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Introduction

Global economic growth moderated marginally to a still robust 4.0% in the second quarter of 2018, as the slowdown in emerging markets slightly outweighed the rebound in advanced economies. The acceleration in real output growth in the advanced economies could mainly be attributed to strong economic activity in the United States (US), where fiscal stimulus supported strong growth in consumption expenditure, and in Japan. The slowdown in emerging markets was especially pronounced among Latin American countries, as real output contracted sharply in Argentina amid a currency crisis and severe drought conditions. World trade volumes contracted in April and May 2018 before increasing somewhat in June, mainly on account of higher US exports, while export volumes in the emerging markets contracted further in June 2018.

International energy prices increased notably in the second quarter of 2018, underpinned by higher prices of natural gas and oil. The price of Brent crude oil increased by more than 60% between June 2017 and May 2018, as supply disruptions and geopolitical tensions continued to boost prices. The higher energy prices contributed to an acceleration in headline consumer price inflation in advanced and emerging market economies, with the latter also affected by currency weakness.

The South African economy entered a technical recession for the first time since 2009, as real gross domestic product (GDP) contracted further at an annualised rate of 0.7% in the second quarter of 2018 following a revised decline of 2.6% in the first quarter. Excluding agriculture, real output increased marginally by 0.1% following a decline of 1.7% in the previous quarter. When measured over four quarters, growth in real GDP halved to only 0.4% in the second quarter, while the average level of real output was only 0.6% higher in the first half of 2018 than in the corresponding period of 2017.

The real output of the primary sector contracted further in the second quarter of 2018 as agricultural output again decreased sharply, owing to the lower production of horticultural products and in particular field crops, in part due to a delay in the harvesting of maize. Mining production rebounded following two consecutive quarters of contraction.

The real gross value added (GVA) by the secondary sector increased marginally in the second quarter of 2018 after contracting in the first quarter, as real activity in the electricity, gas and water; and the construction sectors increased. By contrast, real activity in the manufacturing sector contracted marginally further, impacted by higher input costs and weak domestic demand. Following five consecutive quarters of contraction, real activity in the construction sector increased in the second quarter of 2018 as activity in non-residential buildings and civil construction works improved, despite building and civil construction confidence remaining weak.

The real output of the tertiary sector contracted marginally in the second quarter of 2018, as declines in the real GVA by the transport, commerce and general government services sectors outweighed slightly faster output growth in the finance sector. The contraction in the transport sector was driven by reduced rail and road freight transport as well as a marked decline in road passenger transport following the three-week nationwide bus strike. Real activity in the commerce sector was affected by lower retail and vehicle sales.

Real gross domestic expenditure reverted from a slight increase in the first quarter of 2018 to a contraction of 3.4% in the second quarter, as real final household consumption expenditure and real gross fixed capital formation contracted along with a notable rundown of inventories. By contrast, net real exports and, to a much lesser extent, real final consumption expenditure by general government contributed positively to growth in real GDP.

Real final consumption expenditure by households contracted in the second quarter of 2018, as spending on goods declined notably while spending on services increased at a much slower pace. Real outlays on goods decreased, as households mostly reduced discretionary spending amid a decline in real disposable income following tax increases and successive fuel price hikes. Household spending was also suppressed by diminishing wealth effects in the first eight months of 2018, as the FTSE/JSE All-Share Price Index trended gradually lower amid heightened volatility driven by increased risk aversion towards emerging economies, together with weak domestic economic activity and policy uncertainty, particularly regarding land expropriation without compensation. In addition, annual growth in nominal house prices remained subdued and negative in real terms.

Real gross fixed capital formation decreased further in the second quarter of 2018, as capital spending by general government and by public corporations in particular contracted further. Fixed investment spending by the private sector increased somewhat following a contraction in the first quarter, largely due to increased capital expenditure on non-residential buildings. The decline in capital spending by public corporations reflects the financial, operational and governance challenges faced by many state-owned companies.

Enterprise-surveyed formal employment outside of the agricultural sector increased notably in the first quarter of 2018, boosted by a large number of temporary public sector jobs in preparation for the 2019 general elections. Formal private sector employment increased somewhat in the first quarter but remained virtually unchanged compared to a year earlier. Growth in labour productivity in the formal non-agricultural sector of the economy slowed in the first quarter of 2018 as year-on-year growth in employment accelerated slightly – even when excluding the election-related outliers – while output growth slowed notably.

South Africa's official unemployment rate increased from 26.7% in the first quarter of 2018 to 27.2% in the second quarter, as total household-surveyed employment decreased and the number of unemployed persons increased. The seasonally adjusted unemployment rate also increased in the second quarter. The number of discouraged work seekers increased markedly to a new record high, indicative of the poor domestic employment prospects.

Nominal remuneration growth per worker in the formal non-agricultural sector of the economy moderated further in the first quarter of 2018, as remuneration growth slowed in the public sector and remained unchanged at a fairly subdued rate in the private sector. The slowdown in remuneration growth in excess of output growth resulted in a further moderation in year-on-year growth in nominal unit labour cost to 4.2% in the first quarter of 2018.

Domestic inflationary pressures increased somewhat in recent months, primarily due to successive fuel price increases, the higher value-added tax (VAT) rate as from April 2018, and higher electricity prices and municipal assessment rates. Headline consumer price inflation nevertheless remained within the inflation target range for 17 consecutive months up to August 2018. Consumer food price inflation appears to be nearing a lower turning point, despite a continued slowdown in meat price inflation. The moderation in services price inflation contributed to fairly subdued core inflation below the midpoint of the inflation target range.

South Africa's trade balance with the rest of the world changed from a small deficit in the first quarter of 2018 to a surplus in the second quarter, as the value of net gold and merchandise exports increased much more than that of merchandise imports. The value of merchandise exports was boosted by increased volumes and, to a lesser extent, higher rand prices. The value of mining exports in particular increased significantly in the second quarter, while agricultural and manufactured exports also increased. The slight increase in the value of merchandise imports resulted primarily from mineral products, in particular crude oil. South Africa's terms of trade improved in the second quarter of 2018, as the rand price of exported goods and services increased at a faster pace than that of imports. The improvement in the trade balance far outweighed the small widening in the shortfall on the services, income and current transfer account and rendered an improvement in the deficit on the current account of the balance of payments, from 4.6% of GDP in the first quarter of 2018 to 3.3% in the second quarter.

The net inflow of capital on South Africa's financial account of the balance of payments decreased slightly from the first to the second quarter of 2018. On a net basis, direct and other investment inflows dominated in the second quarter although portfolio investment and financial derivatives also recorded inflows. Net portfolio investment inflows to South Africa decreased significantly in the second quarter, as non-residents' net purchases of domestic equity, and in particular debt securities, declined notably. South Africa's positive net international investment position decreased further from the end of December 2017 to the end of March 2018, as the value of foreign assets deceased more than foreign liabilities.

Following a moderate increase in the first quarter of 2018, the external value of the rand decreased sharply, on balance, by 10.0% on a trade-weighted basis in the second quarter, largely due to US dollar strength, higher international oil prices and increasing global inflation expectations. Risk aversion towards emerging market economies also increased, following concerns of the potential impact of escalating trade tensions between the US and its trading partners on global economic growth. In August 2018, the Turkish lira depreciated sharply after the US imposed sanctions on that country, resulting in a sharp global sell-off of emerging market assets as investors became increasingly concerned about the high levels of US dollar borrowing by some of these countries. At the same time, the Argentine peso also depreciated significantly as the country's debt crisis intensified. In line with other emerging currencies, the nominal effective exchange rate of the rand declined, on balance, by 9.7% in August 2018. Following the depreciation in the exchange value of the rand and increased risk aversion towards emerging markets, South African government bond yields rose notably from March 2018 and the yield curve shifted higher beyond the extreme short end.

The Monetary Policy Committee (MPC) of the South African Reserve Bank kept the repurchase rate unchanged at 6.50% at the July and September meetings, having assessed the monetary policy stance as appropriate, given the current state of the economy. However, the MPC noted the deteriorating domestic inflation outlook, primarily due to supply-side factors. Despite the unchanged policy rate, domestic short-term money market rates increased slightly in the second quarter of 2018 and further in August. Similarly, rates on forward rate agreements trended upwards over this period, with the longer-term rates reacting more.

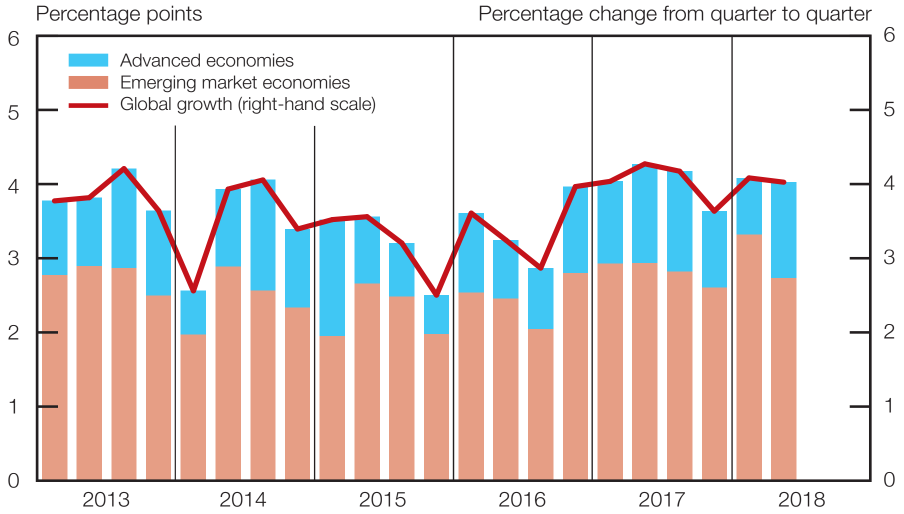
Growth in the broadly defined money supply remained lacklustre in the second quarter of 2018. Household deposit growth fluctuated sideways and continued to outpace that of the corporate sector. The deposit holdings of the corporate sector slowed somewhat over the period, as the slowdown in financial companies outweighed the acceleration in non-financial companies. Bank loans and advances extended to the domestic private sector remained subdued and increased at a slower pace in the first seven months of 2018. Credit extension to the corporate sector slowed further, with the deceleration partly exacerbated by technical reasons related to the implementation of International Financial Reporting Standard 9 from January 2018. Although remaining very subdued, growth in household credit extension continued to trend steadily upwards over this period.

The cash book deficit of national government was much smaller in the first quarter of fiscal 2018/19 than in the corresponding period of the previous fiscal year, as annual growth in revenue far outpaced that in expenditure. The strong growth in revenue was boosted by a sharp increase in VAT collections in particular, following the 1% increase in the VAT rate effective from the start of the current fiscal year. As such, the non-financial public sector borrowing requirement decreased notably in the first quarter of fiscal 2018/19 compared to a year earlier, due to the much smaller cash deficit of consolidated general government. By contrast, the cash deficit of the non-financial public enterprises and corporations increased over the period, as cash receipts from operating activities declined more than expenditure. National government's total gross loan debt increased from 52.7% of GDP at the end of March 2018 to 54.2% at the end of June.

International economic developments

Global economic growth moderated marginally from an annualised 4.1% in the first quarter of 2018 to a still robust 4.0% in the second quarter, as the slowdown in emerging markets more than offset the rebound in advanced economies. The latter was largely brought about by strong economic activity in the United States (US) and a rebound in Japan. However, growth in the major advanced economies became less synchronised with weaker momentum in the euro area.

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



Seasonally adjusted annualised rates

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

In the US, growth in real gross domestic product (GDP) accelerated from 2.2% in the first quarter of 2018 to a solid 4.2% in the second quarter – the strongest growth since the third quarter of 2014. The rebound was mainly driven by robust growth in consumption expenditure and business investment, partly due to the fiscal stimulus from tax cuts introduced late last year. Exports also increased sharply ahead of higher tariffs. By contrast, real economic growth in the euro area failed to bounce back from the weak first-quarter outcome, remaining almost unchanged at 1.5% in the second quarter.

Real output growth in selected advanced economies

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

	2016			2017					2018	
Country/region	Q3	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1	Q2
United States................	1.9	1.8	1.5	1.8	3.0	2.8	2.3	2.3	2.2	4.2
Japan...........................	1.0	0.8	0.9	2.7	2.0	2.3	0.9	1.7	-0.9	3.0
Euro area.......................	1.3	3.1	1.9	2.7	2.8	2.7	2.6	2.4	1.6	1.5
United Kingdom	1.9	3.0	1.9	1.6	0.9	1.4	1.4	1.8	0.9	1.5
Canada	4.3	2.2	1.4	4.0	4.6	1.7	1.7	3.3	1.4	2.9
Australia	-0.5	3.7	2.8	1.5	2.8	2.8	2.7	2.1	4.7	3.5
New Zealand	3.2	1.5	3.5	3.2	3.2	2.6	2.6	3.0	2.2	3.1
Advanced economies...	**1.7**	**2.4**	**1.7**	**2.3**	**2.8**	**2.8**	**2.2**	**2.3**	**1.8**	**2.8**

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

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

In the United Kingdom, real output growth accelerated to 1.5% in the second quarter of 2018 as the economy recovered somewhat from subdued growth owing to the cold weather conditions in the previous quarter. The improvement in the second quarter was mainly due to gross capital formation, especially a change in inventories. Following a contraction in the first quarter of 2018, real GDP in Japan expanded by 3.0% in the second quarter, along with robust consumer spending and strong fixed investment.

The slowdown in real output growth in the emerging markets in the second quarter of 2018 was particularly pronounced among Latin American countries, where output contracted by 0.6%. Real economic activity in Argentina declined sharply in the second quarter, with output contracting by 15.2% amid a currency crisis as well as severe drought conditions. The Mexican economy also contracted in the second quarter, albeit by only 0.6%, due to declines in agricultural output, oil and gas production as well as construction activity.

Real output growth in selected emerging market economies

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

	2016			2017					2018	
Country/region	Q3	Q4	Year*	Q1	Q2	Q3	Q4	Year*	Q1	Q2
China	6.9	6.8	6.7	6.9	7.0	6.7	6.4	6.9	7.2	6.4
India	5.3	3.8	7.1	7.5	5.8	7.8	7.2	6.7	10.1	7.8
Indonesia	4.8	5.1	5.0	4.7	5.4	5.1	5.4	5.1	4.4	6.2
Emerging Asia	**6.1**	**5.8**	**6.5**	**6.8**	**6.5**	**6.8**	**6.3**	**6.6**	**7.7**	**6.5**
Russia	1.2	3.0	-0.2	1.4	4.1	0.1	-1.4	1.5	2.7	6.2
Turkey	-9.9	19.7	3.2	7.4	10.5	5.3	6.7	7.4	6.3	3.8
Poland	0.8	8.2	2.9	4.1	3.6	5.7	4.1	4.6	6.6	4.1
Emerging Europe	**-1.8**	**8.4**	**1.7**	**4.1**	**5.9**	**3.0**	**1.9**	**3.9**	**4.2**	**5.2**
Brazil	-3.2	-1.1	-3.5	4.3	1.7	2.5	0.2	1.0	0.5	0.7
Mexico	4.9	4.0	2.9	1.1	2.2	-0.3	3.3	2.0	4.0	-0.6
Argentina	0.6	2.7	-1.8	3.0	7.7	2.0	3.1	2.9	3.0	-15.2
Latin America	**0.3**	**1.5**	**-0.6**	**2.1**	**2.2**	**1.7**	**1.8**	**1.3**	**2.3**	**-0.6**
Emerging economies	**4.0**	**5.4**	**4.4**	**5.6**	**5.7**	**5.4**	**5.0**	**4.8**	**6.2**	**5.1**

* 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

Real economic growth in emerging Asia decelerated from 7.7% in the first quarter of 2018 to 6.5% in the second quarter. Chinese real GDP expanded at a slower pace of 6.4% in the second quarter from 7.2% in the first quarter, as efforts by the government to rein in credit growth weighed on fixed investment. Meanwhile, real economic growth in Indonesia accelerated to 6.2% in the second quarter – the fastest pace in almost eight years, reflecting robust consumption expenditure.

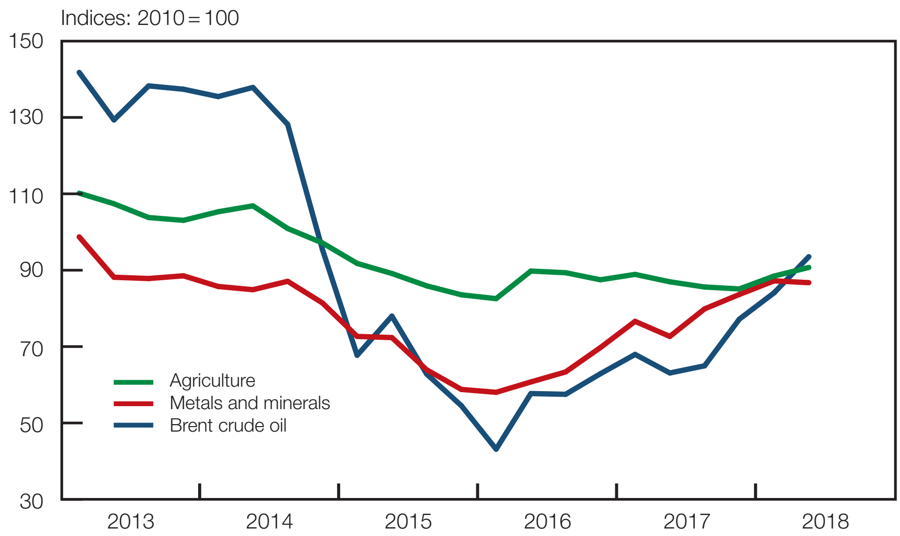
Real output growth in emerging Europe accelerated from 4.2% in the first quarter of 2018 to 5.2% in the second quarter, supported by a rebound in Russian growth from 2.7% in the first quarter to 6.2% in the second quarter. Meanwhile, output growth in Turkey slowed from 6.3% in the first quarter to 3.8% in the second quarter, in the context of an intensifying currency crisis.

Headline consumer price inflation trended higher across advanced economies, largely reflecting rising energy prices. Headline inflation in the US and euro area is now above those central banks' 2% inflation targets, although it remained below target in Japan. Higher international oil prices and weaker exchange rates have also lifted headline inflation in the emerging economies.

Prices for energy and agricultural commodities increased in the second quarter of 2018, while those of metals and minerals receded slightly. Energy prices increased sharply by 8.8%, particularly natural gas and oil. The price of Brent crude oil increased by more than 60% from June 2017 to almost US$77 per barrel in May 2018, as supply disruptions and geopolitical tensions continued to boost prices. In June 2018, the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC oil producers agreed to raise oil production by about one million barrels per day. Oil prices subsequently trended lower and declined below US$70 per barrel in mid-August 2018. However, oil prices increased to around US$80 per barrel in mid-September due to slower growth in US shale production, the prospect of renewed sanctions against Iran and concerns about a hurricane approaching the US.

Agricultural product prices rose by 2.6% in the second quarter of 2018, partly due to higher wheat and soyabean prices amid deteriorating harvest prospects in Argentina and Brazil. Metals and minerals prices, however, declined by 0.5%, owing to lower iron ore, zinc and platinum prices.

International commodity prices in US dollars



Sources: World Bank and SARB

After contracting in April and May 2018, world trade volumes (using world exports as a proxy) increased at an annualised rate of 1.5% in June (in three-month-to-three-month terms). Export volumes in advanced economies increased sharply by 4.5% in June, mainly due to higher US exports. This increase was partially offset by lower exports from emerging markets, where volumes declined by 2.1% in June.

Domestic economic developments

Domestic output[1]

The South African economy entered a technical recession in the second quarter of 2018 with real *gross domestic product* (GDP) contracting for a second successive quarter – the first such occurrence since the first quarter of 2009. The contraction of 0.7% in the second quarter of 2018 followed a revised decline of 2.6% in the first quarter. In the second quarter, the real output of the primary and tertiary sectors contracted, while that of the secondary sector increased only marginally. Year-on-year growth in real GDP halved from 0.8% in the first quarter of 2018 to 0.4% in the second quarter, with the average level of real output only 0.6% higher in the first half of 2018 than in the corresponding period of 2017.

Real gross domestic product

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

Sector	2017					2018	
	Q1	Q2	Q3	Q4	Year*	Q1	Q2
Primary sector	15.4	13.9	13.8	5.2	7.5	-17.0	-4.6
Agriculture	25.6	36.9	41.7	39.0	17.7	-33.6	-29.2
Mining	12.6	7.8	6.2	-4.4	4.6	-10.3	4.9
Secondary sector	-3.7	2.8	1.5	3.1	-0.1	-5.0	0.5
Manufacturing	-4.1	2.9	3.7	4.3	-0.2	-6.7	-0.3
Tertiary sector	-1.7	1.2	1.1	2.7	0.8	0.3	-0.6
*Non-primary sector***	*-2.1*	*1.6*	*1.2*	*2.7*	*0.6*	*-0.9*	*-0.3*
*Non-agricultural sector****	*-1.0*	*2.1*	*1.6*	*2.1*	*0.9*	*-1.7*	*0.1*
Total	**-0.5**	**2.9**	**2.3**	**3.1**	**1.3**	**-2.6**	**-0.7**

* Percentage change over one year
** Non-primary sector is total gross value added excluding agriculture and mining
*** Non-agricultural sector is total gross value added excluding agriculture

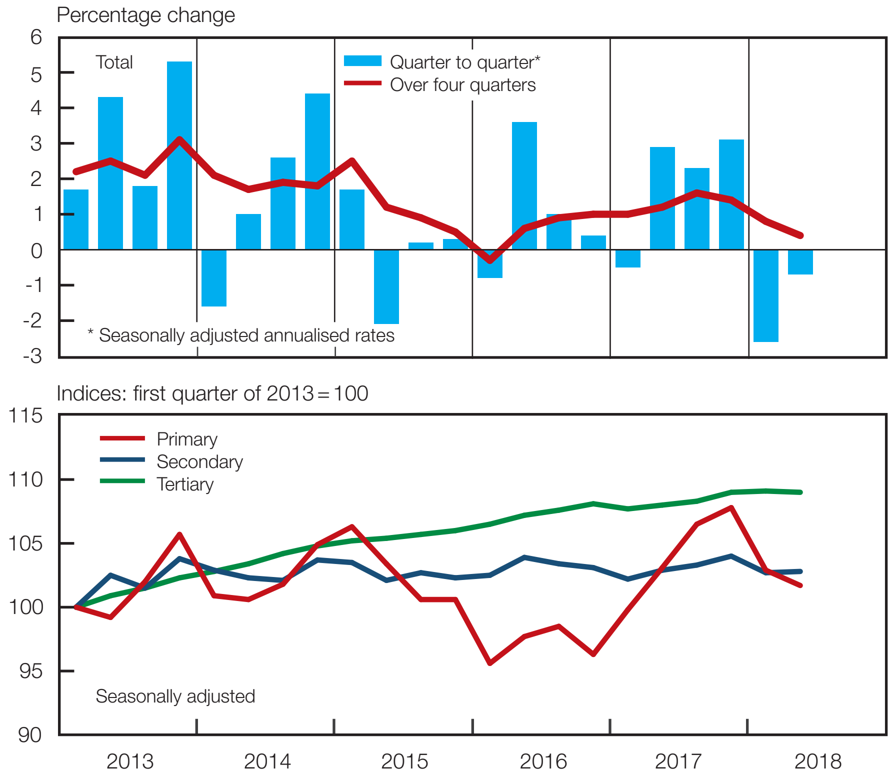
Source: Stats SA

When excluding the contribution of the generally more volatile primary sector, real output declined by 0.3% in the second quarter of 2018 following a contraction of 0.9% in the first quarter. However, when excluding only agriculture, real output increased marginally by 0.1% following a decline of 1.7% in the previous quarter.

Primary sector real gross value added (GVA) contracted further by 4.6% in the second quarter of 2018, following a revised decline of 17.0% in the first quarter. Agricultural sector real output contracted at a slower pace, while mining sector real GVA rebounded following two consecutive quarters of contraction.

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

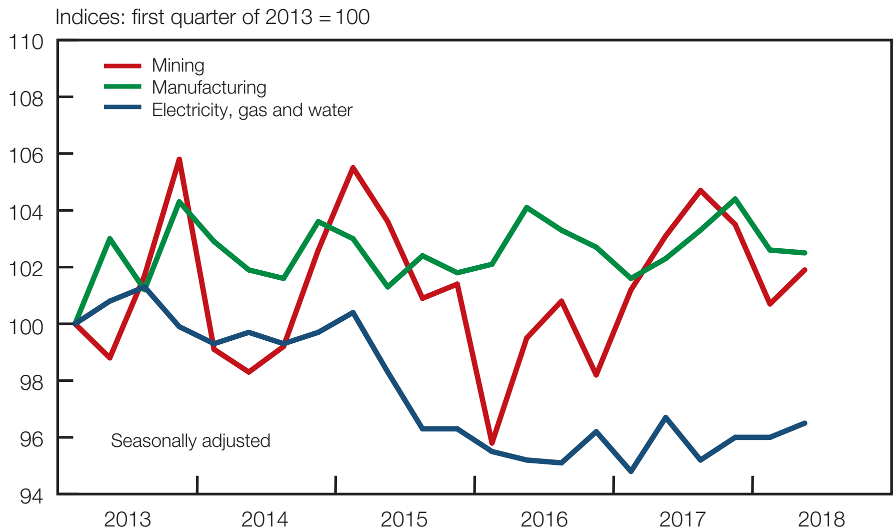
Real gross domestic product



Source: Stats SA

The real output of the *agricultural sector* contracted further but at a slower rate of 29.2% in the second quarter of 2018 and subtracted 0.8 percentage points from real GDP growth. The contraction came about as the decrease in the production of horticultural products and, in particular, also of field crops (due to a delay in the harvesting of maize) outweighed the increase in the output of animal products despite the rebuilding of herds. The level of real agricultural output in the second quarter of 2018 was 5.8% lower than in the corresponding quarter of 2017. The latest commercial maize crop estimates for the 2017/18 production season by the Department of Agriculture, Forestry and Fisheries' Crop Estimates Committee of 13.2 million tons is well below the previous season's record harvest due to a smaller area planted and as only average yields are expected in some areas. However, it is still more than the estimated local demand of 10.8 million tons per annum.

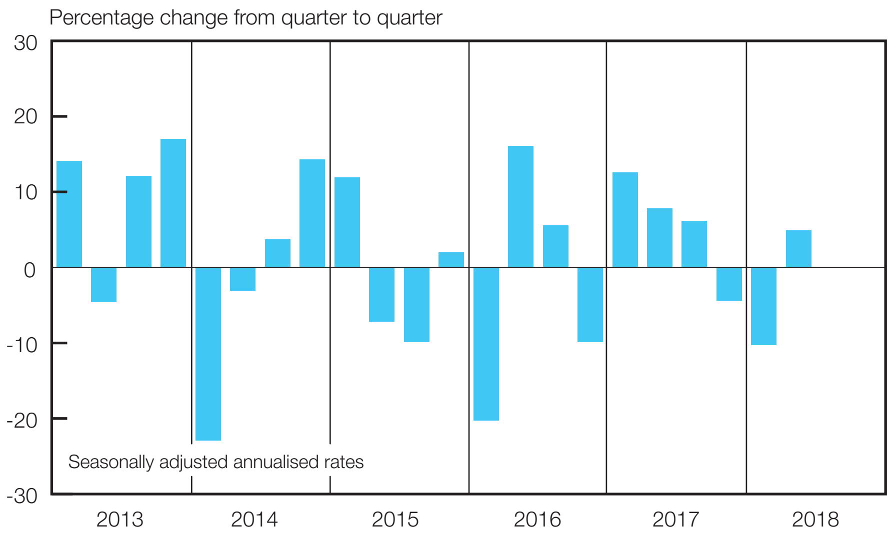
Real gross value added by selected subsectors



Source: Stats SA

Following two consecutive quarters of contraction, *mining output* grew by 4.9% in the second quarter of 2018 and contributed 0.4 percentage points to growth in real GDP. However, the average level of mining production was still 0.8% lower in the first half of 2018 than in the corresponding period of 2017. Mining production was driven by increased production of platinum group metals, diamonds, nickel and copper, which was partly offset by declines in gold, coal and iron ore production. The marked increase in diamonds likely emanated from a recovery in production following safety stoppages in the previous quarter. Lingering regulatory uncertainty, restructuring initiatives and intentions to retrench workers, together with escalating global trade tensions, adversely affected the sector.

Real gross value added by the mining sector

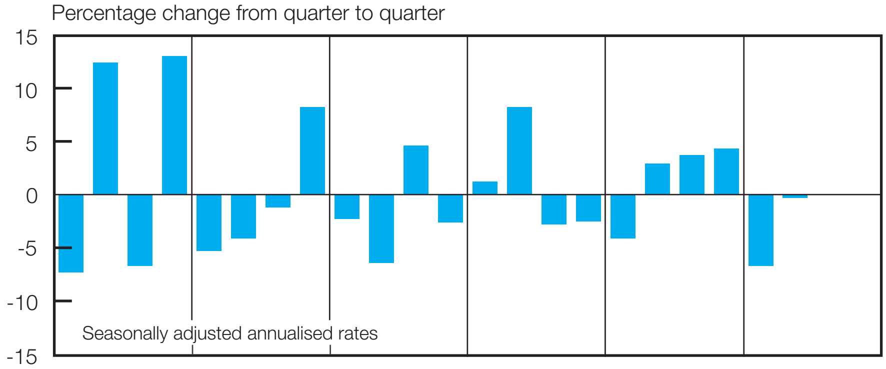


Source: Stats SA

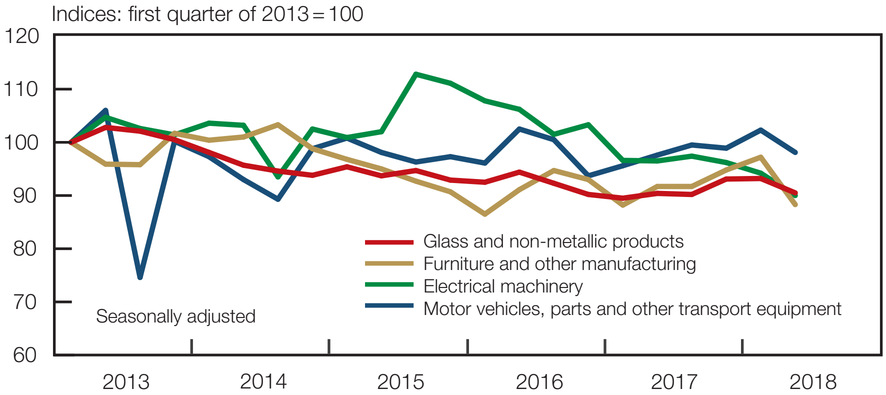
The real output of the *secondary sector* increased by 0.5% in the second quarter of 2018 as the real activity in the electricity, gas and water and the construction subsectors increased. By contrast, the real output of the manufacturing subsector contracted further.

Following a notable contraction of 6.7% in the first quarter of 2018, the real GVA by the *manufacturing sector* receded by a further 0.3% in the second quarter. Production decreased in 7 of the 10 manufacturing subsectors, impacted by higher fuel prices, other cost pressures and muted growth in domestic demand. The subsectors producing furniture and other manufacturing products; electrical machinery, motor vehicles, parts and accessories; and glass and non-metallic mineral products contributed the most to the contraction in manufacturing output. By contrast, fairly solid production growth occurred in petroleum and chemical products. Alongside these developments, the seasonally adjusted utilisation of production capacity in the manufacturing sector remained unchanged at 81.1% in the second quarter of 2018.

Real gross value added by the manufacturing sector



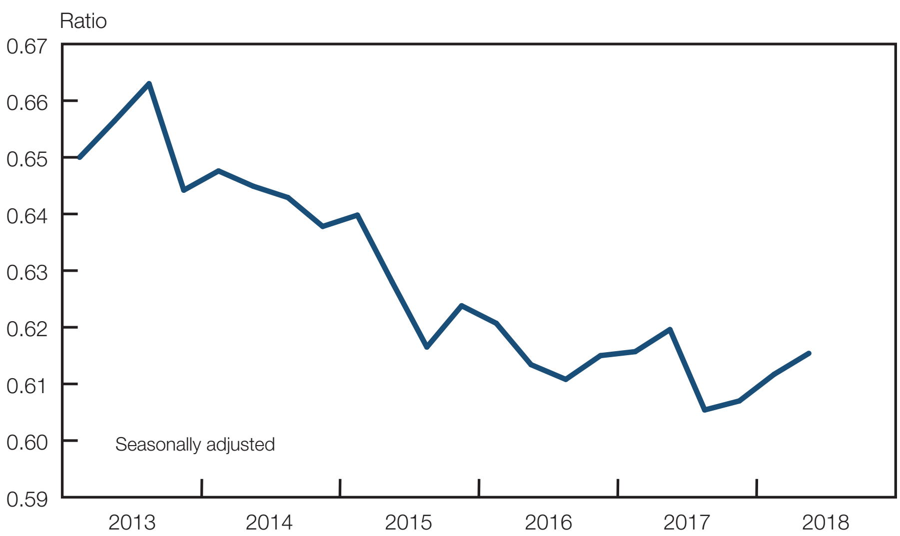
Physical volume of manufacturing production



Source: Stats SA

Growth in real economic activity in the *electricity, gas and water sector* accelerated further to a rate of 2.1% in the second quarter of 2018, following a revised increase of 0.2% in the first quarter. Coal supply shortages at a number of Eskom's coal-fired power stations, industrial action, and continued theft and vandalism of electricity infrastructure contributed to a decrease in electricity production. However, the volume of electricity consumed increased in the second quarter of 2018 along with an increase in electricity imports despite Eskom's continued supply disruptions to defaulting municipalities and the brief implementation of load-shedding. Consequently, the ratio of electricity consumption to real GDP increased further in the second quarter of 2018 after trending lower since 2013.

Electricity consumption relative to gross domestic product



Source: Stats SA

Following five consecutive quarters of contraction, real activity in the *construction sector* expanded by 2.3% in the second quarter of 2018. The increase reflected improved activity in non-residential buildings and civil construction works alongside a slight increase in civil construction confidence. By contrast, prevailing subdued economic conditions continued to hamper residential building activity.

The real GVA by the *tertiary sector* reverted from an increase of 0.3% in the first quarter of 2018 to a contraction of 0.6% in the second quarter. Real activity in the transport, storage and communication; trade; and general government services sectors contracted, while real output growth in the finance, insurance, real estate and business services sectors accelerated slightly.

The real output of the *commerce sector* contracted by 1.9% in the second quarter of 2018, following a contraction of 3.1% in the first quarter. Both retail and motor trade activity decreased, while wholesale trade activity rose marginally. In the retail trade subsector, activity declined in the food, beverages and tobacco; hardware, paint and glass; as well as pharmaceutical and medical goods subsectors. Lower sales of new and used vehicles over the period contributed to the deterioration in activity in the motor trade subsector. The depreciation in the exchange value of the rand in recent months is also expected to affect new vehicle sales through higher price increases.

Wholesale trade activity gained some momentum in the second quarter of 2018, as sales increased in the textiles; clothing and footwear; agricultural raw materials and livestock; and solid, liquid and gaseous fuels subsectors. Growth in the real GVA by the catering and accommodation subsector remained at broadly the same rate as in the previous quarter.

Growth in the real output of the *transport, storage and communication sector* contracted notably by 4.9% in the second quarter of 2018, subtracting 0.4 percentage points from overall GDP growth. The decline resulted from decreased activity in rail and road freight transport as well as a marked decline in road passenger transport following the three-week nationwide bus strike.

Growth in the real GVA by the *finance, insurance, real estate and business services sector* accelerated from 1.1% in the first quarter of 2018 to 1.9% in the second quarter, mainly reflecting increased activity in the banking subsector as the fee income of commercial banks increased at a faster pace. By contrast, activity in the equity market contracted in the second quarter. The average level of real GVA by the finance, insurance, real estate and business services sector in the first half of 2018 was 2.0% higher than in the corresponding period of 2017.

The real GVA by the *general government services sector* reverted from an increase of 1.9% in the first quarter of 2018 to a decline of 0.5% in the second quarter, reflecting a decrease in the number of government employees, which is a significant factor in this sector.

Real gross domestic expenditure[2]

Real *gross domestic expenditure* reverted from an increase of 0.7% in the first quarter of 2018 to a contraction of 3.4% in the second quarter, as real final consumption expenditure by households declined for the first time in two years and as real gross fixed capital formation contracted further, alongside a rundown of real inventory holdings. By contrast, real final consumption expenditure by general government increased at a slightly slower pace. The average level of real gross domestic expenditure was only 1.0% higher in the first half of 2018 compared to the corresponding period of 2017.

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

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

Component	2017					2018	
	Q1	Q2	Q3	Q4	Year*	Q1	Q2
Final consumption expenditure							
Households	0.9	3.8	2.4	3.6	2.2	1.0	-1.3
General government	-1.2	0.6	1.3	1.6	0.6	1.4	0.7
Gross fixed capital formation	-3.1	-0.2	-2.7	7.4	0.4	-3.4	-0.5
Domestic final demand	**-0.3**	**2.4**	**1.2**	**3.9**	**1.5**	**0.2**	**-0.8**
Change in inventories (R billions)**	-6.1	6.3	-12.0	4.4	-1.8	8.8	-14.2
Gross domestic expenditure* **	**0.0**	**4.1**	**-1.2**	**5.6**	**1.8**	**0.7**	**-3.4**

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

Sources: Stats SA and SARB

Real net exports and final consumption expenditure by general government contributed 2.8 and 0.1 percentage points respectively to real GDP growth in the second quarter of 2018, while the change in real inventories and final consumption expenditure by households subtracted 2.9 and 0.8 percentage points respectively.

Contributions of expenditure components to growth in real gross domestic product

Percentage points

Component	2017					2018	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
Final consumption expenditure							
Households	0.5	2.3	1.5	2.2	1.4	0.6	-0.8
General government	-0.3	0.1	0.3	0.3	0.1	0.3	0.1
Gross fixed capital formation	-0.6	0.0	-0.5	1.4	0.1	-0.7	-0.1
Change in inventories	0.1	1.6	-2.4	2.1	0.2	0.6	-2.9
Net exports	-0.5	-1.2	3.5	-2.5	-0.5	-3.3	2.8
Residual	0.3	0.1	0.0	-0.5	0.1	0.0	0.3
Gross domestic product	**-0.5**	**2.9**	**2.3**	**3.1**	**1.3**	**-2.6**	**-0.7**

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

Sources: Stats SA and SARB

Real *exports* rebounded by 3.3% in the second quarter of 2018 after contracting by 4.7% in the first quarter, driven by increased merchandise and net gold exports, while services exports contracted further. An increase in foreign demand for chemical products boosted real manufactured exports, while real exports of vegetable products underpinned a noticeable increase in agricultural exports. The increase in real mining exports reflected higher export volumes of precious metals, including gold, platinum group metals and stones.

Real exports and imports of goods and services

Quarter-to-quarter percentage change*

Component	2018					
	Exports			Imports		
	Contribution** in per cent	Q1	Q2	Contribution** in per cent	Q1	Q2
Total	100	-4.7	3.3	100	-1.8	0.8
Mining	**46.1**	**-2.6**	**4.8**	**20.5**	**1.1**	**1.3**
Of which:						
Mineral products	20.0	-3.1	3.4	15.1	2.2	2.4
Precious metals including gold, platinum group metals and stones	14.7	1.0	10.2	0.9	-18.8	14.5
Base metals and articles	11.3	-6.3	-0.0	4.4	3.6	-5.9
Manufacturing	**32.2**	**-4.9**	**1.7**	**61.5**	**-2.6**	**0.4**
Of which:						
Vehicles and transport equipment	10.4	-3.4	0.8	12.4	-4.6	3.5
Machinery and electrical equipment	6.6	-4.0	0.0	24.8	-5.3	0.5
Chemical products	5.3	-6.5	2.1	8.7	-3.2	-1.8
Prepared foodstuffs, beverages and tobacco	3.3	2.9	-0.6	2.6	-5.0	15.7
Agriculture	**5.3**	**-9.5**	**13.6**	**3.7**	**4.7**	**-4.8**
Of which:						
Vegetable products	4.0	-13.3	18.4	1.5	5.9	12.7
Services	**14.6**	**-4.9**	**-1.2**	**13.6**	**-3.0**	**1.9**

* Based on seasonally adjusted and annualised data
** Average contribution to the total in 2017
Components may not add up to totals due to rounding off and the exclusion of unclassified items.

Sources: SARS, Stats SA and SARB

Following a decline in the first quarter of 2018, the real *imports* of goods and services rose slightly by 0.8% in the second quarter, as the real imports of mining and manufactured products increased marginally while that of agricultural products contracted. Strong growth in the imports of precious metals, including gold, platinum group metals and stones, boosted real mining imports, with real crude oil imports increasing at a much slower pace. The real value of manufacturing imports rose slightly due to increased domestic demand for vehicles and transport equipment; machinery and electrical equipment; and prepared foodstuffs, beverages and tobacco.

The significant contribution of real *net exports* to real GDP growth in the second quarter of 2018 could mainly be ascribed to a contribution of 2.3 percentage points from real net mining exports and, to a lesser extent, to real net agricultural and manufactured exports. Within mining exports, the real net exports of precious metals, including gold, platinum group metals and stones, contributed the most at 1.7 percentage points. By contrast, the real net exports of services subtracted 0.5 percentage points from growth in real GDP in the second quarter of 2018.

Contributions of real exports and imports, and net exports of goods and services to growth in real gross domestic product

Percentage points

Component	2018					
	Exports		Imports*		Net exports	
	Q1	Q2	Q1	Q2	Q1	Q2
Total	**-5.5**	**3.7**	**-2.2**	**0.9**	**-3.3**	**2.8**
Mining	**-1.4**	**2.6**	**0.3**	**0.3**	**-1.7**	**2.3**
Of which:						
Mineral products	-0.7	0.8	0.4	0.4	-1.1	0.3
Precious metals including gold, platinum group metals and stones	0.2	1.8	-0.3	0.2	0.5	1.7
Base metals and articles	-0.9	0.0	0.2	-0.3	-1.0	0.3
Manufacturing	**-1.9**	**0.6**	**-2.0**	**0.3**	**0.1**	**0.3**
Of which:						
Vehicles and transport equipment	-0.4	0.1	-0.7	0.5	0.3	-0.4
Machinery and electrical equipment	-0.3	0.0	-1.7	0.1	1.4	-0.1
Chemical products	-0.4	0.1	-0.4	-0.2	-0.1	0.3
Prepared foodstuffs, beverages and tobacco	0.1	0.0	-0.1	0.4	0.3	-0.5
Agriculture	**-0.6**	**0.8**	**0.2**	**-0.2**	**-0.8**	**1.0**
Of which:						
Vegetable products	-0.6	0.8	0.1	0.2	-0.7	0.6
Services	**-0.8**	**-0.2**	**-0.5**	**0.3**	**-0.3**	**-0.5**

* A positive contribution by imports subtracts from growth and a negative contribution adds to growth.
Components may not add up to totals due to rounding off and the exclusion of unclassified items.

Sources: SARS, Stats SA and SARB

Households' real *final consumption expenditure* contracted by 1.3% in the second quarter of 2018, following an increase of 1.0% in the first quarter. This was the first decrease since the first quarter of 2016, as real spending on durable, semi-durable and non-durable goods declined, while real outlays on services increased at a slower pace. The decline in households' real disposable income, largely due to tax increases and fuel price hikes in the second quarter of 2018, adversely affected real household consumption expenditure. Despite the contraction in the second quarter, real household spending in the first half of 2018 was 2.3% higher than in the corresponding period of 2017.

Real final consumption expenditure by households

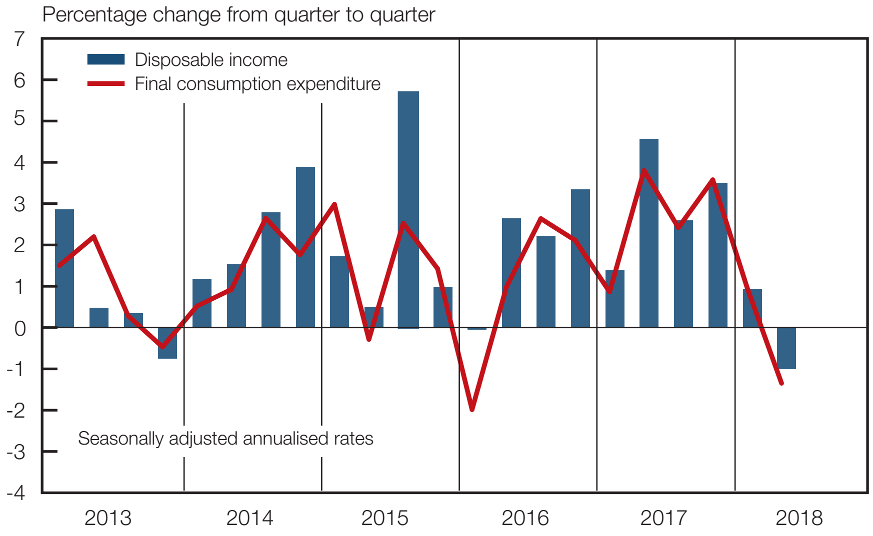
Quarter-to-quarter percentage change at seasonally adjusted annualised rates

Category	2017					2018	
	Q1	Q2	Q3	Q4	Year*	Q1	Q2
Durable goods	4.4	11.2	15.2	13.1	6.0	-0.9	-11.2
Semi-durable goods	-2.2	10.9	4.8	16.7	3.1	-12.1	-5.1
Non-durable goods	-0.1	4.0	-1.2	2.6	1.1	0.5	-2.4
Services	1.6	0.7	2.4	-0.3	2.3	5.0	2.8
Total	**0.9**	**3.8**	**2.4**	**3.6**	**2.2**	**1.0**	**-1.3**

* Percentage change over one year

Source: Stats SA

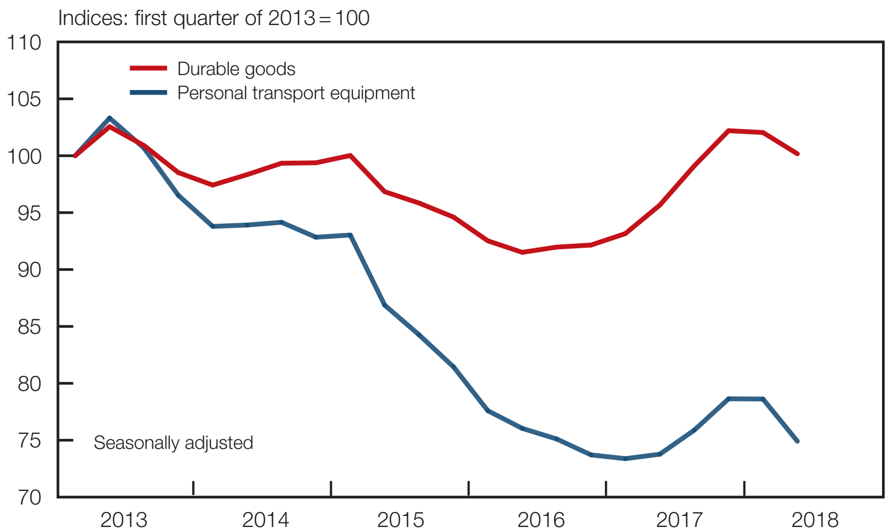
Real final consumption expenditure and disposable income of households



Sources: Stats SA and SARB

Real outlays by households on *durable goods* contracted further by 11.2% in the second quarter of 2018, driven by lower spending on almost all durable subcategories, especially personal transport equipment. The contraction in real outlays on personal transport equipment reflects a combination of pre-emptive vehicle purchases in the previous six months ahead of the value-added tax (VAT) increase effective from 1 April 2018, and the impact of the subdued economic environment on the disposable income of consumers.

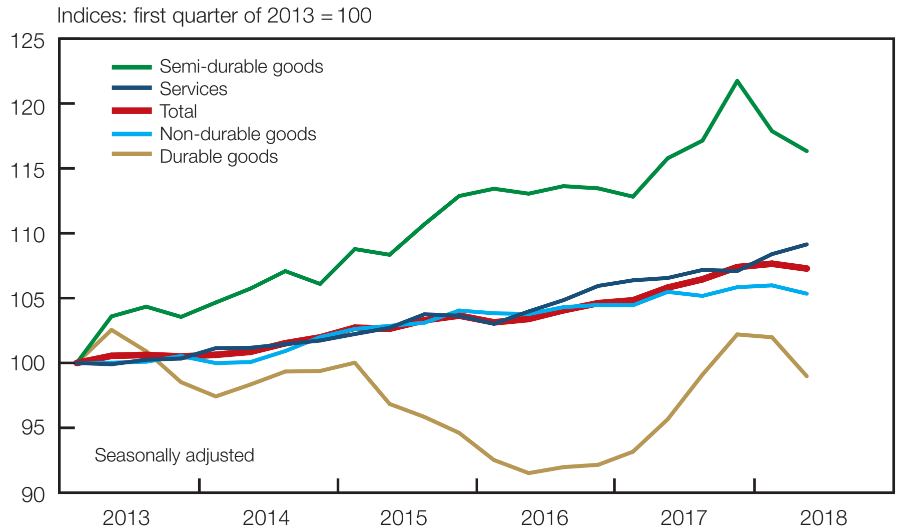
Real final consumption expenditure by households on durable goods and personal transport equipment



Source: Stats SA

Real consumer spending on *semi-durable goods* contracted by 5.1% in the second quarter of 2018 following a decline of 12.1% in the first quarter. Real outlays on clothing and footwear, which accounts for the bulk of semi-durable expenditure, decreased notably, while real spending on household textiles, furnishings and glassware; motorcar tyres, parts and accessories; and recreational and entertainment goods also shrank. By contrast, real household expenditure on miscellaneous goods increased strongly.

Real final consumption expenditure by households

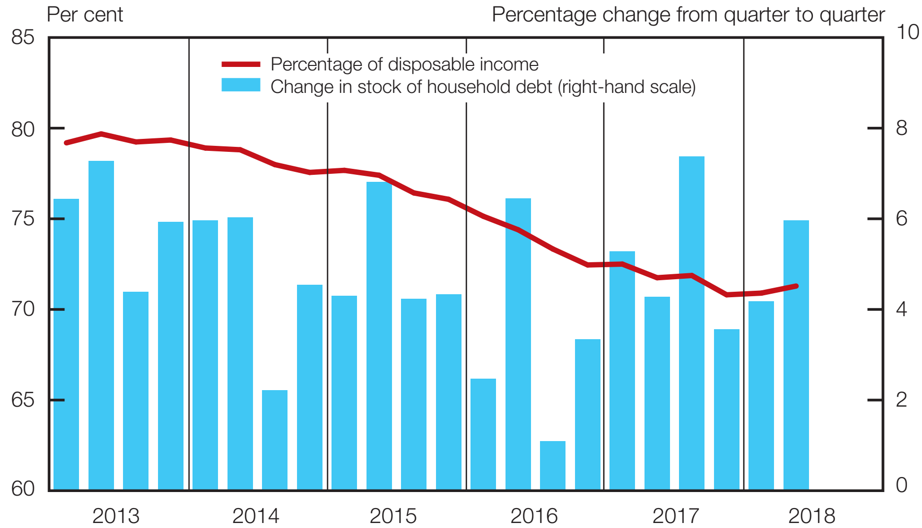


Source: Stats SA

Real expenditure on *non-durable goods* contracted by 2.4% in the second quarter of 2018 following a slight increase of 0.5% in the first quarter. Spending on almost all non-durable subcategories contracted, including food, beverages and tobacco; household fuel, power and water; household consumer goods; and recreational and entertainment goods. Higher fuel price inflation in the second quarter of 2018 adversely affected outlays on household fuel products, particularly paraffin that is used by a large number of households for cooking and heating, while real outlays on petroleum products increased at a steady pace.

Growth in real spending by households on *services* moderated from 5.0% in the first quarter of 2018 to 2.8% in the second quarter and contributed 1.2 percentage points to growth in total final consumption expenditure by households. Real consumption expenditure on medical services rose sharply, while that on transport and communication services and miscellaneous services advanced at a slower pace. Real outlays on recreational, entertainment and educational services slowed, while that on household services declined in the second quarter of 2018.

Household debt



Seasonally adjusted annualised rates

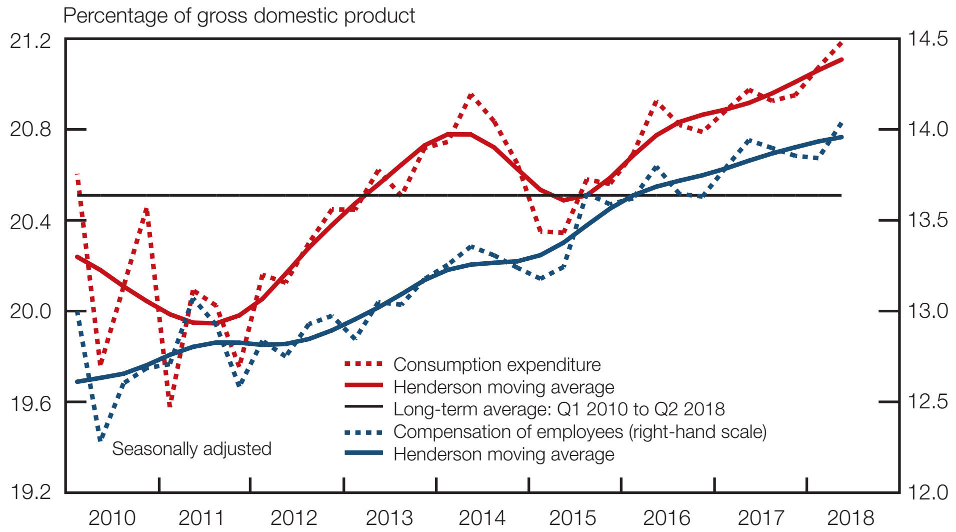
Source: SARB

Following an increase of 0.9% in the first quarter of 2018, the real *disposable income* of households declined by 1.0% in the second quarter, although nominal disposable income rose as compensation of employees increased. Total household debt picked up slightly in the second quarter of 2018, as mortgage advances, instalment sale credit, and the use of credit cards increased over the period. The ratio of household debt to disposable income edged higher from 70.9% in the first quarter of 2018 to 71.3% in the second quarter, as growth in household debt outpaced that in nominal disposable income. However, households' cost of servicing debt as a percentage of disposable income remained unchanged at 9.0% over the period.

Growth in real *final consumption expenditure by general government* moderated to 0.7% in the second quarter of 2018 from 1.4% in the first quarter, as spending on the real compensation of employees declined while growth in real outlays on non-wage goods and services accelerated somewhat. The compensation of employees normalised in the second quarter of 2018, following temporary appointments by the Electoral Commission of South Africa (IEC) in the previous quarter. The average level of real final consumption expenditure by general government in the first six months of 2018 was 1.1% higher than in the corresponding period of 2017.

The nominal consumption expenditure by general government relative to nominal GDP has trended higher over the past seven years and surpassed the long-term average (from the first quarter of 2010 up to the second quarter of 2018) of 20.5% from mid-2015, driven by the compensation of employees – the largest component of government spending.

Nominal final consumption expenditure by general government



Source: Stats SA

Real *gross fixed capital formation* decreased further by 0.5% in the second quarter of 2018, following a contraction of 3.4% in the first quarter. In particular, fixed capital outlays by public corporations and general government decreased in the second quarter, while that by private business enterprises switched from a decline in the first quarter of 2018 to an increase in the second quarter.

Real gross fixed capital formation

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

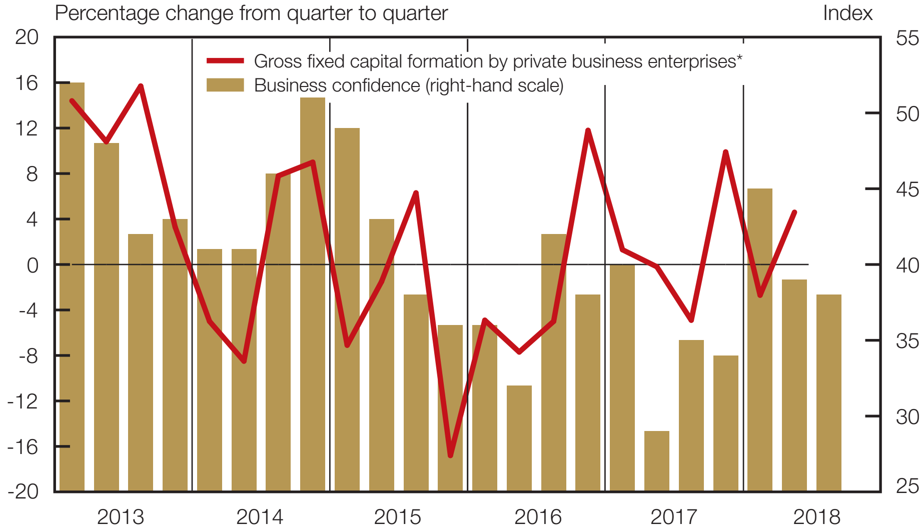
Sector	2017					2018	
	Q1	Q2	Q3	Q4	Year*	Q1	Q2
Private business enterprises	1.3	-0.2	-4.9	9.9	1.2	-3.9	3.1
Public corporations	-16.5	-0.7	-2.6	12.2	-1.3	-3.6	-10.1
General government	-1.9	0.4	6.0	-6.4	-0.7	-1.3	-2.1
Total	-3.1	-0.2	-2.7	7.4	0.4	-3.4	-0.5

* Percentage change over one year

Source: Stats SA

Despite persistent low business confidence and subdued economic activity, real gross fixed capital outlays by *private business enterprises* increased by 3.1% in the second quarter of 2018, following a decline of 3.9% in the first quarter. The rebound added 1.9 percentage points to overall growth in real gross fixed capital formation in the second quarter of 2018. A strong increase in capital expenditure on non-residential buildings more than offset a contraction in capital outlays on residential buildings, and machinery and other equipment.

Real gross fixed capital formation and business confidence



* Seasonally adjusted annualised rates

Sources: Stats SA and RMB/BER

Real capital expenditure by *public corporations* contracted considerably by 10.1% in the second quarter of 2018, following a decline of 3.6% in the first quarter. A slight improvement in real fixed capital outlays on construction works was outweighed by declines in capital expenditure on all other asset types, reflecting the financial, operational and governance challenges faced by state-owned companies.

Growth in real fixed capital spending by *general government* receded further by 2.1% in the second quarter of 2018 – the third consecutive quarterly decline. The contraction was primarily driven by the lack of new projects as well as delays in the completion of a number of large infrastructure projects due to budget constraints.

Following an annualised accumulation of R8.8 billion (at 2010 prices) in the first quarter of 2018, real *inventory holdings* decreased by R14.2 billion in the second quarter. Real inventory levels declined in the mining sector as mining exports increased notably, and were partly countered by a build-up of inventories in the trade sector. Industrial and commercial inventories as a percentage of non-agricultural nominal GDP edged lower from 11.3% in the first quarter of 2018 to 11.1% in the second quarter.

Gross saving

South Africa's *national saving rate* (gross saving as a percentage of GDP) improved from 14.1% in the first quarter of 2018 to 14.5% in the second quarter. The stronger saving performance reflected increased saving by general government, while household saving remained stable. By contrast, saving by corporate business enterprises decreased notably. As a result, the portion of total gross capital formation to be financed through foreign capital (i.e. the foreign financing ratio) decreased from 24.6% in the first quarter of 2018 to 18.6% in the second quarter.

Gross saving as a percentage of gross domestic product

Ratio in per cent at seasonally adjusted annualised rates

Sector	2017					2018	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
Corporate	15.5	13.6	14.5	14.6	14.6	12.6	11.2
General government	-0.3	0.7	-0.2	-0.2	0.0	-0.2	1.6
Household	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Total	**16.8**	**16.0**	**16.0**	**16.0**	**16.2**	**14.1**	**14.5**

Source: SARB

The saving rate of the *corporate sector* weakened from 12.6% in the first quarter of 2018 to 11.2% in the second quarter. This is the lowest saving rate since the first quarter of 2008. Higher dividend payments outweighed the increase in the gross operating surplus.

Gross saving by *general government* as a percentage of GDP improved notably from a dissaving of 0.2% in the first quarter of 2018 to a saving of 1.6% in the second quarter. The increase in government revenue more than offset that in government consumption expenditure. Growth in VAT collection accelerated, while that in personal income tax and corporate tax moderated somewhat in the second quarter.

As a percentage of GDP, gross saving by the *household sector* remained under pressure but stable at 1.6% in the second quarter of 2018, as the increase in nominal disposable income was fully offset by increased nominal household consumption expenditure in the second quarter.

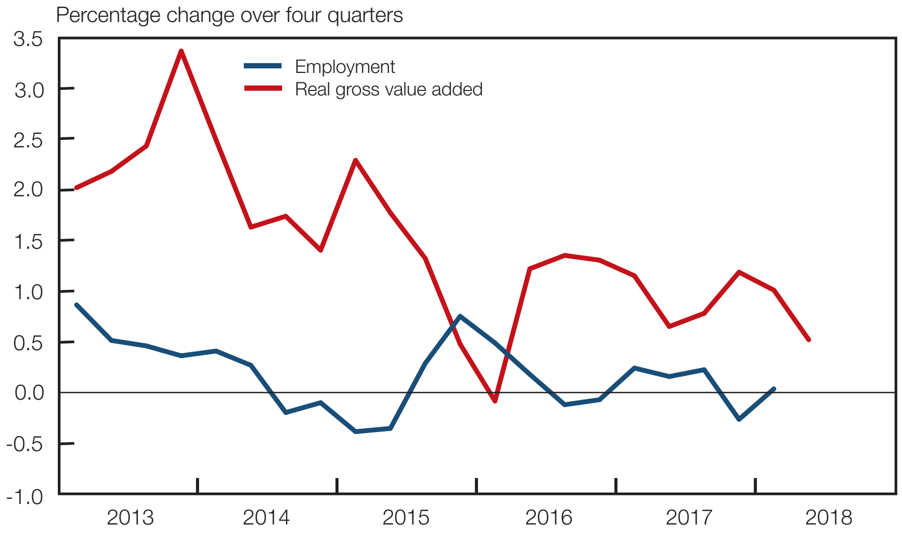
Employment[3]

Year-on-year percentage growth in formal non-agricultural employment fluctuated at around the zero level since 2014, in an environment of slow output growth and weak business confidence.

According to the *Quarterly Employment Statistics (QES*) survey by Statistics South Africa (Stats SA), enterprise-surveyed formal non-agricultural employment increased by 1.1% from the fourth quarter of 2017 to the first quarter of 2018, with approximately 108 700 jobs created, raising the level of employment to an estimated 9.8 million. Almost 66 700 of these jobs represented temporary employment by the IEC in preparation for the 2019 general elections. When excluding these election-related employment opportunities, formal non-agricultural employment still increased, but only by 0.4% in the first quarter of 2018.

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

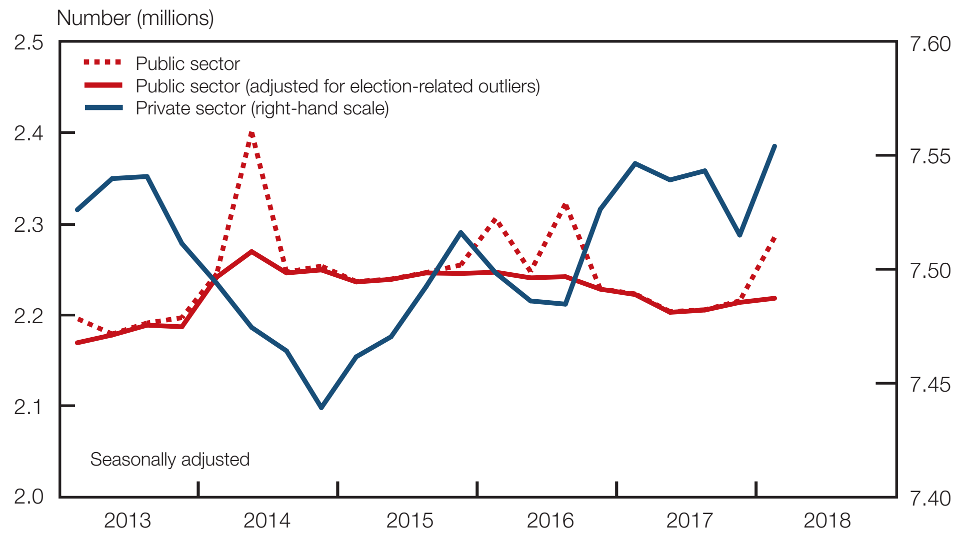
Formal non-agricultural employment and output



Sources: Stats SA and SARB

The increase in total formal non-agricultural employment in the first quarter of 2018 resulted largely from a marked acceleration in *public sector employment* at an annualised rate of 13.2%, driven primarily by temporary IEC employment. When excluding these temporary jobs, public sector employment increased at an annualised rate of only 0.8%. Increased employment at local government level, largely related to the appointment of new interns at a large metropolitan council as well as government's expanded public works programme, more than offset job losses in provincial governments and in the public transport, storage and communication sector.

Formal non-agricultural employment



Sources: Stats SA and SARB

The *private sector* created 39 000 jobs in the first quarter of 2018. Notable employment increases occurred in the trade, catering and accommodation services sector and in the finance, insurance, real estate and business services sector. Encouragingly, the goods-producing manufacturing and construction subsectors collectively also added around 21 800 jobs in the quarter. By contrast, the mining and the private transport, storage and communication services sectors shed jobs over this period.

The services sectors created about 273 600 employment opportunities between the second quarter of 2010 and the first quarter of 2014 – the most recent upward phase in the employment cycle – followed by an additional 170 900 services jobs created during the ensuing downward phase up to the first quarter of 2018. In stark contrast, the goods-producing sectors shed 16 900 jobs during the most recent upward phase in the employment cycle, before shedding a further 110 600 jobs during the current downward phase. The diverging employment trends between the services and the goods-producing sectors resulted in total private sector employment remaining broadly unchanged over the past four years.

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

Sector	Change over one quarter: Q1 2018		Change over four quarters to Q1 2018		Cumulative job losses(-)/ gains(+)**	
	Number	Per cent annualised	Number	Per cent	Q2 2010 to Q1 2014	Q2 2014 to Q1 2018
Total goods-producing	*13 400*	*2.4*	*-40 800*	*-1.8*	*-16 900*	*-110 600*
Total services	*25 700*	*2.0*	*48 500*	*0.9*	*273 600*	*170 900*
Private sector	**39 000**	**2.1**	**7 700**	**0.1**	**256 700**	**60 200**
National departments	100	0.1	-9 900	-2.1	44 000	16 700
Provinces	-2 600	-1.0	-5 600	-0.5	108 000	-58 800
Local governments	6 200	8.1	8 600	2.7	71 600	11 500
Public transport, storage and communication services	- 200	-0.6	-5 900	-5.3	26 700	-24 400
Other public sector enterprises, including electricity and IEC***	66 000	139.4	74 800	28.6	20 400	95 000
Public sector	**69 600**	**13.2**	**62 000**	**2.8**	**270 700**	**39 900**
Grand total	**108 700**	**4.5**	**69 600**	**0.7**	**527 400**	**100 100**

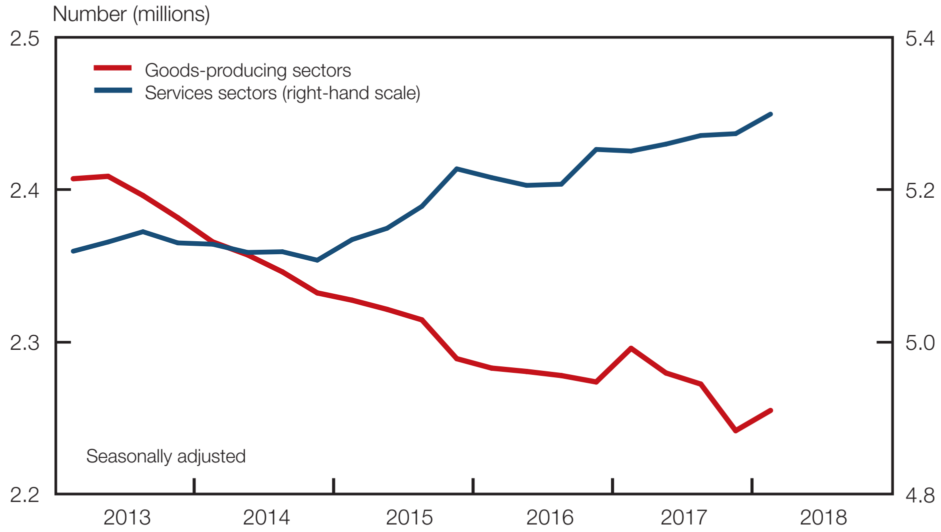
* Numbers may not add up to totals due to rounding off.
** These reflect the two most recent phases in the formal non-agricultural employment cycle.
*** Electoral Commission of South Africa

Sources: Stats SA and SARB

Mining sector employment decreased anew in the first quarter of 2018, more than reversing the marginal gains recorded in the previous quarter. The decrease resulted primarily from a significant decline in gold-mining employment at an annualised rate of 21.7%, and marked the sixth consecutive quarterly contraction in gold-mining employment. Employment in the gold-mining sector fell steadily from a peak of 562 900 in the fourth quarter of 1986 to a new record low of 99 600 in the first quarter of 2018. A combination of factors including, among other things, deepening shafts and declining ore grades, rising energy and labour costs, disruptive labour relations, infrastructure constraints, mechanisation and, in recent years, electricity-supply shortages, low business confidence and policy uncertainty hampered the sector's ability to create jobs. Non-gold mining employment also decreased in the quarter, mainly due to retrenchments in the platinum group metals industry where low international platinum prices resulted in the closure of some unprofitable shafts.

Manufacturing sector employment increased in the first quarter of 2018, following three successive quarterly declines. The increase occurred despite a notable contraction in the real GVA by the sector in the first quarter of 2018. Discouragingly, recent outcomes of sentiment indicators do not seem to support employment creation in the manufacturing sector. The seasonally adjusted *Absa Purchasing Managers' Index* (PMI) rose from 49.2 index points in the first quarter of 2018 to 49.5 index points in the second quarter, remaining below the neutral 50 index level for five successive quarters. The PMI employment index also remained below the neutral level for almost two years up to June 2018. Furthermore, the *Absa Manufacturing Survey* by Stellenbosch University's Bureau for Economic Research (BER) showed a decline in manufacturing business confidence from 37 index points to 27 index points in the second quarter of 2018, weighed down by a sharp and somewhat unexpected fall in demand and activity. Respondents indicated that domestic demand receded to multi-year lows and that export sales volumes fell unexpectedly into negative territory in the second quarter, lowering the prospects for further employment creation.

Private sector employment



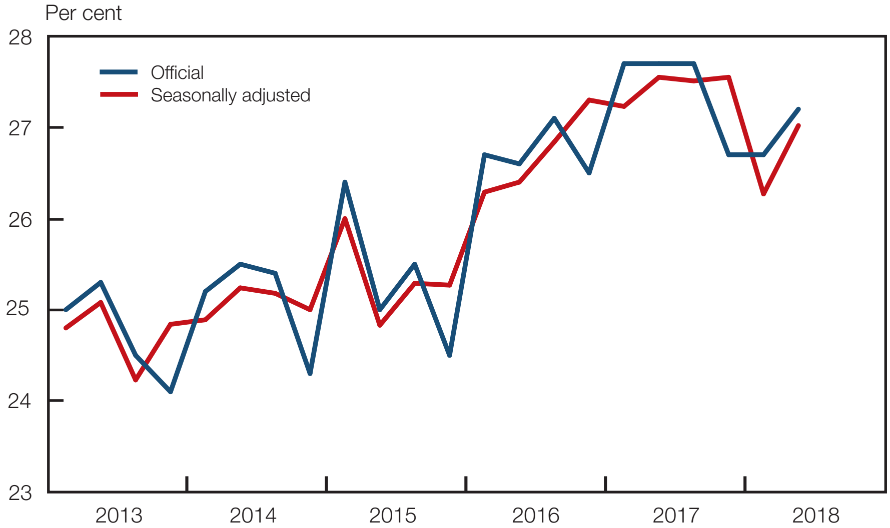
Sources: Stats SA and SARB

Construction sector employment increased by 9 600 jobs in the first quarter of 2018, following the loss of around 23 700 jobs in the previous quarter. However, when measured over four quarters, construction sector employment contracted for four successive quarters up to the first quarter of 2018, with the pace of decline accelerating in the most recent two quarters. This is consistent with the contraction in the real GVA by the sector for five successive quarters, as well as persistently weak building and civil construction confidence. The *First National Bank (FNB)/BER Building Confidence Index* fell from 43 index points in the first quarter of 2018 to 29 index points in the second quarter, led by a sharp drop in confidence among hardware retailers and manufacturers of building materials. This is the first time since the third quarter of 2012 that the index dropped below 30. Business confidence among residential contractors also declined due to a further slowdown in building activity, while non-residential building activity remained broadly unchanged at a low level. The *FNB/BER Civil Confidence Index* rose marginally to a still weak 15 index points in the second quarter of 2018 from an all-time low of 12 index points in the first quarter. The relative pessimism in the civil construction sector reflects the continued decline in construction activity following a decline in government contracts being approved, slow payment by government on already approved state contracts, and disruptive activities by so-called 'business forums', according to industry representatives.

Continued employment gains in the services sectors generated a cumulative 48 700 jobs in the year to the first quarter of 2018. The *trade, catering and accommodation services sector* created the bulk of these jobs, with employment increasing for three successive quarters up to the first quarter of 2018. However, results from the BER's *Retail Survey* showed that business confidence in the retail trade sector fell back in the second quarter of 2018, as sales volumes disappointed relative to earlier expectations. The number of people employed in the *finance, insurance, real estate and business services sector* increased by 15 700 in the first quarter of 2018, following three quarters of broadly unchanged employment levels.

According to the *Quarterly Labour Force Survey* (QLFS) by Stats SA, the total number of people employed in South Africa decreased by 90 000 from the first to the second quarter of 2018, lowering the level of total employment to approximately 16.29 million. However, total employment increased by 188 000 in the year to the second quarter of 2018, or by 1.2%. Employment gains occurred in the formal non-agricultural sector and in the informal sector, which added 127 000 and 68 000 jobs respectively over the period. The community services (132 000), construction (80 000) and transport (60 000) sectors recorded notable annual employment gains. Unspecified-duration contracts increased by 174 000 and limited duration contracts by 72 000, while permanent or medium-term contracts increased by a mere 1 000.

Unemployment rate



Sources: Stats SA and SARB

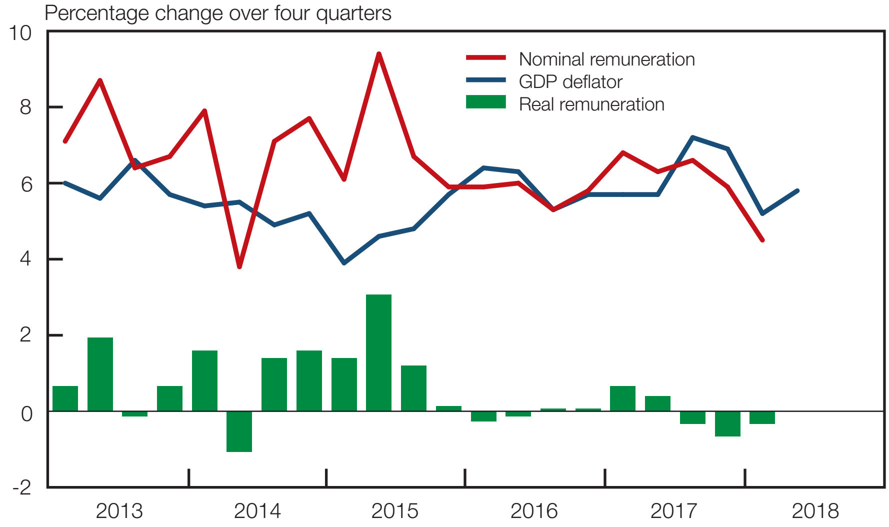
The number of unemployed persons increased by 103 000 from the first to the second quarter of 2018, lifting the total number of unemployed South Africans to 6.08 million; however, this number decreased by 94 000, or 1.5%, when measured over four quarters. The number of discouraged work seekers increased markedly by 503 000, or 21.3%, to around 2.89 million in the second quarter of 2018 – the highest number since the inception of the QLFS in 2008. Within this context, the official unemployment rate increased from 26.7% in the first quarter of 2018 to 27.2% in the second quarter, marginally lower than the 27.7% recorded a year earlier. However, the seasonally adjusted unemployment rate increased from 26.3% in the first quarter of 2018 to 27.0% in the second quarter. Given the sharp rise in the number of discouraged work seekers, the expanded unemployment rate increased to 37.2% in the second quarter of 2018. The youth unemployment rate (for people aged 15 to 24 years) increased to 53.7% in the second quarter of 2018 from 52.4% in the previous quarter, marginally down from 55.9% a year earlier.

Labour cost and productivity

Nominal remuneration per worker in the formal non-agricultural sector of the economy moderated further from a year-on-year pace of increase of 5.9% in the fourth quarter of 2017 to 4.5% in the first quarter of 2018. Growth in public sector remuneration slowed sharply, while that in private sector remuneration remained unchanged. The pace of decrease in real wages per worker slowed from 1.0% in the fourth quarter of 2017 to 0.6% in the first quarter of 2018, marking the third successive quarter of decrease, as prices in the economy (measured by the GDP deflator) increased at a faster pace than nominal wages.

Public sector remuneration growth per worker decelerated sharply, from 8.4% in the fourth quarter of 2017 to 3.0% in the first quarter of 2018, constrained by the sizeable number of temporary IEC employees who only received remuneration for a portion of the quarter. When excluding the temporary IEC employees, public sector remuneration growth per worker still decelerated, from 8.4% to 6.1% over the period. Nominal wage growth moderated at all tiers of the public sector, except at local government level.

Formal non-agricultural remuneration per worker and gross domestic product deflator



Sources: Stats SA and SARB

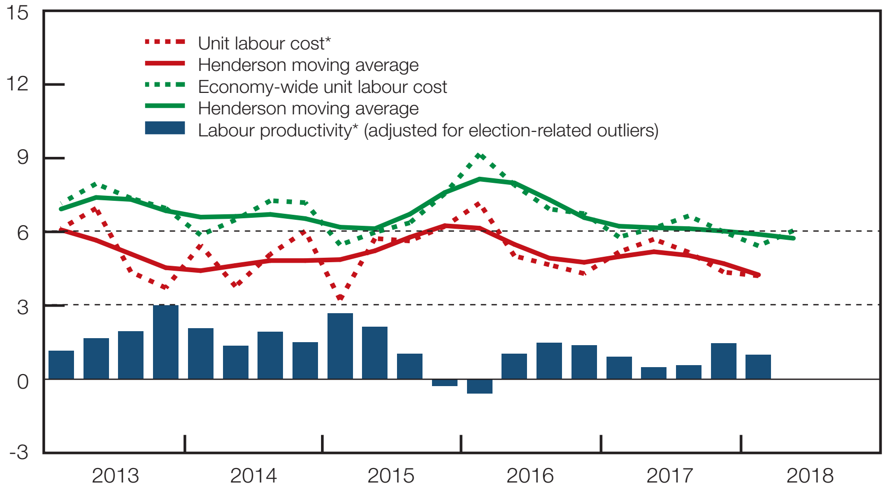
The pace of growth in *private sector remuneration per worker* remained unchanged at 4.9% in the first quarter of 2018. Wage growth per worker quickened in the following subsectors: non-gold mining (from 3.2% to 7.3%); trade, catering and accommodation services (from 3.2% to 4.7%); manufacturing (from 4.1% to 4.3%); construction (from 3.7% to 3.8%); and private transport, storage and communication services (from 2.9% to 4.3%). Conversely, wage growth per worker slowed in finance, insurance, real estate and business services (from 6.7% to 5.3%); community, social and personal services (from 5.7% to 4.4%); and gold mining (from 8.5% to 4.1%). When measured over four quarters, real private sector remuneration per worker contracted from the fourth quarter of 2015, with the pace of contraction moderating from 1.9% in the fourth quarter of 2017 to 0.2% in the first quarter of 2018.

According to Andrew Levy Employment Publications, the *average wage settlement rate* in collective bargaining agreements was 7.3% in the first half of 2018, compared with 7.8% in the same period a year earlier, and an average of 7.6% for 2017 as a whole. The number of working days lost due to strike action increased from 230 000 in the first half of 2017 to 550 000 in the corresponding period of 2018, largely due to the nationwide three-week wage strike in the transport sector which began in April 2018. In addition, multi-year wage agreements in the gold-mining sector and the South African Local Government Authority are due for renewal in the third quarter of 2018, and could impact the number of working days lost due to strike action in the remainder of the year.

Growth in *labour productivity* in the formal non-agricultural sector of the economy slowed from a year-on-year rate of 1.4% in the fourth quarter of 2017 to 0.3% in the first quarter of 2018, as year-on-year growth in employment accelerated while that in output slowed. However, labour productivity adjusted for election-related outliers slowed to a lesser extent, moderating from 1.5% to 1.0% over the same period.

Labour productivity and unit labour cost

Percentage change over four quarters



* Formal non-agricultural sector

Sources: Stats SA and SARB

Similarly, growth in *nominal unit labour cost* in the formal non-agricultural sector of the economy decelerated from 4.4% in the fourth quarter of 2017 to 4.2% in the first quarter of 2018, as year-on-year growth in total remuneration moderated at a faster pace than output growth. Growth in nominal unit labour cost remained within the inflation target range for eight successive quarters. Likewise, year-on-year growth in *economy-wide unit labour cost* accelerated from 5.4% in the first quarter of 2018 to 6.0% in the second quarter, as year-on-year growth in the compensation of employees increased at a faster pace than output growth.

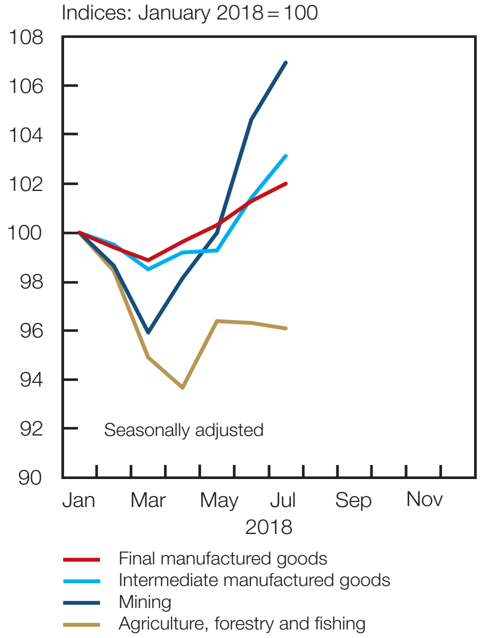
Prices[4]

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

Domestic inflationary pressures increased somewhat in recent months, primarily due to higher fuel prices and the increase in the VAT rate from 14% to 15% in April 2018. Most of the main seasonally adjusted producer price indices increased from April 2018 onwards. Likewise, the seasonally adjusted consumer price indices (CPI) for goods, services and core CPI increased in recent months. The seasonally adjusted consumer food price index also picked up from May 2018, albeit to a much lesser extent.

Producer prices

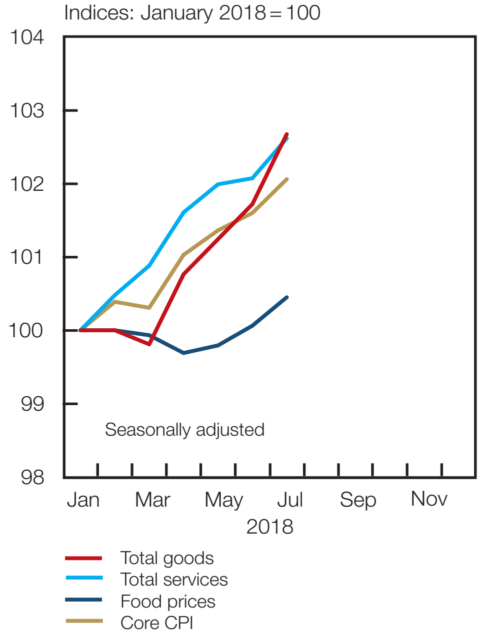
Indices: January 2018 = 100



Sources: Stats SA and SARB

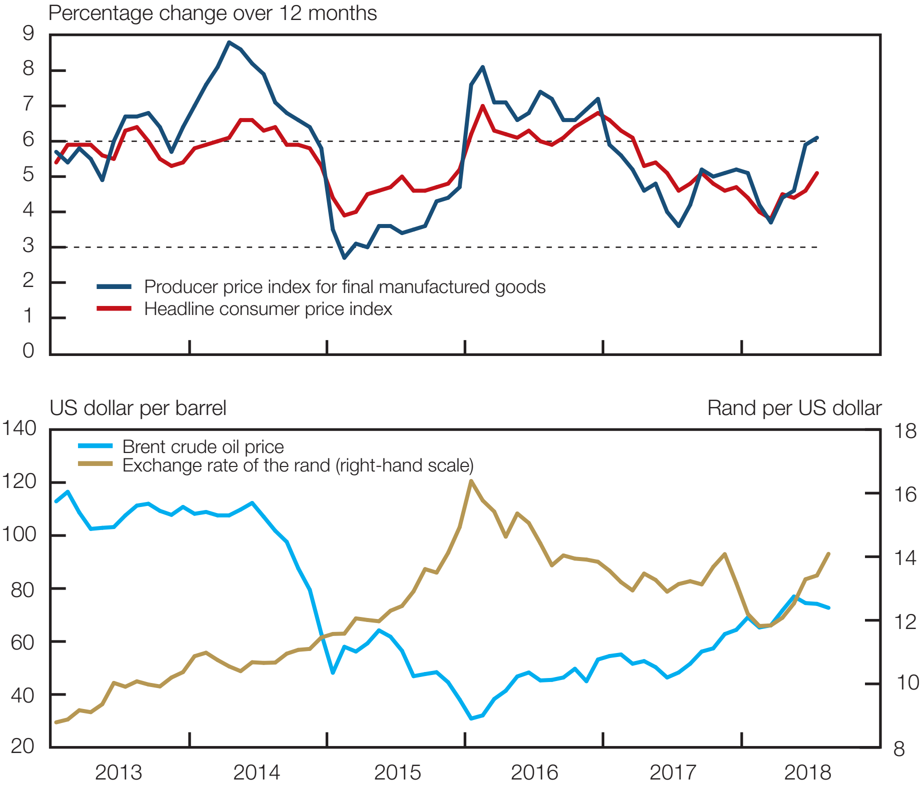
Consumer prices

Indices: January 2018 = 100



Headline consumer price inflation accelerated from a recent low of 3.8% in March 2018 to 5.1% in July and 4.9 in August, remaining within the inflation target range for the seventeenth consecutive month. The seasonally adjusted annualised three-month-to-three-month percentage change in the headline CPI accelerated from 3.2% in May 2018 to 5.4% in July.

Producer and consumer price inflation, oil prices and the exchange rate



Sources: Reuters, Stats SA and SARB

Producer price inflation for final manufactured goods accelerated from 3.7% in March 2018 to 6.1% in July, largely due to higher prices of coal, petroleum and electrical machinery products as well as transport equipment. Producer price inflation for intermediate manufactured goods slowed to -1.3% in March 2018 before accelerating for four consecutive months to 5.5% in July, following a marked quickening in chemicals as well as basic and fabricated metals price inflation. The inflation rates of most of the other final and intermediate manufactured goods price categories remained relatively subdued over this period.

The depreciation in the exchange value of the rand between April and July 2018 contributed to a broad-based acceleration in producer price inflation of mining products, from a low of -4.3% in February 2018 to 9.6% in July, with coal, gas and non-ferrous metal ore price inflation in particular picking up markedly over the period.

Producer price inflation for agriculture, forestry and fishing slowed to 0.4% in April 2018 as agricultural producer price inflation in particular moderated significantly. The year-on-year rate of increase in this producer price category then accelerated slightly to 2.3% in June, before moderating again to 0.8% in July. Producer price inflation for electricity and water remained fairly muted up to June 2018 before more than doubling to 7.8% in July, as both water and, in particular, electricity price inflation accelerated.

Seasonally adjusted consumer price indices

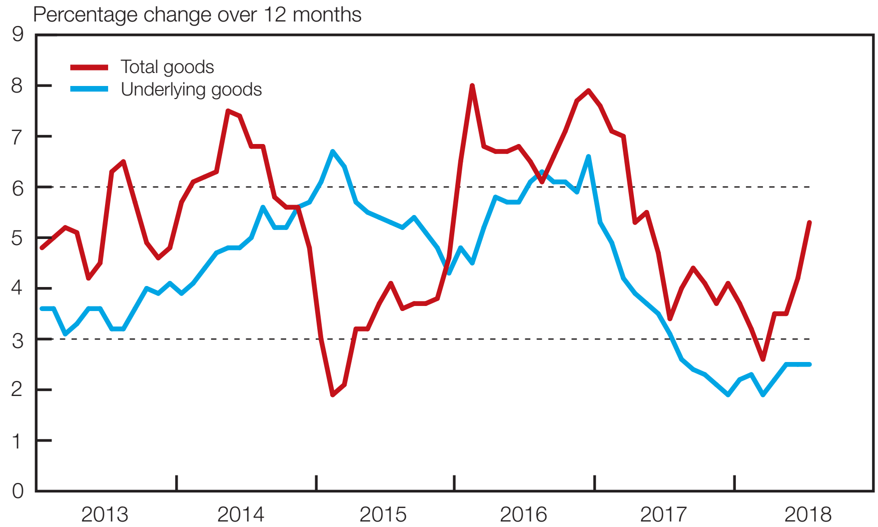
Annualised three-month-to-three-month percentage change

	2018					
	Feb	Mar	Apr	May	Jun	Jul
Headline	4.8	3.8	3.5	3.3	4.5	5.3
Goods	5.3	3.9	3.1	3.2	5.3	6.9
Services	4.4	4.5	5.3	5.8	5.8	5.0
Food	6.2	5.1	2.4	0.2	-0.5	0.9

Sources: Stats SA and SARB

Consumer goods price inflation accelerated from 2.6% in March 2018 to 5.3% in July, impacted by higher international crude oil prices, the depreciation in the exchange value of the rand, and the increase in the VAT rate in April. In particular, non-durable goods price inflation accelerated to 6.9% in July 2018 as fuel price inflation accelerated markedly to 25.3%, also affected by the higher domestic fuel levies in April. Durable and semi-durable goods price inflation, which are both sensitive to the exchange rate, also accelerated marginally over this period, both to 1.4% in July 2018. When the more volatile items, notably food and non-alcoholic beverages, fuel and electricity are omitted from the calculation of consumer goods price inflation, the resultant measure of underlying goods price inflation accelerated slightly from 1.9% in March 2018 to 2.5% in May, and remained at that rate up to July.

Consumer goods price inflation

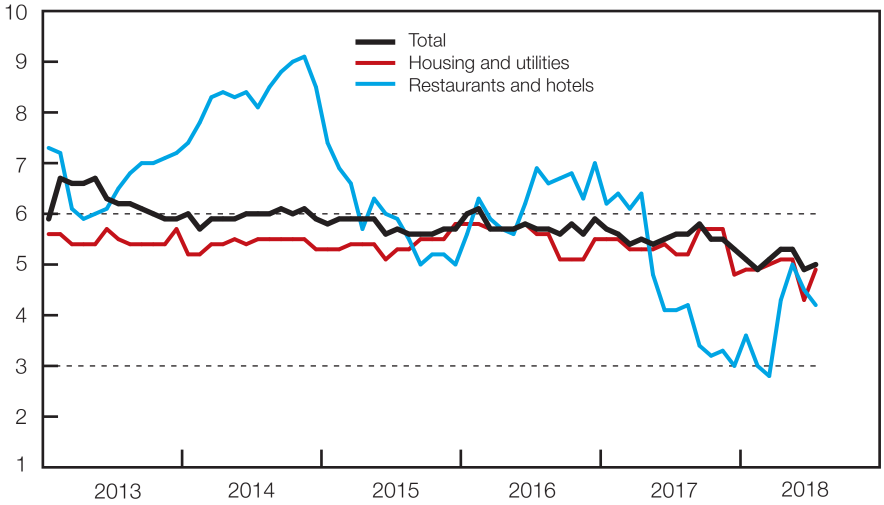


Source: Stats SA

Consumer services price inflation moderated to a seven-year low of 4.9% in February 2018 as price inflation slowed in the majority of services price categories. Services price inflation then accelerated to 5.3% in April and May 2018, driven by an acceleration in five of the nine services price categories, with a combined weight of 78% in the overall consumer services price basket. However, a notable deceleration in price inflation of housing rent, domestic workers' wages and hotel services led to a renewed slowdown in consumer services price inflation to 5.0% in July 2018. The sharp moderation in housing rent inflation is probably indicative of a very competitive rental market. The slowdown in hotel services price inflation was particularly pronounced in the Western Cape but also occurred to a lesser extent in most of the other provinces. The moderation in domestic workers' wage increases likely illustrates the financial constraints faced by households following the recent tax increases, higher fuel prices and slowing wage growth.

Consumer services price inflation

Percentage change over 12 months

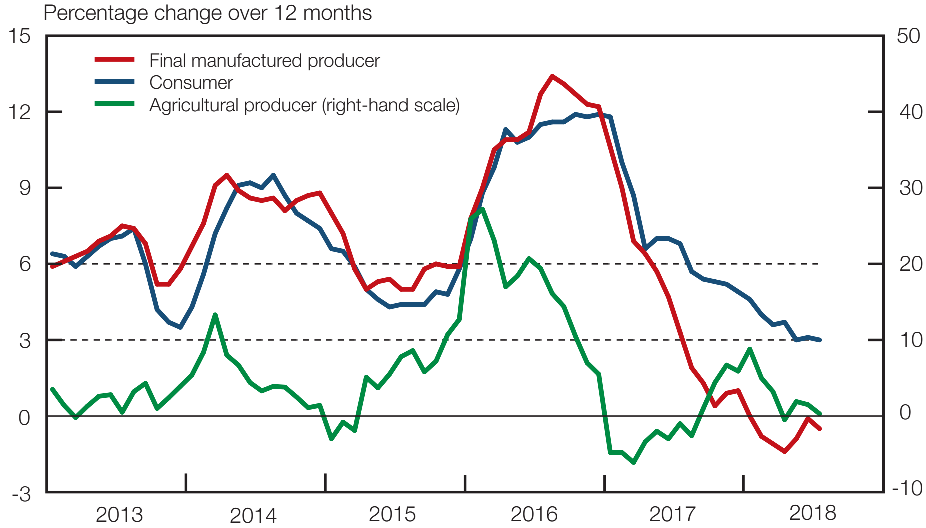


Source: Stats SA

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, before it receded sharply in the three months up to August. The notable decrease during this period reflected lower international prices of all the major food groups included in the index, in particular dairy products, sugar and cereals. As a result, international food prices were 5.4% lower in August 2018 than a year earlier. International US dollar-denominated cereal prices rose notably in the first five months of 2018, mainly due to higher wheat prices. International cereal prices subsequently fell markedly in June and July 2018, following sharp declines in maize and wheat quotations on account of heightened trade tensions between the US and its trading partners. Consequently, international cereal price inflation moderated sharply from 16.6% in May 2018 to -0.2% in July, before accelerating again to 10.1% in August. The rand-denominated FAO food price index decreased by 4.6% in the year to July 2018 and the year-on-year rate of increase in the rand-denominated international cereals price index also slowed, from 11.5% in June 2018 to 1.9% in July, but subsequently quickened to 17.3% in August following renewed depreciation in the exchange rate of the rand in that month.

Producer and consumer food price inflation

Percentage change over 12 months



Source: Stats SA

Domestic *food price inflation* appears to have reached a lower turning point in recent months. Agricultural producer food price inflation moderated from 8.8% in January 2018 to -0.5% in April, before accelerating slightly to 1.5% in June, and then slowing again to -0.3% in July. The acceleration up to June was largely driven by a quickening in price inflation of cereals and other crops, as domestic wheat and maize prices increased somewhat in the first half of 2018. Price increases in most of the other agricultural producer food price categories remained fairly subdued. Likewise, unprocessed consumer food price inflation, with a weight of 44% in the consumer food price basket, decelerated from 6.9% in November 2017 to 3.8% in May 2018, before accelerating marginally to 4.2% in July.

Producer and consumer food prices

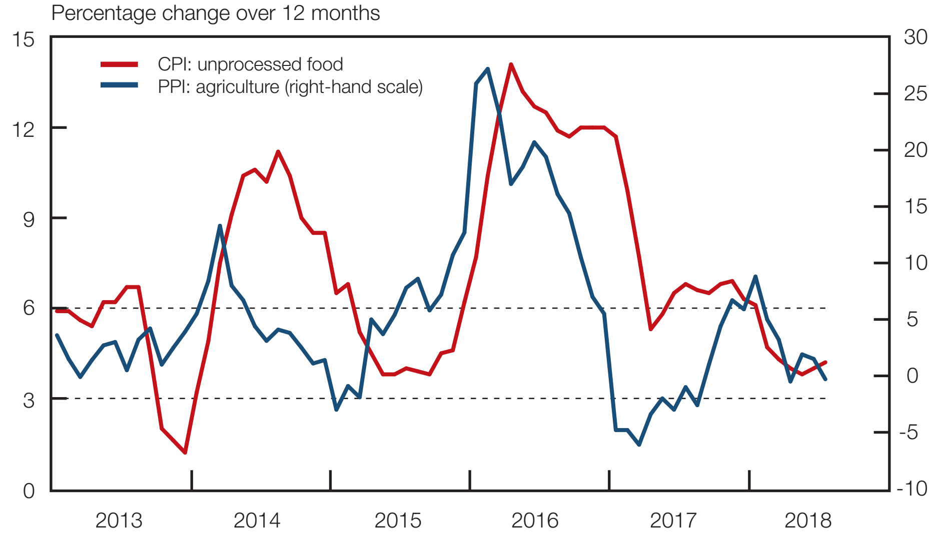
Percentage change over 12 months

	Weights		2018			
	In the agriculture, forestry and fishing PPI or the total CPI	In the respective food price basket	Apr	May	Jun	Jul
Agricultural producer food prices	85.62	100.0	-0.5	1.9	1.5	-0.3
Products of crop and horticulture	43.13	50.0	-1.3	0.8	3.7	1.3
Cereals and other crops	20.54	24.0	-6.5	-1.0	3.1	-1.7
Fruit and vegetables	22.59	26.0	1.1	0.6	2.0	1.4
Live animals and animal products	42.49	50.0	-0.4	2.8	0.3	-0.9
Live animals	31.57	37.0	-2.6	0.9	-2.3	-3.5
Milk and eggs	9.45	11.0	5.9	5.5	5.0	4.7
Other animal products	1.47	2.0	10.1	29.6	38.1	29.6
Unprocessed consumer food prices	6.81	44.0	4.0	3.8	4.0	4.2

Source: Stats SA

Food price inflation

Percentage change over 12 months



Source: Stats SA

Final manufactured producer food price inflation decelerated to -1.4% in April 2018, as price inflation slowed across a broad range of product categories, before accelerating slightly to -0.5% in July. Year-on-year price changes in 6 of the 10 main final manufactured producer food product categories remained in deflation in July 2018. Processed food price inflation at the consumer level, with a weight of 56% in the consumer food price basket, moderated further to 1.5% in July 2018.

Producer and consumer food prices

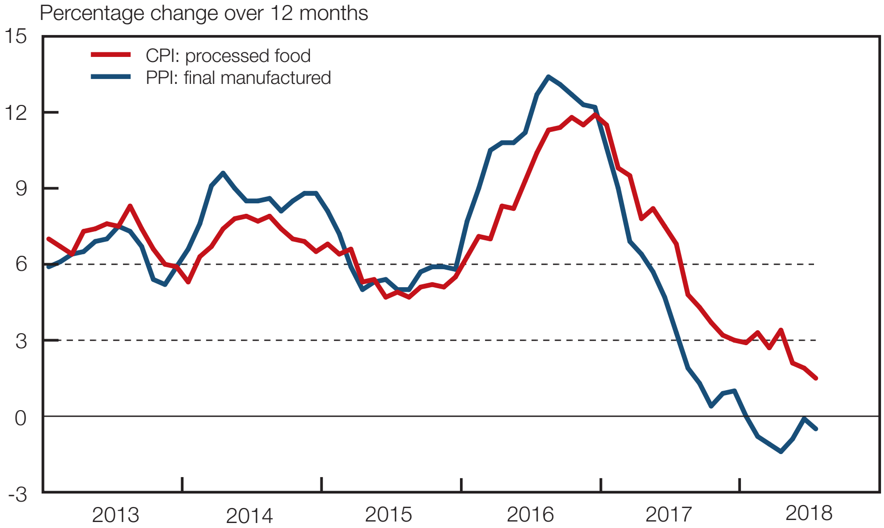
Percentage change over 12 months

	Weights		2018			
	In the agriculture, forestry and fishing PPI or the total CPI	In the respective food price basket	Apr	May	Jun	Jul
Manufactured producer food prices	**25.78**	**100.0**	**-1.4**	**-0.9**	**-0.1**	**-0.5**
Meat, fish, fruit, vegetables, oils and fats	10.06	39.0	1.3	0.8	1.3	-0.1
Meat and meat products	5.41	21.0	2.3	2.0	1.9	-0.1
Fish and fish products	1.94	8.0	2.7	2.1	2.0	2.3
Fruit and vegetables	1.86	7.0	-0.2	-0.8	0.7	-0.7
Oils and fats	0.84	3.0	-6.2	-7.3	-4.3	-5.5
Dairy products	2.27	9.0	1.3	3.6	2.8	1.6
Grain mill, starch and animal feed products	3.54	14.0	-9.2	-7.3	-5.3	-1.9
Grain mill products	2.06	8.0	-13.4	-12.9	-9.1	-6.0
Starch and animal feed products	1.48	6.0	-5.3	-1.6	-0.9	3.1
Other food products	9.92	38.0	-2.6	-1.6	-0.7	-1.1
Bakery products	7.02	27.0	0.2	0.8	0.4	0.4
Sugar	1.55	6.0	-15.1	-12.7	-5.1	-8.1
Other food products	1.35	5.0	-2.0	-1.8	-1.5	-1.3
Processed consumer food prices	**8.67**	**56.0**	**3.4**	**2.1**	**1.9**	**1.5**

Source: Stats SA

Food price inflation

Percentage change over 12 months

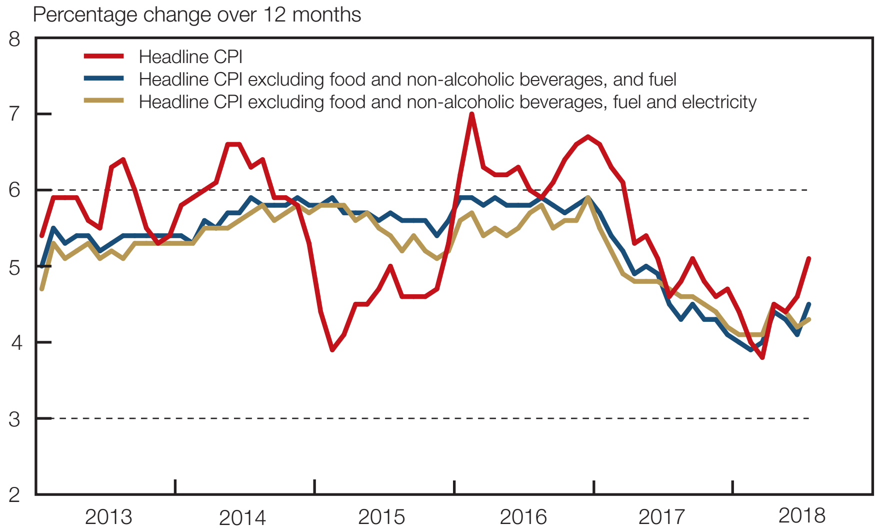


Source: Stats SA

Consumer food price inflation moderated notably throughout 2017 and in the first five months of 2018 before remaining unchanged, on balance, at 3.0% up to July 2018 – its lowest rate since December 2010. The decelerating trend in consumer food price inflation was broad-based among the various subcategories. The seasonally adjusted and annualised three-month-to-three-month percentage change in the consumer food price index slowed sharply to -0.5% in June 2018, reflecting the loss of momentum in food price inflation in the first half of the year, before accelerating slightly to 0.9% in July.

Underlying inflationary pressures remained fairly subdued thus far in 2018. 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 to 3.9% in February 2018, and then accelerated to 4.4% in April due to the impact of the higher VAT rate, and slightly further to 4.5% in July on account of higher electricity prices. The SARB's preferred measure of core inflation (also excluding electricity prices) slowed to 4.1% in the first three months of 2018 – its lowest rate in six years. Following the increase in the VAT rate, core inflation accelerated to 4.5% in April 2018. However, confirming the lack of underlying inflationary pressures and largely reflecting the moderation in services price inflation, core inflation subsequently decelerated again to 4.3% in July 2018.

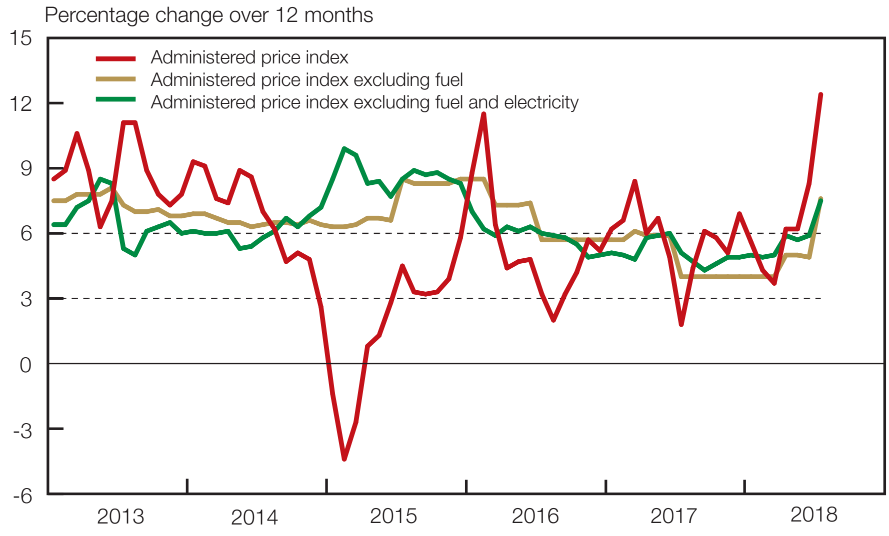
Headline and underlying measures of consumer price inflation



Source: Stats SA

Administered price inflation accelerated from a recent low of 3.7% in March 2018 to 12.4% in July, as fuel price inflation accelerated significantly from 2.9% to 25.3% over the same period. The marked increase in domestic fuel prices resulted from the depreciation in the exchange value of the rand between April and July 2018, higher international crude oil prices, and the increase in fuel levies in April. Excluding fuel prices, administered price inflation remained fairly muted before accelerating from 4.9% in June 2018 to 7.6% in July due to higher electricity prices and municipal assessment rates. When further excluding electricity prices, administered price inflation accelerated from 5.0% in March 2018 to 7.5% in July, in part due to the increase in the VAT rate in April and also due to the sharp increase in municipal assessment rates in July.

Administered price inflation



Source: Stats SA

Average headline inflation expectations, as reflected in the survey conducted by the BER in the second quarter of 2018, remained broadly unchanged from the first quarter. The average expectations for 2018 remained unchanged at 5.2%, while those for 2019 and 2020 edged up marginally by 0.1 percentage point each to 5.4% and 5.5% respectively. The marginal increase in average expectations for 2019 and 2020 is attributed to trade union representatives' upward adjustment of 0.3 percentage points and 0.4 percentage points respectively, which was only partially countered by financial analysts' downward adjustment of 0.1 percentage point and 0.2 percentage points respectively.

Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2018

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2018...	4.9	5.5	5.4	5.2
2019...	5.1	5.6	5.5	5.4
2020...	5.1	5.7	5.7	5.5
The next five years	5.1	5.7	5.3	5.4

Source: BER, Stellenbosch University

Average five-year inflation expectations ticked up marginally from 5.3% to 5.4%, remaining historically low. While financial analysts lowered their five-year expectations by 0.1 percentage point, business and trade union representatives raised their expectations by 0.2 and 0.1 percentage points respectively. After falling notably from 6.2% in the fourth quarter of 2017 to 5.2% in the first quarter of 2018, average household inflation expectations picked up to 5.6% in the second quarter of 2018.

External economic accounts

Current account[5]

South Africa's trade balance switched from a deficit of R15 billion in the first quarter of 2018 to a surplus of R42 billion in the second quarter, as the value of net gold and merchandise exports increased more than that of merchandise imports. The value of merchandise exports was boosted by increased volumes and, to a lesser extent, higher rand prices. The marginal increase in the value of merchandise imports resulted mainly from higher volumes.

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

Current account of the balance of payments

R billions, seasonally adjusted and annualised

	2017				2018	
	Q2	Q3	Q4	Year	Q1	Q2
Merchandise exports	1 089	1 102	1 168	1 108	1 051	1 123
Net gold exports	68	68	79	66	77	70
Merchandise imports*	-1 106	-1 077	-1 158	-1 102	-1 143	-1 151
Trade balance	**51**	**93**	**89**	**73**	**-15**	**42**
Net service, income and current transfer payments	-181	-191	-211	-183	-204	-206
Balance on current account	**-129**	**-98**	**-122**	**-110**	**-219**	**-164**
As a percentage of gross domestic product						
Trade balance	1.1	2.0	1.9	1.6	-0.3	0.8
Services balance	-0.2	-0.1	-0.1	-0.1	0.0	-0.1
Income balance	-2.8	-3.1	-3.4	-3.0	-3.3	-3.4
Current transfer balance	-0.9	-0.9	-0.8	-0.8	-1.0	-0.7
Balance on current account	**-2.8**	**-2.1**	**-2.6**	**-2.4**	**-4.6**	**-3.3**

* Imports of 'paper and paper products' was revised from the fourth quarter of 2017 onwards as the valuation of banknotes at face value was changed to reflect the transaction value of printed paper.

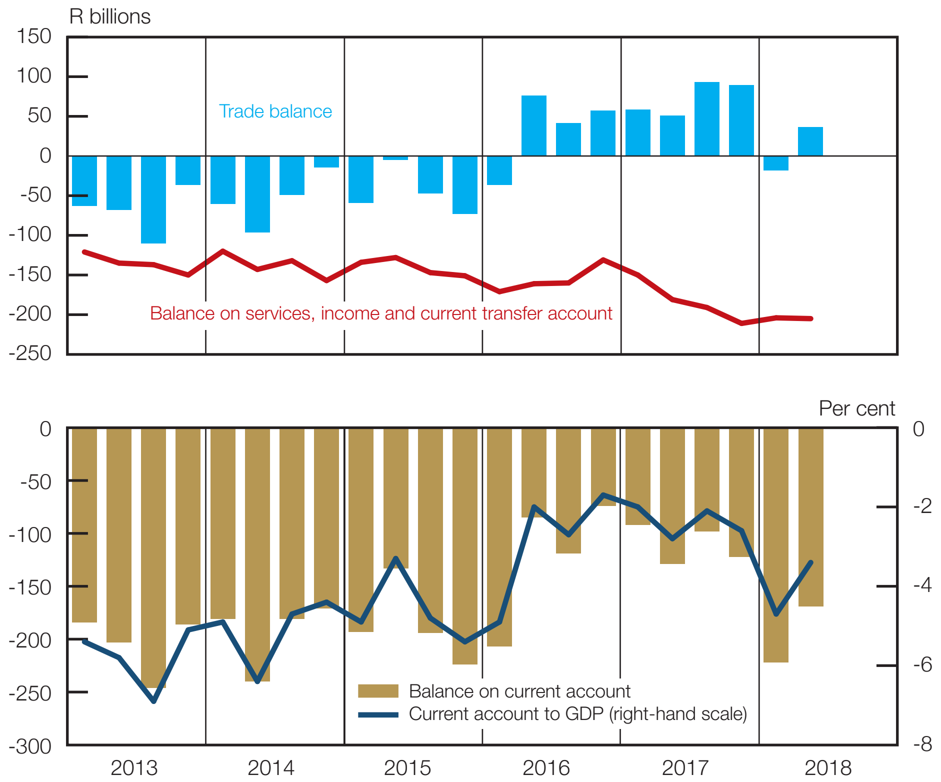
Components may not add up to totals due to rounding off.

Sources: Stats SA and SARB

The shortfall on the services, income and current transfer account widened in the second quarter of 2018, but by much less than the improvement in the trade balance. As a result, the deficit on the current account of the balance of payments narrowed from R219 billion in the first quarter of 2018 to R164 billion in the second quarter. As a ratio of gross domestic product (GDP), the current account deficit narrowed from 4.6% to 3.3% over the same period.

The value of merchandise exports increased by 6.8% in the second quarter of 2018 following a decline of 10.0% in the first quarter. The value of mining exports increased markedly as the exports of platinum group metals and mineral products recovered. Stronger external demand, the processing of pent-up inventories at several mines, and a notable increase in domestic production supported exports of platinum group metals.

Current account of the balance of payments

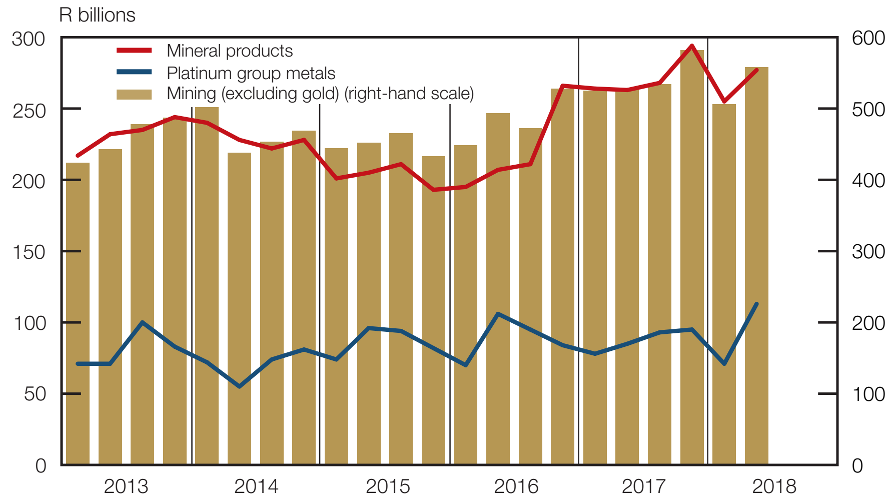


Seasonally adjusted and annualised

Sources: Stats SA and SARB

An increase in the export value of manganese ore and a rebound in that of iron ore following train derailments in the first quarter of 2018 supported the increase in the value of mineral exports. Increased demand by consumers in New Zealand, the United Kingdom and Russia for locally produced citrus contributed to a sharp rise in the value of fruit exports in the second quarter. This, together with a rise in maize exports, increased the export value of agricultural products in the second quarter. The value of manufactured exports also recovered over the period due to higher exports of chemical products, artificial resins and plastics as well as textiles and textile articles.

Mining exports

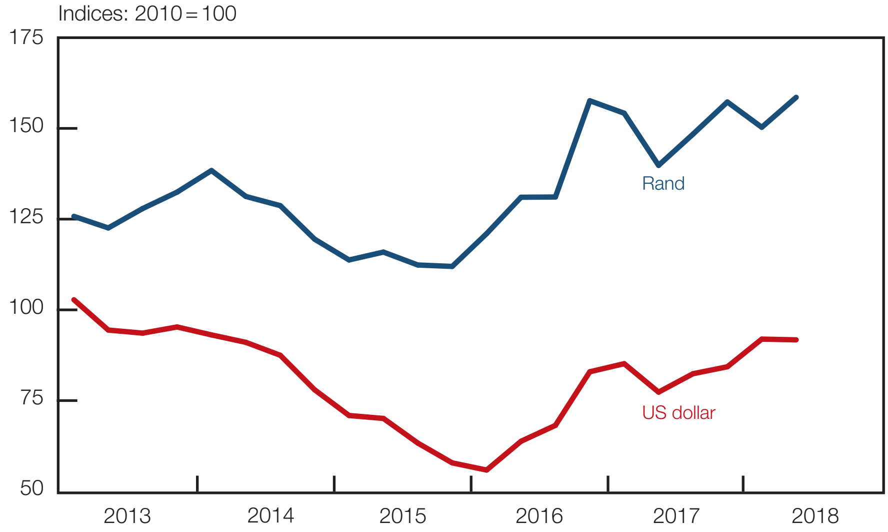


Seasonally adjusted and annualised

Sources: Stats SA and SARB

The US dollar price of a basket of domestically produced non-gold export commodities declined marginally in the second quarter of 2018. A decrease in the international prices of some commodities within the basket, such as iron ore, platinum and copper, marginally outweighed increases in the prices of others, such as coal and nickel. However, the rand price of the basket of non-gold export commodities increased over the period as the external value of the rand depreciated. Consequently, the rand price of merchandise exports increased by 2.0% in the second quarter of 2018, following a decline of 4.9% in the previous quarter.

South African export commodity prices*



* Excluding gold

Source: SARB

The US dollar price of gold per fine ounce on the London market decreased by 1.8%, from US$1 330 in the first quarter of 2018 to US$1 306 in the second quarter, as support from geopolitical tensions were outweighed by the strengthening of the US dollar. The average realised rand price of net gold exports declined only marginally as the depreciation in the external value of the rand moderated the effect of the decline in the US dollar price of gold. This, together with a contraction in the volume of net gold exports, resulted in a decline of 9.3% in the value of net gold exports in the second quarter of 2018.

Box 1 What drives South African exports?[1]

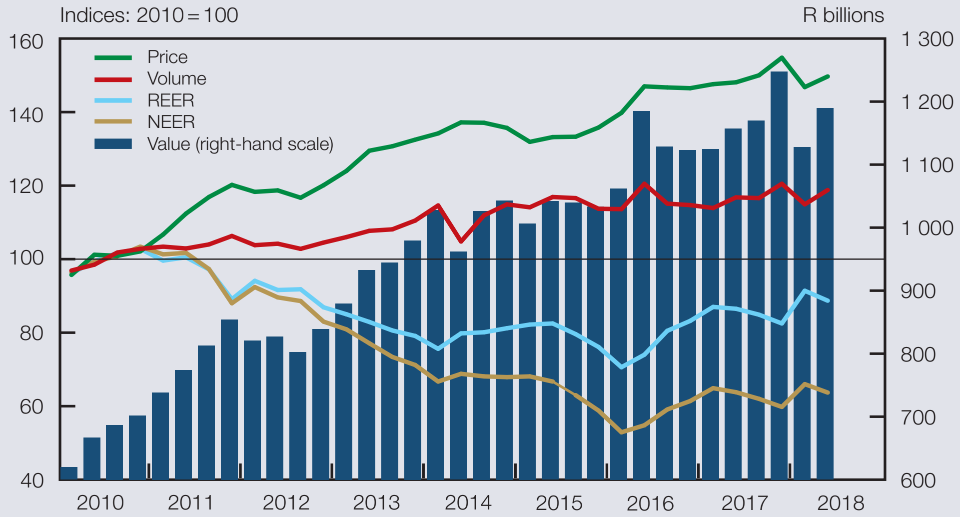
South Africa's *merchandise and net gold exports* are influenced by, among other factors, global demand, international commodity prices, and the exchange rate. Developments in both prices and volumes affect the value of net gold and goods exports, as reflected in the trade balance and the balance on the current account of the balance of payments. From the first quarter of 2010 to the second quarter of 2018, the value of such exports increased by 92%, but the volume, measured in constant 2010 prices, increased by only 23%.

Price increases accounted for the difference and, among other factors, reflect the impact of the exchange value of the rand and, in the case of mining products, of international commodity prices. The nominal effective exchange rate (NEER) of the rand decreased by 33.9% between the first quarter of 2010 and the second quarter of 2018, as the rand depreciated against the currencies of trading-partner countries on a trade-weighted basis, increasing the rand prices of exports.

1 Exports include merchandise and net gold, but exclude services. Unless stated to the contrary, all export data referred to in this analysis are seasonally adjusted and annualised. The primary source of trade in goods data is the South African Revenue Service (SARS), while the South African Reserve Bank (SARB) is responsible for net gold exports. The SARB adjusts the SARS trade data for balance of payments purposes and Statistics South Africa (Stats SA) publishes the data on trade in goods and services at nominal and constant 2010 prices. The analysis is based on these data sources, some of which are reflected in the statistical tables section of the *Quarterly Bulletin* on pages S–82 to S–85 and S–109.

The real effective exchange rate (REER) of the rand also decreased, but by only 7.7%, reflecting only a slight overall improvement in the competitiveness of domestic producers and manufacturers in international markets.

Merchandise and net gold exports*, and effective exchange rates of the rand**

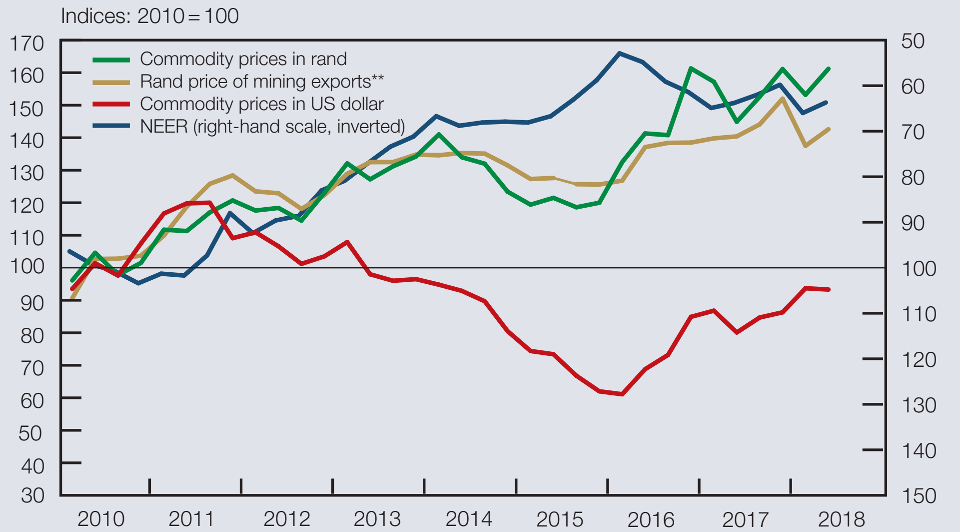


* Seasonally adjusted and annualised
** Quarterly averages
Sources: SARS, Stats SA and SARB

More recently, the seasonally adjusted and annualised value of net gold and merchandise exports increased by a marked 6.6% to R1 247 billion in the fourth quarter of 2017. The value then receded significantly by 9.6% in the first quarter of 2018 to R1 128 billion, before increasing by 5.7% to R1 192 billion in the second quarter. Both prices and volumes contributed to the recent volatility in exports.

The price of mining exports, in particular, is influenced by international commodity prices in US dollar terms which, together with the exchange value of the rand, determine the value of these exports in rand terms.

South African export commodity prices including gold* and the nominal effective exchange rate

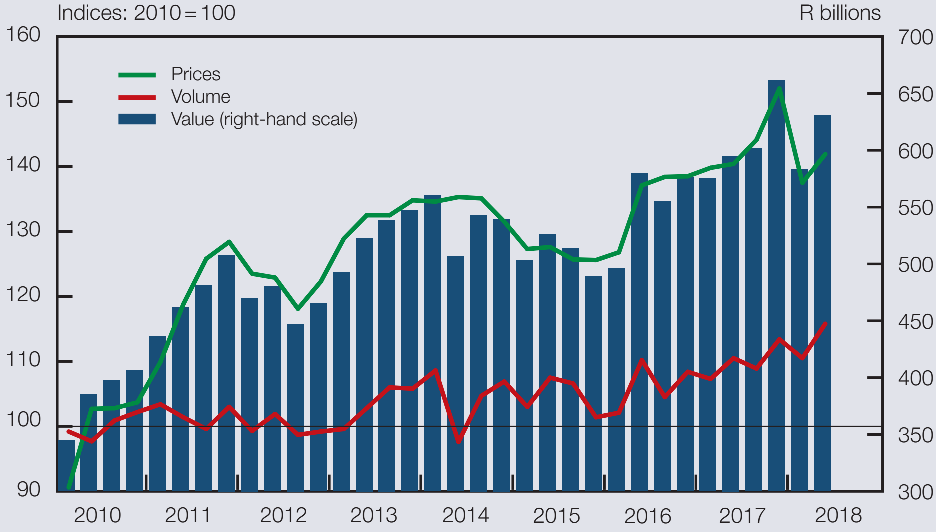


* Basket of 23 commodities
** Calculated as the nominal value of mining exports including gold divided by the value at constant 2010 prices
Sources: SARS, Stats SA and SARB

A decline in the US dollar price of a basket of South Africa's export commodities[2] from the first quarter of 2010 to the first quarter of 2016 was followed by an increase which left the price virtually unchanged, on balance, over the period as a whole. However, along with the decline in the NEER, the rand price of the basket of commodities and the implied price of mining exports including gold increased by 67.7% and 56.6% respectively.

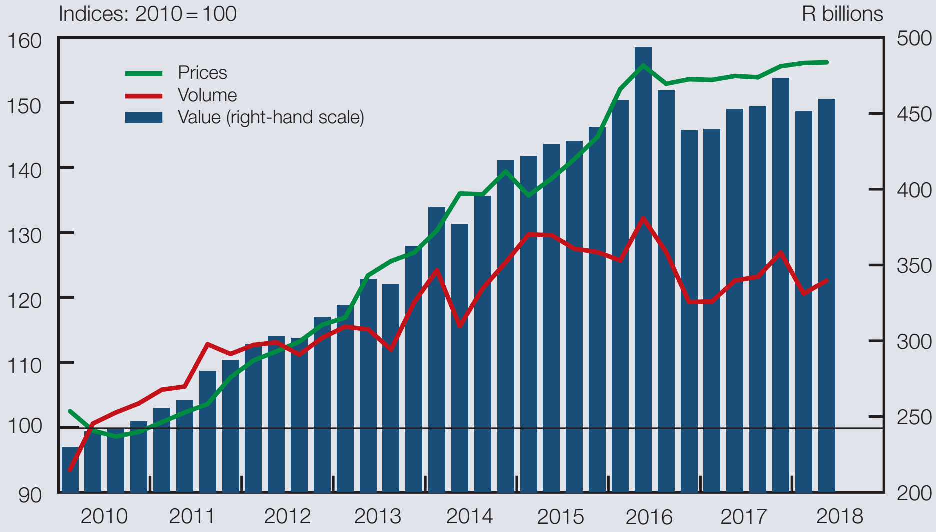
The response of the volume of mining exports to improved prices or profitability in the short to medium term is somewhat limited. Manufactured export volumes are, however, more responsive to a price effect, although this has not been the case in the South African economy in the past two to three years, for idiosyncratic reasons.

Mining and net gold exports*



* Seasonally adjusted and annualised
Sources: SARS, Stats SA and SARB

Manufactured exports*



* Seasonally adjusted and annualised
Sources: SARS, Stats SA and SARB

Focusing more on recent quarterly export volumes, a significant decline in total merchandise export volumes in the first quarter of 2018 detracted notably from growth in real gross domestic product in the quarter.

2 The basket consists of 23 commodities with the biggest six, namely thermal coal, platinum, gold, iron ore, petroleum products and ferrochrome making up 63.7% of the weight. The commodities are weighted according to their nominal export values on an annual basis.

Volume of merchandise and net gold exports

Quarter-to-quarter percentage change*

	Contribution** in per cent	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2
Total	100	-0.6	2.5	-0.2	3.4	-4.6	4.0
Mining	54	-1.0	3.0	-1.5	4.1	-2.6	4.8
Of which:							
Mineral products	23	-5.8	5.8	-3.5	1.4	-3.1	3.4
Precious metals including gold, platinum group metals and stones	17	6.0	-2.5	4.5	3.7	1.0	10.2
Base metals and articles	13	-0.9	5.3	-5.2	9.6	-6.3	-0.0
Manufacturing	38	0.1	2.6	0.5	3.0	-4.9	1.7
Of which:							
Vehicles and transport equipment	12	-0.8	8.2	-3.1	-2.8	-3.4	0.8
Machinery and electrical equipment	8	1.9	-2.7	0.8	6.1	-4.0	0.0
Chemical products	6	-1.8	3.5	3.4	6.7	-6.5	2.1
Prepared foodstuffs, beverages and tobacco	4	5.0	5.4	4.4	3.5	2.9	-0.6
Agriculture	6	-3.9	0.9	8.9	-3.5	-9.5	13.6
Of which:							
Vegetable products	5	-2.0	2.8	18.4	-6.5	-13.3	18.4

* Based on seasonally adjusted and annualised data
** Average contribution to total merchandise and net gold exports in 2017

Source: SARS, Stats SA and SARB

The increase in the rand price of commodity exports supported the higher value of mining exports in the fourth quarter of 2017. In the first quarter of 2018, the rand price of exported mining commodities was adversely affected by the strengthening in the external value of the rand that more than neutralised the further rise in US dollar commodity prices. In the second quarter of 2018, the rand price of mining commodity exports clawed back some of its losses as the external value of the rand depreciated. At times, changes in volumes contribute materially to variations in the value of such exports.

In the fourth quarter of 2017, the increase in the volume of merchandise and net gold exports came from both mining and manufactured products. However, in the first quarter of 2018 the volume of both mining and manufactured exports declined. This was more significant in manufacturing, as the export volumes in the majority of the manufacturing subcategories declined. In the second quarter, the volumes of both mining and manufactured exports increased once again, with the former increasing much more than the latter.

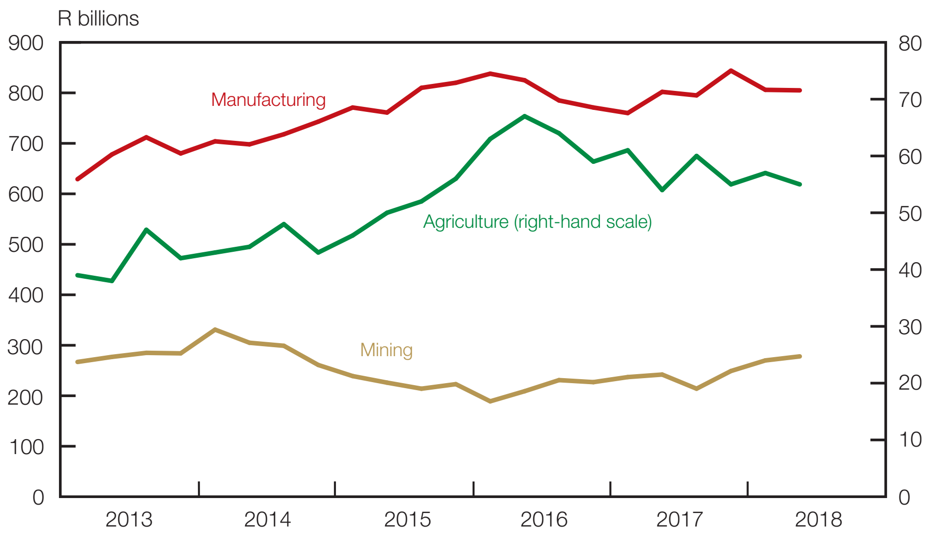
Mining export volumes were supported by all three subcategories in the fourth quarter of 2017. Base metals registered the largest quarter-to-quarter increase on account of exports of iron ore and steel to Indonesia, the Netherlands and Thailand. Coal exports, which form part of mineral products, also increased notably. This changed in the first quarter of 2018 when the volume of mining exports declined noticeably following sharp declines in both iron ore and coal exports, with iron ore exports partially affected by derailments on the line to the Saldanha Bay harbour. The increase in the volume of exported mining commodities in the second quarter of 2018 resulted in its highest level recorded since the first quarter of 2010, as exports of platinum group metals and mineral products recovered notably.

The export volumes of manufactured goods contributed significantly to the increase in total export volumes in the fourth quarter of 2017, as higher exports of machinery and electrical equipment to Europe, together with increases in other manufacturing subcategories, more than countered the decline in vehicle and transport equipment exports. In the first quarter of 2018, a third consecutive quarter-to-quarter decline in the exports of vehicles and transport equipment, together with lower exports in most of the other subcategories of manufactured goods, contributed significantly to the decline in the total volume of merchandise and net gold exports. However, increases in the export volumes of vehicles and transport equipment as well as chemical products contributed primarily to the rise in the volume of manufactured exports in the second quarter of 2018.

The value of merchandise imports increased slightly in the second quarter of 2018, following a contraction of 1.3% in the first quarter. The increase in mining imports outweighed a decrease in agricultural imports, while manufacturing imports remained broadly unchanged. The higher value of mining imports was due to an increase in mineral imports as well as pearls and semi-precious stones, with the latter supported by non-industrial diamonds and the former by an increase in crude oil imports. Contractions in the import values of live animals and animal products as well as animal or vegetable fats and oils contributed to the decline in the value of agricultural imports.

The value of imported vehicles and transport equipment as well as processed food, beverages and tobacco increased in the second quarter of 2018. These increases were almost fully offset by declines in the import values of machinery and electrical equipment, resins, plastics and articles thereof as well as chemical products, leaving the total value of imported manufactured goods almost unchanged.

Merchandise imports



Seasonally adjusted and annualised

Sources: Stats SA and SARB

The rand price of merchandise imports moved broadly sideways in the second quarter of 2018, despite an average quarterly depreciation in the external value of the rand. The impact of the depreciation is not fully reflected as the rand only started to weaken more during the final month of the quarter. At the same time, the volume of merchandise imports rose by 0.6%, following a decrease of 1.6% in the first quarter, as the volumes of both imported mining and manufactured products increased. As a result, South Africa's import penetration ratio (real merchandise imports as a ratio of real gross domestic expenditure increased slightly from 26.0% in the first quarter of 2018 to 26.4% in the second quarter.

South Africa's terms of trade improved in the second quarter of 2018 as the rand price of exported goods and services increased at a faster pace than that of imports.

* Including gold
Sources: Stats SA and SARB

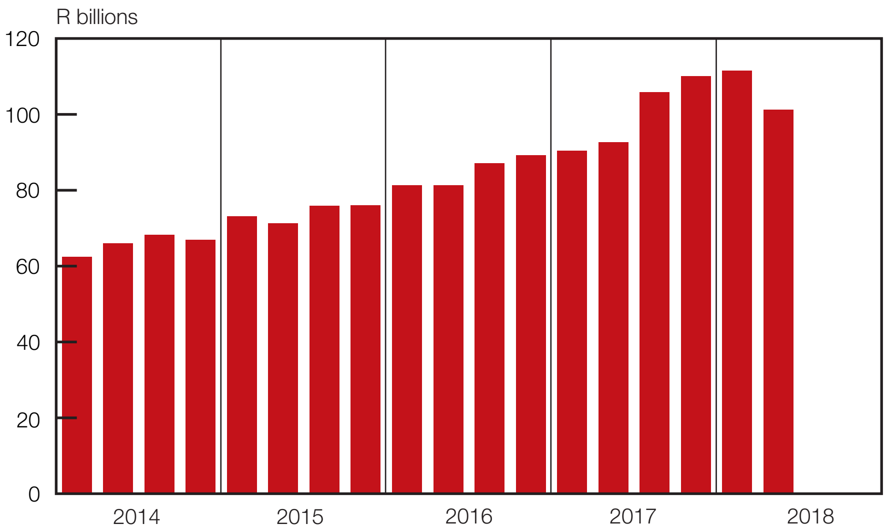
The shortfall on the services, income and current transfer account widened slightly from R204 billion in the first quarter of 2018 to R206 billion in the second quarter, with the deficit to GDP improving marginally from 4.3% to 4.2%. Both the services and income balances deteriorated, while lower net current transfer payments moderated the widening in the overall deficit.

Net payments for services increased somewhat in the second quarter of 2018, as gross payments increased slightly and gross receipts remained broadly unchanged, largely due to a further decrease in gross travel receipts. This occurred despite the weakening in the external value of the rand in the second quarter, which usually supports tourist spending. The decline in gross travel receipts could be temporary, given that some of South Africa's inbound tourists from traditional markets were probably lured to the 2018 FIFA World Cup™ in Russia that started at the end of the second quarter.

Dividend payments to non-resident investors declined in the second quarter of 2018 after three successive quarterly increases. However, net dividend payments increased as dividend receipts from abroad declined by more than dividend payments. The decrease in net interest payments in the second quarter of 2018 contained the widening of the income deficit, as *gross interest payments* declined for the first time in seven quarters. Gross interest payments decreased from an elevated level and were also suppressed by net sales of government bonds by non-residents in the second quarter of 2018.

Net current transfer payments decreased in the second quarter of 2018, as gross current transfer payments declined due to a decrease in payments to South Africa's partner countries in the Southern African Customs Union (SACU) at the commencement of the 2018/19 fiscal year.

Gross interest payments



Seasonally adjusted and annualised

Source: SARB

Financial account

South Africa's financial account of the balance of payments (excluding unrecorded transactions) recorded a smaller net capital inflow of R45.3 billion in the second quarter of 2018, following an inflow of R53.2 billion in the first quarter. On a net basis, direct, portfolio and other investment as well as financial derivatives all recorded inflows. As a ratio of GDP, net financial account inflows receded from 4.5% in the first quarter of 2018 to 3.7% in the second quarter.

Net financial transactions

R billions

	2017				2018	
	Q2	Q3	Q4	Year	Q1	Q2
Change in liabilities						
Direct investment	5.9	16.2	-13.5	17.7	10.5	31.6
Portfolio investment	74.7	83.9	94.3	278.8	89.4	16.6
Financial derivatives	-59.6	-37.8	-39.1	-227.4	-59.5	-45.5
Other investment	-28.4	49.8	-5.6	60.6	2.4	13.1
Change in assets						
Direct investment	-31.7	-58.4	3.2	-98.1	-20.5	-3.3
Portfolio investment	-8.0	-16.8	-14.5	-58.5	-15.6	-8.9
Financial derivatives	58.4	33.3	40.9	223.2	53.0	50.4
Other investment	-0.4	-33.3	-0.5	-69.6	-21.1	14.7
Reserve assets	-1.1	-23.7	-14.9	-25.5	14.6	-23.5
Total identified financial transactions*	9.7	13.1	50.3	101.1	53.2	45.3
As a percentage of gross domestic product	*0.8*	*1.1*	*4.2*	*2.2*	*4.5*	*3.7*

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

Source: SARB

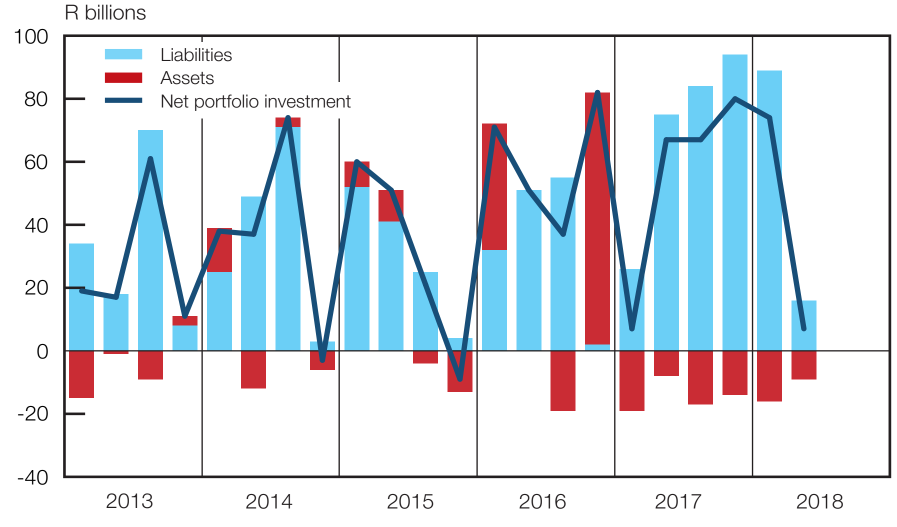
Foreign-owned assets in South Africa

South Africa's direct investment liability inflows increased from R10.5 billion in the first quarter of 2018 to R31.6 billion in the second quarter. The larger inflow resulted from loans extended by foreign parent companies to domestic subsidiaries and, to a lesser extent, an increase in equity holdings, mainly due to a foreign company acquiring a significant stake in a domestic construction company.

Inward portfolio investment into South Africa shrank significantly, from R89.4 billion in the first quarter of 2018 to R16.6 billion in the second quarter, as non-residents' acquisition of both domestic debt and equity securities declined. Non-residents' net purchases of domestic equities decreased from R42.5 billion in the first quarter of 2018 to R12.8 billion in the second quarter and debt securities decreased even more, from R46.9 billion to only R3.8 billion.

Other investment liabilities recorded an inflow of R13.1 billion in the second quarter of 2018, following an inflow of R2.4 billion in the previous quarter. The larger inflow resulted from an increase in foreign currency-denominated deposits at domestic banks, which was partly countered by the repayment of short-term foreign loans by the domestic private non-banking sector.

Portfolio investment flows



Source: SARB

South African-owned assets abroad

South African companies continued to acquire offshore direct investment assets in the second quarter of 2018, albeit at a slower pace than in the first quarter. Outflows to acquire direct investment assets for South Africa abroad slowed sharply from R20.5 billion in the first quarter of 2018 to R3.3 billion in the second quarter, as private non-banking sector companies reduced the acquisition of equity holdings in foreign subsidiaries.

South African residents acquired foreign portfolio assets of R8.9 billion in the second quarter of 2018, down from R15.6 billion in the first quarter, as the domestic private non-banking sector acquired less foreign equity securities.

Other investment assets reverted from an outflow of R21.1 billion in the first quarter of 2018 to an inflow of R14.7 billion in the second quarter, as the repayment of short-term loans by non-residents was partly countered by the domestic banking sector extending long-term loans to non-residents.

Foreign debt

South Africa's total external debt increased notably from US$173.3 billion at the end of December 2017 to US$183.2 billion at the end of March 2018 due to an increase in rand-denominated external debt. South Africa's gross external debt, expressed in rand terms, increased from R2 130 billion to R2 165 billion over the same period.

Foreign debt of South Africa

US$ billions at end of period

	2016	2017				2018
	Q4	Q1	Q2	Q3	Q4	Q1
Foreign currency-denominated debt	**70.7**	**74.3**	**73.0**	**76.5**	**75.9**	**75.9**
Debt securities	24.1	24.1	24.3	26.7	26.7	26.7
Other	46.6	50.2	48.7	49.9	49.2	49.2
Public sector	8.1	9.1	9.2	9.6	9.9	10.4
Monetary sector	19.2	19.2	16.6	17.9	17.1	15.4
Non-monetary private sector	19.3	21.9	22.9	22.3	22.2	23.4
Rand-denominated debt	**72.1**	**77.8**	**85.5**	**86.8**	**97.4**	**107.3**
Debt securities	41.4	45.0	50.3	50.3	57.6	65.2
Other	30.7	32.8	35.2	36.5	39.7	42.1
Total foreign debt	**142.8**	**152.1**	**158.5**	**163.3**	**173.3**	**183.2**
As a percentage of gross domestic product	*48.3*	*48.4*	*48.1*	*47.8*	*49.6*	*50.4*
As a percentage of total export earnings	*147.6*	*148.4*	*151.3*	*151.6*	*157.3*	*161.8*

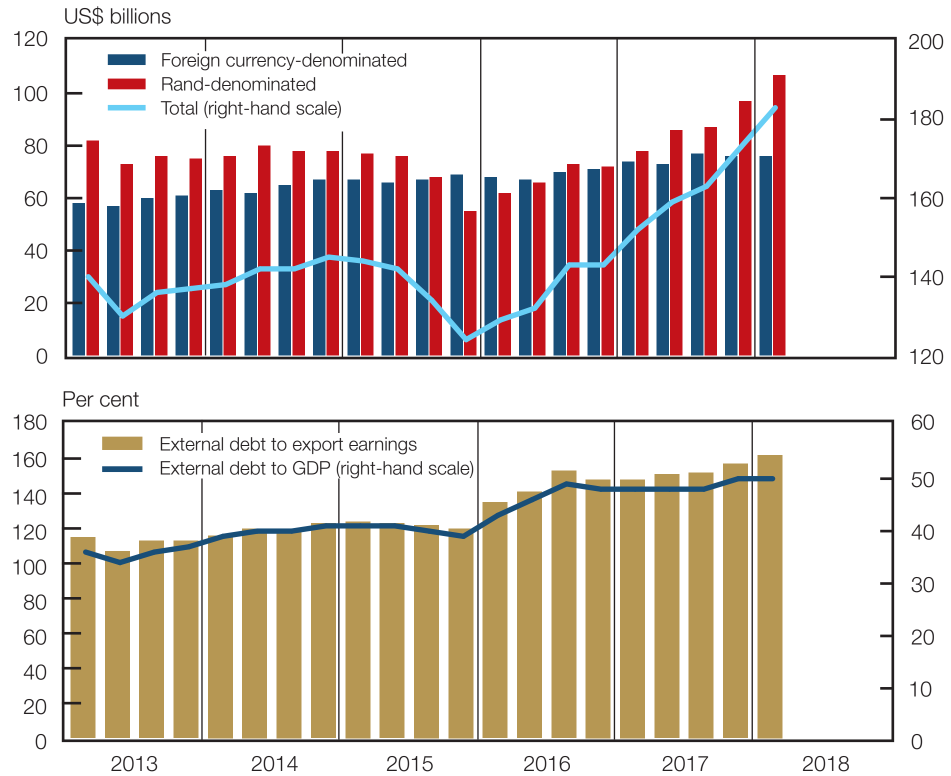
Source: SARB

Foreign currency-denominated external debt remained unchanged at US$75.9 billion from 31 December 2017 to 31 March 2018. The repayment of loans by the domestic banking sector was neutralised by loans extended to public corporations and an increase in trade finance to the private non-banking sector.

Rand-denominated external debt, expressed in US dollar terms, increased significantly from US$97.4 billion at the end of December 2017 to US$107.3 billion at the end of March 2018. The increase in rand-denominated external debt resulted from net purchases of domestic government bonds by non-residents and an increase in non-resident deposits with the domestic banking sector.

South Africa's total external debt as a ratio of annual GDP increased from 49.6% at the end of December 2017 to 50.4% at the end of March 2018, while the ratio of external debt to export earnings increased from 157.3% to 161.8% over the same period.

External debt



Source: SARB

International investment position

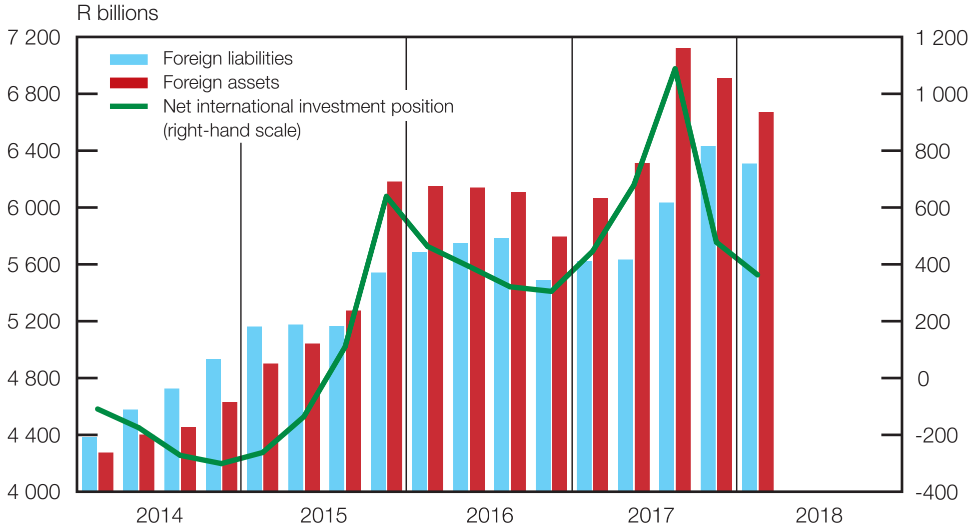
South Africa's positive net international investment position (IIP) decreased further, from R476 billion at the end of December 2017 to R362 billion at the end of March 2018, as the value of foreign assets declined more than that of foreign liabilities. The weighted average exchange rate of the rand had a limited impact on both foreign assets and liabilities as it appreciated by only 1.8% in the first quarter of 2018.

The market value of South Africa's foreign assets (outward investment) decreased by 3.5%, from R6 913 billion at the end of December to R6 673 billion at the of March 2018, following a decrease of 2.9% in the previous quarter. The market value of all the functional categories decreased in the first quarter of 2018. Direct investment decreased mainly as a result of holding losses on a large foreign investment of a South African company. The decline in direct investment was cushioned somewhat by a domestic financial services company acquiring a significant stake in a company abroad and private sector companies increasing equity holdings in foreign subsidiaries. Foreign portfolio assets decreased as the US Standard & Poor's (S&P) 500 Index declined, on balance, by 1.2% in the first quarter of 2018. The market value of 'other' foreign assets decreased marginally due to the moderate appreciation in the exchange value of the rand in the first quarter.

The market value of South Africa's foreign liabilities (inward investment) decreased by 1.9%, from R6 436 billion at the end of December 2017 to R6 312 billion at the end of March 2018, following an increase of 6.7% in the previous quarter. The decrease in foreign liabilities reflected decreases in all the functional categories, with the exception of direct investment liabilities.

The reduction in portfolio investment liabilities resulted from a decline of 6.8% in the FTSE/JSE All-Share Price Index (Alsi) over the period, which was moderated by the acquisition of domestic debt securities by foreign investors. The decrease in 'other' investment liabilities resulted mainly from repayments of foreign currency-denominated loans by the domestic banking sector.

South Africa's international investment position



Source: SARB

As a ratio of annual GDP, South Africa's foreign liabilities decreased from 138.4% at the end of December 2017 to 133.7% at the end of March 2018, and foreign assets decreased from 148.6% to 141.4% over the same period. Consequently, South Africa's positive net IIP declined to 7.7% of GDP at the end of March 2018 from 12.1% three months earlier.

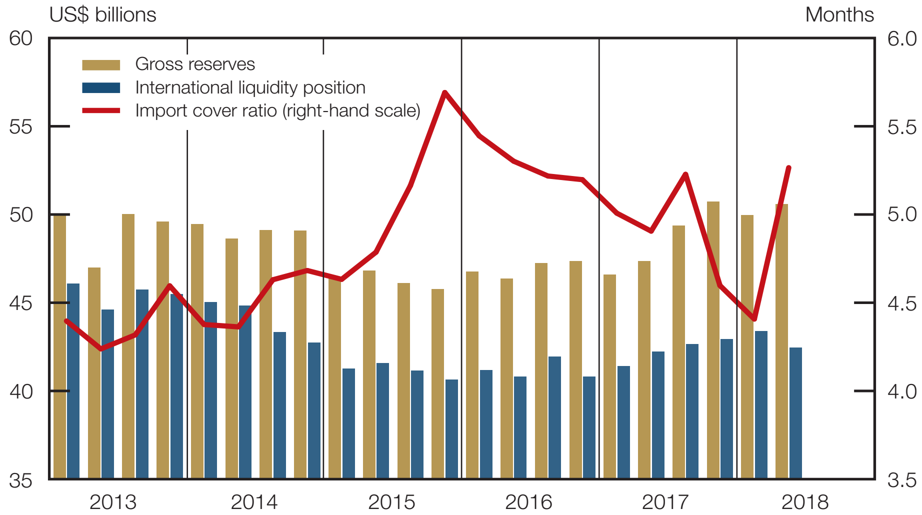
International reserves and liquidity

South Africa's international reserve assets increased by R23.5 billion in the second quarter of 2018, following a decrease of R14.6 billion in the first quarter.

The US dollar value of South Africa's gross gold and other foreign reserves (i.e. the international reserves of the South African Reserve Bank (SARB) before accounting for reserves-related liabilities) increased from US$50.0 billion at the end of March 2018 to US$50.6 billion at the end of June. The increase was mainly due to proceeds from foreign debt issuances by the South African government, while a decline in the US dollar price of gold weighed on the value of reserves. Gross gold and other foreign reserves declined to US$49.8 billion at the end of August. South Africa's international liquidity position[6] decreased from US$43.4 billion at the end of March 2018 to US$42.4 billion at the end of June, and remained unchanged at the end of August.

6 This is 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.

International reserves



Source: SARB

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) increased from 4.4 months at the end of March 2018 to 5.3 months at the end of June.

Exchange rates

Following a moderate 1.8% increase in the first quarter of 2018, the nominal effective exchange rate (NEER) of the rand decreased significantly by 10.0% in the second quarter of 2018 amid increased global uncertainties. The NEER decreased by 3.2% and 7.8% in April and June 2018 respectively, but increased slightly by 0.8% in May 2018. The second-quarter decrease was mainly driven by US dollar strength amid rising 10-year US government bond yields, with higher international oil prices increasing global inflation expectations.

Exchange rates of the rand

Percentage change

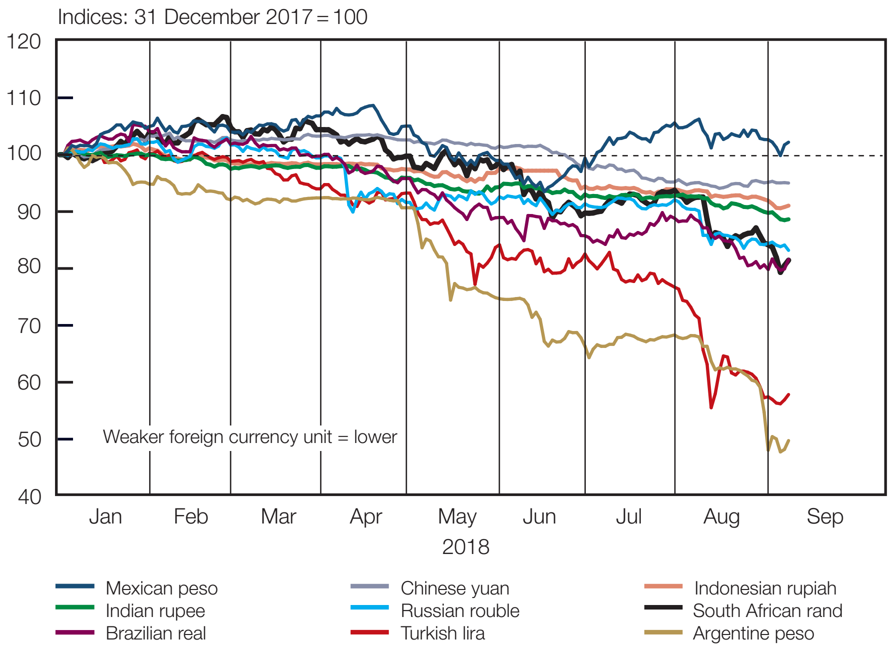
	29 Sep 2017 to 29 Dec 2017	29 Dec 2017 to 29 Mar 2018	29 Mar 2018 to 29 Jun 2018	29 Jun 2018 to 7 Sep 2018
Weighted average*	8.3	1.8	-10.0	-8.2
Euro	8.2	1.2	-9.1	-9.3
US dollar	9.8	4.1	-14.0	-9.3
Chinese yuan	7.5	0.6	-9.6	-6.3
British pound	9.0	-0.1	-8.1	-7.7
Japanese yen	9.9	-1.5	-10.7	-9.2

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

Source: SARB

Risk aversion towards emerging market economies also increased following concerns of the potential impact of escalating trade tensions between the US and its trading partners on global economic growth. A stronger US dollar and a higher US interest rates environment could increasingly affect emerging market economies negatively, especially those with elevated debt levels. As a result, portfolio inflows into emerging market economies reverted to outflows from May 2018. The marked depreciation in the NEER in June 2018 also partly reflected the contraction in South Africa's GDP in the first quarter of 2018 and the widening of the current account deficit.

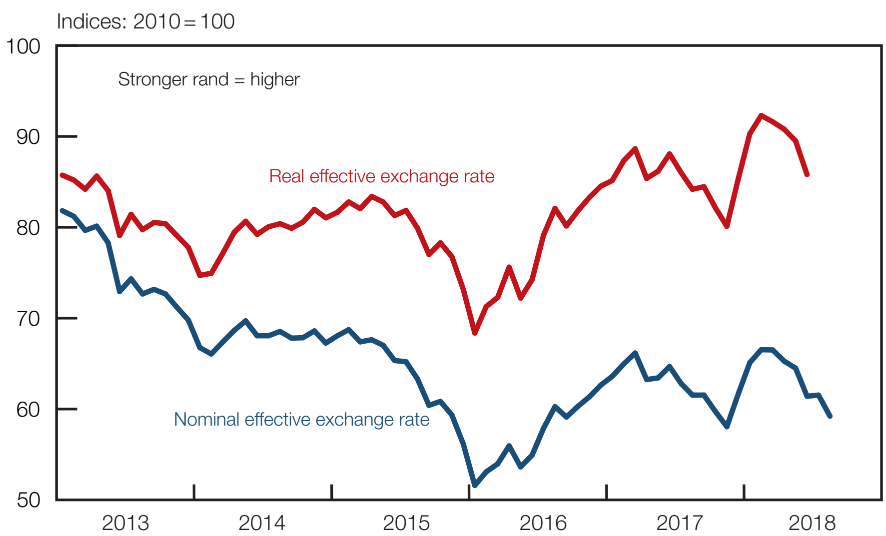
Selected exchange rates: US dollar per foreign currency unit



Source: SARB

Global financial markets stabilised somewhat in July 2018. The exchange value of the rand also appreciated against most currencies in the month, supported by the announcement at the 2018 BRICS summit of increased investment from China into South Africa. Furthermore, lower-than-expected domestic inflation maintained the rand's favourable global carry trade appeal. However, the sharp depreciation in the Turkish lira in August 2018 after the US imposed sanctions on that country resulted in pressure on a broad range of emerging market assets and currencies. This resulted in a significant global sell-off of emerging market assets as investors became increasingly concerned about the high levels of US dollar borrowing by some emerging countries over the past decade. Despite potential contagion, idiosyncratic risks in emerging market countries have been on the rise.

Effective exchange rates of the rand



Source: SARB

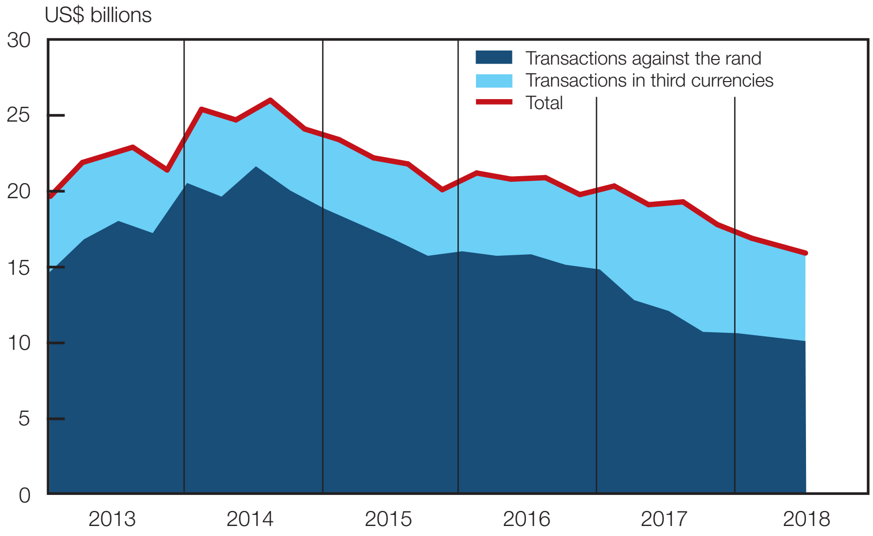
The Turkish lira depreciated by 42.0% against the US dollar from the end of 2017 to 7 September 2018 and the Argentine peso depreciated by 48.7% against the US dollar over the same period as the country's debt crisis intensified. In line with other emerging market currencies, the NEER declined by 9.7% from the end of July 2018 to 31 August.

The real effective exchange rate (REER) of the rand decreased by 2.6% from June 2017 to June 2018, reflecting increased competitiveness of domestic producers in foreign markets.

Turnover in the South African foreign exchange market

The net average daily turnover[7] in the South African market for foreign exchange decreased further by 4.3%, from US$16.9 billion in the first quarter of 2018 to US$16.2 billion in the second quarter. The decrease can be attributed to a decline in the value of transactions against the rand, from US$10.5 billion in the first quarter of 2018 to US$10.0 billion in the second quarter. Turnover in third currencies also decreased slightly from US$6.4 billion to US$6.2 billion over the same period. The decrease in turnover in both categories (against the rand and third currencies) could be attributed to reduced activity by non residents and reflected increased risk aversion.

Net average daily turnover in the South African foreign exchange market



Source: SARB

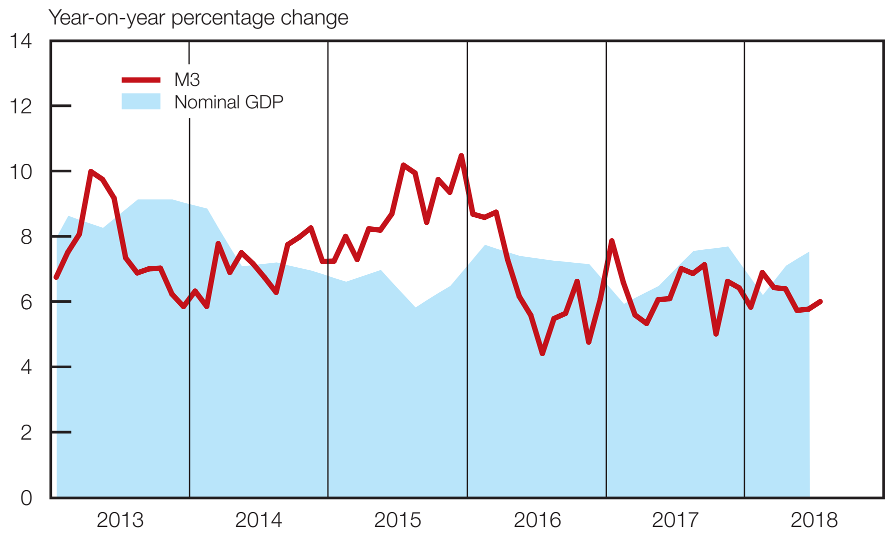
Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) remained weak in the second quarter of 2018 and broadly aligned to the increase in nominal gross domestic product (GDP). Provisional tax payments in June 2018 contributed to the decrease in the deposit holdings of both financial and non-financial companies. Continued efforts by banks to attract and retain deposits of the household sector as a source of stable funding supported the sideways fluctuation of growth in the deposit holdings of households, which outpaced that of the corporate sector.

Quarter-to-quarter seasonally adjusted and annualised growth in M3 decelerated from 10.0% in the first quarter of 2018 to only 0.1% in the second quarter. With the moderate expansion in nominal GDP exceeding stagnant growth in M3, the income velocity of circulation of M3 increased from 1.41 in the first quarter of 2018 to 1.46 in the second quarter.

Money supply and gross domestic product

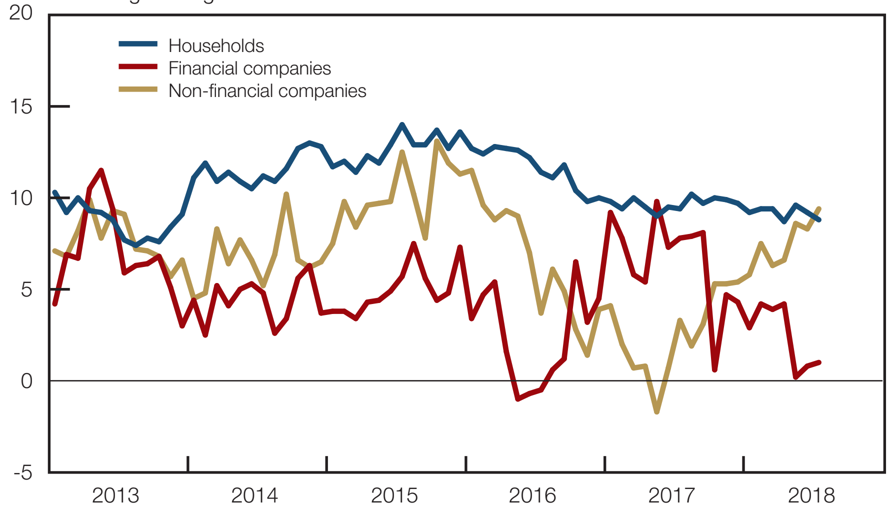


Sources: Stats SA and SARB

Growth over 12 months in M3 slowed from 6.9% in February 2018 to 6.0% in July, along with the deceleration in the corporate sector's deposit holdings from 5.6% to 4.6% over the period. Within the corporate sector, growth in the deposit holdings of financial companies fell back from 4.2% in February 2018 to 1.0% in July as fund managers and public financial companies reduced deposits with the monetary sector, among other factors. By contrast, growth in the deposit holdings of non-financial companies accelerated from -1.7% in May 2017 to 9.4% in July. The increase in the value-added tax (VAT) rate, together with rising fuel prices, probably contributed to slightly lower year-on-year growth in the deposit holdings of households of around 9.2% in the first seven months of 2018, compared with the average of 9.5% in the same period of 2017.

Deposit holdings of households and companies

Percentage change over 12 months

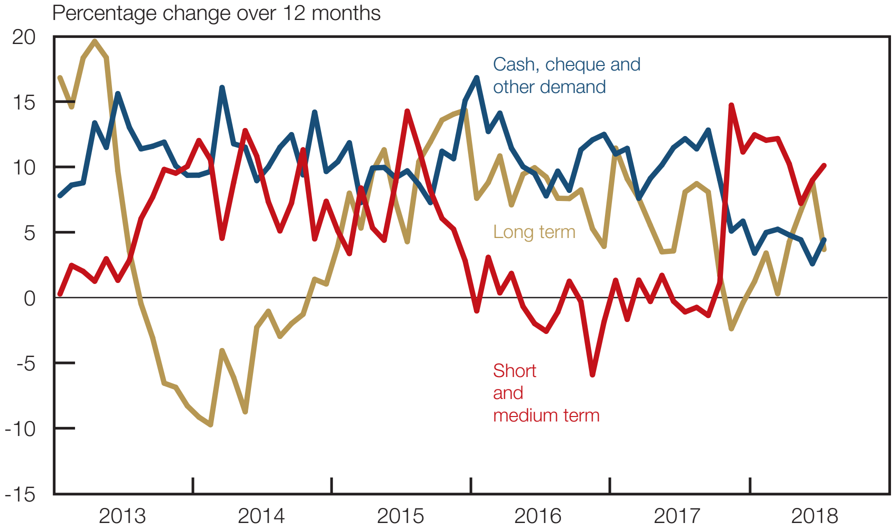


Source: SARB

The preference for deposits switched somewhat from the short and medium term to the long term in the second quarter of 2018. Year-on-year growth in long-term deposits accelerated from 0.3% in March 2018 to 8.9% in June, but moderated somewhat to 3.7% in July. Growth in short- and medium-term deposits moderated from 12.5% in January 2018 to a still buoyant 10.1% in July, while that in the most liquid deposit category of cash, cheque and other demand deposits slowed notably from average growth of around 10% in 2017 to 2.6% in June 2018, before accelerating slightly to 4.4% in July.

Deposits by maturity

Percentage change over 12 months



Source: SARB

Total M3 deposit holdings decreased by R7.1 billion in the second quarter of 2018 compared to an increase of R13.3 billion in the same period of the previous year. Deposit holdings of companies decreased by R36.8 billion in the second quarter of 2018, partly reflecting provisional tax payments. The large decrease in the deposit holdings of financial companies probably also reflected a pursuit of investment opportunities outside the banking sector. Household deposits increased by R29.7 billion in the second quarter of 2018 compared to an increase of R10.7 billion in the first quarter, which was similar to the increase of R29.1 billion in the second quarter of 2017.

M3 holdings of households and companies

	Quarter-to-quarter change R billions						Percentage of total M3 deposit holdings
	2017				2018		2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q2
Households	13.0	29.1	31.4	28.4	10.7	29.7	35.2
Companies: Total	22.5	-15.8	79.8	14.1	27.5	-36.8	64.8
Of which: Financial	27.0	14.0	42.4	-33.8	24.3	-23.5	35.9
Non-financial	-4.5	-29.8	37.4	47.8	3.2	-13.4	28.9
Total M3 deposits	**35.6**	**13.3**	**111.2**	**42.5**	**38.2**	**-7.1**	**100.0**

Source: SARB

In statistical terms, the R7.1 billion decline in M3 in the second quarter of 2018 resulted from declines in net claims on the government sector of R38.3 billion and in net other assets of R49.9 billion, which exceeded increases in claims against the private sector of R8.3 billion and in net foreign assets of the monetary sector of R72.7 billion. The latter resulted mainly from valuation effects as the exchange value of the rand depreciated against the United States (US) dollar over the period. The decrease in claims against the government sector followed an increase in government deposits, boosted by the receipt of provisional tax payments. The decline in net other assets resulted from, among other factors, contra entries related to the aforementioned valuation effects.

Credit extension[8]

Total loans and advances extended by monetary institutions to the domestic private sector grew at a lacklustre pace in the first half of 2018. Year-on-year growth in credit extension averaged 4.3% in the first six months of 2018 compared to 5.6% in the same period a year earlier. Credit extension to the corporate sector decelerated notably in the first half of 2018, due in part to the impact of the implementation of International Financial Reporting Standard 9 (IFRS) from January 2018 and the protracted weakness in domestic economic activity. Growth in loans and advances to companies nearly halved from 11.4% in January 2017 to 5.3% in June 2018. A pronounced and sustained recovery in consumer demand and business confidence may be required to increase the corporate sector's demand for credit. By contrast, credit extension to households continued to inch higher from 3.7% in January 2018 to 4.5% in June. In July 2018, growth in loans and advances to companies moderated further to 5.1% while that to households accelerated to 4.8%.

Quarter-to-quarter seasonally adjusted and annualised growth in total loans and advances to the domestic private sector accelerated from 2.7% in the first quarter of 2018 to 5.0% in the second quarter. The ratio of credit to GDP decreased from 72.8% in the first quarter of 2018 to 70.9% in the second quarter, as credit extension expanded at an even slower pace than the weak expansion in nominal GDP.

Credit extension to the corporate sector decreased notably from R37.6 billion in the first quarter of 2018 to R7.7 billion in the second quarter, but still exceeded the increase of R4.9 billion in the second quarter of 2017. Growth in bank credit extended to companies was suppressed by general loans – historically the preferred source of corporate funding. Nonetheless, year-on-year growth in general loans to companies rebounded to 4.0% in June 2018 and 3.0% in July, after moderating persistently since early 2017 to below zero in May 2018. By contrast, growth in overdrafts and mortgage advances, which contributed 10% and 26% respectively to total corporate loans, accelerated somewhat in the first seven months of 2018.

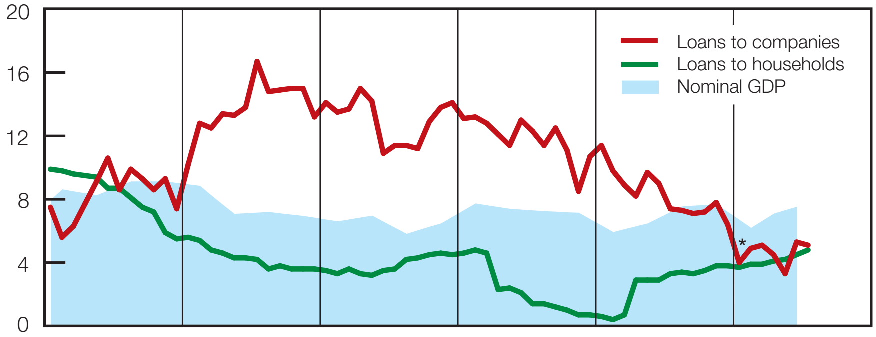
Mortgage advances on commercial property increased by R12.9 billion in the first half of 2018 compared to R8.1 billion in the same period of the previous year. Year-on-year growth in mortgage

8 Growth in credit extension was impacted by the implementation of International Financial Reporting Standard 9 from January 2018. Banks' calculation of the provision for credit losses (impairments) changed fundamentally, which affected outstanding credit balances. For a more comprehensive analysis, see 'Box 3: Impairments and credit statistics' on page 52 of the June 2018 edition of the *Quarterly Bulletin*. http://www.resbank.co.za/Lists/News%20and%20PublicationsAttachments8615/03Impairments%252%20and%20credit%20statistics.pdf

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, before once again moderating to 7.3% in July.

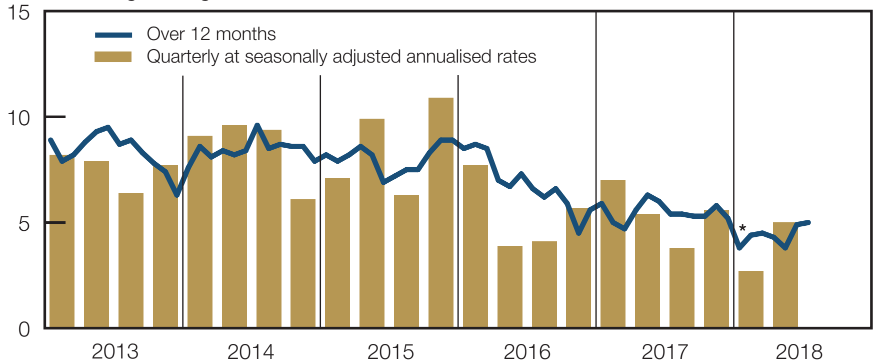
Bank loans and gross domestic product

Year-on-year percentage change



Total loans and advances to the private sector

Percentage change



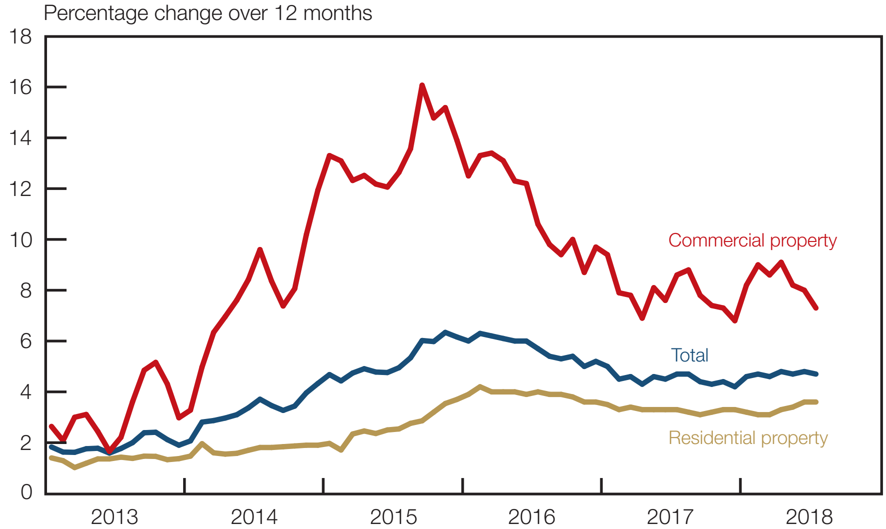
* Growth rates impacted by the implementation of IFRS 9 from January 2018

Sources: Stats SA and SARB

Growth in mortgage advances on residential property remained muted, but nonetheless increased moderately from a recent low of 3.1% in February 2018 to 3.6% in July. The lacklustre growth in residential mortgage advances probably partly reflects caution among households, given slow income growth and weak job prospects. Growth in total mortgage advances fluctuated sideways around an average of 4.7% in the first seven months of 2018, not much different from the average of 4.5% for 2017 as a whole.

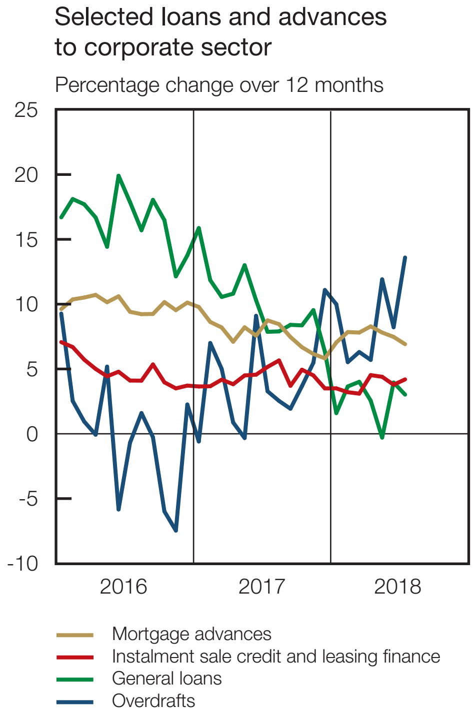
Mortgage advances

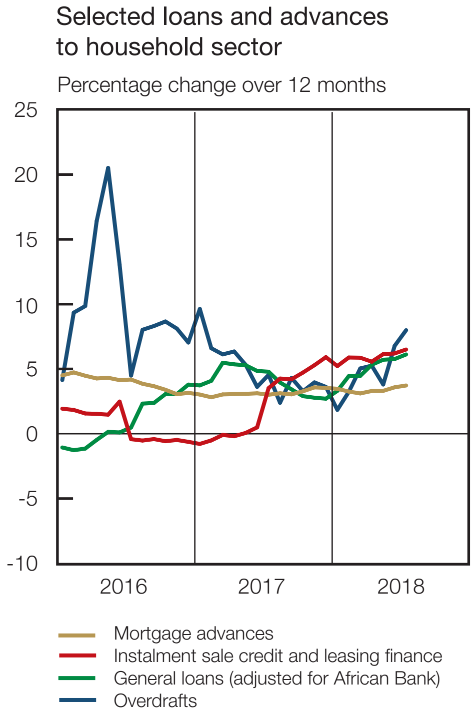
Percentage change over 12 months



Source: SARB

Credit extension to the household sector gained further momentum in the first half of 2018, increasing by R21.7 billion in the first quarter of 2018 and by R15.8 billion in the second quarter. The total increase of R37.5 billion in the first half of 2018 notably exceeded the increase of R26.0 billion during the same period of 2017. Improved consumer confidence within a more stable political environment may partially explain the revival in demand for bank funding by households. In particular, general loans to households increased by a notable R8.9 billion in the first half of 2018, significantly more than the R2.6 billion in the same period a year earlier and even surpassing the R5.5 billion increase for 2017 as a whole. As a result, year-on-year growth more than doubled from 2.7% in December 2017 to 6.1% in July 2018.





Source: SARB

Instalment sale credit and leasing finance, which is predominantly used to finance purchases of new and used vehicles, increased by R5.3 billion in the second quarter of 2018 compared to R4.1 billion in the first quarter. Year-on-year growth in instalment sale credit and leasing finance accelerated slightly from 4.7% in January 2018 to 5.7% in July, reflecting the gradual improvement in demand for vehicle financing from especially the household sector.

The credit demand of the various domestic economic sectors continued to display somewhat divergent growth trends in the second quarter of 2018. Credit extension to the construction sector increased alongside the moderate increase in building plans passed in recent months. At the same time, the real estate sector also experienced relatively buoyant credit growth. Credit growth in the wholesale and retail trade sector accelerated in recent quarters, probably supported by improved consumer and business confidence. Credit demand by the mining sector from banks improved slightly in the second quarter of 2018. Mining companies also accessed financing outside the banking sector. Credit extension to the finance and insurance; manufacturing; business services; and transport, storage and communication sectors remained very weak, likely impacted by the sluggish domestic economic activity.

Growth in bank credit by economic sector

Percentage change over four quarters

Economic sector	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	Percentage of total credit extension*
Households	5	6	4	4	4	34.8
Finance and insurance	1	13	4	2	0	18.0
Real estate	9	9	10	13	12	10.9
Wholesale and retail trade	2	1	8	17	18	5.4
Manufacturing	3	4	-1	-7	0	4.4
Business services	21	12	4	-8	-1	3.4
Transport, storage and communication	5	1	-5	-5	-2	3.1
Electricity, gas and water	39	16	11	25	17	2.5
Agriculture, forestry and fishing	10	6	8	7	10	2.3
Mining and quarrying	-19	-16	-21	-6	2	1.6
Construction	-8	11	8	0	6	0.9
Community, social, personal services and other	-4	3	4	1	11	12.7
Total	4	7	4	4	6	100.0

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

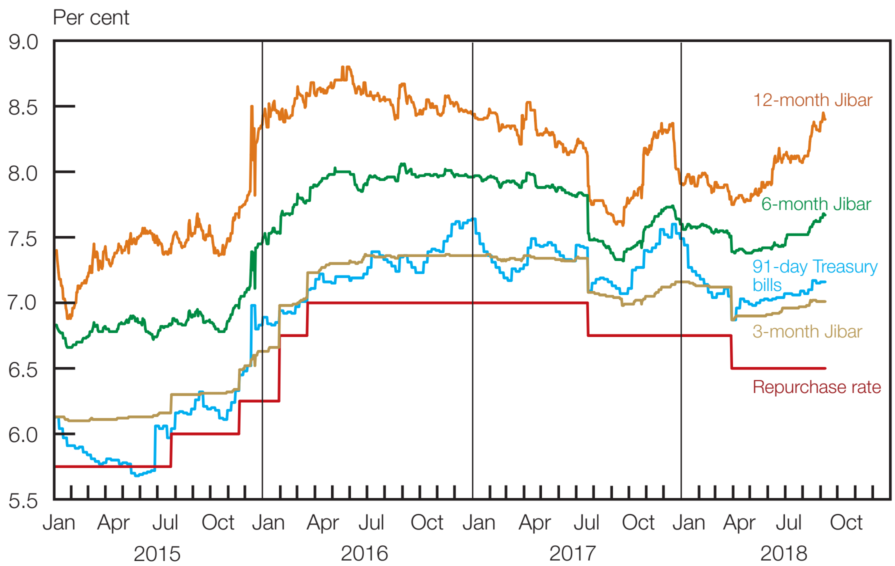
Source: SARB

Interest rates and yields

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) kept the repurchase rate unchanged at 6.50% at the July and September 2018 meetings, having assessed the monetary policy stance as appropriate, given the current state of the economy. However, the MPC noted the deteriorating inflation outlook, driven mainly by supply-side factors.

Domestic short-term money market rates increased in the second quarter of 2018, mostly on account of a significant weakening in the exchange value of the rand during the period, before levelling out in July and August. The three-month Johannesburg Interbank Average Rate (Jibar) fluctuated higher from a recent low of 6.87% on 29 March 2018 to 6.96% in late June, and then remained range-bound between 6.96% and 6.97% for most of July up to early August, before increasing to 7.01% on 7 September. The benchmark 12-month Jibar displayed a slightly stronger upward trend, increasing from 7.75% on 29 March 2018 to 8.18% on 20 June 2018 alongside the depreciation in the exchange value of the rand. Subsequently, the rate levelled off and fluctuated around 8.11% up to the end of the second week of August, following relatively benign domestic consumer price inflation outcomes. The 12-month Jibar then increased to 8.40% on 7 September when the exchange value of the rand depreciated alongside risk aversion towards emerging market economies. Affected by the heightened uncertainty, the tender rate on 91-day Treasury bills fluctuated higher from 7.07% on 30 June 2018 to 7.16% on 7 September.

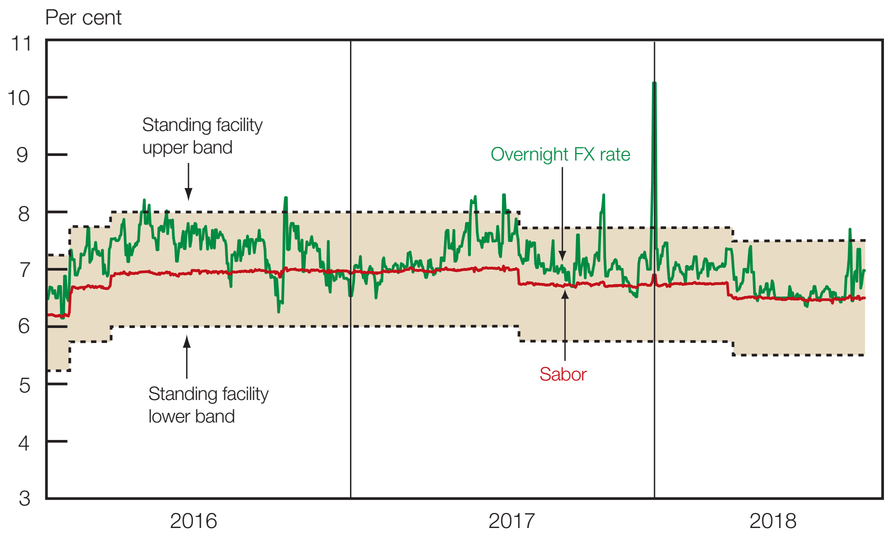
Money market rates



Source: SARB

The South African Benchmark Overnight Rate (Sabor) and the overnight foreign exchange (FX) rate fluctuated well within the standing facility limits in recent months. Both the Sabor and overnight FX rate moved to slightly lower levels following the 25 basis point reduction in the policy rate on 29 March 2018. The Sabor remained closely aligned to the repurchase rate, fluctuating in a narrow range close to 6.50% from late March 2018. However, the overnight FX rate displayed slightly more volatility amid fluctuations in demand for foreign exchange. The overnight FX rate initially decreased from a recent high of 7.40% on 25 April 2018 to 6.35% on 2 July, before increasing to 7.70% on 22 August when the exchange value of the rand depreciated. Subsequently, the overnight FX rate decreased again to 6.98% on 7 September.

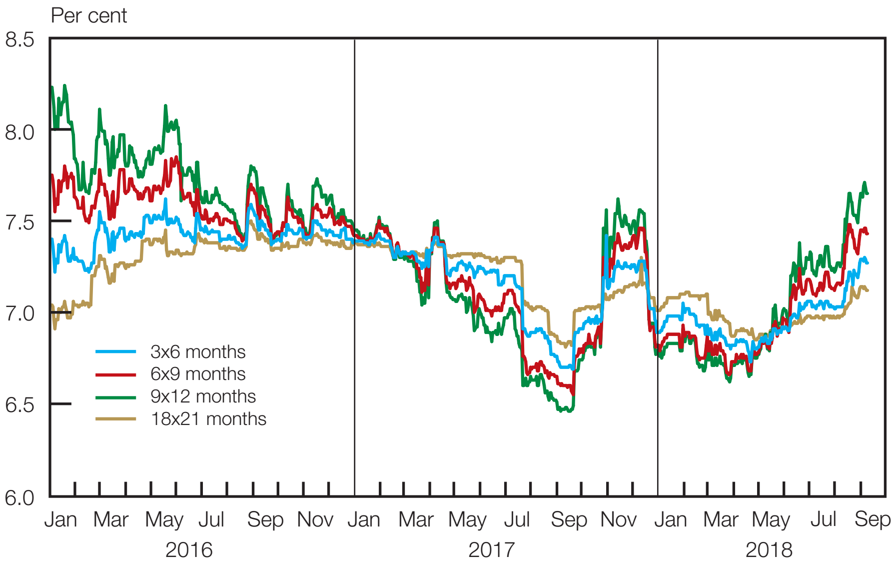
Benchmark overnight rates



Source: SARB

Rates on forward rate agreements (FRAs) trended higher from late March 2018 to mid-June alongside the depreciation in the exchange value of the rand. The longer-term rates reacted more, as the 9x12-month FRA increased from 6.62% on 27 March to 7.38% on 19 June, while the 6x9-month FRA increased from 6.66% to 7.24% over the same period. The shorter-dated FRAs reacted less, as the 3x6-month FRA initially decreased from an average of 6.86% in March 2018 to 6.73% on 20 April before also trending higher to 7.06% on 28 June. In July, the FRA rates remained relatively stable as the exchange value of the rand appreciated. However, by 7 September 2018, the 9x12-month FRAs had once again increased to 7.65% and the 3x6-month FRA to 7.27%, reflecting the recent sharp depreciation in the exchange value of the rand.

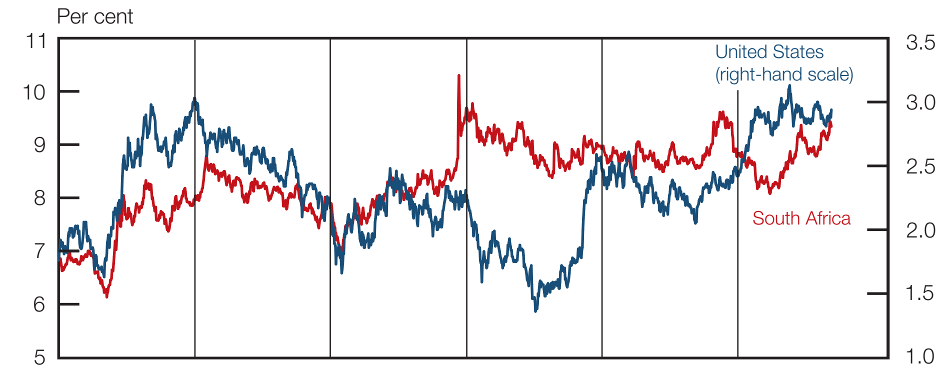
Forward rate agreements



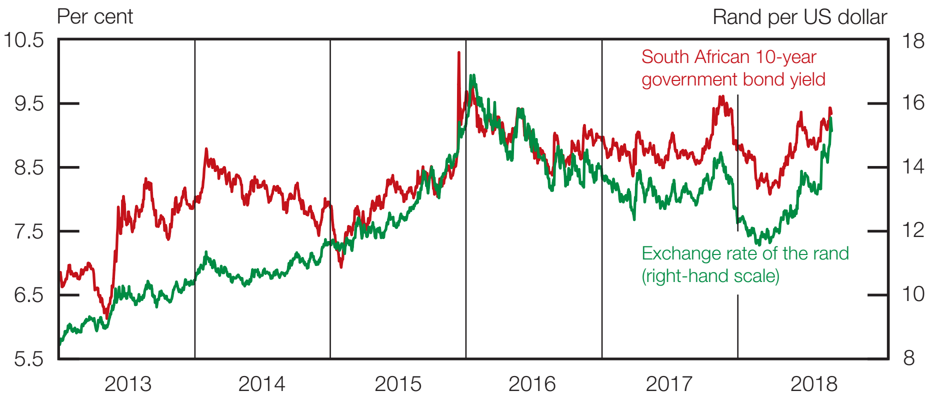
Source: SARB

The upward trend from March 2018 in *yields on South African government rand-denominated bonds* issued and traded in the domestic market was driven by higher US interest rates, a stronger US dollar, and escalating trade tensions between the US and its trading partners, which increased risk aversion towards emerging market economies and affected capital flows. This was followed by a global sell-off of emerging market assets in August when US-imposed sanctions on Turkey led to a significant depreciation in the Turkish lira. These global developments, together with the inflationary effect of higher international oil prices, contributed to the depreciation in the exchange value of the rand and a deterioration in the domestic inflation outlook. In this environment, the daily closing yield on the conventional 10-year South African government bond increased by 126 basis points, from a recent low of 8.08% on 27 March 2018 to 9.34% on 7 September, compared to an increase of only 9 basis points in the US 10-year government bond yield to 2.94%.

Ten-year government bond yields



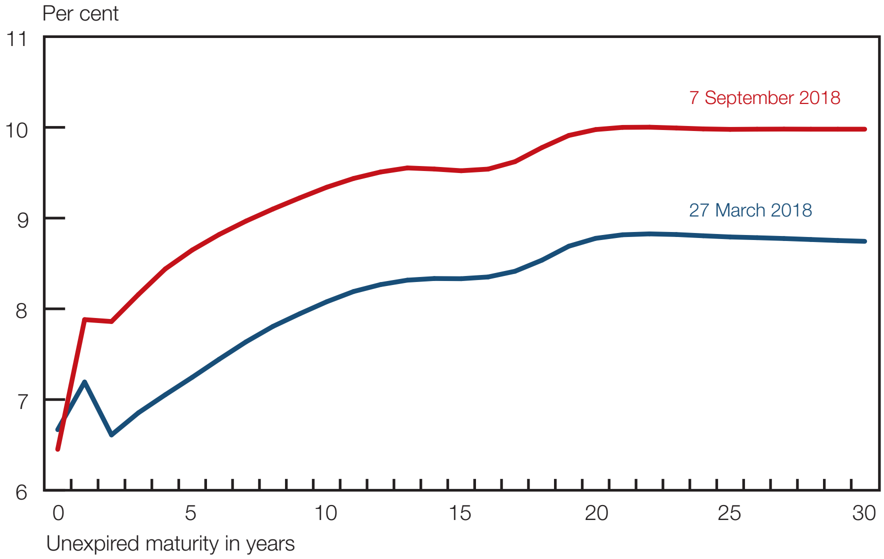
Bond yield and exchange rate



Sources: IRESS, JSE and SARB

The reasons cited above contributed to the upward shift beyond the extreme short end of the *yield curve* from March 2018 to 7 September as well as the widening of the yield gap (measured as the difference between yields at the extreme long and short ends of the curve) from 208 basis points on 27 March 2018 to 353 basis points on 7 September.

Yield curve



Sources: IRESS and JSE

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

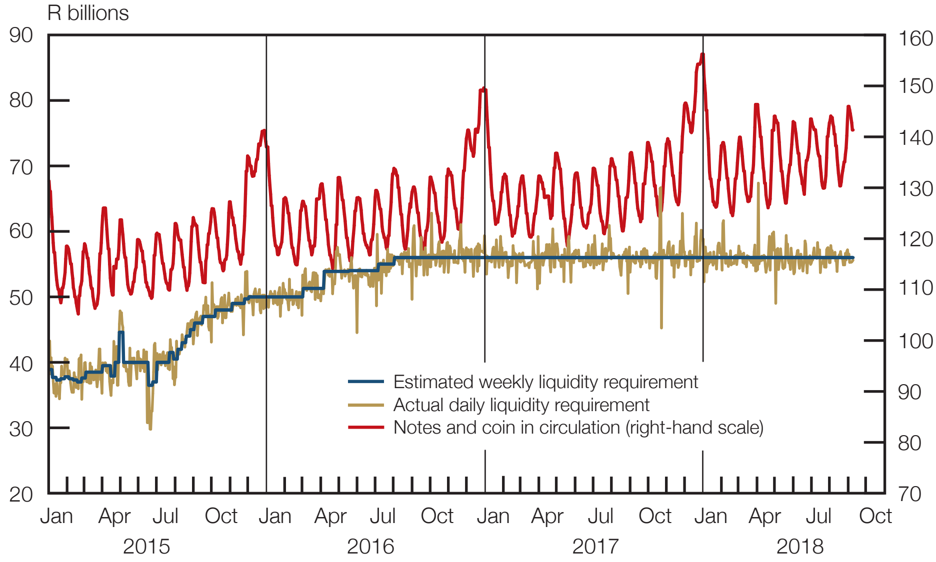
10 The differential between the yield on South African government US dollar-denominated bonds and that on US dollar-denominated bonds of the US government.

The yield spread of emerging markets US dollar-denominated bonds relative to US government bonds, measured by the JPMorgan Emerging Markets Bond Index Plus (EMBI+),[9] widened significantly from 312 basis points in January 2018 to 408 basis points in June, before narrowing to 329 basis points in August. South Africa's *sovereign risk premium*[10] on government's US dollar-denominated bonds in the six-year maturity range widened from an average of 173 basis points in January 2018 to 225 basis points in August.

Money market

The actual daily liquidity requirement of private sector banks varied between R49.0 billion and R67.4 billion in the second quarter of 2018, much wider than the range of between R52.3 billion and R61.6 billion in the first quarter of the year. Nonetheless, the SARB maintained the actual daily liquidity requirement at an average of around R56 billion throughout the first eight months of 2018.

Liquidity requirement

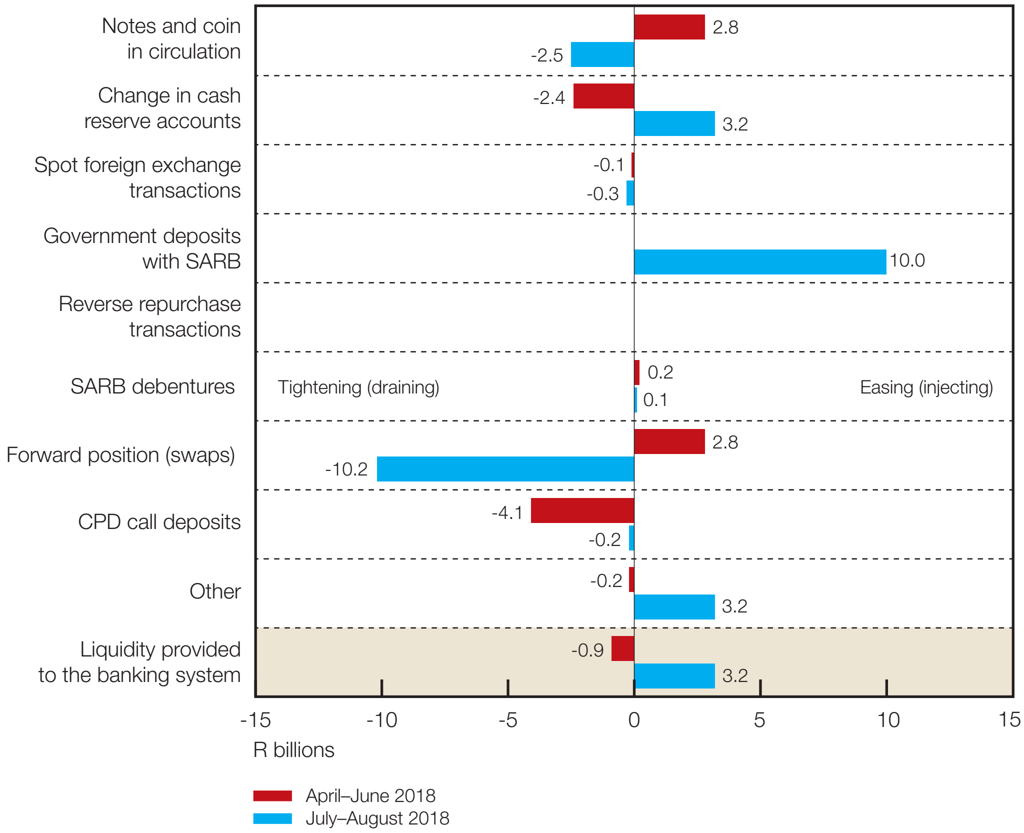


Source: SARB

11 Liquidity management operations include reverse repurchase transactions, issuance of SARB debentures, foreign exchange swaps and call deposits with the CPD.

Money market liquidity contracted by R0.9 billion in the second quarter of 2018, following a contraction of R1.7 billion in the first quarter. The decrease in notes and coin in circulation outside the SARB, which expanded liquidity in the money market by R2.8 billion in the second quarter of 2018, was almost fully countered by an increase of R2.4 billion in banks' required cash reserve balances held with the SARB. In addition, the overall liquidity management operations[11] of the SARB drained a net R1.0 billion from the market. This included R4.1 billion in the Corporation for Public Deposits' (CPD) call deposits placed with the SARB. This tightening was partly offset by maturing foreign exchange swaps of R2.8 billion and SARB debentures of R0.2 billion. In July and August 2018, money market liquidity expanded by R3.2 billion, mainly on account of a decrease in banks' required cash reserve deposits. A withdrawal by National Treasury from the Sterilisation Deposit Account for short-term bridging financing purposes was neutralised by forward foreign exchange swap transactions of a similar magnitude. A contraction in notes and coin in circulation moderated the overall net expansion of liquidity in the market.

Factors influencing money market liquidity flows



Source: SARB

From April to August 2018, government made capital redemption and coupon interest payments of R39.9 billion from the tax and loan accounts. The SARB's relatively small portfolio of government bonds accrued total coupons of only R201 million.

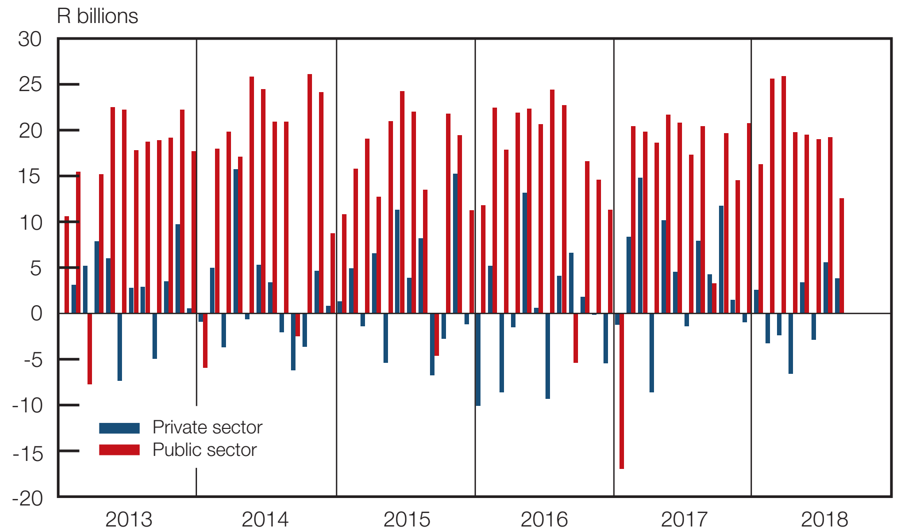
Bond market

Public sector net issues in the domestic *primary bond market* remained robust in the first eight months of 2018, with the nominal value of such issues increasing to R158 billion from R122 billion in the same period of 2017. By contrast, the private sector's net issues declined from R34.6 billion in the first eight months of 2017 to only R0.2 billion over the same period in 2018 as non-financial companies and special purpose vehicles redeemed bonds.

In May 2018 government placed two bonds in the international capital markets to finance foreign currency commitments as projected in the *2018 Budget Review*. The US$1.4 billion 12-year bond maturing in 2030 was priced at a coupon rate of 5.875%, and the US$0.6 billion 30-year bond maturing in 2048 at a coupon rate of 6.3%.

The higher volume of bonds traded due to the factors already mentioned contributed to an increase of 12.2% in the daily average *value of turnover* in the domestic secondary bond market to R122 billion in the eight months to August 2018 compared to the same period of 2017. The higher turnover led to an increase in the annualised bond market liquidity ratio to 11.1 in the first eight months of 2018 compared to 10.4 in the corresponding period of 2017.

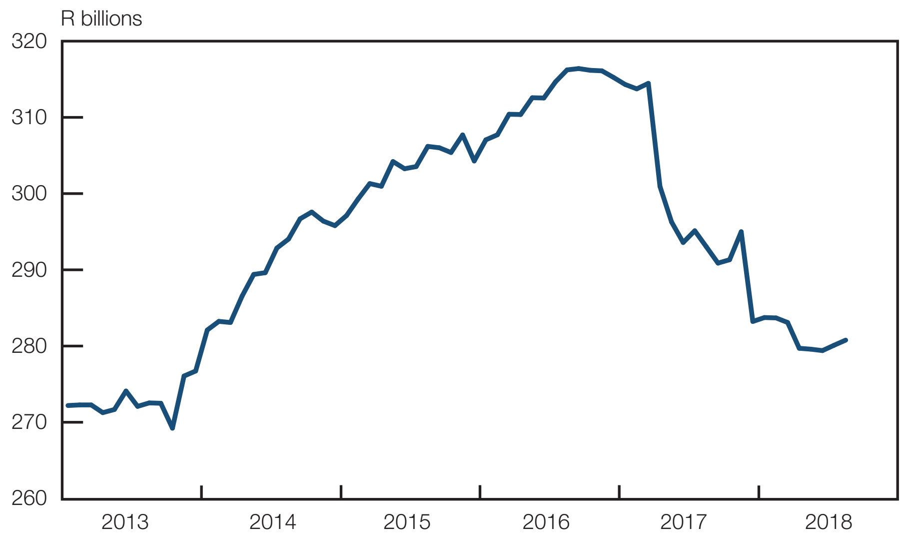
Net issues in the domestic bond market



Source: JSE

The outstanding amount of rand-denominated debt in issue in the *European and Japanese bond markets* decreased further by R2.4 billion in the first eight months of 2018, following sizable net redemptions of R22.2 billion in the same period of 2017. With non-resident issues accounting for 87.3% of the outstanding amount, the decline in the amount in issue reflects negative foreign borrower and investor sentiment towards emerging markets.

Outstanding amount of rand-denominated bonds in issue in the international markets



Source: Bloomberg

The JSE Limited (JSE) reported record high *non-resident* net sales of domestic bonds of R67.6 billion in the second quarter of 2018, following net purchases of only R6.5 billion in the first quarter. Non-residents' holdings of domestic bonds decreased by a further R14.9 billion in July and August. The net sales can be attributed to, among other factors, a deterioration in investor sentiment towards emerging market assets amid mounting concerns about the ongoing trade dispute between the US and China, as well as the recent developments in Turkey. Non-residents' cumulative net sales of domestic bonds of R76.0 billion in the first eight months of 2018 contrasted net purchases of R38.3 billion over the same period of 2017.

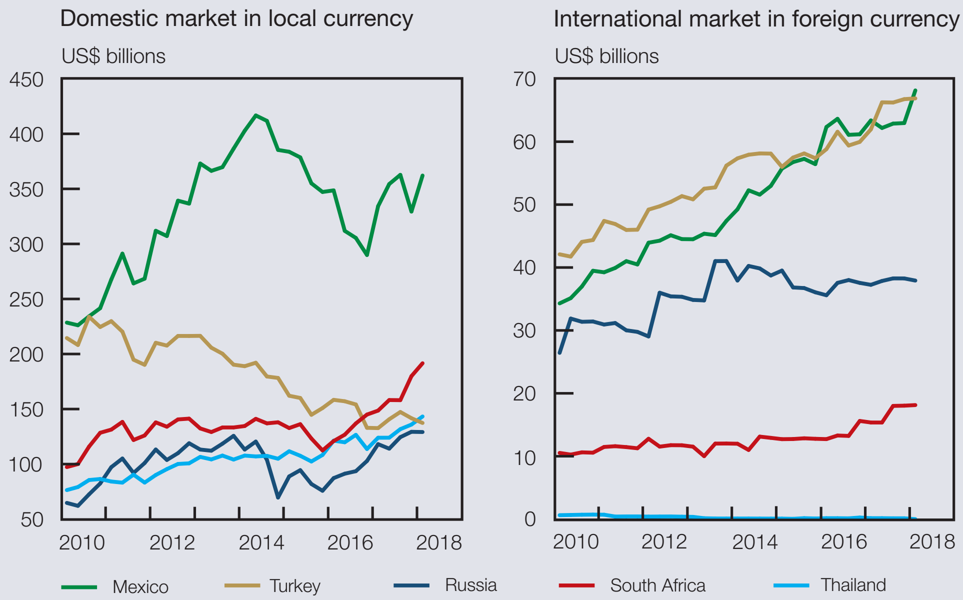
Under these circumstances, non-residents increasingly contributed to the total value of turnover in the secondary bond market with their participation rate, measured as non-resident purchases and sales as a percentage of the total value of bonds traded, which increased, on average, from 8.6% in 2017 to 9.8% in the first eight months of 2018.

Box 2 A comparison of South Africa's general government debt securities with other emerging markets[1, 2]

In South Africa, general government's funding through debt securities is dominated by outstanding amounts of domestic market issues in local currency, which reduces the country's exposure to exchange rate risk. This is also the case in other emerging markets, such as Mexico and Russia. However, non-resident holdings of such debt increase the exposure to sudden sell-offs. In South Africa, non-resident holdings of domestic local currency-denominated debt securities comprised 42.3% of the total debt as at the end of March 2018, somewhat higher than in Mexico and Russia.

South Africa participates in the debt securities database[3] of the Bank for International Settlements (BIS) on which this cross-country analysis of outstanding amounts at nominal or face value[4] of general government[5] debt securities[6], issued in domestic and international markets, and denominated in local and foreign currency, is based.

Country comparison of general government debt securities in issue



Source: BIS

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1 The data for South Africa's general government debt securities are reflected on pages S–54, S–55 and S–105 of the *Quarterly Bulletin*.

2 Four emerging market countries, namely Mexico, Thailand, Turkey and Russia were selected based on the availability of data on the Bank for International Settlements' (BIS) debt securities database and similarities regarding general government debt at nominal or face value, as well as the prevalence of both domestic issuance in local currency and international issuance in foreign currency.

3 The BIS debt securities database is harmonised based on the Handbook on Securities Statistics 2015 of the International Monetary Fund (IMF) (available at https://www.bis.org/publ/othp23.htm). Total debt securities measure issues by residents in all markets and currencies, and comprise domestic securities issued in the country where the borrower resides and international debt securities issued outside the country where the borrower resides.

4 The face value is the amount that the holder of the debt security receives at maturity and the nominal value is the face value including accrued interest not yet paid, less any repayments.

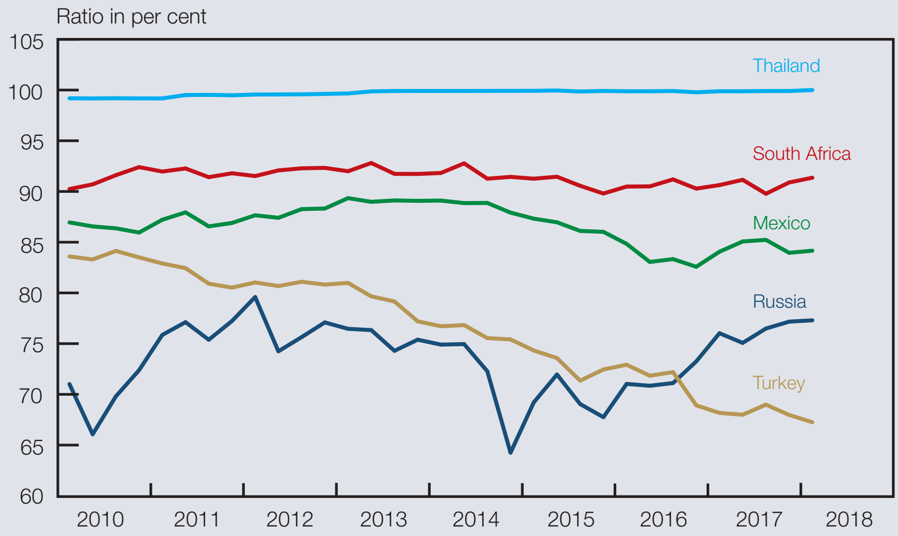
5 According to the Government Finance Statistics Manual 2014 of the IMF (available at https://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf), the general government sector consists of central, state, provincial, regional and local government units, as well as social security funds and unincorporated enterprises owned by government units that are integral parts of those units. In South Africa, general government comprises the central government, which consists of national government, social security funds and extra-budgetary institutions, as well as provincial and local governments. However, in this analysis, debt securities of South Africa's general government comprise only national and local governments.

6 Debt securities are negotiable financial instruments as defined in the Handbook on Securities Statistics 2015 of the IMF. In South Africa, it includes all listed debt securities of general government on the JSE Limited, national government's Treasury bills and all debt securities issued by general government in international markets.

The US dollar value of the stock of outstanding general government debt securities of the selected emerging market countries in domestic markets in local currency continued to exceed that in international markets in foreign currency. Since 2010, the outstanding amount of domestic market issues in local currency has only declined in Turkey, while Thailand's exposure to international markets remained fairly immaterial. The stock of debt in issue by Mexico and South Africa in domestic markets increased markedly over this period, while international markets remained an important source of funding for South Africa and Russia, and even more so for Mexico and Turkey which showed strong growth.

Debt denominated in foreign currency exposes general government to exchange rate risk, as the value of outstanding debt in foreign currency could increase materially when the borrower's local currency depreciates. The dominance of general government debt securities in issue in the domestic market in local currency is reflected by its ratio to total debt securities of general government for the various countries. The residual reflects the prevalence of debt in international markets and in foreign currency, which is exposed to exchange rate risk. Thailand's domestic debt securities in issue as a percentage of total debt has remained near 100% for a number of years, reflecting very limited currency exposure. Domestic debt securities also dominate in South Africa, Mexico and Russia. In South Africa's case, this is as a consequence of government setting risk benchmarks, whereby foreign debt is allocated a ceiling of 15% of total debt, and expected to be below 10% over the medium term.[7] In Mexico, the shift in financing from external to domestic debt after the Mexican peso crisis in 1994 is evident. By contrast, the share of domestic securities in Turkey has fallen steadily since 2010.

Country comparison of general government debt securities in issue in the domestic market in local currency to total debt securities

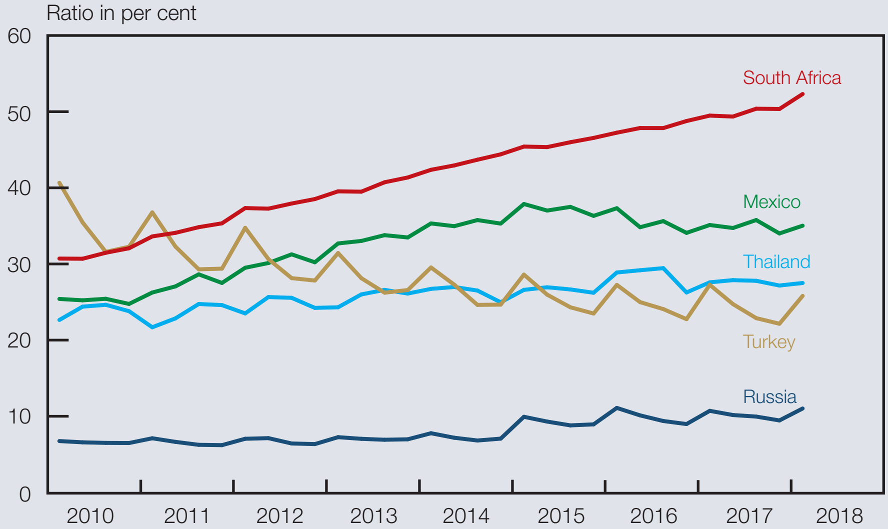


Source: BIS

The increase in the outstanding amount of total general government debt securities in the selected emerging market economies remained fairly proportionate to growth in nominal gross domestic product, in contrast to the fairly marked increased in this ratio in South Africa.

7 See the *2018 Budget Review* (Table 7.2 on page 83).

Total outstanding general government debt securities to nominal gross domestic product



Sources: BIS and IMF

Following the global financial crisis, low interest rates in advanced economies enticed foreign investors to search for higher yields in emerging market economies. However, large holdings of domestic debt securities in local currency by non-residents create external vulnerability, as exogenous events such as the tightening of monetary policy by some advanced economies and credit rating downgrades could trigger sell-offs.

In the sample of emerging market countries, foreign ownership of general government debt securities issued in domestic markets and in local currency ranged from 7.7% in Thailand to 42.3% in South Africa at the end of March 2018. This is not unique to South Africa, as non-residents' share of domestic debt securities in local currency is also relatively high in Russia and Mexico.

Total general government domestic debt securities in local currency in issue and non-residents' holdings as at 31 March 2018

	Outstanding amount (US$ billions)	Non-resident holdings (Per cent)
South Africa	191	42.3
Turkey	137	19.9
Mexico	362	31.9
Thailand	143	7.7
Russia	129	34.2

Sources: BIS, emerging market economies' central banks and National Treasury

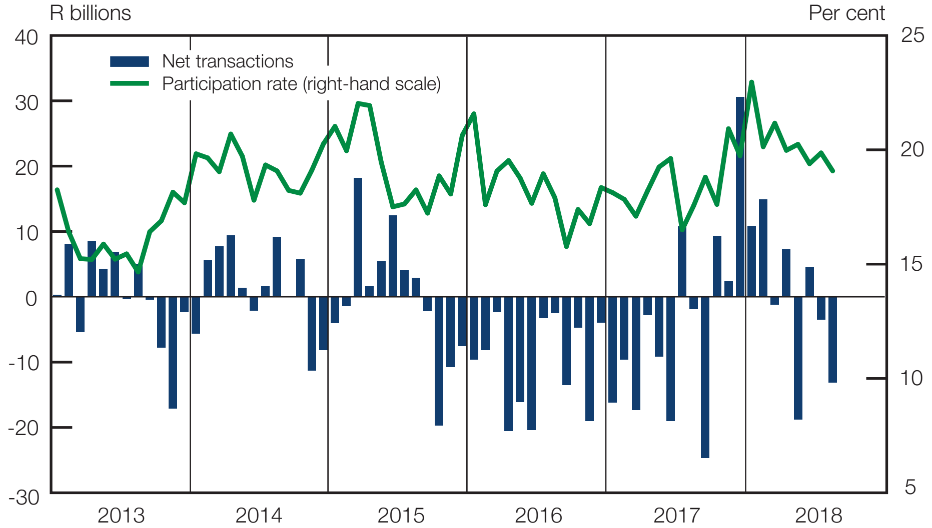
Share market

Equity capital raised by companies listed on the JSE in the domestic and international primary share markets decreased significantly by 60.8% to only R28.2 billion in the eight months to August 2018 compared to the corresponding period of 2017. Share price volatility, fewer listed companies and low business confidence suppressed funding activity. The cost of listings and raising capital could have been affected by the JSE's adoption in October 2017 of the *King IV Report on Corporate Governance for South Africa 2016 (King IV)*, which requires more onerous disclosure. Thus far in 2018, companies in the financial sector contributed the most to the total value of shares issued at 68.6% compared to 42.3% in the corresponding period of 2017. A domestic insurer as well as foreign and domestic property companies made the largest three share issues in the eight months to August 2018 to raise cash and make acquisitions abroad. These included shareholding interest in a Moroccan insurance company and the acquisition of shopping centres in Poland and Spain.

The *value of turnover* in the secondary share market of the JSE increased by 9.2% in the first eight months of 2018 compared to the corresponding period of 2017. The average turnover of R22.5 billion per day in the first eight months of 2018 reflected higher volumes and, on average, higher share prices. The market capitalisation of the JSE decreased from an all-time high of R16.2 trillion in October 2017 to R14.9 trillion in August 2018, consistent with declining share prices and the lower number of shares in issue.

According to the JSE, *non-residents'* net purchases of R42.3 billion in the fourth quarter of 2017 and R24.5 billion in the first quarter of 2018 reverted to net sales of R7.0 billion in the second quarter of 2018 and R16.6 billion in July and August 2018. The recent net sales of shares by non-residents resulted from, among other factors, concerns over the impact of escalating trade tensions between the US and China, general risk aversion to emerging markets, uncertainty over South Africa's policy on land expropriation without compensation, and weak domestic economic activity. These developments contributed to an increase in non-residents' participation rate from 18.4% in 2017 as a whole to an average of 20.4% thus far in 2018.

Non-resident participation in the domestic share market

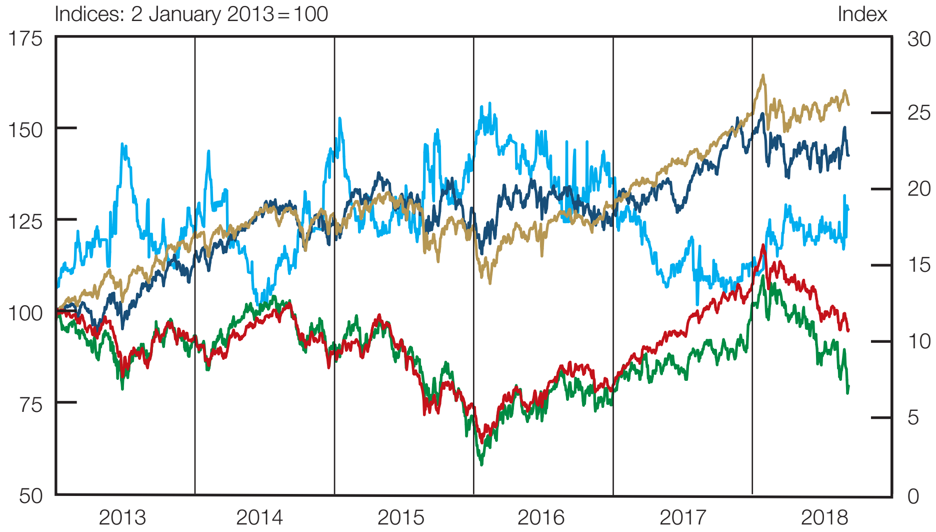


Sources: JSE and SARB

The movements in *share prices* of JSE-listed companies were fairly volatile along a generally declining trend in the first eight months of 2018, similar to other emerging and global markets. This is reflected by the decline of 7.5% in the FTSE/JSE All-Share Price Index from an all-time high of 61 685 index points on 25 January 2018 to 57 068 index points on 7 September, and a decline of 19.0% in the MSCI Emerging Markets Index and 4.3% in the MSCI World Index.

Contributing factors were global developments such as trade tensions and retaliations, risk aversion towards emerging markets, as well as idiosyncratic domestic policy uncertainty and weak economic activity.

Share prices



MSCI Emerging Markets Index
MSCI World Index
FTSE/JSE All-Share Index (rand)
FTSE/JSE All-Share Index (US dollar)
South African Volatility Index (right-hand scale)

Sources: Bloomberg, IRESS and JSE

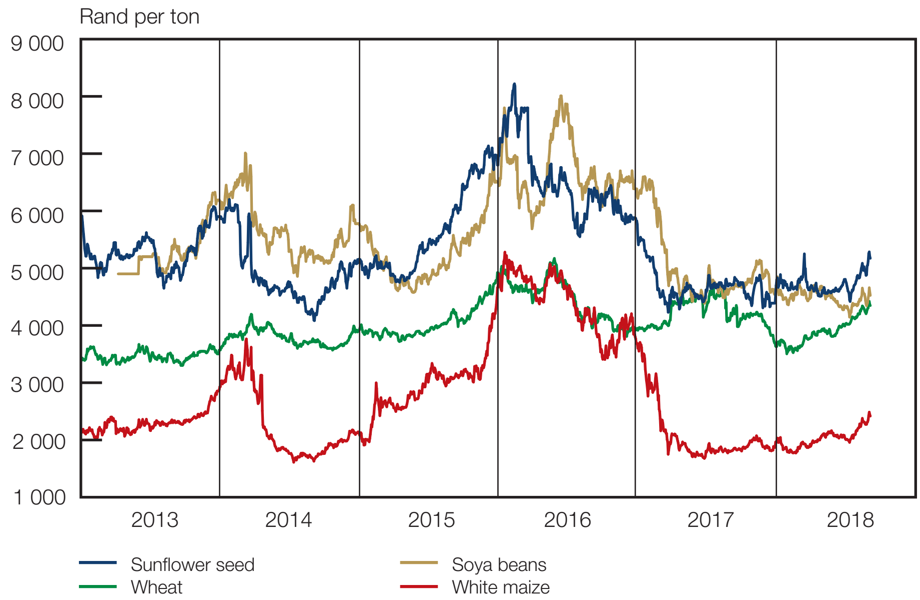
The overall historical *price-earnings ratio* of shares listed on the JSE increased from a recent low of 18.2 in April 2018 to 22.1 in August, as total earnings declined.

Market for exchange-traded derivatives

The *spot prices of most agricultural commodity contracts* listed on the JSE Commodity Derivatives Market as discussed below, moved broadly sideways from the end of March 2017 followed by an upward bias in 2018. The spot price of white maize increased by 36.4% from a low of R1 772 per ton on 23 February 2018 to R2 417 per ton on 7 September, as the exchange value of the rand depreciated and international oil prices increased. However, further increases could be softened somewhat as regional markets are not expected to absorb a significant portion of the domestic surplus. Similarly, the spot price of sunflower seeds increased by 20.1% from a low on 29 November 2017 to 7 September 2018.

The spot price of domestic wheat increased by 24.0% from R3 505 per ton on 31 January 2018 to R4 347 per ton on 7 September, reflecting the depreciation in the exchange value of the rand and global developments as South Africa is a net importer of wheat. International wheat prices increased due to unfavourable weather conditions in the European Union and Black Sea regions. The domestic wheat import tariff was lowered to R281.7 per ton on 13 July 2018, before being increased again to R640.6 per ton on 24 August.

South African agricultural commodity prices



Source: JSE

Hedging activity against adverse movements in exchange rates contributed to a notable increase in turnover in currency derivatives in the eight months to August 2018 compared to the corresponding period of 2017. Meanwhile, turnover in the equity, commodity and interest rate derivatives markets increased only modestly over the same period. However, the value of equity derivatives continued to dominate overall derivatives turnover on the JSE.

Derivatives turnover on the JSE, January to August 2018

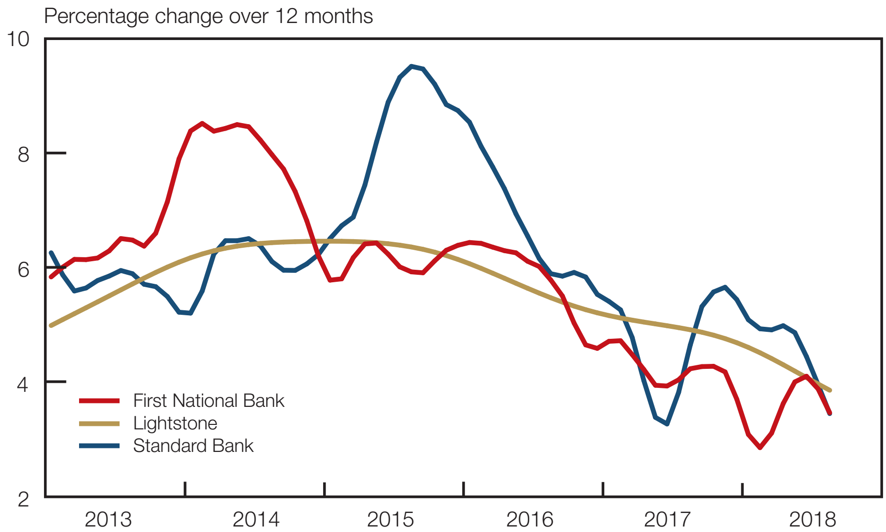
Type of derivative	Value (R billions)	Change over one year (Per cent)
Equity	3 735	1
Warrants	1	72
Commodity	426	8
Interest rate	1 029	9
Currency	635	15

Source: JSE

Real estate market

Growth in nominal house prices remained subdued in 2018, with year-on-year rates of increase varying between 3.4% and 3.9% across the different indicators in August 2018, and therefore recorded a decline in real terms. Growth in residential property prices remained lacklustre despite relatively low domestic interest rates and improved consumer confidence, weighed down by sluggish economic growth, high unemployment, weak property demand and slow growth in household disposable income. The average time that residential properties remained on the market increased markedly from 14.1 weeks in the first quarter of 2018 to 16.4 weeks in the second quarter.

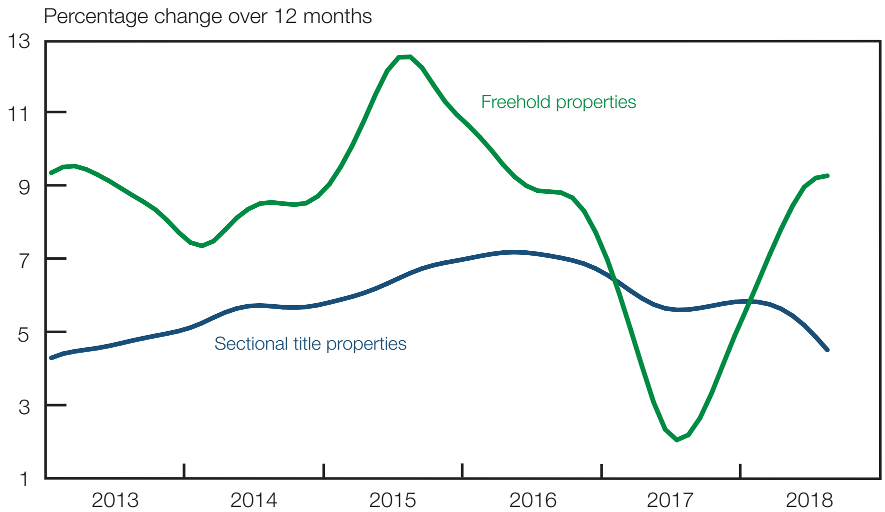
Nominal house prices



Sources: First National Bank, Lightstone and Standard Bank

According to Standard Bank, growth in sectional title property prices slowed slightly from a year-on-year rate of 5.6% in August 2017 to 4.5% in August 2018, while that in freehold property prices accelerated from 2.2% to 9.3% over the same period.

Nominal prices of specific types of properties



Source: Standard Bank

Non-bank financial intermediaries[12]

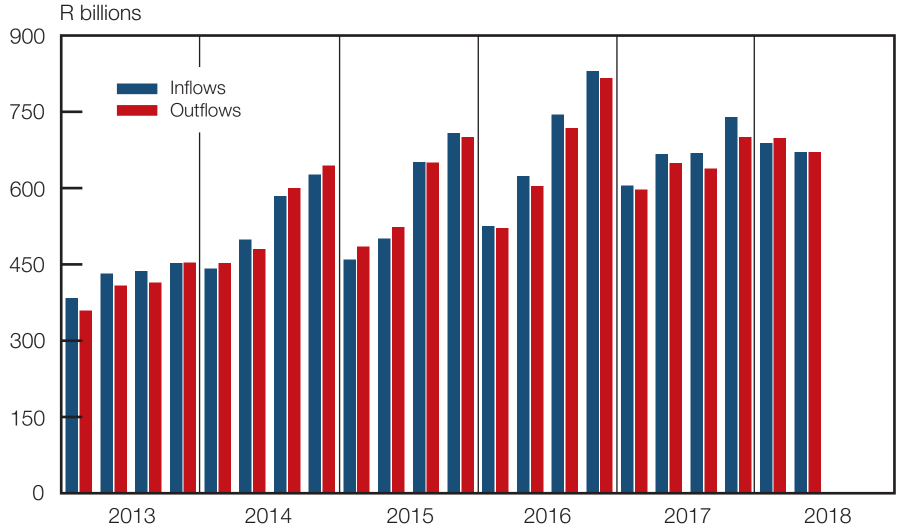
Challenging economic conditions and subdued household disposable income adversely affected the inflow of funds to non-bank financial institutions in the second quarter of 2018. Nominal gross inflows[13] to non-bank financial institutions – a combination of inflows and product switches – increased from R1.3 trillion in the first half of 2017 to R1.4 trillion in the first half of 2018, and declined by 2.6% from the first quarter of 2018 to R671 billion in the second quarter. Measured as a percentage of GDP, gross inflows declined by 0.9 percentage points from the second quarter of 2017 to 13.6% in the second quarter of 2018. Premiums received by insurers increased by 3.3% from the first quarter of 2018 to R149 billion in the second quarter, amid weak employment growth and a strain on the cash flow of households following significant fuel price and tax increases. Premiums received from employer-based business increased the most, by 8.1% to R46.6 billion over the same period, while contributions received by pension

12 Non-bank financial intermediaries consist of insurance companies, pension and provident funds, and unit trusts.

13 Gross inflows consist of contributions, premiums received and sales of units.

and provident funds were negatively affected by the weak labour market. Meanwhile, gross inflows to unit trusts declined by R21.3 billion from the first quarter of 2018 to R485 billion in the second quarter, with sales of units by money market unit trusts declining to R348 billion over the same period.

Gross financial flows of non-bank financial institutions



Source: SARB

Nominal gross outflows[14] from non-bank financial institutions declined by 3.8% from the first quarter of 2018 to R671 billion in the second quarter. Claims, annuities and premiums on reinsurance paid by insurers and policy surrenders increased by 4.3% to R127 billion over the same period, while benefits paid by pension and provident funds declined in the second quarter of 2018. Gross outflows from unit trusts declined by R23.7 billion from the first quarter of 2018 to R472 billion in the second quarter, with repurchases of units by households declining by R2.9 billion to R244 billion over the same period.

14 Gross outflows consist of benefits and claims paid, surrenders, repurchases of units and administrative expenses.

Net cash outflows[15] from non-bank financial institutions declined from R9.8 billion in the first quarter of 2018 to R0.6 billion in the second quarter. Net cash outflows amounted to R10.5 billion in the first half of 2018 compared to net inflows of R25.7 billion in the same period of 2017. Growth in the balance sheet of these institutions is likely to be more affected by holding gains and losses as opposed to inflows in the short to medium term.

15 Net cash outflows are measured as the difference between gross inflows and gross outflows.

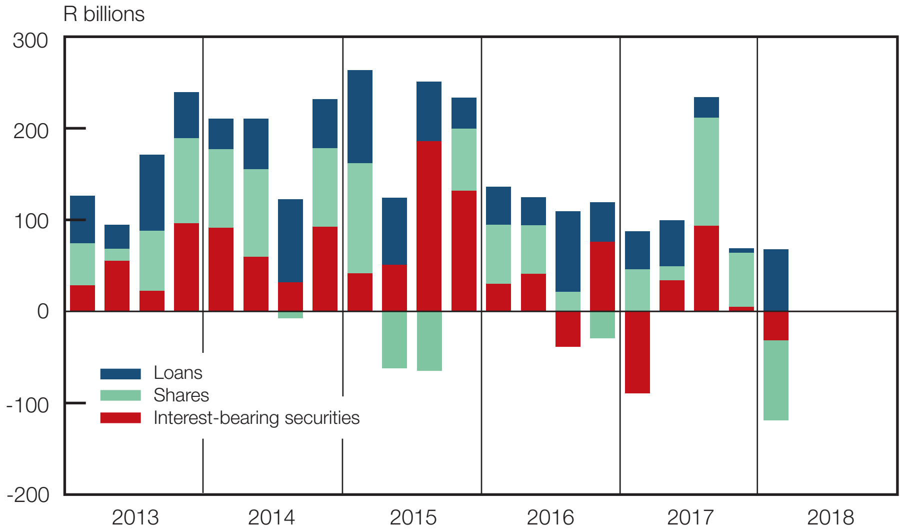
Flow of funds

Net capital inflows from the *rest of the world* of R72.5 billion in the first quarter of 2018 were substantially higher than the R13.4 billion recorded in the final quarter of 2017. Net purchases of interest-bearing securities increased from R26.9 billion in the fourth quarter of 2017 to R46.9 billion in the first quarter of 2018, while inflows from net purchases of domestic shares slowed from R61.0 billion to R48.0 billion over the same period. Meanwhile, net flows through loans rebounded significantly, from a net outflow of R46.7 billion in the last quarter of 2017 to a net inflow of R18.4 billion in the first quarter of 2018.

Financial intermediation flows decreased in the first quarter of 2018 along with the contraction in domestic output. Intermediation through shares and interest-bearing securities contracted by R87.4 billion and R31.5 billion respectively in the first quarter of 2018. However, loans extended by financial intermediaries accelerated to R67.7 billion in the first quarter of 2018, from R4.8 billion in the final quarter of 2017. Bank loans and advances increased notably to R79.0 billion in the first quarter of 2018 from R7.8 billion in the final quarter of 2017, while mortgage loans amounted to R26.1 billion from R20.4 billion over the same period. Most of these loans were extended to non-financial corporate business enterprises.

Financial intermediaries sourced funds through deposits of R40.9 billion and interest in life and retirement funds of R41.2 billion during the first quarter of 2018. In addition, the other financial institutions obtained R15.3 billion for investment into other financial assets.

Financial intermediation by main instruments



Source: SARB

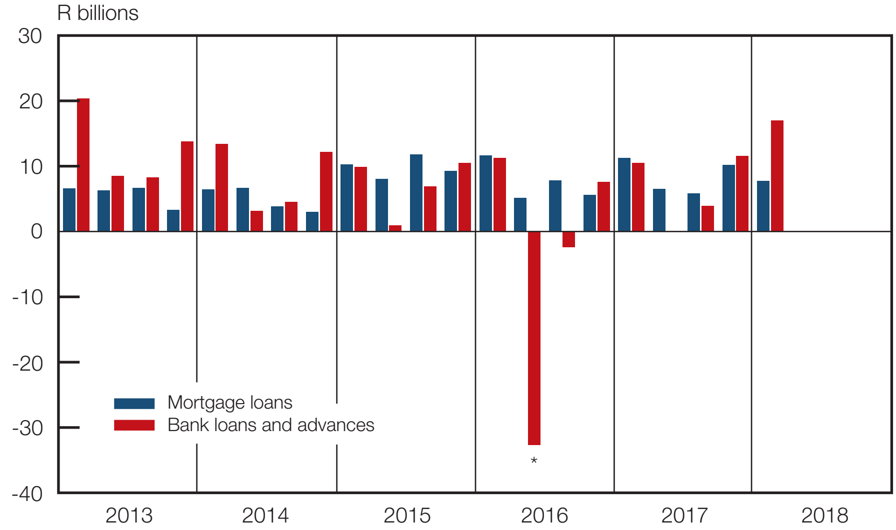
The *general government sector's* net borrowing requirement narrowed from R35.9 billion in the fourth quarter of 2017 to R21.4 billion in the first quarter of 2018. The narrowing occurred in central and provincial governments, while the net borrowing of local governments widened during the review period. General government continued to raise most of its funding in the domestic capital market during the first quarter of 2018 through net issues of long-term government bonds of R54.9 billion. Additionally, this sector reduced its deposit holdings by R18.8 billion. Non-residents continued to be net purchasers of long-term government bonds to the value of R46.7 billion, while non-bank financial institutions took up R8.5 billion.

Public and private non-financial corporate business enterprises' capital outlays contracted from R152 billion in the final quarter of 2017 to R131 billion in the first quarter of 2018, despite the improvement in business confidence. The decrease was particularly pronounced in residential buildings, transport equipment as well as machinery and equipment. Similarly, non-financial corporate business enterprises' deposits contracted by R3.1 billion in the first quarter of 2018. Corporate business enterprises' net borrowing requirement amounted to R2.3 billion in the first quarter of 2018 from R9.5 billion in the previous quarter. This financing shortfall was mainly funded through the accumulation of loans.

Despite improved consumer confidence in the first quarter of 2018, the *household sector's* flows remained subdued amid still high but declining debt levels, slow income growth and a lack of employment opportunities. Trade credit and short-term loans contributed the most to the increase in loans acquired by households from R27.6 billion in the final quarter of 2017 to R43.9 billion in the first quarter of 2018. Mortgage loans slowed from R10.2 billion to R7.7 billion over the review period, whereas bank loans and advances increased from R11.6 billion to R17.0 billion. Meanwhile, household deposits moderated from R24.3 billion in the fourth quarter of 2017 to R11.3 billion in the first quarter of 2018. Households' interest in retirement and life funds as well as funds placed with other financial institutions for investment also slowed markedly to a combined amount of R29.1 billion in the first quarter of 2018 from R71.1 billion in the last quarter of 2017.

Financial asset flows therefore moderated and households' net borrowing position widened from R4.1 billion in the fourth quarter of 2017 to R64.7 billion in the first quarter of 2018.

Borrowing by households



* Technical correction in April due to the restructuring of a bank

Source: SARB

Public finance[16]

Non-financial public sector borrowing requirement[17]

The preliminary *non-financial public sector borrowing requirement* of R44.2 billion in the first quarter of fiscal 2018/19 (April–June 2018) was R29.0 billion less than in the corresponding period of the previous fiscal year. This could be attributed to the much smaller cash deficit of consolidated general government following improvements at all tiers. Extra-budgetary institutions, social security funds and provincial governments all recorded larger cash surpluses than a year earlier. By contrast, the cash deficit of non-financial public enterprises and corporations increased.

16 Unless stated to the contrary, the year-on-year rates of increase in this section compare April–June 2018 to April–June 2017. Data for April–June 2018 are unaudited and remain preliminary.

17 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

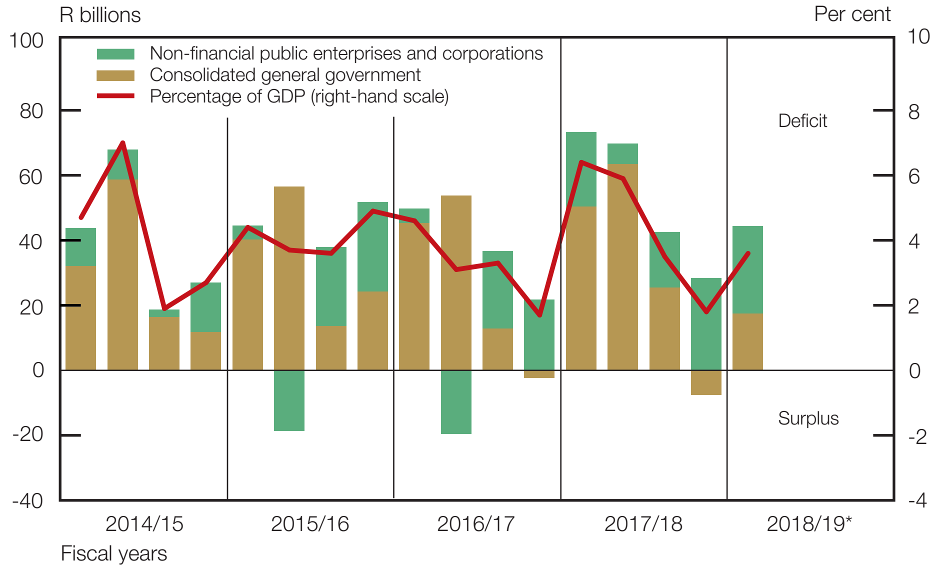
Level of government	Apr–Jun* 2017	Apr–Jun* 2018
Consolidated general government	50.4	17.5
National government	*34.1*	*22.2*
Extra-budgetary institutions	*-3.1*	*-9.0*
Social security funds	*-4.8*	*-6.3*
Provincial governments	*-4.3*	*-8.8*
Local governments	*28.4*	*19.2*
Non-financial public enterprises and corporations	22.9	26.8
Total**	73.3	44.2
As a percentage of gross domestic product	*6.4*	*3.6*

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

Sources: National Treasury, Stats SA and SARB

As a percentage of gross domestic product (GDP), the non-financial public sector borrowing requirement decreased significantly to 3.6% in the first three months of fiscal 2018/19, from 6.4% in the same period of the previous fiscal year.

Non-financial public sector borrowing requirement

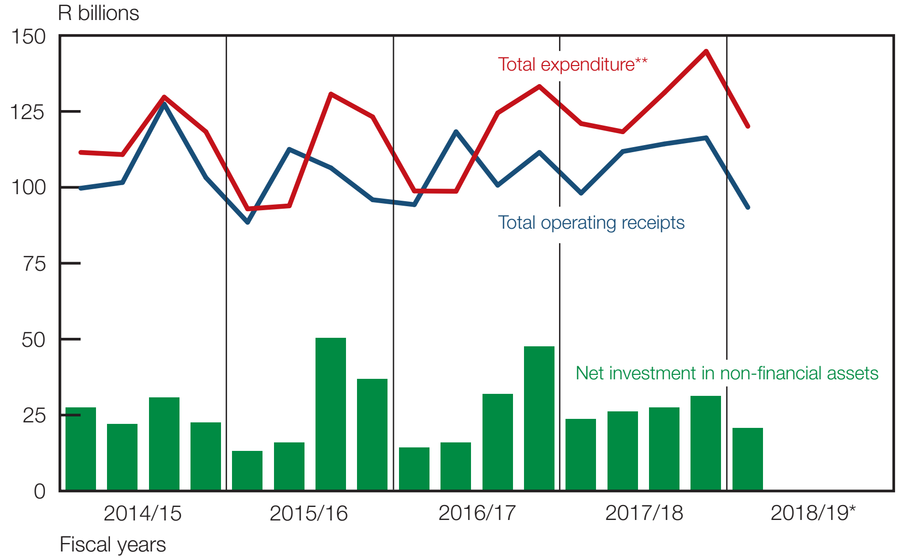


* April–June 2018

Sources: National Treasury, Stats SA and SARB

The cash deficit of the *non-financial public enterprises and corporations*, or non-financial state-owned companies (SOCs), increased by R3.9 billion to R26.8 billion in the period April–June 2017 to April–June 2018, as a marked decline in cash receipts from operating activities exceeded the decline in expenditure. Total operating cash receipts declined by 4.9% from the first quarter of fiscal 2017/18 to R93.4 billion in the first quarter of fiscal 2018/19, and by a notable 19.7% quarter to quarter. This reflected constrained operational performances of major SOCs.

Financial activities of non-financial public enterprises and corporations



* April–June 2018
** Including both operating cash payments and net investment in non-financial assets

Source: SARB

Total expenditure by non-financial SOCs, including both operational expenses and net investment in non-financial assets, decreased to R120 billion, or by 0.7%, in the first quarter of fiscal 2018/19 when compared to the same period a year earlier. The decline reflected lower capital spending by non-financial SOCs, with net investment in non-financial assets decreasing to R20.7 billion in the first quarter of fiscal 2018/19 – R2.9 billion less than in the same period of the previous fiscal year.

Budget comparable analysis of national government finance

National government's cash book deficit was smaller in the first quarter of fiscal 2018/19 than in the same period of the previous fiscal year, as year-on-year growth in revenue outpaced that in expenditure. However, both revenue and expenditure grew by less than projected for the full fiscal year.

National government finances in fiscal 2018/19

Year-on-year percentage change

	Actual Apr–Jun 2017	Actual Apr–Jun 2018	Originally budgeted* Full 2018/19
Expenditure	5.9	5.5	7.7
Revenue	3.8	9.6	10.9
Memo: cash book deficit	R36.9 billion	R27.9 billion	R191 billion

* *2018 Budget Review*

Sources: National Treasury and SARS

National government expenditure of R325 billion in the first quarter of fiscal 2018/19 was 5.5% more than in the first quarter of fiscal 2017/18. As a ratio of GDP, national government expenditure was 26.3% in April–June 2018, slightly lower than the 26.8% recorded in the same period a year earlier.

National government expenditure in fiscal 2018/19

Expenditure item	Originally budgeted Full 2018/19		Actual Apr–Jun 2018	
	R billions	Percentage change*	R billions	Percentage change*
Voted expenditure	814.5	6.0	178.4	5.8
Of which: Transfers and subsidies	*569.7*	*9.4*	*126.4*	*10.6*
Current payments	*226.1*	*5.0*	*49.9*	*0.2*
Payments for capital assets	*14.3*	*1.6*	*2.0*	*-10.8*
Statutory amounts**	697.7	9.7	147.1	5.3
Of which: Interest on debt	*180.0*	*10.7*	*24.3*	*-0.1*
Equitable share transfers	*470.3*	*6.6*	*117.6*	*6.6*
Total expenditure	1 512.2	7.7	325.4	5.5

* Fiscal 2018/19 compared to fiscal 2017/18. Note that the numbers might differ from previous editions of the *Quarterly Bulletin* due to the audited outcome of fiscal 2017/18.
** Including extraordinary payments

Source: National Treasury

Voted expenditure of R178 billion contributed the most to national government expenditure, with current payments as well as transfers and subsidies accounting for about 99% of total voted expenditure. Transfers and subsidies, which accounted for 70.9% of total voted expenditure, increased by a notable 10.6% in the first quarter of fiscal 2018/19 compared to the same period in the previous fiscal year. This largely reflected higher transfers to the departments of Education, Social Development, Transport and Health. Current payments amounted to R49.9 billion in the first quarter of fiscal 2018/19, which was only 0.2% more than in the same period of the previous fiscal year. Current payments mainly comprised spending by the departments of Correctional Services, Police, and Defence and Military Veterans, which together accounted for 67.4% of total current payments.

Interest paid on national government debt of R24.3 billion in the first quarter of fiscal 2018/19 was 0.1% less than in the same period a year earlier. For fiscal 2018/19 as a whole, the R180 billion budgeted for interest payments represents an increase of 10.7% from the previous fiscal year and reflects the rising stock of national government debt.

Equitable share transfers to provinces increased by 6.6% to R118 billion in April–June 2018 compared to the same period of the previous fiscal year. For fiscal 2018/19 as a whole, the February 2018 Budget projected provinces to receive R470 billion as equitable shares and metropolitan municipalities to receive R12.5 billion as their share of the general fuel levy.

After accounting for cash flow adjustments,[18] the cash flow expenditure of national government of R317 billion in the first quarter of fiscal 2018/19 was 6.1% more than in the same period of the previous fiscal year.

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

National government revenue increased by 9.6% to R298 billion in the first quarter of fiscal 2018/19 compared to the same quarter a year earlier. The notable increase in national government revenue resulted from strong growth in almost all tax categories. As a ratio of GDP, national government revenue was 24.1% in the first quarter of fiscal 2018/19 – higher than the 23.6% recorded in the same period of the previous fiscal year. The *2018 Budget Review* projected national government revenue to increase by 10.9% to R1 321 billion in fiscal 2018/19.

National government revenue in fiscal 2018/19

Revenue source	Originally budgeted Full 2018/19		Actual Apr–Jun 2018	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	773.0	8.6	177.5	6.8
Income tax on individuals	*507.3*	*9.6*	*112.5*	*7.8*
Income tax on companies	*234.1*	*6.3*	*56.7*	*4.2*
Payroll taxes	16.9	5.7	4.1	9.6
Taxes on property	17.3	4.4	4.0	-6.8
Taxes on goods and services	484.6	14.8	107.0	16.6
Value-added tax (VAT) net	*348.1*	*16.8*	*75.6*	*19.6*
Domestic	*378.6*	*12.6*	*90.0*	*11.6*
Import	*169.5*	*10.9*	*30.7*	*7.2*
General fuel levy	*77.5*	*9.2*	*17.8*	*9.1*
Excise duties	*46.5*	*13.1*	*10.6*	*14.9*
Taxes on international trade and transactions	54.1	8.2	9.8	4.8
Import duties	*46.3*	*-5.8*	*9.6*	*6.5*
Other revenue**	23.6	-24.9	7.4	-28.1
Less: SACU*** payments	48.3	-13.7	12.1	-13.8
Total revenue	1 321.1	10.9	297.6	9.6

* Fiscal 2018/19 compared to fiscal 2017/18
** Including non-tax revenue and extraordinary receipts, but excluding premiums on debt portfolio restructuring and loan transactions that amounted to R0.3 billion in April–June 2018
*** Southern African Customs Union

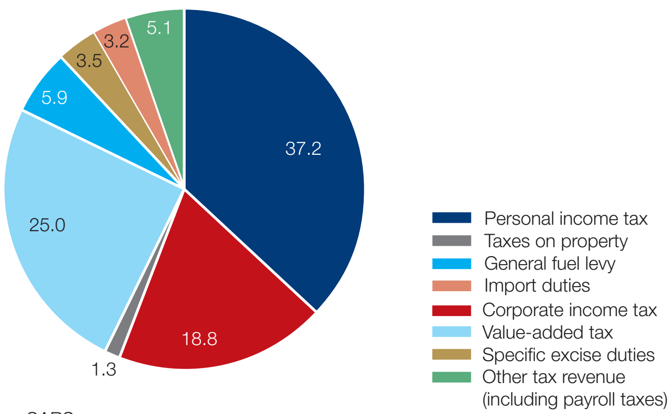
Sources: National Treasury and SARS

Taxes on income, profits and capital gains of R177 billion in April–June 2018 was 6.8% more than in April–June 2017, primarily due to higher personal income tax collected. Corporate income tax collected also increased over the same period, mainly due to higher provisional tax payments in June 2018. However, taxes on income, profits and capital gains still grew at a slightly slower pace than the 8.6% projected for fiscal 2018/19 as a whole.

Taxes on property of R4.0 billion in the first quarter of fiscal 2018/19 decreased by 6.8% compared to the same quarter a year earlier. This resulted from lower collections of transfer duties which declined by 6.9% to R1.9 billion, along with a slowdown in the real estate market which could be reflective of the ongoing debate around land expropriation without compensation.

Composition of national government tax revenue, April–June 2018

Per cent



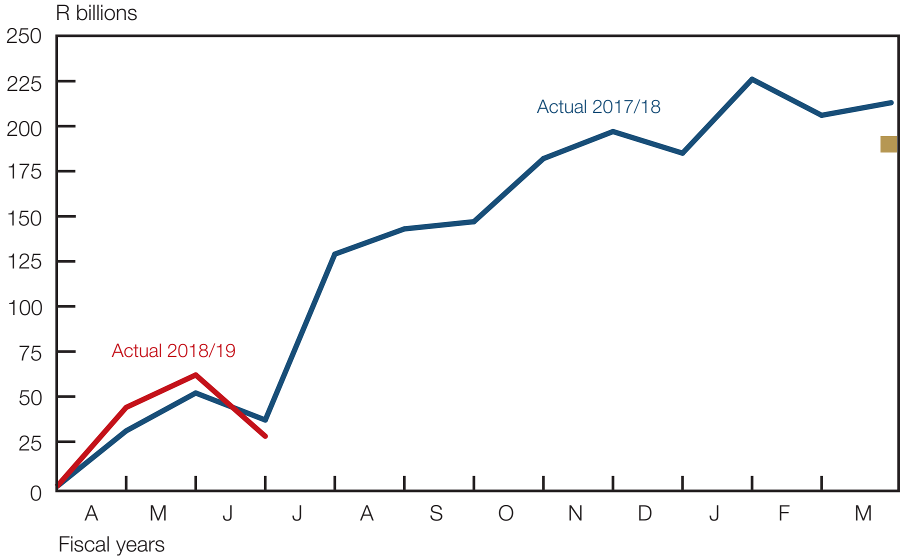
Source: SARS

Taxes on goods and services recorded the strongest growth of 16.6% in the first quarter of fiscal 2018/19 compared to the same quarter a year earlier. In particular, value-added tax (VAT) collected increased significantly by 19.6% and reflected the 1 percentage point increase in the VAT rate to 15% as from 1 April 2018. VAT collections nevertheless still fell short of the originally budgeted monthly targets due to slightly weaker consumer demand than initially anticipated. Revenue from the general fuel levy and excise duties also increased strongly, by 9.1% and 14.9% respectively, in the first quarter of fiscal 2018/19 compared to the same period in the previous fiscal year.

Taxes on international trade and transactions amounted to R9.8 billion in the first quarter of fiscal 2018/19 – an increase of 4.8% compared to the same period of the previous fiscal year – mainly due to higher import duties collected on vehicles and electrical machinery.

Non-tax revenue declined from R10.1 billion in April–June 2017 to R7.4 billion in April–June 2018 due to lower revaluation proceeds from foreign currency transactions. The Southern African Customs Union (SACU) received R12.1 billion in the first quarter of fiscal 2018/19. The *2018 Budget Review* allocated R48.3 billion to SACU in fiscal 2018/19, 13.7% less than in the previous fiscal year, which reflects expected weaker imports and lower customs and excise duties.

Cumulative deficit of national government



Originally budgeted deficit of R191 billion for fiscal 2018/19

Sources: National Treasury, SARS and SARB

Developments in national government revenue and expenditure in the first quarter of fiscal 2018/19 resulted in a cash book deficit of R27.9 billion, which was broadly in line with the monthly budgeted estimates and R9.0 billion less than in the same period of the previous fiscal year. The lower deficit reflected an improvement in national government revenue along with relatively contained expenditure over the period under review. The *2018 Budget Review* projected a cash book deficit of R191 billion, or 3.8% of GDP for fiscal 2018/19 as a whole.

National government's primary deficit[19] of R3.6 billion in the first quarter of fiscal 2018/19 was R9.0 billion less than in the first quarter of the preceding fiscal year. As a ratio of GDP, the primary deficit was 0.3% in April–June 2018 compared to 1.1% in April–June 2017. The *2018 Budget Review* projected a national government primary deficit of 0.2% for the full 2018/19 fiscal year.

19 This is the deficit/surplus recalculated by excluding interest payments from total expenditure.

National government financing

R billions

Item or instrument	Actual Apr–Jun 2017	Actual Apr–Jun 2018	Originally budgeted[1] Full 2018/19
Cash book deficit	**36.9**	**27.9**	**191.1**
Cash flow deficit[2]	**26.6**	**18.0**	**...**
Plus: Cost/profit on revaluation of foreign debt at redemption[3]	1.6	0.3	0.8
Net borrowing requirement	**28.2**	**18.3**	**191.9**
Treasury bills and short-term loans[4]	21.3	4.6	14.2
Domestic government bonds[4]	36.3	34.9	159.9
Foreign bonds and loans[4]	-1.3	24.6	36.8
Change in available cash balances[5]	-28.4	-45.8	-19.0
Total net financing[6]	**28.2**	**18.3**	**191.9**

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

Sources: National Treasury and SARB

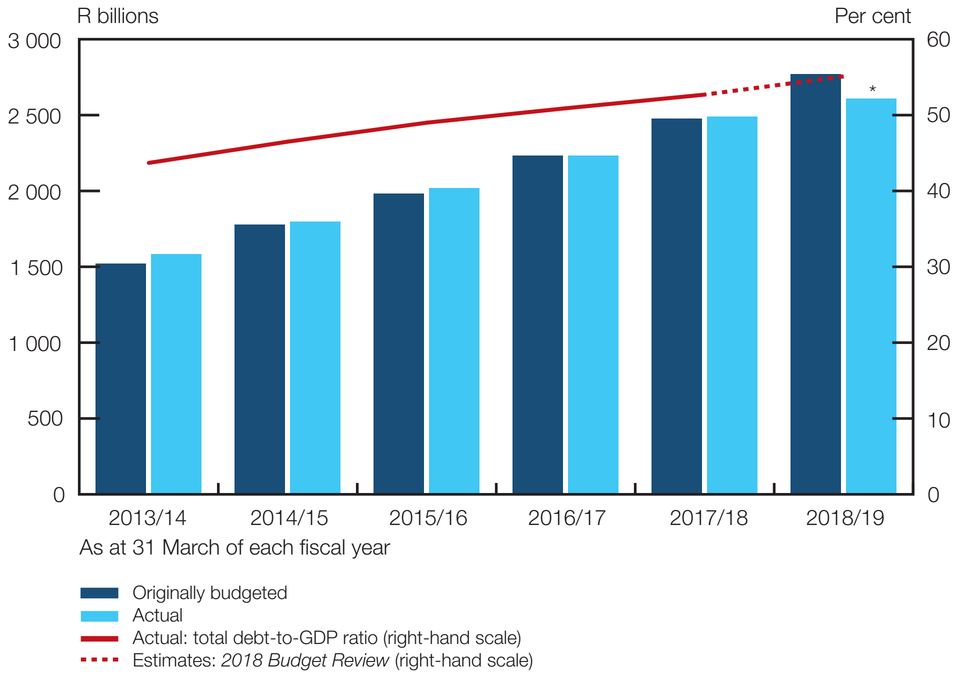
National government's cash flow deficit of R18.0 billion in April–June 2018 was R8.6 billion less than in the same period of the previous fiscal year. After taking the cost on revaluation of foreign debt at redemption into account, the net borrowing requirement of R18.3 billion in April–June 2018 was R9.9 billion less than in the same period a year earlier.

The net borrowing requirement was largely financed in the domestic capital market through the issuance of government bonds, but also through foreign bonds and loans. Total net issuances of domestic government bonds of R34.9 billion in April–June 2018 was slightly less than in April–June 2017. The net issuances of foreign bonds and loans by national government of R24.6 billion in the first quarter of fiscal 2018/19 was in contrast to net redemptions of R1.3 billion in April–June 2017.

The funding activities of national government increased the available cash balances by R45.8 billion in April–June 2018, which brought these balances to R327 billion at the end of June 2018. Of this, R245 billion was on deposit at the South African Reserve Bank (SARB) and the remainder at commercial banks.

National government's total gross loan debt (domestic and foreign currency-denominated debt) increased by R118 billion in the first quarter of fiscal 2018/19, which brought total outstanding debt to R2 608 billion as at 30 June 2018. The stock of both domestic and foreign currency-denominated debt increased during the period under review, with foreign currency-denominated debt increasing slightly more than rand-denominated debt. National government's domestic debt accounted for about 89% of total debt, and foreign currency-denominated debt for the balance.

Total gross loan debt of national government



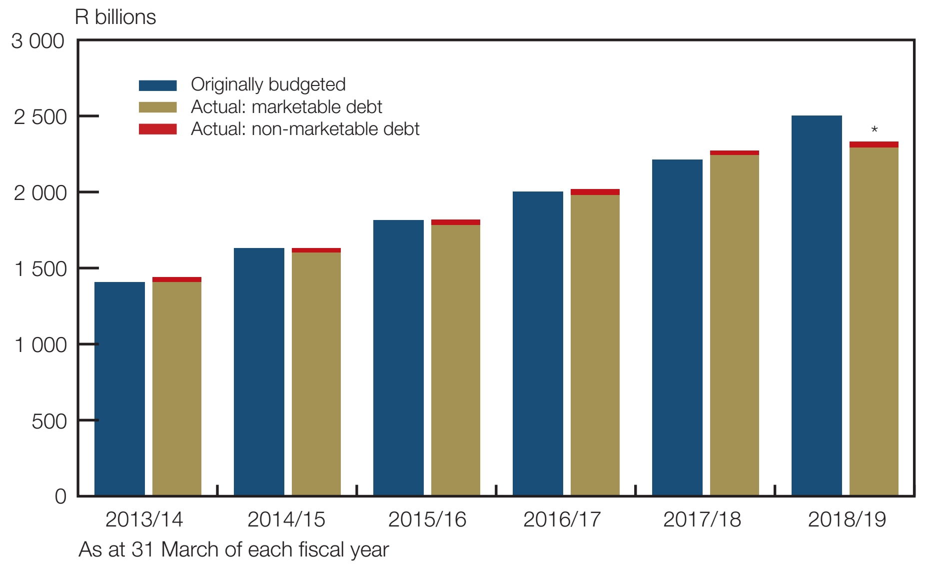
* As at 30 June 2018

Sources: National Treasury, Stats SA and SARB

As a ratio of GDP, national government's total gross loan debt of 54.2% as at 30 June 2018 was higher than the 52.7% as at 31 March 2018. The *2018 Budget Review* projected total gross loan debt of R2 771 billion (55.1% of GDP) at the end of fiscal 2018/19.

Domestic debt of national government increased by R58.4 billion to R2 330 billion between the end of March and the end of June 2018. The increase could largely be attributed to issuances of domestic marketable debt instruments (marketable bonds and Treasury bills). These instruments represented about 98% of total outstanding domestic debt. The *2018 Budget Review* projected total gross domestic debt of national government of R2 502 billion (49.8% of GDP) by the end of fiscal 2018/19.

Domestic debt of national government

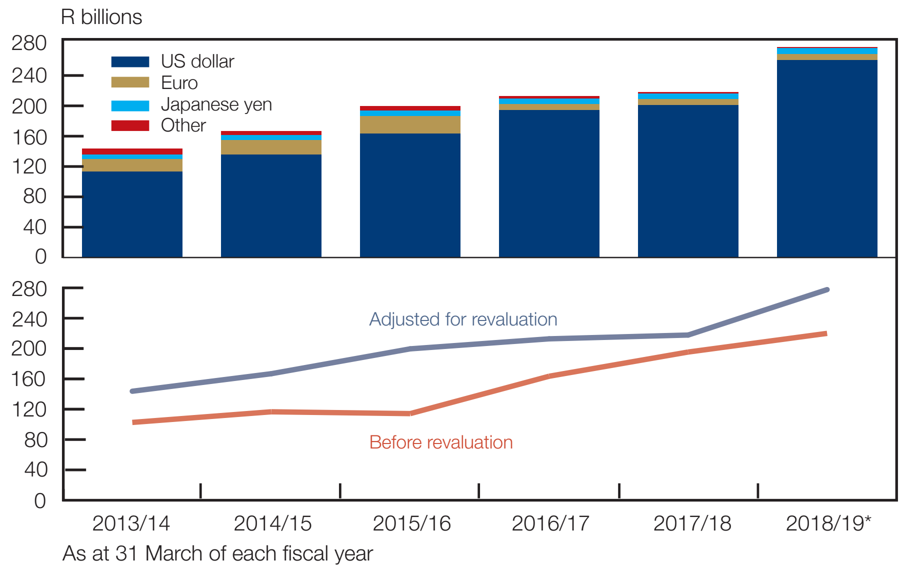


* As at 30 June 2018

Sources: National Treasury and SARB

The total outstanding balance of national government's foreign currency-denominated debt increased by R59.9 billion in the first quarter of fiscal 2018/19, to R278 billion as at 30 June 2018. The increase reflected both net issuances and fluctuations in the exchange value of the rand. National government issued two bonds to the value of US$2.0 billion in May 2018, which raised a rand equivalent of R25.2 billion.

Foreign currency-denominated debt of national government



* As at 30 June 2018

Sources: National Treasury and SARB

The national government's foreign currency-denominated debt was R220 billion as at 30 June 2018 before adjusting for exchange rate revaluation effects (the difference between foreign debt valued at historical versus prevailing exchange rates) and R278 billion after revaluation. The rand depreciated against major currencies, in particular the US dollar, in the first quarter of the current fiscal year. Debt denominated in US dollars accounted for 93.6% of national government's foreign currency-denominated debt, with the balance split between the euro, the Japanese yen, the British pound and the Swedish krona. The *2018 Budget Review* projected foreign currency-denominated government debt of R268 billion (5.3% of GDP) at the end of fiscal 2018/19.

Note on South Africa's international investment position[1, 2]

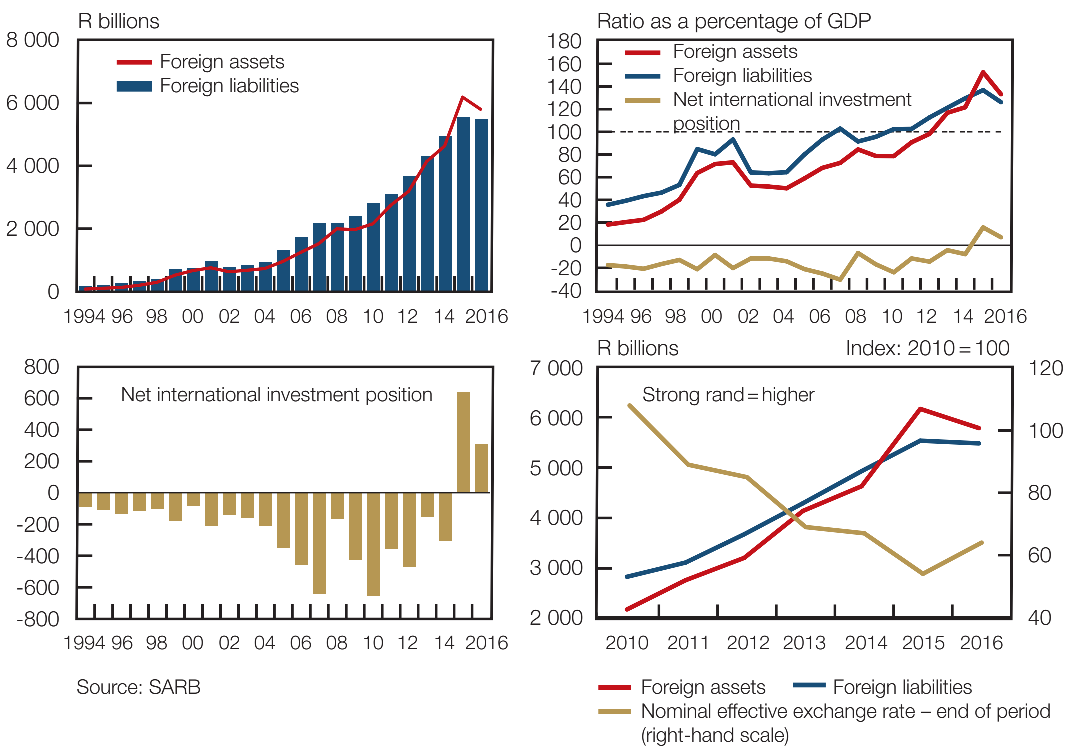
by Piet Swart and Mawande Qubeka

Introduction

The international investment position (IIP) of a country is a point-in-time statement of the value[3] of the residents' financial claims on non-residents (outward investment) and liabilities to non-residents (inward investment). The stock positions, or outstanding balances, of both South Africa's foreign financial assets and foreign liabilities relative to gross domestic product (GDP) increased significantly after 1994, as cross-border financial activity increased notably following the removal of trade and financial sanctions against South Africa. The net IIP is the difference between foreign financial assets and foreign liabilities, which could either be a net claim (creditor) on or a net liability (debtor) to the rest of the world.

The year 2015 marked South Africa's first positive net IIP since the inception of this statistic in 1956. The switch to a net positive asset position was brought about by the decline, on balance, of 19.7% in the nominal effective exchange rate (NEER) of the rand in 2015, together with holding (valuation) gains in South Africa's foreign financial assets due to price increases abroad. Subsequently, the net IIP narrowed in 2016, partly as a result of a strengthening in the exchange value of the rand. Changes in the exchange value of the rand have a larger effect on foreign financial assets, as they are more exposed to foreign currency-denominated financial instruments than foreign liabilities. This is brought about by rand-denominated equity liabilities and a near-equal split between foreign and domestic currency-denominated debt liabilities. The value of domestic currency-denominated debt liabilities is largely due to significant non-resident holdings of South African government bonds.

South Africa's international investment position



Source: SARB

1 The Economic Statistics Division of the Economic Research and Statistics Department of the South African Reserve Bank compiles South Africa's balance of payments according to the methodology as prescribed by the sixth edition of the International Monetary Fund's *Balance of Payments and International Investment Position Manual (BPM6)*.

2 This note is based on statistics presented in the tables on pages S–82, S–86, S–87 and S–92 to S–104 of this *Quarterly Bulletin*.

3 Financial assets and liabilities are generally valued at market value, with the exception of loans, deposits and accounts receivable or payable, which are recorded at nominal value.

The structure of South Africa's IIP dictates dividend and interest receipts from foreign financial assets and payments on foreign liabilities, with net income receipts and payments significantly affecting the balance on the current account of the balance of payments. On balance, net investment income payments persist despite a positive net IIP. This is due to the dominance of low-yielding dividend receipts on account of the high exposure to equity assets and relatively low interest rates on foreign debt assets. This effect is exacerbated by the larger exposure to debt liabilities as well as a significant interest rate differential due to higher interest rates on domestic rand-denominated debt. This explains the coexistence of a positive net IIP and a deficit on the income balance of the current account.

The overall deficit on the current account of the balance of payments is financed by the net inflow of capital as measured by the balance on the financial account. The financial account flows, or transactions between residents and non-residents in a specific time period, comprise the net incurrence of liabilities (net of inflows and outflows) or the net acquisition of financial assets (net of inflows and outflows). This contributes to the change in the foreign financial asset position and the foreign liability position in the IIP. This linkage between the transactions in the financial account and the balances in the IIP comes together in the integrated IIP, which reconciles the opening and closing balances of the IIP. The difference between the opening and closing IIP balances could be decomposed into financial account transactions and other changes in stock positions. The latter consists of revaluations due to both price movements of financial assets and liabilities (holding gains and losses) and exchange rate fluctuations, as well as other volume changes, such as write-offs or reclassifications. South Africa does not yet compile an integrated IIP due to different data sources being used for the IIP and the financial account, such as dedicated surveys and administrative data, and difficulty in bringing the variety of sources together and measuring the population as a whole. The source data also limits the data dimensions of the financial account to only functional categories, financial instruments and resident institutional sectors, as it does not provide for a non-resident counterparty country breakdown or allocation to kind of economic activity, as in the case of the IIP.

The decomposition of foreign financial assets and foreign liabilities in the IIP by the various dimensions and subclassifications mentioned above facilitates the analysis of an economy's international economic relationships and external vulnerability. The only difference in data dimensions between foreign financial assets and foreign liabilities is that the latter are also disaggregated by kind of economic activity.

The functional dimension subclassifies foreign financial assets and foreign liabilities into direct, portfolio and other investment as well as financial derivatives, with reserve assets as an additional asset category. A direct investment relationship is established with equity holdings of 10% or more of the voting rights exerting significant influence, and with control at more than 50%. Under these conditions, and inclusive of transactions between fellow enterprises and affiliates,[4] all equity and debt instruments are classified as direct investment. Cross-border holdings of negotiable equity and debt securities other than direct investment are classified as portfolio investment. Other investment comprises loans, deposits, trade finance and special drawing rights (SDRs) with the International Monetary Fund on the liability side, and with reserve assets separate on the asset side.

4 A direct investment relationship also exists between enterprises that do not control or influence one another if both are under the influence or control of the same direct investor.

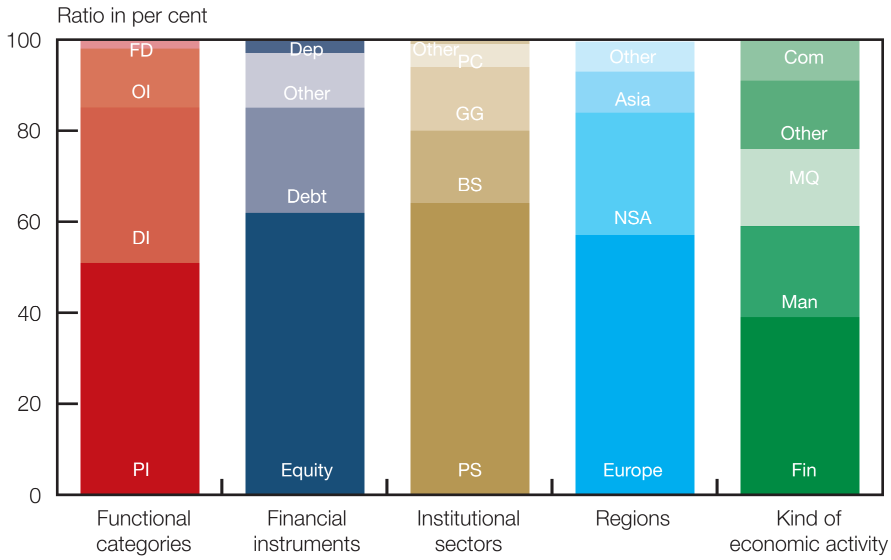
The financial instrument dimension subclassifies foreign financial assets and foreign liabilities into equity and investment fund shares which represent a residual claim on assets; debt instruments and securities requiring payment of the principal and/or interest; deposits with banks; loans where a creditor lends directly to a debtor; trade credit and advances; SDRs; and reserve assets.

The institutional sector dimension subclassifies the resident counterparties to foreign financial assets and foreign liabilities into the private non-banking sector, which comprises non-financial and financial corporations whose principal activity is the production of goods and the provision of financial services; monetary authorities; banks; general government; and public corporations.

The country and region dimension give a geographical breakdown of residence of the non-resident counterparties. South Africa's foreign liabilities are also presented by the kind of economic activity that receives funding.

An analysis of the foreign liability position as at the end of 2016 shows the dominance of portfolio and direct investment. Portfolio investment provides significant funding for the current account deficit and is related to the prevalence of equity and debt securities, with the latter reflecting non-resident holdings of government bonds issued in domestic currency, and with general government as the resident counterparty. The private non-banking sector is the sector with the largest foreign liabilities. Europe is South Africa's largest non-resident creditor counterparty. Most of the foreign funding is destined for the finance, insurance, real estate and business services sector, followed by manufacturing.

Composition of foreign liabilities as at 31 December 2016



Functional categories
PI: portfolio investment
DI: direct investment
OI: other investment
FD: financial derivatives

Financial instruments
Equity: equity and investment fund shares
Debt: debt instruments and securities
Other: loans, trade credit, SDRs and financial derivatives
Dep: deposits

Institutional sectors
PS: private non-banks
BS: banks
GG: general government
PC: public corporations
Other: monetary authorities and SDRs

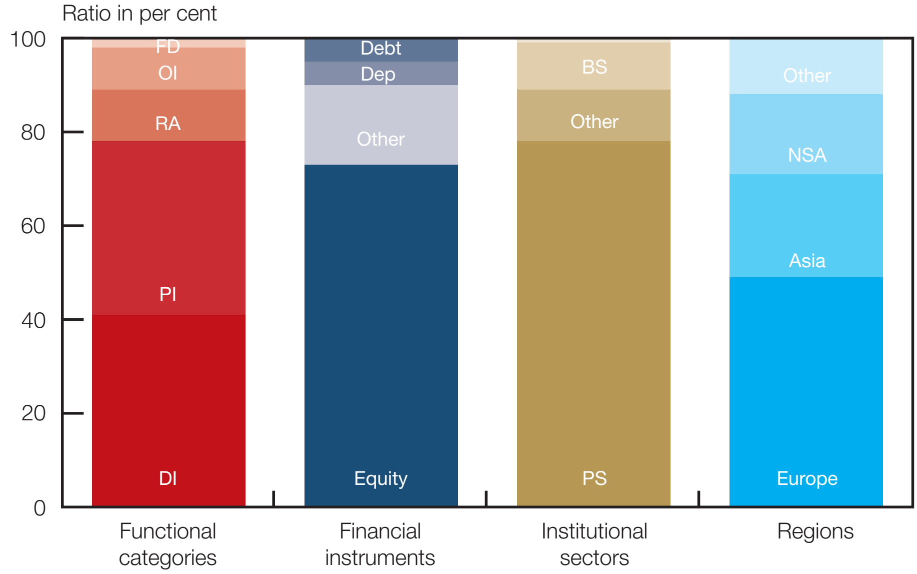
Regions
Europe
NSA: North and South America
Asia
Other: Africa, Oceania, international organisations and unidentified countries

Kind of economic activity
Fin: finance, insurance, real estate and business services
Man: manufacturing
MQ: mining and quarrying
Other: agriculture, forestry, hunting and fishing; electricity, gas and water; construction; wholesale and retail trade, catering and accommodation; and transport, storage and communication
Com: community, social and personal services

Source: SARB

The foreign financial assets position as at the end of 2016 shows the dominance of direct investment, reflecting a domestic technology investment company's significant holding gains from the appreciation in the market price of an investment abroad. This also contributed to the significant allocation to equities and the footprint of the private non-banking sector as resident counterparty, as well as non-resident counterparty exposure to Asia.

Composition of foreign assets as at 31 December 2016



Functional categories
DI: direct investment
PI: portfolio investment
RA: reserve assets
OI: other investment
FD: financial derivatives

Institutional sectors
PS: private non-banks
Other: monetary authorities, general government and public corporations
BS: banks

Financial instruments
Equity: equity and investment fund shares
Other: loans, trade advances, financial derivatives, and gold and foreign exchange
Dep: deposits
Debt: debt instruments and securities

Regions
Europe
Asia
NSA: North and South America
Other: Africa, Oceania, international organisations and unidentified countries

As at the end of 2016, the value of South Africa's foreign portfolio and other investment assets was less than foreign liabilities of the same categories, but a positive net position on direct investment, together with reserve assets, was more than enough to render an overall positive net IIP position. In value terms, net equity assets and debt liabilities dominated. In terms of resident institutional counterparty sectors, only the private non-banking sector and the monetary authorities' foreign assets exceeded foreign liabilities. South Africa also has more foreign liabilities than financial foreign assets in relation to Europe and North and South America. These comparisons shed some light on foreign asset and liability mismatches.

Note on South Africa's locational banking statistics

by Lisa de Beer and Marian van Deventer

Introduction

This note introduces the inaugural publication of South Africa's locational banking statistics (LBS) on pages S–26 and S–27 of the South African Reserve Bank's (SARB) *Quarterly Bulletin.* The Bank for International Settlements (BIS) developed LBS statistics under the guidance of the Committee on the Global Financial System, together with central banks, to provide a comprehensive and consistent source of statistics on banks' cross-border financial exposures to enhance the analysis of macroeconomic and financial stability issues. South Africa joined the initiative in 2009 and became the 43rd member of the group of reporting countries. In 2011, the Committee on the Global Financial System proposed major enhancements, which South Africa implemented fully in September 2013. The data are published in the *Quarterly Bulletin* on a quarterly basis, with a one-quarter lag, as from the third quarter of 2013.

Overview of underlying concepts and data dimensions[1]

The LBS by residency measure the aggregate balance sheet positions of cross-border financial assets (claims) and liabilities of all banks resident in a reporting country in relation to both non-resident counterparties in any currency, as well as resident counterparties of the reporting country in foreign and domestic currency. The reporting is based on the residence of the reporting banks and is aligned with the methodology of compiling the balance of payments. The LBS asset and liability positions are disaggregated into the following main dimensions: instruments, which are presented as financial instruments; bank type; currency; counterparty sectors, which are reflected as counterparty institutional sectors; and counterparty countries, which are aggregated into counterparty regions. All of these statistics are disaggregated into more detailed subcategories. Bank assets (claims) are broken down into loans and deposits, holdings of debt securities, and other claims. Bank liabilities are broken down into deposits and loans, own issues of debt securities, and other liabilities. The bank-type category disaggregates reporting banks into four types of institutions based on the nationality of the controlling parent institution of the reporting bank. The currency positions are broken down into domestic currency and the minimum recommended foreign currencies. The counterparty breakdowns reflect detailed institutional sectors and the regions in which the counterparty of the reporting bank's assets or liabilities reside.

The LBS by nationality regroup LBS by residency based on the nationality of the controlling parent institution of the reporting bank. Therefore, for each reporting country, the total assets (claims) and liabilities as well as the underlying detail for all banks that report according to LBS by residency equal the total assets and liabilities of the same banks in LBS by nationality. This integrated view enables the analysis of the transmission of shocks among countries through the banking system.

The valuation of assets (claims) and liabilities is based on standard valuation principles to ensure consistency and comparability. Positions are mostly valued at market prices, with the exception of deposits at nominal value and loans at nominal or contractual value. Assets (claims) and liabilities are reported on a gross basis (i.e. assets and liabilities in relation to the same counterparty are not netted). Arrears in interest and principal are included in assets and liabilities, and credit impairments are not deducted. However, claims written off are deducted.

The BIS reports LBS in US dollar terms, with currency conversion at the prevailing end-of-quarter exchange rate. The LBS position data reflect balances at quarter end, with transactions and valuation adjustments accounting for the difference between quarter-end balances.

1 For detailed guidance on the interpretation of locational banking statistics, consult 'Guidelines for reporting the BIS international banking statistics', March 2013. https://www.bis.org/statistics/bankstatsguide.htm

Locational banking statistics of South African-registered banks by residency and nationality as at the end of June 2018

R billions

Residency	Assets	Liabilities	Nationality	Assets	Liabilities
Domestic banks	500	391	South Africa	500	391
Subsidiaries	1	2	Bahrain	0	0
			Luxembourg	0	0
			Switzerland	0	0
			Portugal	1	1
			Greece	0	1
			Australia	0	0
Branches	91	149	United Kingdom	17	31
			India	3	8
			France	4	14
			Chinese Taipei	0	2
			United States	32	44
			Germany	2	6
			China	33	44
Total by residency	592	542	Total by nationality	592	542

Source: SARB

South Africa's locational banking statistics

The LBS for South Africa compiled by the Money and Banking Unit of the SARB's Economic Research and Statistics Department adhere to all the BIS principles. Reporting is mandatory for all South African banks (i.e. banks located within the borders of South Africa) registered in terms of the South African banking legislation.[2] Banks located in South Africa report their cross-border positions, which include positions with affiliates (i.e. branches, subsidiaries or joint ventures). All these banks report quarterly data per individual bank but the SARB and BIS only report at an aggregated country level. The classification of the non-resident sector (rest of the world) is based on balance of payments principles, and the distinction between residents and non-residents is explained in the *Institutional Sector Classification Guide for South Africa*[3] published by the SARB. Residents and non-residents can have positions denominated in either domestic or foreign currency.

The LBS are conceptually similar to the balance sheets of depository corporations (banks) used in the compilation of monetary and credit statistics. However, there are some important differences as the LBS exclude non-financial assets and are reported gross of impairments, in accordance with international statistical guidelines. There is also synergy between the LBS, balance of payments and international investment position. Therefore, the LBS' geographical breakdown is particularly useful and the financial instrument breakdown, although somewhat limited, provides input for the compilation of banking positions in the external accounts. The LBS also provide balance sheet information of the South African banking sector that complement the existing statistics in the tables on pages S–6 to S–9 of the *Quarterly Bulletin*, with detailed cross-border positions.

The total assets of banks comprise total cross-border assets, which consist of claims against non-resident counterparties in domestic and foreign currency, and claims against resident counterparties of the reporting country in foreign and domestic currency. Similarly, total liabilities of banks comprise total cross-border liabilities to non-resident counterparties in domestic and foreign currency, and liabilities to resident counterparties of the reporting country in foreign and domestic currency.

2 South African-registered banks refer to all deposit-taking institutions registered under the Banks Act 94 of 1990, excluding mutual banks.

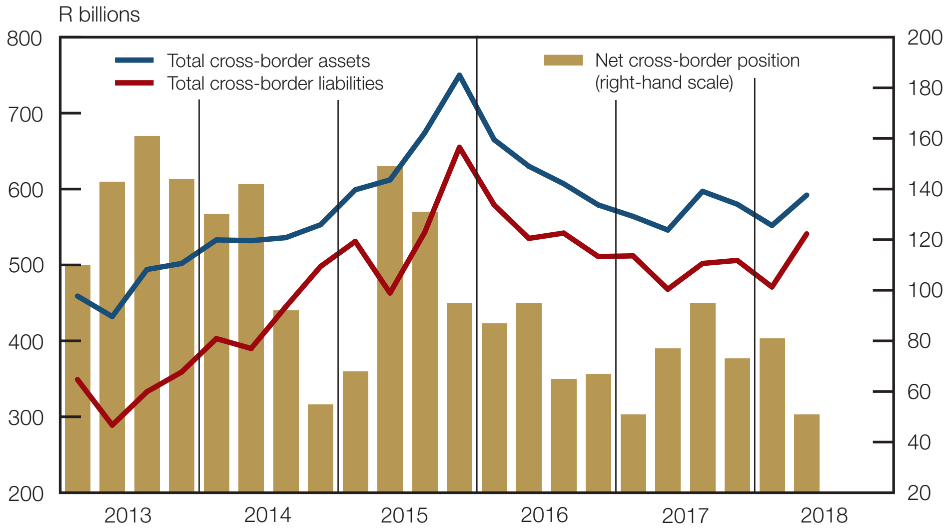
3 *Institutional Sector Classification Guide for South Africa*, March 2017, p 63. https://www.resbank.co.za/Publications/Guides/Pages/Institutional-Sector-Classification-Guide-for-SA-–-2017-.aspx

Analysis of South Africa's locational banking statistics

South African banks are more domestically focused with much less cross-border activity than those of many other countries. This is reflected by cross-border assets (claims) of only 11% of total assets and liabilities of only 9% of total liabilities as at the end of June 2018. This is significantly smaller than, for example, the United Kingdom, where non-resident counterparty assets and liabilities generally account for more than 40% of total assets and liabilities.

South African banks' cross-border assets (claims) exceed liabilities (i.e. assets and liabilities in relation to non-resident counterparties denominated in foreign currency and rand), resulting in a positive net exposure. The value of banks' cross-border assets and liabilities denominated in foreign currency (which is 75% and 48% of total cross-border assets and liabilities respectively) is affected by fluctuations in the exchange value of the rand. The positive net cross-border asset position fluctuated between a high of R161 billion at the end of September 2013 and a low of R51 billion at the end of June 2018.

South African banks' cross-border exposure

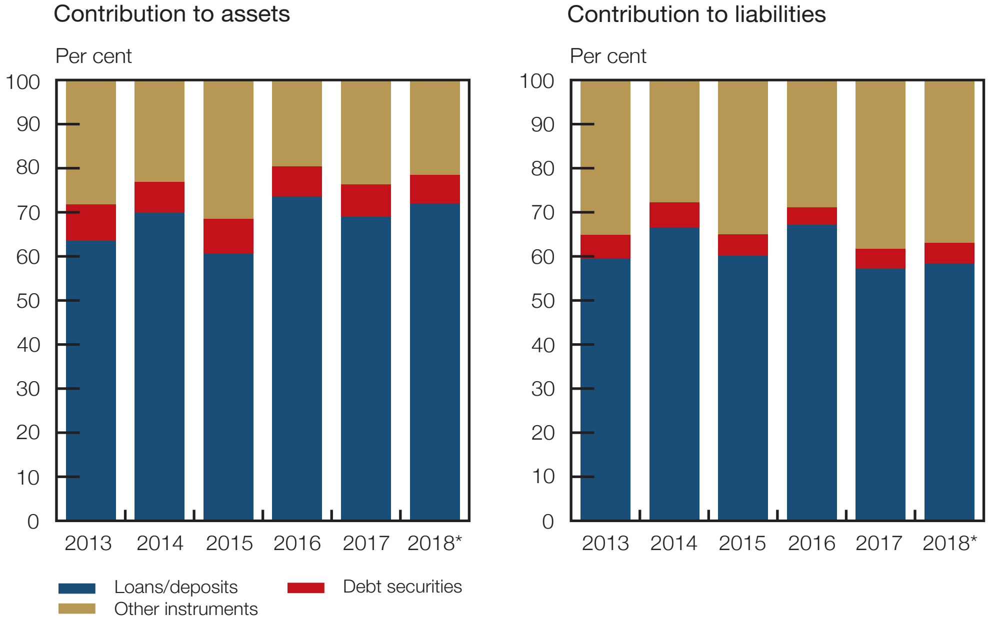


Source: SARB

The LBS disaggregate cross-border asset (claim) and liability positions of banks into a number of dimensions.

Financial instruments on the asset and liability side are categorised as deposits and loans, debt securities, and other instruments which include derivatives and equities. On the asset side, total cross-border claims predominantly consist of a combination of loans to, and deposits with, non-residents, with holdings of debt securities issued by non-residents of around 10%. Total cross-border liabilities mainly consist of deposits by, and loans from, non-residents of about 60%, with own issues of debt securities held by non-residents of less than 10%. Other assets and liabilities comprise, among other things, equity and derivative positions. Deposits and loans dominate both cross-border assets and liabilities, with assets exceeding liabilities in value terms. This facilitates the analysis of banks' cross-border funding and exposure to offshore assets.

Financial instrument composition of South African banks' cross-border assets and liabilities

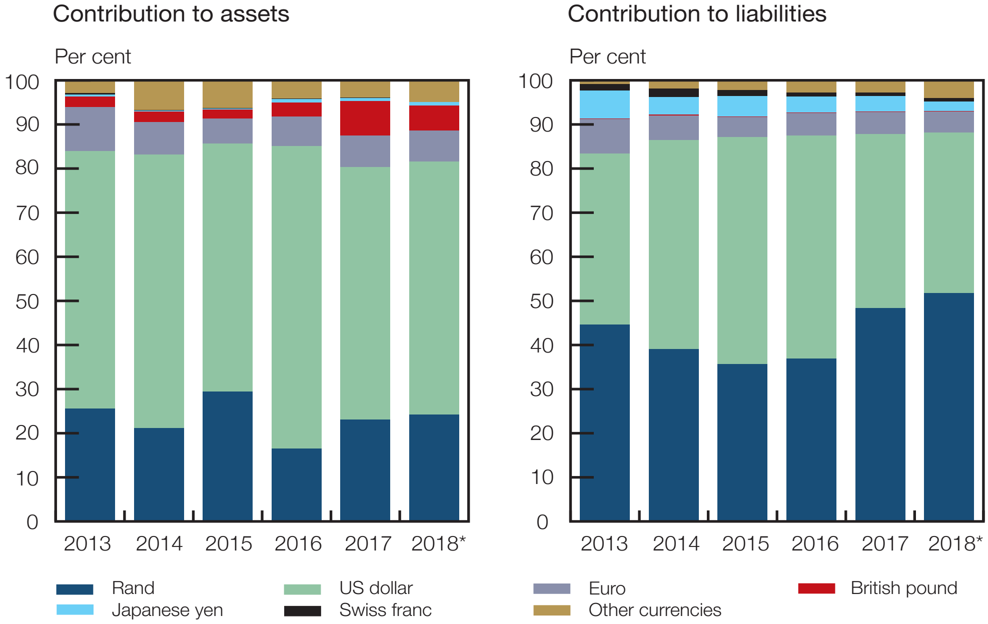


* As at end of June

Source: SARB

Cross-border assets (claims) and liabilities are delineated in terms of rand exposures and five foreign currencies, namely the US dollar, euro, Japanese yen, British pound and Swiss franc, with a residual category for all other currencies. The breakdown by currency shows that the largest part of cross-border assets (claims) is denominated in US dollars with, on average, a fairly equal split between US dollar- and rand-denominated liabilities. US dollar-denominated assets exceed US dollar-denominated liabilities, and rand-denominated liabilities exceed rand-denominated assets. Although a large proportion of foreign assets are exposed to currency risk, this is mitigated by the large proportion of foreign rand liabilities and foreign currency-denominated assets exceeding foreign currency liabilities. This breakdown allows insight into currency mismatches between funding and investments and the hedging thereof.

Currency composition of South African banks' cross-border assets and liabilities

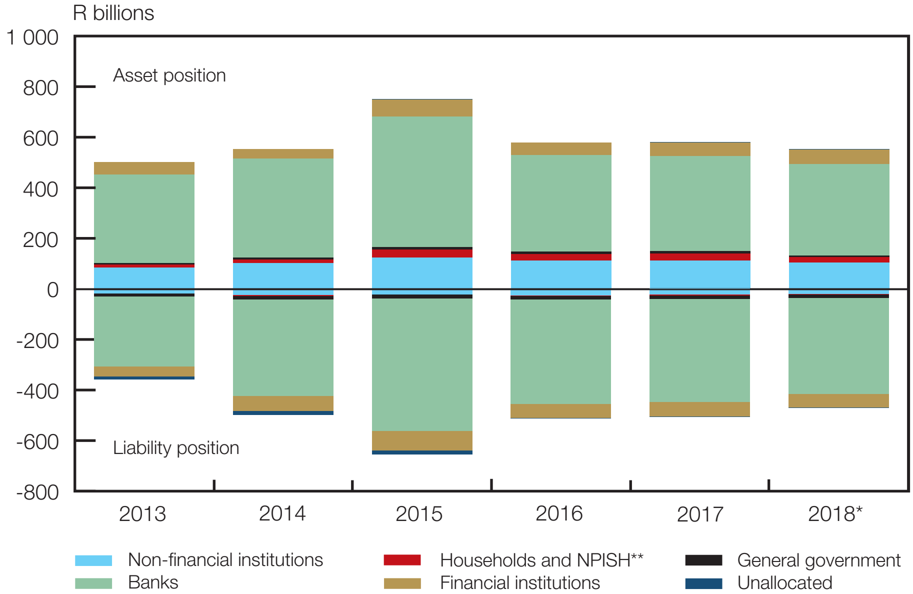


* As at end of June

Source: SARB

The *institutional sector* counterparties to banks' cross-border assets (claims) and liabilities are broken down into the financial and non-financial sectors, with various subcategories. Foreign banks as a counterparty dominate, representing, on average, 68% of assets and 79% of liabilities, followed by foreign non-financial institutions at 18% of assets and 4% of liabilities. The importance of information on institutional sector exposure became evident during the global financial crisis of 2007–08, in particular the exposure to banks.

Total cross-border positions of South African banks by institutional sector

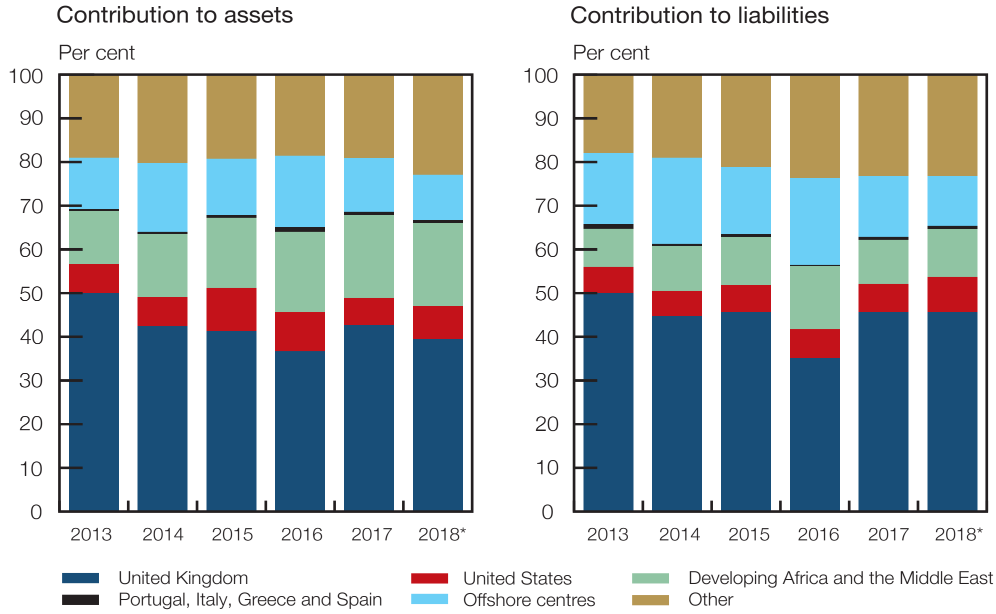


* As at end of June
** Non-profit institutions serving households

Source: SARB

The global financial crisis also highlighted the importance of *counterparty country and regional data*, in particular peripheral countries in the euro area. In terms of banks' cross-border exposure, the United Kingdom, followed by developing Africa and the Middle East and offshore centres (of which the Isle of Man is most prominent) on average account for 71% of both assets (claims) and liabilities. The LBS also indicate limited exposure to the peripheral countries in Europe, with the value of South African banks' cross-border liabilities to these countries mostly exceeding assets. The value of cross-border assets of South African banks to the United Kingdom, United States, and developing Africa and the Middle East exceeds liabilities by a wide margin.

Composition of counterparty countries and regions of South African banks' cross-border assets and liabilities

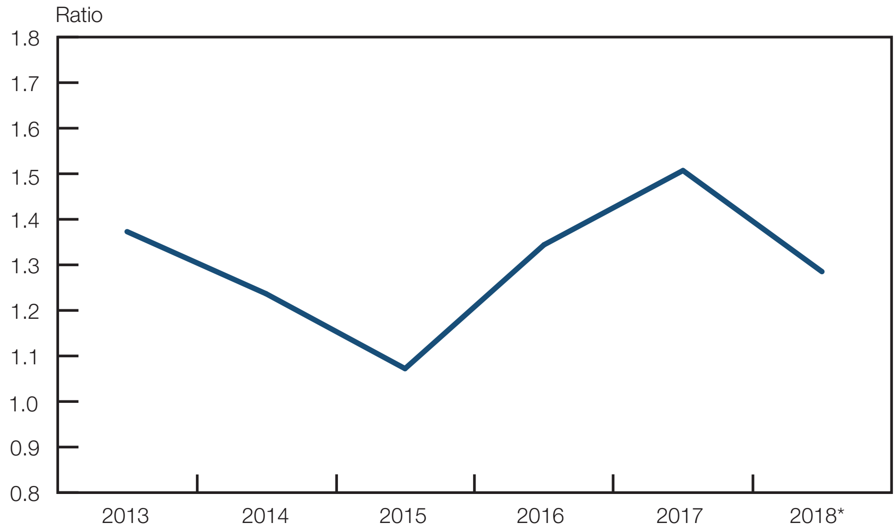


* As at end of June

Source: SARB

When extending the cross-border assets (claims) and liabilities from non-resident counterparties in any currency to also include resident counterparties of the reporting country in foreign currency, the holdings by South African banks of foreign currency-denominated assets generally exceed foreign currency liabilities, resulting in an overall net foreign currency-denominated asset position. An appreciation (depreciation) in the exchange value of the rand will reduce (increase) the value of South African banks' net foreign currency position in rand terms.

Net foreign currency position of South African banks



* As at end of June

Source: SARB

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Abbreviations

BER	Bureau for Economic Research
BIS	Bank for International Settlements
CPD	Corporation for Public Deposits
CPI	consumer price index
EMBI+	Emerging Markets Bond Index Plus
FAO	Food and Agriculture Organization
FRA	forward rate agreement
FX	foreign exchange
GDE	gross domestic expenditure
GDP	gross domestic product
GVA	gross value added
IEC	Electoral Commission of South Africa
IFRS	International Financial Reporting Standard
IIP	international investment position
IMF	International Monetary Fund
Jibar	Johannesburg Interbank Average Rate
JSE	JSE Limited
LBS	locational banking statistics
MPC	Monetary Policy Committee
NEER	nominal effective exchange rate
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PPI	producer price index
QES	Quarterly Employment Statistics
QLFS	Quarterly Labour Force Survey
REER	real effective exchange rate
RMB	Rand Merchant Bank
Sabor	South African Benchmark Overnight Rate
SACU	Southern African Customs Union
SARB	South African Reserve Bank
SARS	South African Revenue Service
SDR	special drawing right
SOC	state-owned company
Stats SA	Statistics South Africa
US	United States
VAT	value-added tax

Notes to tables

Locational banking statistics – Tables S–26 and S–27

This *Quarterly Bulletin* includes the inaugural publication of South Africa's locational banking statistics. Historical data are available from the third quarter of 2013 and will in future be published on a quarterly basis with a one-quarter lag. For an overview of the underlying concepts, data dimensions and analysis, see 'Note on South Africa's locational banking statistics' on page 83 of this *Quarterly Bulletin*.