Annual Economic Report

2006

South African Reserve Bank

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This review of economic and financial conditions in the Republic of South Africa is presented as background to the chairman's address to shareholders at the eighty-sixth ordinary general meeting to be held on 23 August 2006.
The review also forms part of the Reserve Bank's report to Parliament in terms of Section 31 of the South African Reserve Bank Act No 90 of 1989.

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Introduction

The pace of growth in global output reached a peak of 5¼ per cent in 2004 and maintained exceptionally robust momentum in the subsequent eighteen months, with real growth remaining marginally below 5 per cent. Although the prices of crude oil and other commodities soared, consumer price inflation increased only marginally in most parts of the world. In order to contain inflation under these circumstances – and recognising the considerable degree of accommodation which had previously characterised monetary policy in a number of the major economies – central banks generally raised their policy interest rates during the past eighteen months.

Economic activity in Africa benefited from the strength of the world economy, the buoyancy of commodity prices and the strengthening of economic policy frameworks. The continent maintained a real growth rate of around 5 per cent in both 2004 and 2005. There are indications that the robust expansion continued in the first half of 2006, making this the strongest and most consistent growth performance in the recent history of the continent. As may be expected, oil-exporting countries outpaced the rest.

South Africa recorded a real growth rate of almost 5 per cent in 2005 – the strongest since 1984. However, whereas the growth spurt in 1984 was short lived, being straddled by years of economic contraction, the economic expansion in 2005 formed part of a sustained and robust upswing which to date has been the longest in the South African business cycle history. Real growth decelerated somewhat in the second half of 2005 on account of disappointing performances of the mining and manufacturing sectors, but regained momentum in the first half of 2006 as manufacturing activity recovered. The construction and tertiary sectors recorded robust growth throughout this period.

The South African economy became less dependent on commodities over the past quarter of a century as the services sector expanded in importance. Nevertheless, the recent buoyancy of commodity prices supported income, bolstered share prices and raised business and consumer confidence. The favourable commodity prices were mainly reflected in brisk increases in the nominal value added by the mining sector. The overall *volume* of mining output remained subdued over the past year-and-a-half, with a continuation of the downward trend in gold production but also with an expansion of output volumes in areas such as platinum mining.

Growth in real domestic expenditure outpaced that in real domestic production over the past eighteen months, continuing the trend which began in 2001. All the components of domestic final demand recorded vigorous increases over the past year-and-a-half. Real disposable income of the household sector maintained a robust rate of increase, buoyed by rising employment and wage levels, higher transfers from government to households in support of the poor, and some tax relief to individuals. Together with the lower levels of interest rates and attractive prices brought about by a relatively strong exchange value of the rand, this contributed to briskly rising real final consumption expenditure by households, especially on durable and semi-durable goods. Real final consumption expenditure by general government also rose as the delivery of various services was stepped up, with the procurement of high-value military items occasionally adding a fillip to government spending.

A gratifying trend over the past eighteen months was that growth in real fixed capital formation generally outpaced the other final expenditure components. This strong growth was widely dispersed, with both the public corporations and private business enterprises raising their capital expenditure across a range of sectors and activities, from electricity and communication to manufacturing and construction.

The strong growth in expenditure was accompanied by rising debt levels. Household debt relative to disposable income reached a new record high in each successive quarter from mid-2005, with debt mainly incurred in order to acquire real-estate and consumer durables. At the same time, the cost of servicing household debt remained moderate relative to disposable income, given the comparatively low level of interest rates.

With domestic expenditure rising more strongly than domestic production, imports rose considerably. The deficit on the current account of the balance of payments widened from 4 per cent of gross domestic product in the first half of 2005 to more than 6 per cent in the first half of 2006. This was the first time since 1982 that a deficit of more than 6 per cent of gross domestic product has been recorded. When the magnitude of the first-quarter deficit was released in June 2006 it contributed to the depreciation in the exchange rate of the rand; this had started in May with a retreat by international investors from emerging-market exposures. However, over the following weeks the exchange value of the rand partly retraced its earlier decline as emerging-market spreads narrowed again. The market also noted that, while a 6-per-cent deficit was high compared with the history of South African deficits, this was largely due to the lack of sustained, buoyant growth episodes since the early 1980s, which had prevented fixed capital formation with its high import content from taking off.

More than a quarter of the advanced economies of the world, and a third of the other emerging-market and developing countries recorded current-account deficits exceeding 6 per cent of gross domestic product in 2005, and many of them have been doing so for a number of years. In addition, South Africa maintained a low ratio of foreign debt to exports, was in a position to secure long-term foreign finance for much of its capital goods imports and attracted sufficient foreign investor interest to not only finance the current-account deficit in the first half of 2006 but also to add to its reserves of gold and foreign exchange. South Africa’s adoption of an inflation-targeting framework also implied that, unlike with a pegged or targeted exchange rate regime, exchange rate flexibility would assist with the adjustment process, should excessive current-account imbalances develop.

Financing from abroad came in various forms. Foreign direct investment activity continued, and included large transactions in mid-2005 when a bank domiciled in the United Kingdom acquired a controlling interest in a large South African bank, and in early 2006 when another British company acquired a substantial interest in a South African cellular telephone company. In 2005 portfolio capital flowed into South Africa in the form of equity investment, while non-residents were net sellers of South African bonds. The inflow of share capital gained further momentum in the first 4½ months of 2006 as the prices of commodities and shares soared. However, in May 2006 international investor sentiment turned away from emerging-market securities and currencies, resulting in currency depreciation, a fall in share prices and an increase in bond yields in those markets. Non-residents became net sellers of South African shares, but by July 2006, when local bond yields had risen significantly, they developed a strong appetite for South African bonds. In the “other investment” category a net outflow of funds was recorded in both the second half of 2005 and the first half of 2006.

The overall balance of payments remained in surplus during the past year, allowing the South African Reserve Bank (Bank) to raise its gold and foreign exchange reserves from US$18,7 billion in June 2005 to US$24,0 billion in June 2006. During most of this period the exchange value of the rand moved broadly sideways but, as already indicated, it then depreciated significantly from the second week in May 2006.

While employment trended higher during the period under review, average wage settlements remained moderate, amounting to around 6¼ per cent in both 2005 and the first half of 2006. This, together with the firm exchange rate during most of this period, contributed to benign inflation. Twelve-month CPIX inflation has remained within the target band of 3 to 6 per cent since September 2003. However, the recent exchange rate depreciation, rising energy and food prices and strong consumer demand have clouded the near-term prospects for inflation.

This was recognised by the Monetary Policy Committee (MPC) of the Bank when, after a period of fourteen months of an unchanged monetary policy stance, policy was tightened in order to ensure conformity of inflation with the target range over the medium term. The repurchase rate was raised from 7 to 7½ per cent in June 2006 and to 8 per cent in August. Other money-market interest rates moved higher alongside the repurchase rate.

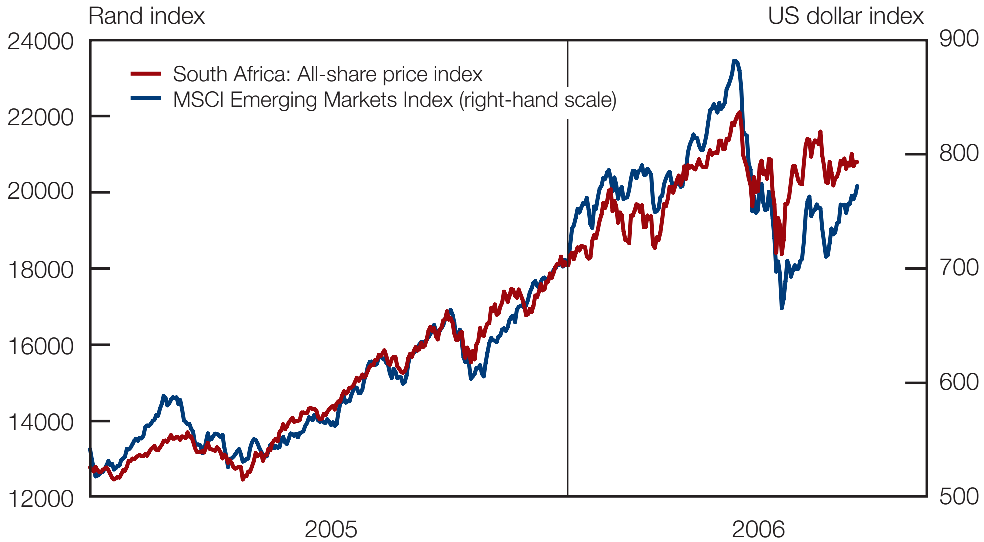
In the bond market yields trended lower until February 2006, when they reached a 36-year low, whereafter they first inched higher and then rose more significantly following the rerating of emerging markets in May. Share prices performed well during the period to early May 2006 and then fell abruptly, but subsequently recovered a substantial part of the lost ground as investors had time for a more dispassionate assessment of risks and prospects. In the real-estate market, activity remained buoyant and although the pace at which average house prices rose decelerated, these prices continued to increase at year-on-year rates in excess of 12 per cent. In the luxury market, however, strong buyer resistance developed, resulting in muted price increases.

The generally upward trend in asset prices created strong wealth effects. Along with strongly rising income and expenditure and lively financial market turnover, these were reflected in rapid increases in the money supply. Accordingly, the income velocity of circulation of M3 reached another record low in the first half of 2006. Most of the build-up of M3 deposits was in the hands of companies, not individuals. The cash-flush position of the corporate sector was further reflected in the banking sector's extension of credit, where the strongest growth was recorded in loans and advances to households rather than to companies.

Government finances continued to be characterised by strong growth in tax revenue, consistent with the robust performance of the economy and the continuous pursuit of greater efficiency in the collection of taxes. In fiscal 2005/06 the national government deficit amounted to less than ½ a per cent of gross domestic product, while for the public sector as a whole a financial surplus was registered for the first time on record. The budgeted projections provide for an easier fiscal stance in 2006/07 as expenditure on infrastructure and service delivery is raised, while remaining within the boundaries of sustainability.

During the past year, the improvement in the performance and resilience of the South African economy was recognised by two credit-rating agencies, that upgraded the country's sovereign debt rating from BBB to BBB+.

Share prices



Domestic economic developments

Domestic output

South Africa's *real gross domestic product* expanded at an annualised rate of 4 per cent in the first half of 2006. This was approximately the same as the growth rate recorded in the second half of 2005. The sustained increase in real gross domestic product can mainly be attributed to growth in the real value added by the secondary and tertiary sectors of the economy which comfortably offset a decline in the real value added by the primary sector.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

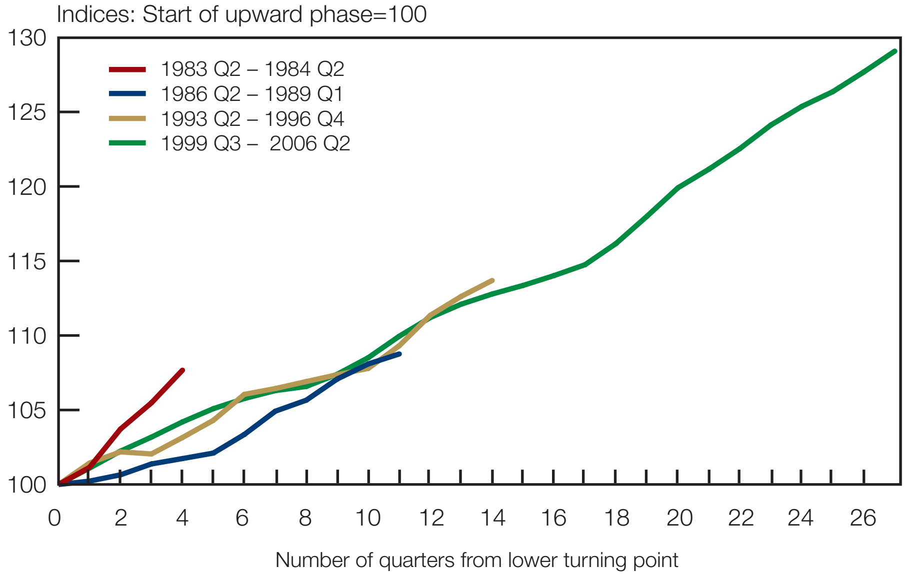
	2004	2005			2006
Sectors	Year	1st half	2nd half	Year	1st half
Primary sector	1½	4½	0	3¼	-7¼
Agriculture	-1¾	4¾	6¾	5½	-17½
Mining	2¾	4½	-2½	2½	-2¾
Secondary sector	5	2½	5	4½	5
Manufacturing	4½	1½	4¾	4	3½
Electricity, gas and water	2½	1	0	1½	3¾
Construction	10¾	10	11	10	13½
Tertiary sector	4¾	5½	4½	5¼	5¼
Commerce	5¾	6¼	7	6	6¼
Transportation and communication	4½	5½	6¼	5½	5¾
Financial and other services	7½	8½	4¼	7¾	7½
Non-agricultural sector	*4½*	*4¾*	*4*	*5*	*4½*
Total	4½	4¾	4¼	5	4

The buoyant activity in the economy during the past eighteen months was recorded alongside a solid performance of domestic demand. Real domestic final demand increased at an annualised rate of almost 7 per cent in both the second half of 2005 and the first half of 2006 as real fixed capital formation continued rising briskly. Real final consumption expenditure by households also held its ground, its rate of growth accelerating from an annualised rate of 6½ per cent in the second half of 2005 to 7¼ per cent in the first half of 2006.

The increase in real gross domestic product at an average annualised rate of 3¾ per cent during the current upward phase of the business cycle is consistent with the rate of growth attained in the previous upswing from 1993 to 1996. What is remarkable about the current upward phase, however, is that growth has been sustained for 27 quarters. This resilience was nurtured by a greater emphasis on sustainability in economic policy-making. Performance was also enhanced by the growth in the global economy and favourable prices of key export commodities.

Following a decline of 1¾ per cent in 2004, the real value added by the *agricultural sector* increased by 5½ per cent in 2005. Field crops, which contribute about 27 per cent to the real value added by the agricultural sector, performed exceptionally well in 2005. This was mainly due to the large crop of maize harvested in the 2004/05 season. Real output by the agricultural sector in 2005 peaked in the second half of the year when growth in real value added accelerated to an annualised rate of 6¾ per cent – this coincided with the late harvest of the largest part of the maize crop. Production in the other subsectors of agriculture also expanded, adding to the growth in the real value added by field crops.

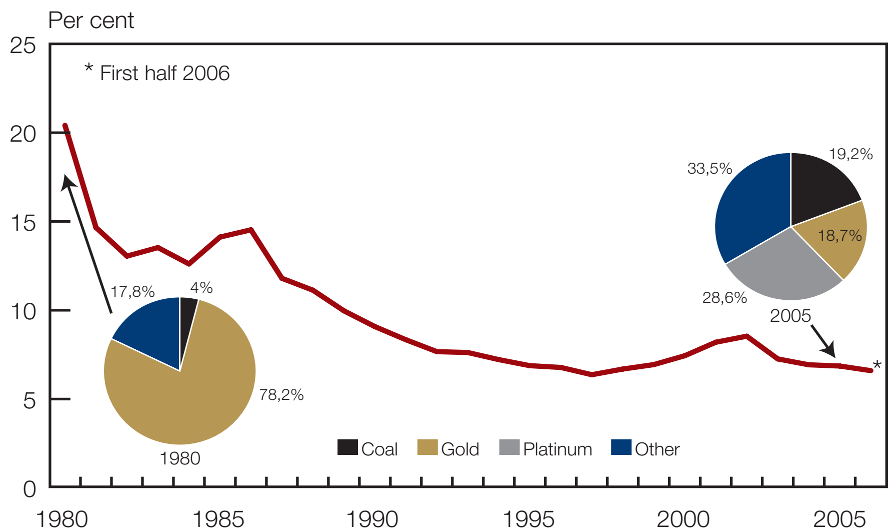
Real gross domestic product during economic recoveries



Despite the bumper maize crop harvested in 2005, income was adversely affected by the lower price of maize. Consequently, the acreage of maize planted was scaled down considerably in the 2005/06 season, reducing the contribution of field crops to the real value added by agriculture in the first half of 2006. Growth in the other subsectors was also modest, with good rainfall raising the carry capacity of the land and prompting farmers to hold back livestock and expand their herds, thereby reducing abattoir supplies. Accordingly, the real value added by the agricultural sector declined at an annualised rate of about 17½ per cent in the first half of 2006 compared with the second half of 2005.

The growth in real value added by the *mining sector* decelerated steadily from 4 per cent in 2003 to 2¾ per cent in 2004 and 2½ per cent in 2005. The downward trend in annual growth in the real value added by the mining sector reflected the lower real output of gold and subdued growth in diamond, coal and platinum production.

Share of mining in gross domestic product



The real value added by the mining sector contracted at annualised rates of 2½ and 2¾ per cent, respectively, in the second half of 2005 and the first half of 2006, despite the strong performance of commodity prices over the period. This could partly be ascribed to the long lags involved in developing mines and expanding the supporting infrastructure. Furthermore, since mining houses tend to plan projects on a longer-term basis, the surge in commodity prices would only be incentive enough to change production capacity if it was perceived to be of a longer-term nature. A more immediate effect might be that it would create the opportunity to lengthen the life span of some mines; in the gold-mining sector this would happen when a lower grade of ore is mined, which would perversely reduce gold production. The benefits of high commodity prices were predominantly evident in the operating surpluses of the mining sector, which rose strongly.

Real output in platinum mining continued to increase over the past number of years, although the momentum recently edged off somewhat. The tightening of regulations requiring cleaner emissions together with the increased demand for diesel cars ensured that demand for catalytic converters continued to expand, offsetting the dip in demand for platinum jewellery resulting from the high platinum price.

Over time the dependence of the South African economy on mining declined, and with that also its degree of exposure to commodity prices. Within mining the production mix also changed substantially, with the production of gold nowadays adding less value than the production of platinum group metals.

Growth in the real value added by the *secondary sector* slowed from 5 per cent in 2004 to a rate of 4½ per cent in 2005. This resulted from slower growth in the real output of all three main subsectors of the secondary sector during this period. In the first half of 2006 an annualised growth rate of 5 per cent was recorded in the real value added by the secondary sector. This was a reflection of slower growth in the manufacturing sector which was offset by an acceleration in the real output of the electricity and construction sectors over this period.

The real value added by the *manufacturing sector* slowed from 4½ per cent in 2004 to 4 per cent in 2005. Output was lower in the manufacturing of textiles, clothing and footwear, where competition from imports was fierce, and in the production of petroleum and chemical products, where the conversion to lead replacement fuel held back refinery output. Production of basic iron and steel, non-ferrous metal products and machinery also edged lower. This was countered by faster growth in the subsectors manufacturing food and beverages, glass and non-metallic mineral products, and motor vehicles, parts and accessories.

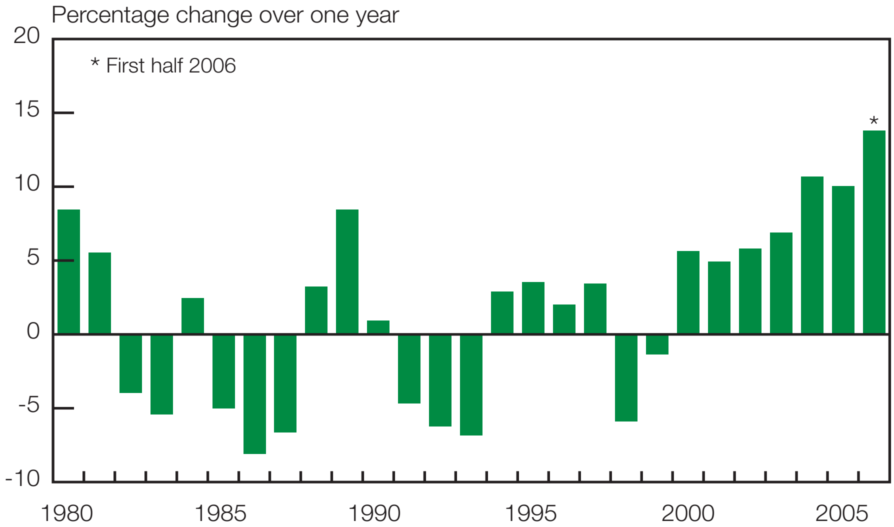
Annualised growth in the real value added by the manufacturing sector slowed from 4¾ per cent in the second half of 2005 to about 3½ per cent in the first half of 2006. The major subsectors within manufacturing, with the exception of the sectors that manufacture basic iron and steel as well as motor vehicles and transport equipment, recorded lower growth and even declines in real output during the first half of 2006.

The real output of the subsector that manufactures motor vehicles and transport equipment increased from 2004 to 2005, gaining further momentum from the second half of 2005 to the first half of 2006. Output in this sector benefited not only from the solid demand for new cars in the domestic market but also from rising exports. On an annual basis the real output of the basic metals industry faltered somewhat, but subsequently recovered during the first half of 2006. This was, *inter alia,* underpinned by industrial demand from the Far East. In addition, domestic demand for steel in the construction industry also strengthened.

Growth in the real value added by the sector that supplies *electricity, gas and water* slowed from 2½ per cent in 2004 to 1½ per cent in 2005, but subsequently accelerated to an annualised rate of 3¾ per cent in the first half of 2006. The smaller output in 2005, mainly on account of the subsector supplying electricity, was partly due to exceptionally mild temperatures experienced during the winter of 2005. In addition, the volume of exports of electricity to neighbouring countries remained virtually unchanged from 2004 to 2005. However, an increase in electricity output in the first half of 2006 was consistent with winter temperatures reverting to what is more "normal". The improvement in platinum output, the mining of which is fairly electricity-intensive, also boosted the real value added by the electricity sector.

Real value added by the *construction sector* rose at an average annualised rate of 8 per cent during the current upward phase of the business cycle, significantly stronger than the average rate of 2½ per cent recorded in the previous upward phase of 1993 – 1996. Following brisk growth rates of 10¾ and 10 per cent recorded in 2004 and 2005, respectively, growth in the real value added by the construction sector accelerated to an annualised rate of 13½ per cent in the first half of 2006. This was mainly driven by robust activity in the construction of residential and non-residential buildings. Simultaneously, civil construction projects rebounded following the slump of the past few years.

Growth in real value added by the construction sector



The demand for residential buildings was underpinned by higher consumer confidence in an environment of lower interest rates. Consumers, particularly the emerging middle class, took up mortgage finance with repayment rates made more affordable due to the lower interest rates. The upward momentum in the non-residential building sector can be attributed to expanding demand for office space, industrial facilities and shopping malls. Building activity in the civil engineering sector gained momentum from the second half of 2005 to the first half of 2006, due to the upgrading of airport facilities and the expansion of harbour capacity.

The *tertiary sector*, which constitutes more than 60 per cent of the total gross domestic product, contributed about 3¼ percentage points to total economic growth in 2005. The real value added by the tertiary sector increased by 4¾ per cent in 2004, accelerating to 5¼ per cent in 2005. This was the result of an improvement in the real output of all the subsectors constituting the tertiary sector. From the second half of 2005 to the first half of 2006 growth in the real output of the trade, and transport and communication services sectors edged lower. However, this was more than neutralised by higher growth in the finance sector, resulting in a somewhat higher rate of growth in the real value added by the tertiary sector during this period.

The demand for consumer goods expanded briskly from 2003 to the first half of 2006, providing a fillip to growth in the real value added by the retail subsector. In the category for clothing and footwear, retailers thrived as consumers responded positively to more competitive prices due to cheaper imports. At the same time the motor trade subsector benefited from record sales. The sale of new cars was augmented by the lower interest rate environment, competitive prices as well as attractive financing and maintenance packages offered by dealers.

Activity in the catering and accommodation subsector remained rather lacklustre when the first half of 2006 is compared with the first half of 2005, with tourist numbers moving broadly sideways as the sector managed to attract and retain a comparable number of visitors. These developments culminated in overall growth in the real value added by the *trade sector* accelerating from 5¾ per cent in 2004 to 6 per cent in 2005. An annualised rate of growth of 6¼ per cent was recorded in the first half of 2006.

The real value added by the *transport, storage and communication services sector* increased by 4½ per cent in 2004 and 5½ per cent in 2005, and registered an annualised growth rate of 5¾ per cent in the first half of 2006. The communication subsector retained its status as the main contributor to growth in the real value added by the transport, storage and communication sector. Though the growth in the transport subsector lagged that of communication, it further underpinned the performance in overall growth in this sector.

The real value added by the communication subsector, particularly cellular telephone communication, continued to increase over the past eighteen months but at more sustainable rates. Expansion of the cellular telephone industry slowed somewhat as penetration of the target market progressed to the point where signs of saturation started to appear.

Protracted industrial action in some sectors during the first half of 2006 adversely affected the demand for transport services, particularly rail transport. Accordingly, growth in the real value added by land transport decelerated from the second half of 2005 to the first half of 2006. This deceleration was, however, more than compensated for by a brisk increase in the real value added by air transport. Activity in land freight transport continued to benefit from the buoyant consumer demand which resulted in higher volumes of goods being transported across the country.

Growth momentum in the real value added by the *finance*, *insurance, real-estate and business services sector* accelerated slightly from 7½ per cent in 2004 to 7¾ per cent in 2005. However, activity in the sector increased at a moderately slower pace in the first half of 2006 compared to the whole of 2005. The increase in 2005 compared to 2004 was driven by, among other things, higher trading volumes on the JSE Limited (JSE) from the second half of 2004. Strong inflows of foreign capital further supported the performance of the JSE, thus boosting the real value added by securities dealers. At the same time the real value added by banks benefited from brisk domestic demand which was supported by credit extension. This was evident in the high growth rate of asset-backed credit, mostly mortgage advances and vehicle finance.

The production of *general government services* displayed accelerating real growth rates in 2005 and the first half of 2006 as more employees were appointed in areas such as police.

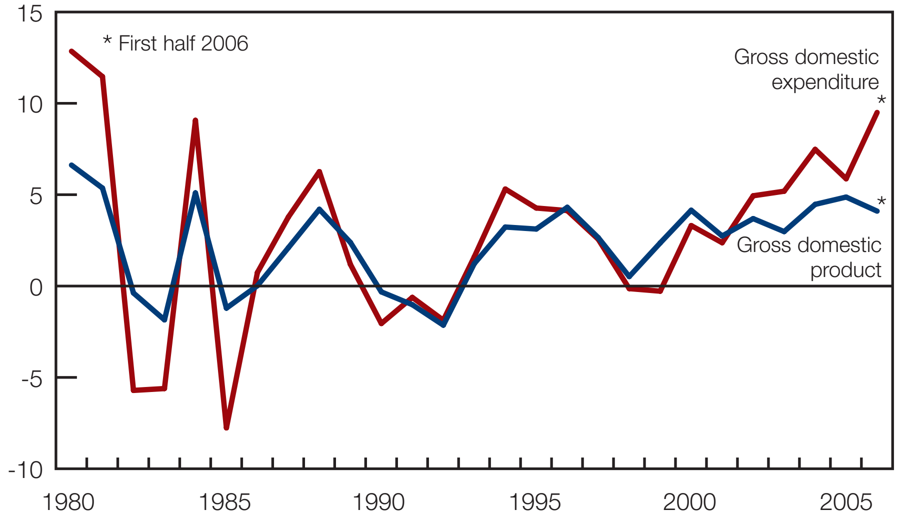
Following an increase of 5½ per cent in 2004, growth in *real gross national income* slowed to 5 per cent in 2005. This was due mainly to higher net primary income payments to the rest of the world, in particular dividend payments. Dividend payments to non-resident shareholders increased by 37 per cent in 2005, compared with 2004 when such payments actually contracted. The higher net primary income payments offset stronger growth in real gross domestic product and the improvement of the terms of trade recorded in 2005. In the first half of 2006, growth in real gross national income edged up to 6½ per cent as dividend payments to non-resident shareholders grew at a slower pace as in 2005. At the same time gross national income per capita increased at an annualised rate of 5 per cent in the first six months of this year.

Domestic expenditure

Real gross domestic expenditure has been a major driver of economic growth in the current upward phase of the business cycle that commenced in September 1999. *Aggregate real gross domestic expenditure* increased at an average annualised rate of 5¼ per cent in the current upward phase, compared to average rates of 4 per cent and 4¾ per cent recorded in the previous two upward phases of the business cycle. During all three upward phases average growth in real gross domestic expenditure outpaced that of real gross domestic production.

Real gross domestic product and expenditure

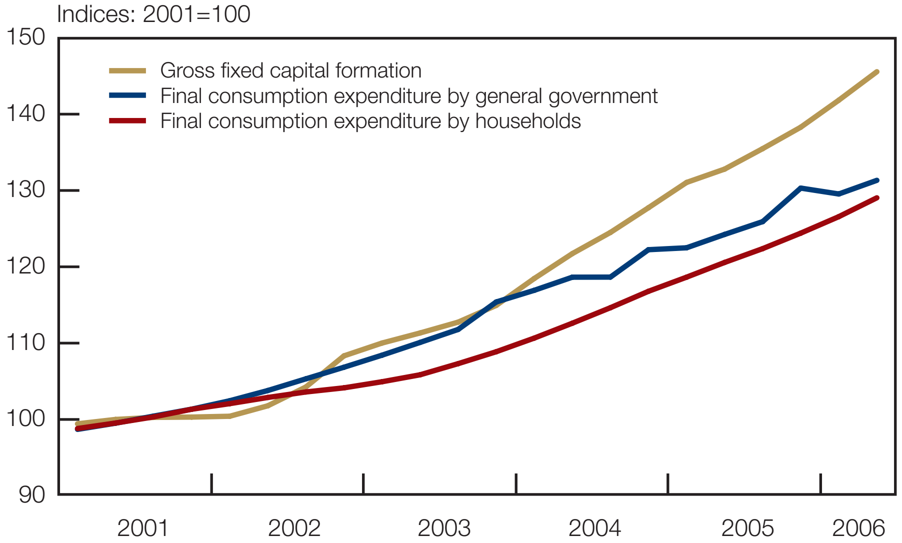
Percentage change over one year



Growth in real gross domestic expenditure accelerated to an annualised rate of 9½ per cent in the first half of 2006 after recording a growth rate of 6 per cent in 2005. The higher expenditure growth reflected the buoyant real final consumption expenditure by households and real gross capital formation. By contrast, growth in real final consumption expenditure by general government slowed in the first half of 2006.

Components of real gross domestic expenditure

Indices: 2001=100

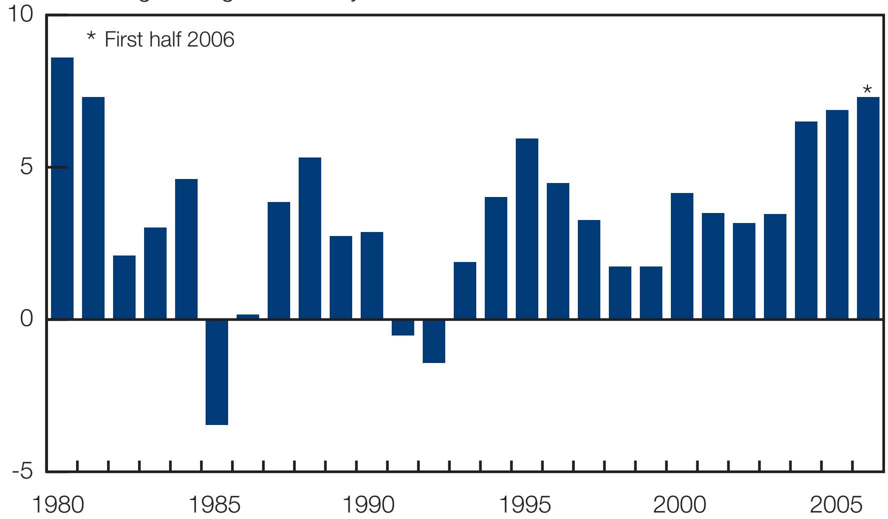


Real final consumption expenditure by households

Real *final consumption expenditure by households*, which comprised approximately 63½ per cent of the gross domestic product in 2005, accelerated from an annualised rate of growth of 6½ per cent in 2004 to 7 per cent in 2005 and 7¼ per cent in the first half of 2006. The strong performance in household consumption expenditure can be attributed to real outlays on durable and semi-durable goods, both of which continued to increase at double-digit rates from around 2004.

Real final consumption expenditure by households

Percentage change over one year



The buoyancy in real final consumption expenditure by households was anchored by relatively strong real outlays on durable and semi-durable goods. During the past eighteen months, expenditure benefited from high consumer confidence; a lower interest rate environment; and stable prices of most goods, with price reductions in categories with high import content which benefited from the strong rand.

Real final consumption expenditure by households
Percentage change at seasonally adjusted annualised rates

	2004	2005			2006
Components	Year	1st half	2nd half	Year	1st half
Durable goods	16	17½	15	18	16¼
Semi-durable goods	18	17	15	17	17
Non-durable goods	3¾	5	5	5¼	5
Services	4	3	3	3	3¾
Total	6½	6¾	6½	7	7¼

Growth in real spending on *durable goods* was at its pinnacle in the first half of 2005. Following an increase at an annualised rate of 17½ per cent in the first half of 2005, growth in real consumer spending on durable goods edged lower to reach a still very buoyant 16¼ per cent in the first half of 2006. The growth primarily reflected the growth in households' real expenditure on personal transport equipment, in particular new cars. Expenditure on new cars accounted for about 43 per cent of durable goods purchases over the past eighteen months. Lower interest rates combined with the release of new models enhanced the competition among dealers and gave rise to attractive packages being offered to customers. In the first half of 2006, however, growth slowed somewhat.

Real expenditure on *semi-durable goods* accelerated from an annualised growth rate of around 15 per cent in the second half of 2005 to 17 per cent in the first half of 2006. These strong increases could be attributed to the brisk consumer spending on clothing, footwear, household textiles and furnishings as consumers took advantage of lower prices in the latter part of 2005 and the first half of 2006.

Growth in real outlays on *non-durable goods* was sustained at annualised rates of 5 per cent in both the second half of 2005 and the first half of 2006. Real spending on food, beverages and tobacco, which constitutes more than two thirds of expenditure on non-durable goods, remained solid throughout this period.

Real household expenditure on *services* increased at annualised rates of 3 per cent in the second half of 2005 and 3¾ per cent in the first half of 2006. This acceleration resulted mainly from increased consumer spending on medical services and recreational and entertainment services.

Real disposable income of households accelerated from an annual increase of 5¾ per cent in 2004 to 6½ per cent in 2005, which supported the robust growth in household consumption expenditure. Growth in real disposable income edged marginally lower to an annualised rate of 6¼ per cent in the first half of 2006. Increases in salaries and wages, which exceeded inflation, and the employment of more workers underpinned growth in real disposable income of households. In addition, personal tax relief measures as well as increases in the threshold for tax exemption were introduced in the 2006/07 Budget. Government transfers to the household sector, such as child grants and pension and disability grants, also continued increasing in real terms.

While part of household expenditure was financed by the increase in real disposable income, consumers also incurred more debt to bolster spending. The ratio of household debt to disposable income increased from 56 per cent in 2004 to 62½ per cent in 2005. In the first half of 2006, household debt as a percentage of disposable income rose to 66¾ per cent, a record high. However, the ratio of debt service cost to disposable income came to about 7 per cent in the first half of 2006, slightly more than the ratio recorded in the second half of 2005 but well below the ratios of more than 12½ per cent recorded seven years earlier which caused great discomfort to borrowers at the time.

Real final consumption expenditure by general government

Real final consumption expenditure by *general government* increased at a rate of 7 per cent in 2004, whereafter growth slowed to an annualised rate of 5½ per cent in 2005 and 3¾ per cent in the first half of 2006. The slower growth during the first half of 2006 partly reflected statistical base effects from the high growth in the second half of 2005 when expenditure included a naval vessel. Over the past three years the increases in government's real outlays on non-wage goods and services exceeded those in compensation of employees, which continued to increase at a more sedate pace.

As a result of these developments, total final consumption expenditure by general government as percentage of gross domestic product picked up from 19¾ per cent in 2004 to 20¼ per cent in 2005 and further to 20½ per cent in the first half of 2006.

Gross fixed capital formation

Growth in *real gross fixed capital formation* accelerated from an annualised rate of 7¾ per cent in the second half of 2005 to 10¼ per cent in the first half of 2006. All three institutional sectors, i.e. private business enterprises, public corporations as well as general government, stepped up real outlays on capital goods. On an annual basis growth in real gross fixed capital formation ranged between 8 and 9¾ per cent in each of the past three calendar years. This strong performance lifted the ratio of gross fixed capital formation to gross domestic product from 15¾ per cent in 2003 to 17¼ per cent in 2005.

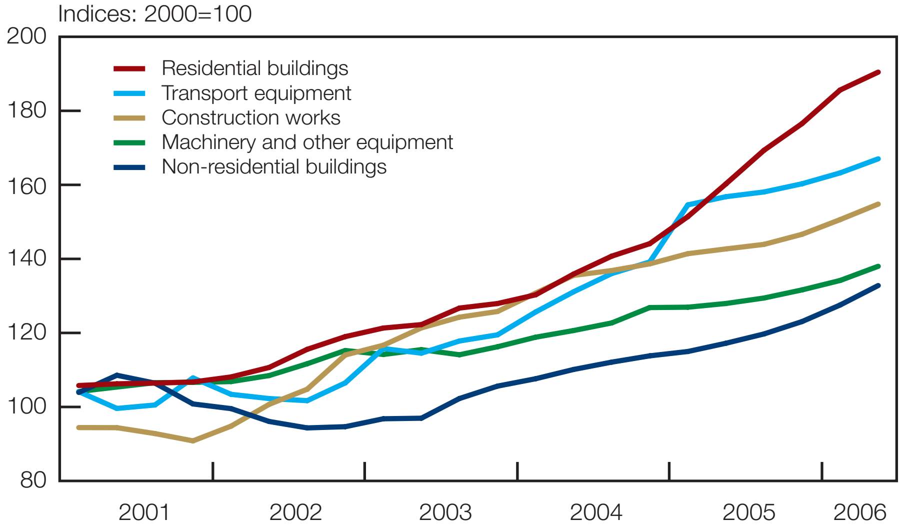
Real gross fixed capital formation by *private business enterprises* increased at annualised rates of 8½ per cent in the second half of 2005 and 10¾ per cent in the first half of 2006. Most sectors of the economy contributed to the solid performance of real gross fixed capital formation during the first half of 2006. Following a sharp contraction in real mining investment in 2004 and 2005, investment activity recovered considerably during the first half of 2006. This was on account of strong nominal sales proceeds in the mining sector, partly influenced by high commodity prices. The expansion of capital formation in the manufacturing sector during the first half of 2006 reflected the high rates of capacity utilisation in the sector and the confidence of manufacturers in the prospects for the industry in the medium term. The planned expansion of capacity in some subsectors such as cement manufacturing, aimed to relieve the backlog in construction supplies and prepare capacity ahead of government's infrastructure drive. In the trade sector the expansion in retail space continued as developers, mindful of the continued buoyancy of domestic demand, added to shopping malls.

All the major *public corporations* stepped up real outlays on capital goods to improve infrastructure. Besides the expansion of the electricity and communications network, capital expenditure was also geared to the maintenance of existing infrastructure to meet the corporations' service delivery obligations. A case in point is the maintenance of the infrastructure to ensure the supply of electricity without periodic interruptions.

There was a welcome improvement in gross fixed capital formation by *general government;* real growth in this aggregate accelerated from an annualised rate of ½ a per cent in the second half of 2005 to 1¼ per cent in the first half of 2006. The major contribution to the increase in general government investment expenditure occurred at provincial level. With gross fixed capital formation by general government as a ratio of gross domestic product having remained virtually unchanged at 2¾ per cent since 2003, significant further increases in economic infrastructure expenditure by general government are planned to facilitate accelerated and shared growth.

An analysis of gross fixed capital formation by type of asset shows record high levels of investment in *residential buildings*, with real growth rates of 23¼ per cent during the

Real fixed capital formation by type of asset



second half of 2005 and 18¼ per cent in the first half of 2006. Demand for housing remained high, particularly in security estates and townhouse developments, despite some concerns about affordability being voiced. Real capital outlays on *machinery and other equipment* also remained high, supported by the affordability of imported machinery and equipment due to the relatively strong exchange rate of the rand. Business enterprises such as car rental companies also participated in the demand for new cars while expenditure on trucks retained strong momentum as well. This lifted annualised growth in real gross fixed capital formation on *transport equipment* from 4½ per cent in the second half of 2005 to 7½ per cent in the first half of 2006.

Changes in inventories

Real inventory investment increased moderately from R7,8 billion during the second half of 2005 to R13,5 billion in the first half of 2006. During the first half of 2006 inventories were primarily accumulated in the manufacturing sector. This constituted mainly oil inventories, as refineries replenished stocks after the change-over from leaded to unleaded fuel during the final weeks of 2005.

With final demand continuing to expand fairly smoothly, the level of industrial and commercial inventories relative to non-agricultural gross domestic product remained at 15 per cent from the second half of 2005 to the first half of 2006.

Factor income

Growth in *total nominal factor income* accelerated from a year-on-year rate of 9½ per cent in the second half of 2005 to 11 per cent in the first half of 2006. This can mainly be attributed to the briskly rising operating surpluses of business enterprises, which contributed more to growth in factor income than compensation of employees.

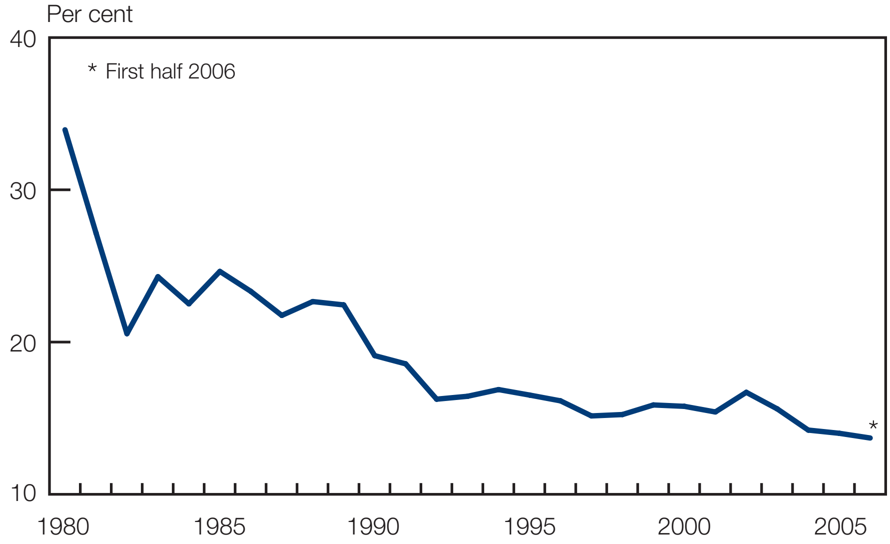
Year-on-year growth in *compensation of employees* remained around 9 per cent for most of 2005 and the first half of 2006. On a net basis, a considerable number of jobs were created in the economy during this period, alongside increases in wage rates and salaries paid to workers. The ratio of compensation of employees to factor income remained above 50 per cent in 2005 and the first half of 2006.

Growth in aggregate *nominal operating surpluses*, measured over one year, accelerated from 10 per cent in the second half of 2005 to 13 per cent in the first half of 2006. Although most sectors of the economy experienced favourable growth in operating surpluses, it was most pronounced in the mining, construction and the finance sectors of the economy. Booming commodity prices reached record highs in the first half of 2006, bolstering the profit margins of mining companies. The sustained increases in consumer demand, partly funded by credit, contributed to the higher operating surplus recorded by banks. In turn, this boosted growth in the operating surplus of the finance, insurance, real-estate and business services sector. In the construction sector, the brisk increase in the real value added was similarly reflected in a significantly higher operating surplus.

Gross saving

Gross saving as a percentage of gross domestic product declined from 14¼ per cent in 2004 to 14 per cent in 2005 and receded further to around 13¾ per cent in the first half of 2006. This trend could be ascribed to a weaker savings performance by the household and corporate sectors, only partly countered by a pick-up in general government saving in the first half of 2006. The relatively low national saving ratio meant that South Africa had to rely on foreign saving to a larger degree than before to finance gross capital formation, as indicated by the widening of the current-account deficit to around 6 per cent of gross domestic product in the first half of 2006.

Gross saving as percentage of gross domestic product



Gross saving by *households* weakened in the first half of 2006 as the marginal propensity to consume increased. The saving ratio of the household sector declined from a level of 2 per cent of gross domestic product in 2004 to 1¾ per cent in 2005 and a record low of 1½ per cent in the first half of 2006. However, this did not mean that household balance sheets weakened. Net household wealth (household assets minus household debt) increased from 247 per cent of disposable income in the first half of 2005 to 264 per cent in the first half of 2006, benefiting from the strong performance of house prices and equities. This provided more breathing space to consumers, contributing to more spending and less saving in the first half of 2006.

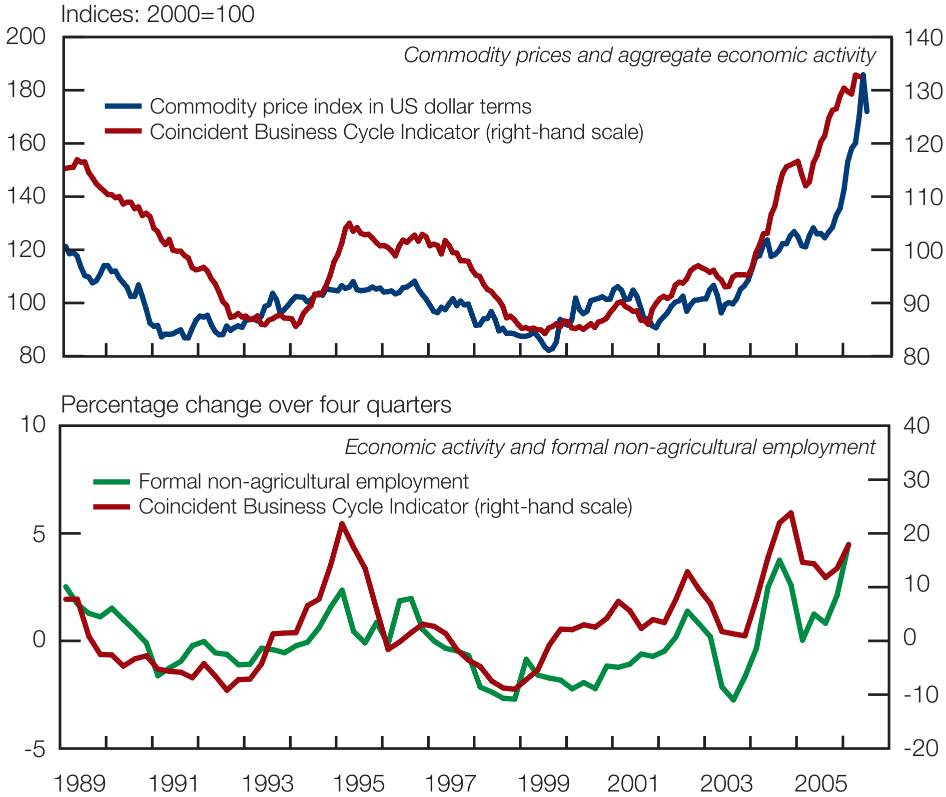
Gross saving of the *corporate sector* as a percentage of gross domestic product, which is the mainstay of national saving, declined from 12½ per cent in 2004 to 11 per cent in 2005 and to more than 10 per cent in the first half of 2006. The deterioration in corporate saving stood in contrast to the buoyant performance of the economy and the operating surpluses of business enterprises. Businesses used a significant part of these surpluses to pay dividends – the rate of increase over one year in dividend payments rose from 7 per cent in 2004 to about 21½ per cent in the first half of 2006. Corporate tax payments also rose significantly over this period.

General government dissaved an amount equal to a ¼ per cent of gross domestic product in 2004. This reverted to a positive saving rate of 1 per cent in 2005 and the first half of 2006. A solid increase in general government's tax revenue was reflected in the first half of 2006.

Employment

The steep rise in international commodity prices since the beginning of 2003 has been impacting positively on labour market conditions in South Africa. The rise in international commodity prices, consistent with the increase in global economic activity, directly benefited commodity-exporting industries in the domestic economy. The elevated level of international commodity prices also supported the exchange value of the rand in international currency markets, contributing to lower inflation and facilitating the easing of nominal interest rates. This helped to bring about a marked improvement in both business and consumer confidence levels. Within this environment, the upward phase of the business cycle was extended into its 27th quarter by June 2006, accompanied by a rise in the level of employment.

Commodity prices, aggregate economic activity and employment



Overall employment growth gained momentum from 2004, as illustrated in the accompanying table. The *Labour Force Survey* indicates that well over a million additional jobs were created over the four-year period to September 2005, with as many as 660 000 jobs in the year to September 2005 alone.

Labour force survey

	September				
	2001	2002	2003	2004	2005
Total employment (millions)	11,18	11,30	11,42	11,64	12,30
Employment in the formal non-agricultural sectors (millions)	7,03	7,18	7,37	7,69	7,99
Unemployment rate (per cent)....................	29,40	30,40	28,00	26,20	26,70

Source: Statistics South Africa, *Labour Force Survey,* September 2005

1 According to the International Labour Organisation's Global Employment Trends Brief, approximately 192 million people, or about 6 per cent of the world labour force, were unemployed during 2005.

Following several years of increasing unemployment, the number of the unemployed declined steadily to 4,1 million in September 2004. A year later, in September 2005, the number of unemployed persons had risen to 4,5 million while the number of discouraged work-seekers had declined by more than 600 000. The rise in unemployment within an environment of improved job prospects probably resulted from previously discouraged work-seekers who decided to again actively engage in job-searching activities. As a consequence, the unemployment rate remained virtually unchanged in September 2005 at 26,7 per cent compared with 26,2 per cent in September 2004[1].

Narrower indicators of employment also point to the creation of more jobs in the recent past. According to the *Quarterly Employment Statistics* (QES) survey by Statistics South Africa, the level of *enterprise-surveyed employment in the formal non-agricultural sector* rose by 4,5 per cent, or approximately 316 000 jobs, over the twelve months to March 2006. In the course of 2005, employment numbers initially contracted in the first quarter of the year due to job losses in especially the finance, insurance, real-estate and business services sectors. In the following period to March 2006, employment numbers rose consistently.

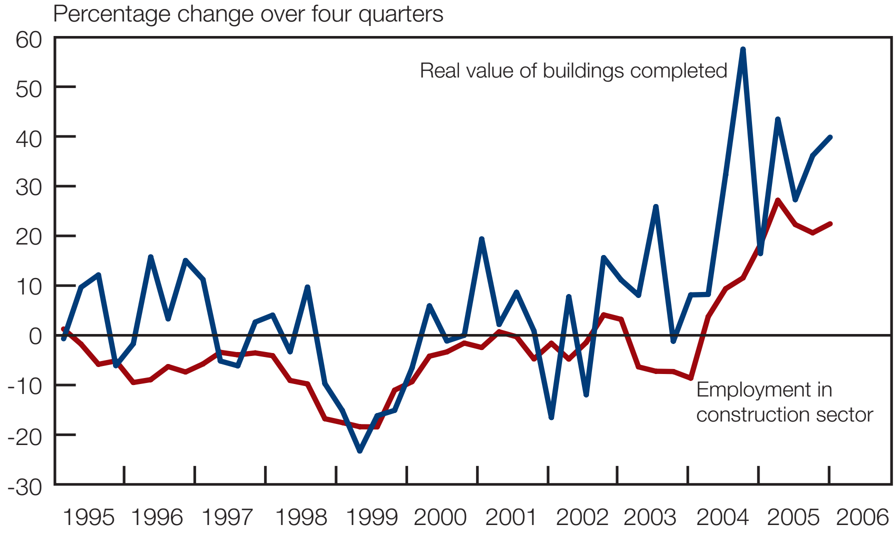
As shown in the accompanying table, the increase in employment opportunities during the twelve months to March 2006 was most pronounced in the *construction sector*, with an additional 87 000 jobs created. Employment by the construction sector was responsible for about 7,7 per cent of total private-sector employment in 2005, compared with only 6,3 per cent in the preceding year. During the past two years activity in the construction sector benefited meaningfully from the lower level of nominal interest rates, high business and consumer confidence and the general strength of the economy. The real value of buildings completed increased by as much as 31 per cent in 2005 and by around 40 per cent in the year to the first quarter of 2006 (see graph at the top of the facing page).

Change in enterprise-surveyed formal non-agricultural employment over the four quarters to March 2006

Sector	Number	Percentage change
Gold mining	-16 000	-9,4
Non-gold mining	8 300	3,0
Manufacturing	24 000	2,0
Electricity supply	1 200	2,7
Construction	87 000	22,4
Trade, catering and accommodation	60 600	4,5
Transport, storage and communication	3 100	1,5
Finance, insurance, real-estate and business services	101 300	7,0
Community, social and personal services	-800	-0,3
Total private sector	**268 900**	**5,0**
National departments	16 400	4,3
Provincial administrations	36 900	4,5
Local governments	-6 000	-2,9
Public-sector enterprises	-500	-0,3
Total public sector	**46 700**	**2,9**
Grand total	**315 600**	**4,5**

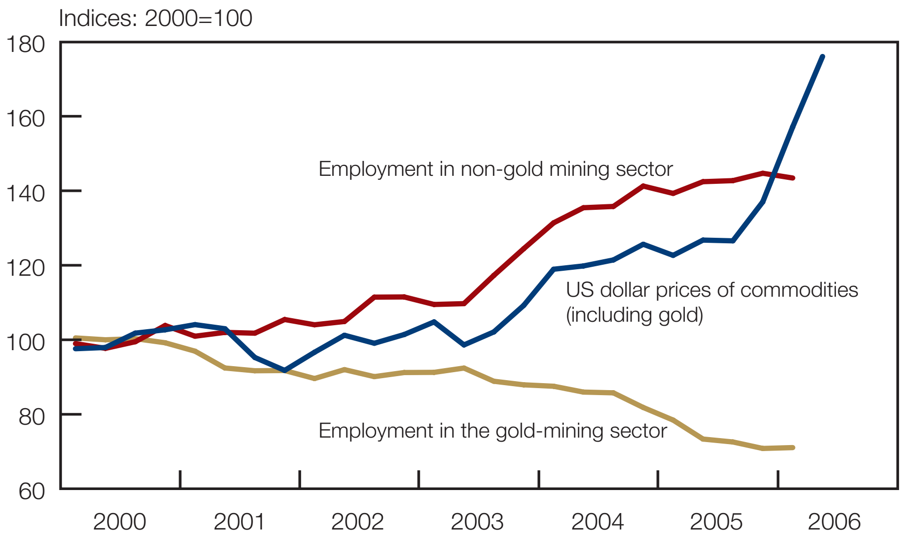
Source: Statistics South Africa, *Quarterly Employment Statistics*

Real value of buildings completed and employment in the construction sector



The physical volume of total mining production increased meaningfully during 2004 and the opening months of 2005. Increased mining production over this period resulted entirely from higher production volumes of non-gold minerals. From around the middle of 2005, the overall volume of mining production started to decrease when non-gold mining production also began to taper off. Various reasons for this decrease in production can be offered, the most prominent being the occurrence of industrial action on various occasions during the year, leading to the disruption of production processes, as well as forced shutdowns at various plants due to unforeseen circumstances. At the same time, the positive effects of rising commodity prices were diluted to some extent by the recovery in the exchange rate of the rand, suppressing rand-denominated revenues. Consequently, non-gold mining employment increased by only around 4 per cent in 2005, compared with a sturdy increase of around 18 per cent in the previous year. Employment in the gold-mining sector, however, contracted by a further 13 per cent in 2005.

Commodity prices and employment in the mining sector

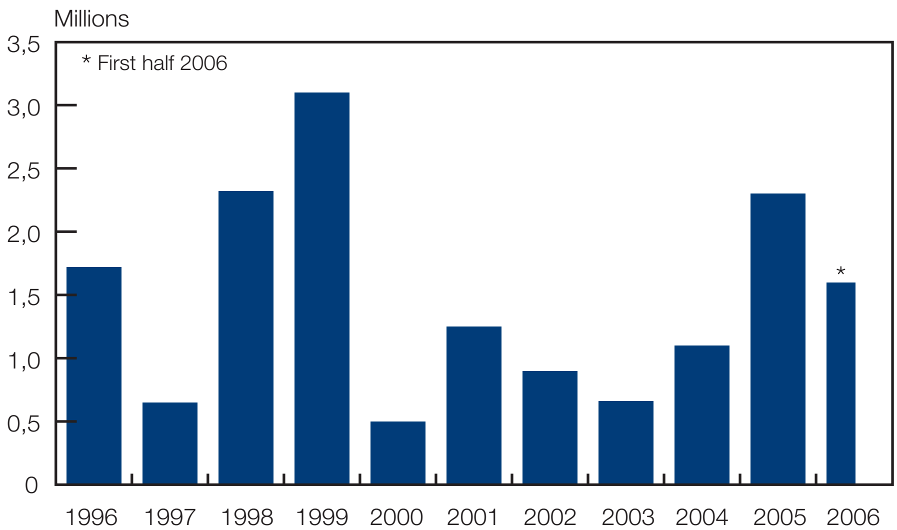


In the manufacturing sector, which is responsible for around 17 per cent of total employment in 2005, employment numbers contracted somewhat in 2005, but rose by 2,0 per cent over the twelve months to March 2006. The positive effects of strong consumer demand in the domestic economy during 2005 and the first half of 2006 were partially offset by the difficulty which South African producers experienced in competing internationally, given the appreciation of the rand against foreign currencies. Nevertheless, vehicle manufacturing shrugged off these concerns, with new vehicle exports rising by 26 per cent in 2005 and by as much as 53 per cent over the year to the first half of 2006. Production for the domestic new vehicle market also expanded briskly, as did the total number of jobs in the industry. The sustained improvement in the Investec Purchasing Managers Index (PMI) from early 2006, signalling purchasing managers' expectations in the manufacturing sector, was particularly noteworthy. According to the PMI employment sub-index in July 2006, accelerating new sales orders and strong growth in output in the manufacturing sector had also translated into expectations of employment gains going forward.

The strength and duration of the expansion in economic activity were reflected in the development of capacity constraints in various sectors of the economy, accentuating the deficiency of appropriate skills in the economy. In an effort to further address the skills shortage in the country, the government introduced the Accelerated and Shared Growth Initiative for South Africa in early 2006, with one of its key components being the Joint Initiative on Priority Skills Acquisition (Jipsa). The main aim of Jipsa is to bring together social partners to act on immediate and medium-term skills needs, particularly high-level and artisan skills. This initiative will also endeavour to attract much-needed expertise back to the country and work towards the speedier issuance of work permits to non-residents with priority skills.

Unlike the consistent decline in the number of mandays lost due to strikes and other forms of industrial action during the preceding decade, the number of mandays lost rose steeply from 700 000 in 2003 to 1,1 million in 2004, and more than doubled to 2,3 million in 2005. With approximately 8 million people in formal-sector employment, the number of mandays lost in 2005 was still reasonably well contained, and could largely be attributed to wage disputes. With employers facing increased competition in many product markets and labour unions resisting the alignment of their wage demands to lower inflation, wage disputes intensified, leading to a loss in mandays worked. The

Number of mandays lost through industrial action



Source: Andrew Levy Employment Publications number of strikes receded but the number of workers involved rose significantly during 2005. A protracted strike in the private security services industry bolstered the number of mandays lost in the first half of 2006 to 1,6 million.

Disconcerting is the finding by the United Nations that the estimated number of South Africans infected with HIV/Aids rose from approximately 5,3 million in 2003 to about 5,5 million in 2005. The impact of this pandemic on the workforce varies across sectors in terms of its effect on absenteeism, deaths and disability claims. According to a South African health consultancy, Health Monitor, the HIV/Aids-related costs incurred by the gold-mining and platinum-mining industries, for instance, amounted to 7,5 per cent and 3 per cent of their respective payrolls in 2005. More than half of these costs was related to the provision of antiretroviral drugs to workers. Companies have become more inclined to provide these treatments as the estimated cost thereof receded meaningfully from around R50 000 per person per year in 1998 to less than R10 000 in 2005.

Labour cost and productivity

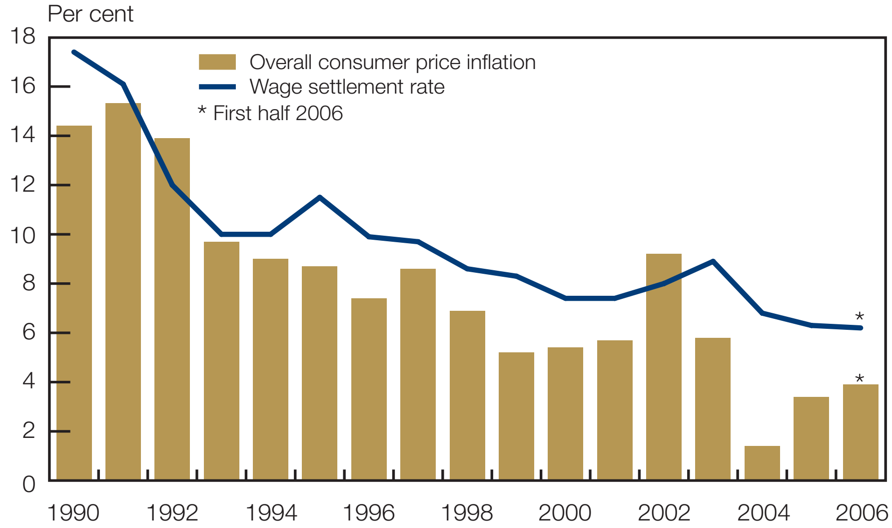
Growth in *nominal remuneration per worker* slowed meaningfully over the past number of years. The year-to-year increase in nominal remuneration per worker in the quarterly surveyed formal non-agricultural sectors of the economy amounted to 7,2 per cent in 2005 and 7,3 per cent in the year to the first quarter of 2006, substantially down from 9,1 per cent in 2004 and 8,9 per cent in 2003. The deceleration in remuneration growth was consistent with the general moderation in price inflation over this period.

Nominal remuneration growth per worker in the *private sector* amounted to 7,2 per cent in 2005 – the lowest rate of increase in more than thirty years[2] – and to 8,1 per cent in the year to the first quarter of 2006. As is usually the case, the recent rates of increase in remuneration varied substantially across subsectors. When measured over periods of four quarters, average nominal remuneration per worker in the transport, storage and communication sector, for instance, increased by 17,8 per cent in the year to the first quarter of 2006, while average earnings in the manufacturing sector rose by only 3,8 per cent.

2 This allows for the statistical break in the time series in the third quarter of 2002 and the fourth quarter of 2005, respectively, following the publication of a new expanded Survey of Employment and Earnings and then a Quarterly Employment Statistics survey by Statistics South Africa.

Alongside decelerating consumer price inflation in recent years, the average rate of wage settlements in collective bargaining agreements declined further from a recent high of 8,9 per cent in 2003 to 6,3 per cent in 2005. With the exception of 2002, settlement rates have consistently exceeded overall consumer price inflation during the past decade,

Wage settlement rates and consumer price inflation



contributing to a rise in workers' real take-home pay. According to the most recent *Wage Settlement Survey* by Andrew Levy Employment Publications, the average level of wage settlements declined slightly to 6,2 per cent in the first half of 2006. While this outcome is lower than that of preceding years, it still exceeds productivity increases, and could accordingly add to overall cost pressures in the economy.

Nominal remuneration growth in the *public sector* fell slightly short of that in the private sector during 2004 and 2005, but unlike in earlier years, closely approximated that in the private sector. Public-sector wage growth at an average rate of 6,8 per cent in 2005 was the lowest it had been in six years, falling from 9,1 per cent in the preceding year. Wage growth came to only 6,0 per cent in the year to March 2006. Similar to the private sector, nominal wage growth varied considerably within the public sector. For instance, nominal wage growth per worker in national departments amounted to 4,7 per cent in 2005, compared with a rate of increase of 13,7 per cent in local governments.

Responding to intensified competitive pressures, growth in *real output per worker* in the formal non-agricultural sectors of the economy was more pronounced at an average annual rate of 3,8 per cent in 2005 compared with 2,5 per cent in the preceding year. Furthermore, the acceleration in the year-to-year rate of increase in labour productivity in 2005 occurred within an environment of rising employment levels. Cognisance should, however, be taken of the fact that estimates of productivity growth based on the number of people employed could sometimes give a somewhat distorted impression because neither the intensity of labour usage in terms of hours worked nor shifts in the skills profile of the labour force are taken into account. When measured over periods of four quarters, labour productivity growth waned considerably in the closing months of 2005 and the opening months of 2006, when employment numbers rose briskly.

The growth in gross domestic product cannot only be explained by the available supply of capital and labour, but also by intangible technological progress; intangibles such as the more efficient management of production processes, that is through the more efficient utilisation of labour and capital; or through reducing the amount of intermediate goods and services needed to produce a given amount of output. Growth in cumulative real output in the formal non-agricultural sectors of the economy exceeded the increases in labour and capital inputs during the past four years, thus signifying an increase in multifactor productivity.

The rate of increase in production per worker in the *manufacturing sector* slowed somewhat from around 6 per cent in 2004 – a seven-year high – to around 5 per cent in 2005, but nevertheless exceeded that for the economy as a whole. Save for the sharp deceleration in labour productivity growth in the closing months of 2005, when the acceleration in year-on-year employment increases in the manufacturing sector exceeded that in production, labour productivity growth would have equalled or surpassed recordings in the preceding year.

Inflationary pressures arising in the labour market are reflected by changes in *nominal unit labour cost.* Nominal unit labour cost is derived as the ratio of nominal remuneration per worker to output per worker, i.e. money wages adjusted for labour productivity. Changes in nominal unit labour cost normally precede or coincide with changes in consumer price inflation. When labour productivity growth falls short of nominal remuneration growth, inflationary pressures emanating from the labour market are shown by a rise in unit labour cost.

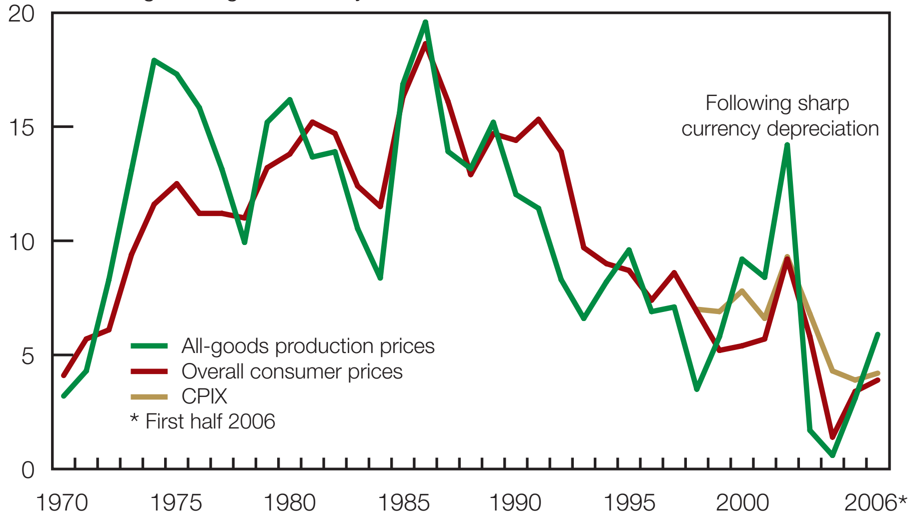
Since labour productivity growth accelerated and nominal wage growth slowed in 2005, growth in non-agricultural nominal unit labour cost receded to a five-year low of 3,4 per cent, from 6,5 per cent in 2004. Following an acceleration in nominal wage growth, nominal unit labour cost increased by 7,6 per cent in the year to the first quarter of 2006. In the manufacturing sector, with its greater exposure to international competition, the increases in nominal unit labour cost were significantly smaller than in the non-agricultural sector. The low rates of increase in nominal unit labour cost in the manufacturing sector played a major role in restraining the potential inflationary impact that high energy prices could have had on the domestic economy.

Prices

Despite extraordinary increases in energy prices and commodity prices in general, inflation in South Africa remained benign over the past year. CPIX inflation, the inflation target measure that omits changes in interest rates on mortgage bonds from the calculation of consumer price inflation, declined from 9,3 per cent in 2002 to 3,9 per cent in 2005. By June 2006, twelve-month CPIX inflation had been maintained inside the target range of 3 to 6 per cent for 34 consecutive months. The consistent application of disciplined monetary and fiscal policies, as well as waning inflation expectations, contributed to the reduction in inflationary pressures. The general downward movement in price inflation in South Africa in recent years also conformed to the world trend towards greater price stability.

Inflation

Percentage change over one year

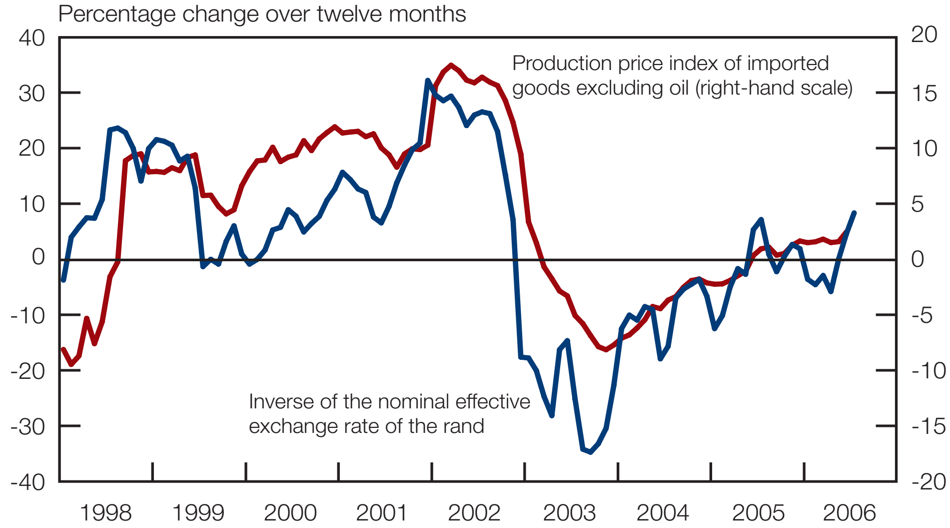


Developments in international commodity markets were reflected in the evolution of price inflation in the South African economy during the past year. As a commodity-exporting country, South Africa benefited from the strong rise in commodity prices which, in turn, supported the exchange value of the rand in international currency markets. The stronger external value of the rand not only suppressed price inflation by containing the prices of imported goods, but also raised the level of price competition in the domestic economy.

However, a number of factors contributed to a deterioration in the outlook for inflation in recent months. These included the marked depreciation in the exchange rate of the rand from the middle of May 2006, the widening current-account deficit, volatile and rising international crude oil prices, rising food prices and the exceptional buoyancy in consumer demand. In an effort to address these inflationary concerns, the MPC on 8 June 2006 announced a half-a-percentage-point increase in the repurchase rate to 7,5 per cent per annum, and again on 3 August 2006 to 8 per cent per annum.

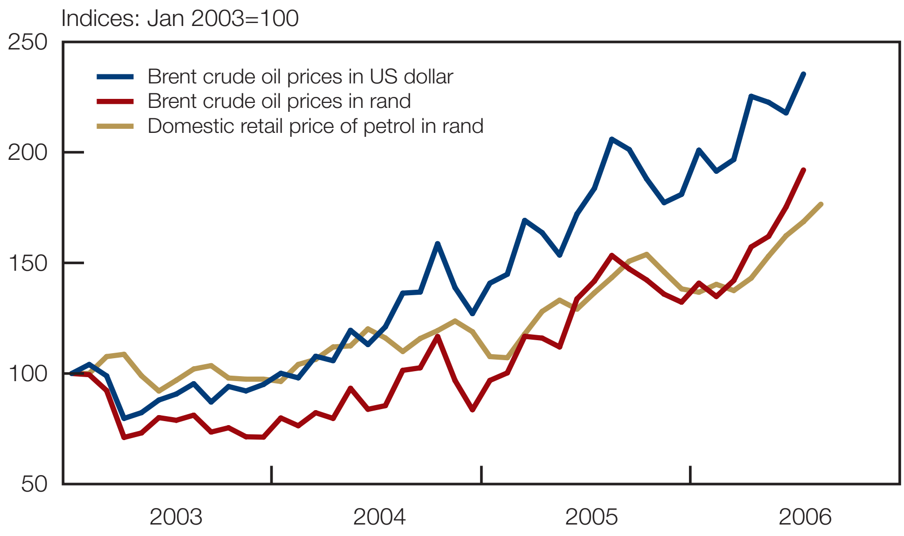
Reviewing the international forces impacting on inflation in South Africa in more detail, the extent to which exchange rate movements feed through to the prices of tradeables in general and *imported goods* in particular is illustrated in the accompanying graph. The comparative strength of the exchange value of the rand during the past eighteen months – supported by the buoyancy of commodity prices – played a major role in containing the prices of imported goods. The imported goods component constitutes 27 per cent of the all-goods production price index, and therefore has the potential to significantly influence the measured outcome of overall production price changes in the economy.

Exchange rate and imported goods prices



Consistent with the general surge in international commodity prices, the international price of crude oil rose steeply during the past year-and-a-half. International Brent crude oil prices reached a level of US$63 per barrel in January 2006. Geopolitical factors and related concerns about supply disruptions pushed international crude oil prices to a new record-

Crude oil and petrol prices



high level above US$78 per barrel by early August 2006. The full inflationary impact of higher international crude oil prices was mitigated by the appreciation of the rand, suppressing increases in the rand price of imported crude oil. In fact, from January 2003 to June 2006, crude oil prices in US dollar rose by as much as 118 per cent, while the increase in the rand price of imported crude oil was only about 75 per cent (see graph on opposite page). The increase in the domestic retail price of petrol was slightly less at 62 per cent over the period.

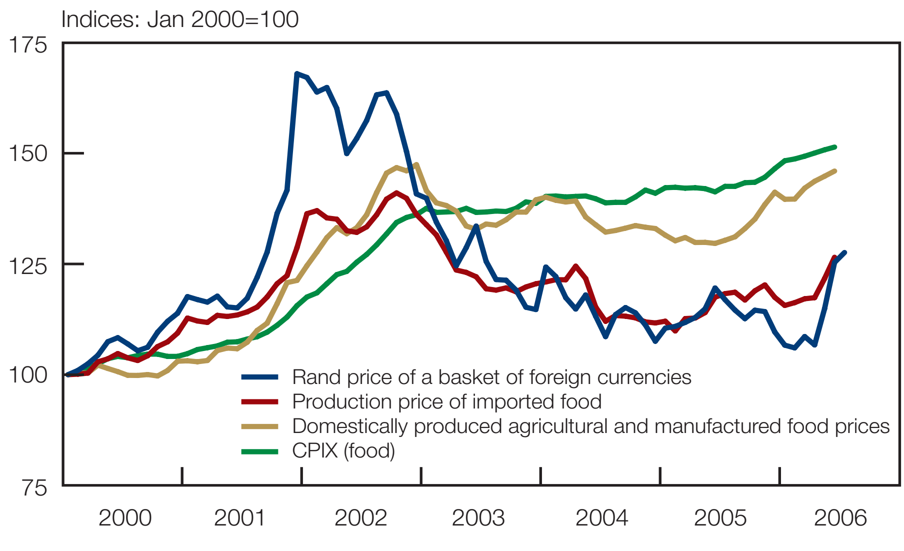
Rising international energy prices had a more muted effect on production price inflation in South Africa's main trading-partner countries. The year-to-year rate of increase in the composite foreign wholesale prices index of South Africa's main trading-partner countries rose only slightly from 3,1 per cent in 2004 to 3,4 per cent in 2005, gaining momentum to 5,1 per cent in the year to May 2006.

Notwithstanding the beneficial effects of the appreciation of the rand on import prices in general, year-on-year changes in the prices of imported goods at the production-price level reverted to increases from March 2005, having declined consistently during the two preceding years. Year-on-year inflation in the production prices of imported goods even exceeded that in domestically produced goods from June 2005 as rising energy prices lifted the price index for imported goods to more elevated levels. The full impact of rising crude oil prices is shown when its effect is removed from the calculation of imported goods prices. In fact, whereas the production prices of *imported goods* increased by as much as 6,1 per cent in the year to April 2006, non-energy imported goods price inflation remained muted at only 1,5 per cent. Imported goods price inflation rose even further to 6,8 per cent in the year to June 2006, as crude oil prices rose somewhat in the month.

Domestically produced goods price inflation fell steeply from around 13 per cent in 2002 to around 3 per cent in 2005. Higher energy prices and steep increases in the production prices of especially agricultural food products as well as processed meat resulted in an acceleration in domestically produced goods price inflation to 7,6 per cent in the year to June 2006.

Inflation in the production prices of domestically produced goods consistently exceeded that in the prices of imported goods during 2003 and 2004, essentially reflecting the more immediate response of imported goods prices to the strengthening of the exchange rate and heightened cost pressures within the domestic market. However, from the third quarter of 2005 inflation in the prices of domestically produced goods fell

Exchange rate of the rand and food prices



below that in the prices of imported goods. This can be explained by increased energy prices pushing imported goods price inflation higher, but also by a reduction in cost pressures within the domestic economy. In the manufacturing sector in particular, a deceleration in nominal unit labour cost growth during the past two years contributed significantly to the containment of domestically-generated inflationary pressures.

Changes in food prices had a significant influence on production price inflation during the past year. Agricultural and manufactured food prices, together constituting around 22 per cent of the production price index for domestically produced goods, respectively declined by 3,3 per cent and 1,2 per cent in 2005. Subsequently, agricultural food prices increased markedly and by June 2006 had risen by as much as 22,5 per cent over the year as grain prices soared. Manufactured food price inflation was considerably lower at 6,0 per cent, but nevertheless represented a significant acceleration from rates of decrease eight months earlier. The acceleration in manufactured food price inflation related mainly to the increase in fresh meat prices in recent months.

Food prices

Percentage change over twelve months

Period		Domestic production prices of food			CPIX consumer food prices
		Agricultural food	Manufactured food	Total	
2005:	Jun	-5,1	-1,8	-3,1	1,1
	Jul	-1,0	-1,7	-1,4	2,7
	Aug	-2,0	-0,4	-1,1	2,6
	Sep	0,9	-0,7	-0,1	3,2
	Oct	3,4	-0,5	1,1	2,4
	Nov	9,1	0,2	3,8	2,0
	Dec	13,3	1,3	6,2	4,0
	Year	**-3,0**	**-1,2**	**-2,0**	**2,1**
2006:	Jan	12,8	1,7	6,2	4,3
	Feb	14,4	2,5	7,2	4,5
	Mar	15,1	4,0	8,5	5,1
	Apr	18,6	5,4	10,6	5,5
	May	19,8	6,0	11,5	6,2
	Jun	22,5	6,0	12,6	7,2

Following a rapid acceleration from year-on-year rates of around 2 per cent in the opening months of 2005 to 5,5 per cent in January 2006, *all-goods production price inflation* remained fairly stationary at this level in subsequent months, before rising to 7,5 per cent in June. When the primary drivers of production price inflation – energy and food prices – are excluded, all-goods production price inflation would have amounted to a lower rate of 4,5 per cent in June 2006.

Despite the upward shift in the level of production price inflation since the middle of 2005, *CPIX inflation* remained muted, fluctuating along a sideways path and remaining comfortably within the 3-to-6-per-cent target range. It came to 4,8 per cent in June 2006. Year-on-year *CPIX goods price inflation* dropped steeply from a most recent high of 13,4 per cent in October 2002 to rates generally falling below the lower boundary of the inflation target range during most of 2004 and the first half of 2005. The combined effect of rising petrol and food prices in the subsequent period pushed CPIX goods price inflation higher to 5,8 per cent in June 2006[3].

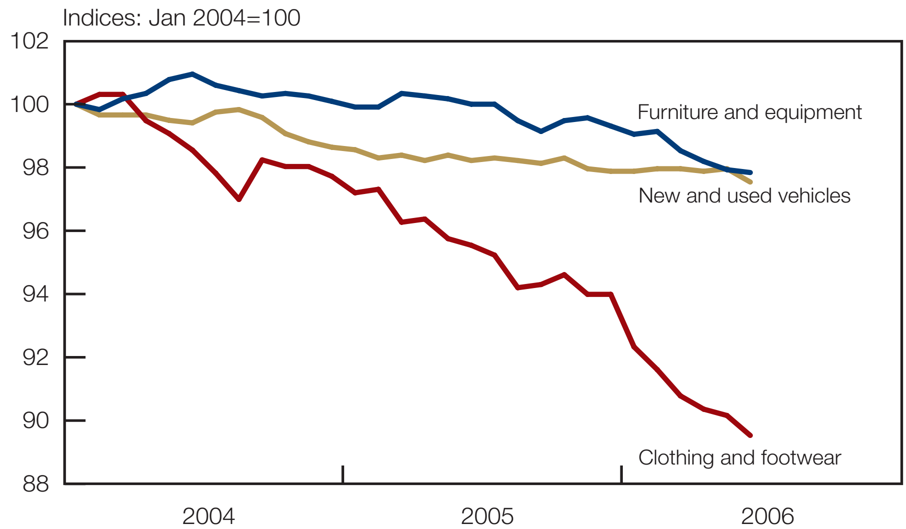
3 The goods component of CPIX accounts for roughly two thirds of the index, with food accounting for the bulk of the goods component, i.e. around 40 per cent. Transport running cost, consisting mainly of the petrol price, has a weight of around 9 per cent in the CPIX goods index.

From year-on-year rates in excess of 20 per cent in the closing months of 2002, consumer food price inflation receded to rates well below 3 per cent during most of 2004 and 2005, reaching a low of 1,1 per cent in June 2005. The appreciation of the rand assisted meaningfully in the containment of food price inflation during that period.

Consistent with the subsequent surge in the production prices of food, consumer food price inflation accelerated briskly to reach 7,2 per cent in June 2006. A disaggregation of consumer food price changes shows that increases in the price of meat outpaced those in all other food categories during the twelve months to June 2006, increasing by 14,9 per cent. By contrast, the price of the staple food of many South Africans, i.e. grain products – comprising almost 20 per cent of the food basket – increased by only 3,8 per cent.

The disinflationary benefits of the appreciation of the rand during 2005 and the opening months of 2006 were not only limited to the extent to which it contained the rise in the rand price of imported crude oil, but also extended to the prices of furniture and equipment, clothing and footwear as well as new and used vehicles. In fact, the prices of furniture and equipment declined by 2,2 per cent from January 2004 to June 2006. New and used vehicle prices were lower by 2,5 per cent while clothing and footwear prices fell by as much as 10,5 per cent over the period. Inflation in the price category for *other goods* also remained muted, not exceeding the 3-per-cent level during the twelve-month period to June 2006.

Consumer prices of selected product groups



CPIX services price inflation consistently exceeded CPIX goods price inflation during the two-and-a-half years to December 2005, but moderated considerably from rates around 8 per cent in 2003 to 5,6 per cent in 2005, receding even further to 3,3 per cent in the year to June 2006. As the exchange rate of the rand has a limited direct influence on services prices, the waning of CPIX services price inflation could mainly be ascribed to a slower pace of increase in administered prices, i.e. the lower rates of increase in electricity tariffs, refuse removal charges, assessment rates, public hospital fees, university boarding fees, rent and communication costs. The rate of increase in the wages of domestic workers also started to moderate.

Lower administered price inflation bears testimony to the authorities' determination to pursue pricing policies that are aligned with inflation-targeting benchmarks. Around 20 per cent of the CPIX basket comprises administered goods (such as petrol) and services. In June 2006, year-on-year inflation in the prices of administered goods and services amounted to 8,4 per cent, substantially lower than the rate of 11,2 per cent recorded ten months earlier. Of note is the outcome of the multi-year price determination process whereby Eskom (the national electricity utility) has been awarded increases in electricity tariffs by the National Electricity Regulator of 5,1 per cent for the period 1 April 2006 to 31 March 2007, 5,9 per cent in the following twelve-month period and 6,2 per cent in the subsequent twelve-month period.

Inflation expectations, as indicated by the Inflation Expectations Survey of the Bureau for Economic Research at the University of Stellenbosch, serve as valuable input to monetary policy decision-making. According to the most recent survey which was conducted in the second quarter of 2006, participants on average expect that annual average CPIX inflation will amount to 4,4 per cent in 2006, rising slightly to 4,9 per cent in both 2007 and 2008 – well within the inflation target range. This survey was conducted over the four weeks to 17 May 2006 and therefore did not account for the impact on inflation expectations of the marked depreciation in the exchange rate of the rand from the middle of May.

CPIX inflation expectations

Per cent, as surveyed in the second quarter of 2006

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2006	4,4	4,5	4,4	**4,4**
2007	4,8	4,8	5,0	**4,9**
2008	4,5	5,0	5,1	**4,9**

Source: Bureau for Economic Research, University of Stellenbosch

Nevertheless, a number of factors are likely to restrain inflationary expectations in the period ahead. These include the authorities' demonstrated commitment to monetary policies which are actively directed at the containment of inflationary pressures; the fairly muted wage pressures to date; the subdued behaviour of inflation measures which exclude the volatile costs of energy and food; the expectation that low-cost producers in Asia will continue to supply goods at highly competitive prices; and the recent imposition of more restrictive monetary policies in a number of major economies, which still has to weigh down on inflationary pressures.

Foreign trade and payments

International economic developments

Global economic growth moderated from 5,3 per cent in 2004 – the highest rate in three decades – to a still high 4,8 per cent in 2005, with indications that it broadly remained robust in the first half of 2006. This solid performance was achieved despite record high prices of crude oil and other commodities, military conflict and unrest in a number of countries, and various natural disasters. It also seemed largely to defy the adoption of tighter monetary policies in many parts of the world, reverting from the accommodative policy stance previously adopted.

In the United States, which faced significant hurricane damage in the second half of last year, real output growth moderated somewhat in 2005. US economic growth rebounded strongly in the first quarter of 2006, but slowed in the second quarter. Real economic growth in Japan accelerated in 2005 and, despite some hesitation in economic activity in the first half of 2006, the economic recovery remained on track. Economic growth in the euro area decelerated somewhat in 2005 as a result of high oil prices and a poor export performance due to the moderation in global demand in the first half of 2005 and the appreciation of the euro. However, economic activity in the euro area regained some momentum in the first half of 2006. Real output growth remained strong in most Latin American and Asian emerging-market countries, especially in China, India and Russia. Africa benefited from the global economic recovery and registered a real growth rate of around 5 per cent in 2005. A slight further acceleration in real growth in Africa as a whole may be expected in 2006, supported by strong growth in oil-exporting countries, robust global demand for non-oil commodity exports, and improved economic policy frameworks.

The strong global economic recovery contributed to the surge in international commodity prices in recent years, especially in oil markets. The price of Brent crude oil,

Spot price of Brent crude oil

for instance, soared from approximately US$40 per barrel in the beginning of 2005 to new record-high levels of around US$79 per barrel in early August 2006. High crude oil prices were underpinned by strong global oil demand, disruptions in oil supply due to bad weather conditions, limited excess oil production capacity and geopolitical tensions in countries and regions such as Nigeria, Iraq, Iran and the Middle East.

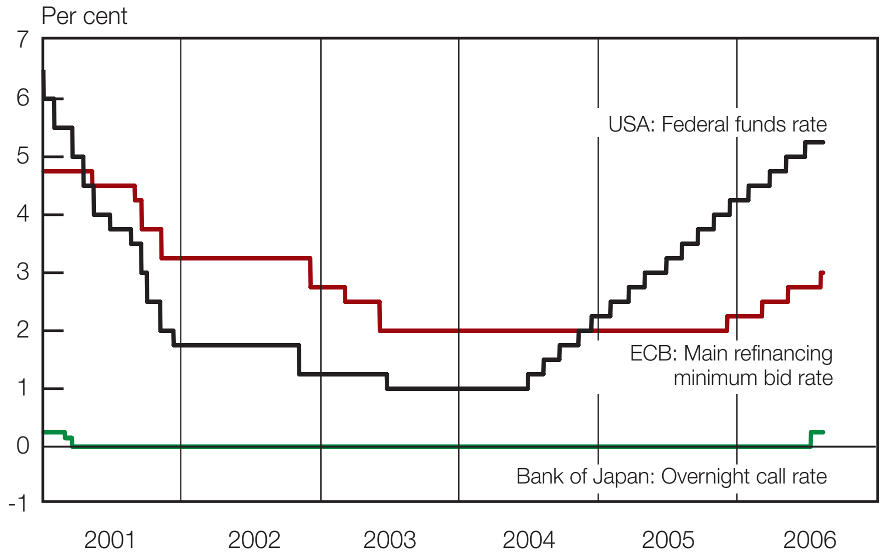
Global current-account imbalances continued to deteriorate with the US external deficit amounting to US$791,5 billion in 2005, almost equal to the combined current-account surpluses of Japan, emerging Asia (including China) and the major oil-exporting countries. A major concern remained the sustainability of these imbalances and the adverse impacts a disorderly adjustment could have on global economic growth. Accordingly, at its *Spring Meetings* in April 2006, the International Monetary Fund (IMF) was given the responsibility to address the issue of growing global imbalances through multilateral consultations. These consultations, forming part of the Fund's *Medium-Term Strategy,* would include the United States, China, the euro area, Japan and Saudi Arabia.

A possible pandemic outbreak of avian influenza (also known as bird flu) remained a further concern during the year under review, although human loss of life had been limited since the first outbreak in mid-2003.

While global headline inflation increased in response to higher crude oil prices during the past eighteen months, core inflation (headline inflation excluding energy prices) and inflationary expectations initially remained well contained. However, concerns about inflationary pressures have intensified with core inflation recently picking up in some countries. This contributed to increased volatility in commodity prices and global financial markets, especially in emerging economies. Expectations that monetary policies would be tightened further and a greater awareness of risk – especially in overheated market situations – reinforced risk aversion among investors, contributing to the sharp correction in exchange rates and financial asset prices since mid-May 2006.

Since the beginning of 2006 monetary policy has been tightened in Australia, Canada, Chile, China, the Czech Republic, Denmark, the euro area, Hong Kong,

Central bank policy rates



Hungary, India, Israel, Malaysia, South Korea, Sweden, Switzerland, Taiwan, Thailand, Turkey, the United Kingdom and the United States. The Bank of Japan ended its quantitative easing monetary policy in March 2006 and increased the uncollateralised overnight call rate by 25 basis points in July. The central banks of Brazil, Indonesia, Mexico, Poland and Russia, however, lowered interest rates.

Policy issues and trade reforms

Government continued to pursue its strategy of gradual relaxation of exchange controls during the past year. In February 2006 the Minister of Finance announced that South African banks would in future be allowed to hold foreign assets of up to 40 per cent of their regulatory capital, as part of the shift from exchange control to the prudential regulation of banks' foreign exposures. Foreign assets held outside Africa would be restricted to 20 per cent of required capital, while foreign assets invested in Africa could constitute up to the full 40 per cent. Furthermore, the foreign exposure limit applicable to collective investment schemes was increased from 20 to 25 per cent of total retail assets under management, while for investment managers this limit was raised from 15 to 25 per cent of their total retail assets. In addition, the offshore foreign currency allowance for individuals was raised from R750 000 to R2 million. South African corporates could henceforth undertake foreign direct investment in Africa more easily by acquiring 25 per cent of the shareholding of a target company, instead of the 50 per cent minimum which was required previously.

Continuous efforts to promote economic growth and development and to enlarge South Africa's market share internationally, led to an expansion of the country's bilateral trade programme. In this regard, trade negotiations with Mercosur (comprising Brazil, Argentina, Paraguay, Uruguay, Chile and Bolivia) were continued. In the first half of 2006, the European Free Trade Association (EFTA)[4] successfully concluded a free trade agreement with the member states of the Southern African Customs Union (SACU), thereby promoting fair and equitable trade relations between these groups of developed and developing countries. The Doha Development Round of World Trade Organisation (WTO) negotiations continued, with the Sixth WTO Ministerial Conference taking place in Hong Kong during December 2005 and a formal meeting of the Trade Negotiations Committee held in Geneva in July 2006, but with little progress. Negotiations were eventually suspended. On the African continent itself, the New Partnership for Africa's Development (NEPAD) continued to promote integration, development and competitiveness.

4 The EFTA members are Iceland, Liechtenstein, Norway and Switzerland.

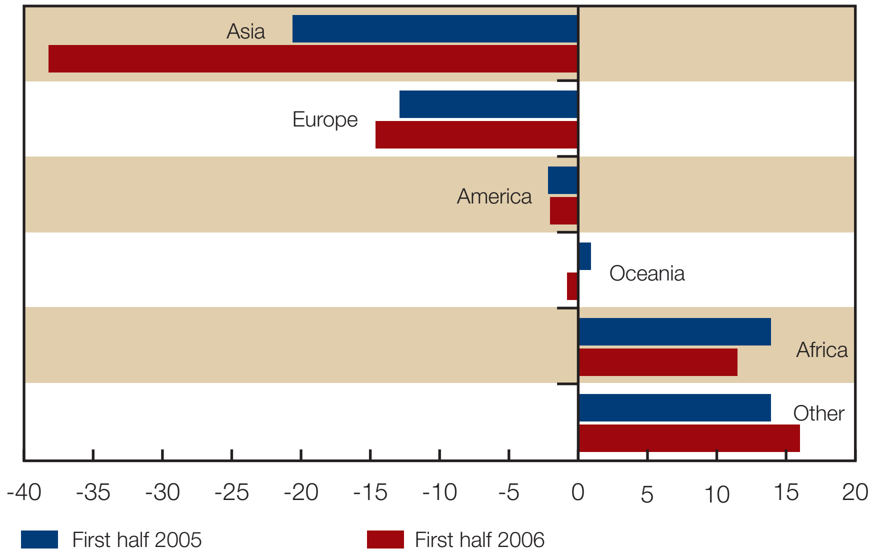
Current account[5]

The sustained strong global economic expansion and the accompanying rise in international commodity prices bolstered the export earnings of South African producers over the past two years. The favourable external environment, however, coincided with vibrant domestic expenditure and consequently strong demand for foreign-produced intermediate, capital and consumer goods. While export proceeds in domestic currency terms were moderated by the relatively strong external value of the rand, domestic expenditure and imports rose to such an extent that, from an almost negligible amount in 2004, the trade deficit widened to R12 billion in 2005 and R37 billion in the first half of 2006. Over this period, South Africa's negative trade imbalance with Asia increased considerably while that with Europe widened very little, as shown in the graph on the next page.

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

South African trade balance by major region

R billions



As could be expected from a country which experienced sizeable capital inflows in recent years, the payment of dividends and interest to non-resident holders of equity and debt obligations rose considerably, contributing to higher net service, income and current transfer payments to the rest of the world. This added to the deficit on the current account of the balance of payments, which widened persistently over the past three years.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

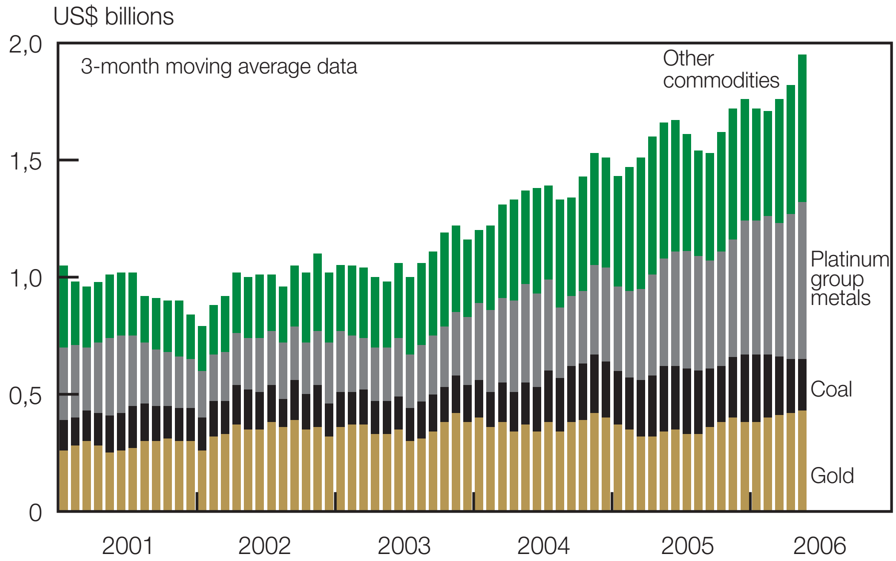
	2004	2005			2006
Sectors	Year	1st half	2nd half	Year	1st half
Merchandise exports	281,8	303,9	337,4	320,7	342,6
Net gold exports.....................................	28,7	25,4	28,6	27,0	31,5
Merchandise imports	-311,8	-337,9	-381,4	-359,7	-411,0
Trade balance	**-1,3**	**-8,6**	**-15,4**	**-12,0**	**-36,9**
Net services, income and current transfers	-46,2	-50,1	-54,6	-52,4	-62,0
Balance on current account	**-47,5**	**-58,7**	**-70,0**	**-64,4**	**-98,9**
As percentage of gross domestic product	*-3,4*	*-4,0*	*-4,4*	*-4,2*	*-6,1*

Relative to gross domestic product, the deficit amounted to more than 6 per cent in the first half of 2006 compared with deficit ratios of 3,4 per cent in 2004 and 4,2 per cent in 2005. Apart from South Africa, many emerging-market and commodity-producing countries, such as Turkey, New Zealand, Hungary, Australia and Poland, also experienced a widening in their current-account deficits over the past eighteen months. By contrast, oil-producing countries generally enjoyed rising surpluses on their current accounts.

Exports

As South African exports benefited from strong global demand for and surging prices of commodities, the *value* of visible exports recorded a sturdy increase of 14 per cent in 2005. The increase was concentrated in the mining category, where the platinum group metals constituted the largest commodity export earner, followed by gold – historically the most important export product – and coal as the third-largest earner. Over the same period, the share of manufactured goods in total visible exports declined to 37½ per cent from 38¼ per cent in 2004. In the first half of 2006 the value of visible exports rose only marginally on account of subdued export volumes.

South African commodity exports



Although export *volumes* displayed considerable volatility from quarter to quarter, the volume of visible exports advanced by 8½ per cent in 2005. The physical quantity of exported goods, which has been responding well to the upturn in commodity prices since the beginning of 2003, moved sideways in the second half of 2005 before declining moderately by 3½ per cent in the first half of 2006. Export volume growth in the mining industry was held back by an increase in the external value of the rand, the long lags involved in adjusting the capacity of the transport infrastructure to the buoyant global demand for commodities, industrial action, the regulatory environment with its compliance processes and accompanying lags, and the decision-making and investment lags internal to the mining industry itself. In gold mining the downward trend in the volume of gold produced continued due to factors such as the mining of lower grades of gold-bearing ore and the closure of some loss-making gold mines and shafts. South Africa's volume of net gold exports accordingly declined from 424 tons in 1999 to 340 tons in 2004 and receded further by 12½ per cent to 298 tons in 2005. It contracted by a further 11,3 per cent in the first half of 2006.

Despite a pick-up in the growth momentum in the euro area, the volume of manufacturing exports remained under pressure in the second half of 2005 and moved sideways in the first half of 2006. The buoyant domestic demand in the generally more lucrative South African market, alongside the relative strength of the rand – and ultimately the movement in relative prices – contributed to the sluggish performance of South Africa's manufactured exports.

Export *prices* were, on average, 4¾ per cent higher in 2005 than in 2004 and increased by no less than 5¼ per cent in the first half of 2006. These increases could largely be explained by the demand-led rise in international commodity prices. The US dollar price index of commodities rose by 37¾ per cent in the eighteen months to June 2006. In London the fixing price of gold reached a peak of US$725 per fine ounce on 12 May

2006. Strong international commodity prices were, however, neutralised in part by the appreciation of the rand.

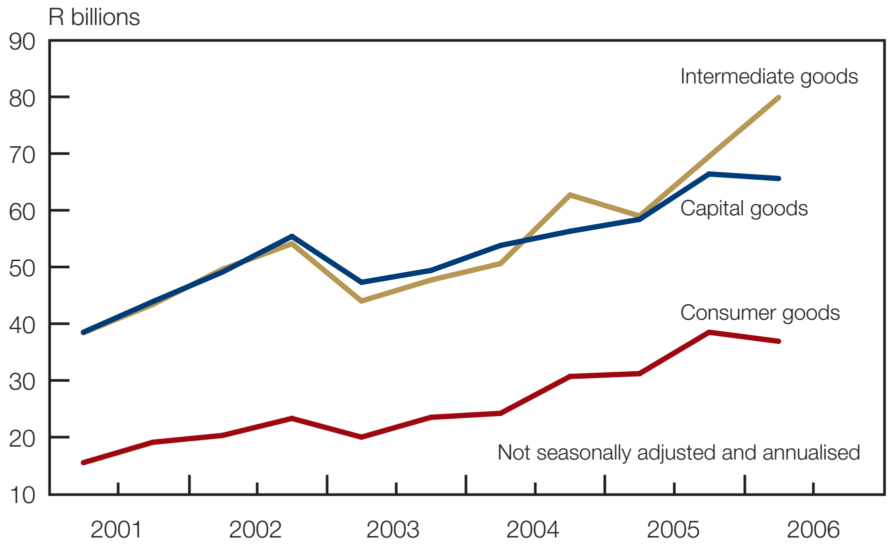
Exports of key precious metals

Period	Gold			Platinum		
	Volume	Price per fine ounce		Volume	Price per fine ounce	
	Tons	US dollar	Rand	Tons	US dollar	Rand
2005: First half	148,5	427	2 647	67,2	866	5 375
Second half	149,2	462	3 005	73,2	926	6 034
2006: First half	132,1	591	3 717	65,9	1 109	7 009

Imports

Vibrant economic activity and domestic demand led to a further increase in expenditure on foreign-produced goods. For the calendar year 2005, the *value* of merchandise imports surged by 15½ per cent, gaining momentum in the second half of the year. Imports of vehicles and transport equipment surged by 20 per cent in 2005, bolstered by the importation of three aeroplanes and a naval vessel during the first and second half of the year, respectively. At the same time, the upward trend in fixed capital formation pushed up the value of imported machinery and electrical equipment by 15 per cent. These trends were sustained in the first half of 2006 when the import bill was raised further on account of the higher value of imported crude oil as domestic oil inventories were replenished. This followed shortages which were experienced towards the end of 2005 when oil refineries changed over to the production of lead replacement fuel.

Merchandise imports



The rising import values were mainly a reflection of quantity increases. Against the background of South Africa's high marginal propensity to import, the *volume* of merchandise imports rose by 11½ per cent in 2005 and by 6½ per cent in the first half of 2006. With the physical quantity of imported goods growing faster than real gross domestic expenditure, the import penetration ratio increased steadily to 23,9 per cent in 2005 and 24,5 per cent in the subsequent half-year. Important reasons for the rise in this ratio included the comparative strength of the exchange value of the rand and its impact on the prices of imported goods relative to the prices of domestically produced goods, and the relatively high income elasticity of demand for imported goods, coupled with firm growth in real aggregate domestic demand. The country's openness to international trade and competition also contributed to this increase.

Primarily as a result of the upward trend in oil prices and modestly higher inflation in South Africa's main trading partners, the average *price* level of merchandise imports rose by 3½ per cent in 2005. The rand price of imported goods continued to trend upwards in the first half of 2006, as international oil prices continued to fluctuate higher and were – from May 2006 onwards – reinforced by a significant depreciation of the exchange value of the rand.

Net service, income and current transfer payments

Net service, income and current transfer payments to the rest of the world rose significantly in 2005 and the first half of 2006. However, as a percentage of gross domestic product the shortfall remained broadly unchanged during the past three-and-a-half years.

The higher deficit on the services account could mainly be ascribed to a strong rise in income payments to non-residents. In particular, interest and dividend payments increased sharply by about 27 per cent in 2005 and by a further 25 per cent in the first half of 2006, following an increase in the country's foreign debt exposure and substantial non-resident investment in South African equity and debt securities. As a result, interest and dividend payments as a ratio of total export earnings increased noticeably from 10½ per cent in 2004 to 11¾ per cent in 2005 and 13 per cent in the first half of 2006. In addition, payments for freight and merchandise insurance services continued to rise owing to the higher value of merchandise imports, while the consumption of foreign services by South Africans travelling abroad also continued to increase in the past eighteen months. The table below indicates the growth rates of the various categories of payments to non-residents.

Growth in gross payments to non-residents by main category
Percentage

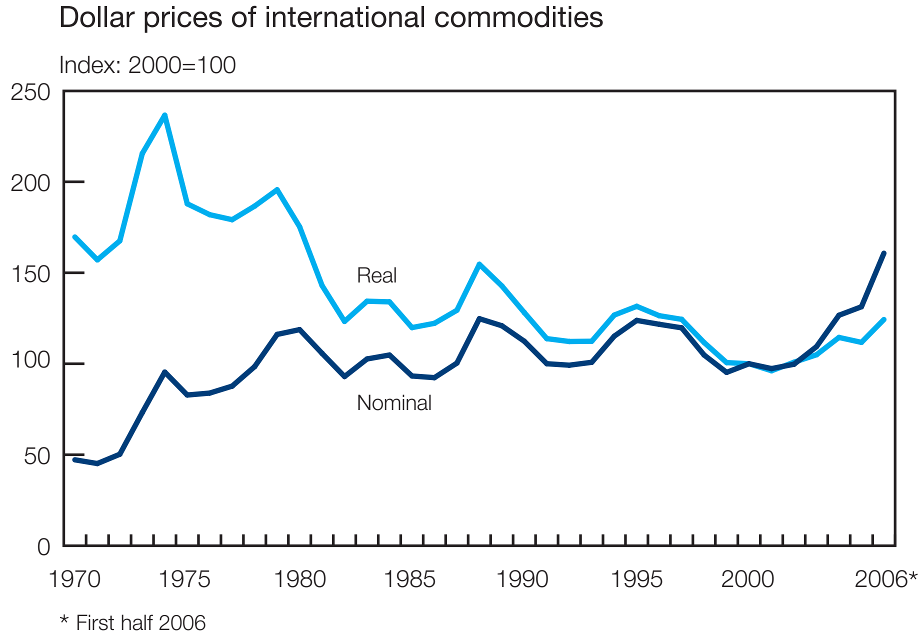
	2001	2002	2003	2004	2005	2006*
Services	10,8	26,5	8,9	8,0	13,3	18,1
Dividends	75,2	-12,6	26,5	-22,1	37,1	20,2
Interest and other income	2,7	12,1	-12,0	1,7	6,2	19,3
Current transfers	2,8	-0,8	12,1	35,6	13,2	39,8
Growth in total gross payments	**21,1**	**10,1**	**8,7**	**0,6**	**17,0**	**20,6**

* First half compared with first half 2005

The higher service and income payments in 2005 and the first half of 2006 were partly countered by higher spending by foreign visitors to South Africa and higher dividends received by residents who had accumulated foreign assets following the relaxation of exchange control measures. Interest received also increased due to higher levels of foreign exchange holdings by the monetary sector and higher nominal interest rates abroad.

Terms of trade

The rise in international commodity prices in 2005 and the first half of 2006 bolstered the prices of South African exports more than the prices of imports. Accordingly, the country's international terms of trade improved over the period, contributing to increased operating surpluses, higher share prices and stronger investment growth.



Financial account

Subdued global inflation and interest rates which increased investors' appetite for higher yielding currencies resulted in a significant flow of international liquidity to emerging-market countries over the past two-and-a-half years. These capital inflows together with a sharp rise in commodity prices significantly benefited resource-rich countries, including South Africa. As a result, the surplus on the financial account of the balance of payments (including unrecorded transactions) improved from R84,6 billion in 2004 to a new record value of R98,4 billion in 2005. This inflow of capital continued during the first half of 2006 when a surplus of R62,1 billion was recorded on the financial account with the rest of the world. As a ratio of gross domestic product the surplus on the financial account increased from 6,1 per cent in 2004 to 6,5 per cent in 2005 and no less than 7,7 per cent in the first half of 2006.

While net portfolio investment flows were mainly responsible for the financial account surplus in 2004, net direct investment flows also contributed significantly to the surplus on the financial account of the balance of payments during 2005. During the first half of 2006, portfolio investment recorded its highest ever half-year inflow, ensuring that the inflow of surplus savings from the rest of the world was not only sufficient to finance the growing deficit on the current account of the balance of payments but also allowed for some accumulation of international reserves.

Net financial transactions not related to reserves

R billions

	2004	2005			2006
	Year	1st half	2nd half	Year	1st half
Liabilities					
Direct investment	5,1	2,8	37,9	40,7	12,1
Portfolio investment	44,9	33,1	3,2	36,3	88,7
Other investment	10,9	19,9	2,2	22,1	40,0
Assets					
Direct investment	-8,8	2,6	-3,0	-0,4	-4,8
Portfolio investment	-6,0	0,8	-6,6	-5,8	-6,3
Other investment	-2,1	-5,6	-17,2	-22,8	-70,0
Financial transactions*	**84,6**	**51,4**	**47,0**	**98,4**	**62,1**

* Including unrecorded transactions

Foreign-owned assets in South Africa

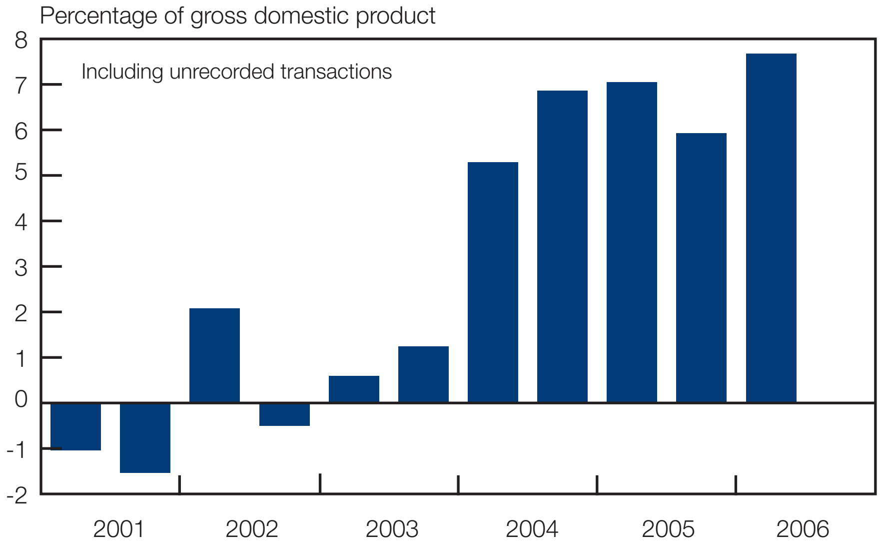
Foreign direct investment into South Africa increased significantly from R5,1 billion in 2004 to R40,7 billion in 2005. The bulk of inward direct investment was registered in the third quarter of 2005 when a bank, domiciled in the United Kingdom, acquired a controlling stake in one of South Africa's major banks. Direct investment into South Africa was probably encouraged by favourable domestic growth prospects and sound monetary and fiscal policy which enhanced price stability and improved the investment climate. In the first half of 2006 foreign direct investment inflows continued, boosted by a significant foreign investment in the telecommunications sector. This was, however, partly offset by the sale of a significant share of a non-resident investor's holdings in a South African gold-mining company.

Portfolio investment liabilities have been recording inflows during each half-yearly period since the start of 2004. Following inflows of R33,1 billion and R3,2 billion in the first and second half of 2005, substantial inflows of R88,7 billion were recorded in the first half of 2006. The inflow of portfolio investment capital in 2005 was the result of investment in equity capital, while an outflow of debt capital was recorded. Inflows into the South African equity market could largely be attributed to rising commodity prices, attractive yields, sound macroeconomic fundamentals and prospects for sustained economic growth. Portfolio inflows continued in the first half of 2006 as a result of further accumulation of domestic equity securities by non-resident investors and as non-resident investors changed to being net buyers of debt securities.

Also supportive of portfolio liability inflows were the issues in the Eurorand bond market during 2005, when the highest net issuance since 1999 was recorded. These issues of rand-denominated bonds by highly rated non-resident institutions supported the value of domestic bonds and the exchange rate of the rand. All three major credit-rating agencies rate South Africa as investment grade, lowering the country's borrowing cost and encouraging an inflow of portfolio investment capital. This was amplified by further rating upgrades in the second half of 2005. Furthermore, non-banking private-sector entities also issued international foreign-currency denominated bonds during 2005 and early 2006 after an extended absence from this market. Issues by such entities from the beginning of 2005 to the end of June 2006 exceeded R10 billion.

Other foreign investment into South Africa declined from R19,9 billion in the first half of 2005 to R2,2 billion in the second half. Inflows during 2005 were generally related to increases in short-term loans extended to and rand and foreign-currency denominated deposits with South African banks by non-residents. While the non-bank private sector also contributed to the inflow of capital during 2005, public corporations continued to repay their foreign loans. In the first half of 2006 other investment inflows of R40,0 billion were recorded. These inflows again mainly resulted from short-term loans extended to and rand and foreign-currency denominated deposits with South African banks by non-residents. South Africa attracted deposits from non-residents amounting to R7,2 billion, R5,8 billion and R27,1 billion during 2004, 2005 and the first half of 2006, respectively. These deposits were mainly rand denominated; non-residents were attracted by the positive, although narrowing, interest rate differential between South Africa and the developed countries. Only approximately 10 per cent of non-resident rand-denominated deposits are classified as long-term deposits.

Balance on financial account



South African-owned assets abroad

While South African enterprises continued to acquire *foreign direct investment* assets in the rest of the world in 2005, capital inflows (i.e. a reduction in foreign direct investment assets) also occurred as a number of South African companies sold part of their shareholding in direct investment enterprises abroad. Following an increase in direct investment assets of R8,8 billion in 2004, a reduction of these assets to the value of R2,6 billion and an increase of R3,0 billion were registered in the first and second half of 2005, respectively. On a net basis, South African companies increased their direct investment assets by R4,8 billion during the first half of 2006.

Foreign portfolio investment assets (i.e. foreign debt and equity securities) predominantly held by South African institutional investors declined by R0,8 billion in the first half of 2005, but changed to an outflow of R6,6 billion in the second half. The increase in investment abroad could partly be ascribed to South African investors making use of the stability of the rand and improved global financial conditions to diversify their portfolios. Further outflows were recorded in the first half of 2006, as investors continued to diversify their portfolios.

Other foreign investment assets, which had increased by only R2,1 billion in 2004, increased by R5,6 billion and R17,2 billion in the first and second half of 2005, respectively. The increase in other foreign investment assets, particularly in the second half of 2005, could be attributed to an increase in the offshore foreign-currency deposits of South African banks. Mainly on account of the further easing of exchange controls applicable to banks, which was announced late in 2005, the foreign-currency denominated assets of the banking sector which formed part of the country's foreign reserves were reclassified and recorded in the category *other investment assets*. During the first half of 2006 the accumulation of other foreign investment assets accelerated when an amount of R70,0 billion was invested abroad. The increase in rand and foreign-currency denominated deposits of resident South African banks was again the main reason for this accumulation of foreign assets.

International reserves and liquidity

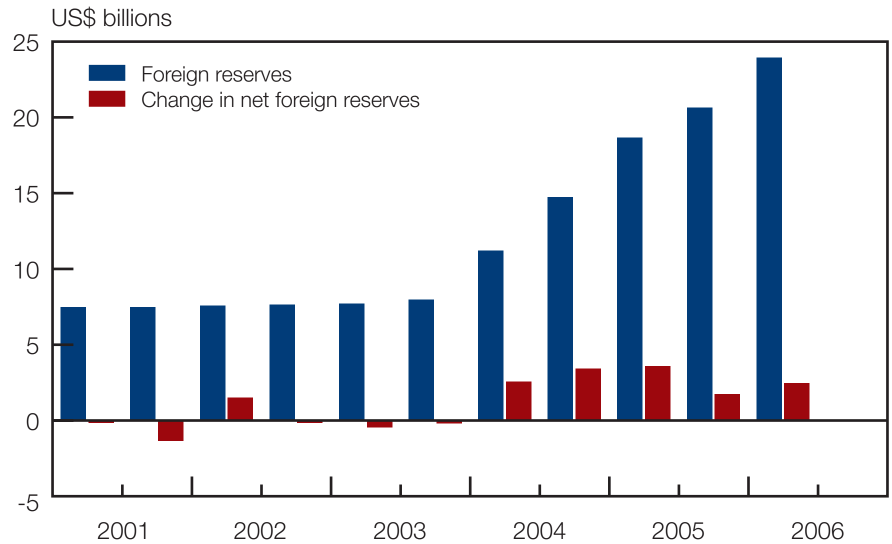
Balance-of-payments transactions resulted in a R37,5 billion increase in South Africa's net international reserve position in 2004. A further increase of R34,3 billion was registered in 2005 as the financial account of the balance of payments continued to finance the growing deficit on the current account quite easily. Although the accumulation of reserves in 2005 was more pronounced in the first half of the year, South Africa has been recording a build-up of foreign reserves in each half-year period since the start of 2004. The mounting deficit on the current account of the balance of payments during the first half of 2006 contributed to a slowdown in the accumulation of net international reserves towards the end of that period.

The gross international reserves of the Bank improved by US$5,9 billion from the end of 2004 to a level of US$20,7 billion at the end of 2005. Although the build-up of gross reserves gained momentum, the ratio of foreign exchange reserves of the Bank to the current-account deficit remained around 2:1 in 2004 and 2005. The Bank's gross international reserves increased further to US$24,0 billion at the end of June 2006.

The level of imports of goods and services covered by gross official international reserves increased from 9 weeks' worth at the end of December 2004 to 13 weeks' worth at the end of December 2005. At the end of June 2005 this ratio equalled 15 weeks' worth.

The international liquidity position of the Reserve Bank also continued its gradual improvement from US$11,4 billion at the end of December 2004 to US$17,2 billion at the end of December 2005, rising further to US$20,2 billion at the end of June 2006.

Gold and other foreign exchange reserves



Foreign debt

South Africa's total outstanding foreign debt increased from US$43,3 billion at the end of 2004 to US$46,2 billion at the end of 2005, expanding further to US$53,1 billion at the end of March 2006. This increase could be attributed mainly to an increase in rand-denominated debt, although foreign-currency denominated debt also edged higher: An increase in non-residents' foreign-currency denominated deposits with and loans extended to South African banks in 2005 was partly countered by the redemption of two international bonds issued by the public sector. Foreign-currency denominated debt increased further in the first quarter of 2006 on account of a further increase in foreign-currency denominated deposits, as well as international bond issues by a public corporation and non-bank private-sector entities.

Exceptional non-resident interest shown in the rand-denominated bonds of the public sector, together with an increase in foreign investors' short-term rand-denominated deposits with South African banks, lifted the rand-denominated debt in 2005. Apart from further deposits in the first quarter of 2006, the rand-denominated debt was also raised by a loan obtained to finance an inward direct investment transaction.

Foreign debt of South Africa

US$ billions

End of period	2000	2001	2002	2003	2004	2005	2006*
Foreign-currency denominated debt...	**24,9**	**24,0**	**25,0**	**27,4**	**27,9**	**28,4**	**30,0**
Bearer bonds	5,5	6,0	7,8	9,7	9,7	9,5	10,4
Converted long-term loans	0,2	0,1	0,0	0,0	0,0	0,0	0,0
Public sector	4,2	3,0	5,0	4,9	4,9	4,6	4,5
Monetary sector	8,3	8,9	6,3	5,9	7,0	7,8	8,6
Non-monetary private sector	6,7	6,0	5,9	6,9	6,3	6,5	6,5
Rand-denominated debt	**12,1**	**7,0**	**8,0**	**10,7**	**15,4**	**17,8**	**23,1**
Bonds	8,3	4,3	4,5	4,2	5,5	6,0	6,3
Other	3,8	2,7	3,5	6,5	9,9	11,8	16,8
Total foreign debt	**37,0**	**31,0**	**33,0**	**38,1**	**43,3**	**46,2**	**53,1**

* First quarter

Measured in rand, the country's total foreign debt increased from R244 billion at the end of 2004 to R292 billion at the end of 2005, and further to R329 billion at the end of March 2006. Despite this increase, total debt as a ratio of gross domestic product declined from 20,2 per cent at the end of 2004 to 19,3 per cent at the end of 2005, indicating South Africa's modest foreign debt commitment compared to other developing economies. Relative to total annual export proceeds, total external debt declined from 71,8 per cent in 2004 to 66,5 per cent in 2005; the pace of debt accumulation was slower than that of foreign reserves build-up.

South Africa's short-term foreign-currency denominated debt (i.e. debt with an original maturity of less than one year and other foreign-currency denominated debt maturing within the next twelve months) amounted to 41,3 per cent of total foreign-currency denominated debt at the end of 2005, compared with 37,5 per cent at the end of 2004. This deterioration in the maturity structure of South Africa's foreign-currency denominated debt mainly reflected an increase in the short-term debt of the monetary sector.

Exchange rates

Following three years of significant appreciation, the nominal effective exchange rate of the rand, on balance, fluctuated moderately downward during 2005. On a net basis, it declined by 2 per cent, having depreciated by 9 per cent during the first half of the year before recovering nearly all the lost ground during the second half. The reversal of these losses in the second half of 2005 were related to a sizeable inflow of direct investment capital, strong non-resident interest in South African shares as share prices rose briskly, and an upgrade in South Africa's sovereign debt rating from BBB to BBB+ by both Standard and Poor's and Fitch Ratings.

Exchange rates of the rand

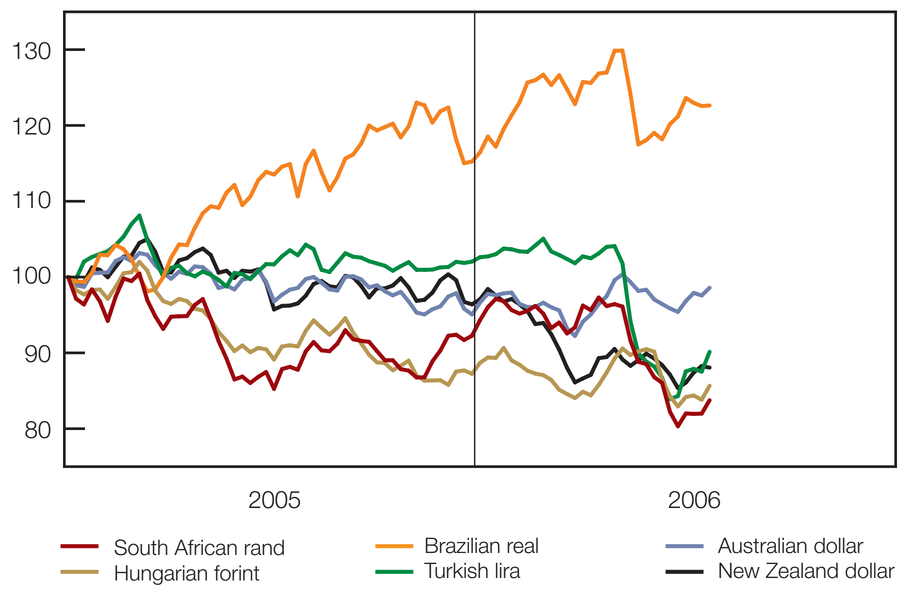
Percentage change

	31 Dec 2004 to 30 Jun 2005	30 Jun 2005 to 31 Dec 2005	31 Dec 2005 to 30 Jun 2006
Weighted average............................	-9,0	7,7	-15,4
Euro	-4,6	7,5	-17,4
US dollar	-15,5	5,6	-11,5
British pound	-9,8	10,2	-16,5
Japanese yen	-9,1	12,1	-13,4

The nominal effective exchange rate of the rand fluctuated broadly sideways in the first 4½ months of 2006. However, from 12 May 2006 the rand, together with the currencies of other emerging-market economies, found itself on the unfavourable side of investor sentiment. Against a basket of currencies the rand lost more than 15 per cent of its value within six weeks. The accompanying graph indicates that the South African rand, Turkish lira, Australian dollar and the New Zealand dollar began to depreciate against the US dollar in early May when the US Federal Reserve signalled the possibility of a further interest rate increase at its June monetary policy meeting. In addition, the

Exchange rates against US dollar

Indices: January 2005=100



depreciation of these currencies was driven by global risk aversion, rising interest rates in the United States, Western Europe and developed Asia, a decline in international commodity prices and the widening of the external trade and current-account deficits in these emerging markets. By contrast, emerging-market economies such as Russia and Poland, whose external current-account balances remained in surplus, succeeded in maintaining the external value of their currencies against the US dollar.

Adjusted for the inflation differential between South Africa and its most important trading-partner countries, the real effective exchange rate of the rand trended higher from 2002 to 2004. During the first half of 2005, the real effective exchange rate of the rand decreased by 8,7 per cent, but subsequently increased by 8,4 per cent during the second half of 2005. In the first six months of 2006, the real effective exchange rate of the rand declined by approximately 12 per cent.

The average daily turnover in the domestic market for foreign exchange amounted to US$11,3 billion in 2004, but with the somewhat heightened volatility of the exchange rate of the rand in 2005 and higher participation of non-resident investors in the domestic securities market, the average daily turnover increased to US$13,3 billion in 2005 – reaching a peak of US$15,2 billion in March. As the domestic securities markets scaled new heights and thereby attracted further non-resident interest, the average daily turnover rose further to US$13,9 billion in the first half of 2006. Non-residents' share in the activity on the domestic market for foreign exchange averaged around 75 per cent in the first half of 2006. In 2002 the share of non-residents in the domestic market for foreign exchange was less than 60 per cent.

Monetary developments and interest rates

Structural and regulatory issues

During the past year the South African banking sector continued to benefit from the favourable economic environment which underpinned household and corporate balance sheets and cash flows. Under these circumstances, banks were able to increase profitability through expansion without any visible strains on asset quality.

At the end of June 2006, there were 36 registered banks in South Africa, as well as 47 representative offices of foreign banks. Four major banking groups continued to dominate, representing about 83 per cent of the total assets of the South African banking sector.

Size of the South African private banking sector

	June 2005		June 2006	
	Number of institutions	Total assets R billions	Number of institutions	Total assets R billions
Locally controlled banks	14	1 424	14	1 768
Foreign controlled banks	5	6	5	8
Mutual banks	2	1	2	1
Foreign branches	15	134	15	183
Total registered banks	**36**	**1 565**	**36**	**1 960**

Banks utilised various mechanisms to keep their capital adequacy at prudent levels and to maintain a diversified funding base. Aligned with the strong growth in assets, banks increasingly issued bonds and notes as a means of raising funds, and also entered into securitisation transactions to restructure assets and manage risk exposure to certain asset classes. Over the year to June 2006, banks raised net funding to the amount of R20,5 billion in the primary bond market, while R9,2 billion was raised through issuing other financial instruments. Asset securitisation amounted to R13,8 billion over the same period. The issuance of securitised paper by private banks increased from R250 million in 1989 to a cumulative total of R30,1 billion by the end of June 2006. As a further response to market demand for alternative investment products and as a diversified means of raising funds, a major banking group also listed retail deposit notes on the JSE and the Bond Exchange of South Africa – the first such transaction by a domestic bank.

Banks continued their preparations for the January 2008 implementation of the new capital adequacy framework, Basel II, during the year under review. Their activities were co-ordinated by the Accord Implementation Forum.

In an effort to attract new customers and retain their existing clientele, banks continued to develop innovative banking products and in some instances formed partnerships with non-financial institutions to supply more affordable banking products. In one such instance, a major banking group launched a foreign-branded credit card through a joint venture with a company registered in the United Kingdom. In expanding the provision of banking services, banks increasingly embraced electronic instruments such as cellular phones and the Internet, and also increased the installation of automated teller machines (ATMs) at places convenient to customers. This was in accordance with the Financial Services Charter which states that 80 per cent of low-income earners should have access to banking services and products within 20 kilometres of their homes by the year 2008. Through the low-cost banking account, Mzansi, it is estimated that over 3,3 million new accounts have been opened in the banking sector. The functionality of the Mzansi bank account was improved by adding debit order facilities, facilitating the payment of premiums and instalments to insurance companies, credit providers and the like.

The banking sector made progress in its commitment to provide housing finance to low-income earners. While some banks started developing their own housing projects in underdeveloped areas, others entered into loan agreements with international banks to implement an affordable housing-loan scheme for low-income earners. In terms of a Memorandum of Understanding between the banking sector and the government, the banking sector is expected to advance R42 billion in low-income housing finance by 2008. The funds have already started to be extended to borrowers, with a substantial amount already having been made available. Negotiations regarding a second tranche of loans to follow the first R42 billion have started, exploring ways to mitigate the risks that banks face when lending to a market with little experience of mortgage bonds. The first tranche has no risk mitigation.

In the past year government relaxed the restrictions on banks' holdings of foreign assets by allowing banks to hold foreign assets with a value of up to 40 per cent of their regulatory capital. Foreign assets invested outside Africa were restricted to 20 per cent of regulatory capital, while assets invested in Africa could constitute the entire 40 per cent.

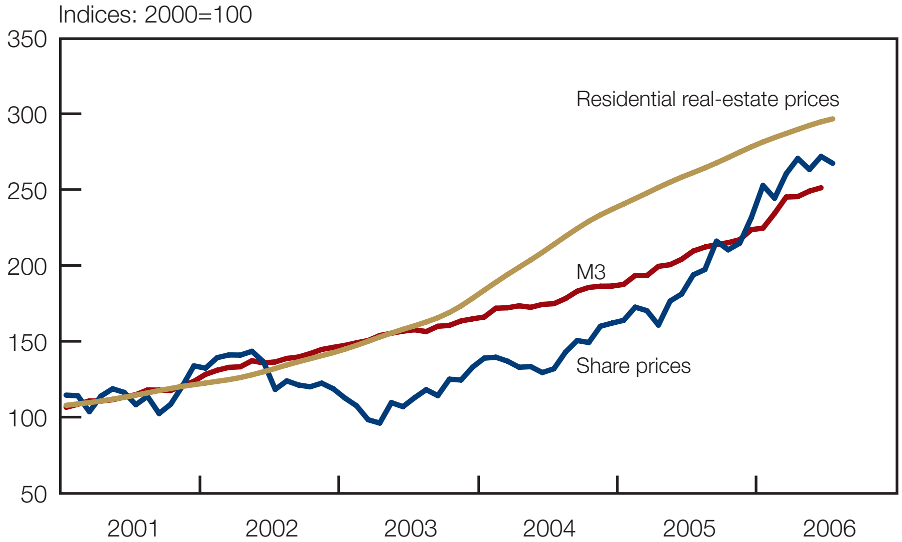
The National Credit Act, No 34 of 2005, was promulgated on 10 March 2006, providing for the regulation of all consumer credit and the repeal of the Usury Act of 1968 and Credit Agreements Act of 1980. The Act regulates all credit transactions and credit providers, including banks, retailers, pawnbrokers and micro-lenders – and will be implemented in three phases. Most of the administrative provisions of the Act, including new credit thresholds, came into effect on 1 June 2006. A new regulator, the National Credit Regulator, also came into being on 1 June 2006. The Regulator's tasks include to enforce the new Act, monitor market trends, advise the Minister of Trade and Industry on matters of national policy relating to consumer credit, and education on consumer rights. It has also taken over the duties of the Micro Finance Regulatory Council. The National Consumer Tribunal and measures to protect consumers against unfair practices are envisaged to come into effect on 1 September 2006. The final stage, which includes a section on maximum prescribed interest rates and initiation fees for home loans, credit facilities, unsecured debt and short-term loans, will come into effect on 1 June 2007.

During 2005 the Financial Sector Charter Council approved the standards for access to banking products and collective investments. The standards include physical accessibility, appropriateness, affordability and fair value, simplicity, understandability and non-discrimination. The Access Committee also completed work on standards to measure consumer education. In terms of these standards, the Charter Council will co-ordinate integrated and appropriate consumer education initiatives. A scoring mechanism for access has been agreed to, forming the basis for each company to measure its contribution from 2006.

Money supply

In an environment of positive economic sentiment characterised by robust real economic activity, lower inflation, a relativity low level of interest rates and soaring prices of financial assets and real estate, growth in the broadly defined money supply (M3) strengthened substantially during 2005 and in the first half of 2006. Positive wealth effects and buoyant transactions needs bolstered growth in money supply, and were reinforced by increased monetisation as employment rose and access to banking services improved.

Asset prices and M3



Twelve-month growth in M3 accelerated from 16,3 per cent in May 2005 to breach the 20-per-cent level in February 2006 and accelerated further to 26,8 per cent in March 2006 – the highest level in seventeen years. Subsequently, growth in M3 moderated somewhat to 23,1 per cent in June 2006. Growth over twelve months in the narrower monetary aggregates remained strong and generally resembled that in M3. However, long-term deposits rose exceptionally briskly over the past eighteen months, probably reflecting the public's expectations during most of this period that interest rates were on a downward or sideways track.

Growth in monetary aggregates

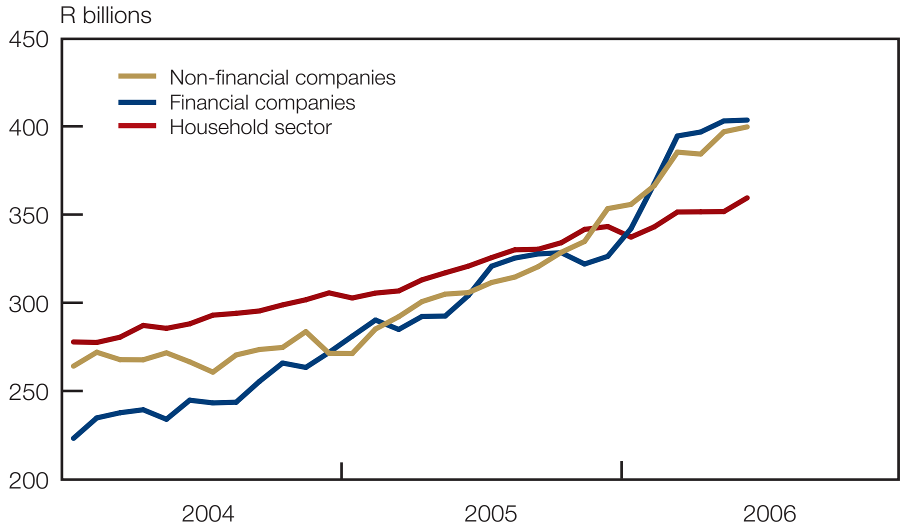
Percentage change over twelve months at end of period

Monetary aggregates	2004	2005	June 2006
Banknotes and coin in circulation	15,9	11,1	13,1
Cheque and transmission deposits	10,9	21,0	19,0
M1A	**11,6**	**19,4**	**18,1**
Other demand deposits	4,9	19,2	26,8
M1	**8,7**	**19,3**	**21,8**
Short and medium-term deposits	14,9	15,3	17,7
M2	**11,6**	**17,4**	**19,9**
Long-term deposits	27,9	41,8	45,6
M3	**13,1**	**19,9**	**23,1**

In the twelve months to June 2006, the robust growth in M3 was more strongly concentrated in the deposits of the corporate sector than in that of the household sector. Non-bank financial institutions in particular increased their deposits with banks considerably against the backdrop of wealth effects associated with buoyant financial and real-estate markets. Such deposit holdings were also bolstered by the strong cash flow from the capital redemption of the final tranche of the R150 government bond and coupon interest payments at the end of February 2006.

By contrast, the household sector's holdings of M3 were more subdued during the period under review. Nevertheless, over the twelve months to June 2006, household M3 deposits expanded by a solid 12,1 per cent, reflecting factors such as rising real disposable income, in turn influenced by rising employment levels and sizeable increases in salaries and wages.

M3 holdings by institutional sector



Annualised growth in M3 exceeded growth in nominal gross domestic product for most of 2005 and in the first half of 2006. Accordingly, the income velocity of circulation of M3 declined to a record low of 1,36 in the second quarter of 2006. The exceptionally high liquidity available in the economy seemed to a considerable degree to be concentrated in the hands of non-bank financial institutions such as insurers and unit trusts, as mentioned earlier.

The statistical counterparts of the changes in M3 are presented in the accompanying table, illustrating the prominence of increases in banks' claims on the private sector in statistically explaining the increases in M3 during 2005 and the first half of 2006. In turn, this mainly reflected strong growth in loans and advances. The net foreign assets of the monetary sector also rose markedly during this period.

Counterparts of change in M3

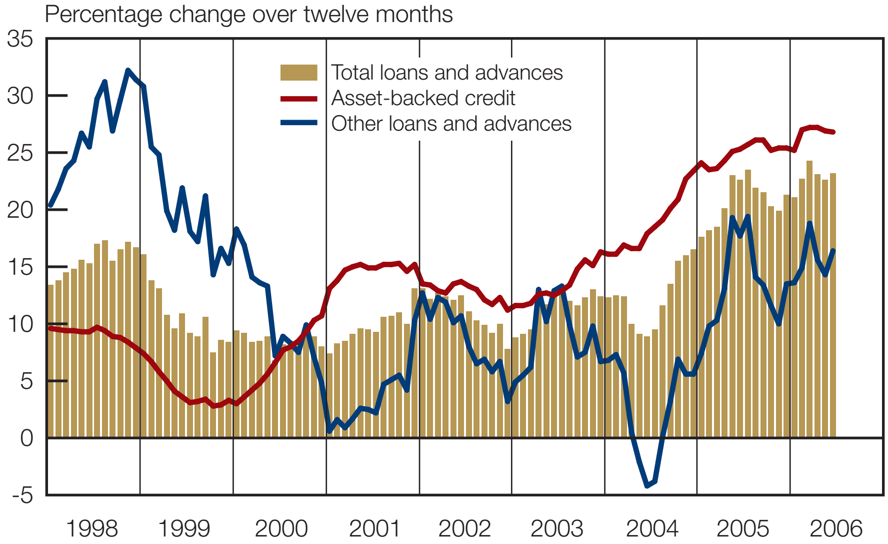
R billions

	2004	2005	1st half 2006
Net foreign assets	27,7	48,8	66,5
Net claims on the government sector	-3,1	-41,7	-13,2
Claims on the private sector	115,7	186,9	129,2
Net other assets and liabilities	-34,2	-11,9	-47,6
Total change in M3	106,1	182,1	135,5

Credit extension

Total loans and advances recorded an average twelve-month growth rate of about 20 per cent during 2005 and 22,8 per cent in the first half of 2006. The robust growth in total loans and advances extended to the private sector continued to benefit from an increase in real disposable income, favourable lending and borrowing conditions, wealth effects associated with the strength in asset prices, strong domestic expenditure and a rebound in the use of bank-intermediated funding by the corporate sector. Even the conclusion of the largest traditional securitisation by a single bank to date could not cause a significant slowdown in overall growth in bank credit. While debt-to-income ratios reached record high levels, debt service costs remained well contained during the period under review. Non-performing loans also remained at low levels.

Loans and advances to the private sector



Banks' total loans and advances extended to the private sector rose by R221,6 billion in the twelve months to June 2006, with asset-backed credit contributing three quarters of this increase despite securitisation transactions which were entered into by some of the reporting banks. Banks restructured their assets through asset securitisation to a net total of R13,8 billion in the primary bond market. Significant transactions included blocks of residential mortgages to the value of R4,5 billion and R3,0 billion which were securitised in October 2005 and June 2006, and instalment sale and leasing advances to the value of R3,0 and R2,0 billion which were securitised in September 2005 and March 2006, respectively. The contribution to the overall increase in total loans and advances by type of credit is reflected in the accompanying table.

Credit aggregates

Component	June 2005 R billions	June 2006 R billions	Change Per cent
Asset-backed credit	627	795	26,8
Instalment sale and leasing finance	167	198	18,6
Of which: New passenger cars	*47*	*63*	*34,0*
Other passenger cars	*44*	*50*	*13,6*
*Other goods**	*76*	*85*	*11,8*
Mortgage advances	460	596	29,6
Other loans and advances	327	381	16,5
Total loans and advances	954	1 175	23,2

* Sum of minibuses, trucks, agricultural machinery and equipment, and other equipment

Brisk growth in asset-backed credit continued to receive its strongest impetus from *mortgage advances* throughout 2005 and the first half of 2006. Twelve-month growth in mortgage advances remained above 24 per cent throughout 2005, and reached an all-time high of 30,1 per cent in April 2006, before receding to 29,8 per cent in June. Mortgage advances continued to benefit from the favourable lending and borrowing conditions brought about by relatively low interest rates and debt service cost; sustained increases in real-estate prices which reinforced the strong demand for mortgage finance, in turn supporting further increases in property prices; brisk economic activity, expanding employment and rising real disposable income; an increase in the capital gains tax threshold applied in the case of a primary residence and a reduction in fixed property transfer duties announced in the February 2006 Budget; and increasingly flexible mortgage arrangements, making it easier for borrowers to obtain readvances and to access amounts repaid on mortgage advances in excess of the contractually required instalment.

From June 2005 to June 2006 the number of mortgage advances outstanding rose from 1,84 million to 1,93 million, and the average amount per mortgage outstanding from R247 000 to R307 000.

Growth in *instalment sale and leasing finance*, which is directed at financing expenditure on motor vehicles and other durable goods, remained relatively firm throughout 2005 and the first half of 2006. Twelve-month growth fluctuated in a narrow range between 19 and 20 per cent from September 2005 and amounted to 18,8 per cent in June 2006. The increased affordability of new vehicles together with the introduction of technologically advanced, fuel-efficient models as well as favourable lending and borrowing conditions continued to support the strong growth in this credit category.

Other loans and advances, which tend to be dominated by changes in the use of bank-intermediated funding by the corporate sector, registered twelve-month growth rates in excess of 10 per cent from March 2005 with growth amounting to 16,4 per cent in June 2006. The increase in the use of bank-intermediated funding by the corporate sector reflected companies' immediate need for working capital in an expanding economy, as well as the need for longer-term funding of fixed investment projects.

The household sector's use of bank loans and advances rose strongly by R133,0 billion, or 28,0 per cent, in the twelve months to June 2006. The corporate sector's use of bank loans and advances increased by R68,0 billion or 16,0 per cent over the same period.

Banks' loans and advances by industry are shown in the accompanying table, indicating that over the past year the strongest growth was recorded in the extension of credit to the construction and household sectors of the economy and in interbank advances.

Banks' loans and advances by industry

Component	June 2005 R billions	June 2006 R billions	Change Per cent
Agriculture, forestry and fishing	23	26	13,0
Mining	17	17	0,0
Manufacturing	47	61	29,8
Construction	10	16	60,0
Electricity, gas and water	6	6	0,0
Trade and accommodation	29	37	27,6
Transport and communication	24	26	8,3
Finance and insurance	332	470	41,6
Of which: Interbank	*64*	*106*	*65,6*
Real-estate and business services	109	144	32,1
Community, social and personal services	36	40	11,1
Individuals	517	699	35,2
Other	86	74	-14,0
Total	**1 236**	**1 616**	**30,7**

Interest rates and yields

Following a reduction of 50 basis points in April 2005, the Bank's repurchase rate had been maintained at 7 per cent – the lowest level since 1980 – for the remainder of 2005 and the first five months of 2006. This was against a backdrop of benign inflationary pressures, lively economic growth and an appreciation of the external value of the rand, defying substantial increases in international oil prices. However, with trends in the oil price, exchange rate, household consumption and the current-account balance suggesting a significantly increased risk of inflation rising above the target range in the absence of remedial action, the MPC decided to increase the repurchase rate to 7,5 per cent at its June 2006 meeting and to 8 per cent at its August meeting.

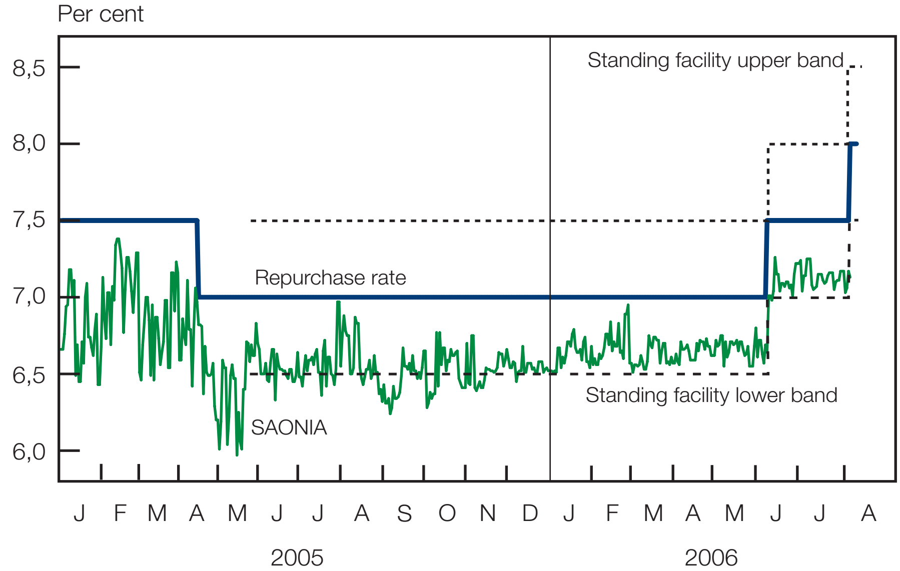
Money-market interest rates in general closely emulated the developments in the repurchase rate as announced by the MPC.

Reserve Bank's repurchase rate

Date effective	Per cent
12 Dec 2003	8,0
13 Aug 2004	7,5
15 Apr 2005	7,0
8 Jun 2006	7,5
4 Aug 2006	8,0

Following the introduction of new accommodation arrangements on 25 May 2005 and the unchanged monetary policy stance for the remaining part of 2005 and the first five months of 2006, the South African Overnight Interbank Average (SAONIA) rate fluctuated around levels slightly below the 7-per-cent repurchase rate level and – as could be expected – rarely fell below 6,5 per cent, the lower band of the rates on the standing facilities introduced in May 2005. Following the increase in the repurchase rate and, consequently, in the rates on standing facilities, the SAONIA rate adjusted upward to fluctuate in a range of 6,64 per cent to 7,51 per cent from 8 June 2006 to 5 August 2006, as shown in the accompanying graph.

Repurchase rate and overnight interbank rate



Other money-market interest rates such as the Johannesburg Interbank Agreed Rate (Jibar) and rates on Treasury bills also moved in tandem with the repurchase rate. However, Treasury bill rates deviated somewhat from the repurchase rate towards the end of November 2005, consistent with the international oil price increases and changes in market expectations regarding future interest rates. The demand for liquid assets by the private-sector banks also influenced tender rates on Treasury bills; these increased somewhat after the redemption of the final tranche of the R150 government bond at the end of February 2006. The accompanying table illustrates the demand for Treasury bills for the various maturities, prior to and after the redemption of the final tranche of the R150 government bond.

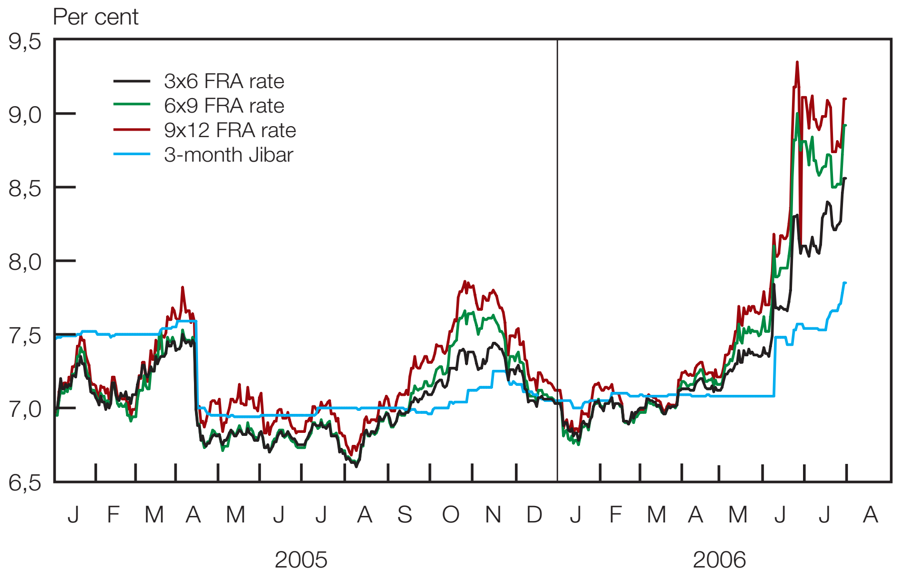
Demand for Treasury bills

	Amount on offer R millions	Amount tendered for R millions	Coverage*	Average rate Per cent
	During January 2006			
91 days	2 150	6 535	3,0	6,66
182 days	300	1 435	4,8	6,69
273 days	150	583	4,0	6,72
	During March 2006			
91 days	2 150	7 451	3,5	6,52
182 days	300	1 320	4,4	6,53
273 days	150	657	4,4	6,62

* Amount tendered for as ratio of amount on offer

During the second half of 2005, rates on forward rate agreements (FRAs) indicated that market participants expected interest rates to remain steady, with some possibility of a repurchase rate increase towards the end of 2006. Towards the end of October 2005 rates on longer-term forward rate agreements moved to their highest level for the year, partly in response to high oil prices and exchange rate movements.

Rates on forward rate agreements



This upward movement was largely reversed in subsequent months as commodity prices gained further momentum and the exchange value of the rand appreciated. However, from around mid-February 2006 rates on longer-term forward rate agreements trended higher – a development which persisted, gathering momentum from mid-May as the external value of the rand depreciated alongside that of a number of other developing countries' currencies. Well before 8 June 2006, rates on forward rate agreements discounted a view in the market that there was a significant probability of an increase in the Bank's repurchase rate. Forward rate agreements continued to indicate expectations of further increases in money-market interest rates subsequent to the MPC decision of 8 June 2006.

Having followed the repurchase rate downward by 50 basis points on 15 April 2005, the private banks kept their *prime overdraft rates* and *predominant rate on mortgage loans* unchanged at 10,50 per cent for the remainder of 2005, and increased these rates by 50 basis points in June and August 2006 to 11,50 per cent in reaction to the increases in the repurchase rate during this period.

The *predominant rate on twelve-month fixed deposits* with banks increased from 6,2 per cent in May 2005 to 6,9 per cent in August 2006, broadly reflecting steady returns from the cash asset class.

Interest rates on the RSA Government Retail Bonds are priced off the government bond yield curve and are changed when the yields on equivalent government bonds move either negatively or positively by more than 50 basis points. The accompanying table depicts how these rates have changed since inception in May 2004. The latest change was an increase of 50 basis points across the board on 1 August 2006.

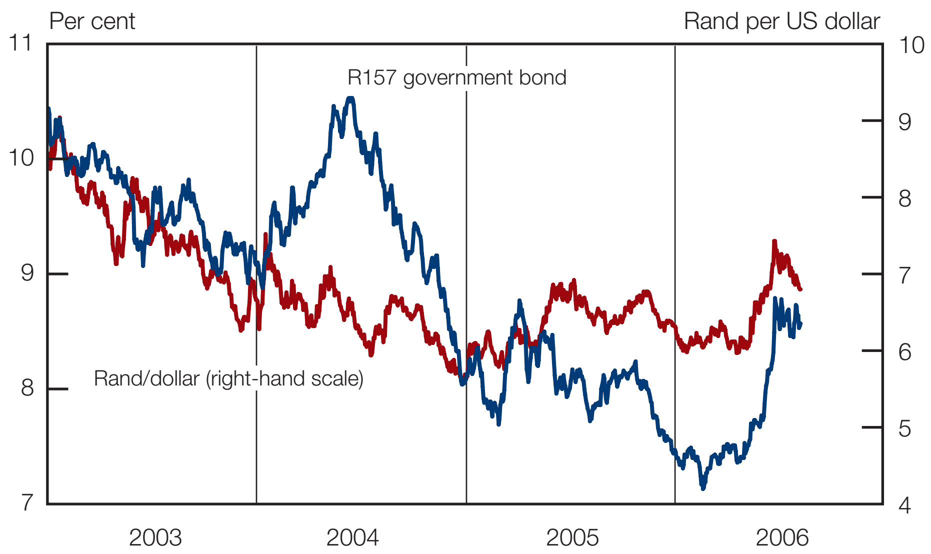
Interest rates on RSA Government Retail Bonds

Per cent

Effective from	2-year bond	3-year bond	5-year bond
24 May 2004	9,25	9,50	10,00
1 Sep 2004	8,25	8,50	9,00
1 Jan 2005	7,50	7,75	8,25
1 Jan 2006	7,50	7,75	8,00
1 Mar 2006	7,25	7,50	7,75
1 Jul 2006	8,00	8,25	8,50
1 Aug 2006	8,50	8,75	9,00

The *daily average yield* on the R157 long-term government bond (maturing in 2015) increased from 7,69 per cent on 28 February 2005 to 8,77 per cent on 5 April before declining to a recent low of 7,13 per cent on 20 February 2006. This decline in domestic bond yields occurred against the backdrop of subdued consumer and producer prices, improved sovereign credit ratings, the relative strength of the exchange value of the rand, and the low supply of government bonds – originating from better-than-expected national revenue collections. Long-term bond yields then increased to 8,79 per cent on 26 June – the highest daily yield recorded since November 2004 – alongside concerns regarding high oil prices, deteriorating inflation expectations and worsening inflation data, a weaker exchange value of the rand, an upward movement in global bond yields, and the increase of the repurchase rate by 50 basis points on 8 June 2006. The recent downgrade of Hungary's sovereign credit ratings in June 2006 exacerbated the bearish sentiment in emerging-market bond centres. Subsequently, long-term bond yields declined to 8,54 per cent on 10 August 2006, mainly due to the partial recovery in the exchange value of the rand.

Long-term bond yield and exchange value of the rand

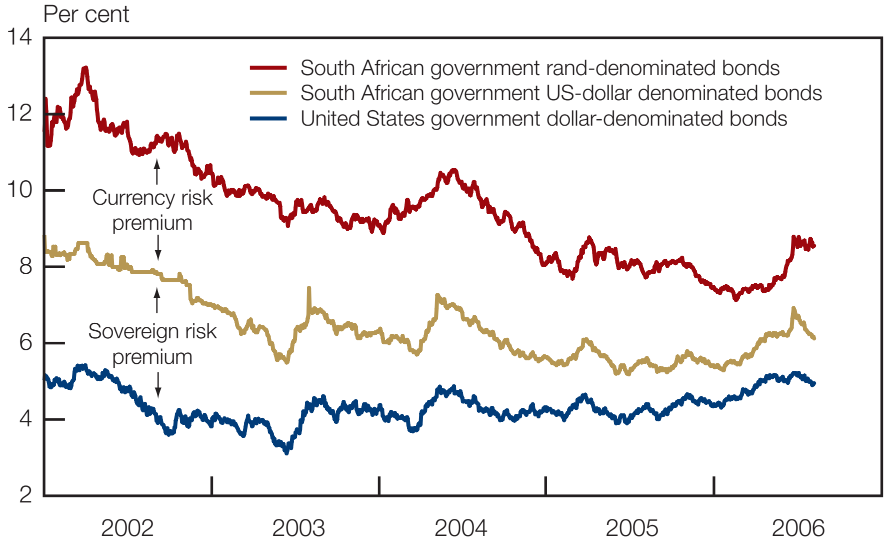


At the same time the level of the *yield curve* increased from 28 February 2005 to 24 October 2005 before declining significantly to 20 February 2006. The level of the yield curve then drifted moderately higher but in May and June moved significantly upwards and steepened, particularly at the short end of the curve on account of the factors outlined in the previous paragraph. Subsequently, the level of the yield curve, remained on the same level to the end of July. After having been negative since 19 December 2005, the *yield gap*, calculated as the difference between bond yields at the extreme long and short ends of the yield curve, became positive on 28 March 2006 and widened from 4 basis points to 121 basis points on 6 July. The yield gap again narrowed in August when the short end of the curve responded to the increase in the repurchase rate.

The daily average yield on the R189 inflation-linked government bond declined progressively from the latter half of 2005 into early 2006. The yield declined from 3,42 per cent on 1 June 2005 to 2,33 per cent on 20 March 2006, before increasing to 2,67 per cent on 10 August. The *break-even inflation rate* in the four-to-seven-year maturity range fell from 5,12 per cent on 13 October 2005 to a low of 4,33 per cent on 21 February 2006 before resuming a steady upward trajectory to 5,58 per cent on 10 August, signalling the deteriorating inflation outlook as perceived by the bond market.

Three major international agencies upgraded South Africa's sovereign credit ratings in 2005 as a result of the country's well-managed monetary and fiscal policies, positive economic growth prospects and improved foreign exchange reserve position. As such the *sovereign risk premium* on South Africa's foreign currency-denominated bonds that trade in international markets declined impressively from an average of 117 basis points in April 2005 to a new record low of 68 basis points in February 2006, as emerging-market bond spreads narrowed. Subsequently, the sovereign risk premium increased to 115 basis points in July. The yield spread of the JP Morgan Emerging Markets Bond Index (EMBI+) followed a similar trend as it narrowed by 204 basis points from the end of April 2005 to February 2006, before widening by 30 basis points to June. However, the sovereign risk premia incorporated in the external-currency denominated debt of emerging markets improved somewhat from July 2006.

Yields on long-term government bonds



The *currency risk premium* on South African government bonds narrowed from 308 basis points in May 2005 to 116 basis points in April 2006, before widening again to 232 basis points in July. The latest widening can be attributed to the sharp increase in domestic bond yields which exceeded the increase in offshore bond yields.

Financial markets

Structural and regulatory changes in financial markets

In recent years the focus of regulatory and legislative changes in the South African financial sector shifted from the introduction of new legislation to amending and monitoring the implementation of existing laws. Authorities focused more intensely on transparency, trust and the protection of consumers. This resulted in the detection of a number of irregularities in the financial system, several fraud charges, recovery of some embezzled funds and significant progress towards meeting deadlines envisaged earlier on. Some of the key developments are discussed below, while others have been dealt with in the section on *Monetary developments and interest rates*.

Over the past year the life insurance industry was influenced to a significant extent by a number of rulings by the Pension Funds Adjudicator. In December 2005, the Minister of Finance and the Life Offices' Association of South Africa signed a statement of intent to, among other things, set minimum standards for benefits in the event of early termination of retirement annuities and endowment policies; and pledge their commitment to examine other issues impacting on cost, including commission structures, disclosure standards and consumer education.

On 30 March 2006, the National Treasury issued a discussion paper on contractual savings in the life insurance industry to reflect on issues that impact on the ability of the industry to deliver products that are cheap, fair and appropriate. In a work plan analysing the discussion paper, the key areas were categorised and various deadlines were set for comments on short, medium and long-term issues. Long-term issues include the regulatory and policy review initiative of the South African retirement industry that National Treasury and the Financial Services Board (FSB) embarked upon in 2004. This initiative aims at updating and modernising the Pension Funds Act, No 24 of 1956, to ensure protection of the interests of members of retirement funds and to enable more people to make adequate provision for retirement while they are still economically active. In working towards this endeavour, the tax rate on interest income for retirement funds was halved from 18 per cent to 9 per cent in the Budget for fiscal 2006/07.

The life insurance industry's practice of "bulking" fund accounts in order to garner maximum interest payable came under close scrutiny by the FSB and National Treasury in 2006. The issue pertained to those instances where fund administrators did not disclose bulking, and the re-allocation of the interest income benefits was found not to be trickling down to fund members. Subsequently, a large fund administrator was obligated to compensate its members.

Amendments to legislation include the Special Pensions Amendment Act, No 27 of 2005, assented to on 12 January 2006, providing for the regulation of payments to a surviving spouse and dependants. Amendments to regulations include notices redefining government requirements from the Registrar of Pension Funds, reviewing minimum data submission requirements from financial institutions, and stipulating new levies payable to the FSB by financial institutions.

Up to the end of 2005, all companies listed on the JSE were classified according to the FTSE Global Classification System. This was replaced by the Industry Classification Benchmark (ICB) on 3 January 2006. The ICB is an international classification system developed by the FTSE Group and Dow Jones.

Following the removal of its tax-exempt status, the JSE demutualised on 1 July 2005 and became an unlisted public company. After extensive consultations with stakeholders and approval by the Registrar of Securities Services at the FSB, the JSE listed its own shares on the Main Board on 5 June 2006, placing its shares on the formal trading platform with the benefits of improved visibility, enhanced liquidity and price transparency. Other exchanges that have taken the same route in the past include the London Stock Exchange, New York Stock Exchange, Hong Kong Stock Exchange and Gruppe Deutsche Börse.

The South African Social Investment Exchange (SASIX), an exchange focused on social investment, was launched on 15 June 2006. SASIX operates in the same manner as a stock exchange and gives non-profit organisations in need of funds for specific development or poverty eradication projects access to social investments by donors, trusts, corporate investors and the general public. Social shares in SASIX projects cost R50 each and the projects are categorised into four fields, namely early childhood education and development; enterprise development; food security; and orphans and vulnerable children. At the end of July 2006 there were 16 non-profit organisations listed on this exchange with shares worth R2,8 million in issue.

The JSE launched the FTSE/JSE Dividend Plus Index in August 2006. This is a yield-weighted index, designed to select and measure the performance of higher yielding instruments within the FTSE/JSE Top 40 and FTSE/JSE Mid Cap indices. The weightings of the top 30 constituents in the index are thus determined by their dividend yield as opposed to market capitalisation.

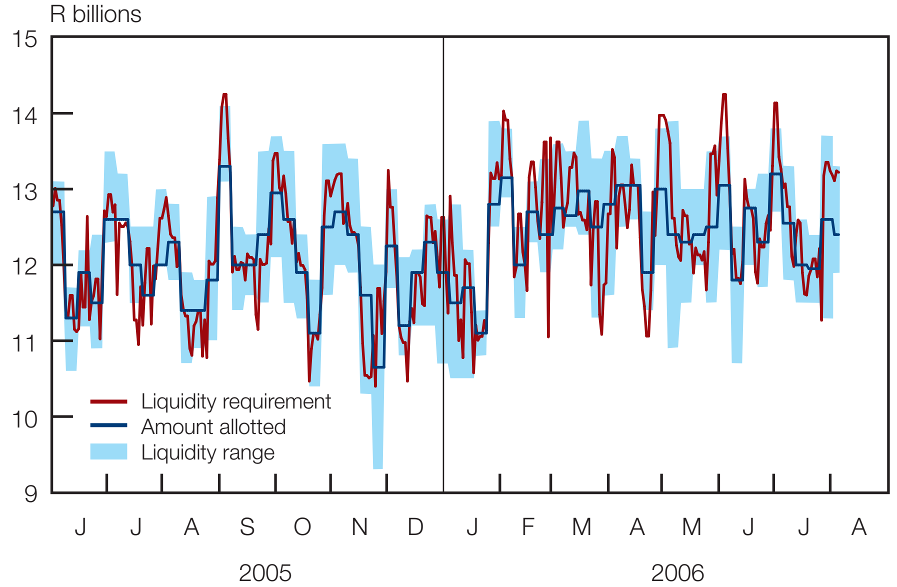
Other structural changes affecting financial markets during fiscal 2005/06 and beyond include the change, as from 1 March 2006, in the domestic interest income tax-exemption threshold which was raised from R15 000 to R16 500 per annum for taxpayers under the age of 65 and from R22 000 to R24 500 for taxpayers aged 65 years and over. The exemption applicable to foreign interest income and dividends was also raised from R2 000 to R2 500.

Money market

Prior to the implementation of changes to the Bank's refinancing operations on 25 May 2005, the amount of accommodation provided at the weekly main refinancing auctions remained stable at levels around R13 billion. As a result of the amended operational procedures, the repurchase agreement amounts allotted at the Wednesday auctions started to vary somewhat – the amount of liquidity provided varied between R10,7 billion and R13,3 billion from June 2005 to June 2006, usually with higher levels towards month-ends and lower levels in the middle of the month. The highest and lowest limits of the weekly liquidity range (the weekly range within which the Bank expects the daily liquidity requirement to vary, as announced prior to the weekly main repurchase tender) during the period under review came to R13,9 billion and R10,5 billion, respectively.

As shown in the graph on the next page, the realised daily liquidity requirement of the private-sector banks occasionally breached the liquidity range – usually due to extraordinary short-term banknote flows. In order to manage their liquidity, banks generally utilised their cash reserve accounts with the Bank, seldom using the standing facilities to square off their end-of-day positions.

Liquidity requirement, range and amounts allotted



The statistical counterparts impacting on money-market liquidity from mid-2005 to mid-2006 are shown in the table below.

Money-market liquidity flows

R billions (easing +, tightening -)

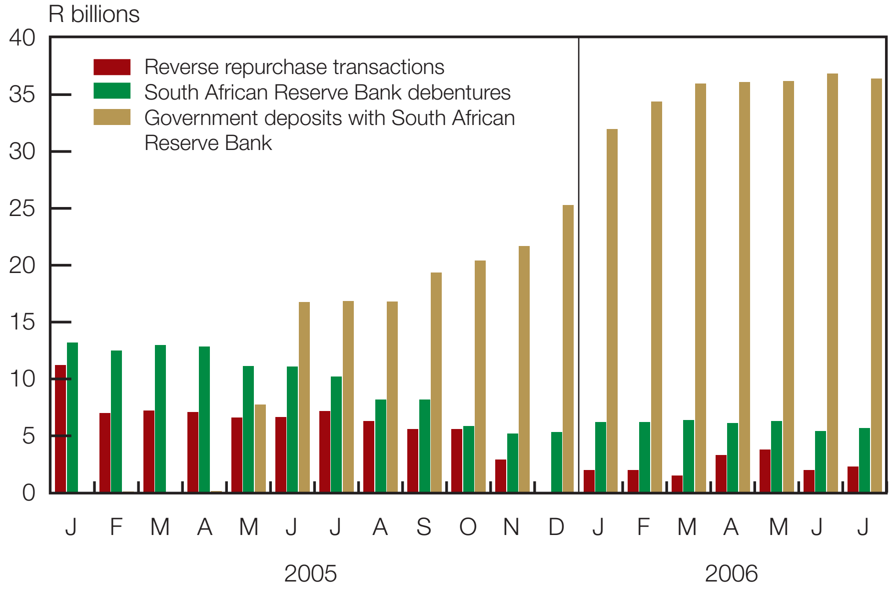
	Jul – Dec 2005	Jan – Jun 2006
Notes and coin in circulation	-5,3	0,4
Redemption of foreign loans by National Treasury	0	0
Required cash reserve deposits	-1,6	0,1
Money-market effect of Reserve Bank's foreign exchange transactions	9,9	17,0
Government deposits with Reserve Bank	-8,5	-11,5
Use of liquidity management instruments*	12,4	-2,1
Outright sales of government bonds	-0,5	-3,1
Other items net	-5,7	-2,1
Banks' liquidity requirement	**0,7**	**-1,3**

* Reserve Bank debentures and reverse repurchase transactions

The Bank continued to increase its foreign exchange reserves through net purchases from the market, raising the Bank's foreign exchange reserves by US$4,6 billion in the year to June 2006. These transactions, some of which were related to a foreign direct investment transaction, expanded money-market liquidity by R26,9 billion over the same period. Accordingly, several offsetting factors were utilised to drain the liquidity created. These included interest payments and redemption payments on maturing bonds in the Bank's asset portfolio received from government, and a build-up in government deposits with the Bank. The gradual increase in the level of notes and coin in circulation outside the Bank also acted as a liquidity absorption mechanism.

The total amount of liquidity absorbed from the money market through the other interest-bearing liquidity-draining instruments at the disposal of the Bank, i.e. reverse repurchase agreements and SARB debentures was, on balance, reduced over the eighteen months to June 2006. The accompanying graph illustrates the structure of and developments in money-market intervention instruments utilised.

Liquidity-draining operations: Outstanding balances



Over the past number of years government has accumulated high cash balances towards February, in order to effect coupon interest and capital redemption payments on the three tranches of the R150 government bond at the end of each February from 2004 to 2006. Accordingly, the government's Tax and Loan deposits rose from R21,3 billion in August 2005 to R46,8 billion in January 2006.

The Bank's portfolio of government bonds declined notably at each of the past three February month-ends, following the redemption of the three tranches of the R150 government bond. The Bank's holdings of such bonds receded from R12,7 billion at the end of January 2005 to R9,7 billion at the end of February 2006.

Bond market

Portfolio investment into emerging markets ascended to new heights in 2005 and 2006 as investors embraced both debt and equity. Excess international liquidity and improving credit fundamentals, underpinned by rising commodity prices and more robust macro-economic policy regimes, played an important role in financial markets in the recent past.

The bull run in the bond market from the second half of 2004 to February 2006 was supported by the reduced issuance of government bonds due to the exceptional performance of the government fiscal accounts. Total net issues of fixed-interest securities by *public-sector borrowers* in the domestic primary bond market amounted to R22,5 billion in fiscal 2005/06, well below the net issues of R40,8 billion in fiscal 2004/05. Net redemptions of government bonds to the value of R21,6 billion occurred in February 2006, somewhat more than the R19,6 billion redeemed in February 2005, and included the redemption of the final tranche of the R150 government bond, namely the R152. After an absence of almost two years, the National Treasury re-entered the international bond market in March 2006 and issued a €750-million ten-year bond with a coupon rate of 4,5 per cent at a spread of 81 basis points over equivalent German government bonds.

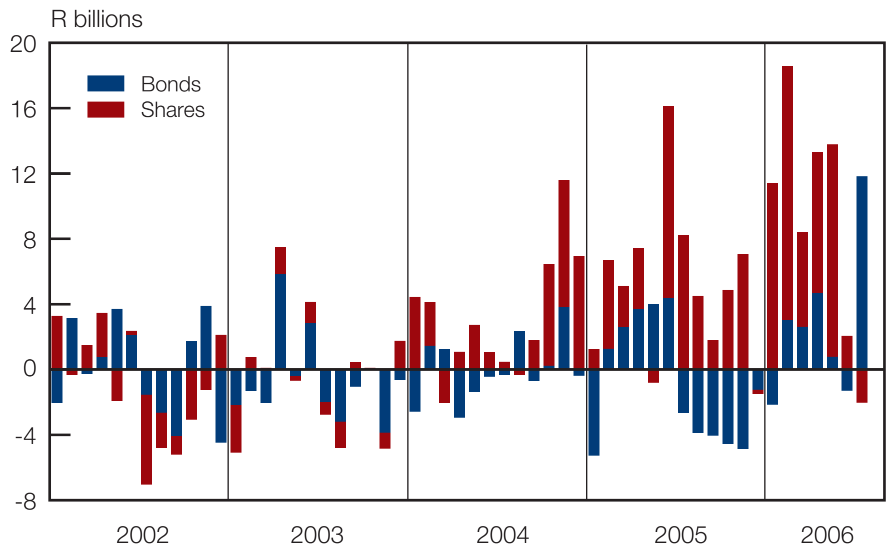
Taking advantage of a policy change by the FSB which permitted South African insurers to raise regulatory debt capital, subject to prior approval, long-term insurers progressively entered the bond market towards the end of 2005. After an initial issue of R2,0 billion in September 2005 by a large insurer which took advantage of the environment of low interest rates and strong investor interest in investment opportunities, issues continued, bringing the outstanding amount of listed long-term insurers' stock on the Bond Exchange of South Africa (BESA) to R6,0 billion at the end of July 2006. Beyond long-term insurers only, activity in the corporate bond market more generally remained strong in 2005 and in the first part of 2006 as the private sector increasingly sourced funding in the primary bond market. After increasing by R31,5 billion in 2005, the *outstanding value of private-sector loan stock* listed on BESA increased by a further R30,6 billion in the first seven months of 2006 to reach R140 billion.

Short-term *commercial paper* also remained a popular alternative to supplement the financing needs of the private sector. The outstanding nominal value of commercial paper listed on BESA increased by R10,7 billion in 2005 and by a further R2,9 billion in the seven months to July 2006 to reach a level of R29 billion. Up to the end of 2005, some 505 trades in non-listed commercial paper were effected through the formal exchange and a further 616 trades were recorded in the first seven months of 2006, bringing the cumulative nominal value traded since April 2005 to R19 billion.

Turnover on BESA had been trending downwards from 2002, but this was reversed in 2005 when total turnover on BESA came to R9,8 trillion, 3 per cent higher than in 2004. Trading activity in the domestic secondary bond market continued to improve during the first seven months of 2006 with the value of turnover amounting to R7,6 trillion, benefiting from the volatility in bond prices and non-resident participation. The daily average turnover increased from R42 billion in November 2005 to a new record high of R67 billion in June 2006.

Non-residents were net buyers of bonds to the value of R0,4 billion in 2004 and net sellers to the value of R10,7 billion in 2005. In the first seven months of 2006 non-residents on a net basis purchased bonds to the value of R19,5 billion. This included record high net purchases of R11,8 billion recorded in the month of July. Non-resident participation in trading on BESA, measured as the sum of their purchases and sales as a percentage of total purchases and sales of bonds, increased markedly from 9 per cent in February 2004 to an average of 19 per cent in the first seven months of 2006.

Net purchases of shares and bonds by non-residents



In the *international bond markets* non-resident issuer interest in rand-denominated bonds remained buoyant in 2005. The net issuance of rand-denominated bonds in the European bond markets of R6,5 billion in 2005 was more than double the net issuance of R3,1 billion recorded in 2004. However, net redemptions of R0,4 billion were recorded in the first seven months of 2006 as non-resident issuer interest in these instruments waned.

The issuance of rand-denominated bonds by foreign borrowers in the Japanese *Uridashi* market continued in the first half of 2006, albeit at a much slower pace than in 2005. Rand-denominated bonds were first issued in this market in July 2004 and total net issues for that year amounted to R2,5 billion. This was followed by net issues of R8,8 billion in 2005. In the first seven months of 2006, the nominal value of rand-denominated bonds issued by non-residents in the Uridashi market amounted to R1,8 billion.

Share market

Buoyant commodity prices, an equity-friendly policy environment with lower interest rates, positive sentiment towards the share market, the prospect of higher domestic growth and stronger international markets led domestic bourses to consecutive highs during 2005 and early 2006.

The total *value of equity capital raised* in the domestic and international primary share markets by companies listed on the JSE was 96 per cent higher in 2005 compared to 2004 and continued to grow sturdily in the first seven months of 2006. Equity funding by companies with primary listings on the JSE amounted to only R26 billion in 2005 compared with R56 billion raised by companies with primary listings on foreign bourses and secondary listings on the JSE. The value of equity capital raised by all companies listed on the JSE amounted to R66 billion in the first seven months of 2006, or 402 per cent higher than in the corresponding period of 2005.

Interest in *exchange traded funds (ETFs)* has been increasing worldwide over the past number of years because these instruments offer diversification benefits at a low cost as there are no fund management fees. An ETF is a security that tracks an index or a basket of shares and trades on an exchange, thus experiencing price fluctuations throughout the day as it is bought and sold. Although ETFs are still relatively new and the range available in South Africa is fairly narrow, the market capitalisation of these funds increased from just below R3 billion at the end of 2000 to R12,6 billion at the end of July 2006.

Currently there are nine ETFs listed in the South African market with the first ETF, Satrix 40, listed in November 2000. This was followed by four Satrix-listed funds, namely, Satrix Fini (February 2002); Satrix Indi (February 2002); Satrix Resi (April 2006) and Satrix Swix Top 40 (April 2006). In June 2003 the NewRand index was launched comprising the top 10 South African rand hedge shares having the highest long-term correlation with the rand/US dollar exchange value of the rand. This was followed by the issue of the NewGold ETF in November 2004. In October 2005, Itrix FTSE 100 and Itrix DJ Euro Stoxx 50 funds were listed, paving the way for South African individual and institutional investors to gain exposure to top European companies. Individual investors are not subject to exchange control limitations when investing in these ETFs, while institutional investors still need to comply with those regulations. The JSE expects to list additional ETFs later in 2006 to give investors exposure to Asian and American shares.

Generally rising share prices and the heightened volatility in share prices and in the exchange value of the rand boosted trading activity in the *secondary share market* to reach new record high levels in 2006. The value of shares traded on the JSE amounted to R1,3 trillion in the seven months to July 2006, or 89 per cent higher than in the corresponding period of 2005. The total market capitalisation of the JSE increased to an all-time high of R4 300 billion in June 2006, before declining to R4 262 billion in July.

Market liquidity – the annualised turnover as a percentage of market capitalisation – increased from an average of 43 per cent in 2005 to 53 per cent in the first seven months of 2006.

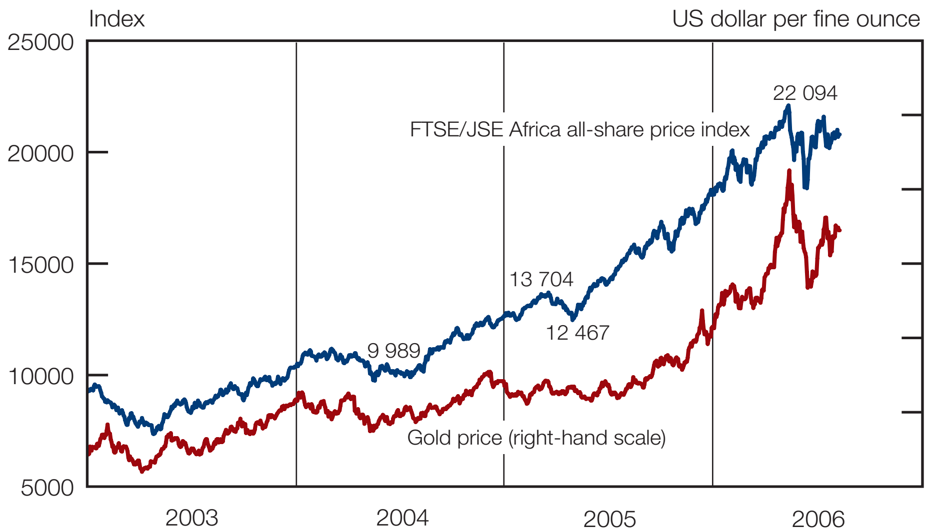
Alt^X, the JSE bourse for small to medium-sized companies, succeeded in attracting a wide diversity of companies to list during its nearly three years of existence. The number of companies listed on Alt^X reached 23 at the end of July 2006 – three in the mining, three in the financial and seventeen in the industrial sector. The combined market capitalisation of all the companies listed on Alt^X increased from R1,4 billion in July 2005 to R4,0 billion in July 2006.

Non-residents' interest in shares listed on the JSE continued in 2005 as they recorded cumulative net purchases of shares to the value of R50,2 billion. For the whole of 2005, non-residents were only net sellers of shares in May and December for an amount of R1,0 billion. Non-residents' participation in the share market, measured as their purchases and sales as a percentage of the total value of shares traded on the JSE, averaged 21 per cent in the seven months to July 2006, compared to 20 per cent in 2005 and 2004. Net purchases of shares by non-residents reached a high of R54,5 billion for the seven months to July 2006.

Having trended higher from 19 July 2004, the all-share price index receded somewhat in the six weeks to 28 April 2005. Share prices resumed their upward trajectory throughout the remainder of 2005, before fluctuating sideways during the first two months of 2006 in response to higher oil prices and some profit-taking. The all-share price index increased by 77 per cent from its recent low in April 2005 and reached an all-time high on 11 May 2006. The mainstay behind the impressive performance of the all-share price index was the handsome growth in commodity prices. After lagging other sectors for the most part of 2004, resources share prices trended upwards and increased by 115 per cent from 28 April 2005 to 11 May 2006.

With the reversal in sentiment towards emerging markets due to weaker global markets – following renewed inflation concerns and higher interest rates – resources share prices declined by 21 per cent to 13 June, contributing to the 17 per cent shed by the daily all-share price index. Renewed concerns about geopolitical instability in a major oil-exporting country revived interest in resources shares which subsequently gained 22 per cent to 10 August, contributing to the 12 per cent gain of the daily all-share price index in the process.

Share prices and gold price



The Morgan Stanley Capital International (MSCI) Emerging Market Index, which measures equity market performance in global emerging markets, more than doubled from 17 May 2004 to its all-time high level on 8 May 2006, largely on account of higher commodity prices, before falling by 25 per cent to 13 June, as investors reassessed risks associated with emerging-market portfolios. Subsequently, the index increased by 15 per cent to 10 August.

The increase in share prices was reflected in the *price-earnings ratio* on all classes of shares, which increased from 13,7 in May 2005 to 16,5 in April 2006 (its highest level since May 1998), before declining somewhat to 16,4 in July. The current level of the price-earnings ratio may be compared with its 1990 to 2005 long-term average of 13,6.

Market for exchange-traded derivatives

During 2005 and the first half of 2006 the product range on the *Financial Derivatives Division* of the JSE was enhanced with a variety of new products. Within the equity index sector, futures and options on the FTSE/JSE SA Listed Property Index (SAPI) were made available for trading in February 2005. In April 2005, new single stock futures were introduced when futures and options on debentures were made available for trading. Metal futures were added when futures on the Kruger Rand Tenth were introduced in May 2005. Following the demand in the market to hedge dividend risk, dividend futures were listed in May 2006 after the expiration in November 2005 of the first listing of such futures. The JSE's latest derivative offering, namely Can-Do Options, gives investors from June 2006 the advantages of listed derivatives, with the flexibility of over-the-counter (OTC) contracts.

The rising share prices brought renewed interest in the derivatives market in 2005 and the first seven months of 2006. The total number on *futures and options on futures contracts* traded on the Financial Derivatives Division rose briskly in 2005, with the vigour in this market carried over into the seven months ending July 2006.

The volume of *warrants* trading activity on the JSE more than doubled in 2005, with this impetus continuing well into 2006. The actual number of warrants listed on the JSE also fluctuated on an upward trend from 297 in January 2004 to 384 in July 2006.

Trading activity on the Agricultural Products Division of the JSE declined somewhat in 2005 and remained lacklustre in the first seven months of 2006, despite the fact that maize prices, the contracts of which dominated trading activity, on balance rose from R471 per ton on 25 February 2005 to R1 344 per ton on 31 July 2006.

The exchange for interest rate derivatives on the JSE, *Yield-X*, experienced brisk growth after it commenced trading in February 2005. Turnover in the market for exchange-traded derivatives is indicated in the accompanying table.

Derivatives turnover

		Change over one year	
	Turnover in 2005 R billions	2005 Per cent	Jan – Jul 2006 Per cent
Financial futures and options on futures	1 551	48	131
Warrants	4	81	193
Agricultural commodity futures and options	98	-36	65
Interest rate derivatives	11*	-	146**

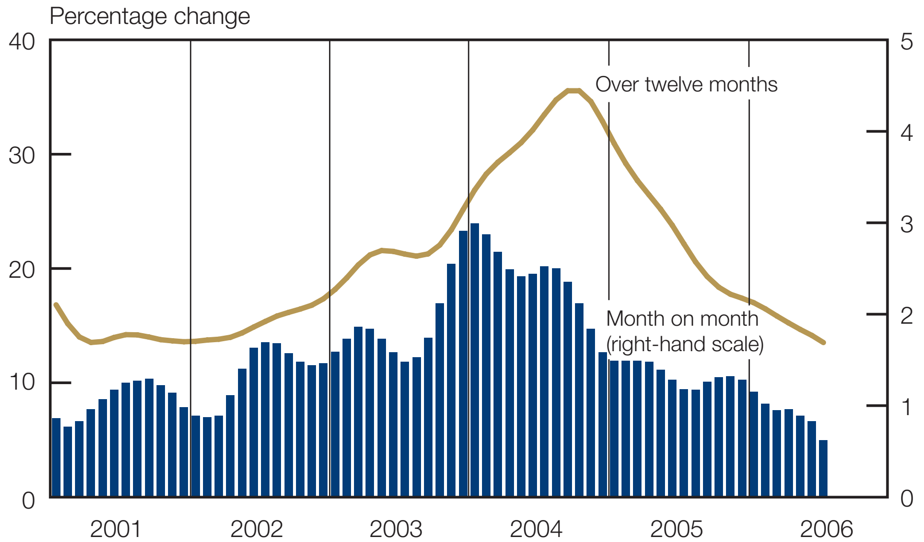
* February to December 2005
** February to July 2006 compared with February to July 2005

Real-estate market

In an attempt to encourage first-time home-owners in South Africa, the thresholds for transfer duty exemption were increased with effect from 1 March 2006. For properties valued below R500 000 (previously R190 000) no transfer duty would for instance be payable, while properties valued from R500 000 to R1 000 000 would attract a duty of 5 per cent of the amount above R500 000 and for properties valued above R1 000 000, the transfer duty would be R25 000 plus 8 per cent of the amount above R1 000 000. Transfer duties payable by non-natural persons were lowered from 10 to 8 per cent of the value of the property.

These reductions in duties payable rendered support to the real-estate market. Real-estate market conditions remained buoyant in the first seven months of 2006, boosted by the healthy growth in mortgage advances as the demand for property in the lower to middle segments of the market persisted. House prices nevertheless lost some momentum. The year-on-year rate of increase in average house prices declined from a high of 35,6 per cent in September 2004 to 13,5 per cent in July 2006. The month-on-month increase in house prices also slowed from 2,3 per cent to 0,6 per cent during the same period. In the market for luxury properties, strong buyer resistance resulted in muted price increases over the past year.

House prices



Source: Absa

The slowdown in property prices, the weakening of share markets globally since May 2006 and the increase in the repurchase rate on 8 June contributed to a sharp fall in the share prices of listed property companies in the real-estate sector of the JSE. After having been on an upward trend since the beginning of 2005, the property loan stock price index declined by 21 per cent from 11 May 2006 to 31 July, eroding all the gains achieved from the beginning of 2006 and exceeding the decline in the all-share price index over the same period by a substantial margin.

Non-bank financial intermediaries

The accompanying table gives an indication of the portfolio allocation, as a percentage of total assets, of selected non-bank financial institutions. Equities have been the best performing asset class for most non-bank financial intermediaries in recent quarters, largely due to the impressive performance of the domestic share market.

Asset allocation of selected non-bank financial intermediaries
End of March 2006

	Equity	Bonds	Cash	Fixed property	Other	Total assets	
	Percentage of total assets						R billions
Insurers	52	15	10	4	19	100	1 268
Pension and provident funds	49	33	8	2	8	100	982
Collective investment schemes	54	8	35	-	3	100	449

Premiums received by insurers and pension and provident funds increased by 38 per cent from R66,7 billion in the first quarter of 2005 to R91,8 billion in the first quarter of 2006. Unit trusts managed to gain a lucrative share of the contractual savings market as they experienced an increase in net sales of units from R11,4 billion to R19,7 billion during the same period. The total number of unit trust funds, including index-tracking funds which have characteristics similar to exchange-traded funds, increased from 549 in the first quarter of 2005 to 665 in the first quarter of 2006. The Public Investment Corporation (PIC) retained its role as asset manager of the government pension fund, as more than 92 per cent of the funds it received in 2005 and thus far in 2006 were from the Government Employee Pension Fund. The PIC capitalised on this financial position by progressively using the assets under its management for the development of historically neglected areas and infrastructure through property investment.

Claims by households on the selection of non-bank financial intermediaries, depicted in the table, increased by 24 per cent from R1,8 trillion in the first quarter of 2005 to R2,2 trillion in the first quarter of 2006. However, this increase in household wealth was also accompanied by a significant increase in household debt.

Public finance

Fiscal policy

Strong economic growth and soaring prices of export commodities contributed to exceptionally high tax collections in 2005/06, resulting in a much smaller government deficit than initially budgeted for in early 2005. Against this backdrop the Minister of Finance tabled the 2006 Budget in Parliament on 15 February 2006, presenting a set of fiscal policies providing for robust growth in public service delivery and infrastructure investment, and building on the buoyancy in tax revenue and the positive economic outlook. Having established a sound and sustainable macroeconomic platform over the past decade by improving the tax administration, obeying expenditure limits and moderating the level of government debt, room was created for a fiscal policy stance that allows for robust growth in real expenditure.

The less restrictive fiscal policy approach initiated in 2001 was stepped up further in the 2006 Budget by providing significantly more resources for investment in infrastructure and increasing real expenditure in pursuit of economic and social objectives. Capital expenditure would be raised relative to current expenditure in support of the Accelerated and Shared Growth Initiative for South Africa. Projecting further vigorous growth in revenue, government dissaving was expected to be reversed by 2008, which would provide further support to a process of strong and sustainable economic growth and development.

The strong fiscal position also enabled the government to continue with its tax reform agenda in the 2006 Budget; the measures introduced included, among other things, personal income tax relief, reduction of the retirement fund tax rate, raising the transfer duty thresholds to broaden property ownership, and extending the learnership allowance to promote skills development. The development of the tax framework would support the goals of accelerated and shared economic growth not only through these measures but also by reducing the burden of compliance cost and tax on all businesses, fostering an enabling environment for small business development, and encouraging investment in technology.

Real economic growth was expected to average 5 per cent per annum over the next three years. This positive outlook was supported by strong commodity prices, buoyant global economic growth and the stable foundation laid by prudent domestic monetary and fiscal policies. Further reforms would also be introduced to address other constraints which hamper economic expansion and to improve competitiveness in certain earmarked sectors. In recognition of the capacity constraints to the effective delivery of services, government would review its regulatory practices and provide technical support as well as build managerial capacity to boost planning and financial management at all levels of the public sector.

Government would place new emphasis on improving the financial and corporate governance of state-owned enterprises to enable them to better contribute to the development of the country's infrastructure base and to economic growth. This would give greater impetus to social development and public service delivery, continuing the strong focus on poverty reduction and the extension of basic services to all South Africans.

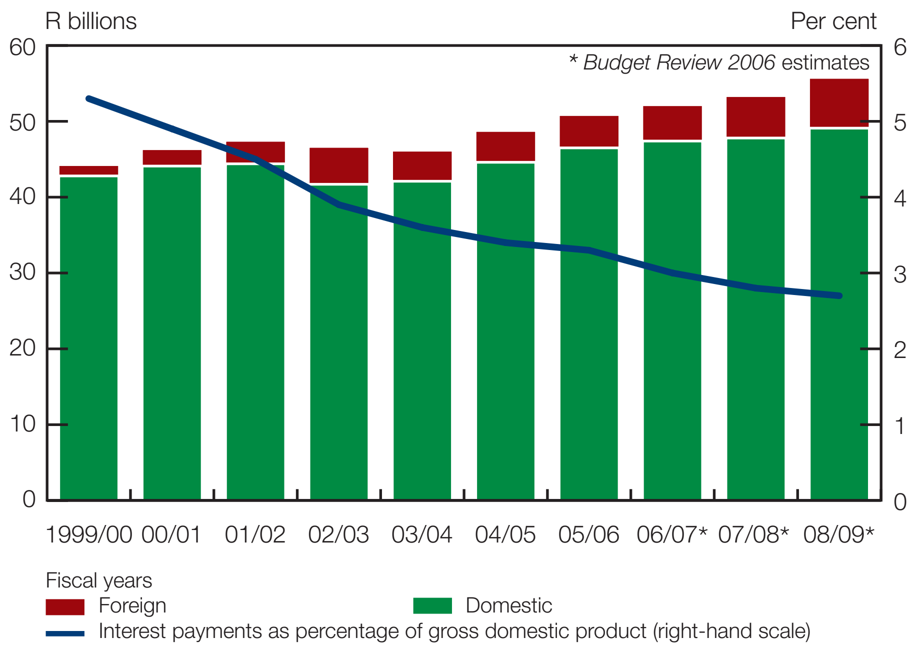
The Budget further supported South Africa's international engagement, which focuses on consolidation of the development agenda for Africa, co-operation between developing nations, improved global governance and strengthening bilateral relations.

National government expenditure

National government expenditure in fiscal 2005/06 amounted to R417 billion, implying an increase in the ratio of expenditure to gross domestic product from 26,0 per cent in fiscal 2004/05 to 26,7 per cent in fiscal 2005/06. The increase in this ratio in recent years bears testimony to the less restrictive fiscal policy stance that has been adopted by government since 2001.

The year-on-year rate of increase in national government expenditure amounted to 13,1 per cent in fiscal 2005/06 – closely aligned to the original budget projection of 13,4 per cent. In *real terms,* the increase in national government expenditure in fiscal 2005/06 amounted to 8,9 per cent, demonstrating government's commitment to higher economic growth through increased public spending on economic infrastructure as well as social and economic services. Real growth in targeted areas of expenditure, together with declining interest costs, contributed strongly towards improved growth in fiscal 2005/06. Government's non-interest spending during the same period was also closely aligned with original budget expectations.

Interest payments by national government



The marginally lower-than-budgeted expenditure in fiscal 2005/06 can partly be attributed to lower interest payments on national government debt. Prudent debt management, lower borrowing requirements, lower global interest rates and the appreciation of the rand, all contributed towards the lower payments. Interest payments increased by 4,5 per cent in fiscal 2005/06, just over half of the originally budgeted increase of 8,9 per cent. This released additional resources for further economic development and poverty relief initiatives.

Non-interest current expenditure, mainly consisting of transfers to provincial governments and voted amounts to national departments, amounted to R359 billion in fiscal 2005/06 which was 13,9 per cent more than a year earlier. Real non-interest expenditure grew at a rate of 10,2 per cent in fiscal 2005/06 and was expected to increase at an average annual rate of 6,4 per cent over the next three years.

A transfer of R2,7 billion made to the Road Accident Fund to proceed with scheduled payments to successful claimants and to settle an outstanding payment to the South African Revenue Service, as well as a R2,0 billion transfer made to Denel (Pty) Ltd for recapitalisation, restructuring and refocusing of its business, were also included in other expenditure during fiscal 2005/06.

Strong growth in capital spending reflected government's commitment to support economic growth through infrastructure development. Payments for capital assets continued on an upward trend and amounted to R7,2 billion in fiscal 2005/06, representing a 45-per-cent rate of increase if compared to the previous fiscal year. As a proportion of total national government spending, capital spending amounted to 1,7 per cent in fiscal 2005/06.

Given the additional resources required for infrastructure development and increases in social and economic programmes, total national government expenditure was estimated to amount to R473 billion in fiscal 2006/07, representing a year-on-year rate of increase of 13,4 per cent. It was estimated that national government expenditure would increase at an average annual rate of 11,1 per cent over the medium term. As a ratio of estimated gross domestic product, it was estimated that national government expenditure would be kept at around 27 per cent over the three-year planning horizon.

National government revenue

The *Statement of the National Revenue, Expenditure and Borrowing* indicated that national government revenue outstripped the original budget projections by a substantial margin. National government revenue amounted to R411 billion in fiscal 2005/06 – R41,3 billion more than the originally budgeted revenue for fiscal 2005/06. The economy outperformed the set of macroeconomic projections stated in the *Budget Review 2005* which was used to compile the originally budgeted national government revenue. Increased household consumption demand contributed noticeably to the increase in gross domestic expenditure, which in turn fuelled the importation of consumer goods, thereby leading to increased revenue collections from customs duties. In addition, companies benefited from a broad-based increase in economic activity, leading to higher profits and taxation levels. Greater efficiency in tax collection was also evident.

The rate of increase in national government revenue of 18,4 per cent in fiscal 2005/06 was extraordinarily high, given the concurrent inflation rate of barely 4 per cent. National government revenue as a ratio of gross domestic product amounted to 26,3 per cent in fiscal 2005/06 due to higher-than-anticipated collections, compared to the 24,5 per cent recorded in fiscal 2004/05.

As indicated in the table on the opposite page, almost all categories of revenue outperformed the original budget projections. The strong growth in tax collections pertaining to income, profits and capital gains reflected the strong growth in corporate income tax collections – especially from the retail and financial sectors. The better performance could also be attributed partly to the more comprehensive approach adopted by the Large Business Centre of the South African Revenue Service (SARS) to improve corporate compliance. SARS plans to modernise the corporate income tax administrative system. On 1 June 2006 a managed pilot programme of e-filing for large companies' income tax returns commenced. A move to a full self-assessment system, which will provide faster turnaround times and greater certainty, is also being explored. An advance tax ruling system will be brought into operation on a phased basis starting in the latter part of 2006.

National government revenue in fiscal 2005/06

Revenue source	Originally budgeted		Preliminary outcome	
	R billions	Percentage change*	R billions	Percentage change*
Taxes on income, profits and capital gains	200,9	2,9	230,9	18,3
Payroll taxes	4,9	10,5	4,9	10,0
Taxes on property	9,8	9,0	11,1	23,6
Domestic taxes on goods and services	143,0	8,8	150,7	14,7
Taxes on international trade and transactions	13,2	-0,7	18,2	37,0
Other revenue	10,2	38,4	9,5	29,2
Less: SACU** payments	12,1	-9,6	14,1	6,1
Total revenue	**369,9**	**6,5**	**411,2**	**18,4**

* Fiscal 2004/05 to fiscal 2005/06
** Southern African Customs Union

Taxes on property continued to reflect buoyant real-estate activity, although rising less rapidly than before. Domestic taxes on goods and services also grew strongly, mainly driven by real final consumption expenditure by households. The annual growth rates in real household expenditure recorded in the past two fiscal years have been the highest since fiscal 1979/80. Taxes on international trade and transactions grew strongly in fiscal 2005/06, reflective of strong demand for imports stemming from buoyant domestic expenditure and the relative strength of the exchange value of the rand.

Due to higher-than-projected customs duties collected and increased imports from South Africa by other members of the customs union, transfers to the SACU partners – Botswana, Lesotho, Namibia and Swaziland – exceeded the estimates made in the 2005 Budget, and are expected to increase steadily over the next three fiscal years.

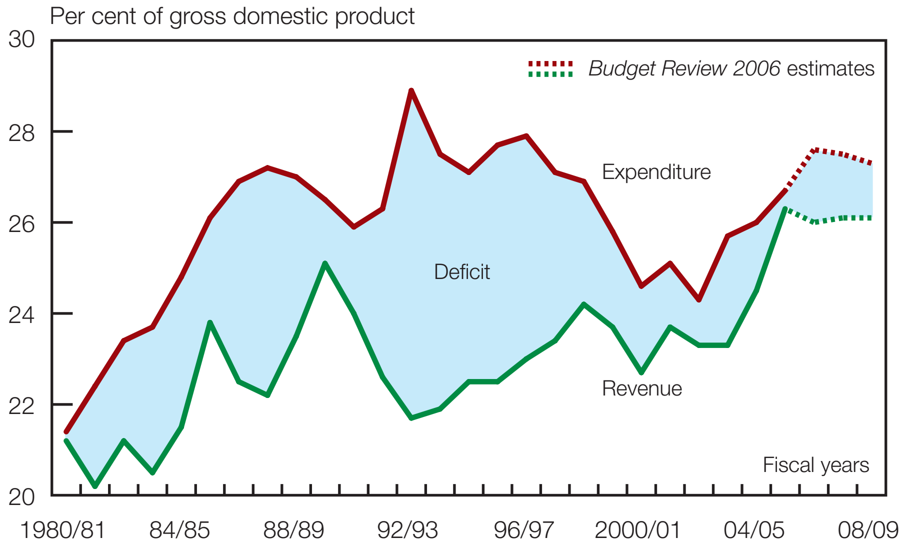
The total revenue of national government was estimated to amount to R446 billion in fiscal 2006/07, representing a year-on-year rate of increase of 8,6 per cent. The strong growth in revenue created room for tax relief, budgeted to amount to R19,1 billion in fiscal 2006/07. The 2006 tax proposals aim to reduce the tax burden on individuals and businesses, expand the tax base and simplify tax administration. It was estimated that national government revenue as a ratio of gross domestic product will edge lower to an average of 26,1 per cent over the medium term after taking into account the effects of the tax proposals.

National government deficit

The net result of the higher-than-budgeted revenue and lower-than-budgeted expenditure in fiscal 2005/06 was a *cash book deficit* of R5,6 billion, substantially lower than the originally budgeted amount of R48,0 billion and also lower than the revised estimate of R7,9 billion presented to Parliament in February 2006. The national government deficit before borrowing and debt repayment as a ratio of gross domestic product amounted to 0,4 per cent in fiscal 2005/06, compared with a ratio of 1,5 per cent recorded in the previous fiscal year. The deficit ratio recorded in fiscal 2005/06 was also well below the originally budgeted ratio of 3,1 per cent.

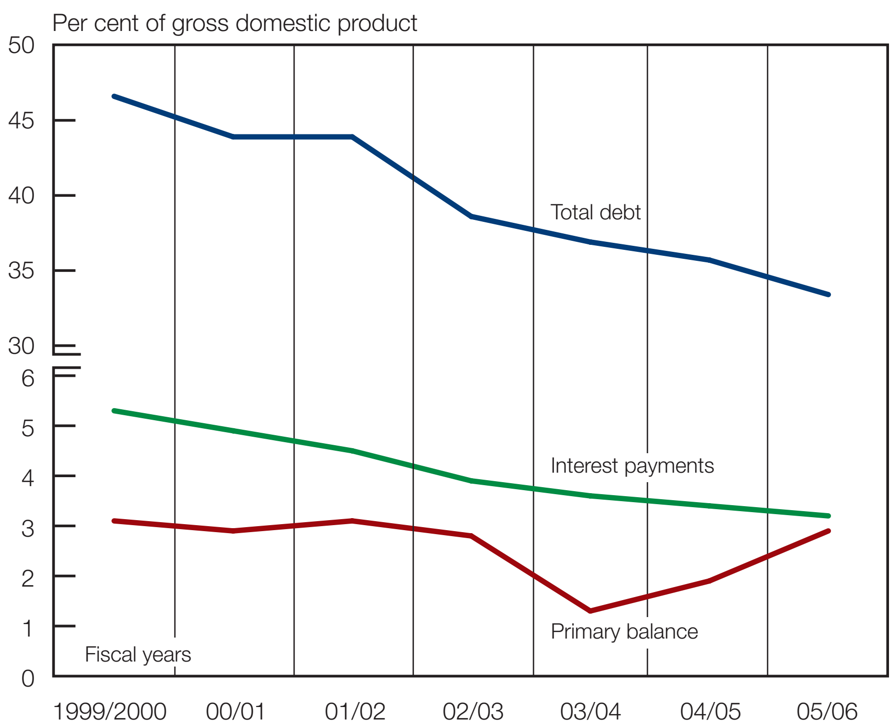
The national government deficit as a ratio of gross domestic product in fiscal 2005/06 was at its lowest since fiscal 1980/81, when it amounted to 0,1 per cent. Government revenue increased substantially in 1980 because of the buoyant economic conditions, which were reflected in, among other things, substantially higher company profits, consumer expenditure and imports. In particular, the marked rise in the price of gold and its effect on gold-mining profits contributed significantly to such a low deficit being recorded in fiscal 1980/81.

National government revenue and expenditure



According to the *Budget Review 2006*, the national government deficit as a ratio of gross domestic product is expected to increase to a level of 1,5 per cent in fiscal 2006/07, after which a steady reduction is envisaged. The deficit was projected to reach a level of 1,2 per cent of gross domestic product in fiscal 2008/09.

National debt sustainability indicators



The robust economic growth of the past year, together with the higher revenue collections as well as the containment of expenditure, supported government's borrowing and debt sustainability strategy. Accordingly, the debt of national government as a ratio of gross domestic product declined substantially. This contributed to lower interest cost and resulted in a lower borrowing requirement. As a result, the *primary balance* (i.e. the deficit recalculated by excluding interest payments from total expenditure) reached a surplus of 2,9 per cent of gross domestic product in fiscal 2005/06, higher than the 1,9 per cent recorded in the previous fiscal year. The higher primary surplus also implied the release of further resources for infrastructure and essential social spending.

Financing of national government deficit

After taking into account cash-flow adjustments (i.e. transactions recorded as a result of timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), government's *cash-flow deficit* amounted to R1,0 billion in fiscal 2005/06. This was significantly lower than the cash-flow deficit of R15,9 billion recorded a year earlier.

National government's net borrowing requirement in fiscal 2005/06 was partly impacted by extraordinary payments and receipts. Extraordinary payments essentially consisted of R4,5 billion paid to the Bank to defray losses on the Gold and Foreign Exchange Contingency Reserve Account. Extraordinary receipts included special dividends paid to national government by Telkom and Eskom amounting to R1,0 billion and R0,7 billion, respectively. Foreign exchange amnesty proceeds to the amount of R2,7 billion were also received in fiscal 2005/06.

National government financing in fiscal 2005/06
R billions

Item or instrument	Originally budgeted	Actual
Deficit	**48,0**	**1,0***
Plus: Extraordinary payments	7,0	4,5
Cost on revaluation of maturing foreign debt	0,7	0,5
Less: Extraordinary receipts	1,0	4,5
Net borrowing requirement	**54,7**	**1,5**
Treasury bills	5,0	5,7
Domestic government bonds	26,3	22,1
Foreign bonds and loans	12,8	1,0
Change in available cash balances**	10,6	-27,3
Total net financing	**54,7**	**1,5**

* Cash-flow deficit
** Increase -, decrease +

These extraordinary transactions increased the net borrowing requirement of national government to only R1,5 billion in fiscal 2005/06, compared to a net borrowing requirement of R27,0 billion recorded a year earlier. The small net borrowing requirement in fiscal 2005/06 was more than fully financed, mainly through the issuance of bonds in the domestic capital market as indicated in the accompanying table above. The funding beyond the net borrowing requirement was utilised to increase government deposits.

Domestic long-term funding in fiscal 2005/06 was obtained at an average rate of 7,9 per cent per annum, while domestic short-term instruments were sold at an average rate of 6,8 per cent per annum.

During fiscal 2005/06, the National Treasury introduced several new government securities of various maturities. Treasury bills with a maturity of 273 days were first issued in May 2005. This was followed by new fixed-income bonds with maturity dates in 2012, 2014 and 2020.

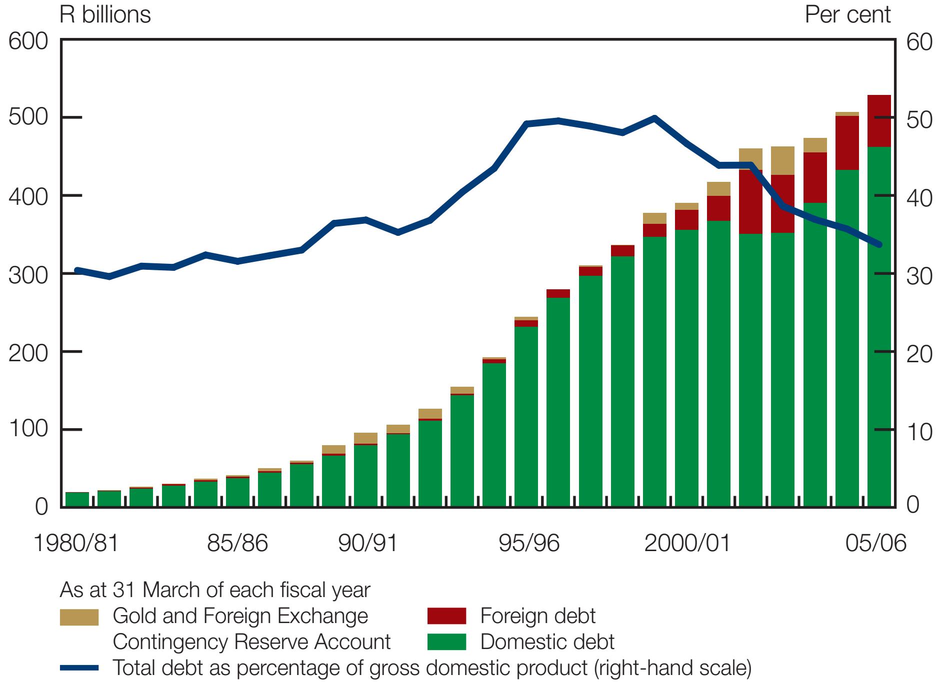
Net issues of foreign bonds and use of foreign loans amounted to R1,0 billion during fiscal 2005/06. Net foreign funding included amounts drawn on the credit facilities which had been arranged for the financing of the Strategic Defence Procurement Programme to the amount of R2,9 billion, partly offset by the prepayment of an arms procurement loan to the value of R0,6 billion.

Since 1996, the strategy of government has been shifting towards extending the maturity profile of its foreign-currency denominated debt. However, due to the early redemption of foreign debt the average maturity of the foreign marketable bonds of national government decreased from 78 months at the end of March 2005 to 68 months at the end of March 2006, while the maturity of domestic marketable bonds decreased slightly from 99 months to 98 months over the same period.

The financial activities of national government resulted in an increase in government's bank balances from R30,9 billion at the end of March 2005 to R58,2 billion at the end of March 2006. During fiscal 2005/06 government's deposits with the Bank increased substantially as part of the authorities' liquidity-draining operations, largely aimed at sterilising the money-market impact of the accumulation of foreign exchange reserves.

The net issues of debt instruments by the national government led to an increase in the total loan debt of national government from R502 billion at the end of March 2005 to R528 billion at the end of March 2006. Total loan debt as a ratio of gross domestic product decreased from 35,3 per cent at the end of March 2005 to 33,8 per cent at the end of March 2006.

Total debt of national government



Initially, with the re-entering into the foreign capital markets in 1994, government concentrated on re-establishing the country's presence and creating benchmarks in key markets as well as reaching out to new investor bases. This was reflected in the steady increase in the share of foreign debt in government's total loan debt. From 1995 to 2001 this share rose from 3 to 8 per cent. In fiscal 2001/02 this ratio peaked at 19 per cent due to the depreciation of the exchange value of the rand alongside sizeable foreign debt issues. With the subsequent strengthening of the exchange rate of the rand, the outstanding value of foreign bonds and loans in rand terms receded and the share of foreign loans in total loan debt accordingly declined, reaching levels of 13,8 per cent at the end of March 2005 and 12,6 per cent at the end of March 2006.

It was also announced that the unsettled realised *profits* on the Gold and Foreign Exchange Contingency Reserve Account amounted to R1,7 billion at the end of March 2006 compared with *losses* of R5,3 billion at the end of March 2005. This account therefore ceased to contribute to the total debt of national government. Government-guaranteed debt declined from R76,0 billion at the end of March 2005 to R67,9 billion at the end of March 2006.

Gold and Foreign Exchange Contingency Reserve Account

	R billions
Balance as at 31 March 2005	5,3*
Less payment by Treasury, April 2005	4,5
Less forward cover and revaluation profits, 2005/06	2,5
Balance as at 31 March 2006	-1,7*

* Loss +, profit -

General government finance

The borrowing requirement of the consolidated general government (i.e. consolidated central government, provincial and local governments) for fiscal 2005/06 was the lowest level ever recorded – amounting to 0,4 per cent of gross domestic product. Over the course of the subsequent three fiscal years the consolidated general government is, however, projected to record a borrowing requirement averaging 1,5 per cent of the estimated gross domestic product. The increase in the borrowing requirement would be accompanied by the expansion of investment and social spending to meet developmental objectives, all within a sound and sustainable budget framework.

The significant increase in the current revenue, together with the decrease in current expenditure of consolidated general government, contributed to a decline in the *gross dissaving* of general government in fiscal 2005/06. The gross dissaving of the general government (i.e. the shortfall of current income vis-à-vis current expenditure before provision for depreciation at replacement value of the fixed capital stock) is used in the calculation of gross saving for the economy as a whole.

An analysis of the *Provincial Revenue Fund Statements* indicated that provincial governments' cash surplus declined from R2,3 billion in fiscal 2004/05 to R0,3 billion in fiscal 2005/06. The decrease confirms the improvement in provincial spending on infrastructure as well as the reduction in underspending on capital expenditure and conditional grants.

The increase in local government allocations, as stated in the *Budget Review 2006*, reaffirms government's commitment to support the development of municipal infrastructure, particularly in low-income communities. Funding is targeted to assist in the building of township roads, water reticulation, sanitation systems, electricity connections, street lighting, community halls, and other infrastructure needs. The increase in the Municipal Infrastructure Grant is aimed at helping municipalities to alleviate infrastructure backlogs. The estimated cash deficit of local governments amounted to R8,0 billion in fiscal 2005/06, compared to a deficit of R10,6 billion in fiscal 2004/05. This decline in the cash deficit resulted partly from an increase in grants received and a moderate improvement in revenue collection.

The consolidated central government (i.e. national government, extra-budgetary institutions and social security funds) recorded a surplus of R0,7 billion in fiscal 2005/06 compared with a deficit of R27,4 billion recorded in the previous fiscal year. This turnaround can mainly be attributed to the large revenue overrun at national government level.

The accompanying table indicates that spending on community and social services remains the most important and largest functional category of government spending and is projected to amount to 53,2 per cent of the projected expenditure by consolidated national and provincial governments and social security funds in fiscal 2008/09. Spending on these services is the foundation for future growth through human capital development, alongside the provision of direct support to the poor. This type of spending is expected to increase at an average annual rate of 11,6 per cent over the medium term, with housing and community services clearly deemed to be a priority area.

Functional classification of expenditure of consolidated national and provincial governments and social security funds

Spending category	Percentage of total expenditure		Average growth rate 2005/06 – 2008/09
	2005/06[1]	2008/09[1]	Per cent
Protection services	**16,9**	**15,3**	**7,4**
Defence and intelligence	6,0	4,8	3,2
Public order and safety[2]	10,9	10,5	9,7
Community and social services	**52,3**	**53,2**	**11,6**
Education	19,1	18,5	9,7
Health	11,0	10,5	9,6
Social security and welfare	17,0	16,5	9,8
Housing and community services[3]	5,2	7,7	27,5
Economic services	**13,2**	**14,5**	**14,7**
Fuel and energy	0,6	0,7	11,8
Agriculture, forestry and fishing	2,0	2,3	16,8
Mining, manufacturing and construction	0,5	0,4	8,2
Transport and communication	4,6	5,7	20,0
Other economic services[4]	5,5	5,5	10,6
State debt cost[5]	**11,7**	**9,3**	**2,9**
General government services and unallocatable expenditure	**5,9**	**7,6**	**21,3**
Total	**100,0**	**100,0**	**11,0**

1 *Budget Review 2006*, adjusted for comparability
2 Including police, prisons and justice
3 Including recreation and culture as well as sport services
4 Including water schemes, tourism, labour, environmental protection and related services
5 Including interest, management cost and the cost of raising loans

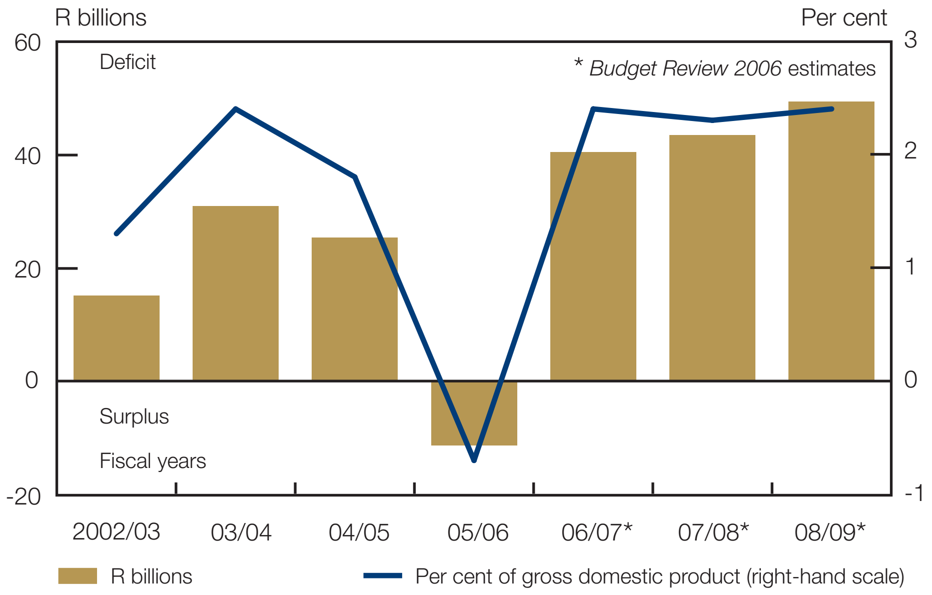
Government's commitment to the improvement of the transport and communication infrastructure is reflected in the brisk growth in this expenditure category. Due to the projected decline in spending on state debt cost relative to total expenditure, more funds are to become available to be spent on essential services.

The significant increase in general government services can mainly be attributed to the inclusion of a contingency reserve, rising from R2,5 billion in fiscal 2006/07 to R8,0 billion in fiscal 2008/09. The contingency reserve provides for unforeseen and unavoidable spending in all functional areas.

Non-financial public-sector borrowing requirement

For the first time ever the non-financial public sector (i.e. the consolidated central government, provincial and local governments and non-financial public-sector business enterprises) recorded a *surplus* of 0,7 per cent of gross domestic product in fiscal 2005/06. This stood in contrast to the revised borrowing requirement of 0,6 per cent of gross domestic product projected in the *Budget Review 2006*. This healthy state of affairs could be attributed to the revenue overrun of national government, together with an increase in the surplus of the social security funds as well as a large increase in the surplus recorded by the non-financial public-sector enterprises and corporations in fiscal 2005/06. The large increase in the surplus of the non-financial public-sector enterprises and corporations could be attributed to a significant decrease in payments for operating activities and subdued capital expenditure.

Non-financial public-sector borrowing requirement



Over the medium term – i.e. 2006/07 to 2008/09 – spending on infrastructure by the public sector is expected to accelerate strongly to a cumulative amount of R372 billion. Several investment programmes, industrial policy initiatives and regulatory reforms aim to ensure that both infrastructure capacity and improved economic performance support accelerated economic growth and higher living standards. The accelerated spending on infrastructure and other capital goods by the public sector will be partly financed through greater recourse to the capital market.

Medium-term estimates contained in the *Budget Review 2006* indicate that the borrowing requirement of the public sector will increase to an average of 2,4 per cent of the estimated gross domestic product from 2006/07 to 2008/09.

National government finance in the April-June quarter of fiscal 2006/07

National government expenditure and revenue in the first quarter of fiscal 2006/07 resulted in a *cash book deficit* of R3,3 billion compared with R7,5 billion in the same period of the previous fiscal year. After taking into account the cost on revaluation of foreign bonds and loans, the net borrowing requirement amounted to R5,0 billion in the period April to June 2006. During this quarter the government issued a new foreign bond which yielded R5,5 billion for the fiscus. However, this was partly neutralised by the early redemption of a foreign loan to the amount of R3,3 billion.

National government financing in fiscal 2006/07
R billions

Item or instrument	Originally budgeted	Actual April-June 2006
Deficit	**26,4**	**4,6***
Plus: Extraordinary payments	0,0	0,0
Cost on revaluation of maturing foreign debt	1,4	0,4
Less: Extraordinary receipts	0,2	0,0
Net borrowing requirement	**27,6**	**5,0**
Treasury bills	5,8	5,4
Domestic government bonds	10,2	11,2
Foreign bonds and loans	3,8	2,5
Changes in available cash balances**	7,8	-14,1
Total net financing	**27,6**	**5,0**

* Cash-flow deficit
** Increase -, decrease +