked slowdown to -6.1% in March 2017, agricultural producer food price inflation picked up pace to 8.8% in January 2018 as live animal price inflation accelerated anew and the low base in the prices of crops and horticultural products dissipated. However, agricultural producer food price inflation slowed to -0.5% in April as live animal price inflation decelerated markedly.

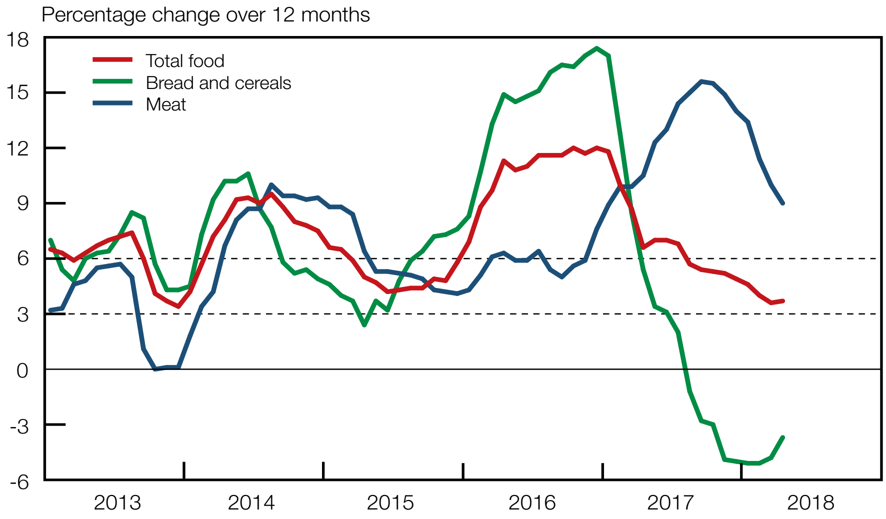
Producer and consumer food price inflation



Source: Stats SA

Consumer food price inflation moderated for the ninth consecutive month to 3.6% in March 2018 – its lowest rate since December 2013 – before accelerating marginally to 3.7% in April. The seasonally adjusted annualised three-months-to-three-months percentage change in the consumer food price index decelerated notably from 10.1% in February 2017 to 2.3% in April 2018, indicating the loss of momentum in food price inflation. Bread and cereals price inflation – with the highest weight (of 21%) in the consumer food price basket – contributed the most to the deceleration in consumer food price inflation, moderating to -3.7% in April 2018. The continued acceleration in meat price inflation initially moderated the broad-based deceleration in consumer food price inflation. However, consumer meat price inflation has since moderated from 15.6% in September 2017 to a still high 9.0% in April 2018. This reflects a gradual normalisation in both the beef and the poultry industries following the alleviation of supply constraints related to the earlier drought and the outbreak of avain flu last year. Pork price inflation also receded notably in recent months due to weak demand following the outbreak of listeriosis that was linked to the production of certain processed pork products.

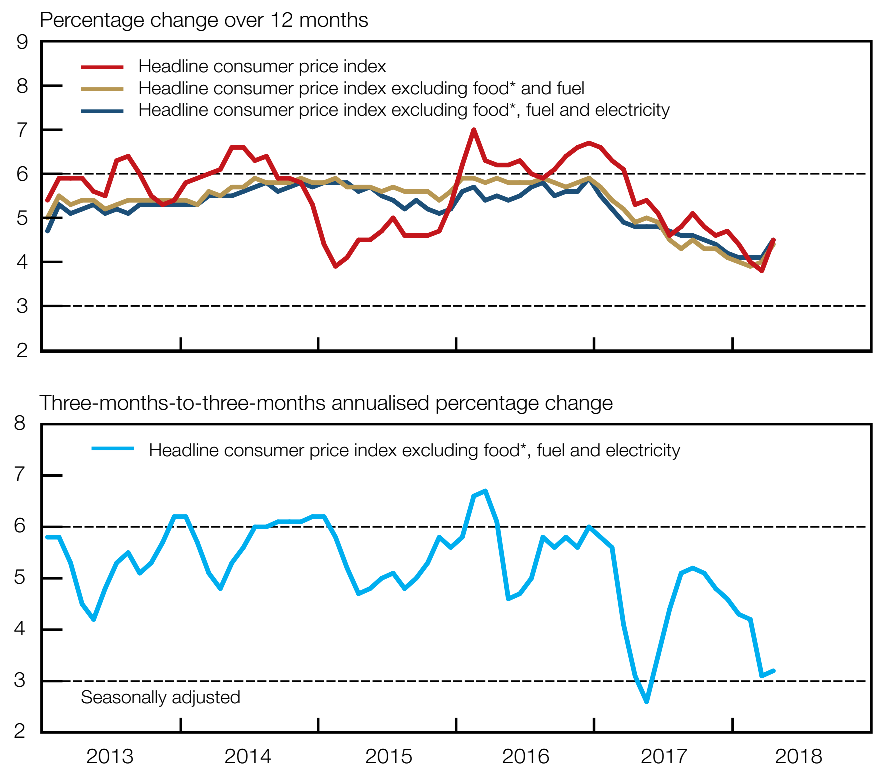
Consumer food price inflation



Source: Stats SA

Underlying inflationary pressures receded further in the first quarter of 2018, reflecting continued subdued consumer demand and the ongoing disinflationary effect of the earlier appreciation in the exchange value of the rand. Subtracting the impact of food, non-alcoholic beverages and fuel prices from the calculation of headline consumer price inflation, the resultant measure of underlying inflation decelerated from 5.7% in January 2017 to 4.0% in March 2018 before accelerating to 4.4% in April. The South African Reserve Bank's (SARB) preferred measure of core inflation (also excluding electricity prices) slowed from 5.5% to 4.1% over the same period – its lowest rate in six years – remaining below the midpoint of the inflation target range for the fifth successive month in March 2018. The higher VAT rate largely resulted in core inflation accelerating to 4.5% in April 2018. However, confirming the lack of underlying inflationary pressures, the seasonally adjusted annualised three-months-to-three-months percentage change in the core CPI moderated to 3.2% in April 2018.

Headline and underlying measures of consumer price inflation



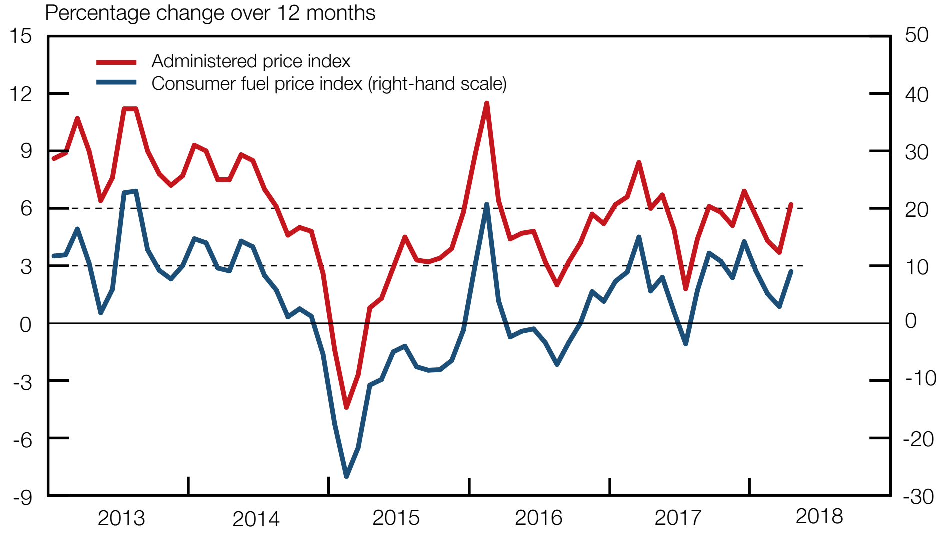
* Food includes non-alcoholic beverages

Sources: Stats SA and SARB

Movements in *administered price inflation* continued to be largely driven by changes in fuel prices in the first three months of 2018. Administered price inflation decelerated from a recent high of 6.9% in December 2017 to 3.7% in March 2018 as fuel price inflation moderated significantly over the same period. Following the acceleration in fuel price inflation, administered price inflation almost doubled to 6.2% in April 2018. Excluding fuel prices, administered price inflation remained unchanged at 4.0% for 10 consecutive months, before accelerating to 5.0% in April 2018. When further excluding electricity prices from the calculation, administered price inflation accelerated from 5.0% in March 2018 to 5.9% over the same period, impacted by the VAT increase.

Administered price inflation

Percentage change over 12 months



Source: Stats SA

Average headline inflation expectations, as reflected in the survey conducted by the BER in the first quarter of 2018, receded to multi-year lows and declined across all the respondent groups. The average expectations for 2018 and 2019 declined to 5.2% and 5.3% respectively from 5.7% and 5.9% previously, while an average of 5.4% is expected for 2020 (surveyed for the first time). The largest adjustment was seen among business representatives, with downward revisions of around 1 percentage point for both 2018 and 2019.

Headline consumer price inflation expectations

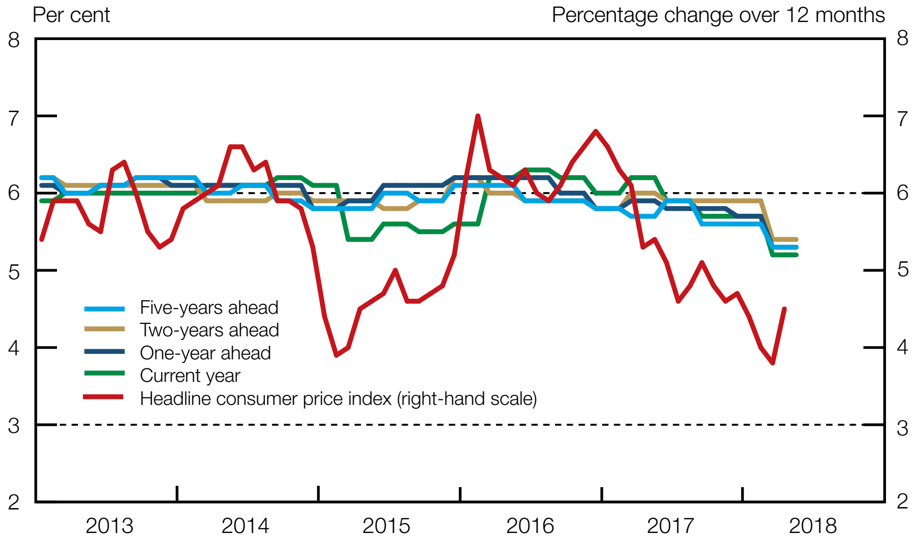
Per cent, as surveyed in the first quarter of 2018

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2018	4.9	5.6	5.3	5.2
2019	5.2	5.6	5.2	5.3
2020	5.3	5.6	5.3	5.4
The next five years	5.2	5.5	5.2	5.3

Source: BER

Five-years-ahead inflation expectations declined to 5.3%, the lowest rate since first surveyed in 2011. Encouragingly, this is the first time since 2007 that inflation expectations across all four time horizons have dipped noticeably below the 6% upper limit of the inflation target range.

Inflation expectations and headline consumer price inflation



Sources: BER and Stats SA

External economic accounts

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

Current account[6]

South Africa's trade balance switched from a surplus of R74 billion in the fourth quarter of 2017 to a deficit of R25 billion in the first quarter of 2018, as the value of net gold and merchandise exports decreased more than that of merchandise imports. The value of merchandise exports was affected by both lower export volumes and lower rand prices as the external value of the rand strengthened. At the same time, the value of merchandise imports decreased due to lower volumes.

Balance of payments on current account

R billions, seasonally adjusted and annualised

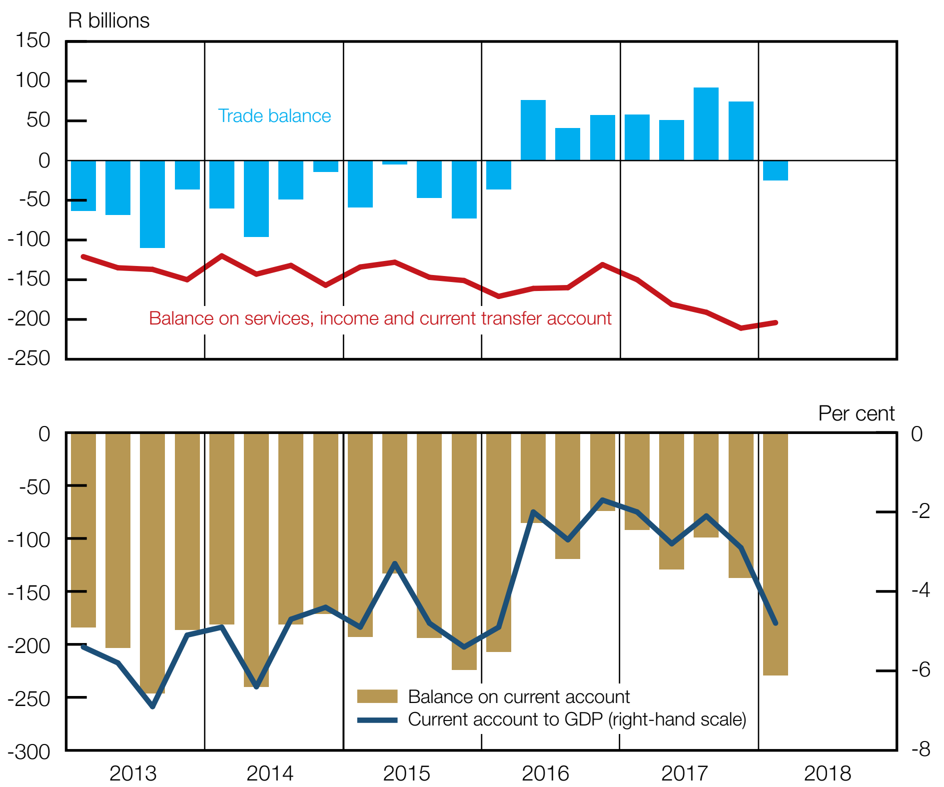
	2017					2018
	Q1	Q2	Q3	Q4	Year	Q1
Merchandise exports	1 074	1 089	1 102	1 168	1 108	1 056
Net gold exports	50	68	68	79	66	77
Merchandise imports	-1 066	-1 106	-1 078	-1 173	-1 106	-1 158
Trade balance	**58**	**51**	**92**	**74**	**69**	**-25**
Net service, income and current transfer payments	-150	-181	-191	-211	-183	-204
Balance on current account	**-92**	**-129**	**-99**	**-137**	**-114**	**-229**
As a percentage of gross domestic product						
Trade balance	1.3	1.1	2.0	1.5	1.5	-0.5
Services balance	-0.1	-0.2	-0.1	-0.1	-0.1	0.0
Income balance	-2.6	-2.8	-3.1	-3.4	-3.0	-3.3
Current transfer balance	-0.6	-0.9	-0.9	-0.8	-0.8	-1.0
Balance on current account	**-2.0**	**-2.8**	**-2.1**	**-2.9**	**-2.5**	**-4.8**

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

Sources: Stats SA and SARB

The shortfall on the services, income and current transfer account narrowed in the first quarter of 2018 but by much less than the deterioration in the trade balance. As a result, the deficit on the current account of the balance of payments widened significantly from R137 billion in the fourth quarter of 2017 to R229 billion in the first quarter of 2018, and as a ratio of GDP from 2.9% to 4.8%.

Balance of payments: current account

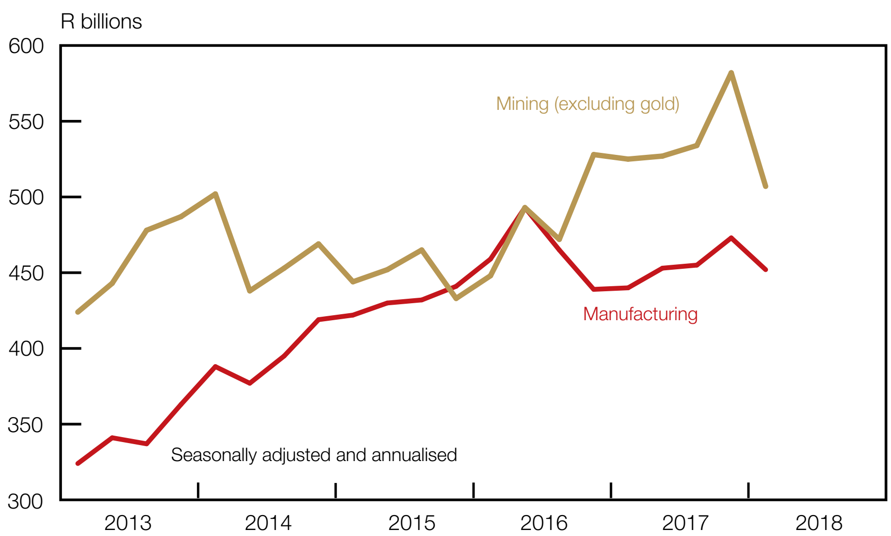


Seasonally adjusted and annualised

Sources: Stats SA and SARB

The value of merchandise exports decreased by 9.6% in the first quarter of 2018 after advancing by 6.0% in the previous quarter. A marked decline in the value of mining exports in the first quarter of 2018, weighed down by the decrease in the rand price of mining commodities, contributed most to the decrease in the total value of merchandise exports. The value of mineral exports declined the most, largely due to iron ore and coal which were affected by, among other factors, the derailment of a train transporting iron ore to the Saldanha Bay harbour. The value of manufactured exports also decreased in the first quarter of 2018, with broad-based declines in various product categories. At the same time, a drop in the value of maize and citrus exports contributed to a contraction in agricultural exports.

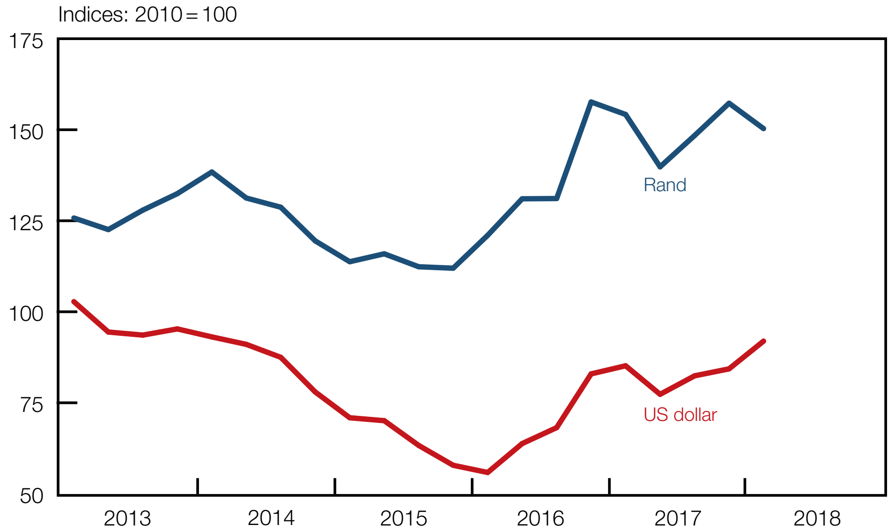
Merchandise exports



Sources: Stats SA and SARB

The increase in the price of a basket of domestically produced non-gold export commodities, measured in US dollar terms, of 9.0% in the first quarter of 2018 was supported by strong growth in global manufacturing production and a weaker US dollar over the quarter. The international prices of iron ore and nickel increased the most over the period, by 13.1% and 14.5% respectively. In rand terms, however, the price of the basket of non-gold export commodities produced by South Africa declined by 4.4% in the first quarter of 2018 due to the strengthening in the external value of the rand. As a result, the rand price of merchandise exports decreased by 4.7% in the first quarter of 2018 following two consecutive quarterly increases.

South African export commodity prices*



* Excluding gold

Source: SARB

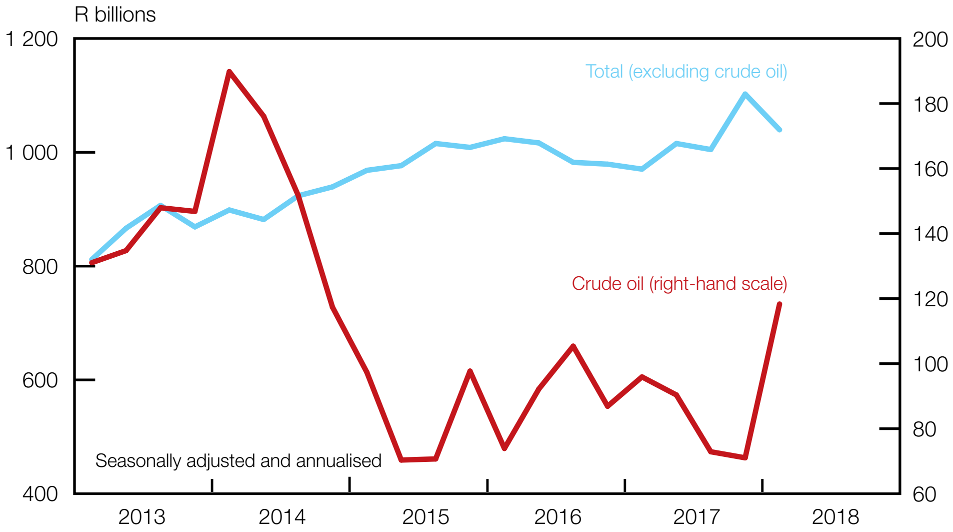
The total volume of exported bulk and break bulk cargo handled at South African ports increased further in the first quarter of 2018, albeit at a slower pace than in the previous quarter. The increase occurred despite a sharp contraction in the volume of bulk cargo handled at the Saldanha Bay port following the iron ore derailment.

The US dollar price of gold per fine ounce on the London market increased by 4.3% in the first quarter of 2018, mainly due to the weaker US dollar. However, the average realised rand price of gold decreased by 12.4% over the same period, partly due to the appreciation in the exchange value of the rand. The decline in the price marginally outweighed the increase in the volume and resulted in a 3.0% decrease in the value of net gold exports in the first quarter of 2018.

The value of merchandise imports decreased marginally by 1.3% in the first quarter of 2018 following an increase of 8.9% in the previous quarter. The first-quarter decline reflected a contraction in the value of imported manufactured products, particularly machinery and electrical equipment as well as vehicles and transport equipment. The decline in the value of manufacturing imports was partially offset by an increase in mining and agricultural imports. The value of mining imports rose by 8.8%, primarily due to increased domestic demand for mineral products, specifically crude oil. When excluding crude oil imports, the value of merchandise imports contracted by 5.7%. The value of agricultural imports rose slightly in the first quarter of 2018, primarily as a result of live animals and animal products as well as animal or vegetable fats and oil.

The rand price of merchandise imports remained broadly unchanged in the first quarter of 2018 while the volume contracted by 1.5%. The contraction in the volume of merchandise imports resulted from lower manufacturing import volumes, while higher mining import volumes were buoyed by a strong increase in crude oil imports despite a 45-day maintenance shutdown at one of the country's crude oil refineries in the first quarter of 2018.

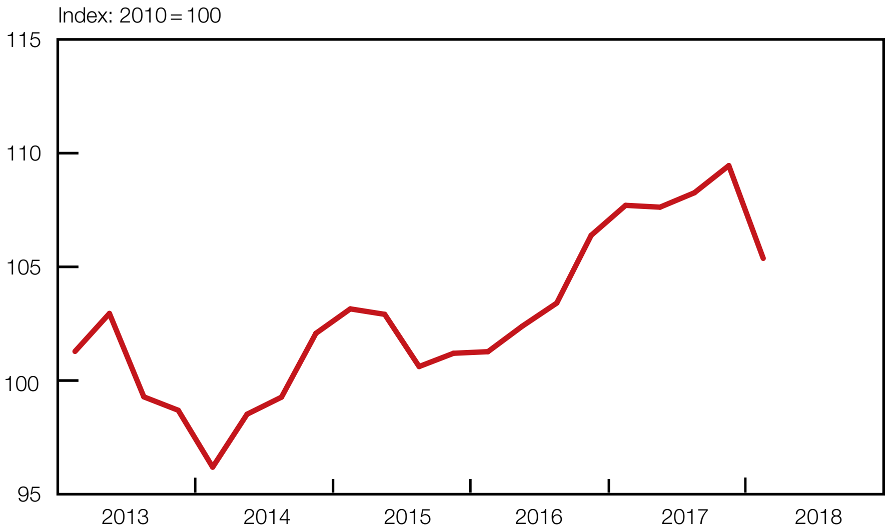
Merchandise imports



Sources: Stats SA and SARB

The import penetration ratio (real merchandise imports as a ratio of real GDE decreased from 26.8% in the fourth quarter of 2017 to 26.3% in the first quarter of 2018.

Terms of trade*



* Including gold

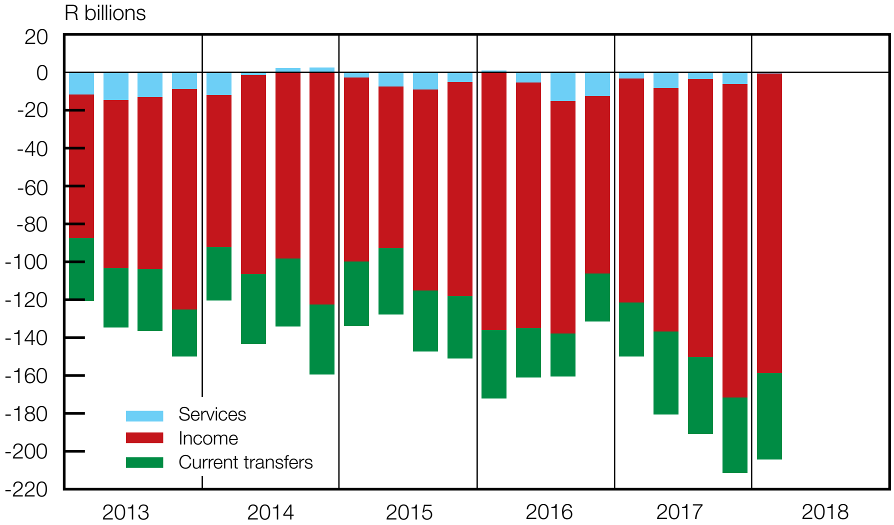
Sources: Stats SA and SARB

South Africa's terms of trade deteriorated significantly from the fourth quarter of 2017 to the first quarter of 2018 as the rand price of exports, including gold, declined notably while the rand price of imports remained broadly unchanged.

The shortfall on the services, income and current transfer account narrowed in the first quarter of 2018. Relative to GDP, this deficit improved marginally to 4.3% in the first quarter of 2018 from 4.4% in the fourth quarter of 2017. Following four consecutive quarterly increases, the smaller deficit in the first quarter of 2018 could mainly be attributed to a narrowing of both the income and services deficits. By contrast, net current transfer payments increased somewhat in the first quarter of 2018.

Dividend payments to non-residents increased for a third successive quarter in the first quarter of 2018 from a fairly low base in mid-2017; this was also boosted by the resumption of dividend payments by companies which had held back on dividends amid challenging economic conditions. However, dividend receipts from abroad increased more than dividend payments, resulting in a narrowing of the income deficit in the first quarter of 2018. Over the past 10 years, the income deficit has accounted for almost 70% on average of the shortfall on the overall account.

Net service, income and current transfer payments



Seasonally adjusted and annualised

Sources: Stats SA and SARB

Net payments for services declined in the first quarter of 2018 as gross receipts declined by less than gross payments. The broad-based decline in both the receipts of and the payments for services in the first quarter of 2018 was partly due to the strengthening in the external value of the rand against major currencies. By contrast, net current transfer payments increased slightly in the first quarter of 2018 as gross current transfer receipts decreased somewhat.

Financial account

South Africa's financial account of the balance of payments (excluding unrecorded transactions) recorded a net inflow of capital of R53.2 billion in the first quarter of 2018 following an inflow of R50.3 billion in the fourth quarter of 2017. On a net basis, portfolio investment recorded a large inflow during the first quarter of 2018 while direct investment, financial derivatives and other investment recorded outflows. Overall, financial account inflows amounted to 4.5% of GDP in the first quarter of 2018.

Net financial transactions

R billions

	2017					2018
	Q1	Q2	Q3	Q4	Year	Q1
Change in liabilities						
Direct investment	9.1	5.9	16.2	-13.5	17.7	10.5
Portfolio investment	25.9	74.7	83.9	94.3	278.8	89.4
Financial derivatives	-90.9	-59.6	-37.8	-39.1	-227.4	-59.5
Other investment	44.8	-28.4	49.8	-5.6	60.6	2.4
Change in assets						
Direct investment	-11.2	-31.7	-58.4	3.2	-98.1	-20.5
Portfolio investment	-19.2	-8.0	-16.8	-14.5	-58.5	-15.6
Financial derivatives	90.6	58.4	33.3	40.9	223.2	53.0
Other investment	-35.4	-0.4	-33.3	-0.5	-69.6	-21.1
Reserve assets	14.2	-1.1	-23.7	-14.9	-25.5	14.6
Total identified financial transactions*	27.9	9.7	13.1	50.3	101.1	53.2
As a percentage of gross domestic product	*2.5*	*0.8*	*1.1*	*4.2*	*2.2*	*4.5*

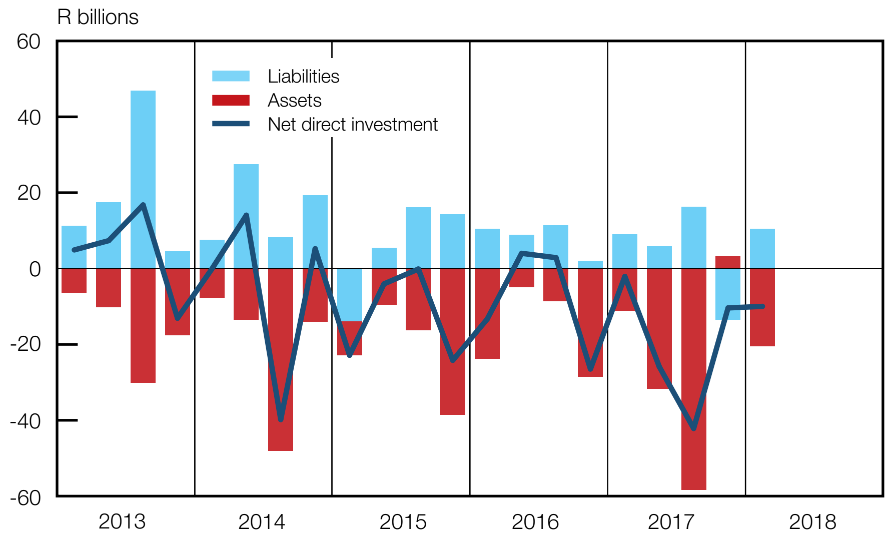
* Excluding unrecorded transactions
Inflow (+) outflow (-)

Source: SARB

Foreign-owned assets in South Africa

South Africa's direct investment liabilities reverted from an outflow of R13.5 billion in the fourth quarter of 2017 to an inflow of R10.5 billion in the first quarter of 2018 due to an increase in equity holdings and loans extended by foreign parent companies to South African subsidiaries. Net direct investment had mostly recorded outflows in recent years due to a combination of an increase in direct investment outflows by South African companies acquiring assets abroad and declining direct investment inflows as non-residents reduced their acquisition of equity holdings in domestic companies, and as loans extended by foreign parent companies to South African subsidiaries decreased.

Direct investment flows



Source: SARB

Portfolio investment liabilities recorded a further sizeable inflow of R89.4 billion in the first quarter of 2018 following an inflow of R94.3 billion in the previous quarter. Non-residents' net purchases of domestic equities decreased from R66.7 billion in the fourth quarter of 2017 to R42.5 billion in the first quarter of 2018 while those of debt securities increased from R27.6 billion to R46.9 billion over the same period.

Other investment liabilities switched to an inflow of R2.4 billion in the first quarter of 2018 following an outflow of R5.6 billion in the fourth quarter of 2017. The inflow resulted from drawings on foreign long-term loans by public corporations and an increase in rand-denominated deposits at domestic banks, which was partly countered by repayments of short-term foreign currency-denominated loans by the domestic banking sector.

South African-owned assets abroad

South African entities' direct investment abroad recorded an outflow of R20.5 billion in the first quarter of 2018 following an inflow of R3.2 billion in the fourth quarter of 2017. The larger outflow occurred as a domestic financial services company acquired a significant stake in a company abroad and as private sector companies increased equity holdings in foreign subsidiaries while also advancing debt financing to foreign subsidiaries.

South African residents' acquisition of foreign portfolio assets of R15.6 billion in the first quarter of 2018 was more than the R14.5 billion in the previous quarter as the domestic private non-banking sector acquired foreign equity securities.

Following the relatively small outflow of R0.5 billion in the fourth quarter of 2017, other investment assets recorded a notable outflow of R21.1 billion in the first quarter of 2018 as the domestic banking sector extended short-term loans to non-residents.

Foreign debt

South Africa's total external debt increased from US$163.3 billion at the end of September 2017 to US$173.3 billion at the end of December due to an increase in rand-denominated debt. However, when expressed in rand terms, South Africa's gross external debt declined from R2 204 billion at the end of September 2017 to R2 131 billion at the end of December as the external value of the rand appreciated.

Foreign debt of South Africa

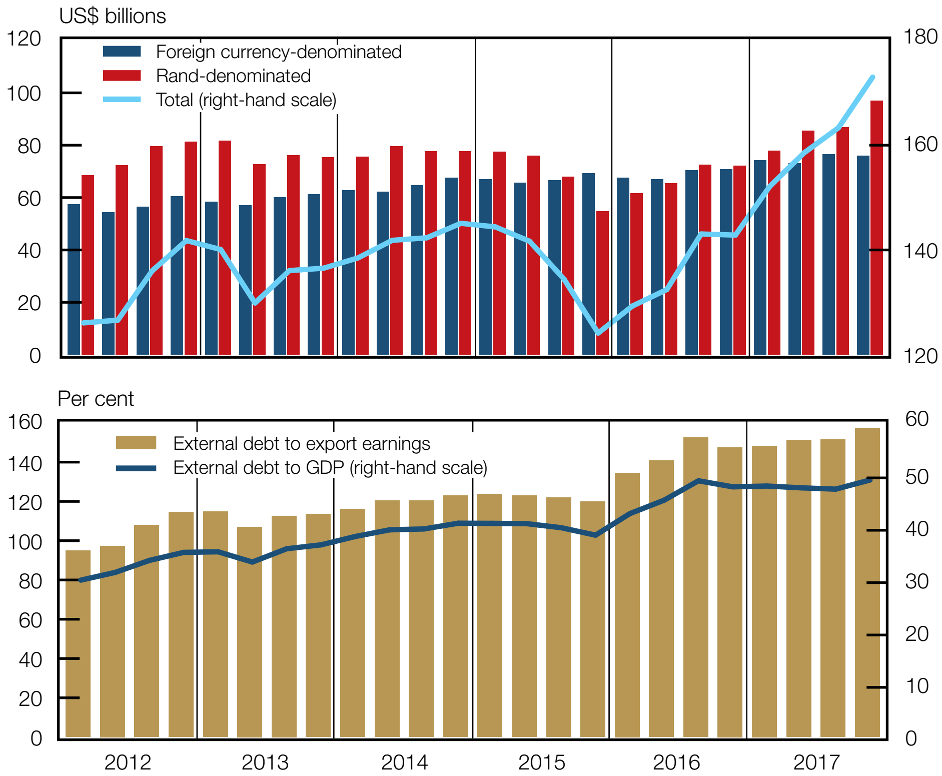
US$ billions at end of period

	2016		2017			
	Q3	Q4	Q1	Q2	Q3	Q4
Foreign currency-denominated debt	**70.4**	**70.7**	**74.3**	**73.0**	**76.5**	**75.9**
Debt securities	21.9	24.1	24.1	24.3	26.7	26.7
Other	48.5	46.6	50.2	48.7	49.9	49.2
Public sector	8.1	8.1	9.1	9.2	9.6	9.9
Monetary sector	20.6	19.2	19.2	16.6	17.9	17.1
Non-monetary private sector	19.8	19.3	21.9	22.9	22.3	22.2
Rand-denominated debt	**72.6**	**72.1**	**77.8**	**85.5**	**86.8**	**97.4**
Debt securities	42.2	41.4	45.0	50.3	50.3	57.7
Other	30.4	30.7	32.8	35.2	36.5	39.7
Total foreign debt	**143.0**	**142.8**	**152.1**	**158.5**	**163.3**	**173.3**
As a percentage of gross domestic product	*49.4*	*48.3*	*48.4*	*48.1*	*47.8*	*49.6*
As a percentage of total export earnings	*152.6*	*147.6*	*148.4*	*151.3*	*151.6*	*157.3*

Source: SARB

Foreign currency-denominated external debt declined slightly from US$76.5 billion at the end of September 2017 to US$75.9 billion at the end of December, largely as a result of repayments on short-term loans by the domestic monetary sector. Over the same period, the debt of the public and the non-monetary private sectors remained broadly unchanged.

External debt



Source: SARB

Rand-denominated external debt, expressed in US dollars, increased substantially from US$86.8 billion at the end of September 2017 to US$97.4 billion at the end of December. The increase resulted from net purchases of domestic government bonds by non-residents and valuation effects following the appreciation of the rand against the US dollar.

South Africa's total external debt as a ratio of annual GDP increased from 47.8% at the end of September 2017 to 49.6% at the end of December. Similarly, the ratio of external debt to export earnings increased from 151.6% to 157.3% over the same period.

Box 2 The structure of South Africa's external debt[1]

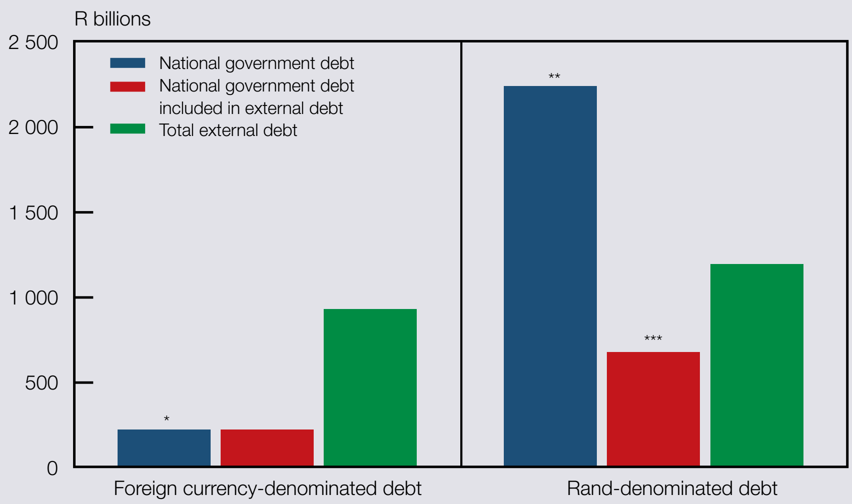
South Africa's total external debt[2] has increased significantly from 2002. This increase gained further momentum from 2010 as the currency composition changed, with rand-denominated debt mostly exceeding foreign currency-denominated debt. The change in currency composition was driven by non-residents' increased holdings of domestically issued rand-denominated debt of national government, and as a consequence general government[3] became a significant contributor to total external debt. Despite government's dominance of debt securities, the value of other debt – comprising loans and deposits, and reflecting borrowing by the non-monetary private, monetary and public sectors – always exceeded that of debt securities.

1 This discussion is based on the statistics presented in the tables on pages S–102 and S–103 of this *Quarterly Bulletin.*
2 External debt is all the liabilities of residents, denominated in both domestic and foreign currencies, to non-residents that require repayment of principal and/or payment of interest.
3 General government includes national, provincial and local governments.

General government and public corporations dominate foreign currency-denominated debt securities, with just more than half maturing in 2024 and beyond. By contrast, the monetary and non-monetary private sectors dominate other debt denominated in foreign currency, with more than half due in the short term.

From a general government debt perspective, the contribution to external foreign currency-denominated debt was modest whereas that to external rand-denominated debt through non-resident holdings was significant as at the end of 2017.

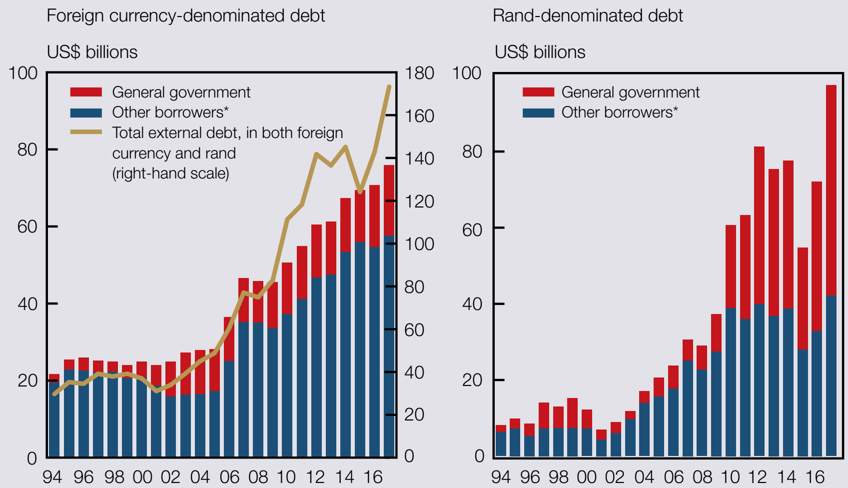
National government's contribution to external debt as at the end of 2017



* National government total foreign debt
** National government total domestic debt
*** National government domestic debt held by non-residents
Sources: National Treasury and SARB

South Africa's total external debt, in US dollar terms, increased at a compounded annual growth rate of 8.0% from US$29.7 billion at the end of 1994 to US$173.3 billion at the end of 2017. The rand-denominated portion grew at a much faster pace of 11.5% while the foreign currency-denominated share increased at a slower rate of 5.6%. This markedly changed the currency composition of total external debt, away from foreign currency-denominated debt (comprising 73.0% of the total at the end of 1994) to rand-denominated debt (comprising 56.2% of the total at the end of 2017). At the end of 2017, rand-denominated debt held by non-residents amounted to US$97.4 billion and exceeded foreign currency-denominated debt of US$75.9 billion.

Currency and issuer of South Africa's external debt

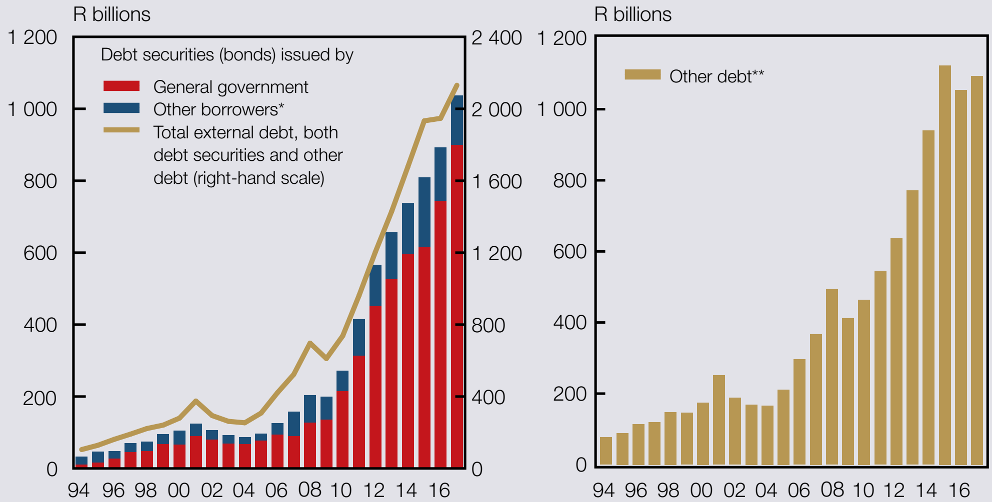


* Other borrowers include public corporations, the central bank, banks and the non-monetary private sector
Source: SARB

Growth in South Africa's total external debt has accelerated since 2010 as the outstanding amount of domestically issued rand-denominated bonds of the general government held by non-residents increased from US$6.4 billion at the end of 2008 to US$55.2 billion at the end of 2017. Non-resident holdings of South African general government domestically issued rand-denominated bonds accounted for 31.8% of total external debt at the end of December 2017 compared to only 8.6% at the end of December 2008. This increase can mainly be attributed to a search for yield by non-resident investors following the global financial crisis as well as the inclusion of South Africa in the Citi World Government Bond Index in 2012.

South Africa's total external debt, in rand terms, amounted to R2 131 billion (equivalent to US$173.3 billion) at the end of 2017, comprising debt securities (bonds) of R1 037 billion and other debt (loans and deposits) of R1 094 billion. Loans and deposits have always exceeded bonds. The non-monetary private sector contributed most to other debt through loans and trade finance, followed by loans and deposits of the banking sector and then public sector loans. General government's debt securities accounted for 86.6% of total debt securities at the end of 2017, with almost two-thirds being rand-denominated.

Financial instrument composition of South Africa's external debt



* Other borrowers include public corporations, the central bank, banks and the non-monetary private sector

** Loans, trade finance and deposits

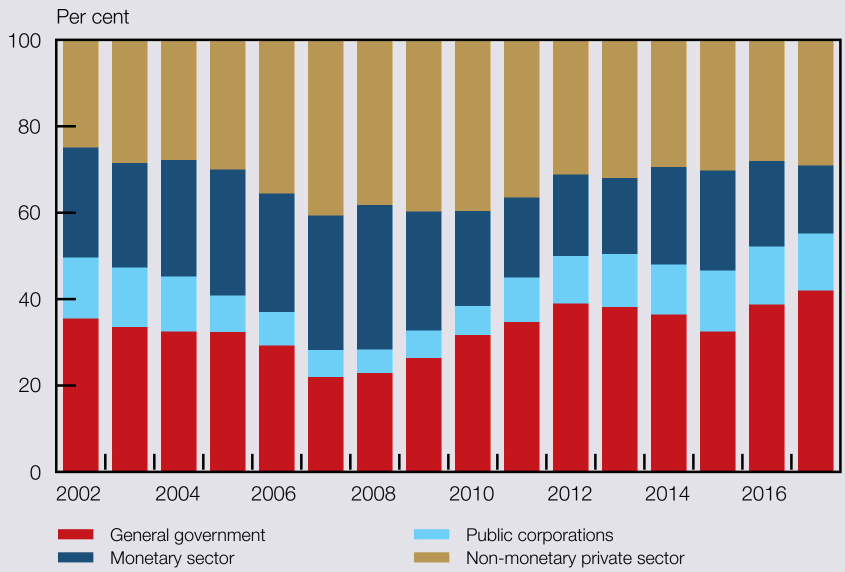
Source: SARB

At the end of 2017, general government accounted for the largest overall share of total external debt at 42% followed by the non-monetary private sector at 29%. However, since 2002, the share of both general government and public corporations has increased while that of the monetary sector and the non-monetary private sector has decreased. The increase in the external debt of general government reflects fiscal deficit funding requirements while that of public corporations points to the upgrading of South Africa's transport and energy infrastructure.

The redemption schedule of the US$26.7 billion total foreign currency-denominated debt securities as at the end of 2017, according to original maturity, shows that 51.8% are due as from 2024, most of which is general government debt.

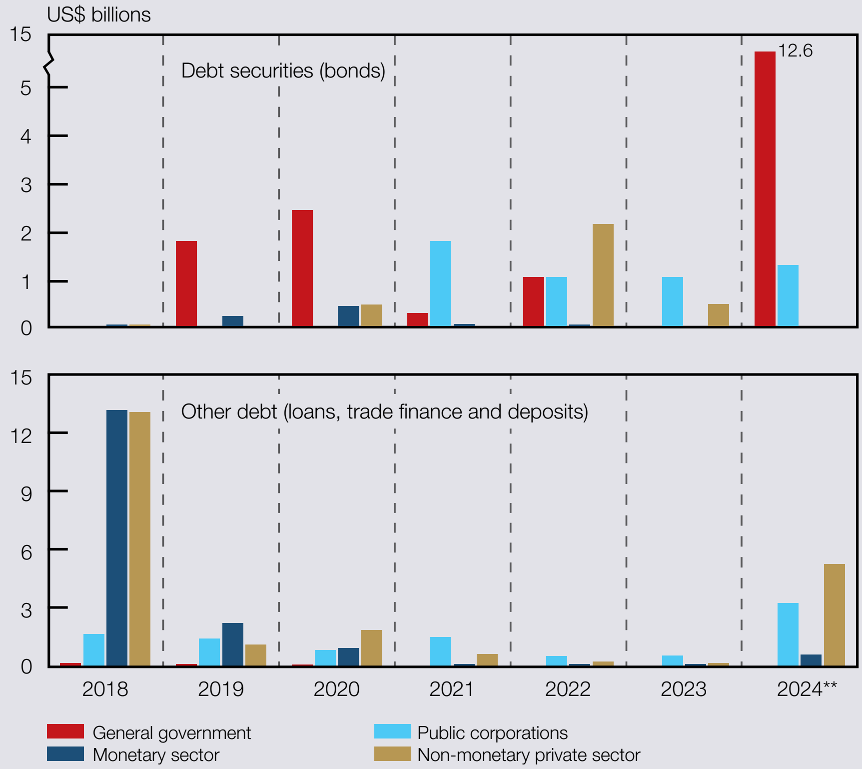
The repayment schedule of the US$49.2 billion total foreign currency-denominated other debt as at the end of 2017, according to original maturity, shows that 56.9% is due in 2018, of which the monetary sector and the non-monetary private sector together account for 53.3%. While these percentages are quite high, the majority of this debt is usually rolled over and therefore not repaid. The non-monetary private sector's external debt is mostly between entities in a foreign direct investment relationship and therefore usually of a longer-term nature.

Sectoral issuer contribution to South Africa's external debt



Source: SARB

Maturity structure of foreign currency-denominated external debt as at the end of 2017*



* Based on original maturity
** 2024 and onwards

Source: SARB

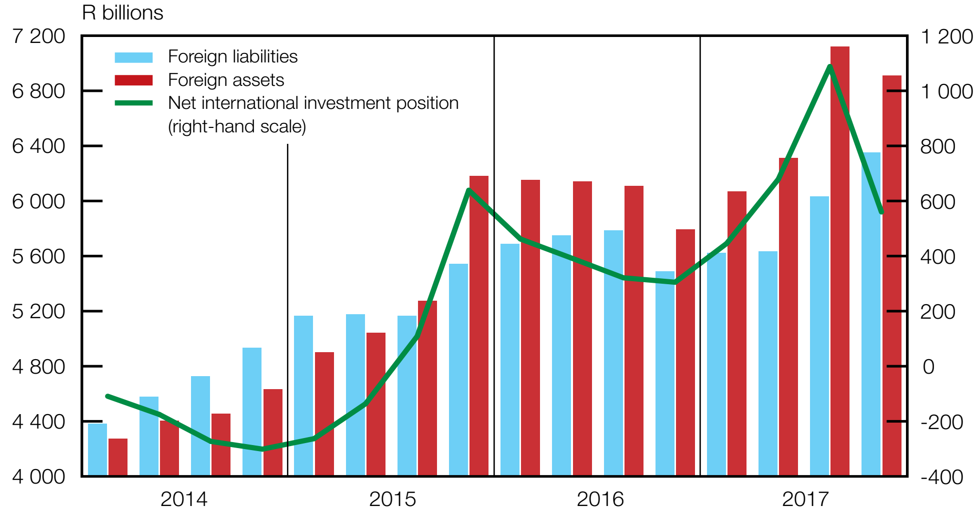
In conclusion, while South Africa's external debt in absolute terms has increased from 2008 to the current period, the relative contribution of foreign currency-denominated debt to rand-denominated debt in US dollar terms has declined. In addition, most of government's external debt continues to be denominated in rand. Where government is exposed to foreign-currency debt, this effectively constitutes long-term debt that matures in 2024 and beyond.

International investment position

South Africa's positive net international investment position (IIP) almost halved from R1 088 billion at the end of September 2017 to R562 billion at the end of December as the value of foreign liabilities increased and that of foreign assets decreased. The increase of 8.3% in the nominal effective exchange rate (NEER) of the rand over the period contributed to the decline in the net IIP as foreign assets have a larger foreign-currency exposure than foreign liabilities.

The market value of South Africa's foreign assets (outward investment) decreased from R7 122 billion at the end of September 2017 to R6 912 billion at the end of December – a decrease of 2.9% following a substantial increase of 12.8% in the previous quarter. With the exception of financial derivatives, the market value of all the functional categories decreased in the fourth quarter of 2017. Foreign portfolio assets declined as the increase in the share prices of companies abroad was more than neutralised by the increase in the NEER. The Standard & Poor's (S&P) 500 Index increased by 6.1% from 30 September 2017 to 31 December, partly offsetting the impact of the stronger rand. On balance, the appreciation in the exchange value of the rand in the fourth quarter of 2017 also decreased the market value of 'other' investment assets and reserve assets over the period.

South Africa's international investment position



Source: SARB

The market value of South Africa's foreign liabilities (inward investment) increased further from R6 034 billion at the end of September 2017 to R6 350 billion at the end of December – an increase of 5.2%. The increase in foreign liabilities reflected an increase in portfolio investment and financial derivatives, while direct investment and 'other' investment liabilities decreased. The increase of 7.1% in the FTSE/JSE All Share Price Index (Alsi) from 30 September 2017 to 31 December affected the market value of portfolio investment liabilities. The increase in portfolio investment liabilities could also be attributed to the acquisition of domestic debt securities by foreign investors. The decrease in 'other' investment liabilities resulted mainly from repayments of short-term loans by the domestic banking sector. The increase in the value of foreign liabilities was softened somewhat by the increase in the NEER over the period.

South Africa's foreign liabilities as a ratio of annual GDP increased from 132.2% as at 30 September 2017 to 136.5% as at 31 December, while foreign assets decreased from 156.0% to 148.6% over the same period. This resulted in a sharp decline in the positive net IIP to 12.1% of GDP as at 31 December 2017 from 23.8% at the end of September.

On an annual basis, South Africa's foreign liabilities increased by 15.7% from 31 December 2016 to 31 December 2017, while foreign assets increased at a faster pace of 19.3% over the period.

International reserves and liquidity

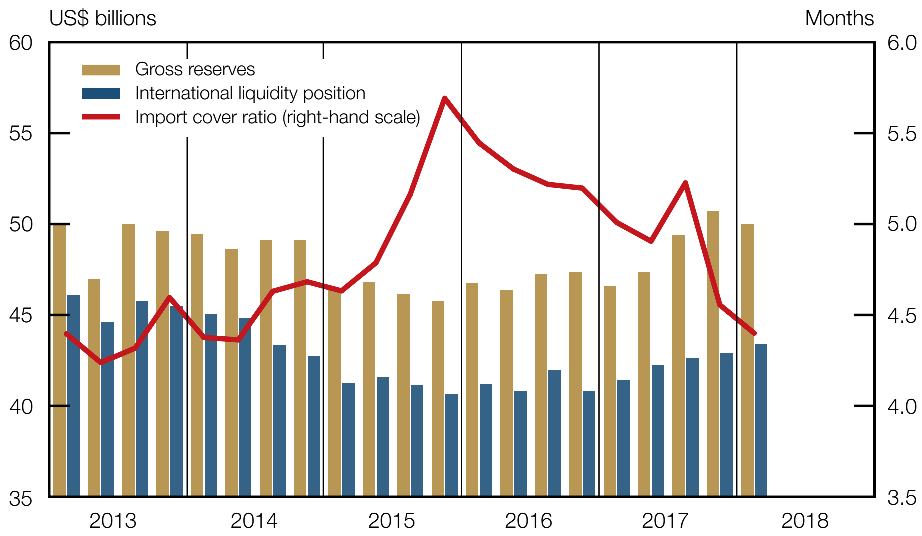
South Africa's international reserve assets decreased by R14.6 billion in the first quarter of 2018 following an increase of R14.9 billion in the fourth quarter of 2017.

The US dollar value of South Africa's gross gold and other foreign reserves (i.e. the international reserves of the SARB before accounting for reserves-related liabilities) decreased from US$50.7 billion at the end of December 2017 to US$50.0 billion at the end of March 2018, mainly reflecting foreign-currency payments made on behalf of the South African government. Gross gold and other foreign reserves subsequently increased to US$51.1 billion at the end of May. South Africa's international liquidity position[7] increased from US$42.9 billion at the end of December 2017 to US$43.4 billion at the end of March 2018 before decreasing to US$42.9 billion at the end of May.

7 Calculated as the SARB's gross gold and foreign reserves minus foreign currency-denominated liabilities against both domestic and foreign counterparties plus/minus the forward position in foreign currency.

The level of import cover (i.e. the value of gross international reserves relative to the value of merchandise imports as well as services and income payments) decreased from 4.6 months at the end of December 2017 to 4.4 months at the end of March 2018.

International reserves



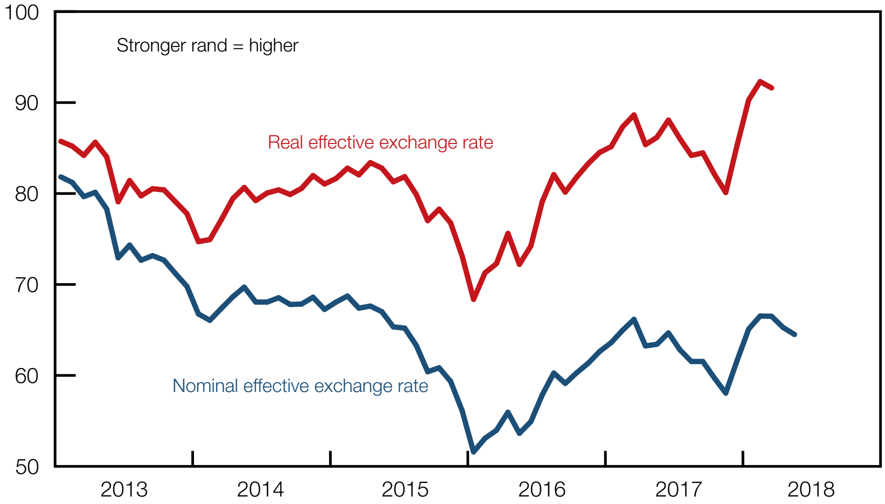
Source: SARB

Exchange rates

Following an increase of 8.3% in the fourth quarter of 2017, the NEER increased by a further 1.8% in the first quarter of 2018. The NEER increased by 0.6% and 2.1% in January and February 2018 respectively followed by a decline of 0.8% in March. The increase in January 2018 resulted mainly from US dollar weakness amid fiscal concerns in the US. The rand strengthened further in February 2018 following government's renewed commitment to fiscal consolidation in the national budget. However, risk aversion towards emerging markets increased following a sell-off in global equity markets which limited the rand's gains. Moody's Investor Services affirmed South Africa's investment-grade credit rating and revised the credit outlook from negative to stable which, together with better-than-expected South African GDP growth in the fourth quarter of 2017, supported the rand in March 2018. However, the SARB's decision to lower the repurchase rate by 25 basis points in that month reduced the rand's carry trade appeal, while continued talks of the possible imposition of import tariffs by the US and China also weighed on sentiment towards the rand.

Effective exchange rates of the rand

Indices: 2010 = 100



Source: SARB

Exchange rates of the rand

Percentage change

	30 Jun 2017 to 29 Sep 2017	29 Sep 2017 to 29 Dec 2017	29 Dec 2017 to 29 Mar 2018	29 Mar 2018 to 31 May 2018
Weighted average*	-4.6	8.3	1.8	-2.4
Euro	-6.2	8.2	1.2	-0.6
US dollar	-3.1	9.8	4.1	-5.3
Chinese yuan	-5.0	7.5	0.6	-3.7
British pound	-5.9	9.0	-0.1	-0.2
Japanese yen	-2.7	9.9	-1.5	-3.4

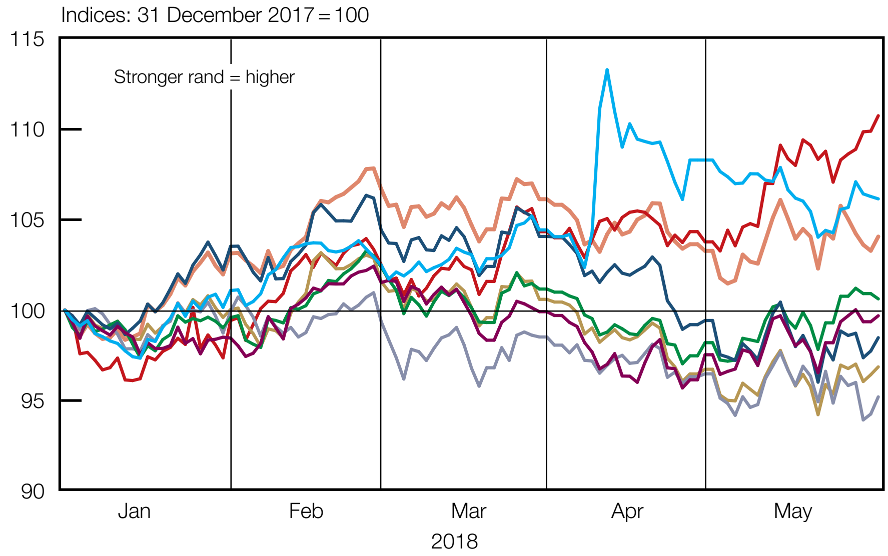
* Trade-weighted exchange rate against a basket of 20 currencies (nominal effective exchange rate)
Depreciation – appreciation +

Source: SARB

In April and May 2018, the value of the rand depreciated against most currencies while the US dollar strengthened significantly. Higher international crude oil prices increased global inflation expectations and contributed to the benchmark US Treasury 10-year bond yield trading above 3.0% in April and May 2018. This decreased the appetite for emerging market assets and limited the effect of a marked improvement in both domestic business and consumer confidence.

The real effective exchange rate (REER) of the rand increased by 3.3% from March 2017 to March 2018, indicating a deterioration in the competitiveness of domestic manufacturers in international markets.

Selected exchange rates: foreign-currency unit per rand



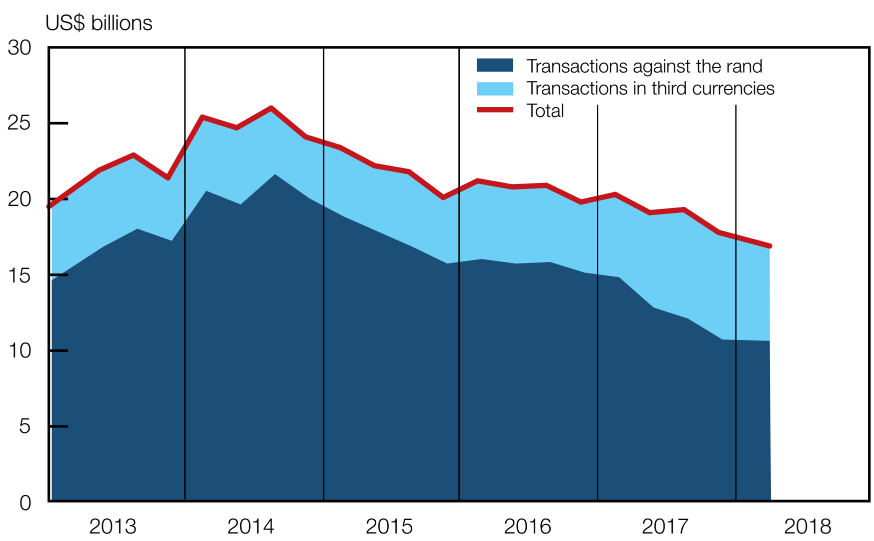
Source: SARB

Turnover in the South African foreign exchange market

8 Calculated as the daily average of all new foreign exchange transactions concluded during a specified period, adjusted for local interbank double-counting.

The net average daily turnover[8] in the South African market for foreign exchange decreased by 5.1% from US$17.8 billion in the fourth quarter of 2017 to US$16.9 billion in the first quarter of 2018. Turnover in third currencies decreased from US$7.2 billion to US$6.4 billion, while turnover in the rand market decreased marginally from US$10.6 billion to US$10.5 billion over the same period.

Net average daily turnover in the South African foreign exchange market



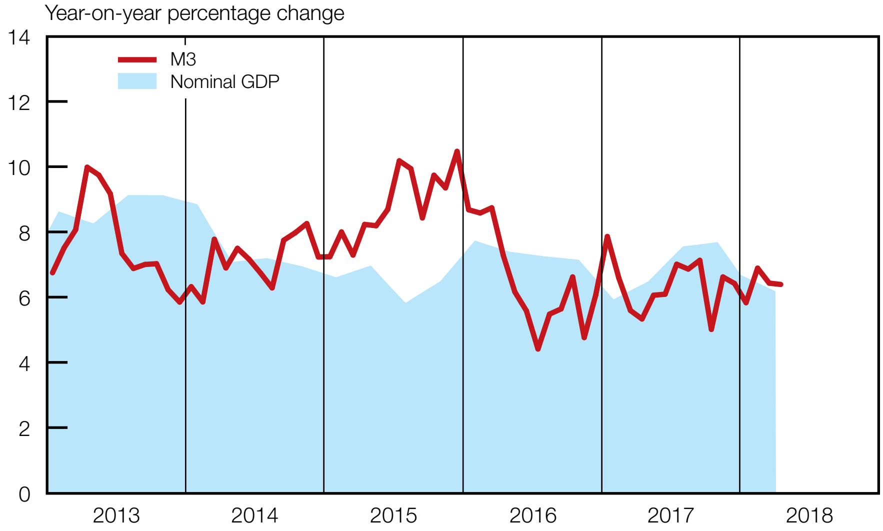
Source: SARB

Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) remained subdued in the first quarter of 2018 and closely aligned to growth in nominal GDP. Growth in the deposit holdings of the household sector trended broadly sideways in the first four months of 2018, at a moderately lower rate than in 2017. The deposit holdings of the corporate sector continued to increase at a slower pace than that of the household sector in the first quarter of 2018, with financial and non-financial companies diverging. Growth in the deposit holdings of non-financial companies accelerated from June 2017 to February 2018, while that of financial companies decelerated over the same period. The income velocity of circulation of M3 increased from 1.41 in the first quarter of 2017 to 1.45 in the fourth quarter before retracing back to 1.41 in the first quarter of 2018, when the moderate expansion in M3 exceeded that in GDP.

Money supply and gross domestic product

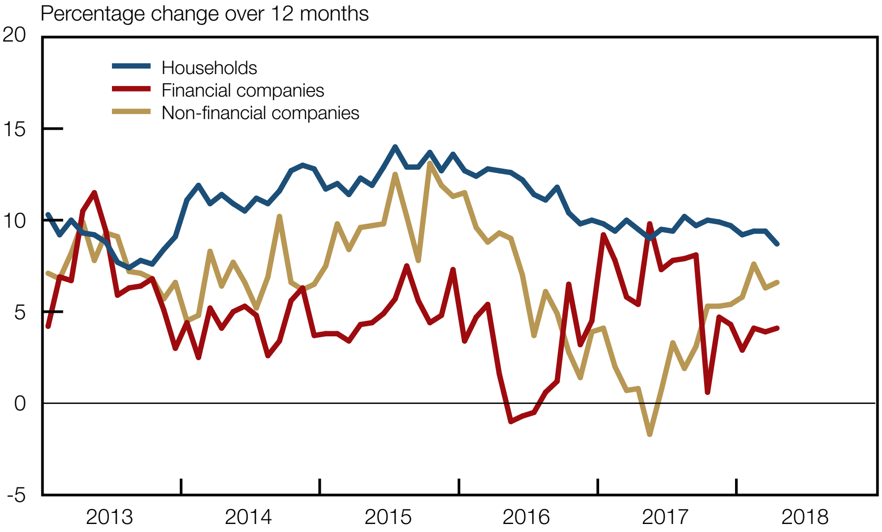


Sources: Stats SA and SARB

Year-on-year growth in M3 moderated from 7.9% in January 2017 to 5.0% in October before accelerating to 6.4% in April 2018. Twelve-month growth in the deposit holdings of the household sector moderated slightly from an average of 9.7% in 2017 to 9.2% in the first four months of 2018. After contracting by 1.7% in May 2017, the deposit holdings of non-financial companies rebounded to a year-on-year rate of 7.6% in February 2018. By contrast, growth in the deposit holdings of financial companies decelerated from 9.8% to 4.1% over the same period. Subsequently, growth in the deposit holdings of both financial and non-financial companies slowed in April 2018.

Year-on-year growth in long-term deposits decelerated sharply from 8.1% in September 2017 to -0.4% in December as heightened domestic political uncertainty during this period discouraged longer-term commitments. Over the same period, growth in short- and medium-term deposits rebounded from -1.4% to 11.1% while that in cash, cheque and other demand deposits slowed from 12.8% to 5.9%.

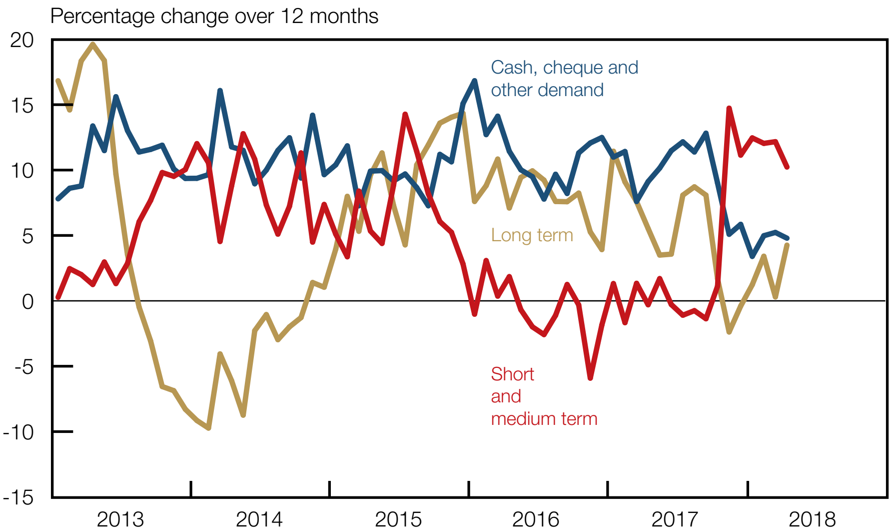
Deposit holdings of households and companies



Source: SARB

Despite the easing of political tensions early in 2018, growth in long-term deposits remained muted up to April 2018 while growth in short- and medium-term deposits stayed brisk at 10.2%. Growth in cash, cheque and other demand deposits accelerated moderately from 3.4% in January 2018 to 4.8% in April.

Deposits by maturity



Source: SARB

M3 increased by R38.2 billion in the first quarter of 2018, marginally more than the increase of R35.6 billion in the same quarter of the previous year. The deposit holdings of the corporate sector contributed R27.5 billion to the increase in the first quarter of 2018, as the deposits of financial companies increased by R23.8 billion and those of non-financial companies by only R3.7 billion. In the first quarter of 2018, the deposit holdings of financial companies probably benefitted from coupon payments on domestic government bonds, among other things. At the same time, the deposit holdings of non-financial companies were partly supported by equitable share transfers and the distribution of fuel levy allocations to metropolitan municipalities. Local authorities are part of non-financial companies in the compilation of money-supply statistics. The household sector contributed R10.7 billion to the increase in M3 in the first quarter of 2018, down from R28.4 billion in the fourth quarter of 2017 and also slightly less than the R13.0 billion in the first quarter of 2017.

M3 holdings of households and companies

	Year-on-year change R billions					Percentage of total M3 deposit holdings
	2017				2018	2018
	Q1	Q2	Q3	Q4	Q1	Q1
Households	13.0	29.1	31.4	28.4	10.7	34.3
Companies: Total..................	22.5	-15.8	79.8	14.1	27.5	65.7
Of which: Financial	27.0	14.0	42.4	-33.8	23.8	36.5
Non-financial.....	-4.5	-29.8	37.4	47.8	3.7	29.2
Total M3 deposits................	35.6	13.3	111.2	42.5	38.2	100.0

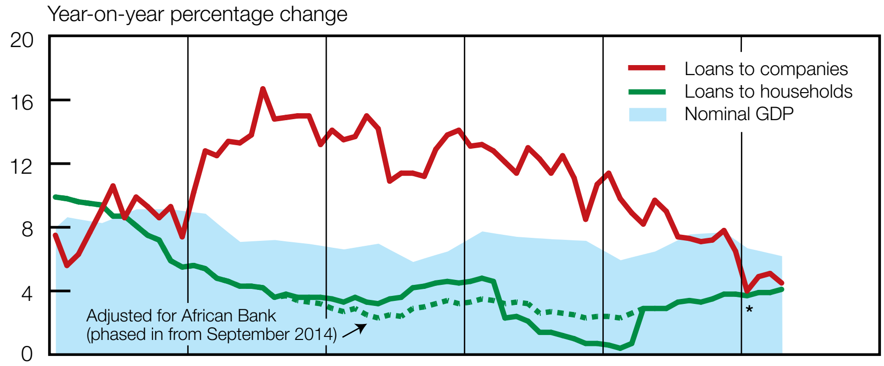
Source: SARB

Credit extension[9]

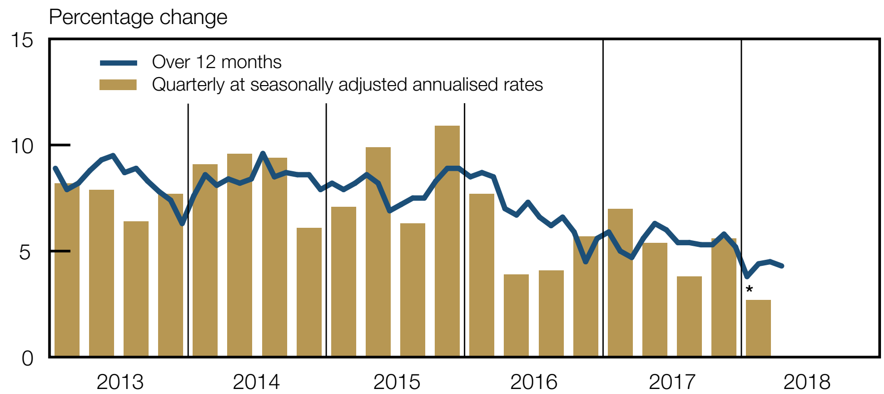
Growth in total loans and advances extended by monetary institutions to the domestic private sector moderated somewhat in recent months after trending broadly sideways in 2017. Year-on-year growth in credit extension averaged 4.3% in the first four months of 2018 compared to 5.3% in the same period a year earlier. The moderation in credit extension reflected the weakness in domestic economic growth in the first quarter of 2018. Loans and advances extended to companies decelerated persistently from average year-on-year growth of 9.6% in the first four months of 2017 to 4.6% in the first four months of 2018. By contrast, growth in credit extended to the household sector inched higher from a very low base early in 2017 to 4.1% in April 2018.

9 Growth in credit extension was impacted by the implementation of International Financial Reporting Standard (IFRS) 9 from January 2018. Banks' calculation of provision for credit losses (impairments) changed fundamentally, which affected outstanding credit balances.

Bank loans and gross domestic product



Total loans and advances to the private sector



* Growth rates impacted by the implementation of IFRS 9 from January 2018

Sources: Stats SA and SARB

Box 3 Impairments and credit statistics[1]

The level of private sector credit extension (PSCE) decreased in January 2018, and year-on-year growth in this aggregate was lower because of a technical increase in impairments. Loan loss provisioning increased when the International Financial Reporting Standard (IFRS) 9 for financial instruments became effective for annual periods, beginning on or after 1 January 2018.

The change from the International Accounting Standard 39 incurred loss model to the IFRS 9 expected credit loss (ECL) model came about as a response to the 2007-08 global financial crisis. The earlier recognition of impairment losses by taking into account the general pattern of deterioration or improvement in credit quality based on a forward-looking view of macroeconomic developments, will be made possible by the ECL model. The delayed recognition of impairment losses was seen as a major weakness in accounting practices.

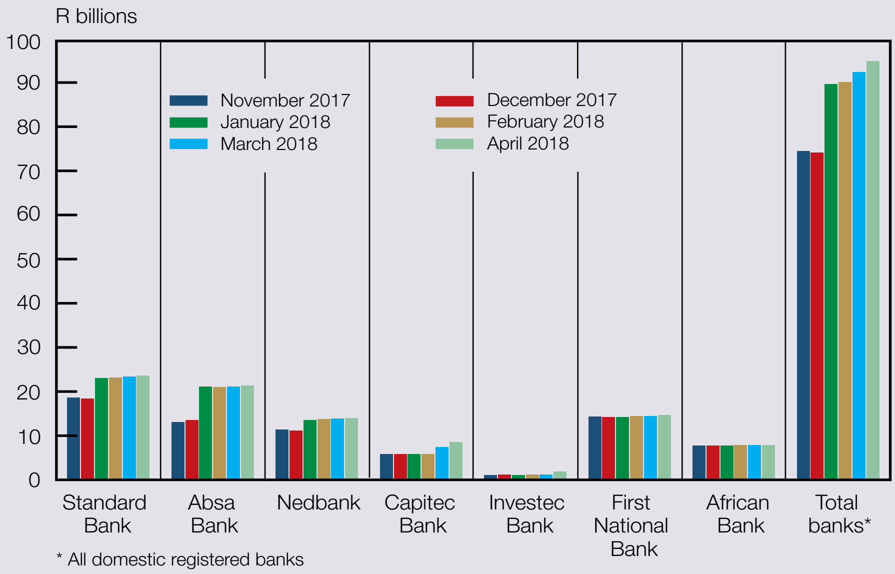
The ECL model is expected to result in a significant increase in the impairments of South African banks in 2018, and will from time to time affect the level and growth rate of PSCE and other related credit aggregates. The table shows the effective dates of implementation of the ECL model by banks with the largest credit impairments under the incurred loss model. In December 2017, this selection of banks, in aggregate, reported 97% of the total value of credit impairments.

Implementation of IFRS 9 for selected banks

Bank	Financial year-end	IFRS 9 implementation
Standard Bank	December	January 2018
Absa Bank	December	January 2018
Nedbank	December	January 2018
Capitec Bank	February	March 2018
Investec Bank	March	April 2018
First National Bank	June	July 2018
African Bank	September	October 2018

Total credit impairments[2] of loans and advances by the South African banking sector increased by R15.2 billion in January 2018, mostly as three large banks implemented IFRS 9. This is expected to be the most substantial monthly increase in impairments in 2018, as historically these three banks have accounted for about 60% of the total value of impaired advances.

Credit impairments of selected banks in sequence of IFRS 9 implementation date



* All domestic registered banks

Source: SARB

1 This discussion is based on the statistics presented in the tables on pages S–8 to S–10 and S–20 to S–24 of this *Quarterly Bulletin*.

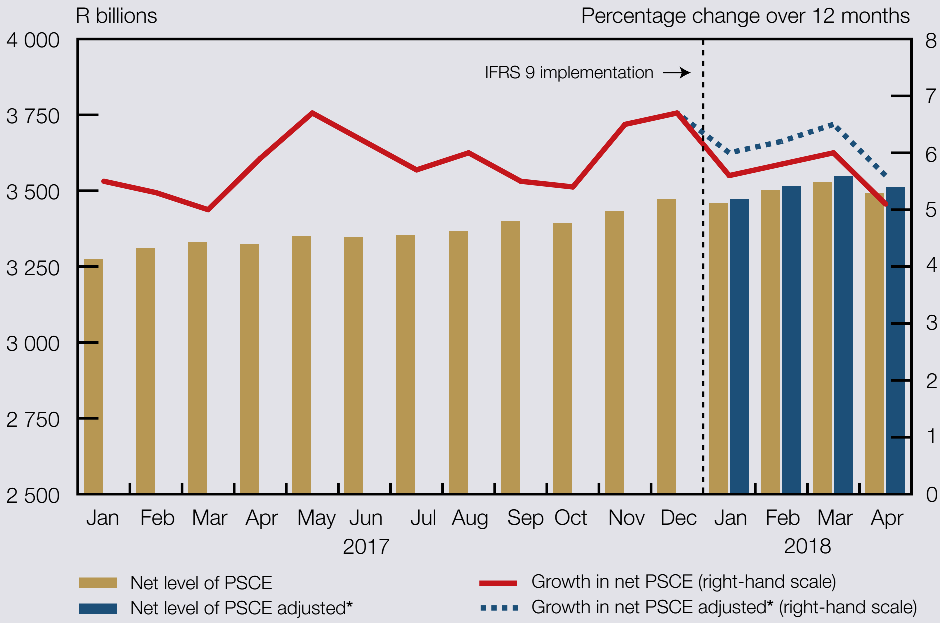
2 South African banks report impairments on the BA900 return in respect of both loans and advances as well as investments separately. Impairments in respect of investments account for only 0.2% of total impairments.

IFRS 9 adjusts the asset value of loans for impairments. However, from a national accounts point of view, the measurement of financial assets remains unchanged. Loan asset values are still presented on a gross basis with expected loan losses as a memorandum item to ensure symmetry of debtor and creditor reporting.

Credit extension statistics are presented on a gross basis (not deducting impairments) and/or on a net basis (deducting impairments). The South African Reserve Bank reports credit aggregates net of impairments, which is consistent with the IFRS 9 standard. One-off adjustments, such as those discussed here due to impairments, should not necessarily be interpreted as a contraction in credit as it will mostly reflect the actual level of credit excluding loan loss provisions.

On a net-of-impairment basis, the level of PSCE decreased by R13.2 billion in January 2018, mostly reflecting the introduction of IFRS 9. This lowered year-on-year growth in credit extension to 5.6%. Should the increase in impaired advances due to IFRS 9 of around R15 billion for January 2018 be added back to PSCE, the year-on-year growth rate would have been 6.0% for the month. Similarly, PSCE would have increased by 5.6% in April 2018, compared to an increase of 5.1%.

Private sector credit extension



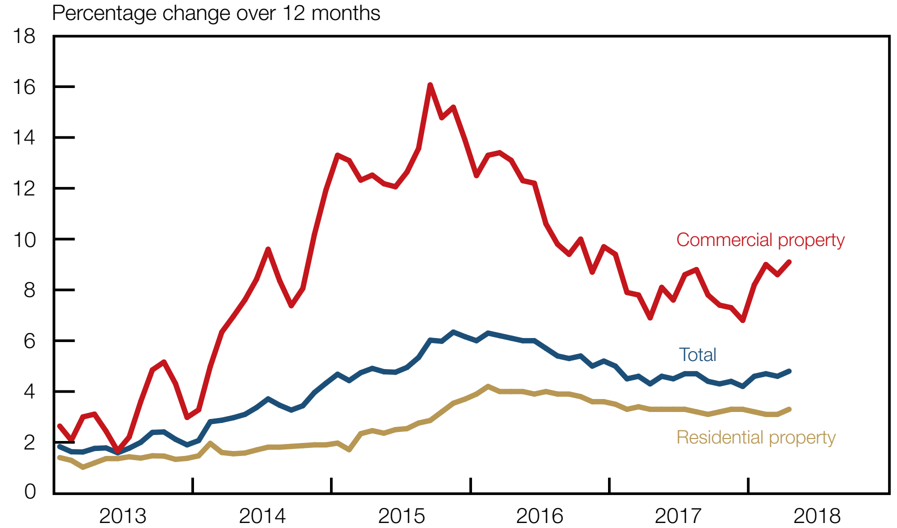
* Adjusted by adding back the IFRS 9 related increase in the value of impairments
Source: SARB

The loss of momentum in credit extension is reflected by the deceleration in quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances to the domestic private sector from 5.6% in the fourth quarter of 2017 to 2.7% in the first quarter of 2018. The ratio of credit to GDP decreased from 73.1% in the first quarter of 2017 to 72.8% in the first quarter of 2018, as credit extension expanded at a slower pace than nominal GDP.

Credit extension to the corporate sector increased from R11.5 billion in the fourth quarter of 2017 to R37.1 billion in the first quarter of 2018 but was nonetheless significantly less than the R55.1 billion increase in the first quarter of 2017. Corporates' weak demand for credit was especially noticeable in general loans – the preferred source of credit – which only increased by R21.5 billion in the first quarter of 2018 compared to an increase of R40.5 billion a year earlier. Year-on-year growth in general loans to companies moderated persistently from 15.9% in January 2017 to single-digit growth in July and further to 2.6% in April 2018. By contrast, growth in mortgage advances to the corporate sector accelerated somewhat in the first four months of 2018 after moderating in 2017.

Mortgage advances on commercial property increased by R8.4 billion in the first quarter of 2018, significantly more than the R2.0 billion increase in the same period a year earlier and also higher than the R4.9 billion recorded in the fourth quarter of 2017. Year-on-year growth in mortgage advances on commercial property accelerated from a recent low of 6.8% in December 2017 to 9.1% in April 2018, partly supported by increased demand from property companies. Twelve-month growth in mortgage advances on residential property remained muted, averaging 3.3% in 2017 and 3.1% in the first four months of 2018. Consequently, growth in total mortgage advances decelerated steadily from 5.0% in January 2017 to 4.8% in April 2018.

Mortgage advances



Source: SARB

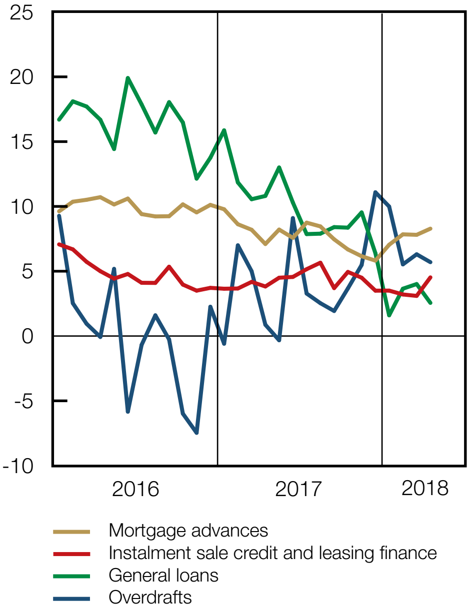
Credit extension to the household sector gained further momentum in the early months of 2018, albeit at a relatively subdued pace. Loans and advances to households increased by R21.7 billion in the first quarter of 2018, marginally up from the increase of R20.2 billion in the preceding quarter and the increase of R19.7 billion in the first quarter of 2017. Steady growth in mortgage advances, together with faster growth in instalment sale credit and a moderate acceleration in general (unsecured) loans, supported the expansion in credit extension to the household sector. General loans increased by a notable R6.7 billion in the first quarter of 2018 compared to R2.7 billion in the previous quarter. This was the highest quarterly increase in general loans to households since the first quarter of 2013, partly driven by banks' attempts to attract more business through promoting the uptake of personal loans. The decrease in interest rates in March 2018 also provided some relief to households through lower debt repayments, but this was probably negated to some extent by the contemporaneous increase in the VAT rate.

Instalment sale credit and leasing finance, which is predominantly used to finance purchases of new and used vehicles, was affected by a securitisation transaction of R2.4 billion in January 2018. Nonetheless, this credit category increased by R4.1 billion in the first quarter of 2018, almost equalling the R4.4 billion increase in the same period a year earlier. The steady acceleration in year-on-year growth in instalment sale credit and leasing finance to the household sector from a very low base early in 2017 to 5.6% in April 2018 reflected the increase in vehicle sales.

Growth in the credit demand of the various domestic economic sectors displayed diverse trends in the first quarter of 2018. Credit extension to the electricity, gas and water sector increased noticeably, partially related to a loan facility to a public sector entity by a consortium of local and international banks. Credit demand by the real estate sector accelerated moderately in late 2017 and early 2018, indicating a revival in the property market.

Selected loans and advances to corporate sector

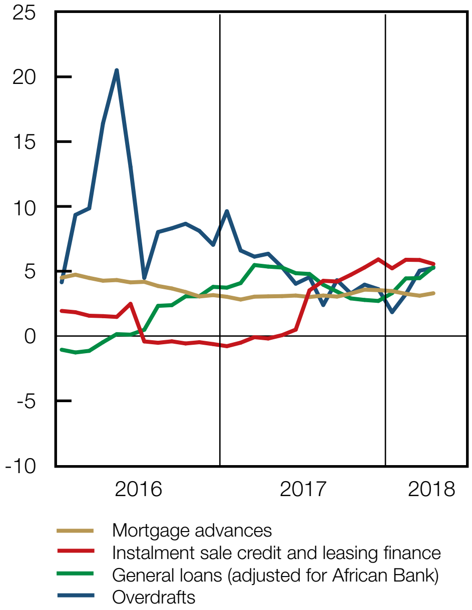
Percentage change over 12 months



Source: SARB

Selected loans and advances to household sector

Percentage change over 12 months



Growth in credit extended to the wholesale and retail trade sector accelerated significantly in the first quarter of 2018, boosted by a revival in both business and consumer confidence. However, credit extension to the mining, manufacturing, business services as well as transport, storage and communication sectors contracted in the first quarter of 2018, likely reflecting the ongoing sluggish domestic economic conditions.

Growth in bank credit by economic sector

Percentage change over four quarters

Economic sector	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	Percentage of total credit extension*
Households	5	5	6	4	4	35.3
Finance and insurance	0	1	13	4	2	18.1
Real estate	7	9	9	10	13	11.0
Wholesale and retail trade	2	2	1	8	17	5.6
Manufacturing	8	3	4	-1	-7	4.3
Business services	22	21	12	4	-8	3.4
Transport, storage and communication	2	5	1	-5	-5	3.1
Electricity, gas and water	38	39	16	11	25	2.6
Agriculture, forestry and fishing	12	10	6	8	7	2.4
Mining and quarrying	-31	-19	-16	-21	-6	1.5
Construction	-10	-8	11	8	0	0.8
Community, social, personal services and other	-1	-4	3	4	1	12.0
Total	4	4	7	4	4	100.0

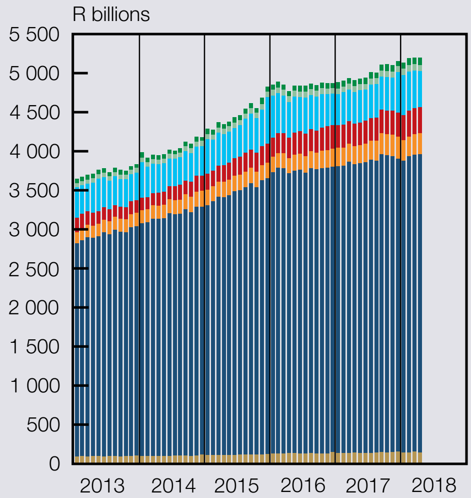
* Expressed as a percentage of the total outstanding balance for March 2018

Source: SARB

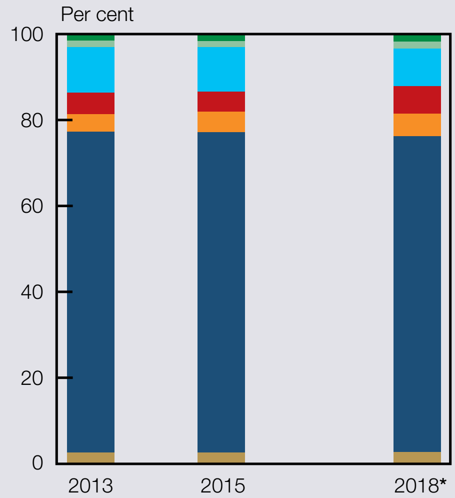
Box 4 Recent trends in the growth and composition of bank assets[1]

Growth in total bank[2] assets was mostly driven by a similar increase in loans and advances which, on average, has contributed 75% to total assets from January 2013 to date. Growth in the holdings of government bonds increased significantly from mid-2014 and that of Treasury bills from mid-2016. Banks' combined holdings of these two financial assets increased by 82% from January 2013 to April 2018, and the aggregate value increased from R331 billion to R604 billion over the same period. Interestingly, the relative contribution of government bonds and Treasury bills together only increased from 9.1% to 11.6% over the period. Part of the increased holdings of government bonds and Treasury bills was probably offset by the cumulative growth in other financial investments[3] that fell below that of total assets as from March 2016.

Composition of bank assets

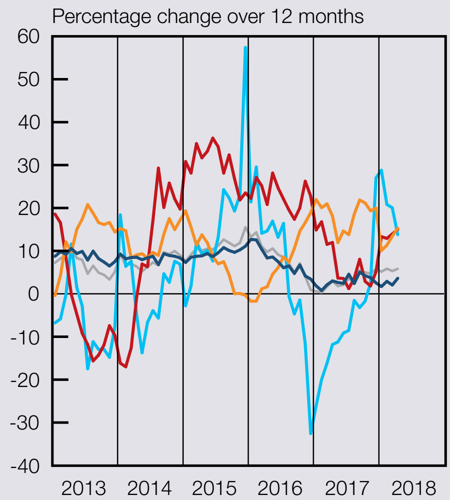


Contribution to bank assets

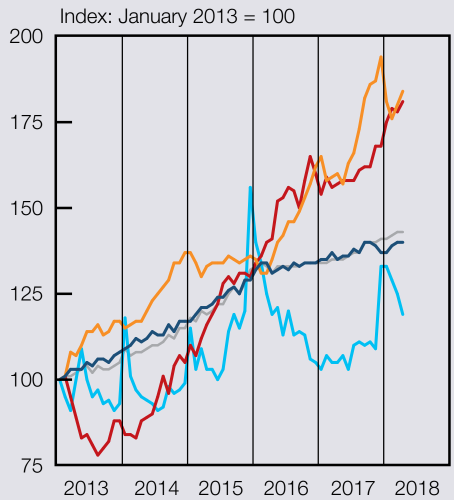


* April

Growth in selected bank assets



Selected bank assets



Central bank money and gold
Government bonds
Other assets
Loans and advances
Other financial investments
Total assets
Treasury bills
Non-financial assets

Source: SARB

1 This discussion is based on the statistics presented in the tables on pages S–8 and S–9 of this *Quarterly Bulletin*.
2 A bank is a public company (Limited) registered as a bank in terms of the Banks Act 94 of 1990. See also the SARB's Institutional Sector Classification Guide for South Africa published in March 2017.
3 Other financial investments include equities and interest-bearing securities such as bills (excluding Treasury bills), bonds (excluding government bonds), debentures, acceptances, commercial paper and promissory notes.

These developments most likely reflect the introduction on 1 January 2015 of the Basel III liquidity coverage ratio (LCR) requirements and the concomitant increase in unencumbered high-quality liquid assets (HQLA) to manage liquidity between shorter-dated funding and medium- to long-term credit extension. However, these requirements did not materially change the relative contributions of the respective asset categories to total assets, while the balance between banks' HQLA as well as loans and advances has been maintained.

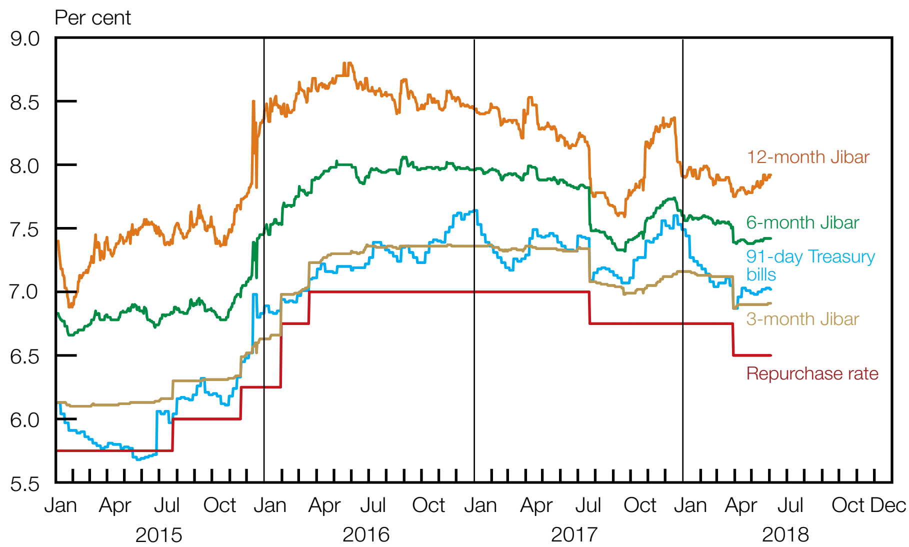
An area that would require more research and analysis is the extent to which credit extension through loans and advances could potentially have been higher in the absence of the Basel III requirements, given also that these requirements probably increased banks' cost of funding and therefore the cost of credit. This has to be weighed up against increased robustness to short-term liquidity demands. However, increased holdings of government bonds expose banks to changes in bond yields.

Interest rates and yields

The Monetary Policy Committee (MPC) of the SARB reduced the repurchase rate by 25 basis points to 6.50% with effect from 29 March 2018 as the inflation outlook improved and risks to the forecast diminished. Furthermore, some of the domestic uncertainties had abated along with the emergence of a slightly more positive domestic growth outlook. Subsequently, the repurchase rate was kept unchanged at the MPC meeting in May.

Domestic short-term money market rates have fluctuated lower since mid-December 2017 following a period of turbulence in the build-up to the African National Congress' (ANC) elective conference. The decrease reflected improved confidence, which was further supported by the reduction in the repurchase rate and the moderation in domestic consumer price inflation to a seven-year low in March. The three-month Johannesburg Interbank Average Rate (Jibar) decreased from 7.16% on 21 December 2017 to as low as 6.87% on 29 March 2018 and then increased marginally to 6.90% on 6 April before remaining largely unchanged up to the end of May. Movements in the 12-month Jibar were somewhat more volatile and closely aligned to the fluctuations in the exchange value of the rand.

Money market rates

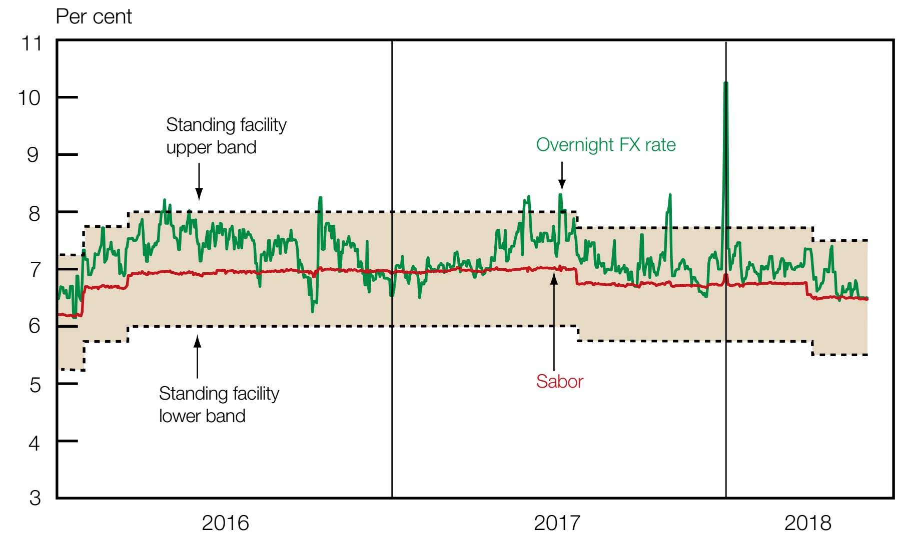


Source: SARB

The tender rate on 91-day Treasury bills decreased by 73 basis points from 7.60% on 15 December 2017 to 6.87% on 29 March 2018 following a sharp decline late in March when an international rating agency kept the credit rating of South Africa's domestic and foreign debt above sub-investment grade and changed the outlook from negative to stable.

Liquidity conditions in the market for interbank lending have eased in recent months as both the South African Benchmark Overnight Rate (Sabor) and the overnight foreign exchange (FX) rate remained well within the standing facility limits. Sabor remained fairly stable and closely aligned to the repurchase rate, averaging 6.74% from January 2018 to late March. Following the reduction in the policy rate, Sabor decreased and averaged 6.50% in April and May 2018. The overnight FX rate initially increased from 6.74% on 6 February 2018 to 7.40% on 25 April but decreased to 6.45% on 3 May as liquidity conditions eased. The overnight FX rate then increased to 6.80% on 21 May but closed the month lower at 6.48%.

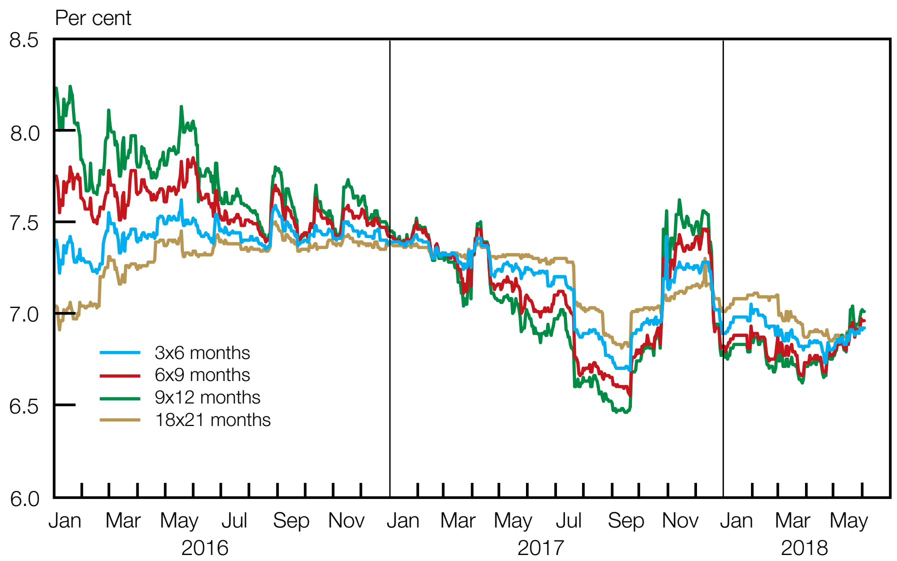
Benchmark overnight rates



Source: SARB

In early 2018, the rates on forward rate agreements (FRAs) gravitated lower on account of the appreciation in the exchange value of the rand and its potentially positive impact on domestic inflation along with somewhat more convergence across the maturity spectrum. The 3x6-month FRA decreased from 7.05% on 30 January 2018 to 6.73% on 20 April, while the 9x12-month FRA declined from 6.91% to 6.66% over the same period. However, when the exchange value of the rand depreciated, the 3x6-month FRA increased to 6.91% and the 9x12-month FRA increased to 7.02% on 31 May.

Forward rate agreements

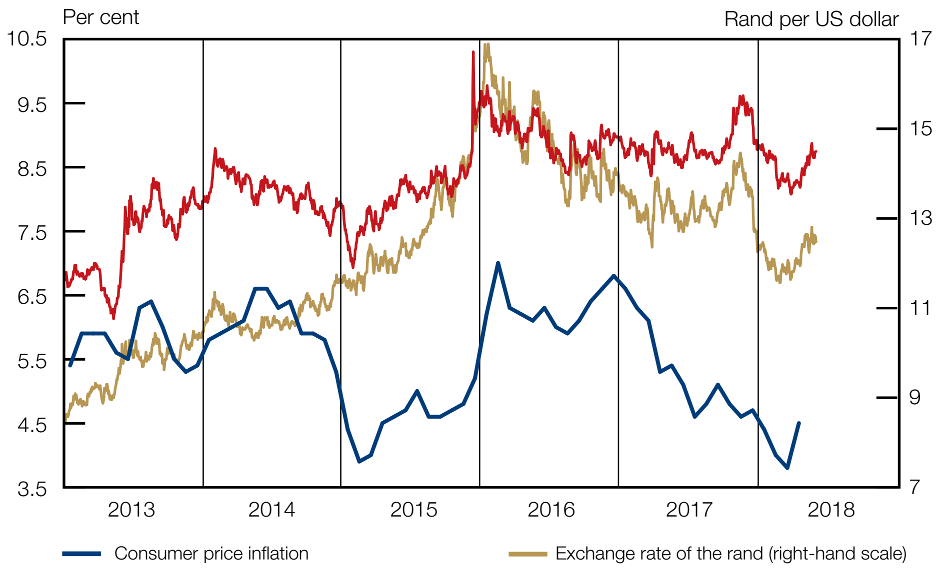


Source: SARB

Yields on South African government rand-denominated bonds issued and traded in the domestic market decreased from November 2017 to March 2018 as the exchange value of the rand appreciated and domestic inflationary pressures moderated. Investor sentiment also improved as South Africa's local currency credit rating was affirmed at investment grade and the outlook was revised from negative to stable. These developments contributed to the decline in the daily closing yield on the conventional 10-year South African government bond of 154 basis points from a recent high of 9.62% on 21 November 2017 to a low of 8.08% on 27 March 2018.

Subsequently, yields on bonds issued in emerging markets increased, largely due to external factors such as an interest rate increase by the US Federal Reserve (Fed), the US-China trade dispute, and higher international crude oil prices. This also contributed to a depreciation in the exchange value of the rand and an increase of 67 basis points in the 10-year South African government bond yield to 8.75% on 31 May following an unchanged credit rating by another agency. The US 10-year government bond yield also increased but only by 28 basis points from 27 March 2018 to 3.13% on 18 May – its highest level since the beginning of July 2011 – partly reflecting concerns about the projected rise in the US federal budget deficit.

Bond yield, inflation and the exchange rate



Sources: IRESS, JSE, Stats SA and SARB

The *yield curve* shifted lower from the end of November 2017 and flattened markedly towards the end of March 2018 as the extreme short end remained anchored to the unchanged repurchase rate while the remainder of the curve reflected lower inflation expectations. However, the yield curve then moved higher as the exchange value of the rand depreciated. The yield gap, measured as the difference between yields at the extreme long and short ends of the curve, initially narrowed from 381 basis points on 21 November 2017 to 208 basis points on 27 March 2018 – its lowest level since January 2015 – before widening again to 299 basis points on 31 May.

The yield spread of emerging market US dollar-denominated bonds relative to US government bonds, as measured by the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[10], narrowed significantly from 383 basis points in November 2016 to 312 basis points in January 2018 before rising again to 387 basis points in May. Emerging market yields were impacted by a bond sell-off following the increase in both US interest rates and bond yields as well as the probability of further interest rate increases in the US given higher inflation expectations. Similarly, South Africa's *sovereign risk premium*[11] on government's US dollar-denominated bonds in the eight-year maturity range widened from 188 basis points in January 2018 to 233 basis points in May.

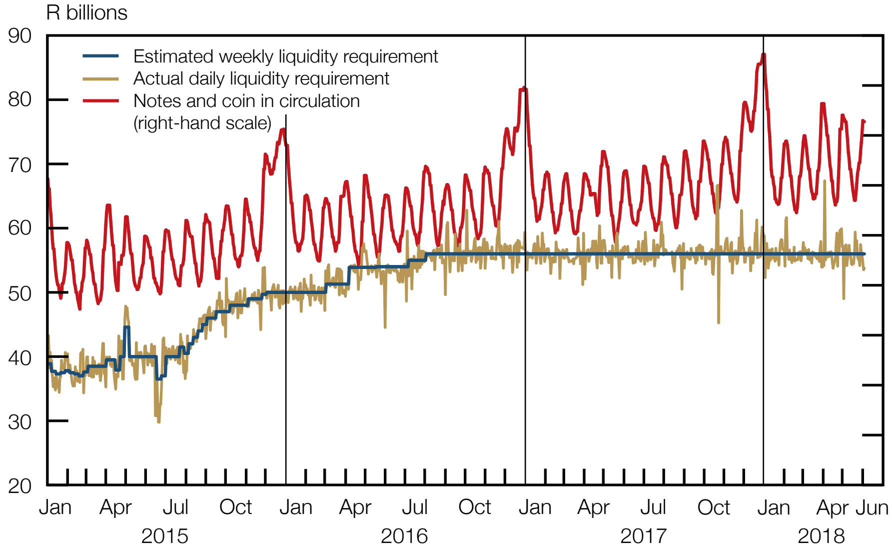
10 The EMBI+ measures the total returns on US dollar-denominated debt instruments of emerging market economies.

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

Money market

The actual daily liquidity requirement of private sector banks fluctuated between R52.3 billion and R61.6 billion in the first quarter of 2018, which was narrower than the range of between R45.2 billion and R66.7 billion recorded in the final quarter of 2017. The SARB nonetheless maintained the average daily liquidity requirement of private sector banks at around R56 billion over both quarters. In April and May 2018, the actual daily liquidity requirement averaged R56.0 billion.

Liquidity requirement



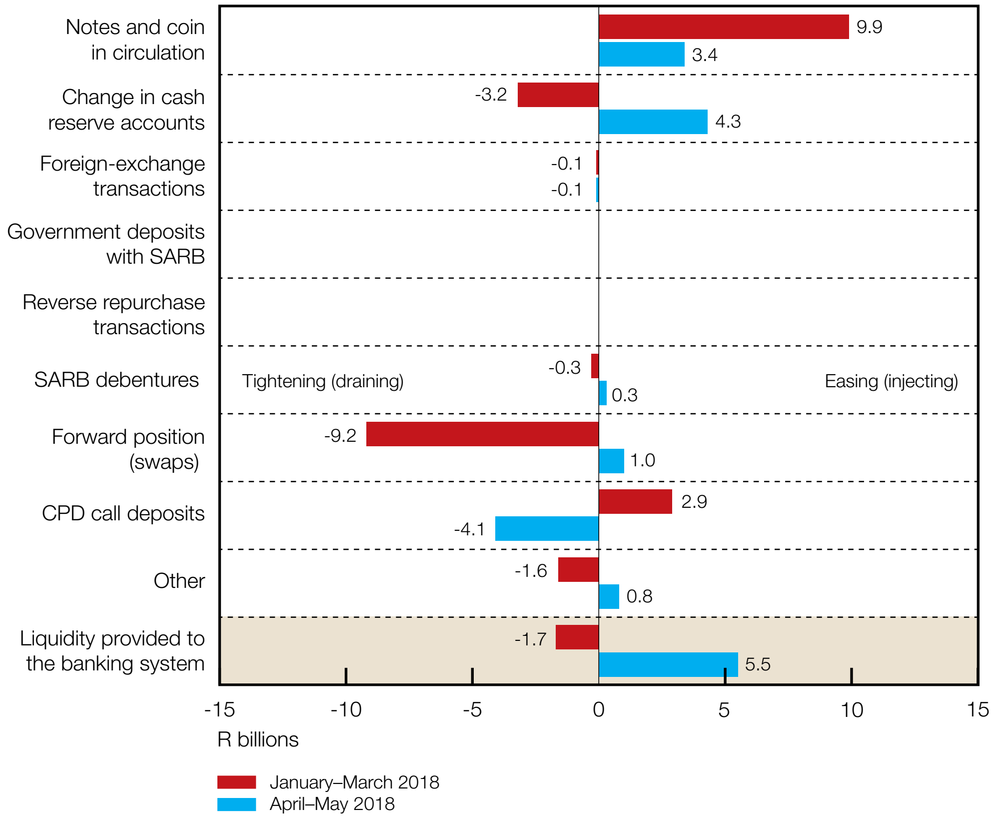
Source: SARB

12 Liquidity management operations include reverse repurchase transactions, SARB debentures, foreign exchange swaps and call deposits with the Corporation for Public Deposits (CPD).

Money market liquidity contracted by R1.7 billion in the first quarter of 2018, in contrast to an expansion of R2.0 billion in the fourth quarter of 2017. A contraction in notes and coin in circulation outside the SARB expanded money market liquidity by R9.9 billion in the first quarter but was moderated by a R3.2 billion increase in banks' required cash reserve deposits. In addition, the liquidity management operations[12] of the SARB drained R6.6 billion from the market, mainly through foreign exchange swaps and a small amount of SARB debentures. Foreign exchange transactions of the SARB in the spot market had only a slight tightening effect on money market liquidity. In April and May 2018, liquidity conditions eased by R5.5 billion, mainly through a decrease in banks' required cash reserve deposits and a contraction in notes and coin in circulation outside the SARB, which was partly offset by a decrease in the Corporation for Public Deposits' (CPD) call deposits with the SARB.

Capital redemption payments and scheduled coupon interest payments on various government bonds amounting to R32.7 billion were effected from the government tax and loan accounts from January to May 2018, with only R257 million accruing to the SARB.

Factors influencing money market liquidity flows



Source: SARB

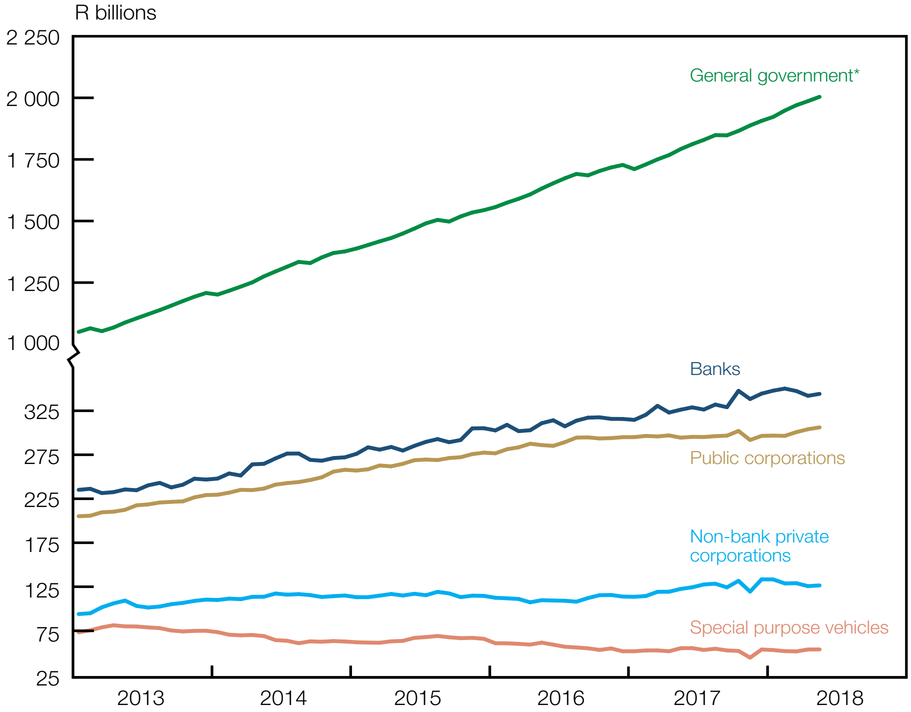
Bond market

The nominal value of *net bond issuance* in the domestic primary bond market by the public sector remained high in the first five months of 2018 at R107 billion compared to R63.7 billion in the same period of 2017. However, the weekly fixed-rate bond auction amount was reduced from R3.3 billion to R2.4 billion as of 27 March 2018, while the amount of inflation-linked bonds on auction was lowered from R0.9 billion to R0.6 billion as from 6 April 2018. By contrast, private sector net bond redemptions of R7.2 billion in the first five months of 2018, in particular by banks and non-financial companies, compared with net bond issuances of R22.7 billion in the same period of 2017.

As a percentage of total public sector bonds in issue, national government contributed most at 85.9% in May 2018, followed by public corporations to finance infrastructure development and maintenance. Governance issues at some public corporations, together with the sovereign credit ratings downgrades in 2017, have made it difficult to roll over debt. Furthermore, cancelled and undersubscribed bond auctions adversely affected liquidity and necessitated government guarantees while increasing borrowing costs. In May 2018, the JSE Limited (JSE) announced plans to tighten disclosure rules for listed debt instruments.

Following the increased global focus on climate change, the JSE launched the Green Bond Segment in October 2017 to provide a platform to raise finance for low-carbon initiatives; the first domestic private company issued such bonds in April 2018. This broadens the investment opportunities for institutional investors and facilitates the financing or re-financing of new or existing green infrastructure projects which may traditionally have been funded mainly through banks and government.

Listed bonds by issuer category



* General government includes national and local government bonds in issue

Source: JSE

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

Thus far in 2018, the *value of turnover* in the secondary bond market was boosted by the decline in bond yields and higher trading volumes. The daily average value of turnover of R122 billion in the first five months of 2018 was 11.3% more than in the same period of 2017. However, the annualised liquidity ratio[13] in the bond market increased from 10.4 in the first five months of 2017 to 10.7 in the same period of 2018. Following a gain of 10.2% in 2017, the All-Bond Index (ALBI) increased further by 5.3% in the first five months of 2018 despite decreasing by 2.6% in April and May from the all-time high reached in March.

The outstanding amount in issue of rand-denominated debt in the *European and Japanese bond markets* decreased further by R3.7 billion in the five months to May 2018 following net redemptions of R32.0 billion for the whole of 2017. The lower rand-denominated debt issuance in international capital markets could probably be attributed to pessimism over currency and bond market volatility as well as earlier sovereign credit rating downgrades.

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

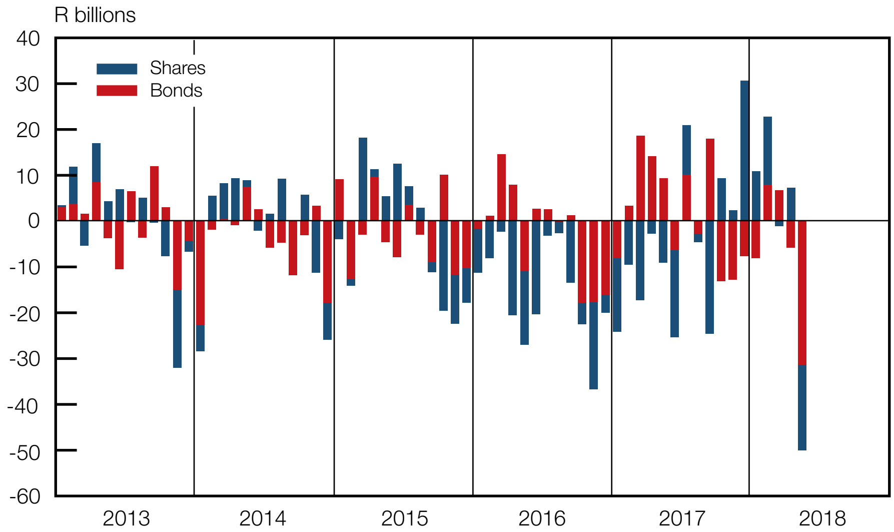
R millions

	Eurorand		Uridashi		Total	
	2017	2018	2017	2018	2017	2018
Issues	3 411	2 497	2 296	586	5 707	3 083
Redemptions	19 650	5 160	5 023	1 599	24 673	6 759
Net	-16 239	-2 663	-2 727	-1 013	-18 966	-3 676

Source: Bloomberg

Following significant net sales of domestic debt securities by *non-residents* in the final quarter of 2017, non-residents became net purchasers of R6.5 billion in the first quarter of 2018, according to JSE data. However, non-residents once again reduced holdings of domestic bonds by R37.3 billion in April and May 2018. This resulted in cumulative net sales of R30.8 billion in the first five months of 2018, compared with net purchases of R37.3 billion in the same period of 2017. The recent substantial sell-off of domestic bonds by non-residents was mainly attributable to the depreciation in the exchange value of the rand and the continued rise in US government bond yields as expectations of further monetary policy tightening in the US increased, which reduced demand for emerging market bonds.

Non-resident net transactions in JSE-listed shares and bonds

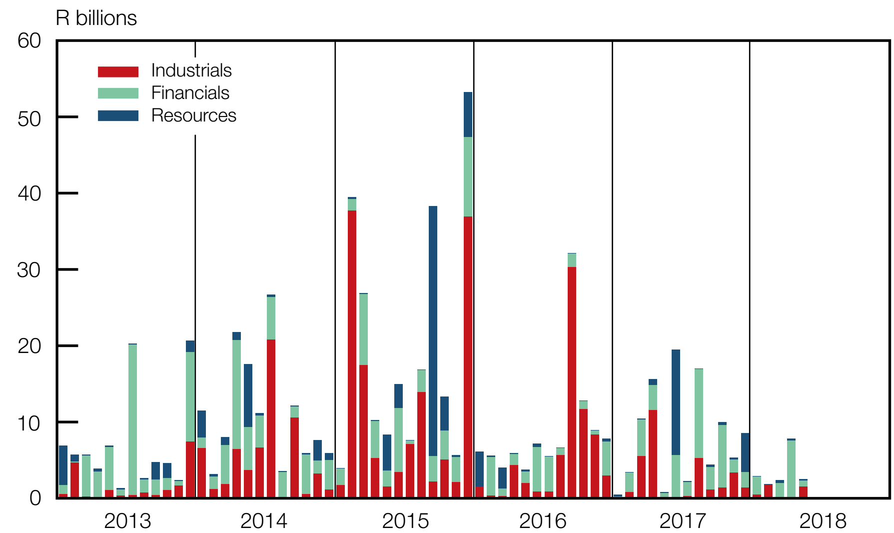


Source: JSE

Share market

Equity capital raised in the domestic and international primary share markets by companies listed on the JSE continued to decrease thus far in 2018. The value of shares issued of R18.2 billion in the first five months of 2018 was 45.1% less than in the corresponding period of 2017. This was influenced by a decrease in the number of listed companies and share price volatility. A domestic insurer, through a general share issue for cash, funded the acquisition of the remaining 53.4% shareholding in a Moroccan insurance company, and was the largest contributor to equity funding in the first five months of 2018. This contributed to primary listed companies in the financial sector raising most of the equity capital, at 68.9% in the five months to May 2018.

Equity capital raised on the JSE



Source: JSE

The *value of turnover* in the secondary share market of the JSE remained robust thus far in 2018. The daily average turnover of R23.8 billion in the first five months of 2018 was 16.7% more than in the same period of 2017, driven by both higher volumes and higher share prices. The market capitalisation of the JSE reached an all-time high of R16.2 trillion in October 2017, supported by a record number of shares in issue, before declining to R14.2 trillion in May 2018 as both the number of shares in issue as well as share prices decreased.

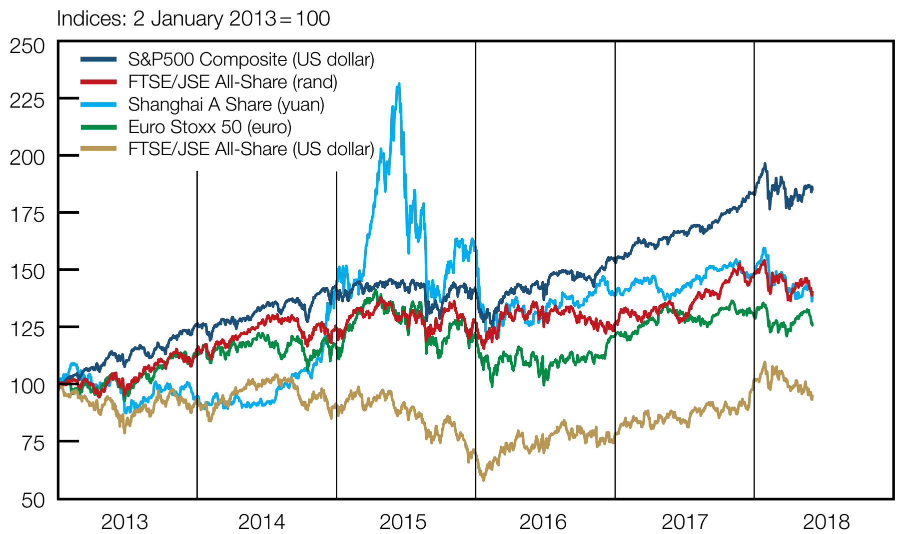
Non-resident holdings of JSE-listed shares have increased notably since the fourth quarter of 2017 after persistent net selling in 2016 and the first three quarters of 2017. Net purchases of listed shares by non-residents of R24.5 billion in the first quarter of 2018 followed net purchases of R42.3 billion in the previous quarter, according to JSE data. Apart from the political change in December 2017 which restored some confidence in South Africa, the increase in non-residents' holdings of JSE-listed shares was also driven by various other factors, including:

- the positively received *2018 Budget Review*, which showed government's recommitment to fiscal consolidation;
- the decision by an international rating agency to change South Africa's credit rating outlook from negative to stable;
- the marked improvement in domestic business and consumer confidence; and
- a number of international institutions raising forecasts for South Africa's real GDP growth in 2018.

However, non-residents' holdings of JSE-listed shares declined by R18.7 billion in May 2018 as higher US treasury yields and geopolitical concerns continued to weigh on sentiment towards emerging market shares. Non-residents' cumulative net purchases of JSE-listed shares amounted to R13.1 billion in the first five months of 2018 compared with net sales of R55.0 billion in the corresponding period of 2017.

The *share prices* of JSE-listed companies declined in early 2018 despite the marked improvement in business and consumer confidence. The FTSE/JSE All-Share Price Index (Alsi) declined by 11.5% from an all-time high of 61 685 index points on 25 January 2018 to 54 603 index points on 4 April, mainly impacted by the then appreciation in the exchange value of the rand and lower international share prices. Globally, share prices were affected by prospects of accelerated monetary policy tightening by the major central banks and concerns of a potential trade war between the US and China. Notwithstanding these risks, the prices of shares listed on the JSE recovered somewhat, tracking international share prices in general and in line with a more positive domestic economic outlook and improved investor confidence. Consequently, the Alsi increased by 2.8% to 56 158 index points on 31 May.

Share prices



Sources: IRESS, JSE and SARB

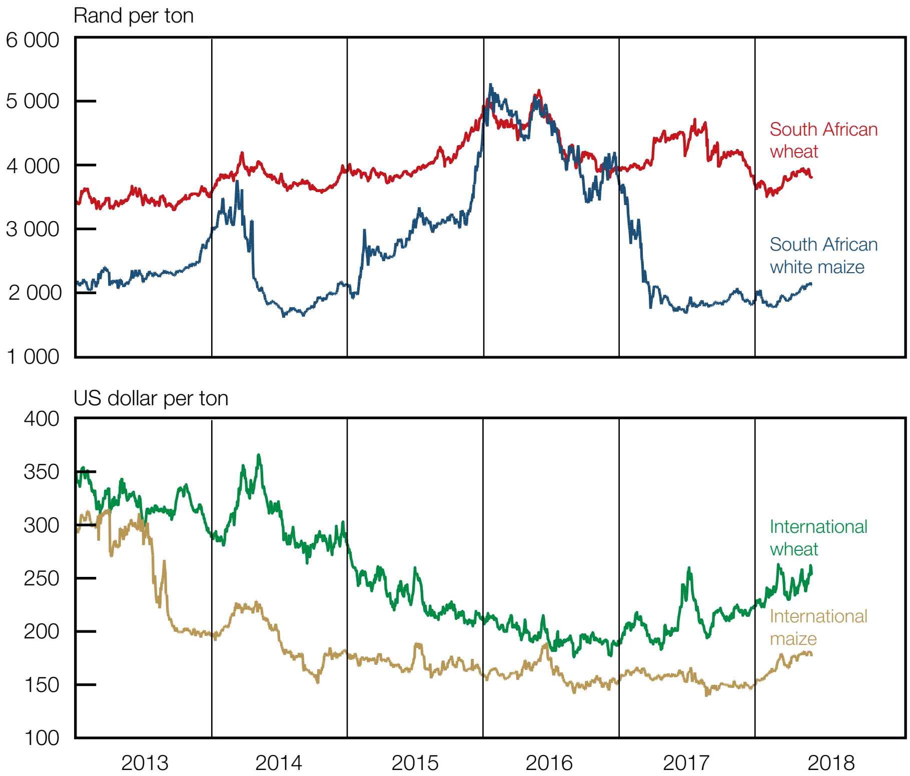
The total earnings of companies listed on the JSE increased by 14.6% in the first four months of 2018. This, together with the decline in share prices, resulted in a decline in the historical *price-earnings ratio* of all classes of shares from 22.0 in January 2018 to 18.2 in April. Subsequently, the price-earnings ratio increased to 20.4 in May alongside a decline in total earnings. The *dividend yield* of all classes of shares listed on the JSE increased somewhat from 2.0% in January 2018 to 2.3% in April, reflecting higher dividends declared and lower share prices, before declining marginally to 2.2% in May.

Market for exchange-traded derivatives

The domestic *spot prices of white and yellow maize* contracts listed on the JSE Commodity Derivatives Market generally increased from the end of February 2018. This reflected unfavourable weather conditions (which had resulted in a smaller area planted), higher international maize prices, and the depreciation in the exchange value of the rand. The spot price of white maize increased by 19.6% from a low of R1 772 per ton on 23 February 2018 to R2 120 per ton on 31 May, while that of yellow maize increased by 17.5% over the same period. Nevertheless, the production forecasts released by the Department of Agriculture, Forestry and Fisheries' Crop Estimates Committee, together with the relatively large carry-over stock from the previous season, are expected to be well above domestic consumption needs in the 2018/19 production season, suggesting that South African maize prices are not likely to increase dramatically from current levels.

The *spot price of domestic wheat* increased by 8.6% from R3 505 per ton on 31 January 2018 to R3 808 per ton on 31 May, in line with higher international wheat prices. Consequently, the wheat import tariff was lowered significantly by 44.9% to R394.90 per ton. The intended area planted also increased on expectations that the Western Cape, which accounts for roughly two-thirds of domestic wheat production, could receive above-normal rainfall between the end of April and June 2018.

Grain prices



Sources: International Grains Council and JSE

Turnover in the equity, currency and commodity derivatives markets increased marginally in the first five months of 2018. However, the turnover of interest rate derivatives increased notably by 22.2% over this period, reflecting increased hedging activity against adverse movements in bond yields.

Derivatives turnover on the JSE, January to May 2018

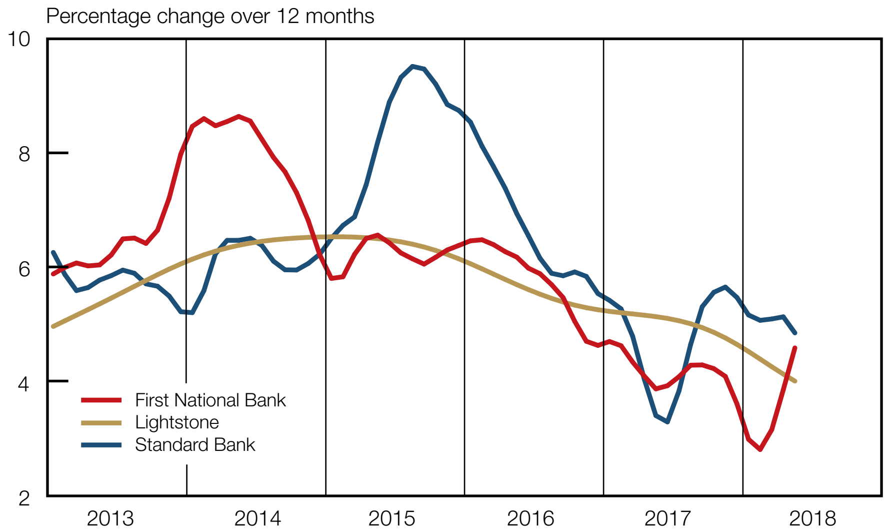
Type of derivative	Value (R billions)	Change over one year (per cent)
Equity	2 196	4
Warrants	0.4	179
Commodity	241	9
Interest rate	723	22
Currency	349	8

Source: JSE

Real estate market

Growth in South African residential property prices remained subdued in the first five months of 2018 despite the prevailing low interest rate environment and improved consumer confidence. The year-on-year rate of increase in nominal house prices ranged between 4.0% and 4.8% across the various indicators in May 2018. The muted growth in nominal house prices continued to be a reflection of high unemployment levels and weak residential property demand, and was also visible in the subdued growth in mortgage advances. Growth in nominal house prices may also be adversely affected by the 1.0% VAT increase applicable from 1 April 2018, which will raise the cost of property transactions, registrations and estate-agent commission.

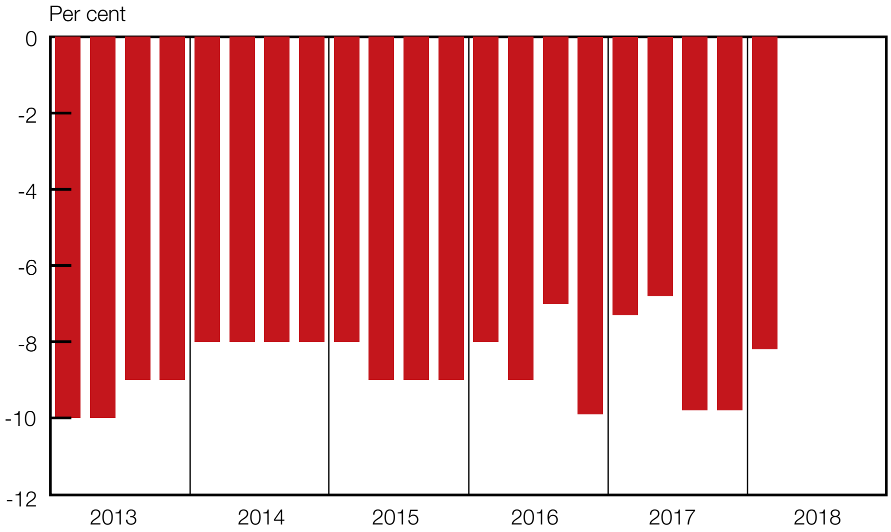
Nominal house prices



Sources: First National Bank, Lightstone and Standard Bank

However, the average time that residential properties remained on the market, as measured by First National Bank (FNB), declined noticeably from 17.2 weeks in the fourth quarter of 2017 to 14.1 weeks in the first quarter of 2018. According to the latest FNB Estate Agent Survey, the percentage of sellers that was required to reduce asking prices in order to make sales also declined, from 95% to 91%, over the same period. Furthermore, sellers that were forced to reduce their asking prices had to do so to a lesser degree – 8.2% on average in the first quarter of 2018 compared with 9.8% in the final quarter of 2017.

Average reduction in residential property asking prices

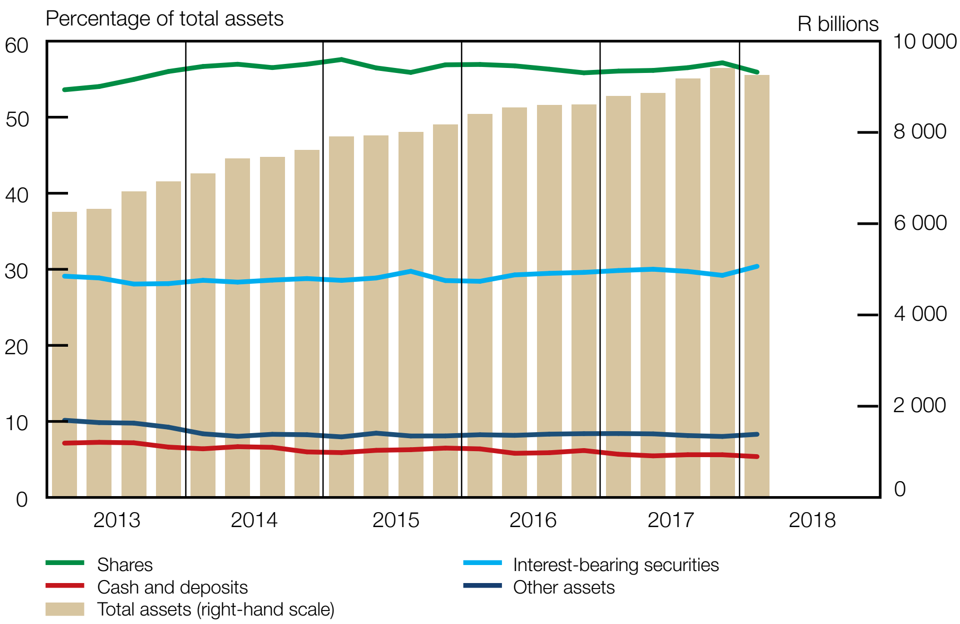


Source: First National Bank

Non-bank financial intermediaries[14]

The balance sheet of non-bank financial institutions declined in the first quarter of 2018. The value of the total consolidated assets of these institutions declined by 1.7% from the final quarter of 2017 to R9.3 trillion in the first quarter of 2018 – the first quarterly decline since the second quarter of 2010. The assets of insurance companies and unit trusts declined by 0.9% and 3.0% respectively over the period. By contrast, the asset base of finance companies grew by 1.4% in the first quarter of 2018. The balance sheet of non-bank financial institutions increased by 5.2% year on year in the first quarter of 2018 compared with an increase of 4.6% in the same period of 2017.

Total assets of non-bank financial institutions



Source: SARB

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

Non-bank financial institutions' holdings of interest-bearing securities increased by 1.2 percentage points from the final quarter of 2017 to 30.4% of total assets in the first quarter of 2018, buoyed by higher bond prices, as reflected by an increase of 8.1% in the ALBI over the period. The proportion of assets held in cash and deposits fell slightly by 0.2 of a percentage point to 5.4% of total assets in the first quarter of 2018 despite an environment of increased volatility in financial markets over the period.

The proportion of assets held in shares declined notably by 1.2 percentage points to 55.9% of total assets in the first quarter of 2018, reflecting the decline in share prices over this period. Nevertheless, non-bank financial institutions' exposure to shares was still some 2.2 percentage points higher than the 10-year average. Heightened share market volatility, together with relatively subdued real economic growth, might reduce appetite for shares going forward.

Although the total value of loans extended by non-bank financial institutions increased slightly from the final quarter of 2017 to 5.0% of total assets in the first quarter of 2018, the growth rate in credit extended by finance companies to households and companies decelerated to 1.4% in the first quarter of 2018 from 2.0% in the previous quarter.

Public finance[15]

Non-financial public sector borrowing requirement[16]

The *non-financial public sector borrowing requirement* of R190 billion in fiscal 2017/18 was R50 billion more than in the previous fiscal year. The increase could be attributed to the larger cash deficits of both national government as well as the non-financial public enterprises and corporations. By contrast, local governments, social security funds as well as extra-budgetary institutions and provincial governments recorded cash surpluses in fiscal 2017/18.

15 Unless stated to the contrary, the year-on-year rates of increase in this section compare fiscal 2017/18 to fiscal 2016/17. Data for fiscal 2016/17 are unaudited and remain preliminary.

16 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.

Non-financial public sector borrowing requirement

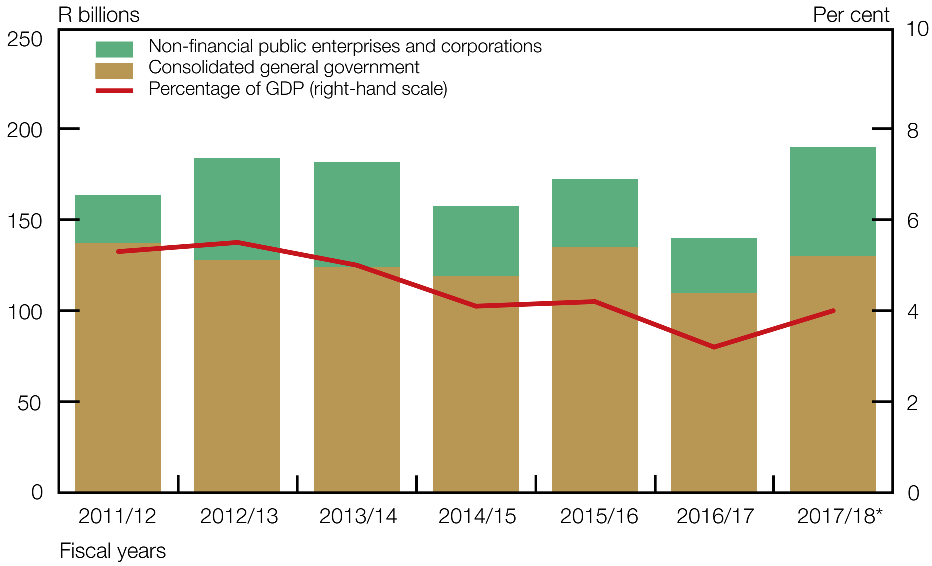
R billions

Level of government	Fiscal 2016/17*	Fiscal 2017/18*
Consolidated general government	109.7	130.0
National government	*162.0*	*201.2*
Extra-budgetary institutions	*-8.5*	*-7.6*
Social security funds	*-9.5*	*-22.2*
Provincial governments	*1.9*	*-2.2*
Local governments	*-36.2*	*-39.2*
Non-financial public enterprises and corporations	30.3	60.0
Total**	**140.0**	**190.1**
As a percentage of gross domestic product	*3.2*	*4.0*

* 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 notably to 4.0% in fiscal 2017/18 from 3.2% in the previous fiscal year.

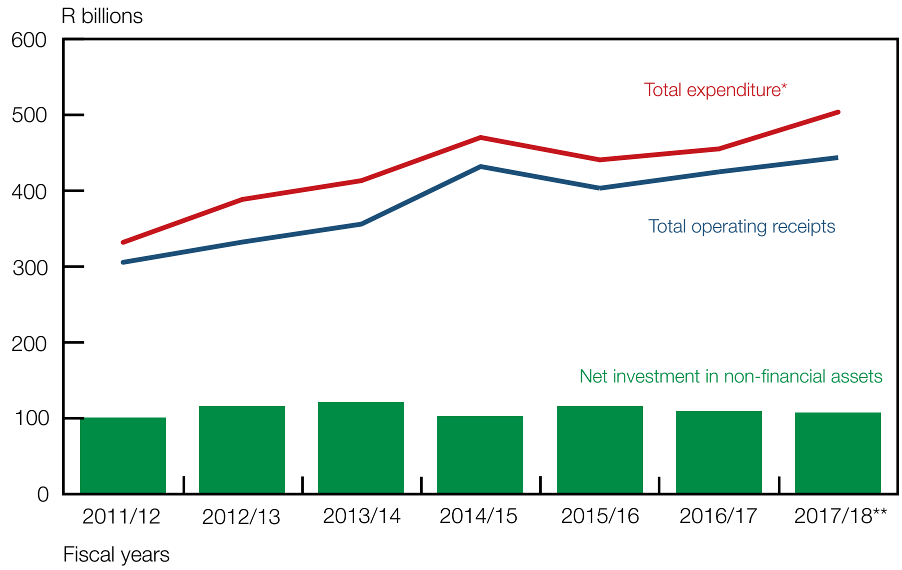
Non-financial public sector borrowing requirement



* Preliminary estimates
Sources: National Treasury, Stats SA and SARB

The preliminary cash deficit of the *non-financial public enterprises and corporations, or non-financial state-owned companies* (SOCs), almost doubled to R60.0 billion in fiscal 2017/18 as the increase in total expenditure outpaced that in total cash receipts from operating activities by a wider margin.

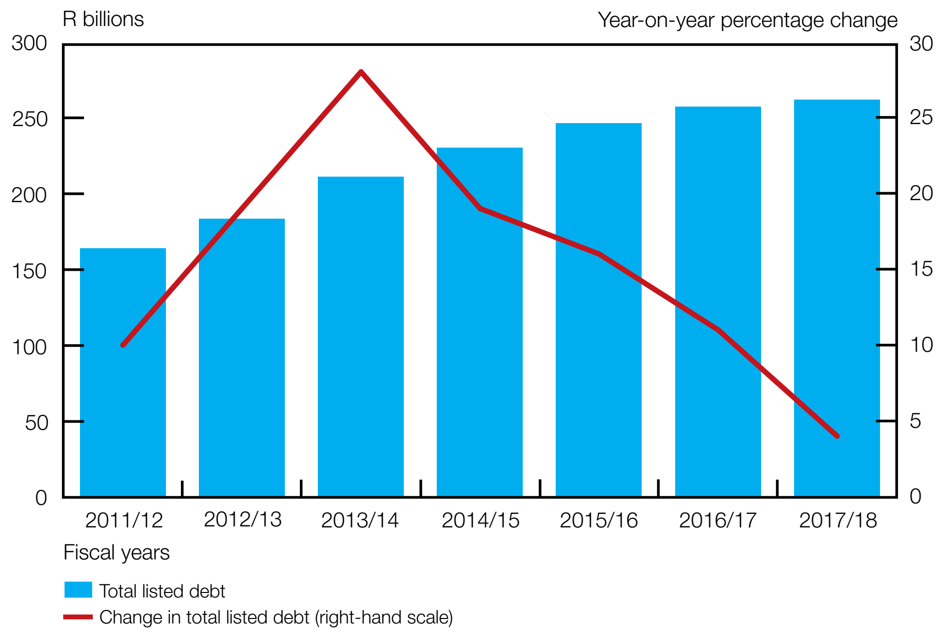
Financial activities of non-financial public enterprises and corporations



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

Total expenditure by non-financial SOCs, which includes both operational expenses and net investment in non-financial assets, increased by 10.7% to R504 billion in fiscal 2017/18. However, total operating cash receipts increased by only 4.4% to R444 billion over the same period. Net investment in non-financial assets decreased to R107 billion in fiscal 2017/18 after peaking at R122 billion in fiscal 2013/14.

Total listed domestic debt of non-financial public enterprises and corporations



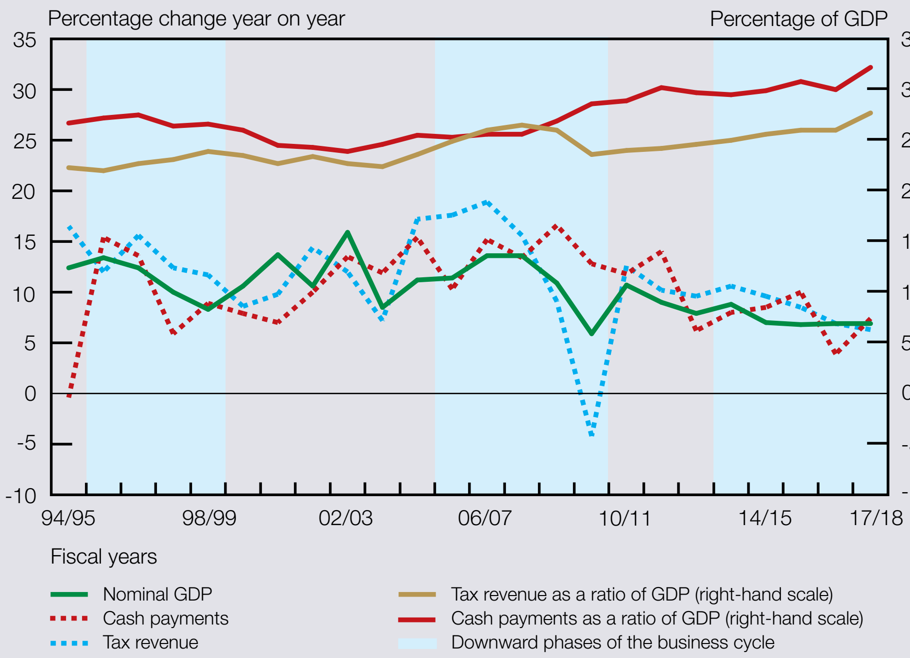
Sources: STRATE and SARB

The total outstanding domestic listed debt securities of the non-financial SOCs amounted to R262 billion as at 31 March 2018, only R4.4 billion more than a year earlier. The slowing pace of increase in the stock of outstanding debt over the past five years reflects increasingly constrained access to funding. Low investor confidence and rising borrowing costs could inhibit capital investment programmes.

Box 5 Trends in national government's revenue and expenditure[1]

National government's tax revenue[2] increased at an annual average rate of 11.2%, slightly higher than that of nominal gross domestic product (GDP) of 10.3% from fiscal 1994/95 to fiscal 2017/18. Growth in expenditure[3] (measured as cash payments for operating activities) was in line with GDP growth and increased at an annual average rate of 10.4% over the same period. Growth in both revenue and expenditure over this period exceeded annual average consumer price inflation of 6.3%. The impact of the global financial crisis and of the contraction in South Africa's real GDP in 2009 on growth in tax revenue and counter-cyclical expenditure is clearly evident, as well as the effects of economic activity over the phases of the business cycle. The interplay between economic activity and national government's revenue and expenditure is also evident from the respective ratios to GDP, which changed from a fairly balanced position just before the global financial crisis to expenditure exceeding revenue by a fair margin in its aftermath.

Revenue, expenditure and GDP growth

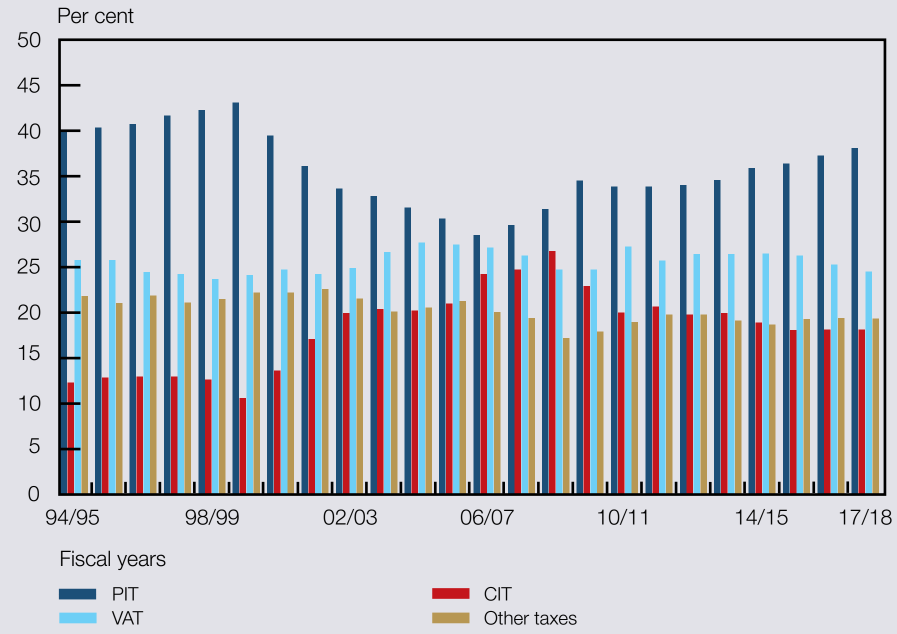


Sources: SARS and SARB

The composition of tax revenue has changed somewhat since fiscal 1994/95, with personal income tax (PIT) continuing to contribute the most, although the contribution moderated from fiscal 2000/01 to fiscal 2006/07. The next-largest contribution came from value-added tax (VAT) at an average contribution of 25.6% over the period, with the exception of fiscal 2008/09 when corporate income tax (CIT) exceeded VAT. The contribution of CIT increased from fiscal 2000/01, with CIT generating more revenue than other taxes[4] from fiscal 2006/07 to fiscal 2011/12.

1 This discussion is based on the statistics presented in the tables on pages S–48 and S–49 and on page S–65 of this *Quarterly Bulletin*.
2 Tax revenue includes PIT, CIT, VAT and other taxes, but excludes non-tax revenue.
3 National government's expenditure is measured as cash payments for operating activities, which include compensation of employees, purchases of goods and services, interest payments, subsidies, grants, social benefits and other payments, but exclude spending on non-financial assets. Grants include current and capital transfers to foreign governments, international organisations, and other general government units. Other payments include miscellaneous (all other) current and capital expenses (including transfers to non-profit institutions serving households and non-social benefits to households as well as property expenses other than interest).
4 Other taxes comprise, among other things, taxes on payroll, taxes on property, and taxes on international trade and transactions.

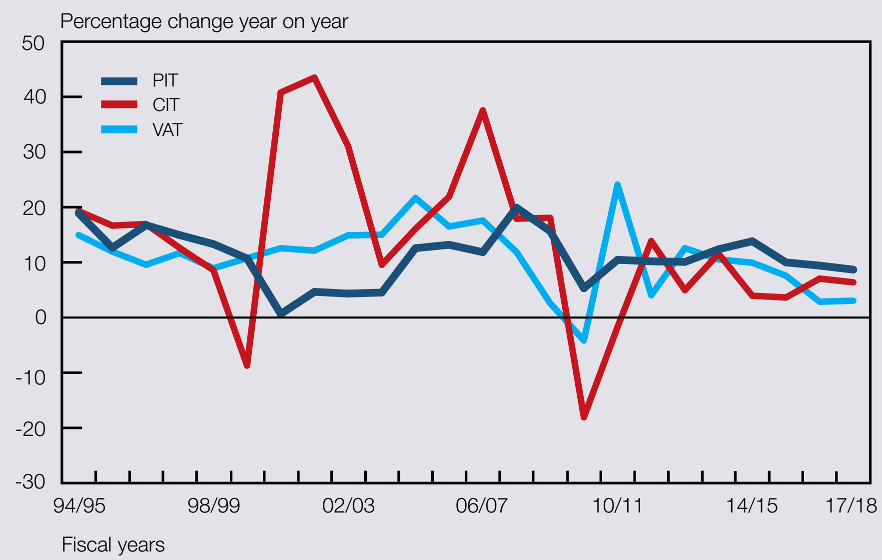
Contribution to national government tax revenue



Sources: SARS and SARB

Year-on-year growth in PIT moderated from fiscal 2007/08 to fiscal 2009/10, but thereafter remained fairly resilient compared to the other tax categories. This could be attributed to the increasing number of registered tax payers and the concomitant increase in the tax base, some tax-rate adjustments, and an increase in the real remuneration per worker. Strong growth in CIT prior to the global financial crisis was mostly associated with tax reforms, improved compliance, and favourable economic and financial conditions at the time. However, growth in CIT contracted sharply during the crisis and has not reached previous growth rates as company profits have remained under pressure. Growth in VAT receipts has not yet recovered due to a decrease in the number of active vendors, constrained household spending, and subdued economic activity.

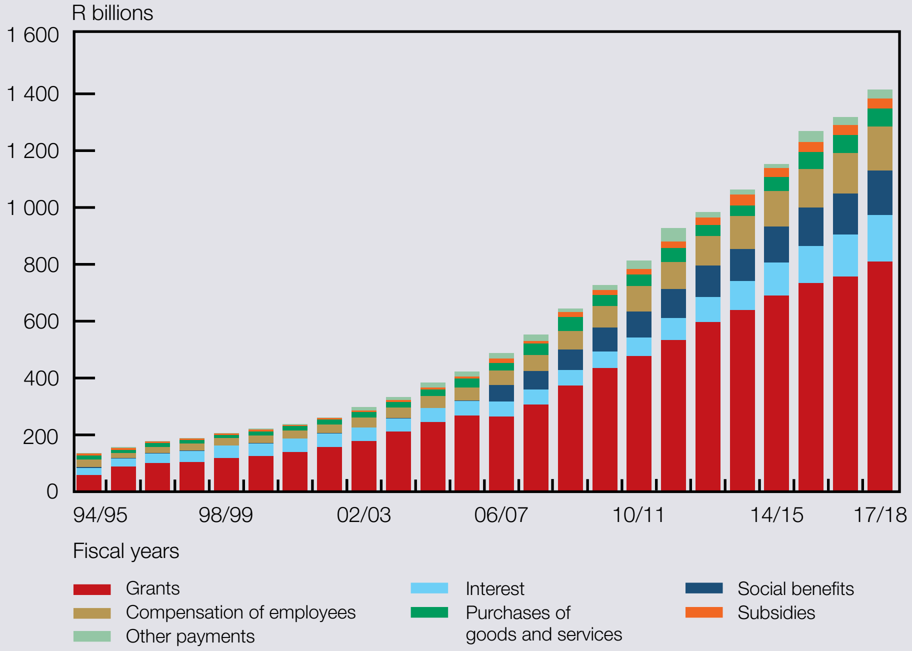
Growth in selected tax revenue



Sources: SARS and SARB

Growth in total national government expenditure, measured as cash payments for operating activities, moderated after peaking in fiscal 2008/09, in line with government's commitment to fiscal consolidation. The composition of cash payments changed notably between fiscal 1994/95 and fiscal 2017/18, with declines in the contribution of national government's compensation of employees (from 19.0% to 10.8%), purchases of goods and services (from 10.8% to 4.4%), interest (from 17.1% to 11.4%), and subsidies (from 4.7% to 2.5%). Conversely, the contribution of other payments increased (from 1.7% to 2.2%), as did the contribution of grants (from 43.4% to 57.7%) and social benefits (from 3.2% to 11.0%).

National government's cash payments for operating activities



Sources: National Treasury and SARB

Total grants (equitable share and conditional transfers), mainly paid to provincial and local governments, were the key driver of national government's spending, contributing on average 58.0% to the total between fiscal 1994/95 and fiscal 2017/18. These grants are used for the provision of provincial and municipal services such as education, health, social development, housing, roads, infrastructure, electricity and water as well as for the compensation of employees at these levels of government.

The larger contribution of interest payments in recent years reflects the rising stock of outstanding government debt. The shift towards more social spending reflects government's resolve to reduce poverty and income inequality. Expenditure on social benefits represents spending by the Department of Social Development (DSD)[5], mainly in the form of transfers to households as income support for the elderly, the disabled and children. The old-age grant accounts for most of the social benefits paid by the DSD, followed closely by the child-support grant and the disability grant.

5 Prior to fiscal 2005/06, social benefits were included as part of the grants to provincial government. With the introduction of the South African Social Security Agency in 2005, social benefits were allocated through the national DSD.

Budget comparable analysis of national government finance

In fiscal 2017/18, growth in both national government revenue and expenditure was below the original 2017 Budget and the 2018 Budget projections. The cash book deficit was much larger than originally projected as annual growth in revenue was significantly slower than expenditure.

National government finances in fiscal 2017/18: key statistics

Year-on-year percentage change*

	Originally budgeted** Full 2017/18	Revised estimates***	Actual Full 2017/18
Expenditure	7.9	8.2	7.6
Revenue	9.5	5.3	5.1
Memo: cash book deficit	**R167 billion**	**R217 billion**	**R213 billion**

* Fiscal 2017/18 to fiscal 2016/17
** *2017 Budget Review*
*** *2018 Budget Review*

Sources: National Treasury and SARS

National government expenditure of R1 405 billion in fiscal 2017/18 was 7.6% higher than in the previous fiscal year and 0.3% lower than the original 2017 Budget estimates. As a ratio of GDP, expenditure was 29.8% in fiscal 2017/18 – slightly higher than the 29.6% in fiscal 2016/17 and the 29.7% originally estimated in the 2017 Budget.

National government expenditure in fiscal 2017/18

Expenditure item	Originally budgeted Full 2017/18		Actual Full 2017/18	
	R billions	Percentage change*	R billions	Percentage change*
Voted amounts	767.0	7.0	768.6	7.2
Of which: Transfers and subsidies	*529.2*	*8.1*	*521.0*	*6.4*
Current payments	*216.9*	*5.0*	*215.2*	*4.2*
Payments for capital assets	*15.8*	*1.5*	*14.1*	*-9.8*
Statutory amounts**	642.2	9.1	636.1	8.0
Of which: Interest on debt	*162.2*	*10.9*	*162.6*	*11.1*
Equitable share transfers	*441.3*	*7.5*	*441.3*	*7.5*
Total expenditure	1 409.2	7.9	1 404.7	7.6

* Fiscal 2017/18 to fiscal 2016/17. Note that the 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

Transfers and subsidies, the main driver of voted expenditure, increased by only 6.4% in fiscal 2017/18 compared to the 8.1% projected in the original 2017 Budget. The departments of Education, Social Development, Cooperative Governance and Traditional Affairs, Transport, Health and Human Settlements as well as National Treasury accounted for the largest share of total transfers and subsidies.

Payments for financial assets, although a small share of voted expenditure, increased significantly to R18.3 billion in fiscal 2017/18. This mainly reflected recapitalisation transfers of R10.0 billion to South African Airways and R3.7 billion to the South African Post Office as well as an instalment of R4.1 billion for the subscription to the New Development Bank in February 2018.

Current payments amounted to R215 billion in fiscal 2017/18, or 4.2% more than in the previous fiscal year. The increase could mostly be attributed to the departments of Correctional Services, Defence and Military Veterans, and Police, which accounted for 66.4% of total current payments. Payments for capital assets of R14.1 billion in fiscal 2017/18 were 9.8% lower than in the preceding fiscal year.

Equitable share transfers to provinces, the main source of provincial government revenue, increased by 7.5% in fiscal 2017/18 compared to the originally budgeted R441 billion. In accordance with the general fuel levy sharing agreement, metropolitan municipalities received R11.8 billion in fiscal 2017/18 – 5.0% more when compared with fiscal 2016/17.

Interest paid on national government debt of R163 billion in fiscal 2017/18 was 11.1% more than in fiscal 2016/17 and marginally above originally budgeted projections. The increase in interest payments was consistent with the rising stock of national government debt, with the *2018 Budget Review* estimating a further increase over the medium term before stabilising at around R214 billion in fiscal 2020/21.

National government revenue[17] of R1 192 billion in fiscal 2017/18 was R50.7 billion less than the original 2017 Budget estimates. The revenue shortfall was mainly due to lower-than-expected personal income tax (PIT) and VAT collections. As a ratio of GDP, revenue was 25.2% in fiscal 2017/18, lower than both the 25.7% recorded in the previous fiscal year and the 26.2% projected in the 2017 Budget.

17 In the calculation by the SARB, revenue excludes premiums on debt portfolio restructuring and loan transactions. These came to R3.5 billion in fiscal 2017/18.

National government revenue in fiscal 2017/18

Revenue source	Originally budgeted Full 2017/18		Actual Full 2017/18	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	739.2	11.2	711.7	7.1
Income tax on individuals	*483.3*	*13.5*	*462.9*	*8.7*
Income tax on companies	*221.1*	*6.8*	*220.2*	*6.4*
Payroll taxes	16.6	8.7	16.0	4.6
Taxes on property	16.5	5.4	16.6	5.9
Taxes on goods and services	439.3	9.2	422.0	4.9
Value-added tax (VAT)	*312.8*	*8.2*	*298.0*	*3.1*
Domestic VAT	*344.8*	*7.3*	*336.3*	*4.6*
Import VAT	*162.3*	*8.7*	*152.8*	*2.4*
General fuel levy	*70.9*	*12.9*	*70.9*	*13.0*
Excise duties	*43.5*	*11.1*	*41.1*	*5.0*
Taxes on international trade and transactions	53.6	16.4	49.9	8.3
Import duties	*52.6*	*15.4*	*49.2*	*7.8*
Other revenue**	33.1	11.1	31.4	5.3
Less: SACU*** payments	56.0	41.8	56.0	41.8
Total revenue	1 242.4	9.5	1 191.7	5.1

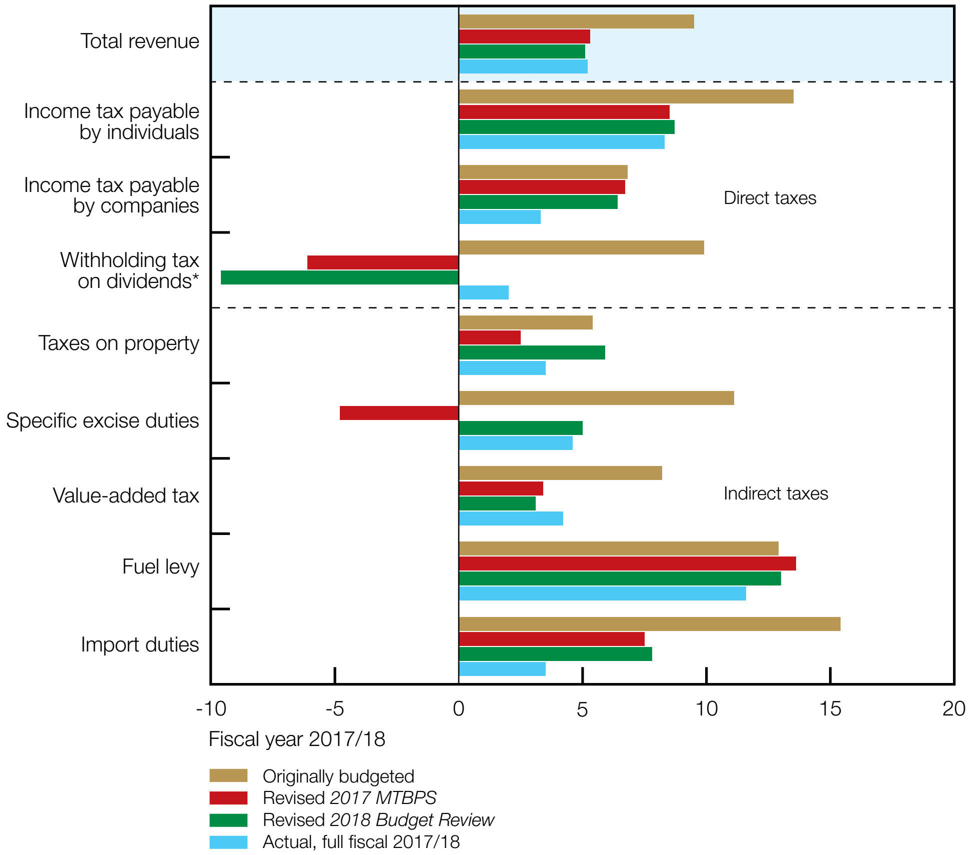
* Fiscal 2017/18 to fiscal 2016/17
** Including non-tax revenue and extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions that amounted to R3.5 billion in fiscal 2017/18.
*** Southern African Customs Union

Sources: National Treasury and SARS

Taxes on income, profits and capital gains increased by 7.1% to R712 billion in fiscal 2017/18. PIT and corporate income tax (CIT) were the main drivers of the increase. PIT was driven by higher provisional payments in February 2018 and CIT by higher-than-expected assessment payments in December 2017 as well as higher provisional tax payments, particularly from the mining and quarrying, financial intermediation, and manufacturing sectors. However, both PIT and CIT collections were below original budget targets, by R20.4 billion and R0.9 billion respectively.

Components of national government revenue

Percentage change over one year



* Includes secondary tax on companies and withholding tax on interest

Sources: National Treasury, SARS and SARB

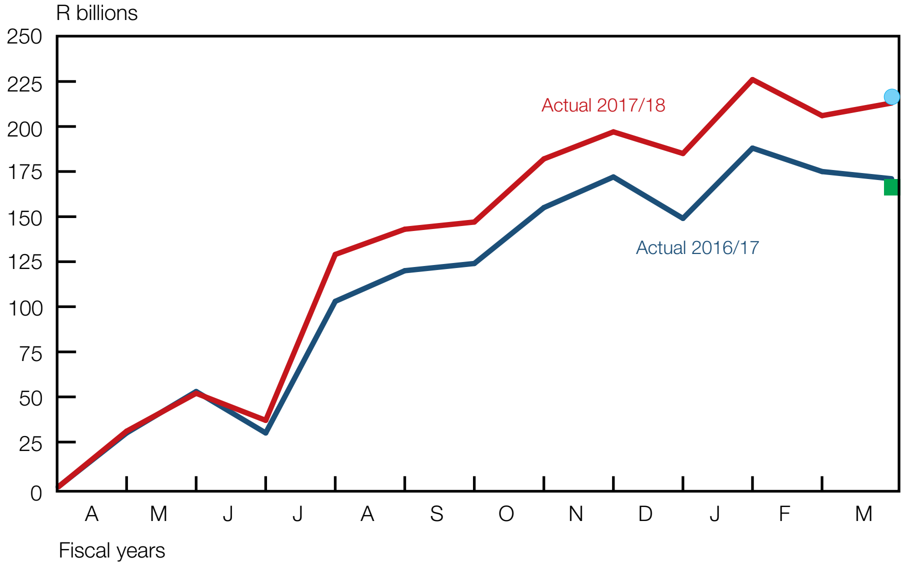
Taxes on property increased by 5.9% year on year to R16.6 billion in fiscal 2017/18. Higher proceeds from this tax category emanated from transfer duties and security transfer tax along with a marginal improvement in economic activity in the real estate market.

Taxes on goods and services of R422 billion in fiscal 2017/18 were 4.9% more than in the previous fiscal year but well below the originally budgeted annual increase of 9.2%. Collections from VAT, the general fuel levy and other excise duties increased by 3.1%, 13.0% and 5.0% respectively. Notably, VAT collections were R14.8 billion short of the original 2017 Budget target, mainly due to constrained household consumption expenditure on account of high levels of household indebtedness, weak consumer confidence, feeble employment growth, and a moderation in nominal remuneration growth.

Taxes on international trade and transactions increased by 8.3% year on year to R49.9 billion in fiscal 2017/18, driven mainly by increases in import duties on vehicles, meat products and tobacco products.

Non-tax revenue increased by 5.5% in fiscal 2017/18, mainly on account of revaluation profits on foreign-currency transactions of R13.1 billion and rent on land of R7.8 billion. Rent on land included mineral and petroleum royalties as well as mining lease and ownership fees. In fiscal 2017/18, an amount of R56.0 billion was transferred to the Southern African Customs Union (SACU), as originally allocated in the *2017 Budget Review*.

Cumulative deficit of national government



Originally budgeted deficit of R167 billion for fiscal 2017/18, *2017 Budget Review*

Revised budget deficit of R217 billion for fiscal 2017/18, *2018 Budget Review*

Sources: National Treasury, SARS and SARB

The difference between national government's revenue and expenditure yielded a cash book deficit of R213 billion in fiscal 2017/18 – R41.6 billion more than in the previous fiscal year and R46.2 billion more than the originally budgeted deficit of R167 billion. As a ratio of GDP, the cash book deficit amounted to 4.5% compared with 3.9% in the preceding fiscal year and the 3.5% projected in the *2017 Budget Review*.

National government's primary deficit[18] more than doubled to R50.4 billion in fiscal 2017/18, largely due to the significant revenue under-collection. As a ratio of GDP, the primary deficit was 1.1% in fiscal 2017/18 compared to 0.6% in the previous fiscal year, and much higher than the 0.1% originally estimated in the 2017 Budget.

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

National government's cash flow deficit amounted to R180 billion in fiscal 2017/18 – R53.9 billion more than in the previous fiscal year. After accounting for the cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R183 billion in fiscal 2017/18. This compares with a borrowing requirement of R139 billion recorded in the previous fiscal year.

The net borrowing requirement of national government was largely financed in the domestic capital and money market, mainly through the issuance of government bonds and, to a lesser extent, Treasury bills. Net issuances of national government domestic bonds amounted to R149 billion in fiscal 2017/18, some R62.0 billion more than in the previous fiscal year. National government also raised R33.4 billion through domestic short-term financing (i.e. the issuance of Treasury bills and short-term loans) in fiscal 2017/18.

The net issuance of foreign bonds and loans by national government amounted to R31.9 billion in fiscal 2017/18, much lower than the R49.0 billion recorded in the previous fiscal year.

National government financing

R billions

Item or instrument	Actual Full 2016/17	Originally budgeted[1] Full 2017/18	Revised estimates[2] Full 2017/18	Actual Full 2017/18
Cash book deficit[2]	...	166.8	217.3	...
Cash flow deficit[3]	126.5	...	...	180.4
Plus: Cost/profit on revaluation of foreign debt at redemption[4]	12.6	2.5	2.3	2.1
Net borrowing requirement	139.2	169.3	219.6	182.5
Treasury bills and short-term loans	40.5	21.0	33.0	33.4
Domestic government bonds	86.7	142.0	169.2	148.7
Foreign bonds and loans	49.0	27.5	32.1	31.9
Change in available cash balances[5]	-37.1	-21.2	-14.7	-31.5
Total net financing[6]	139.2	169.3	219.6	182.5

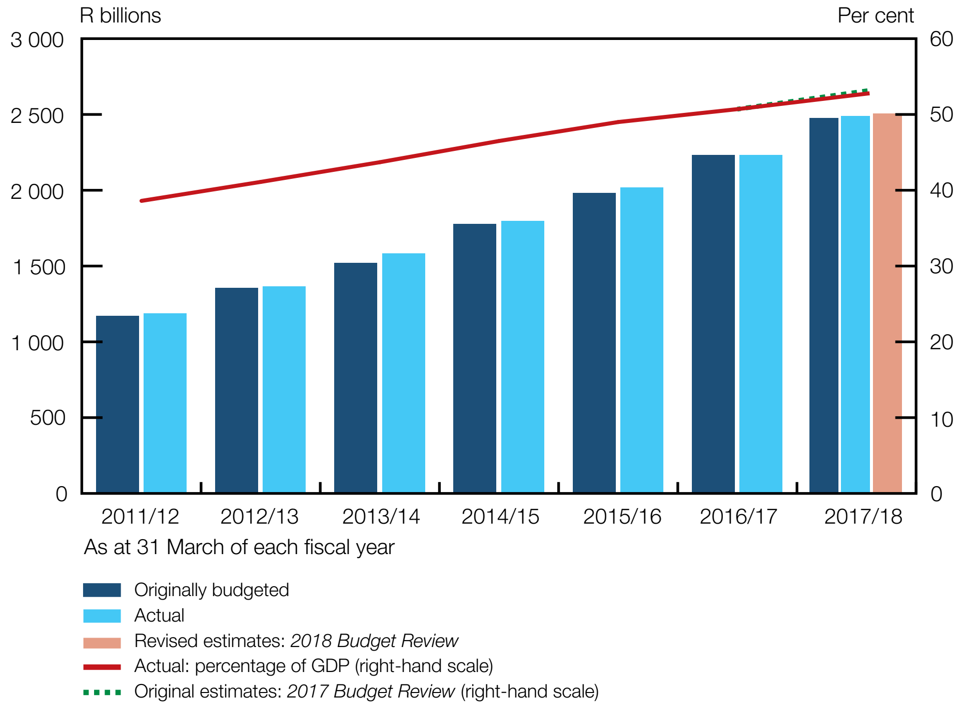
1 *2017 Budget Review*
2 *2018 Budget Review*
3 The cash flow deficit includes extraordinary receipts and payments, and differs from the cash book deficit.
4 Cost + profit –
5 Increase – decrease +
6 Components may not add up to totals due to rounding off.

Sources: National Treasury and SARB

National government's funding activities increased available cash balances by R31.5 billion in fiscal 2017/18, bringing these balances to R281 billion as at 31 March 2018. Of this, R225 billion was on deposit with the SARB and the remainder at commercial banks.

The total gross loan debt of national government (domestic and foreign currency-denominated debt) of R2 490 billion was 52.7% of GDP as at 31 March 2018. This was R12.0 billion more than the 2017 Budget estimate and R257 billion more than as at 31 March 2017. Domestic debt accounted for 98.0% of this increase.

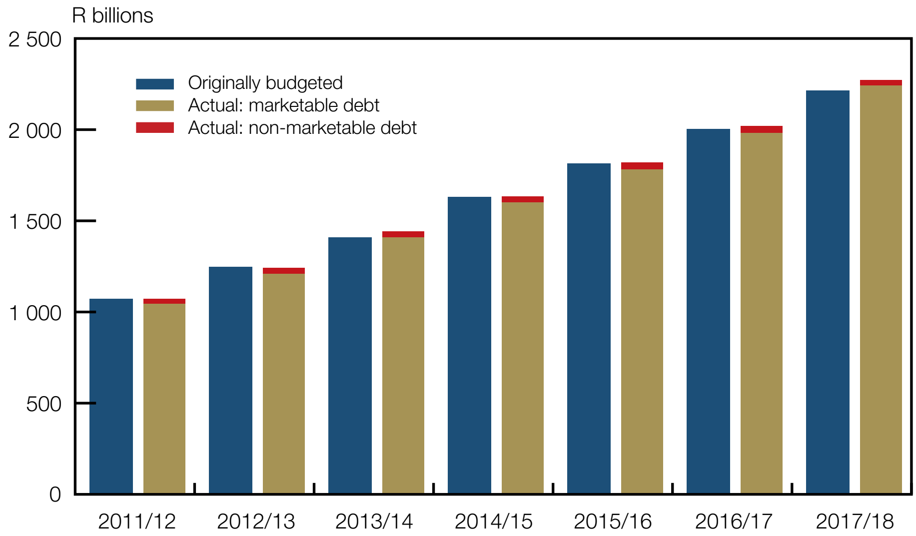
Total gross loan debt of national government



Sources: National Treasury and SARB

The total domestic debt of national government of R2 272 billion (91.3% of total gross loan debt) as at 31 March 2018 was R56.7 billion more than the 2017 Budget estimate and R252 billion more than a year earlier. This increase could mainly be attributed to increased issuances of domestic marketable debt instruments (bonds and Treasury bills). The stock of domestic marketable bonds of national government of R1 950 billion as at 31 March 2018 was R218 billion more than as at 31 March 2017. Net Treasury bill issuance of R43.4 billion in fiscal 2017/18 brought the stock of these debt instruments to R293 billion at the end of March 2018. Treasury bills to the value of R10.3 billion were redeemed in fiscal 2017/18.

Domestic debt of national government



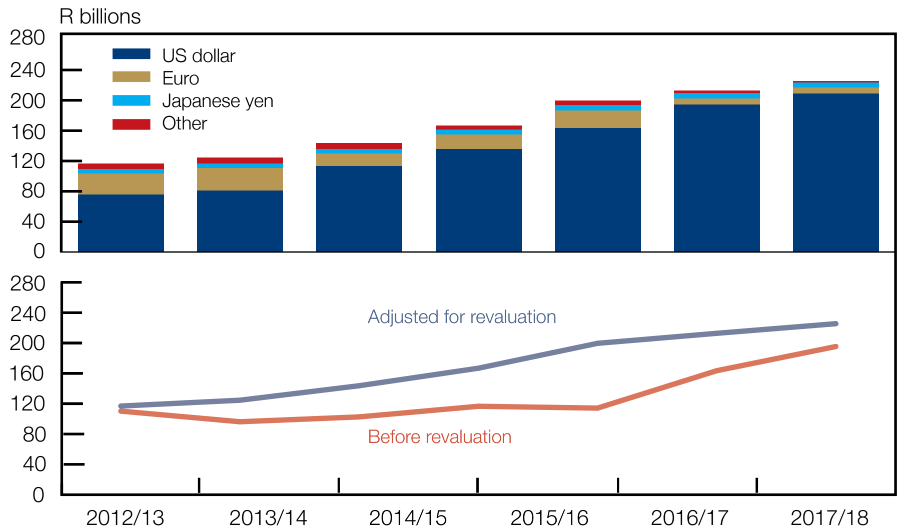
As at 31 March of each fiscal year

Sources: National Treasury and SARB

Domestic non-marketable debt (bonds and short-term loans) decreased by R9.5 billion from 31 March 2017 to 31 March 2018, bringing the outstanding balance on these debt instruments to R28.9 billion at the end of fiscal 2017/18. Short-term loans from the CPD, which accounted for the largest share of domestic non-marketable debt at 59.7%, amounted to R17.3 billion as at 31 March 2018, down from R27.2 billion as at 31 March 2017.

The foreign currency-denominated debt of national government of R218 billion as at 31 March 2018 was R5.1 billion more than a year earlier and R44.7 billion less than the original 2017 Budget estimate. Government issued two US dollar-denominated bonds to the value of US$2.5 billion (R33.9 billion) during the current fiscal year, namely a 10-year bond of US$1.0 billion (R13.6 billion) and a 30-year bond of US$1.5 billion (R20.3 billion). Government's foreign currency-denominated debt as a share of total gross loan debt remained small at 8.7% as at 31 March 2018.

Foreign currency-denominated debt of national government



As at 31 March of each fiscal year

Sources: National Treasury and SARB

Before adjusting for exchange rate revaluation (the difference between foreign debt valued at historical versus prevailing exchange rates), foreign currency-denominated debt amounted to R195 billion as at 31 March 2018 compared with R218 billion after revaluation – a revaluation of R22.5 billion. The gap between foreign currency-denominated debt before and after exchange rate revaluations has narrowed over the past two fiscal years. With no foreign debt redemptions, the narrowing of the gap resulted solely from the appreciation in the exchange value of the rand against foreign currencies. About 92.0% of South Africa's total foreign currency-denominated debt is denominated in US dollars, with the balance shared among the euro, the British pound, the Japanese yen and the Swedish krona. The average outstanding maturity of foreign marketable bonds increased from 123 months as at 31 March 2017 to 132 months as at 31 March 2018.