Annual Economic Report

2012

South African Reserve Bank

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Enquiries relating to this *Report* should be addressed to:
Head: Research Department
South African Reserve Bank
P O Box 427
Pretoria 0001
Tel. +27 12 313-3668/3676

http://www.reservebank.co.za

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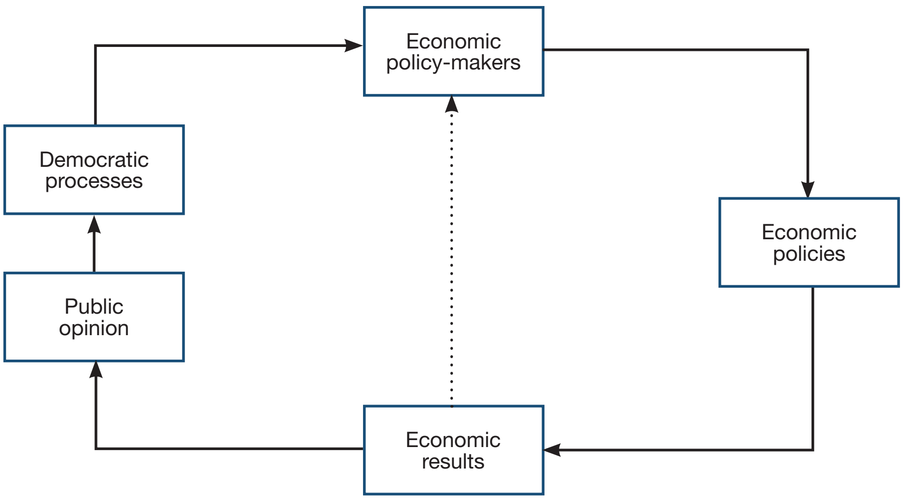
Introduction

The global economy continued on an uneven recovery path in 2011 and the first half of 2012, with the buoyancy experienced in the emerging-market economies being in sharp contrast to the hesitancy observed in the developed economies. Concerns about fiscal sustainability and the health of the financial sector continued to plague the euro area, with austerity measures aggravating the unemployment situation and lack of growth in the region. With no fiscal parallel to the high level of monetary integration in the euro area, decisions regarding the nature, magnitude and timing of, and conditions for, support to the troubled peripheral European economies were difficult to take and implement. Furthermore, the frictions that inevitably arose resulted in disillusionment among the electorate, in several instances leading to a change of government following elections held. This introduced additional uncertainty regarding the orderly and timely resolution of the euro area's problems, raising risk premia on financial instruments issued by peripheral European governments – which, in turn, raised borrowing costs and further aggravated concerns about sustainability. In the United States (US) raising the limits set for government debt became an important political issue in 2011, with a political agreement only reached at the eleventh hour. One of the credit rating agencies subsequently downgraded the sovereign debt of the US.

The political economic cycle



Monetary authorities in the developed economies maintained exceptionally low interest rates to support economic activity and also continued with unconventional measures to bolster liquidity in the financial markets. Under these circumstances, and with continued growth in emerging-market economies, international commodity prices remained in firm territory but were, to some extent, dampened by the lacklustre progress of the developed economies and projections of slightly less buoyant growth prospects for China. However, concerns about crude oil supply interruptions in the wake of the so-called Arab Spring led to high levels of the oil price with a peak of more than US$125 per barrel registered in early 2012 before receding to below US$100 per barrel by the middle of the year. Overall, global inflation was fairly well contained as the world economy continued to be characterised by a fair amount of surplus capacity, alongside the easing of the supply chain bottlenecks that arose after the March 2011 earthquake and tsunami in Japan, and the dissipation of some of the food price pressures of the past year.

In the past 18 months the South African economy continued to function significantly below full capacity, although in a number of areas bottlenecks visibly inhibited economic progress.

The National Planning Commission released a vision statement and development plan for the country in November 2011, targeting the elimination of poverty and reduction of inequality by 2030 through appropriate changes, hard work, leadership and unity. Having identified the key developmental challenges facing the country and its people, the commission developed a plan focusing on

– the creation of jobs;
– improving South Africa's infrastructure;
– appropriate transition to a low-carbon economy;
– an inclusive and integrated rural economy;
– reversing the spatial effects of apartheid;
– improving the quality of education, training and innovation;
– providing quality healthcare for all;
– social protection;
– building safer communities;
– reforming the public service to build a capable state;
– eliminating corruption; and
– transforming society and uniting the country.

Addressing the infrastructure bottlenecks was recognised as of particular importance. In 2011, to ensure timeous and effective implementation in this area, Cabinet created the Presidential Infrastructure Co-ordinating Commission, chaired by the President and including half the members of Cabinet, the nine provincial premiers, and the mayors of the metropolitan areas. The President underlined the need for speeding up the capital programmes of the public sector in his State of the Nation address to Parliament early in 2012, when he unveiled the government's infrastructure development programme.

Real fixed capital formation started recovering in 2010 and rose further in 2011 and the first quarter of 2012, although it remained below its previous peak level registered in the final quarter of 2008. Capital spending by general government started rising in 2011, adding to the increases in capital formation by the public corporations and private sector. While the real fixed capital stock and capital-output ratio increased further, in the electricity-generation sector the point where the main new plants being established start producing electricity and alleviating bottlenecks would only be reached in 2013. In the private sector capital expenditure rose notably in 2011 and the first quarter of 2012 in the agricultural, mining, manufacturing and communication sectors, but residential construction activity remained in the doldrums, rising only marginally in the early months of 2012.

Over the five quarters starting in the first quarter of 2011 the household sector continued to provide momentum to the economy through firm increases in real final consumption expenditure, which remained well aligned with households' real disposable income. Expenditure on durable goods, especially motor vehicles, rose briskly. While households incurred more debt, their disposable income rose more strongly than their indebtedness, with the result that the household debt-to-income ratio declined further. At the same time, real final consumption expenditure by government continued to trend higher. With rising levels of expenditure in the economy, real inventories continued on the upward trajectory that had commenced in mid-2010, although the aggregate level of inventories remained fairly low.

Real gross domestic product increased at an uneven pace in 2011, with output growth held back in the middle quarters of the year on account of transitory factors such as industrial action and supply chain disruptions in the wake of the tragic events in Japan. Growth in the first quarter of 2012 was also curtailed by strike activity in the platinum mining sector. The average growth rate over the five quarters starting in the first quarter of 2011 came to a pedestrian 3 per cent per annum – far below the rates required to make strong inroads into the high level of unemployment in the economy. While the services sectors recorded sturdy growth over this period, the primary and secondary sectors registered an erratic performance.

Employment in the formal non-agricultural sector started recovering in 2010 and trended higher in 2011 and early 2012, mainly driven by public-sector employment. Apart from temporary employment related to the 2011 municipal elections and population census, the public sector continued to expand its permanent staff complement. In the private sector the most significant increases in employment were registered in the construction, non-gold mining, trade and business services sectors. Average wage settlements moderated slightly over this period.

Consumer price inflation picked up in 2011, driven by the prices of food, petrol and electricity, eventually to reach levels above the 6 per cent upper limit of the inflation target range. However, the price momentum started reversing early in 2012 and by May inflation had moderated to 5,7 per cent.

The subdued performance of the goods-producing sectors of the economy in 2011 and early 2012 was mirrored in the relatively slow pace of expansion in export volumes, which stood in contrast to the generally stronger rate of growth in import volumes, aligned with brisk growth in domestic expenditure. However, with generally firm export prices the terms of trade continued to favour South Africa, softening the impact of the hesitant export quantities on the trade balance. The deficit on the current account of the balance of payments nevertheless widened to 3,3 per cent of gross domestic product in 2011 and 4,9 per cent in the first quarter of 2012, the latter value also reflecting exceptionally high dividend declarations in anticipation of the less favourable tax treatment of dividends effective from April 2012.

The financial account of the balance of payments recorded surpluses that offset the deficits on the current account in 2011 and early 2012, mainly through foreign direct investment and other investment inflows. Portfolio inflows predominantly consisted of purchases of South African bonds by non-residents.

Swings in international investor sentiment filtered through to the exchange value of the rand, with greater uncertainty about the resolution of the crisis in Europe usually being associated with greater risk aversion, doubt about the sustainability of commodity prices, a flight to the familiarity of the core developed markets and depreciation of the rand. The rand depreciated notably in the second half of 2011, recovering partly in early 2012 before depreciating again in the second quarter of the year.

The real-estate market remained in the doldrums during the past 18 months, consistent with the stagnation in banks' mortgage advances. Instalment sale advances picked up as purchases of durable goods increased, while general advances gained considerable momentum – in the case of general advances to households, also sometimes referred to as unsecured lending, the twelve-month rate of increase reached levels around 40 per cent in mid-2011 before moderating to around 30 per cent more recently. Overall, bank loans and advances gradually gained momentum over the period, with its twelve-month rate of increase remaining in single-digit territory. Growth in the broad M3 monetary aggregate fluctuated broadly sideways, its twelve-month rate of increase mostly between 6 and 8 per cent.

Money-market conditions remained normal during the period under review, while short-term interest rates continued to be anchored by the repurchase rate of the South African Reserve Bank (the Bank), which has been unchanged at 5,5 per cent since November 2010. Long-term interest rates edged lower over the period, reflecting well-contained inflation expectations, firm interest in South African bonds by international investors, and the forthcoming inclusion of domestic bonds in the Citigroup World Government Bonds Index (WGBI). Share prices fluctuated higher to record levels in the first half of 2012.

The economic recovery was supported by the relatively expansionary fiscal policy stance, with national government recording a deficit of almost 5 per cent of gross domestic product in the previous fiscal year and planning for a similar deficit in the current fiscal year. Domestic government bonds continued to be the most important instrument used to finance the deficit. Adding the cash shortfalls of other levels of government and non-financial public enterprises and corporations, the public-sector borrowing requirement in 2011/12 amounted to 6,4 per cent of gross domestic product, reflecting both the government's countercyclical intentions and the public sector's infrastructure drive.

1 The focus in the *Annual Economic Report* is on broader economic developments and trends in the calendar year 2011 and first half of 2012, going beyond the Bank's financial year which covers the period 1 April 2011 to 31 March 2012.

Domestic economic developments[1]

Domestic output

Despite the sustained economic recovery since the third quarter of 2009, growth has remained pedestrian as the South African economy continued to be characterised by levels of activity significantly below potential. Following the contraction in 2009 resulting from the spill-over effects of the global financial crisis, positive growth in *real gross domestic product* was resumed at rates of 2,9 per cent in 2010 and 3,1 per cent in 2011 before losing some momentum in the first quarter of 2012. The growth in 2011 resulted mainly from the further expansion of economic activity in the tertiary sector as well as positive, albeit slower growth in the secondary sector – the real value added by the primary sector remained unchanged over the period.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

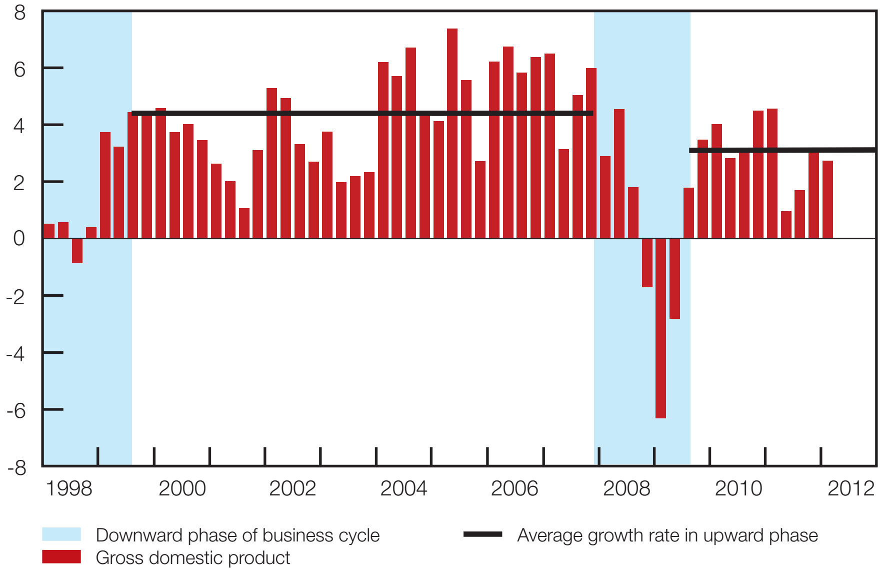
Sector	2009	2010	2011					2012
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sector	-4,2	4,0	-4,7	-6,0	-14,7	-1,0	0,0	-11,2
Agriculture	-1,5	0,5	-4,8	-9,5	-6,9	-5,0	-0,4	3,4
Mining	-5,4	5,5	-4,6	-4,5	-17,8	0,7	0,2	-16,8
Secondary sector	-6,9	4,3	10,1	-6,5	-0,5	3,5	2,1	6,4
Manufacturing	-10,1	5,4	12,8	-8,8	-0,7	4,2	2,4	7,7
Electricity, gas and water	-1,4	1,7	3,1	1,0	-2,6	1,2	1,3	-0,1
Construction	7,8	0,9	1,2	0,8	1,8	1,9	0,8	3,8
Tertiary sector	1,0	2,3	3,8	4,0	4,2	3,5	3,6	3,0
Commerce	-1,2	3,5	2,4	5,2	6,1	5,2	4,4	3,0
Transport and communication	0,9	2,0	4,1	4,3	2,3	2,9	3,3	2,5
Financial and other services	1,0	2,0	5,3	2,7	4,5	2,3	3,5	4,1
Non-primary sector	*-1,1*	*2,8*	*5,3*	*1,3*	*3,1*	*3,5*	*3,3*	*3,8*
Total	-1,5	2,9	4,6	1,0	1,7	3,2	3,1	2,7

The average annualised rate of increase of 3,1 per cent in real gross domestic production during the current upward phase of the business cycle from September 2009 is, however, well below the average rate of 4,4 per cent recorded during the previous upward phase which lasted from September 1999 to November 2007. This disappointing performance in the more recent period could mainly be attributed to the fragile global recovery, relatively weak domestic demand, deleveraging and the destruction of some domestic productive resources which hampered the post-recession economic recovery.

The real value added by the *primary sector* remained unchanged from 2010 to 2011. This stagnation in growth was the net result of a contraction in the real output of the agricultural sector, which was offset by an increase in the real output of the mining sector over the period.

Real gross domestic product

Percentage change from quarter to quarter



Seasonally adjusted and annualised rates

Following an increase of 0,5 per cent in 2010, the real value added by the *agricultural sector* contracted by an almost similar magnitude in 2011 before advancing again in the first quarter of 2012. Field crop production contracted in 2011 while production in other subsectors remained subdued. Insufficient rainfall caused sugar cane production in KwaZulu-Natal to shrink in 2010 and to remain at roughly the same level in 2011. In addition, the 2010/11 maize crop was about 19 per cent smaller than in the preceding year, partly due to a smaller area planted. By contrast, the maize crop for the 2011/12 season is currently estimated at 11,1 million tons or approximately 7 per cent more than the 2010/11 crop of 10,4 million tons, suggesting that field crop production may be more buoyant in 2012.

Maize crop estimates

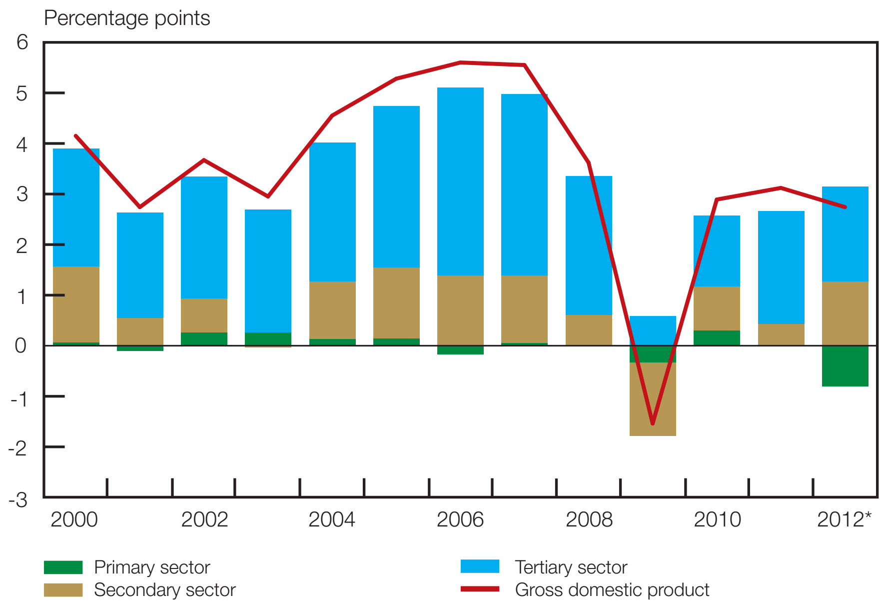
Season	2009/10	2010/11	2011/12*
Area planted (ha)	2 742 400	2 372 300	2 699 200
Production (tons)	12 815 000	10 360 000	11 055 550
Yield (t/h)	4,7	4,4	4,1

* Preliminary estimate
Source: National Crop Estimates Committee

Growth in real output of the *mining sector*, which amounted to 5,5 per cent in 2010, decelerated to a mere 0,2 per cent in 2011 – the contribution of mining to overall growth in gross domestic production receded from 0,3 of a percentage point to virtually zero over the same period. Domestic mining production remained lacklustre in 2011 as the industry had to deal with a range of domestic challenges such as escalating cost pressures emanating from increased salaries and wages, elevated administered prices including electricity prices, policy uncertainty and infrastructure constraints. Moreover, global demand for many of South Africa's mining commodities lost momentum against the background of the fragile and uneven global economic recovery.

The declining trend in mining production continued in the first quarter of 2012 with drawn-out strike activity at a large platinum mine inhibiting output. The quarter was also characterised by slower growth in coal production, while activity in diamond mining declined. Gold production recovered slightly in 2011, but remained subdued as the average grade of ore mined reflected the depletion of richer ore bodies.

Annual contribution to growth in gross domestic product



* First quarter 2012

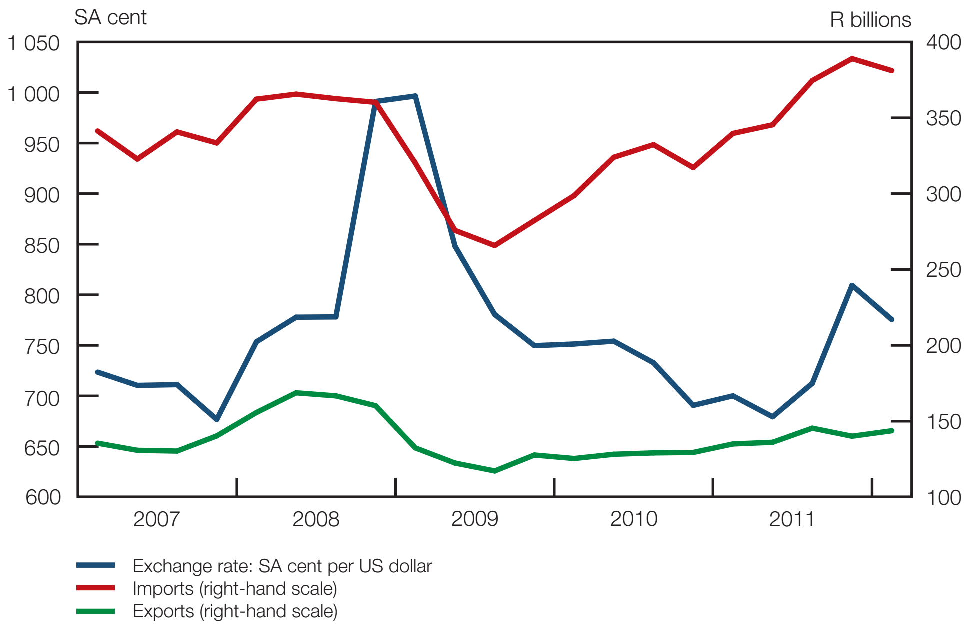
Platinum production decreased considerably throughout 2011, affected by reduced global industrial demand, occasional industrial action, cost pressures and the volatility in the exchange rate of the rand. The demand for auto catalysts was weighed down by the sluggish recovery in Europe's automotive market following the financial crisis and exacerbated by the spill-over effects of the tsunami which struck Japan in March 2011. In addition, platinum production decreased on account of safety-related stoppages at a number of platinum mines in the course of the year.

Coal production increased in 2011, following higher domestic and international demand for coal. Infrastructure development by Eskom and Sasol and increased demand from India boosted production over the period. Gold production recovered slightly in 2011 as the international price of the yellow metal was supported by very low or negative real interest rates, a lack of confidence in financial systems and lower global economic growth. Diamond production slowed markedly in 2011, causing South Africa's share in global diamond production to shrink further favouring countries such as China and India. Production was adversely affected by a moderation in capital spending, infrastructure maintenance and excessive rainfall in the first half of 2011. In addition, industrial action at the country's largest diamond producer gave rise to lower production in July 2011.

Growth in real value added by the *secondary sector* slowed substantially from 4,3 per cent in 2010 to 2,1 per cent in 2011. Although slower growth was evident in all subsectors of the secondary sector, it was particularly pronounced in the manufacturing sector.

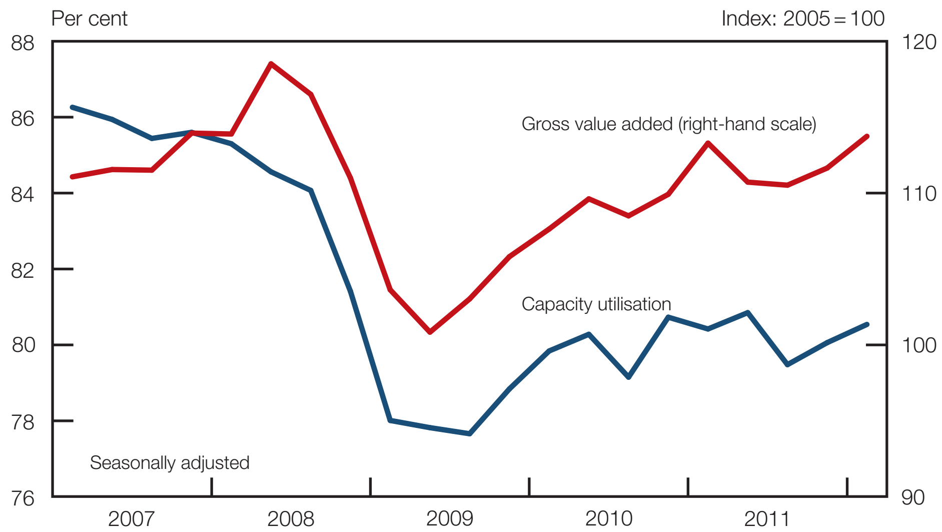
Growth in the real value added by the *manufacturing sector* slipped from 5,4 per cent in 2010 to 2,4 per cent in 2011, causing its contribution to overall growth in real gross domestic product to halve from 0,8 of a percentage point in 2010 to 0,4 of a percentage point in 2011. The more moderate pace of increase was especially evident in the sectors supplying chemical products, rubber and plastic products; basic iron and steel, non-ferrous metal products and machinery; and motor vehicles, parts and accessories and other transport equipment. The weaker performance of the manufacturing sector in 2011 could be explained by fairly depressed global demand for South African manufactured products; subdued domestic demand conditions; industrial action; unplanned production stoppages in a number of subsectors; soaring production cost; as well as the strength and volatility of the exchange rate of the rand which hampered export-oriented manufacturers. At the same time, competitively priced imports displaced domestic production in certain instances.

Volume of manufactured imports and exports and the exchange rate



Capacity utilisation in the manufacturing sector fluctuated around 80 per cent in both 2010 and 2011, meaningfully below its most recent peak of 86,3 per cent in the first quarter of 2007. In the first quarter of 2012 the utilisation of production capacity edged higher to 80,5 per cent. Insufficient demand for manufactured products contributed materially to the idle capacity. While capital expenditure often only takes off at high levels of capacity utilisation, it is encouraging to note that gross fixed capital formation in the manufacturing sector started rising during 2011.

Manufacturing: Capacity utilisation and real value added



Growth in the real value added by the sector supplying *electricity, gas and water* moderated from 1,7 per cent in 2010 to 1,3 per cent in 2011, mainly on account of lower activity levels in the mining and manufacturing sectors in the course of the year. The generation of electricity in the early part of 2011 was also negatively affected by heavy rainfall which subsequently hampered the delivery of coal to Eskom. Capacity issues which resulted in the 2008 electricity supply disruptions have not been resolved in full and are continuously placing strain on the power grid. Although Eskom is continuously expanding its power generation capacity, the new power stations will only come into operation in late 2013 as industrial action during the first half of 2011 delayed progress at the Medupi and Kusile project sites. In addition, some power stations had to close for maintenance in 2011 which placed a further strain on the supply of electricity.

Real output growth of the *construction sector* slowed considerably from a brisk rate of 7,8 per cent in 2009 to a mere 0,9 per cent in 2010 and 0,8 per cent in 2011. Fairly subdued confidence levels and an oversupply of residential and non-residential buildings suppressed building activity during the period. Despite the marginal improvement in the construction confidence indices and enhanced activity levels, the demand for new construction works remained relatively frail during the latter part of 2011, hampered by electricity supply constraints and a lack of new construction projects. Activity levels in the construction sector, however, picked up in the first quarter of 2012.

The *tertiary sector*, which had been the key driver of overall economic growth during the past decade, contributed 1,4 and 2,2 percentage points to gross domestic production in 2010 and 2011, respectively. The real value added by all the sectors constituting the tertiary sector accelerated in 2011.

An improvement in employment alongside increased consumer confidence levels supported the real value added by the *commerce sector* in 2011. Growth in the real value added by the commerce sector accelerated from 3,5 per cent in 2010 to 4,4 per cent in 2011 and contributed 0,4 and 0,5 of a percentage point to growth in gross domestic production in the respective years. Activity in all three major subsectors, namely wholesale, retail and motor trade, improved further in 2011. The motor trade subsector benefited from the low interest rate environment and a pick-up in credit extension; apart from the normal replacement cycle of private vehicles, growth was also stimulated by fairly strong demand from the car rental industry. The production of motor vehicles was only temporarily affected by the shortage of certain vehicle components sourced from Japan in the middle quarters of the year. Although retail trade sales were fairly subdued in the first half of 2011, a recovery was evident in the second half of the year. Improved consumer spending was also supported by relatively high salary and wage increases in the public sector. Growth in real value added by the trade sector, however, moderated in the first quarter of 2012, in tandem with a slower rate of increase in consumer spending.

Growth in real value added by the *transport, storage and communication sector* accelerated from 2 per cent in 2010 to 3,3 per cent in 2011. Activity in land freight transport picked up in the course of 2011 in response to increased consumer demand. The enhanced performance of the communication sector reflected continuous growth in the number of customers, technological advances in equipment and increased usage of data. A slightly slower pace of increase was recorded in the first quarter of 2012.

The real value added by the *finance, insurance, real-estate and business services sector* increased by 3,5 per cent in 2011 following an increase of 2 per cent in the preceding year. The sector's contribution to growth in overall gross domestic production accordingly rose from 0,4 of a percentage point in 2010 to 0,7 of a percentage point in 2011, stemming mainly from increased activity in the equity and bond markets as well as in the banking industry. The banking industry in particular benefited from the introduction of more innovative products and services offered to clients. Affordable new-generation products for low-income customers and those with more sophisticated financial needs were launched by a number of banks. Activity in the finance sector increased further in the first quarter of 2012.

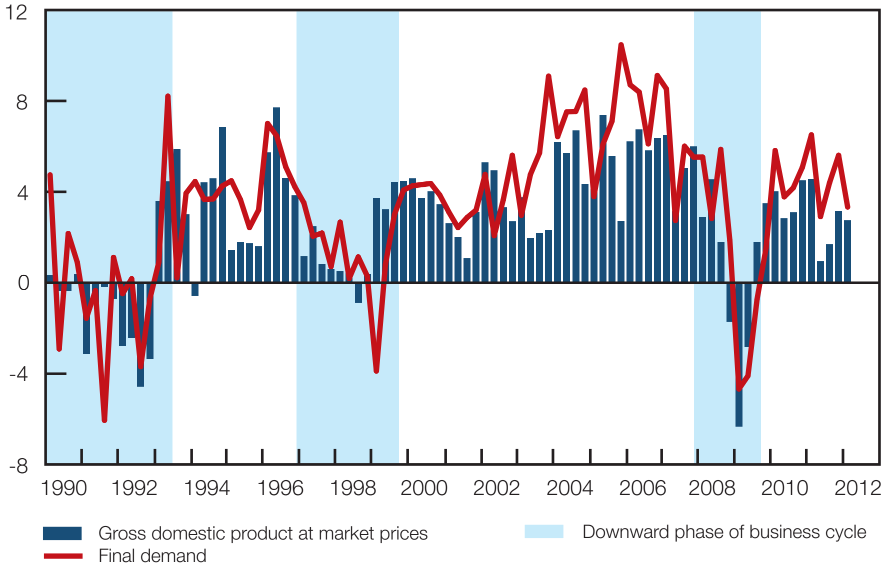
The real output of the *general government* grew by 3,9 per cent in 2011, following an increase of 2,7 per cent during 2010. The improved performance could be explained by increased employment during the 2011 National Census project and the concomitant increase in compensation. In the first quarter of 2012 growth in real value added by general government decelerated somewhat.

Domestic expenditure

Aggregate *real gross domestic expenditure* increased at an average annualised rate of 4,8 per cent in the current upward phase, compared with an average annualised rate of 5,3 per cent in the previous upward phase of the business cycle. During both upward phases average growth in real gross domestic expenditure was strongly correlated with changes in domestic final demand. In fact, growth in both aggregates outpaced that of real gross domestic production during these upward phases.

Real gross domestic product and final demand

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Growth in real gross domestic expenditure accelerated from 4,2 per cent in 2010 to 4,3 per cent in 2011. This marginal acceleration emanated from continued brisk spending by households alongside a fairly strong rebound in real gross fixed investment and real inventory holdings – growth in government consumption expenditure moderated somewhat over the period. The rebound in gross fixed capital formation contributed 0,8 of a percentage point to the growth in real gross domestic expenditure in 2011; this contribution increased to 1,0 percentage point in the first quarter of 2012.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Component	2009	2010	2011					2012
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Final consumption expenditure								
Households	-1,6	3,7	6,2	3,4	3,8	4,6	5,0	3,1
General government	4,7	4,9	9,4	-0,4	4,8	7,3	4,5	2,2
Gross fixed capital formation	-3,2	-1,6	4,4	5,0	5,9	7,2	4,4	5,3
Domestic final demand	**-0,7**	**2,9**	**6,5**	**2,9**	**4,4**	**5,6**	**4,8**	**3,3**
Change in inventories (R billions)*	-28,0	-1,8	7,1	3,1	4,0	4,9	4,8	5,9
Gross domestic expenditure	**-1,6**	**4,2**	**4,6**	**1,4**	**4,8**	**5,1**	**4,3**	**4,3**

* At constant 2005 prices

Real final consumption expenditure by households

Real *final consumption expenditure by households* declined for the first time in 17 years in 2009. Consumption spending by the household sector thereafter recovered and registered growth rates of 3,7 per cent and 5 per cent in 2010 and 2011, respectively. The brisk spending by households was underpinned by steady increases in real disposable income emanating, *inter alia,* from employment gains, including the creation of temporary jobs by general government to assist with the municipal elections and national population census. In addition, salary and wage increases at rates in excess of the upper limit of the inflation target range, and the stable 30-year low interest rate environment since the latter part of 2010, also supported household spending in 2011. The relatively firm pace of increase in household spending lost some momentum in the first quarter of 2012, alongside slower growth in household disposable income.

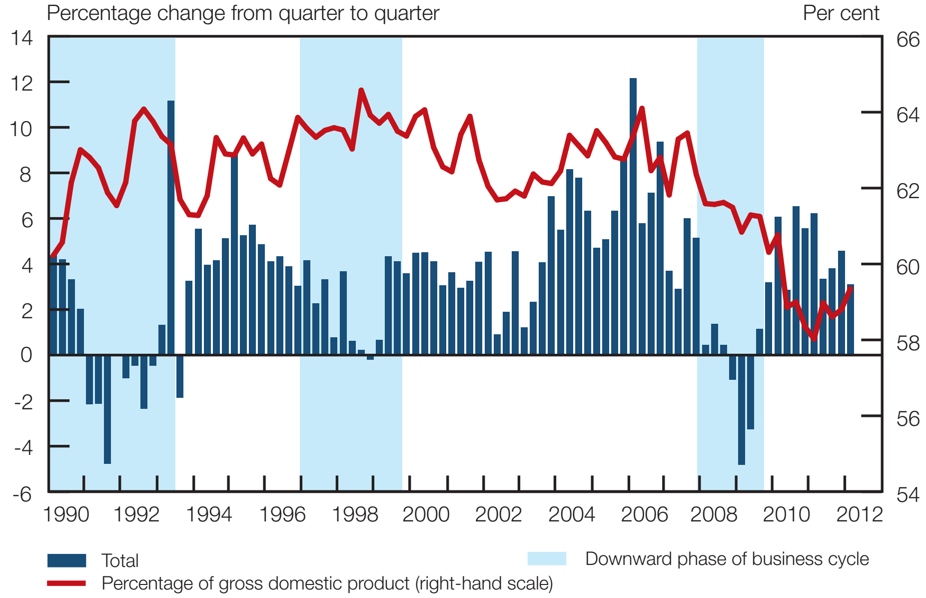
Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2009	2010	2011					2012
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods	-12,6	18,1	19,6	13,5	17,5	16,6	15,7	8,2
Semi-durable goods	-1,9	2,0	12,5	7,8	6,7	7,3	7,0	2,9
Non-durable goods	-1,0	1,3	5,0	2,1	2,0	2,2	2,9	3,5
Services	0,5	3,4	2,9	1,0	1,4	2,9	3,8	1,6
Total	-1,6	3,7	6,2	3,4	3,8	4,6	5,0	3,1

Growth in real spending by households in 2011 was characterised by strong increases in spending on durable and semi-durable goods. Real outlays on non-durable goods and on services accelerated at a moderate pace over the same period. Despite these advances in household consumption expenditure, the ratio of real outlays to gross domestic product has been significantly lower in the current upward phase of the business cycle compared with the preceding two upward phases.

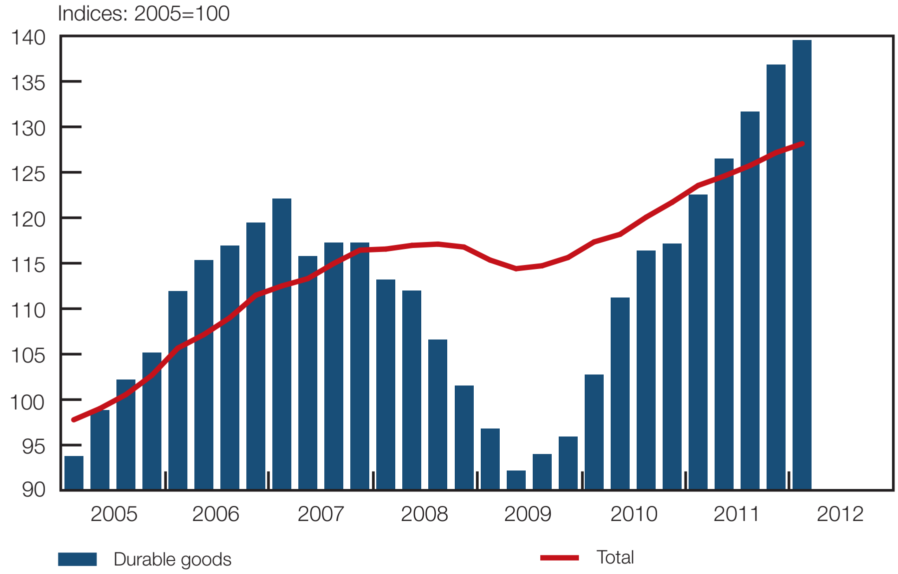
Real final consumption expenditure by households



Seasonally adjusted annualised rates

Growth in real outlays on *durable goods* contributed meaningfully to aggregate consumption expenditure by households in 2011. Following an increase of 18,1 per cent in 2010, growth in real spending on durable goods edged lower to a still buoyant 15,7 per cent in 2011, reflecting double-digit growth rates in spending on all components of durable goods. Expenditure on personal transport equipment, mainly new motor vehicles, accounted for more than 50 per cent of durable purchases over the period. The release of new passenger vehicle models alongside the relatively low interest rate environment and attractive package deals being offered to customers supported sales growth. In addition, households stepped up spending on furniture, household appliances, and computers and related equipment. Growth in real outlays on durable goods tapered off to a single-digit rate in the first quarter of 2012.

Real final consumption expenditure by households



Seasonally adjusted annualised rates

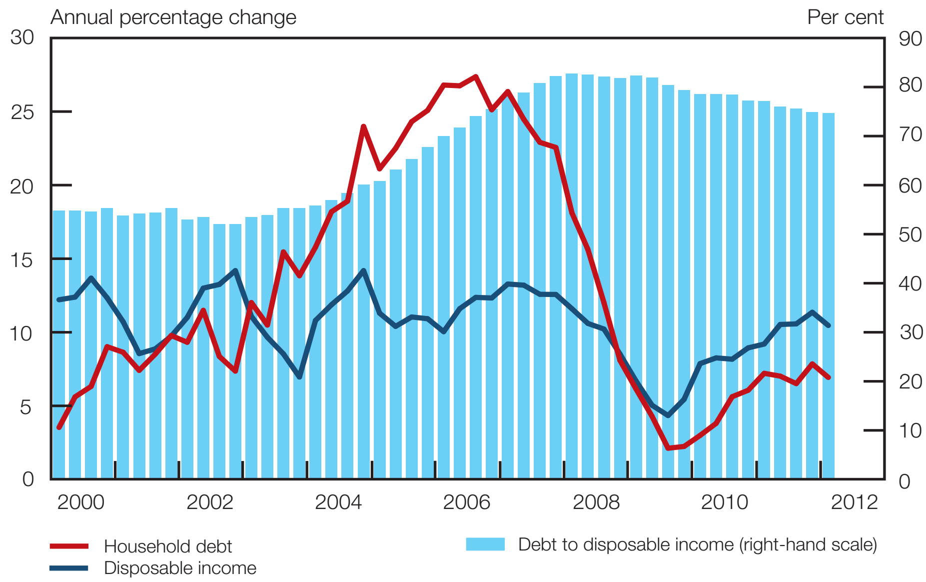
Subsequent to a decline in 2009 and a fairly subdued performance in 2010, buoyant quarter-to-quarter growth in spending on *semi-durable goods* culminated in an annual increase of 7 per cent in 2011. Although increased spending was apparent across all subcategories of semi-durable goods, spending on especially clothing and footwear, and household textiles, furnishings and glassware advanced at a fairly robust pace. Resilient consumer demand supported by an increase in employment numbers probably enticed consumers to replace and upgrade their household textiles and furnishings following three years of relatively difficult economic conditions. In the first quarter of 2012, growth in real spending on semi-durable goods increased at a slower pace.

Being more pliant compared with spending in the other goods categories, real expenditure on *non-durable goods* increased by 1,3 per cent and 2,9 per cent in 2010 and 2011, respectively. This acceleration was evident in spending on all sub-categories of non-durable goods. Underpinned by increases in spending on food, beverages and tobacco products, which constitute more than 65 per cent of this category, real outlays on non-durable products increased further at a rate of 3,5 per cent in the first quarter of 2012.

Growth in real spending by households on *services* edged higher from 3,4 per cent in 2010 to 3,8 per cent in 2011. A higher rate of increase in spending on medical, transport and communication services was partly offset by slower growth in spending on rent and miscellaneous services. The rate of increase in spending on rent slowed to 1,4 per cent in 2011 – the lowest rate of increase since 2003. Over the same period, the pace of increase in foreign tourism receipts slowed partly on account of the high base set at the time of the hosting of the 2010 FIFA World Cup™ tournament. Spending on services by households increased at a slower pace in the first quarter of 2012.

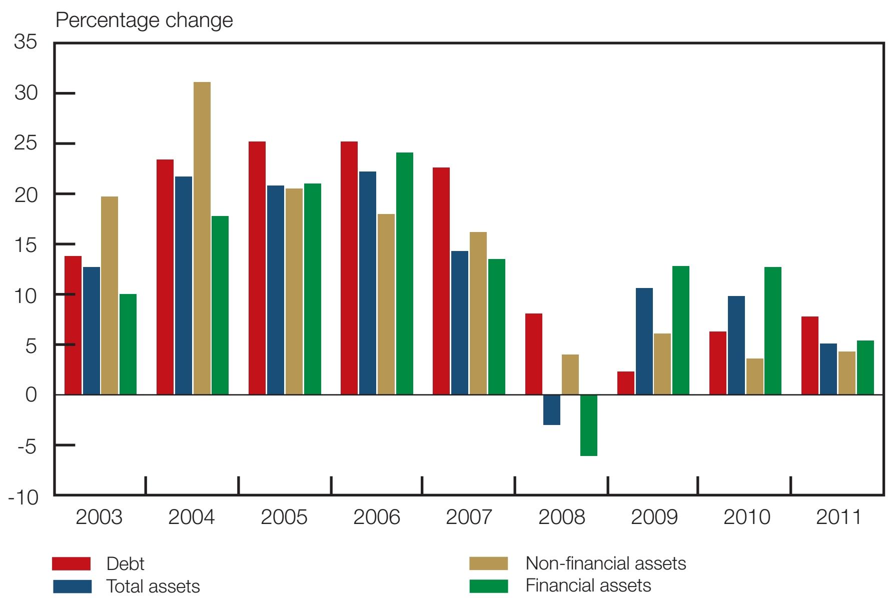
Household spending in 2011 was largely financed by income growth rather than being boosted by credit extension. Average nominal household debt amounted to R1 317 billion in 2011 – 7,2 per cent higher than in 2010. This rate of increase is, however, much lower than the average rate of increase of around 20 per cent between 2003 and 2008. Growth in household disposable income, however, outpaced growth in household debt from the fourth quarter of 2008. Consequently, the ratio of household debt to disposable income receded from an average rate of 78,2 per cent in 2010 to 75,9 per cent in 2011 and 74,7 per cent in the first quarter of 2012. With interest rates remaining unchanged throughout 2011, the debt-service cost of households decreased from 7,8 per cent of disposable income in 2010 to 6,8 per cent in 2011.

Ratio of debt to disposable income



The slower growth in house prices as well as in the value of financial assets in 2011 resulted in a slower pace of increase in the net wealth of the household sector compared with 2010. While the net wealth position of households still appears to be fairly healthy, the overall leverage ratio of households, defined as the ratio of total debt to net wealth, increased from 23,7 per cent at the end of 2010 to 24,4 per cent at the end of 2011.

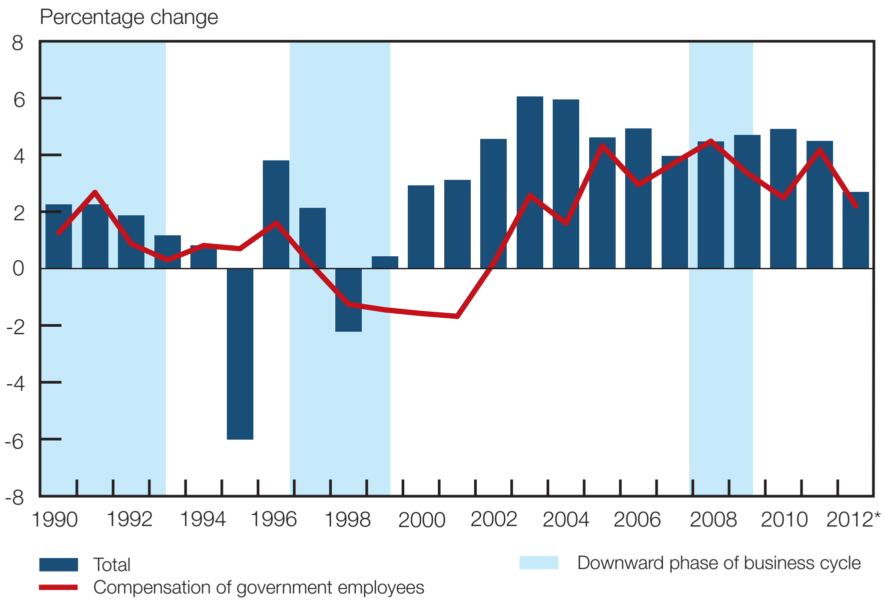
Household debt and asset holdings at year-end



Real final consumption expenditure by general government

Growth in real *final consumption expenditure by general government* moderated from 4,9 per cent in 2010 to 4,5 per cent in 2011. This moderation could mainly be attributed to slower growth in expenditure on non-wage goods and services following the high base set in 2010 with the hosting of the FIFA World Cup™ tournament. By contrast, growth in compensation of employees, accounting for roughly 60 per cent of aggregate government consumption expenditure, accelerated from a real rate of increase of 2,5 per cent in 2010 to 4,2 per cent in 2011. This increase reflected, *inter alia*, additional expenses associated with the 2011 National Census activities and the implementation of the *Improvement of Conditions of Service* during the period. Total real outlays by general government slowed noticeably in the first quarter of 2012, primarily due to the absence of expenditure on armaments procured during the quarter.

Real final consumption expenditure by general government



* First quarter 2012

Seasonally adjusted annualised rates

In the current upward phase of the business cycle that commenced in the fourth quarter of 2009, government expenditure has increased at an average annualised rate of 4,4 per cent (i.e., at a similar rate than in the previous upward phase). The relatively firm growth in government expenditure during the past two and a half years mainly reflected strong increases in spending on education and health services. Apart from structurally devoting more resources to basic education and health, temporary increases in spending could be ascribed to the hosting of the 2010 FIFA World Cup™ tournament as well as the national, provincial and local elections that took place over this period. As a result of these developments, the ratio of final consumption expenditure by general government to gross domestic product increased from an average of 19 per cent in the previous upward phase in the business cycle to about 22 per cent in the current phase.

Real gross fixed capital formation

Capital formation plays a key role in the process of economic development, adding to aggregate demand in the economy at the time that capital spending takes place, but also adding to future aggregate supply as the expanded capital stock bolsters the production capacity of the economy. Infrastructure bottlenecks are currently recognised as binding constraints inhibiting South Africa's economic progress, and removing them through appropriate capital projects has been targeted by government as a key priority.

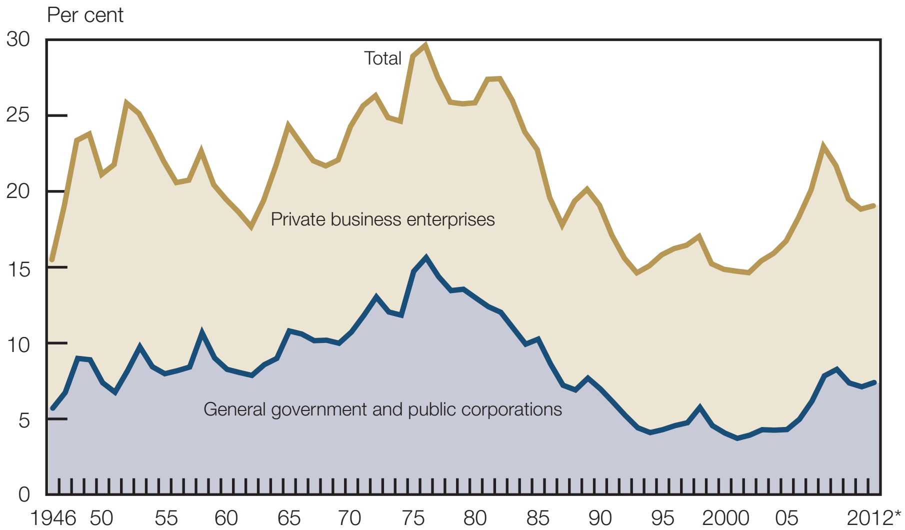
Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Component	2009	2010	2011					2012
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Private business enterprises	-9,6	-0,8	4,9	5,3	5,4	6,2	5,3	1,8
Public corporations	22,2	1,8	6,2	6,0	9,0	9,6	4,2	13,1
General government	-3,4	-9,5	-0,5	1,7	3,4	7,8	0,8	9,3
Total	-3,2	-1,6	4,4	5,0	5,9	7,2	4,4	5,3

The steady increase in *real gross fixed capital formation* from 2002 was abruptly halted as the worsening of the global financial crisis in 2008 visibly filtered through to aggregate capital investment from the first quarter of 2009. Real fixed capital formation contracted throughout 2009, reducing the ratio of capital expenditure to gross domestic product from 24,6 per cent in the final quarter of 2008 to levels below 20 per cent from the second quarter of 2010 to date. The stagnant and fairly subdued ratio reflected the continued existence of surplus capacity in most sectors of the economy – capital formation is often only ignited when actual output approaches full capacity, so that capital expenditure tends to be a lagging economic indicator.

Ratio of gross fixed capital formation to gross domestic product

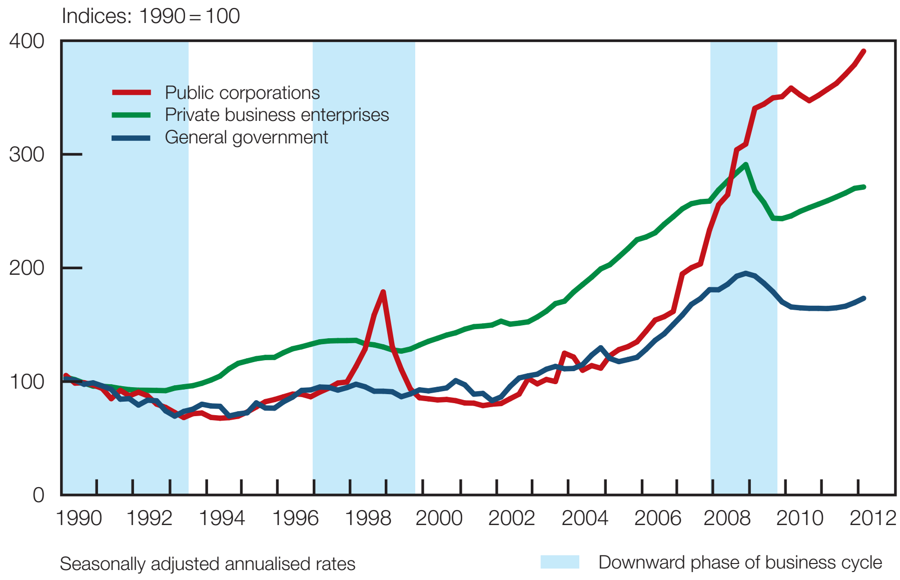


* First quarter 2012

Following two successive years of annual decline, real gross fixed capital formation increased by 4,4 per cent in 2011. Capital spending by private business enterprises trended higher, albeit off a low base, but the recovery in capital expenditure was also underpinned by improved activity of public corporations and general government over the period. The momentum in 2011 was carried forward to the first quarter of 2012, mainly by public corporations and general government, with real fixed capital formation registering an annualised rate of increase of 5,3 per cent during this period.

Real capital outlays by *private business enterprises* increased at an annual rate of 5,3 per cent in 2011, following contractions in the preceding two years. The increase in capital spending in 2011 extended to most sectors of the economy, but was most prominent in the agricultural, mining and manufacturing sectors. However, the steady pace of improvement in capital expenditure by private business enterprises throughout 2011 slowed in the first quarter of 2012.

Real gross fixed capital formation by institutional sector



Increased capital spending on tractors and combine harvesters by farmers could be attributed to favourable commodity prices and sizeable crops in 2011. Following a contraction in real mining investment in 2010, capital spending involving both existing and new projects recovered meaningfully in 2011, partly influenced by high commodity prices. Capital outlays in coal mining increased in 2011 due to the construction of coal treatment plants, storage and transport facilities in preparation for increased demand for coal.

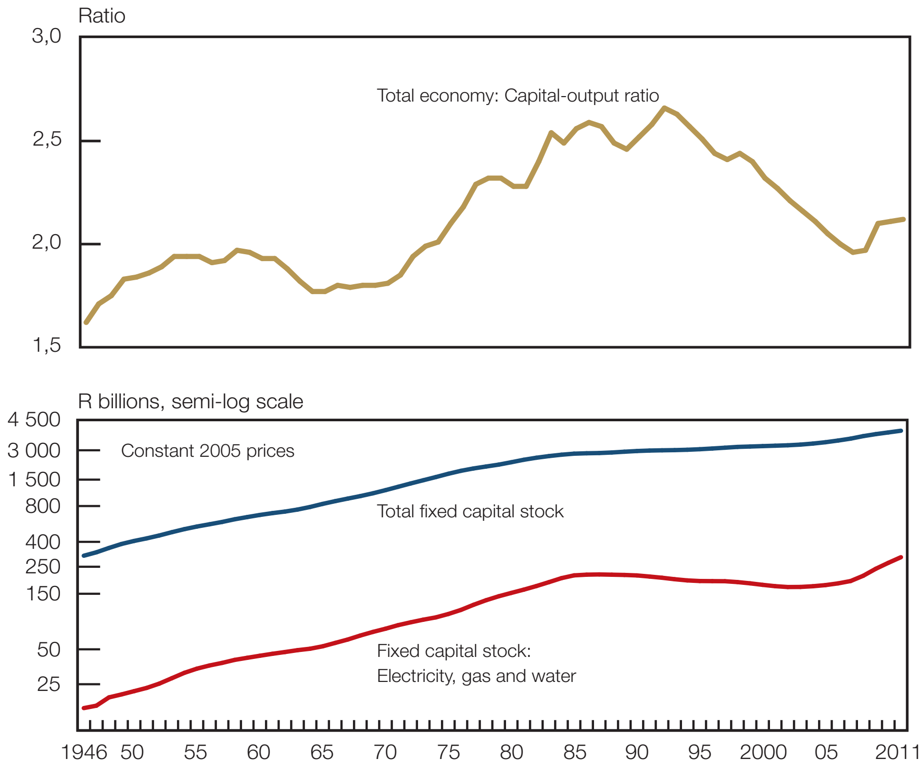
Subdued demand for manufactured products contributed to relatively low levels of capacity utilisation and lacklustre capital expenditure. During 2011 growth in gross fixed capital formation in the manufacturing sector continued with its positive trend and contributed 2,7 percentage points to total growth in capital investment by private business enterprises over the period. This brisk increase was mirrored in strong imports of machinery and equipment, with several new projects being initiated by manufacturers. Capital outlays in the transport and communication sector increased firmly as logistics companies increased capacity to take advantage of the higher demand for the transportation of commodities. Mobile cellular service providers continued to invest in the expansion of their networks to cater for the increasing number and sophistication of subscribers.

All the major *public corporations* continued to step up real capital investment throughout the calendar year 2011. Eskom continued with the construction of its Medupi and Kusile power stations in the Limpopo and Mpumalanga provinces respectively. Capital expenditure by Transnet continued, covering its freight, rail, port and pipeline operations. Transnet's world-class multi-product pipeline from Durban to Heidelberg came into operation during 2011, with the full project including terminals expected to be completed by late 2013. The South African National Roads Agency (SANRAL) continued with its road network improvements and upgrades across most provinces.

The contraction in real capital spending by *general government* recorded in 2009 and 2010 was reversed in 2011 when growth in real gross fixed capital formation by general government accelerated to 0,8 per cent. This increase was consistent with government's policy of spending on infrastructure in order to support economic growth and job creation. The key driver of capital investment by general government in 2011 was increased investment at provincial level, mainly focused on infrastructure improvement underpinning the provision of health and educational services.

The accompanying graph illustrates the deceleration in the tempo of increase in South Africa's real fixed capital stock since the early 1980s. In the case of the electricity, gas and water sector there was in fact a contraction in the capital stock following the mid-1980s, when major power stations were completed. However, most recently the drive to add electricity generation capacity has resulted in a renewed upward trend in the sector's capital stock. The operational capital stock – that which actually produces services – lags the actual capital stock because significant capital outlays over a lengthy time horizon are required before the first electricity can flow from a new power station.

Capital stock and capital-output ratio



South Africa's capital-output ratio reached a peak in the 1980s, raised by capital-intensive projects related to power generation and strategic self-sufficiency, and an even higher peak in the early 1990s when output fell back under recessionary conditions. Since 1993 the ratio has fallen back notably, only to turn up most recently with the current set of initiatives to raise capital formation.

Change in inventories

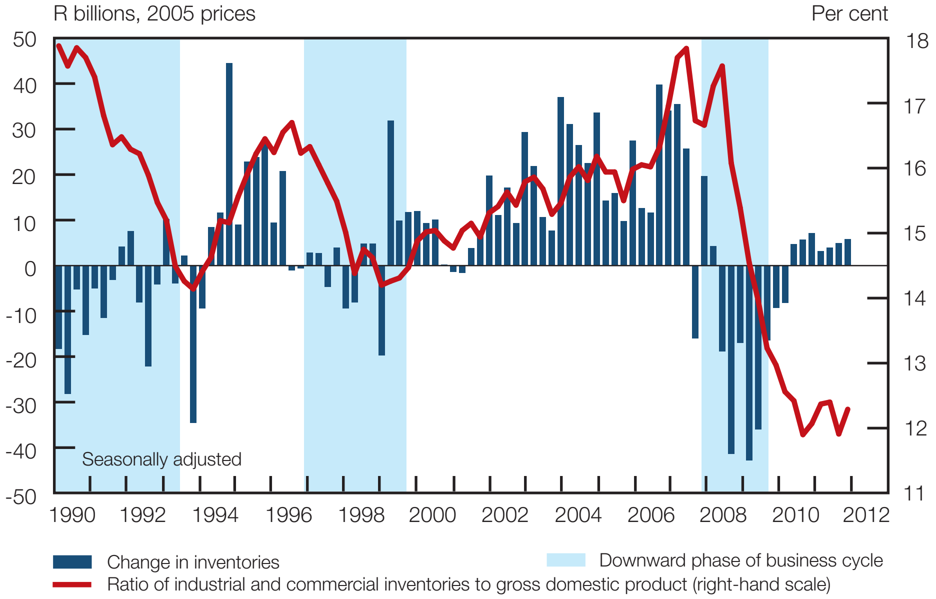
Following sizeable contractions during the recent downward phase in the business cycle and first three quarters of the current upward phase, *real inventory investment* increased continuously since the third quarter of 2010.

Inventory holdings were reduced by R1,8 billion (at 2005 prices) in 2010, but this made room for accumulation to the amount of R4,8 billion in 2011. This was largely due to a strong build-up of inventories in the manufacturing sector while stocks in the mining, commerce and services sectors declined. A steady increase of R5,9 billion in inventory levels was recorded in the first quarter of 2012.

After three consecutive years of depletion of inventories in the manufacturing sector, an increase in real inventory holdings in this sector made a significant contribution to the build-up of total inventories in 2011. Despite a slower rate of increase in manufacturing production over this period, the value of imported manufactured products exceeded that of exports, contributing to the accumulation of stock in the manufacturing sector. Aggregate inventory investment contributed 0,3 of a percentage point to growth in aggregate real gross domestic expenditure in 2011.

Despite rising inventory holdings in 2011, the ratio of industrial and commercial inventories to non-agricultural gross domestic product receded from 12,4 per cent in 2010 to 12,2 per cent in 2011. Consistent with increased production of manufactured goods, this ratio increased marginally to 12,3 per cent in the first quarter of 2012. In a historical context these values remained quite low, pointing at structural improvements in inventory management over time as well as the increasing share of services rather than goods in overall gross domestic product.

Change in real inventories



Factor income

Measured over one year, growth in *total nominal factor income* remained broadly unchanged at 10,9 per cent and 10,8 per cent in 2010 and 2011 respectively. This slight deceleration in nominal factor income could be explained entirely by slower growth in the compensation of employees. During the first quarter of 2012 factor income growth continued to decelerate to a year-on-year rate of 9,4 per cent.

The year-on-year rate of increase in *total compensation of employees* decelerated from 11,5 per cent in 2010 to 9,6 per cent in 2011, consistent with the moderation in average wage settlements in 2011. Although the deceleration was evident in almost all sectors of the economy, it was more prominent in those sectors where employment levels fell during the course of the year. Consequently, the share of compensation of employees in total factor income decreased from 50,6 per cent in 2010 to 50,1 per cent in 2011. Measured over a year, growth in compensation of employees moderated further to 7,6 per cent in the first quarter of 2012.

By contrast, the rate of increase in aggregate *gross operating surpluses* accelerated from 10,2 per cent in 2010 to 12 per cent in 2011. While most sectors experienced favourable gains in gross operating surpluses, it was most pronounced in the agricultural and manufacturing sectors of the economy. On the contrary, the increase in operating surpluses in the construction sector decelerated due to the high level of competition, low profit margins and the reduced appetite for residential and non-residential market activity. Although global economic conditions remained fragile in 2011, impacting negatively on South Africa's export performance, domestic demand improved, raising the gross operating surpluses of business enterprises. However, growth in operating surpluses started to taper off from the fourth quarter of 2011. This moderation could be attributed to lower domestic demand over the period.

Gross saving

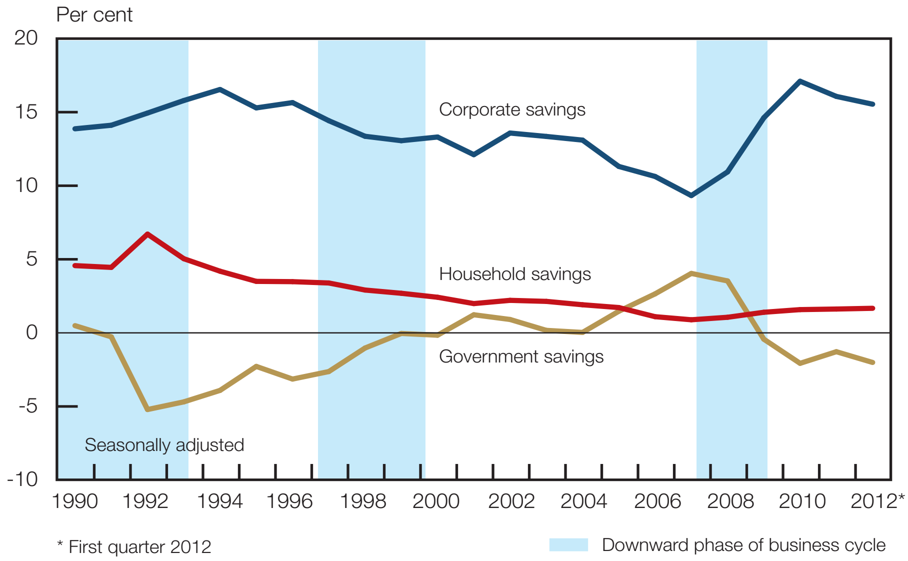
The *national savings ratio* as measured by the ratio of gross saving to gross domestic product receded from 16,6 per cent in 2010 to 16,4 per cent in 2011 and further to 15,2 per cent in the first quarter of 2012. The deterioration could largely be ascribed to the weaker saving performance of the corporate sector. The contribution by foreign finance towards financing gross capital formation increased from 14,7 per cent in 2010 to 16,8 per cent in 2011 and then surged to 24,4 per cent in the first quarter of 2012. The relatively lower national saving ratio in the first quarter of 2012 indicated that South Africa to a larger extent had to rely on foreign saving to finance gross capital formation, as indicated by the widening of the current-account deficit to 4,9 per cent of gross domestic product in the first quarter of 2012.

South Africa's domestic savings ratio at 16,1 per cent of gross domestic product in the current upward phase is somewhat higher than the average ratio of 15,2 per cent recorded during the previous economic upward phase that commenced in September 1999 lasting up to November 2007.

The ongoing recovery in the domestic economy in 2010 yielded strong growth in the operating surpluses of incorporated business enterprises, contributing to an improvement in the *corporate* savings ratio to 17,1 per cent of gross domestic product. Increased dividend and tax payments in 2011, however, caused the savings ratio of corporates to decrease to 16,1 per cent. During the first quarter of 2012, weaker global demand gave rise to a moderation in operating surpluses, resulting in a further decline in the savings ratio to 15,5 per cent.

General government dissaved in 2009 following eight consecutive years of increased saving. Dissaving by general government as a ratio of gross domestic product, however, moderated from 2,1 per cent in 2010 to 1,3 per cent in 2011. Government income was boosted through improved tax compliance while major expenditure items – notably current transfers to households, including social benefit payments and subsidies – recorded strong growth in 2011. Government continued to address poverty alleviation through social benefit payments while expanding the tax base to sustain these payments. In the light of continued dissaving by government, government acknowledged that it needs to monitor public finance trends carefully, attend to cash management controls, improve procurement processes and continue with training of staff involved in public finance management, to be able to sustain its countercyclical fiscal stance.

Gross saving as a percentage of gross domestic product



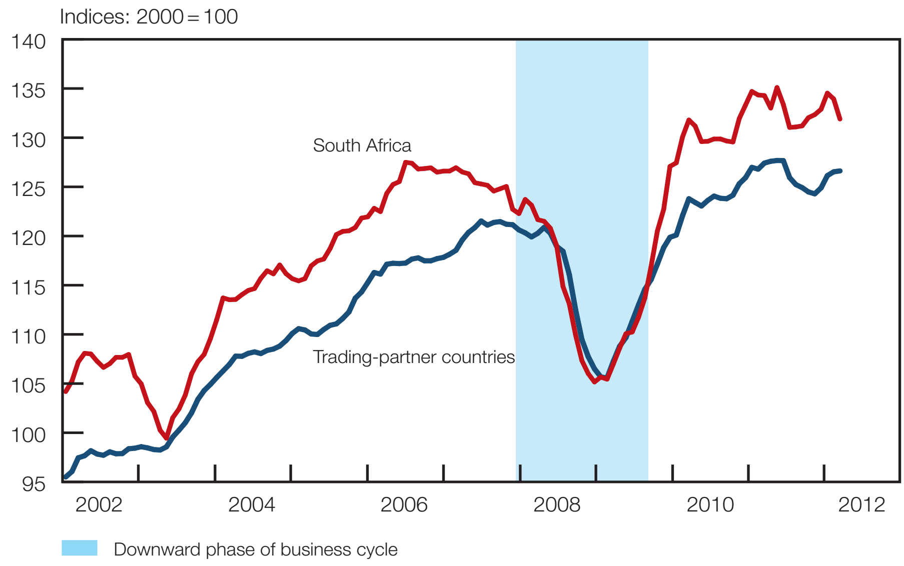
After maintaining a saving ratio of 1,6 per cent in both 2010 and 2011, the *household* savings ratio edged higher to 1,7 per cent of gross domestic product in the first quarter of 2012. In the first quarter of 2012, disposable income grew at a faster pace than spending by households, consequently leading to the higher savings ratio.

Business cycle developments

The current upward phase in the South African business cycle started in September 2009. Similar to the previous downward phase – from December 2007 to August 2009 – the domestic economic recovery has been well synchronised with the recovery in the global economy. The accompanying graph illustrates the high degree of co-movement between the composite *leading* business cycle indicator for the South African economy and a composite leading trading-partner indicator,[2] particularly from 2008 onwards. Since 2010, the South African composite leading business cycle indicator has followed a slight upward trend, but has nevertheless oscillated within a fairly narrow band – consistent with the slow and uneven recovery in the domestic economy, and indicative of the prevailing domestic and international uncertainty.

2 Comprising composite leading business cycle indicators for the United States, the United Kingdom, Germany, Italy, France, Japan, Taiwan and the Republic of Korea, weighted according to South African exports to these countries.

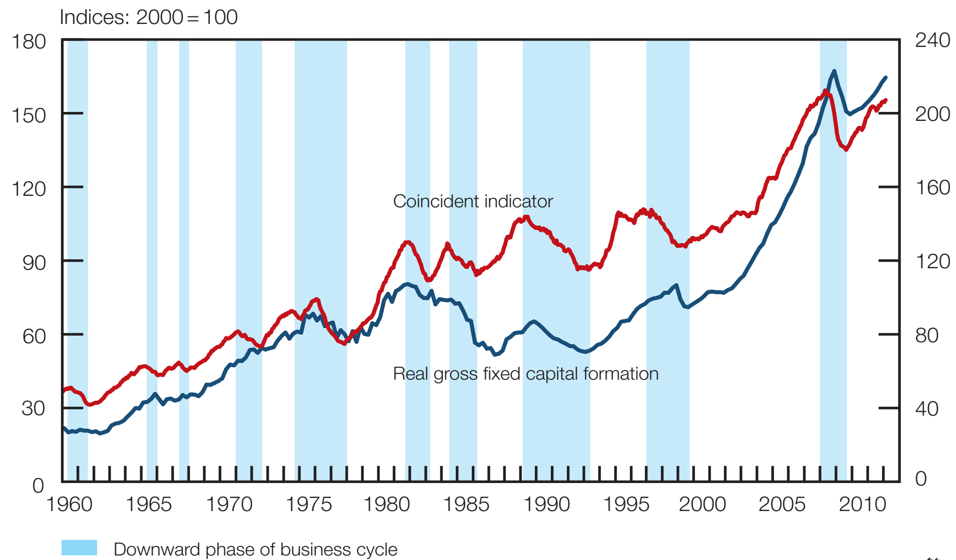
Composite leading business cycle indicators



The composite *coincident* business cycle indicator reached a lower turning point in August 2009, before embarking on an upward trend. However, during the second half of 2011 and the opening months of 2012, the rate of increase in the coincident indicator moderated somewhat.

A fairly good correlation exists between the composite coincident business cycle indicator and real gross fixed capital formation in the South African economy, albeit with turning points in the coincident indicator generally preceding those in capital formation.

Composite coincident business cycle indicator and real gross fixed capital formation



During the 1980s and the early part of the 1990s, gross fixed capital formation displayed a declining trend, while the trend in the coincident indicator was slowly rising. Subsequently, gross fixed capital formation increased notably between 2002 and 2008, with the coincident indicator also picking up markedly over this period.

Employment

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

During the most recent downward phase in the South African business cycle, the formal non-agricultural sector of the economy shed an estimated 384 000 jobs, according to the *Quarterly Employment Statistics (QES)* survey conducted by Statistics South Africa (Stats SA).[3] Since the start of the subsequent upward phase in the employment cycle, an estimated 249 000 formal-sector jobs have been reclaimed from the second quarter of 2010 to the fourth quarter of 2011, with an additional 49 000 jobs being reclaimed in the first quarter of 2012. Encouragingly, formal non-agricultural employment increased by 2,2 per cent in 2011, following employment losses of 3,0 per cent and 0,7 per cent in 2009 and 2010 respectively.

Following two years of contraction in employment, the private sector expanded its staff complement by 1,4 per cent in 2011. With the exception of the manufacturing and the gold-mining sectors, all other sectors registered employment gains in 2011. Acting in a counter-cyclical manner, the public sector increased its employment levels throughout the recent downward phase in the business cycle as well as during the subsequent economic recovery. In fact, public-sector employment growth accelerated to 4,6 per cent in 2011, the highest rate of growth since 1975.

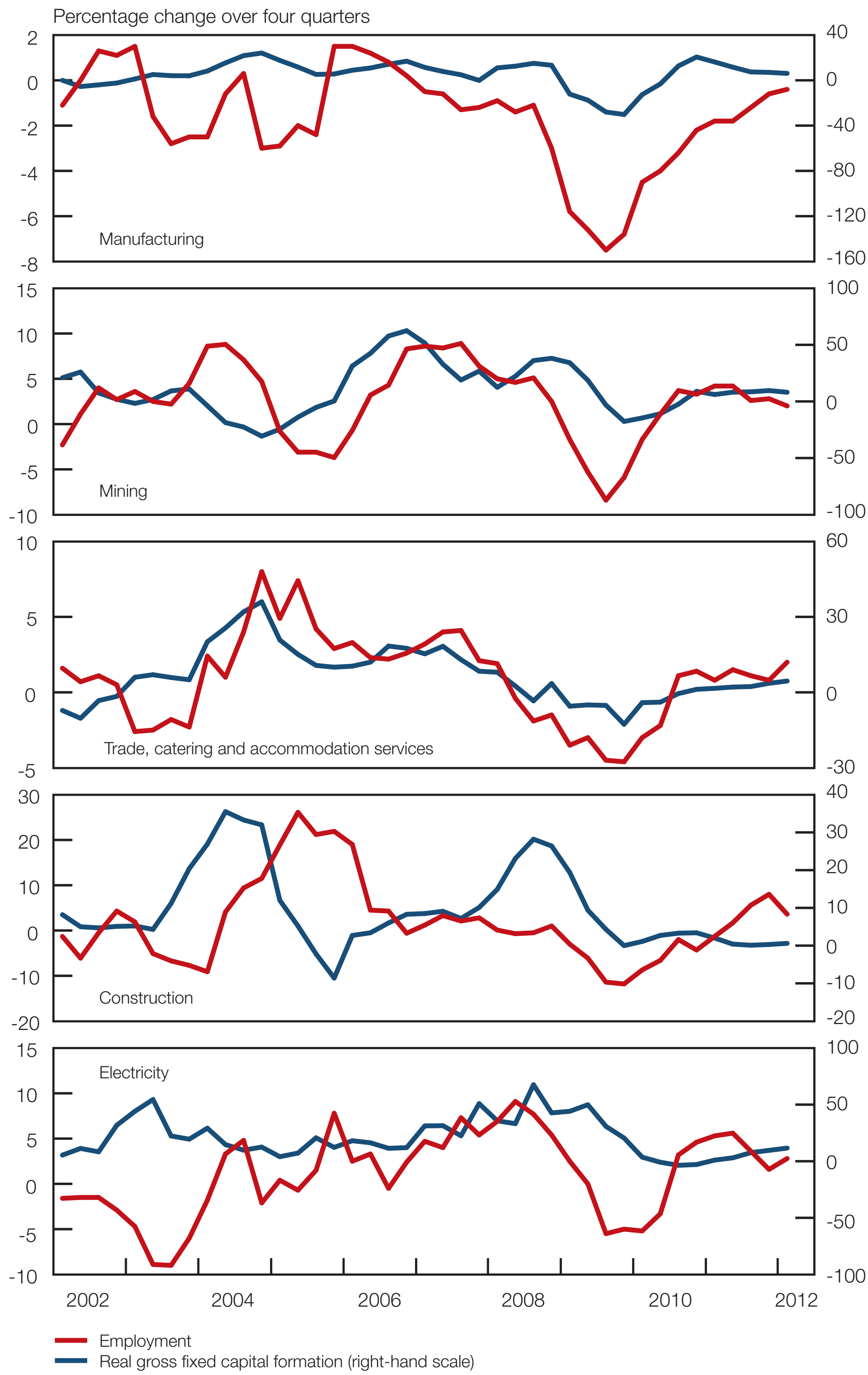
The graph on the next page depicts year-on-year growth in total formal non-agricultural employment and gross fixed capital formation in selected sectors of the South African economy. In most sectors these two indicators correlate fairly well, emphasising the need for continued capital investment to enhance employment creation.

The manufacturing sector has been shedding jobs almost uninterruptedly from the middle of the 1990s to the second quarter of 2011, with an estimated 30 per cent of the manufacturing workforce being dismissed over this period. These job losses occurred despite steady increases in gross fixed capital formation in the manufacturing sector throughout most of this period, as the sector continued to mechanise in an effort to remain competitive. More recently, employment in the manufacturing sector increased marginally at annualised rates of 1,6 per cent and 0,4 per cent in the fourth quarter of 2011 and first quarter of 2012 respectively. However, employment growth in the sector remains very hesitant, with the employment sub-index of the Kagiso PMI remaining below the neutral level of 50 for 15 consecutive months to May 2012. In addition, the manufacturing sector remains susceptible to renewed weakness in the global economy, particularly in the euro area, through possible declines in exports.

The dismal employment performance by the manufacturing sector prompted government to step up various growth initiatives in an effort to promote job creation. In this regard, government's Industrial Policy Action Plan (IPAP) has been implemented in stages since 2007 and is gaining momentum. In April 2011 the Minister of Trade and Industry launched the new IPAP2 for the period 2011/12 to 2013/14 involving a R5,8 billion Manufacturing Competitiveness Enhancement Programme (MCEP) – a grant and loan programme aimed at growing and expanding South Africa's manufacturing sector over the next three years. The initiative aims to support relatively labour-intensive and value-adding manufacturing firms that have been adversely affected by the global financial crisis.

Supported in part by the rise in international commodity prices to the third quarter of 2011, employment growth in the mining sector more than doubled from an annual average rate of 1,6 per cent in 2010 to a rate of 3,4 per cent in 2011. Employment in the non-gold mining sector increased at a brisk pace of 7,7 per cent in 2011, while labour paring continued for a fourth consecutive year in the gold-mining sector, at a rate of 6,0 per cent. Increases in international commodity prices have tapered off since the fourth quarter of 2010 on account of fears that global economic growth was slowing. Subsequently, employment growth in the mining sector decelerated notably from a year-on-year rate of 4,2 per cent in the second quarter of 2011 to 2,0 per cent in the year to the first quarter of 2012. The mining sector has been plagued by widespread industrial action and safety-related work stoppages since the middle of 2011. Throughout 2011 the mining sector was negatively affected by the uncertainty surrounding the mining nationalisation debate. However, the uncertainty has subsided somewhat, as government indicated that instead of mining nationalisation, changes to mining taxation would be considered.

Growth in employment and real gross fixed capital formation



Following a two-year period of brisk employment growth, employment levels contracted marginally in the electricity-generation sector in 2009 and 2010. However, this sector resumed the expansion of its workforce in 2011, with employment increasing by 4,0 per cent; as the pace of capital spending in the sector accelerated throughout the year. As a key element of Eskom's sustained capacity expansion programme that started in 2008, Medupi power station is expected to start generating electricity in 2013.

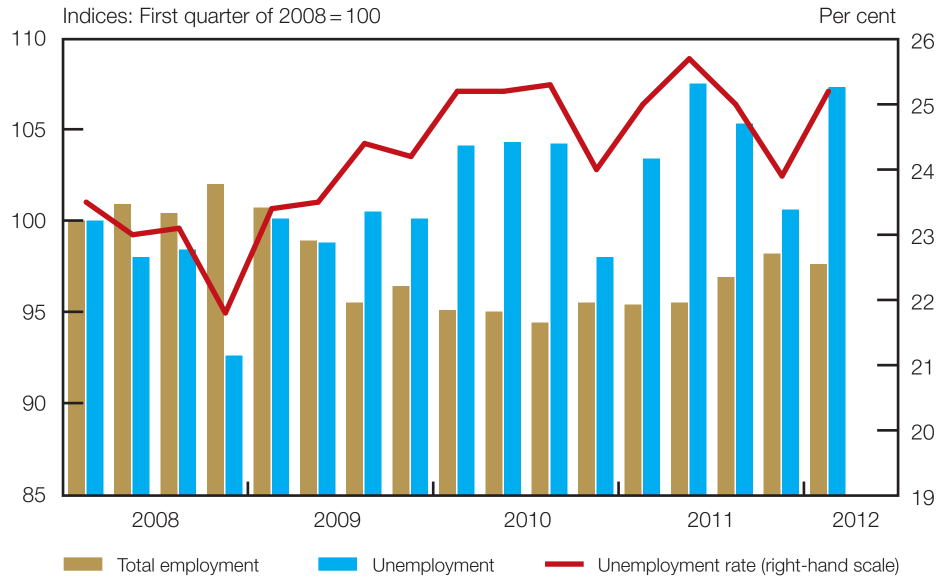
Following three years of labour paring, employment in the trade, catering and accommodation services sector increased by 1,1 per cent on an annual average basis in 2011, while simultaneously employment levels in the finance, insurance, real-estate and business services sector increased by 2,5 per cent. Robust growth in household consumption expenditure, coupled with a gradual acceleration in private-sector credit extension, supported employment creation in these two sectors in 2011 alongside increases in employment by labour brokers which form part of the business services sector.

Subsequent to the 2008–2009 economic recession, the construction sector continued to shed employment opportunities up to the fourth quarter of 2010, before registering notable increases in employment in the first three quarters of 2011. However, only a slight increase in employment was recorded in the fourth quarter of 2011; the construction sector increased its employment levels by, on average, 3,5 per cent in 2011. Although increased construction activity was evident in a number of sectors, it resulted primarily from existing or ongoing projects:

- In the public sector, work by Transnet (on the expansion of port facilities and the new multi-product pipeline between Durban and Gauteng) and by Eskom (on the Medupi, Kusile and Ingula power station projects) continued to support expenditure by public corporations. As for government, spending on roads, water and waste-water management projects remained dominant, especially at municipal level.
- Construction work in the private sector emanated mainly from the mining sector, on account of relatively high commodity prices during most of the year, and in preparation for an expected increase in coal demand once Eskom's new power stations become operational.

The hesitant nature of the recovery in employment is corroborated by Stats SA's household-based *Quarterly Labour Force Survey (QLFS).* According to this survey – which apart from formal-sector employment also includes employment in the agriculture and informal sectors – an estimated 1 052 000 jobs were lost between the fourth quarter of 2008 and the third quarter of 2010. By the first quarter of 2012, only 448 000 of these employment opportunities were regained. Disappointingly, the number of discouraged work-seekers has been increasing continuously since the inception of the *QLFS* in 2008. The number of discouraged work-seekers increased by 240 000 between 2010 and 2011, notwithstanding the fact that the year-on-year pace of increase in the number of discouraged work-seekers moderated gradually from the first quarter of 2010 to the first quarter of 2012.

Total employment, unemployment and the official unemployment rate



Source: *Quarterly Labour Force Survey*, Statistics South Africa

South Africa's official unemployment rate rose from a low of 21,8 per cent in the fourth quarter of 2008 to 25,7 per cent in the second quarter of 2011, before declining to 23,9 per cent in the fourth quarter. Owing to seasonal variations in employment in many sectors of the economy, it is advisable to analyse changes in the unemployment rate over four quarters. In this regard the official unemployment rate increased marginally from 25,0 per cent in the first quarter of 2011 to 25,2 per cent in the first quarter of 2012. The number of unemployed increased by an estimated 162 000 people over the same period, mostly driven by unskilled people and new entrants to the job market.

Key labour market indicators

Thousands

	Average for 2009	Average for 2010	Average for 2011	Mar 2012	Actual change 2010 on 2009	Actual change 2011 on 2010
Population: 15–64 years	31 494	32 007	32 494	32 786	513	487
Labour force	17 670	17 393	17 662	17 948	-277	269
Employed	13 456	13 061	13 265	13 422	-395	204
Formal sector (non-agricultural)	9 453	9 123	9 367	9 509	-330	244
Informal sector (non-agricultural)	2 129	2 159	2 172	2 106	30	13
Agriculture	687	639	614	656	-48	-25
Private households	1 187	1 140	1 113	1 151	-47	-27
Unemployed	4 215	4 332	4 397	4 526	117	65
New entrants to the job market	1 714	1 840	1 939	1 993	126	99
Job losers	1 441	1 393	1 328	1 400	-48	-65
Other	1 060	1 099	1 131	1 133	39	32
Not economically active	13 824	14 614	14 832	14 838	790	218
Discouraged work-seekers	1 532	1 998	2 237	2 335	466	239
Other	12 292	12 617	12 595	12 503	325	-22
Rates	Per cent				Percentage points	
Unemployment rate	23,9	24,9	24,9	25,2	1,0	0,0
Youth unemployment (15–24 age group)	48,1	50,5	49,8	51,6	2,4	-0,7
Employed/Population ratio (absorption rate)	43,7	40,9	40,8	40,9	-2,8	-0,1
Labour force participation rate	57,1	54,3	54,4	54,7	-2,8	0,1

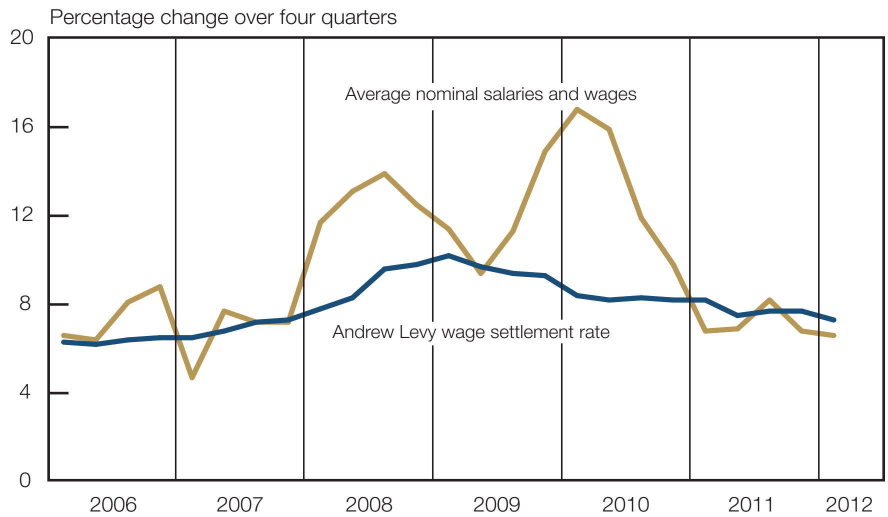
Source: Statistics South Africa, *Quarterly Labour Force Survey*
Numbers may not add up to totals due to rounding

Similar to the marginal increase in domestic unemployment, global unemployment remained stubbornly high in 2011. According to the *Global Employment Trends 2012* report of the International Labour Organisation (ILO), global unemployment remained elevated for the fourth consecutive year in 2011, with more than 197 million people being unemployed around the world. The ILO estimated that the global unemployment rate remained at around 6,0 per cent in 2011, despite global economic growth of 4,0 per cent. Of particular concern is the high global youth unemployment rate (people aged between 15 and 24 years) which, at 12,7 per cent in 2011, remains a full percentage point above its level before the start of the global financial crisis.

Labour cost and productivity

Growth in nominal remuneration per worker in the formal non-agricultural sector of the economy decelerated markedly from 13,5 per cent in 2010 to 7,2 per cent in 2011. Headline consumer price inflation, however, accelerated from 4,3 per cent to 5,0 per cent over the same period, reducing the real take-home remuneration of those employed in the non-agricultural formal sector of the economy. Nominal wage growth moderated notably in both the public and private sectors, amounting to 7,1 per cent and 6,7 per cent respectively in 2011. In the private sector average wage increases remained within the inflation target range in the finance, insurance, real-estate and business services sector (5,1 per cent), the construction sector (4,9 per cent), and the trade, catering and accommodation services sector (6,0 per cent). Despite moderating in 2011, increases in remuneration per worker nevertheless exceeded the upper limit of the inflation target range in the community, social and personal services sector (6,6 per cent), the private transport, storage and communication sector (8,7 per cent), the manufacturing sector (8,9 per cent) and the mining sector (13,6 per cent).

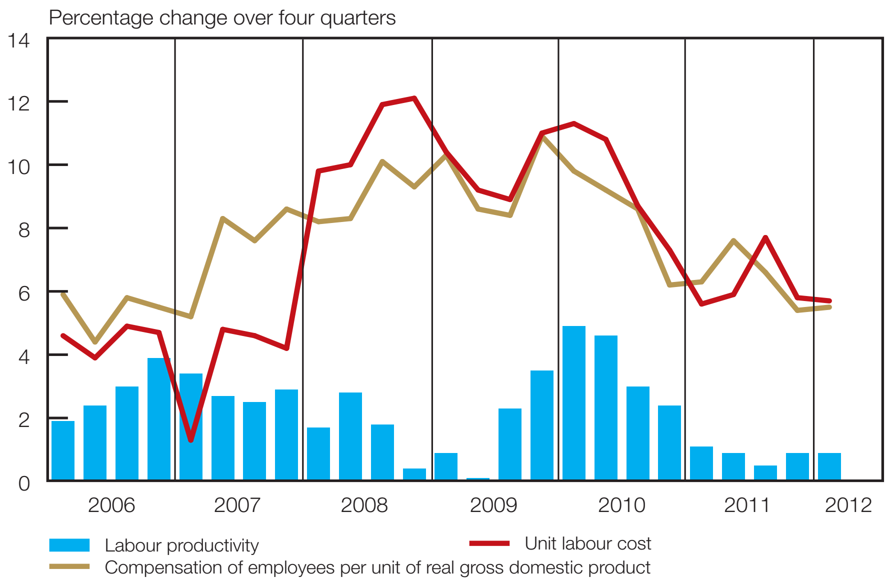
Nominal remuneration per worker and wage settlement rates



According to Andrew Levy Employment Publications, wage settlement rates in collective bargaining agreements moderated from 8,2 per cent in 2010 to 7,7 per cent in 2011 and further to 7,3 per cent in the first quarter of 2012. The average number of working days lost due to strike action amounted to 6,2 million in 2011, compared with 14,6 million recorded in 2010, with the majority of strike triggers being related to wages.

The rate of increase in labour productivity in the formal non-agricultural sector decelerated from 3,7 per cent in 2010 to 0,9 per cent in 2011, as the acceleration in employment growth exceeded the marginal acceleration in output growth in 2011. Similarly, labour productivity growth in the manufacturing sector moderated from 8,7 per cent in 2010 to 3,9 per cent in 2011, as output growth slowed while employment contracted at a slower pace in the manufacturing sector.

Labour productivity and labour cost

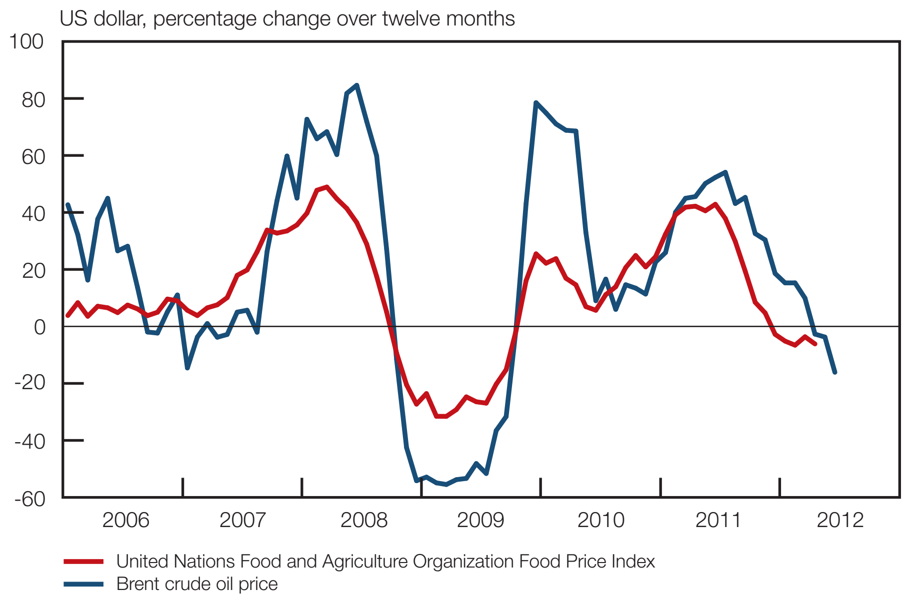


Despite the moderation in labour productivity, the marked deceleration in remuneration growth resulted in a deceleration in nominal unit labour cost from 9,5 per cent in 2010 to 6,3 per cent in 2011 – the lowest rate of increase in four years. The slowdown in unit labour cost growth should assist in mitigating inflationary pressures in the economy going forward.

Prices

Despite the fairly hesitant global economic recovery and persistently large output gaps, international inflationary pressures intensified towards the end of 2010, with notable increases registered in especially international food and crude oil prices. Price increases in both these components, however, eased markedly from the second half of 2011 in response to a moderation in global economic activity, particularly in Europe. As expected, the notable rise in international food and crude oil prices since the middle of 2010 spilled over to domestic consumer price inflation, which accelerated steadily from October 2010, notwithstanding relatively sluggish domestic output growth and excess production capacity.

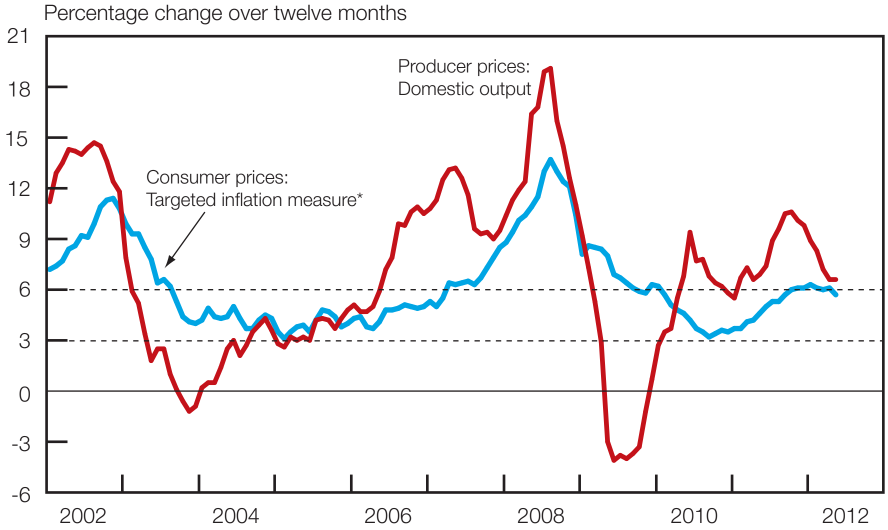
International food and oil price inflation



The twelve-month rate of increase in the headline producer price index decelerated to 5,5 per cent in January 2011 on account of a slower pace of increase in the prices of mining commodities and an appreciation in the exchange value of the rand. Producer price inflation thereafter accelerated notably to peak at 10,6 per cent in October 2011, primarily as a result of the adverse impact of rising international commodity prices and the depreciation in the exchange value of the rand, which caused price pressures to intensify in almost all the categories of the producer price index. Year-on-year producer price inflation subsequently moderated to a rate of 6,6 per cent in April and May 2012, reflecting a marked moderation in price increases in the categories for mining and quarrying, and for agricultural products. The pattern observed in South Africa was not unique: the year-on-year rate of change in the composite foreign wholesale price index of South Africa's main trading-partner countries accelerated to 6,6 per cent in July 2011, before moderating in ensuing months to 1,7 per cent in April 2012.

Producer price inflation for imported goods accelerated from a low year-on-year rate of 0,5 per cent in November 2010 to 16,4 per cent in December 2011, before moderating to 8,3 per cent in May 2012. The acceleration primarily emanated from notable increases in the prices of imported mining commodities, which amounted to a year-on-year rate of 51,2 per cent in November 2011 – marked increases in international crude oil prices were exacerbated by the depreciation of the rand over the period. In line with overall producer price inflation, the pace of the increase in the prices of imported mining commodities moderated in the opening months of 2012, underpinned by the appreciation in the exchange rate of the rand. At the same time, year-on-year producer price inflation for imported agricultural commodities changed to deflation from December 2011 onwards.

Prices

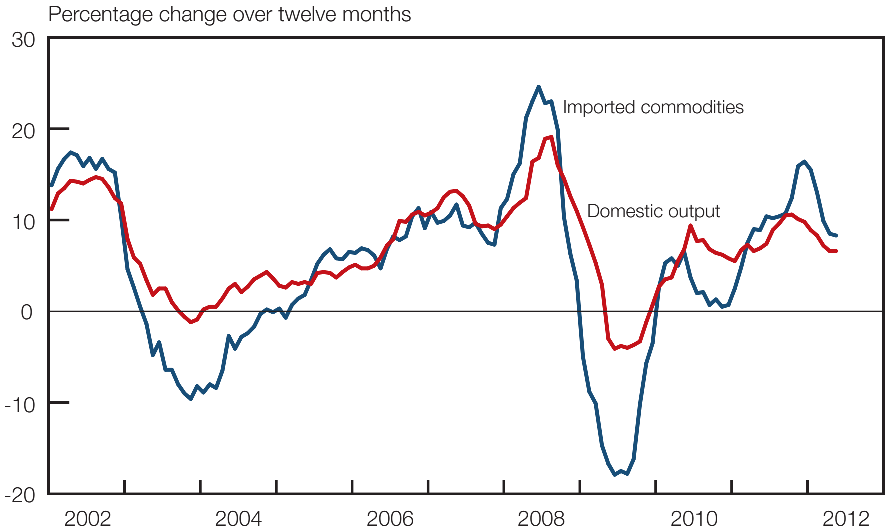


* CPIX up to December 2008; CPI for all urban areas from January 2009 onwards

The price of producer food with a weight of 9,76 per cent in the producer basket moved from rates of deflation to inflation in February 2011 and thereafter accelerated to 10,0 per cent in the year to October, before moderating to 6,3 per cent in the year to May 2012. The initial upward trajectory was characterised by a marked acceleration in producer food price inflation at the agricultural level to 11,9 per cent in the year to October 2011, and by a gradual acceleration in producer food price inflation at the manufactured level to 10,9 per cent in February 2012. Producer food price inflation at both the agricultural and the manufactured levels subsequently moderated to twelve-month rates of 2,3 per cent and 8,4 per cent respectively in May 2012. The most pronounced year-on-year slowdowns in the opening months of 2012 were registered by the prices of grain and meat.

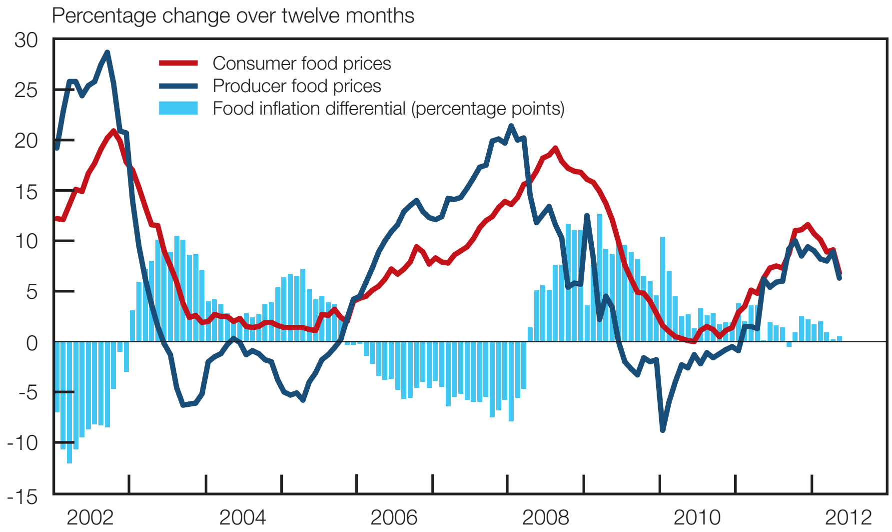
Following the acceleration in producer food price inflation, twelve-month consumer food price inflation accelerated meaningfully from zero per cent in June 2010 to 11,6 per cent in December

Producer price inflation



2011, as elevated food prices at the producer level fed through to food prices at the retail level. This was exacerbated by soaring international food price inflation in the opening months of 2011, coupled with a depreciation in the exchange rate of the rand in the latter half of the year. Consumer food price inflation, however, decelerated in the opening months of 2012 to 6,8 per cent in May 2012. The moderation in consumer food price inflation resulted mainly from lower rates of increase in the prices of bread and cereals, meat, oils and fats, fruit, and vegetables. Notably, meat price inflation – representing the highest weight within the consumer food basket – decelerated from a high of 16,7 per cent in December 2011 to 7,0 per cent in May 2012. The deceleration in meat price inflation in recent months stem from increased slaughterings amid increasingly scarce and expensive feed and an inability to pass on higher input costs to consumers.

Food prices



Food price outcomes are increasingly being complicated by the variable nature of factors contributing to the base prices of food products, such as price movements on world commodity markets, exchange rate fluctuations, expanding bio-fuel industries, particularly in the US, and adverse weather conditions. Despite the recent moderation in domestic consumer food price inflation, food prices are expected to remain elevated during the remainder of the year due to cost–push pressures arising from elevated transport costs, high electricity and refrigeration costs, and wage increases.

Targeted year-on-year headline consumer price inflation accelerated gradually from a recent low of 3,2 per cent in September 2010 to 6,0 per cent in October 2011, remaining within the inflation target range of 3 to 6 per cent for 21 consecutive months. Headline consumer price inflation thereafter breached the upper limit of the inflation target range and accelerated to 6,3 per cent in the year to January 2012, before moderating again to 5,7 per cent in the year to May 2012.

The acceleration in headline consumer price inflation resulted mainly from a quickening in consumer goods price inflation from a low of 1,5 per cent in the year to September 2010 to 6,7 per cent in the year to December 2011. Over this period the prices of non-durable goods in particular increased markedly, primarily driven by notable increases in the prices of food and petrol. Consumer goods price inflation, however, moderated somewhat in the opening months of 2012 to a year-on-year rate of 5,5 per cent in May 2012, assisting in the moderation of headline consumer price inflation. The recent moderation in goods price inflation was brought about by a deceleration in the twelve-month rate of increase in the prices of food and non-alcoholic beverages. Despite remaining at elevated levels, the year-on-year rate of increase in petrol prices also moderated during the opening months of 2012. In addition, consumer price inflation for semi-durable goods remained very subdued throughout 2011 and into 2012, while price changes of durable consumer goods have remained in deflation for 27 consecutive months, amounting to a rate of 0,9 per cent in the year to May 2012. Technological advances and strong international competition played and important role in moderating these prices.

Contrary to the deceleration in consumer goods price inflation, year-on-year consumer services price inflation accelerated steadily throughout 2011 amounting to 5,9 per cent in January 2012. Subsequently, consumer services price inflation hovered around this level. The acceleration in headline consumer services price inflation could largely be attributed to a marked acceleration in price inflation in the transport and miscellaneous services categories, while price inflation remained at elevated levels in the health and education categories.

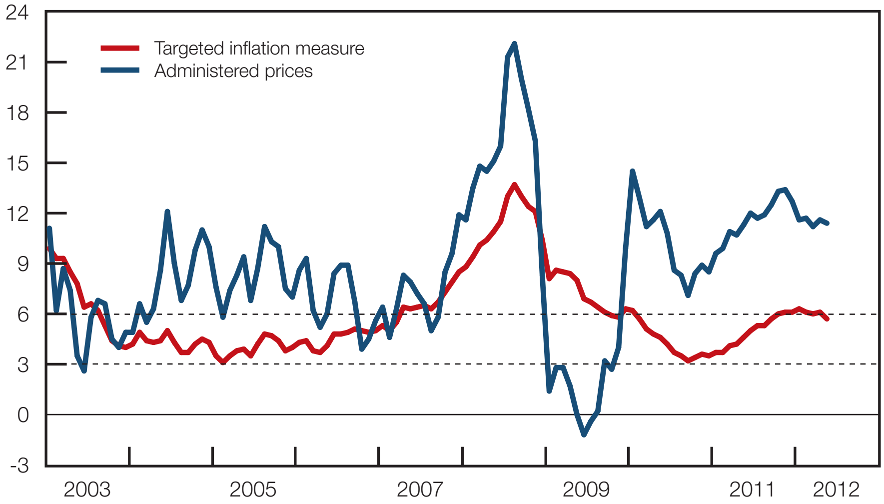
Prices of consumer goods and services

When excluding the impact of the more volatile food and petrol prices from the calculation of targeted headline consumer price inflation, underlying inflation accelerated gradually to a year-on-year rate of 4,8 per cent in May 2012. When also excluding the impact of electricity prices from the calculation of targeted headline consumer price inflation, year-on-year consumer price inflation displayed a similar steady acceleration and amounted to 4,4 per cent in May 2012 – the mid-point of the inflation target range. Despite remaining relatively subdued, the gradual upward trend in underlying measures of inflation could reflect the possible emergence of second-round price inflation following earlier supply-side price shocks.

Twelve-month administered price inflation continued to record rates of increase well above the 6 per cent upper limit of the inflation target range, accelerating to 13,4 per cent in the year to November 2011 largely on account of rapidly rising petrol prices. Apart from petrol prices, most other administered prices also continued to increase at rates in excess of 6 per cent. When the effect of petrol and electricity price increases is excluded from the calculation of administered prices, the increase still amounted to 6,3 per cent in May 2012. Despite a deceleration in petrol price inflation in the opening months of 2012, price inflation in education and university boarding fees accelerated further and together with notable price increases in the housing category is expected to keep administered price inflation at elevated levels for the remainder of the year. In March 2012 the National Energy Regulator of South Africa (NERSA) revised the average electricity price increase from 25,9 per cent to 16,0 per cent for the period 1 April 2012 to 31 March 2013, which should assist in moderating administered price inflation somewhat in the latter half of 2012.

Targeted inflation and administered prices

Percentage change over twelve months



Inflation-targeting countries in general have most recently experienced fairly benign inflation outcomes, with inflation benefiting from the moderation in international food and commodity prices and large output gaps. This is illustrated in the accompanying table.

Targeted and actual inflation in inflation-targeting countries, mid-2012

Per cent

Country	Inflation target	Inflation rate	Month
Australia	2–3	1,6	1st qr 2012
Brazil	4,5 (± 2 pp)	5,0	May 2012
Canada	1-3	1,2	May 2012
Chile	3 (± 1 pp)	3,1	May 2012
Colombia	2–4	3,4	May 2012
Czech Republic	2 (± 1 pp)	3,2	May 2012
Ghana	8,5 (± 2 pp)	9,3	May 2012
Hungary	3,0	5,3	May 2012
Iceland	2,5	6,0	May 2012
Indonesia	5 (± 1 pp)	4,5	Jun 2012
Israel	1–3	1,6	May 2012
Mexico	3 (± 1 pp)	3,9	May 2012
New Zealand	1–3	1,6	1st qr 2012
Norway	2,5	0,2	May 2012
Peru	2 (± 1 pp)	4,1	May 2012
Philippines	4 (± 1 pp)	2,9	May 2012
Poland	2,5 (± 1 pp)	3,6	May 2012
Romania	3 (± 1 pp)	1,8	May 2012
South Africa	3–6	5,7	May 2012
South Korea	3 (± 1 pp)	2,2	Jun 2012
Sweden	2,0	1,0	Jun 2012
Thailand	0,5–3*	1,9*	Jun 2012
Turkey	5 (± 2 pp)	8,9	Jun 2012
United Kingdom	2 (± 1 pp)	2,8	May 2012

* Core inflation rate
pp: percentage point
Inflation rates shown in red do not comply with the inflation target

Foreign trade and payments

International economic developments

Growth in the global economy slowed decisively from more than 5 per cent in 2010 to 3,9 per cent in 2011. Real economic growth in advanced economies slowed significantly over the period as Japan entered into a recession and the sovereign debt crisis intensified in the euro area. Economic activity in emerging-market and developing economies remained the main driver underpinning global growth despite moderating somewhat in 2011.

Real growth in global production

Per cent

	2010	2011	2012 (projected)
Advanced economies	3,2	1,6	1,4
Emerging-market and developing economies	7,5	6,2	5,6
World output	5,3	3,9	3,5

Source: IMF *World Economic Outlook Update,* July 2012

Economic growth in the US picked up somewhat in the second half of 2011, following subdued growth during the first half of the year. Activity in the first half of 2011 was suppressed by supply chain disruptions following the natural disasters in Japan and the dampening effect of higher food and energy prices on consumer demand. Output growth slowed to 1,7 per cent in 2011 – a relatively modest pace compared with the growth rate of 3,0 per cent recorded in the preceding year. Growth in 2011 was largely underpinned by positive contributions from personal consumption expenditure, exports and private investment, which more than offset the contraction in government consumption and investment. The pace of increase in non-residential investment accelerated in 2011, whereas residential investment remained subdued. In the first quarter of 2012 real growth in the US moderated slightly.

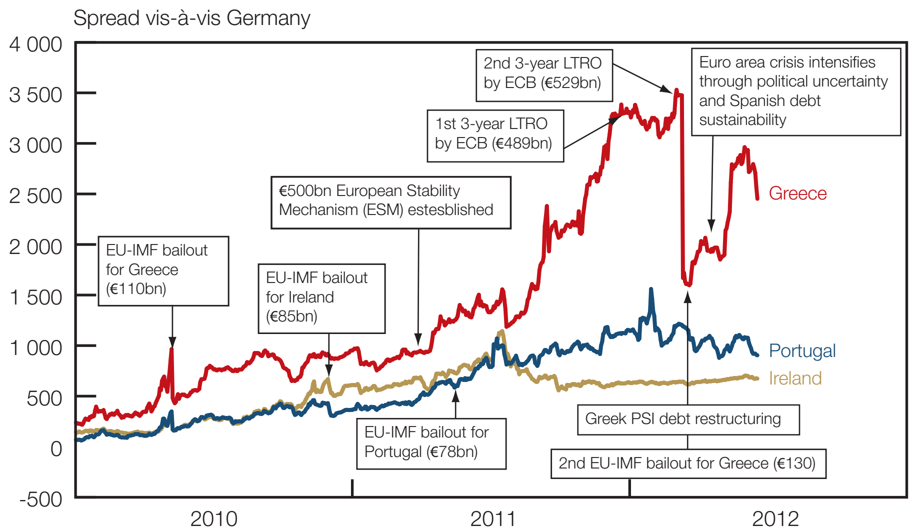
Sustained growth in the US is vital to regain job losses incurred during the recession. Having lost 8,8 million jobs between January 2008 and February 2010, the US government in 2010 announced payroll tax cuts to boost employment. Non-farm payroll employment increased for 19 consecutive months from late 2010, rising by just more than 3 million jobs over this period. The unemployment rate declined to 8,1 per cent in April 2012, its lowest level in more than three years, despite the constraints to the US economy imposed by fiscal austerity, weakness in the housing and labour markets, and potential negative spillovers from Europe.

Following a recovery in 2010, real output growth in the euro area moderated to 1,5 per cent in 2011, partly on account of slower growth in investment and exports. Growth in private consumption expenditure also decelerated, stifled by declining confidence levels and the erosion of real income caused by rising inflation. In the euro area gross fixed capital formation contracted in the fourth quarter of 2011 after having peaked in the second quarter of 2010. Government austerity measures, and deleveraging by households and banks have impacted fixed investment negatively.

The ongoing financial and economic crisis in the euro area intensified in the course of 2011 as the sovereign debt crisis adversely impacted the banking sector. In response to the crisis, the European Council agreed in March 2011 to establish the European Stability Mechanism (ESM), which will come into force in July 2012, replacing the European Financial Stability Facility. In April 2011 Portugal became the third euro area country to require a bailout after Greece and Ireland in 2010. Portugal received a €78 billion financial bailout package from the European Union (EU) and the International Monetary Fund (IMF) in May 2011 to support its struggling economy. In July 2011 European leaders agreed to reduce the interest rate that Ireland was paying on its EU-IMF bailout loan and to extend the repayment period to double its initial duration.

The sovereign debt crisis, however, spread in the second half of 2011 from smaller peripheral countries to larger euro area countries, more specifically Italy and Spain. As the state of the banking sector worsened in an environment of weakening economic conditions, European banks became increasingly reluctant to transact with one another in the interbank market. However, the European Central Bank (ECB) adopted a range of non-standard measures in August and additional measures in December 2011, including two longer-term refinancing operations (LTROs) to support bank lending and liquidity in the euro-area money market. The first LTRO was conducted on 21 December 2011 and the second on 29 February 2012.

Sovereign bond yield spreads of selected peripheral euro area countries vis-à-vis German government bonds



Source: Bloomberg

Many euro area economies moved into recession in the fourth quarter of 2011, including Italy, the Netherlands, Portugal, Ireland, Greece, Slovenia and Cyprus; and Spain in the first quarter of 2012. Real output in the euro area subsequently contracted at an annualised rate of 1,2 per cent in the fourth quarter of 2011, while the level of real gross domestic product essentially remained unchanged in the first quarter of 2012.

Greece faced severe budgetary imbalances in 2011 and, as a result, performed worse than expected. The IMF and the euro area finance ministers approved a second economic adjustment programme in March 2012, amounting to €130 billion. Financial markets remain concerned about Greece's ability to honour its commitments, given that economic conditions continued to deteriorate and political developments remained uncertain. The Greek debt restructuring (through private-sector involvement) was completed successfully in March 2012 when approximately €107 billion of debt was written off. Spain, the euro area's fourth largest economy, recently became the focus of the crisis as the government front-loaded further austerity measures in order to meet targets for the government budget agreed by the EU. However, the social consequences of these austerity measures are beginning to be felt across the euro area with political upheaval and ongoing social discontent.

Economic activity in the United Kingdom (UK) remained fragile throughout 2011 and the economy technically slipped into recession after real output had declined by 0,8 per cent in the first quarter of 2012, following a 1,2 per cent contraction in the preceding quarter. Real economic growth was severely weighed down by declines in business investment, inventories and external demand. Private fixed investment contracted in most of 2011.

The Japanese economy was significantly affected by the earthquake and tsunami in March 2011 and the subsequent nuclear disaster. Economic activity contracted during the first half of the year as production and exports declined abruptly, and consumer demand slowed substantially.

Growth rebounded strongly in the third quarter of 2011 as the unwinding of the supply-side constraints progressed faster than originally anticipated, and production and exports were restored to previous levels. Growth was underpinned by reconstruction-related expenditure such as public investment, business fixed investment, housing investment and the demand for durable consumer goods. Real economic growth displayed a remarkable recovery in the first quarter of 2012, recording an increase of 4,7 per cent following an increase of 0,1 per cent in the preceding quarter.

Economic growth in Australia and Canada slowed in 2011, whereas growth in New Zealand recovered after contracting during the previous two years.

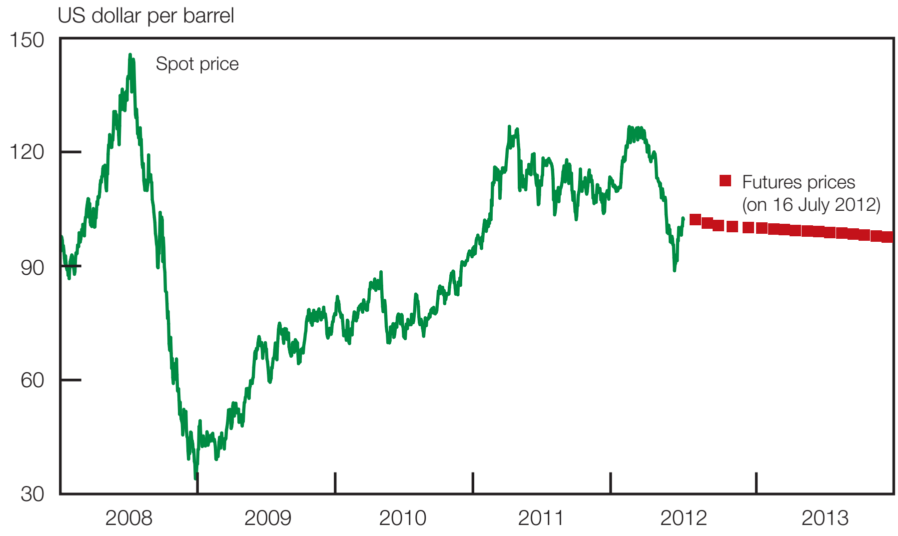
Emerging-market and developing economies did not exit 2011 unaffected by world economic developments, particularly the crisis in the euro area. Slowing demand from advanced economies during 2011, as well as contractionary monetary policy in response to overheating pressures and rising inflation restricted growth to 6,2 per cent in 2011 from 7,5 per cent in the previous year. In emerging Asia, economic growth slowed mainly due to weakening external demand and significant policy intervention. China and India played a prominent role in the deceleration in the region's growth outcome. Investment growth in China is considered as one of the reasons for the shrinking trade surplus in the region. Investment in housing construction and renewed expansion of manufacturing has proved to be more import-intensive, particularly for commodities and minerals. The slower real output growth in the first quarter of 2012 in China and the official downgrading of the growth target for 2012 have heightened concerns about the future trend of economic growth in the country and its repercussions should it experience a hard landing.

The turmoil in advanced European countries weighed markedly on the economic activity of the emerging-European economies in 2011. Significant economic downturns were registered in smaller countries such as Hungary and Romania. Growth in 2011 was resilient in Russia, but volatile in Turkey. Sluggish private consumption expenditure and weak external demand led to a significant moderation in Russia's growth performance in the first quarter of 2012. Growth in the export-reliant economies continued to be fragile in 2012 due to the crisis in major trading partners.

Economic growth in emerging Latin America slowed from 6,2 per cent in 2010 to 4,5 per cent in 2011. Growth was adversely affected by the weaker performances of Brazil and Mexico, while it also slowed in Argentina, Chile and Peru. Real economic growth in sub-Saharan Africa remained robust in 2011, exceeding 5 per cent, and is expected to accelerate to 5,4 per cent in 2012. While the growth outlook for Africa was affected by uncertainty and instability in advanced economies, especially Europe, the relatively high prices of export commodities and the successful start-up of resource extraction facilities supported growth in a range of sub-Saharan economies such as Ghana.

During the past two years, the global oil market has been characterised by intensified global macroeconomic uncertainties, the sovereign debt crisis in the euro area, oil supply constraints in North Africa and the Middle East, social unrest in many parts of the world, natural disasters and extreme oil price volatility. Concerns about oil supply disruptions in Libya due to the political unrest drove Brent crude oil prices in February 2011 to the highest levels since the financial crisis in 2008. The Organization of the Petroleum Exporting Countries (OPEC), and Saudi Arabia in particular, responded to global oil supply shortages by increasing oil production. Although still highly volatile, crude oil prices drifted lower towards the end of 2011, before surging again in the beginning months of 2012. The dispute over Iran's alleged nuclear programme caused markets to be concerned about potential disruptions in oil supply in the months ahead.

Brent crude oil prices

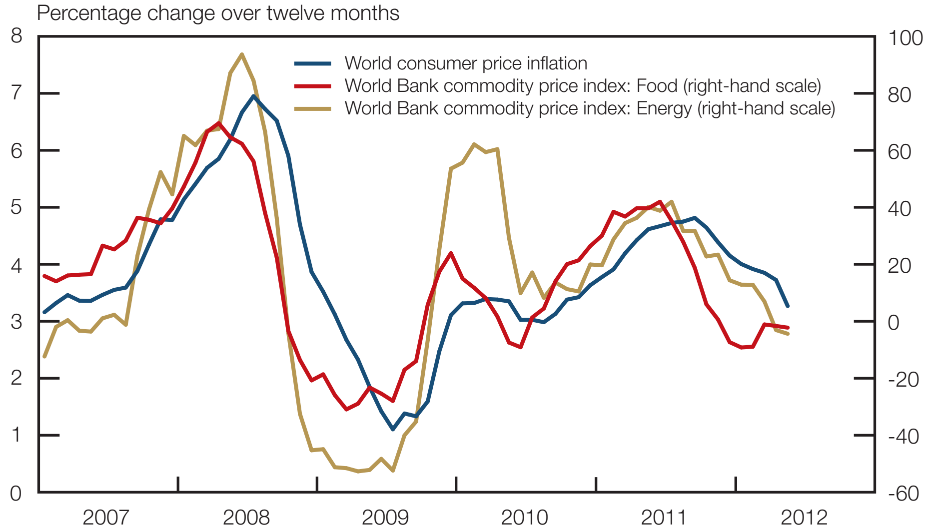


Source: Bloomberg

Having traded sideways at around US$125 per barrel since mid-February 2012, Brent crude oil prices declined sharply in the second quarter of 2012 due to a weaker global economic outlook, more specifically in the euro area, and easing supply conditions. Part of the additional supply of crude oil was diverted into strategic storage as evidenced by the rise in US crude oil stocks at the end of April 2012. Geopolitical factors, however, continue to pose an upside risk to oil prices.

Global price inflation accelerated from 3,7 per cent in 2010 to 4,8 per cent in 2011 due to robust domestic demand in emerging-market economies and rising commodity prices, particularly of food and oil. Commodity price increases peaked in mid-2011 before moderating in the second half of the year.

World consumer price inflation and commodity prices



Source: International Monetary Fund

Consumer price inflation in advanced economies accelerated from 1,5 per cent in 2010 to 2,7 per cent in 2011. In the euro area inflation accelerated from 0,8 per cent in February 2010 to 3,0 per cent in November 2011, mainly due to rising housing, transport and food prices, but moderated to 2,4 per cent in May 2012. After reaching a one-year high in September 2011, US consumer price inflation moderated in the first part of 2012 on account of lower food and energy prices. Core inflation has, however, picked up during the past year after registering record-low increases at the end of 2010. The average annual rate of decrease in Japan's consumer prices amounted to 0,3 per cent in 2011. Headline inflation has trended upwards since the beginning of 2012, but remained around zero in the first quarter of 2012. Inflation in the UK persistently exceeded the inflation target of 2 per cent throughout 2011 as a result of higher food prices and the effect of increased value added tax from March 2011.

Inflation accelerated across the board in commodity-exporting countries in 2011, with Australia, Canada and New Zealand all recording higher rates of inflation relative to the preceding year. Inflation outcomes for Australia, New Zealand and Canada in early 2012 supported forecasts of lower inflation in these countries in 2012. Consumer price inflation in emerging-market and developing economies accelerated to 7,1 per cent in 2011 from 6,1 per cent in 2010. Inflation in emerging Asia has been moderating mainly due to the normalisation of food prices. After peaking at around mid-2011, consumer price inflation in emerging Europe trended lower in the second half of 2011 and at the beginning of 2012, also reflecting recent declines in food prices.

The Bank of Japan has kept its uncollateralised overnight call rate unchanged at 0,05 per cent since October 2010. The central bank, however, introduced an Asset Purchase Programme in 2010 to ease monetary policy in order to address deflation. This facility was raised by 5 trillion yen in April 2012 to about 70 trillion yen in an attempt to ease monetary policy further.

The Bank of England has kept its base rate unchanged at a historically low 0,5 per cent since March 2009. However, there were two endorsements of quantitative easing between October 2011 and February 2012, amounting to £325 billion. Australia and New Zealand have both lowered their policy rates since the beginning of 2011 by a cumulative 100 basis points and 50 basis points to 3,75 and 2,5 per cent, respectively. Canada has maintained its policy rate at 1,0 per cent since the end of 2010. The European Central Bank (ECB) raised its policy rate in the first half of 2011 but, sensing the deterioration of prospects in the euro area, reduced the rate on two occasions towards the end of 2011 and again in July 2012, to a record low 0,75 per cent.

Across emerging Asia policy rates have either been kept unchanged or have been reduced in an attempt to support domestic demand. Monetary policy responses in the region were balanced between supporting growth and anchoring inflationary pressures. Hungary and Poland have increased their policy rates by a total of 75 and 100 basis points respectively since the beginning of 2011. In contrast, Russia initially increased its key policy rate by 50 basis points in early 2011, before reducing the rate by 25 basis points towards the end of 2011. The monetary authority has been very active in Brazil since the beginning of 2011 with the central bank changing its policy rate 11 times. Brazil's central bank raised the policy rate on five consecutive occasions to reach 12,5 per cent by July 2011, representing a cumulative increase of 175 basis points. However, in view of the strong capital inflows and the appreciation of the exchange rate adversely effecting the country's export competitiveness, coupled with an increasingly weaker outlook for growth, the central bank then aggressively reversed its stance and has since lowered its policy rate in eight consecutive moves to 8,0 per cent. The central bank of Chile increased its policy rate by 200 basis points during 2011 to a high of 5,25 per cent before reducing it by 25 basis points to 5,0 per cent in January 2012. The rate has subsequently been left unchanged. Policy action has been relatively muted in the rest of the region, with Mexico, for instance, maintaining rates unchanged since mid-2009.

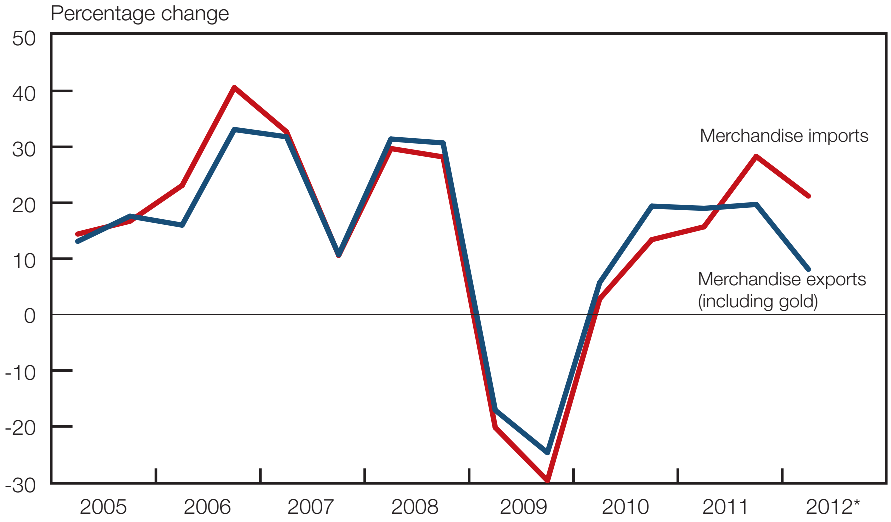
Monetary policy in most African countries remained accommodative in 2011 to support growth. However, in Kenya and Nigeria policy rates were raised significantly towards the end of 2011 on concerns of rapid increases in consumer inflation.

Current account[4]

The recovery in the South African economy over the past two years has been characterised by stronger growth in domestic expenditure than in domestic production, resulting in a deterioration in the trade balance over the period. The narrowing of the surplus on the trade account could be attributed to the relatively faster pace of increase in the value of merchandise imports compared to that of merchandise exports. As a ratio of South Africa's gross domestic product, the trade balance switched from a surplus of 1,1 per cent in the first half of 2011 to virtually zero in the second half, and deteriorated further into a deficit in the first quarter of 2012 on account of a continuous surge in imports.

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

Value of merchandise imports and exports



* January–May 2012

The deterioration in the trade balance in 2011 coincided with a moderate widening of the shortfall on the service, income and current transfer account with the rest of the world. The latter deficit widened somewhat in the first half of 2011 and thereafter remained broadly unchanged in the second half, before edging lower in early 2012, allowing the developments on the trade balance to dominate the trends observed on the current account. Relative to South Africa's gross domestic product, the deficit on the current account widened markedly from the first to the second half of 2011 and continued to do so in the first quarter of 2012.

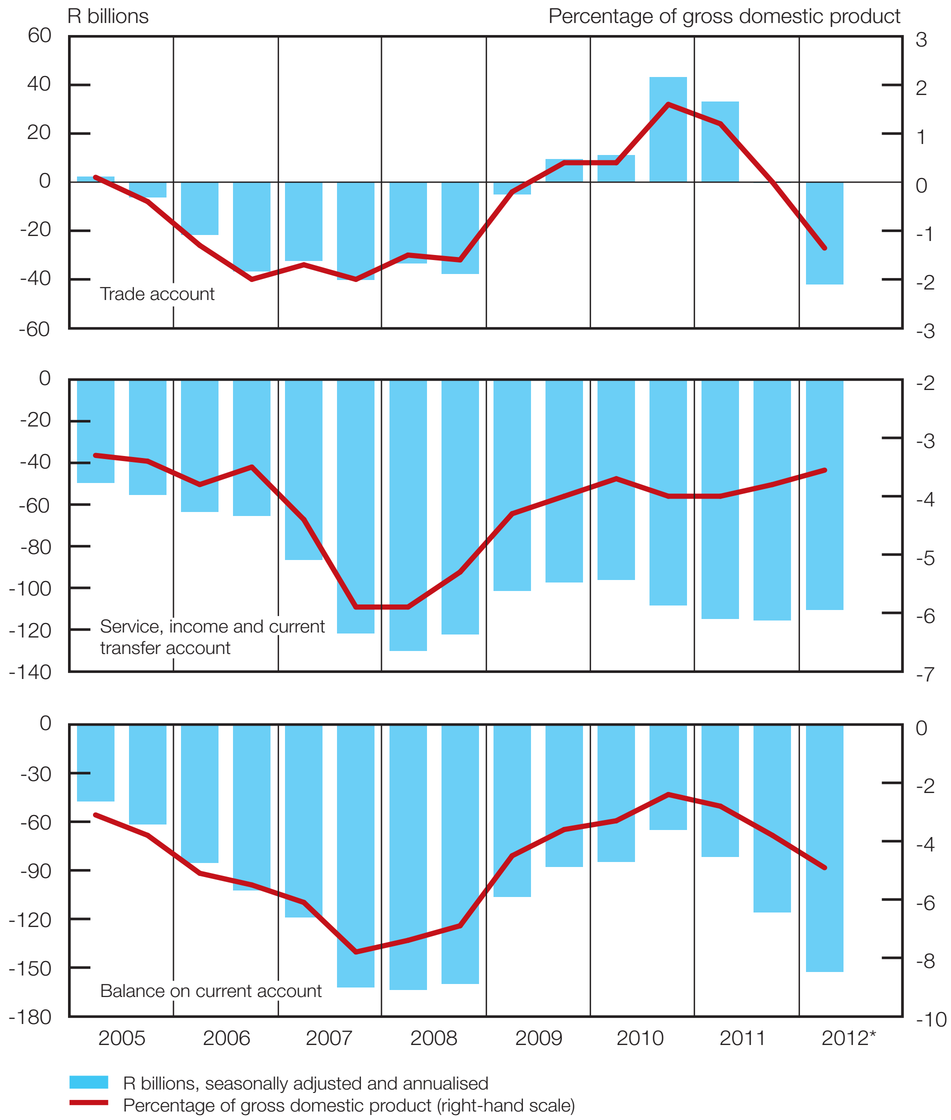
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2010			2011			2012
	1st half	2nd half	Year	1st half	2nd half	Year	1st qr
Merchandise exports	544,4	587,3	565,9	649,1	693,3	671,2	697,7
Net gold exports	56,6	62,4	59,5	66,3	84,3	75,3	79,3
Merchandise imports	-589,7	-606,6	-598,2	-682,3	-778,0	-730,1	-819,1
Trade balance	11,3	43,1	27,2	33,1	-0,4	16,4	-42,1
Net service, income and current transfer payments	-96,1	-108,2	-102,2	-114,8	-115,5	-115,2	-110,5
Balance on current account	-84,8	-65,1	-75,0	-81,7	-115,9	-98,8	-152,6
As a percentage of gross domestic product	*-3,3*	*-2,4*	*-2,8*	*-2,8*	*-3,8*	*-3,3*	*-4,9*

Although the deficit on the service, income and current transfer account widened by R13 billion from 2010 to 2011, it remained virtually unchanged as a ratio of gross domestic product over the period. The larger shortfall primarily reflected a substantial increase in net income payments to non-residents, more specifically net dividend payments to non-resident investors, while net service payments and net current transfer payments changed very little over the period.

Balance of payments: Current account

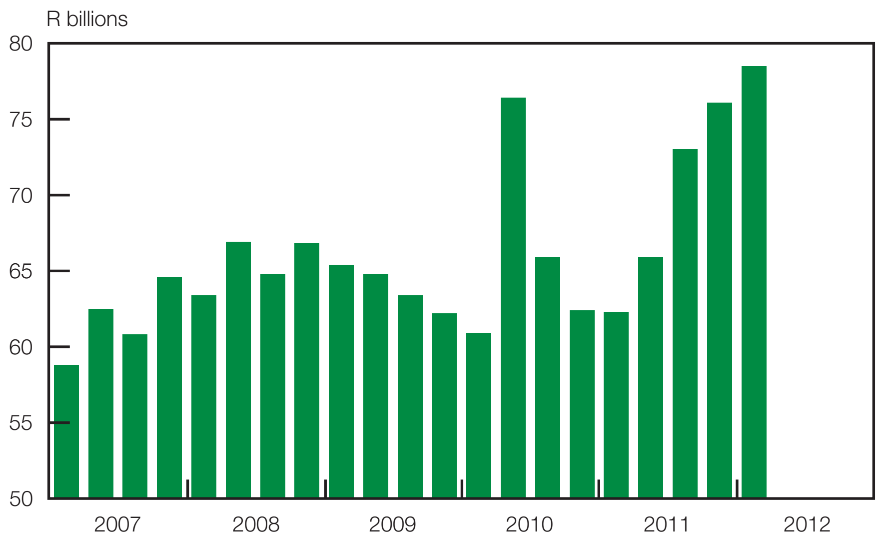


* First quarter

An analysis of the components of the service, income and current transfer account reveals that gross payments for services rendered by non-residents increased at a slightly faster pace than service receipts in 2011. The increase in net service payments was largely brought about by higher net payments for transportation services rendered by non-residents, which more than neutralised an increase in net travel receipts. Strong increases in travel receipts, traditionally the largest credit component, coincided with lower travel-related payments by South African residents travelling abroad in the course of 2011. South Africa's travel receipts most recently reached levels in excess of those recorded at the time of the 2010 FIFA World Cup™ tournament.

Having remained broadly unchanged in 2009 and 2010, net income payments to non-resident investors rose noticeably in 2011 due to a sharp increase in gross income payments, which more than neutralised a moderate increase in gross income receipts from abroad. Gross dividend payments advanced by almost 32 per cent in 2011, buoyed by increased dividend payments by unlisted companies that occasionally award dividend returns to shareholders at times that are

Travel receipts



Seasonally adjusted and annualised

often not well synchronised with the phase of the domestic business cycle. Dividend payments previously grew at a double-digit rate in 2007 due to high profit distributions amid a strong economic expansionary phase. By contrast, net interest payments showed virtually no growth in 2011 as interest rates remained at historically low levels. Net income payments advanced further in the first quarter of 2012 as dividend payments were bolstered by the announcement that a higher effective rate of taxation on dividends would apply from April 2012.

Balances: Components of service, income and current transfer account

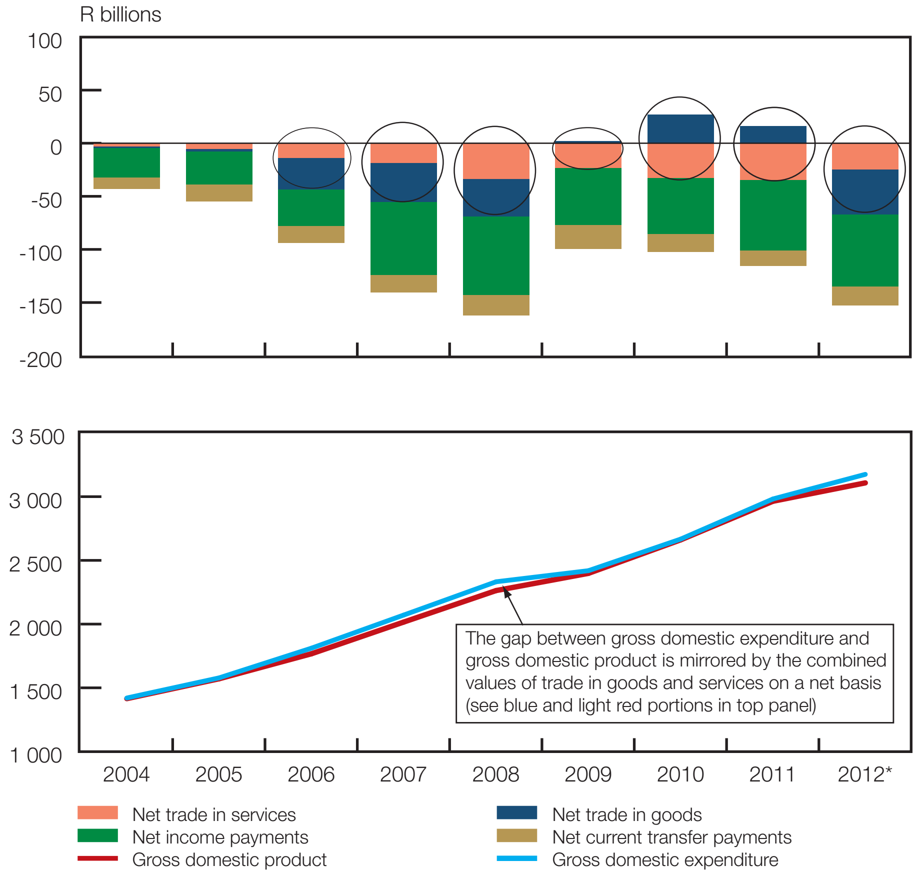
Percentage of gross domestic product

				2011			2012	10-year annual
	2008	2009	2010	1st half	2nd half	2011	1st qr	average
Net service payments	-1,5	-1,0	-1,2	-1,3	-1,0	-1,2	-0,8	-0,7
Of which: Net travel receipts	*1,3*	*1,2*	*1,0*	*0,9*	*1,2*	*1,1*	*1,5*	*1,4*
Net income payments	-3,3	-2,2	-2,0	-2,2	-2,3	-2,2	-2,2	-2,5
Of which: Net dividend payments	*-2,6*	*-1,6*	*-1,5*	*-1,8*	*-1,9*	*-1,8*	*-1,7*	*-1,9*
Net current transfer payments	-0,8	-0,9	-0,6	-0,5	-0,5	-0,5	-0,6	-0,7
Overall balance	-5,6	-4,1	-3,8	-4,0	-3,8	-3,9	-3,6	-3,9

Deficit – surplus +

The accompanying graph illustrates the developments on the service, income and current transfer account along with those of the trade account, collectively culminating in the balance on the current account. As expected, periods in which spending on foreign goods and services exceeds the value of exports of goods and services, as in 2006 to 2008, are mirrored by a widening gap between gross domestic expenditure and gross domestic product as spending on goods and services exceeded domestic production. During this period the negative imbalance on net trade in goods widened gradually. The expenditure and production gap, however, narrowed in the course of 2009, consistent with the smaller deficit in net trade in goods and services. Although net payments for services increased in 2010 and 2011, the simultaneous widening of the trade surplus resulted in a better alignment between gross domestic expenditure and production over the period. In the first quarter of 2012 the gap resurfaced as the deterioration in the trade balance gained momentum.

Components of balance on current account, gross domestic expenditure and gross domestic product



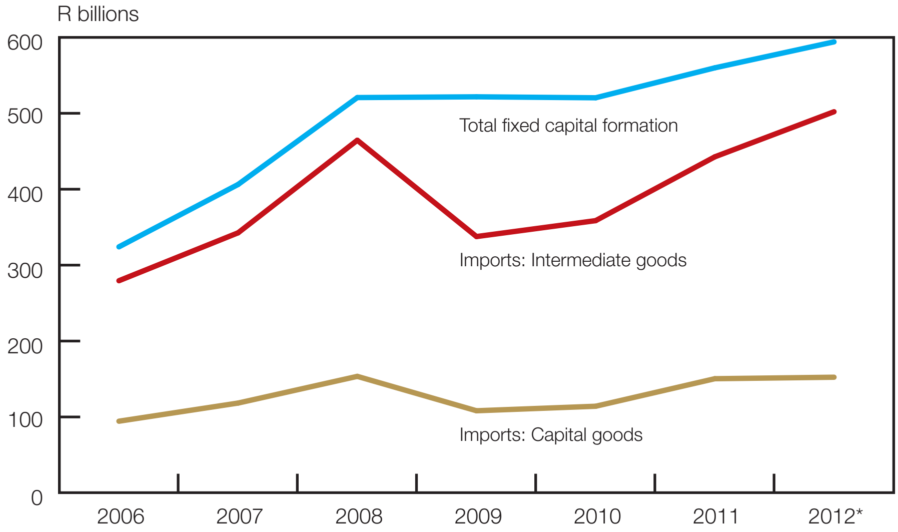
* First quarter 2012, seasonally adjusted and annualised

The increase in domestic expenditure in 2011 was consistent with a surge in the value of merchandise imports. Analysed according to stage of production, the value of imported capital goods rose by 32 per cent and of intermediate goods by 23 per cent in 2011, following subdued growth in 2010. These higher import values could partly be attributed to increased domestic demand for machinery and electrical equipment associated with the development of infrastructure. The value of merchandise imports rose firmly in both the first and the second half of 2011, and continued to trend higher in the first quarter of 2012.

The 22 per cent higher import bill in 2011 primarily reflected an increase in import volumes, even though import prices also rose materially over the period. Merchandise import volumes advanced by 12,8 per cent in 2011 as the steady increase in real gross domestic expenditure led to an increase in the demand for imported goods. In fact, the rate of increase in import volumes exceeded that of real gross domestic expenditure, raising the country's import penetration ratio from 21,8 per cent in 2010 to 23,6 per cent in 2011 – this ratio recently peaked at 25,9 per cent in 2007 when an economic growth rate of 5,5 per cent was registered.

A slight increase in output prices in the main countries supplying goods to South Africa, together with the price-raising effects of the depreciation of the rand, more specifically in the second half of the year, caused import prices to rise by 8,2 per cent in 2011 following a marginal decline in 2010. International crude oil prices remained elevated throughout 2011 due to, among other factors, political tension in the Middle East.

Fixed capital formation and imports of non-consumer goods

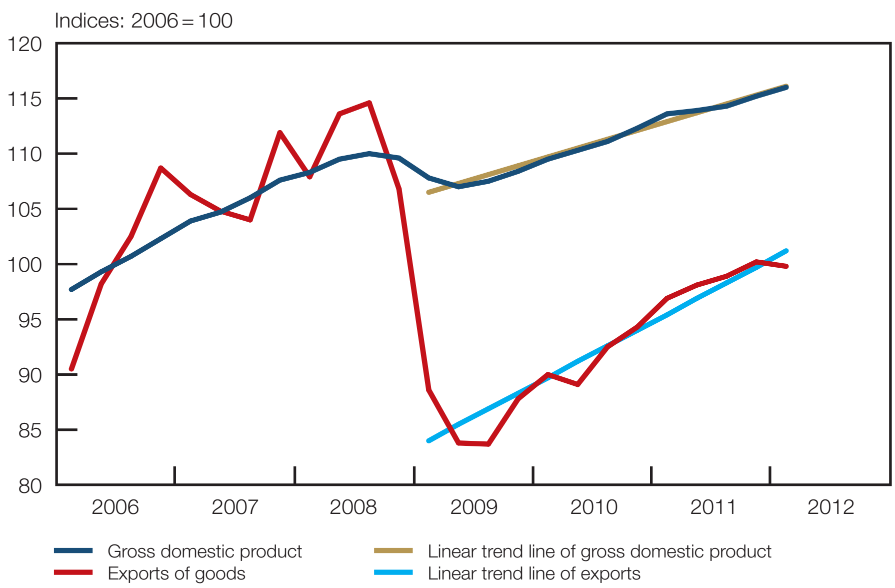


* First quarter, seasonally adjusted and annualised

Notwithstanding the uneven economic recovery in South Africa's most important trading-partner countries, the value of merchandise exports (excluding gold) advanced by 18,6 per cent in 2011. The firm growth performance of exports in the first half of 2011, however, slowed somewhat in the second half. The value of merchandise exports destined for the US accelerated in 2011, mainly underpinned by higher exports of vehicles and transport equipment, and chemical products. Although the value of exports to Germany remained relatively flat over the year, the value of precious and semi-precious metal exports to the UK and Switzerland raised export proceeds from Europe over the period. The value of mining exports to China remained firm despite the marginal slowdown in economic activity in the second half of 2011. However, following the positive performance of exports in 2011, the value of merchandise exports contracted from the fourth quarter of 2011 to the first quarter of 2012 weighed down, among other things, by domestic supply constraints.

In volume terms, merchandise sold abroad as a ratio of gross domestic product edged higher by almost a percentage point to 18,7 per cent in 2011. Despite not having recovered to the levels seen during 2008, the tempo of growth in exports over the past three years exceeded that of gross domestic product by a fair margin, as depicted in the accompanying graph.

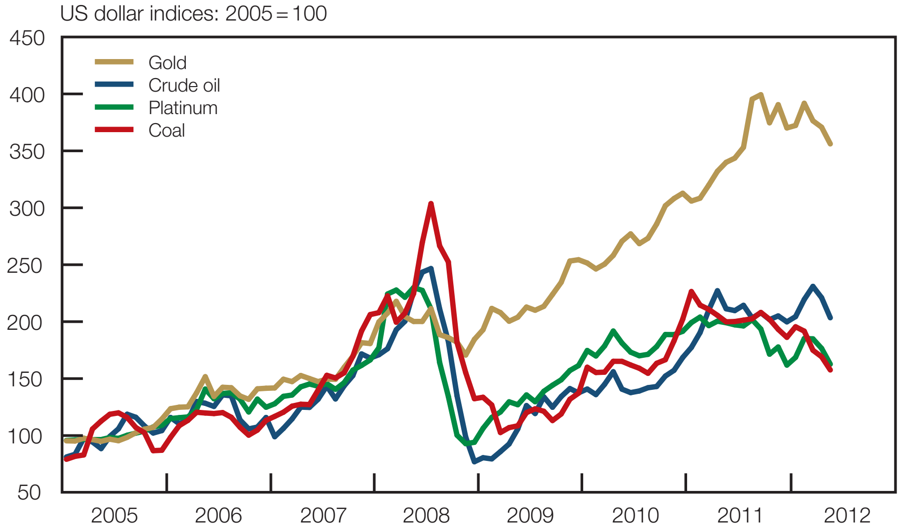
Real merchandise exports and gross domestic product



Earnings of local producers were further augmented by a 10,1 per cent rise in the rand price of merchandise exports in 2011 – almost double the pace recorded in 2010. The rand price of exports was supported by the increase in the international price of South African-produced commodities alongside the depreciation of the rand against major currencies. International prices of metals and minerals remained high in 2011, supported by firm demand from China, the recovery in industrial production in some countries and concerns about supply constraints. Nevertheless, the price of most international commodities receded in the second half of the year as global prospects deteriorated. The downward trend in international commodity prices continued in the first half of 2012, partly on account of the resurgence of uncertainty about the sovereign debt crisis in the euro area.

The large-scale uncertainty that characterised global financial markets in 2011 caused the price of gold on the London market to surge from an annual average of US$1 225 per fine ounce in 2010 to US$1 569 per fine ounce in 2011. Besides the higher dollar price of gold, the rand price of the yellow metal also benefited from the depreciation in the exchange value of the rand, while the volume of net gold exports was weighed down by longer-term structural supply-side constraints. In addition, production in the gold mining industry continued to be affected by sporadic industrial strike action that occurred in the course of 2011 as well as in the opening months of 2012.

International prices of selected commodities



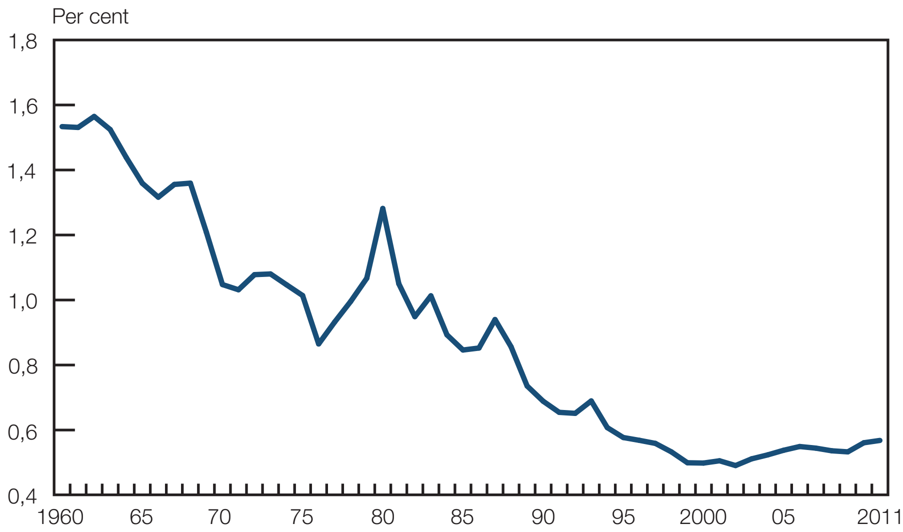
Global demand for gold contracted in the first half of 2011, but rebounded in the second half of the year, largely due to increased investment demand for gold by central banks, which offset the decline in jewellery and technological demand for the precious metal. During 2011, the Central Bank of Mexico became the largest net buyer of gold, adding almost 100 tonnes to its official gold reserves, followed by the Central Bank of Russia, which added around 95 tonnes. Other central banks that expanded their gold reserves in 2011 include South Korea, Thailand, Bolivia and Venezuela. Despite this increase in the global demand for gold, the volume of South Africa's net gold exports decreased by 2,0 per cent in 2011 following a marginal increase of 1,8 per cent in 2010. Owing to an increase of 29 per cent in the realised transaction price of gold, gold export proceeds in rand terms consequently rose by no less than 27 per cent in 2011.

Over the longer run, South Africa's export performance has not been satisfactory. The country's share in global exports has been trending downwards over the past five decades, as shown in the accompanying graph. There are many reasons for this structural decline, such as

- the depletion of natural resources such as gold;
- infrastructure and licensing constraints;

– domestic education and skills constraints;
– the increased emergence of more low-cost, highly competitive emerging-market economies; and
– relatively slow growth in the countries forming South Africa's traditional export markets.

Share of South Africa's exports in global trade



In response to this adverse trend, South Africa has stepped up its industrial strategy and infrastructure provision, and is addressing other binding constraints. The pattern of exports by destination has also adjusted notably, as shown in the accompanying table.

South African exports by destination

Percentage of total

	2002	2007	2012*
Africa	20,4	22,0	22,6
America	14,5	13,8	11,7
Asia	22,9	28,0	36,8
China	1,7	5,9	12,4
India	1,3	1,9	4,8
Europe	37,3	32,4	24,7
Oceania	2,0	2,0	1,1
Unallocated	3,0	1,8	3,1
Total merchandise exports excluding gold	100,0	100,0	100,0

* First five months of 2012
Components may not add to totals due to rounding

On an annual basis, South Africa's terms of trade continued to improve in 2011, albeit at a slower pace than in preceding years. Apart from the depreciation in the exchange rate of the rand, export prices were supported by an increase in the international prices of those commodities produced by South Africa. At the same time, a firm increase was recorded in international crude oil prices. The faster rate of increase in crude oil prices relative to that of export commodities underpinned the deterioration of the country's terms of trade in the first quarter of 2012.

Financial account

Sentiment in global financial markets in 2011 and the first half of 2012 was dominated by uncertainty about the outcome of the sovereign debt crisis in the euro area. Furthermore, the second half of 2011 was characterised by the downgrading of the sovereign debt of the US, Japan and Italy, and negotiations about the bailout of, and adherence to, austerity measures by some peripheral countries in the euro area. Simultaneously, the banking system in Europe continued to remain fragile, inhibiting liquidity and restricting bank lending to the real economy. As a result, capital flows from advanced economies to emerging-market economies shrank considerably in the second half of 2011. In addition, tension in the Middle East and the subsequent rise in international crude oil prices raised concerns about the prospects for global economic growth. The tension in financial markets continued in the first half of 2012, aggravated further by the downgrading of the sovereign debt of six European countries and certain Spanish banks in May. Nonetheless, positive growth prospects for the US and a slower-than-anticipated moderation in economic activity in China occasionally comforted markets in the opening months of 2012.

Net financial transactions not related to reserves

Percentage of gross domestic product

	2010			2011			2012
	1st half	2nd half	Year	1st half	2nd half	Year	1st qr
Liabilities							
Direct investment	0,5	0,2	0,3	1,4	1,4	1,4	1,0
Portfolio investment	5,7	2,6	4,1	3,9	-0,6	1,6	3,8
Other investment	-1,4	1,8	0,3	0,9	1,2	1,1	-0,5
Assets							
Direct investment	-0,2	0,2	0,0	-1,0	1,2	0,2	-0,7
Portfolio investment	-0,8	-1,7	-1,3	-2,2	-0,8	-1,5	-1,8
Other investment	0,5	-2,1	-0,8	1,1	-1,3	-0,1	-1,8
Total financial transactions*	5,8	2,3	4,0	5,3	3,6	4,4	6,6

* Including unrecorded transactions

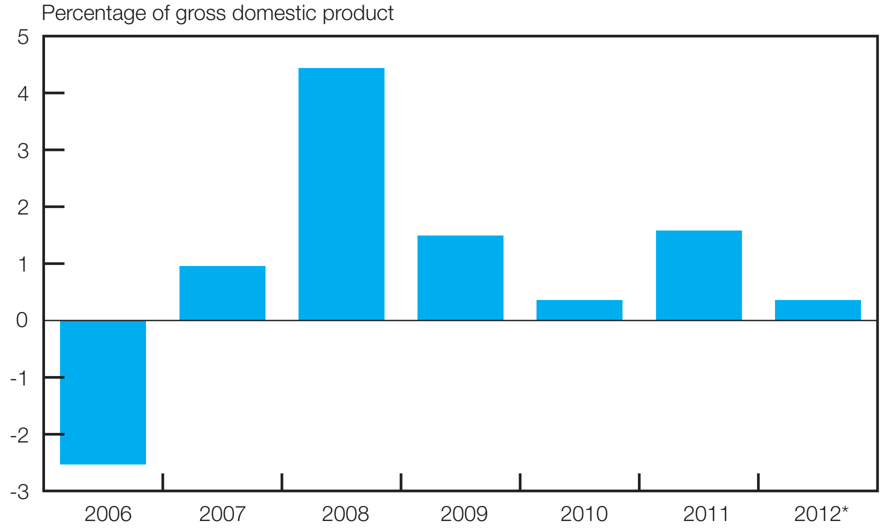
Against this background, changes in global investors' sentiment gave rise to significant volatility in capital flows to emerging-market economies. Net other investment into South Africa switched from an outflow of capital in 2010 to a sizeable inflow of capital in 2011, while net portfolio inflows decreased substantially over the period. Positive economic growth prospects for the country and improved economic ties with existing foreign direct investment enterprises, however, raised the level of net foreign direct investment inflows in 2011. Overall, capital inflows on the financial account of the balance of payments increased from R106 billion in 2010 to R131 billion in 2011, and further by R50,5 billion in the first quarter of 2012.

Net foreign direct investment

After registering record-high foreign direct investment inflows on a net basis in 2008, net foreign direct investment inflows shrank in 2009 and 2010 before rebounding in 2011. While the global financial crisis posed several challenges to multinational structures and operations, it also created new investment opportunities, including an attractive global acquisitions market.

Although developing economies traditionally absorb a large portion of global foreign direct investment, these economies are also responsible for sizeable outward direct investment transactions. In the case of South Africa, net foreign direct investment inflows rose from R9,5 billion in 2010 to R46,7 billion in 2011 reflecting substantially higher inward investment into various sectors. The mining sector, which has traditionally been a core industry in the South African economy, attracted sizeable net inflows in 2011. Inward direct investment into especially the platinum and iron ore industries was aimed at the expansion of the production capacity of mines in anticipation of increased future demand. The maturity of the South African gold mining sector has, however, resulted in mergers and acquisitions of domestic companies in the industry with limited greenfield investment in 2011. The maturity of the industry has, in addition, led to an increase in outward investment by domestic gold mining companies in the search for new international growth opportunities.

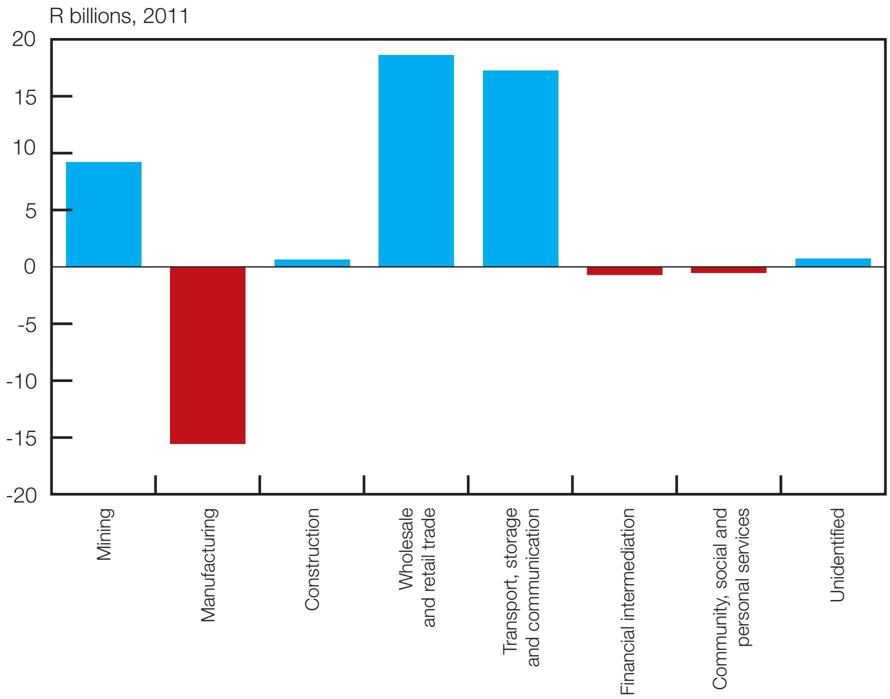
Net foreign direct investment flows



* First quarter 2012

In 2011 inward foreign direct investment also occurred in the wholesale and retail as well as the transport, storage and communication sectors. The inflow of direct investment capital into the wholesale and retail sector was largely related to the acquisition of a substantial share in a South African wholesaler by a multinational enterprise. Direct investment inflows into the domestic transport, storage and communication sector mainly reflected an injection of working capital into a domestic subsidiary by a foreign parent company and the repayment of loans previously extended to foreign subsidiaries.

Net foreign direct investment flows per sector*

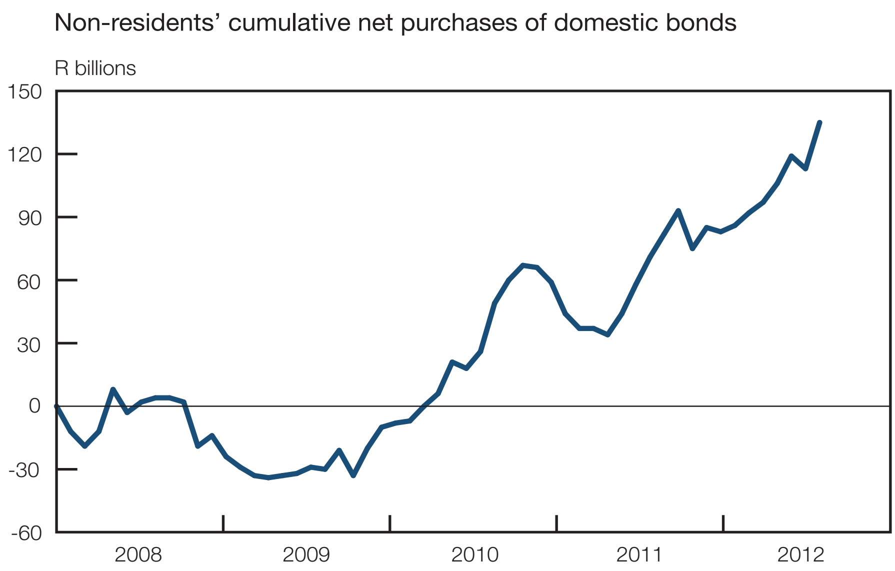


* Equity and long-term debt

These large inflows were, however, partially countered by net capital outflows emanating from the acquisition of foreign companies in the manufacturing sector by South African entities with a view to extending their manufacturing and distribution networks abroad. Net foreign direct investment inflows continued in the first quarter of 2012, albeit at a slower pace.

Net portfolio investment

Uncertainty in global financial markets usually brings about more volatility in portfolio investment flows between advanced and emerging-market economies. The substantial net inflow of portfolio investment capital into South Africa in the first half of 2011 decreased significantly in the second half as uncertainty in global financial markets influenced global investors to exchange their holdings of assets in developing countries for those more familiar assets of developed economies. South Africa, however, attracted sizeable debt security-related investment inflows in the first half of 2011 through the issuance of international bonds by National Treasury, parastatals and private-sector entities. These portfolio inflows fully countered the disposal of rand-denominated debt securities by non-resident investors in the opening months of the year. The appetite for South Africa's international bond issues was, in part, supported by perceptions of relatively lower risk – as partly proxied by sovereign debt ratings – encouraging capital flows towards developing economies. The progress made with the finalisation of the second bailout package for Greece by European leaders furthermore increased international investors' appetite for domestic debt securities in the second quarter of 2011.



On a cumulative basis non-resident investors remained net purchasers of South African bonds in 2011, albeit at a slightly reduced pace compared with 2010. The cumulative acquisition of domestic debt securities by non-resident investors was, however, higher in the first six months of 2012 than in the corresponding period of the preceding four years. By contrast, non-resident investors reduced their holdings of domestic equity securities throughout 2011 and into the opening months of 2012 as increased currency risk seemed to outweigh the benefits of a relatively large yield differential. The apparent slowdown in economic activity in some emerging-market economies, together with a fairly widespread decline in industrial production in a range of countries, could also have contributed to the lower demand for equity securities in the second half of 2011 and the first quarter of 2012. Overall, inward portfolio capital switched from an inflow in the first half of 2011 to an outflow in the second half of the year, before reverting to an inflow in the first quarter of 2012.

Outward portfolio investment by institutional and individual investors increased significantly in the first half of 2011 before moderating in the second half of the year. The outward investment, partly encouraged by the declining prices of certain assets along with the relative strength of the rand, further exaggerated the outflow of net portfolio capital in the second half of 2011. The outward movement of portfolio capital continued in the first quarter of 2012.

Net other investment

Net other investment capital flows changed from an inflow of almost R30 billion in the first half of 2011 to an outflow of R1,4 billion in the second half of the year. The inflow of capital in the first half of 2011 in part reflected an increase in non-resident deposits with the domestic banking sector and a decline in foreign deposits of domestic banks. The increase in other investment inflows during the first half of 2011 was, nonetheless, partly countered by the repayment of short-term foreign loans by the domestic banking sector.

The domestic banking sector increased its assets with foreign banks during the second half of 2011, suggesting strong international liquidity positions of domestic banks and a simultaneous demand for domestic currency by offshore banks. In the first quarter of 2012, outward other investment switched to an inflow as the domestic banking sector reduced its foreign assets abroad.

Foreign debt

South Africa's total outstanding foreign debt increased notably from the end of 2010 to the end of 2011, in part due to increased financing requirements associated with infrastructure development. The increase in the external debt mainly resulted from a rise in foreign currency-denominated debt, while the increase in rand-denominated debt remained fairly muted over the period. The country's outstanding foreign debt advanced further in the first quarter of 2012.

South Africa's external debt

US$ billions at end of period

	2007	2008	2009	2010	2011	2012*
Foreign currency-denominated debt................	45,1	44,1	42,1	45,2	50,9	53,2
Bearer bonds..	15,2	13,9	15,4	16,5	20,9	22,9
Other..	29,9	30,2	26,7	28,7	30,0	30,3
Public sector	5,6	5,3	5,7	6,5	7,6	8,3
Monetary sector	12,7	12,8	10,6	10,3	9,9	11,0
Non-monetary private sector......................	11,6	12,1	10,4	11,9	12,5	11,0
Rand-denominated debt	30,2	28,8	36,5	59,2	60,6	65,3
Bonds..	7,9	8,0	11,6	24,6	30,3	33,2
Other..	22,3	20,8	24,9	34,6	30,3	32,1
Total foreign debt	75,3	72,9	78,6	104,4	111,5	118,5
As a percentage of gross domestic product...	*26,4*	*26,6*	*27,6*	*28,7*	*27,3*	*29,2*
As a percentage of total export earnings........	*77,8*	*70,1*	*95,9*	*100,3*	*90,6*	*96,4*

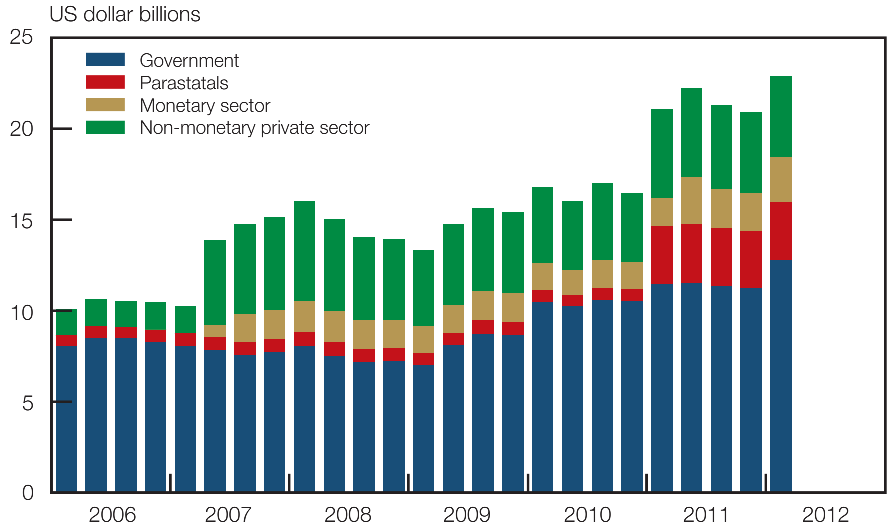
* First quarter

The increase in foreign currency-denominated debt primarily reflected international bonds issued by parastatals and the monetary sector in 2011. As a result, the outstanding amount of foreign-currency bonds issued by parastatals surged over the period, mirroring the firm drive for infrastructure development in the transportation, energy and mining sectors. In addition, the national government also issued an international bond in 2011. Government bonds issued abroad comprised the largest component of this category. The foreign-currency debt classified as "other debt" also edged higher, raised by additional loans granted to parastatals. In addition, the non-monetary private sector also increased its use of foreign trade finance and other short-term loan facilities.

The maturity structure of foreign currency-denominated debt deteriorated with the share of short-term debt in the total rising from 26,6 per cent at the end of 2010 to 37,8 per cent at the end of 2011. A significant portion of loans with an original long-term maturity together with ordinary short-term loans will become due for payment within the following twelve months.

Outstanding rand-denominated debt rose marginally from the end of 2010 to the end of 2011 as the reduction in the outstanding amounts of other rand-denominated debt partly offset an increase in the acquisition of domestic currency issued bonds by non-resident investors. Apart from the purchases of ordinary government bonds over the period, the increase in rand debt was further boosted by long-term loans granted to the telecommunications and motor manufacturing industries.

Outstanding foreign currency-denominated bonds

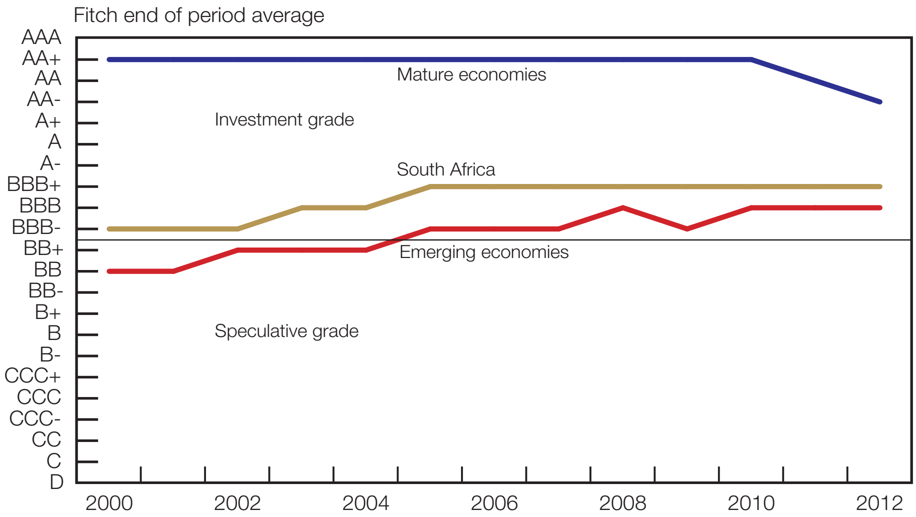


Expressed in rand terms, external debt increased substantially from R691 billion at the end of December 2010 to R904 billion at the end of December 2011 and further to R910 billion at the end of the first quarter of 2012. Despite the rise in South Africa's external debt, the ratios of external debt to gross domestic product and to export earnings improved in 2011.

As a result of concerns about fiscal sustainability and the soundness of fiscal processes in a number of indebted countries, international rating agencies amended the sovereign credit ratings of those economies, including the US, Japan, Italy, Spain and Greece. South Africa's sovereign credit rating, nonetheless, remained unchanged, except for a change in the outlook from stable to negative towards the end of 2011 and early 2012 by respective rating agencies. Despite the change in the outlook, the national government successfully issued international bonds at a somewhat lower coupon rate in 2012 compared with rates in the opening months of 2011.

A credit risk assessment of international economies by one of the rating agencies indicates that subsequent to the sovereign debt crisis in 2008, the sovereign credit ratings of most emerging-market economies were downgraded partly on account of a lack of contingency plans to deal with the probable spill over of the financial crisis from advanced to developing economies. The downgrading also reflected the political tension that prevailed in some of these economies over the period. The sovereign credit ratings of most developing economies were upgraded in 2010 due to fairly resilient economic activity in many countries amid the heightened global financial crisis. Simultaneously, the average sovereign credit ratings of the advanced economies deteriorated gradually towards an AA rating on account of a lack of a suitable long-term strategy to deal with the accumulation of sovereign debt and feasible austerity measures to assist in the redemption of obligations as they become due. South Africa's sovereign credit rating had remained at BBB+ over the period since its last upgrade in 2005 by Fitch and Standard and Poor's (S&P) rating agencies. The current global credit rating status has put emerging-market economies in favour of receiving capital flows through their respective government debt securities.

Sovereign credit ratings on long-term debt



* Current average ratings

Sources: Fitch and South African Reserve Bank

International liquidity

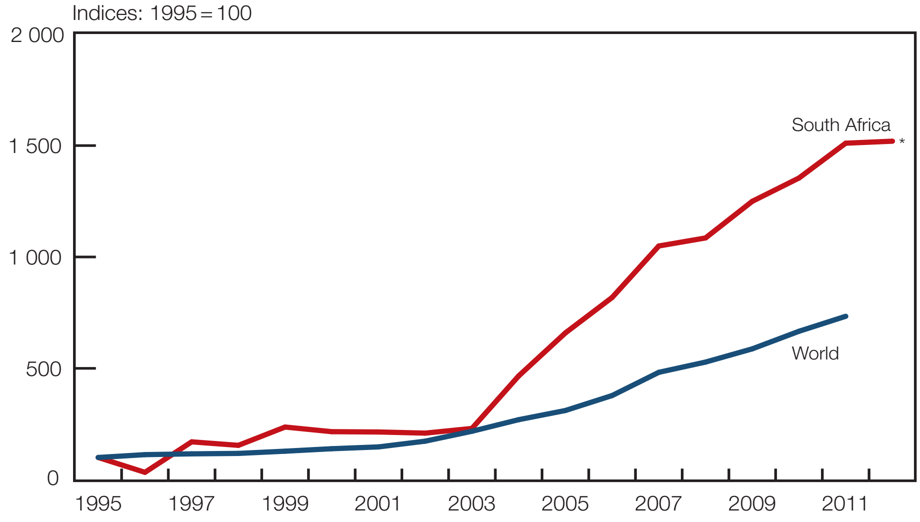
South Africa's overall balance-of-payments position was in surplus in the amount of R32,7 billion in 2011, following an improvement of R31,3 billion in 2010. In the first half of 2012 the country's net international reserves rose by R3,3 billion.

The gross gold and other foreign-exchange reserves, measured in US dollar, increased from US$43,8 billion at the end of 2010 to US$48,9 billion at the end of 2011 and further to US$49,2 billion at the end of June 2012. The value of the gold reserves, on balance, rose over this period mainly on account of valuation adjustments. Foreign-exchange reserves surged from US$38,1 billion at the end of 2010 to US$42,6 billion at the end of 2011 and further to US$42,8 billion at the end of June 2012. As a consequence, the level of imports of goods and services covered by gross international reserves improved from 18,3 weeks of import cover at the end of December 2010 to 19,7 weeks at the end of December 2011, before inching lower to 18,8 weeks at the end of March 2012.

According to an IMF publication, *Currency Composition of Official Foreign Exchange Reserves* (COFER), South Africa was ranked the 36th largest holder of foreign-exchange reserves in March 2012. While global foreign-exchange reserve holdings have risen strongly over the past decade, that of South Africa increased more briskly than the global aggregate, as shown in the graph on the following page.

The international liquidity position of the Bank improved from US$43,4 billion at the end of December 2010 to US$47,9 billion at the end of December 2011 and further to US$48,8 billion at the end of May 2012 before decreasing somewhat in June. This position currently includes an overbought forward currency position of US$6,2 billion.

Foreign-exchange reserves



* At the end of June 2012

Sources: IMF *Currency Composition of Official Foreign Exchange Reserves (COFER)* and South African Reserve Bank

Exchange rates

Uncertainty about the sovereign debt crisis in peripheral European countries to an important extent dominated foreign-exchange markets over the past 18 months, although factors such as political turmoil in North Africa and the economic impact of the natural disaster in Japan also had a bearing on currencies. During the second half of 2011, investor sentiment was largely influenced by the downgrading of the sovereign debt of Italy, Slovenia, Japan and the US as well as the declining trend in commodity prices, and the rand together with many other emerging-market currencies depreciated. The nominal effective exchange rate of the rand, however, strengthened somewhat in the beginning of December 2011, in view of renewed risk appetite for emerging-market assets following the progress made in resolving the euro area debt crisis as well as the positive vote by the European authorities, including those from Germany and France, to expand the European Financial Stability Facility (EFSF). The average level of the nominal effective exchange rate of the rand declined by 3,2 per cent in 2011, following an increase of 14,4 per cent in 2010.

Exchange rates of the rand

Percentage change

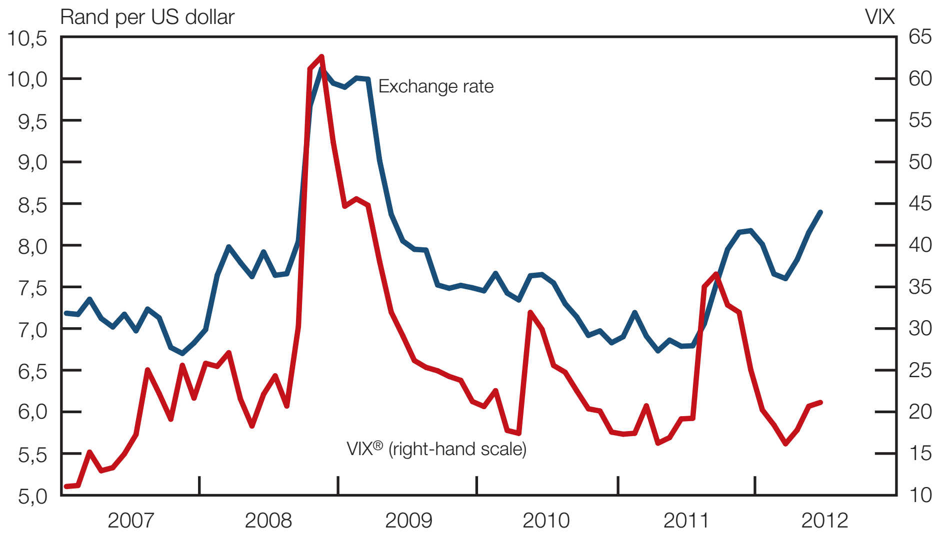
	31 Dec 2009 to 30 Jun 2010	30 Jun 2010 to 31 Dec 2010	31 Dec 2010 to 30 Jun 2011	30 Jun 2011 to 31 Dec 2011	31 Dec 2011 to 30 Jun 2012
Weighted average*	3,1	8,6	-6,4	-11,9	-0,6
Euro	13,5	5,9	-10,0	-6,5	0,6
US dollar	-3,6	15,5	-2,3	-16,6	-2,1
Chinese yuan....................	-4,2	12,2	-4,2	-18,8	-1,2
British pound....................	3,3	12,2	-5,5	-13,4	-3,4
Japanese yen...................	-7,4	6,1	-3,5	-19,5	0,3

* Against a basket of 15 currencies

The domestic currency appreciated in the first quarter of 2012, boosted by, among other factors, the IMF's commitment to increasing its lending capacity to countries in need together with the US$430 billion pledged to the IMF by G-20 countries. The rand received further impetus from the announcement by Citigroup in April 2012 that South Africa's government bonds may in future be included in its World Government Bond Index (WGBI) however from the end of March 2012 to the end of June the rand depreciated, partly on account of renewed concerns about the euro area and global growth prospects alongside declining commodity prices.

The Chicago Board Options Exchange Market Volatility Index (VIX®) is a measure of the implied volatility of S&P500 index options. Often referred to as the *fear index* or the *fear gauge*, it represents a measure of the market's expectation of stock market volatility over the next 30-day period. The VIX® is quoted in percentage points and roughly translates, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualised. In some instances of heightened global equity and bond market volatility, high-yielding currencies tend to depreciate while low-yielding ones tend to serve as a "safe haven". As regards to tracking the VIX®, the South African rand displayed patterns similar to those of other high-yielding currencies as depicted in the accompanying graph.

Exchange rate and Chicago Board Options Volatility Index (VIX®)



The real effective exchange rate of the rand declined by 13,7 per cent in 2011, following an increase of 10,1 per cent in 2010. The index rebounded somewhat in the first quarter of 2012 but fell back in April and May as commodity prices receded and risk aversion among investors intensified alongside lack of progress in addressing euro area concerns.

The average net daily turnover in the domestic market for foreign exchange increased by 34,3 per cent from US$16,5 billion in 2010 to US$22,1 billion in 2011 and approximately US$20 billion in the first five months of 2012. The higher turnover in the domestic market for foreign exchange could largely be attributed to increased activity by non-resident investors in the swap market. The value of transactions in the market for third currencies also rose firmly in 2011 compared with the preceding year before levelling out in the early months of 2012.

Monetary developments, interest rates and financial markets

Structural and regulatory issues

Wide-ranging regulatory and legislative reforms in the South African financial sector focused on modernising the regulatory framework and market infrastructure, and on new product offerings. Key developments are outlined below.

In the 2011 *Medium Term Budget Policy Statement* (MTBPS) the Minister of Finance announced that all inward-listed shares on the JSE Limited (JSE) would henceforth be classified as 'domestic assets' and be included in the JSE indices, provided they met all the specified criteria.

Citigroup announced in April 2012 that South African government bonds would be considered for inclusion in the World Government Bond Index (WGBI). In June, with all the selection criteria successfully met, it was indicated that South Africa would be included in the benchmark WGBI from October 2012 – the first African country in the index. Inclusion in the WGBI is set to give South Africa a larger and more diversified investor base, which could raise capital inflows and support the raising of funds for infrastructural programmes.

The Financial Markets Bill was tabled in Parliament in April 2012 and will replace the Securities Services Act, 2004 (Act No. 36 of 2004) which took effect on 1 February 2005. The Bill will align the regulation and supervision of South African financial markets with prevailing international developments in regulatory standards. It will govern the regulation of securities services in South Africa, including securities exchanges, central securities depositories, clearing houses and their respective members.

Following the introduction of Can-Do dollar/rand currency contracts on the interest rate derivatives market of the JSE, Yield-X, in February 2011, the JSE Equity Derivatives Division announced the commencement of trading in Can-Do Structured Futures in May 2011. This new Can-Do product type provides participants with greater flexibility to pursue complex strategies, diversify or hedge. The JSE continued to extend its currency segment on Yield-X, adding new Can-Do currency products in March 2012 with the pound sterling/rand, Australian dollar/rand and New Zealand dollar/rand exchange rates as underlying instruments.

In July 2011 the JSE Commodity Derivatives Division introduced more foreign-referenced commodity futures, particularly the soft red winter wheat contract (REDW), which is cash-settled off the Chicago Board of Trade. After signing a licensing agreement with the Kansas City Board of Trade, the JSE further enhanced its product range in March 2012 to include futures on the cash-settled hard red winter wheat contract (KANS). This addition to the existing wheat products will allow holders with exposure in any of the wheat contracts to compare trading margins. Since the quality of this product is similar to South African-produced wheat, it enables market participants to trade this alternative product for price risk management purposes specific to their wheat exposure.

In March 2012 the JSE announced the cross-listing of BRICS (Brazil, Russia, India, China, South Africa) benchmark indices which would provide investors with easy access to international emerging markets through cash-settled rand-priced derivatives on the BRICS indices. Consequently, the JSE's Equity Derivatives Division introduced trade on futures on the Hang Seng Index, providing investors with an opportunity to trade and gain exposure to shares listed on the Hong Kong Futures Exchange.

In April 2012 the JSE announced that its Africa Board would close towards the middle of the year with the two current listings being incorporated in the main board. The JSE decided to change its strategy to enhance Africa offerings, as African companies would now list directly on the main board and Alternative Exchange (Alt^{X}).

It was announced in the *2012 State of the Nation address* that as from April 2012, a national housing subsidy of up to R83 000 would be extended to people with monthly earnings of between R3 500 and R15 000, to make them eligible for housing finance from accredited banks.

Further legislative and regulatory changes affecting financial markets announced in the national government's Budget for fiscal 2012/13 included the following:

– The government introduced five new bonds as shown in the table below.

New domestic government bonds

Fixed income		Inflation linked	
Bond code	Maturity date	Bond code	Maturity date
R2023	28 February 2023	I2025	31 January 2025
	28 February 2047	I2038	31 January 2038
R2048*	28 February 2048		
	28 February 2049		31 December 2049
		I2050*	31 December 2050
			31 December 2051

* Bond of which the maturity value is split equally over the three maturity years

– From 1 March 2012, the capital gains tax (CGT) inclusion rate for individuals and special trusts increased from 25 to 33,3 per cent, shifting their effective rate to 13,3 per cent. Similarly, for companies and other trusts the CGT inclusion rate increased from 50 to 66,6 per cent, raising the effective rate for companies to 18,6 per cent and for other trusts to 26,7 per cent. To limit the impact of CGT on middle-income earners, the annual exclusion was increased from R20 000 to R30 000, the exclusion amount on death was increased from R200 000 to R300 000, while the primary residence exclusion was increased from R1,5 million to R2 million effective from 1 March 2012.

– Employer contributions to medical schemes on behalf of former employees would be deemed a taxable fringe benefit, as such former employees would be able to claim appropriate tax credits.

– The secondary tax on companies (STC) was replaced with the new dividend withholding tax (DWT) on 1 April 2012. The liability for tax on dividends now rests with the investor and no longer with the company. The DWT rate of 15 per cent is 5 percentage points higher than the previous rate of STC.

– National Treasury proposed that a securities transfer tax for brokers must be implemented and that the inclusion of financial derivatives in the base of this tax should also be considered.

– Tax relief for housing developers and employers who provided housing valued at up to R300 000 a unit was proposed.

– The Minister of Finance indicated that the government would publish a Green Paper proposing major social security reforms for South Africa. Key recommendations were that the current system should be replaced with a mandatory statutory fund or integrated system that provided for pension benefit, life insurance and disability benefits. To encourage retirement savings, it was announced that employees' and employers' contributions to pension, provident and retirement funds would be tax deductible by individual employees as from 1 March 2014.

Following the adoption of the twin peaks model of financial regulation by South Africa, the National Treasury (NT) and Financial Services Board (FSB), in their endeavours to ensure the soundness and stability of the financial system, and increase domestic savings, financial inclusion and consumer protection, released a range of regulations and discussion documents outlining proposals on the current and future changes to the legislation dealing with financial intermediaries.

Retirement industry surveys conducted in 2011 indicated that most pension and provident fund members encashed their pension benefits when changing or leaving employment. In addressing this and other challenges, the National Treasury and South African Revenue Service (SARS) proposed in the Taxation Laws Amendments Bill 2011 that the transfer of funds from provident and provident preservation funds to retirement annuity or pension preservation funds be made tax-free. All living annuity products would be renamed Retirement Income Drawdown Accounts (RIDDAs) from 1 March 2012 and the list of product providers was expanded to include collective investment schemes. Other proposals made included that premiums paid by employers in respect of a group income protection policy should be deemed to be a fringe benefit if they are meant to benefit employees.

In June 2011 National Treasury released a policy document on microinsurance entitled "The South African Microinsurance Regulatory Framework". The policy objective of this framework is to improve access to long- and short-term insurance products to the low-income population, formalise insurance provision currently offered by informal service providers, ensure protection of consumers, promote competition, and facilitate effective prudential supervision and enforcement in the industry. Provision will also be made for a separate microinsurance licence in a stand-alone Act. The Microinsurance Bill is expected to be released for public comment in 2012.

The FSB released discussion papers for comments on insurers' solvency assessment and management (SAM), outlining reporting, disclosure and capital requirements and governance issues. The final implementation date of SAM was changed from January 2014 to January 2015. The first South African quantitative impact study (SA QIS 1) on SAM was conducted during 2011; the objective of this study was to measure the direct impact of the proposed rules on both short- and long-term insurers.

In May 2012 the National Treasury published an overview paper on the reform of the retirement industry, outlining that a series of technical discussion documents on strengthening and promoting retirement savings would be released in the course of 2012. The papers would, among other things, deal with inadequate pension savings, the high costs of retirement fund products and the low level of preservation of retirement savings. In enhancing prudential regulation, in March 2012 the FSB released a notice in terms of Regulation 28 that a pension fund could invest up to a maximum of 10 per cent of its total assets in private equity funds.

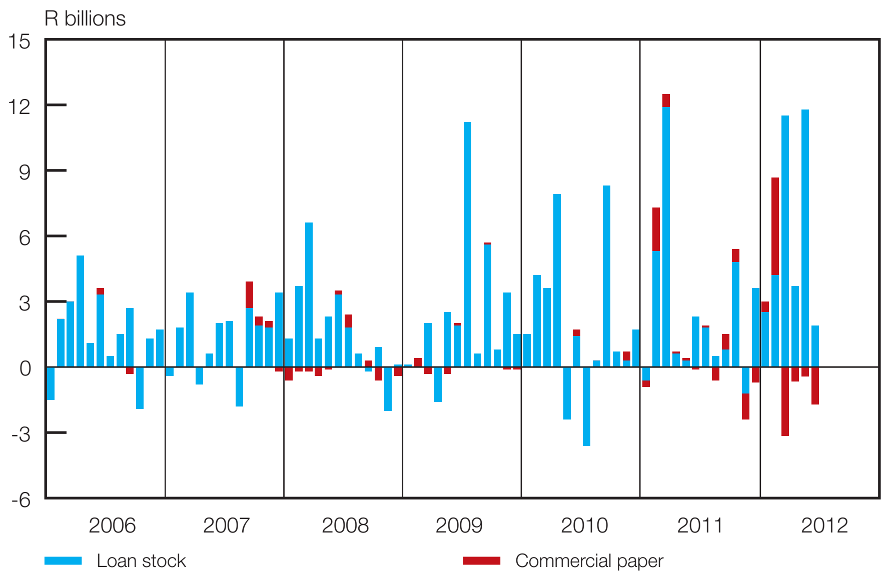
Draft regulations on the demarcation between health insurance policies and medical schemes were released by the National Treasury. The regulations seek, among other things, to ensure that health- and financial-sector policy objectives are aligned, in order to address the potential risk that may be caused by health insurance products attracting younger and healthier members away from medical aid schemes to insurance products.

During the past year the South African banking sector had to deal with an uneven pace of recovery in financial and real economic activity, together with enhancements to the regulatory environment. Based on the challenges posed by lower economic growth, low interest rates and high consumer indebtedness, prominent international ratings agencies revised the credit outlook of banks in early 2012, resulting in the downgrading of the subordinated debt and deposit ratings of five large banks during this period. Notwithstanding these developments, the banking sector remained sound, stable and adequately capitalised, with limited exposure to the sovereign debt risks that affected countries in the euro area in particular.

Changes to the Regulations Relating to Banks issued under the Banks Act, 1990 (Act No. 94 of 1990), implemented on 1 January 2012, form part of a phasing-in approach eventually to meet the requirements of the Basel III regulatory framework. The Regulations giving effect to Basel 2.5 (an interim point on the way to Basel III) aim, among other things, to strengthen the risk coverage of the capital framework; to reduce risks from certain securitisation and off-balance-sheet activities; to discourage excessive lending; to strengthen senior management oversight in banks and banking groups; to increase disclosure to the public; and to strengthen the oversight of bankers' remuneration. While the banking sector is well positioned to comply with the Basel III regulatory framework, strong reliance on short-term wholesale funding and a shortage of high-quality liquid assets as defined in the Basel III framework pose a challenge to South African banks to meet the new liquidity standards. The Basel III liquidity framework sets two minimum standards for funding liquidity. Firstly, it requires banks to adhere to a new liquidity coverage ratio (LCR) to ensure that they have sufficient, unencumbered high-quality liquid assets to survive a month-long significant stress scenario. In May 2012 the Bank approved the provision of a committed liquidity facility, to be introduced from January 2013, to assist banks in meeting the LCR requirement. The Bank simultaneously approved that statutory cash reserves could be included in banks' high-quality liquid assets for purposes of calculating the LCR.

The second minimum standard is a net stable funding ratio (NSFR), promoting a movement to less volatile and more medium- and long-term funding of banks' activities. In 2011 and the first six months of 2012 private-sector banks lengthened the maturity of their funding through increased issuances of bonds, both domestically and internationally, in an effort to mitigate maturity mismatches in funding and lending activity. The issuance of commercial paper also increased during the 18 months to June 2012, while assets to the value of R4,0 billion were securitised in 2011, compared with R4,5 billion in the preceding twelve months.

Funding by private-sector banks in the bond market*



* Change in outstanding nominal value of loan stock listed by private-sector banks on the JSE Limited

The banking sector continued to be dominated by four large banks, which together accounted for 84 per cent of the total assets of the South African banking sector during the period under review. In May 2012 locally registered banks in South Africa numbered 30, including 12 registered as branches of foreign banks. The number of foreign banks with approved local representative offices in South Africa increased to 43 at the end of May 2012, compared to 41 at the end of April 2011. The total assets of the banking sector increased at an annual rate of about 9 per cent during the year as banks strategically lowered the concentration of their business in areas that were negatively impacted by the global financial crises and domestic economic recession. The banking sector continued to develop innovative banking products, increase penetration into the unbanked segment of the population, and use its sound financial position to expand its footprint in the rest of the world. With the entry-level banking account, Mzansi, not gaining much further ground, banks also re-branded and re-packaged their low-cost entry-level products to gain wider appeal.

Size of the South African private banking sector

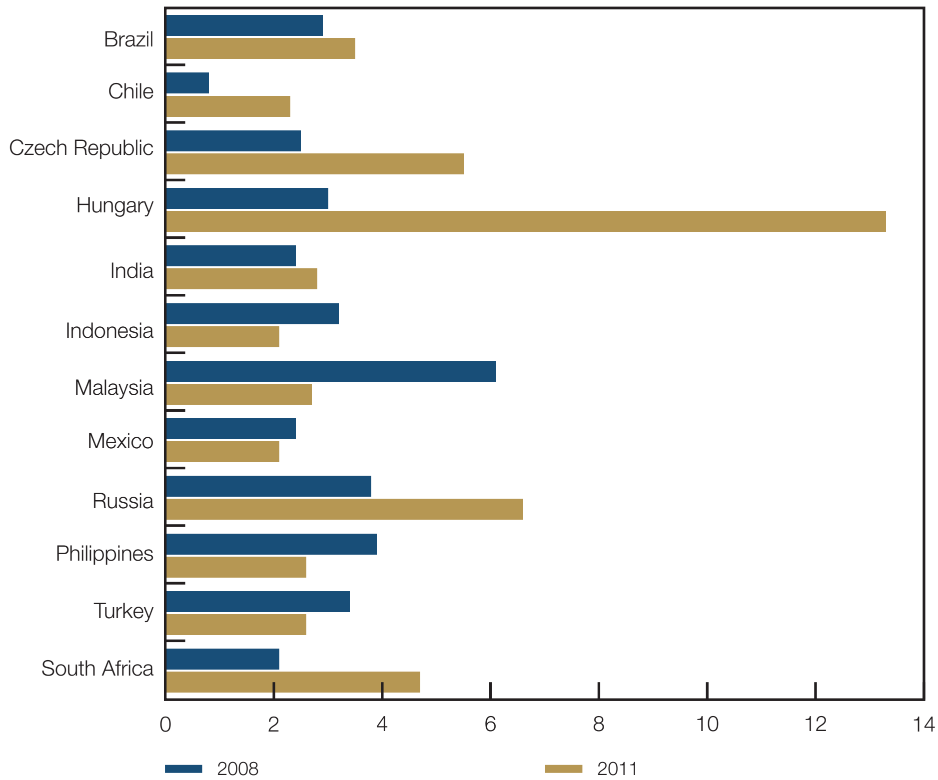
	May 2011		May 2012	
	Number of institutions	Total assets (R billions)	Number of institutions	Total assets (R billions)
Locally controlled banks	11	2 876	10	2 532
Foreign-controlled banks	5	14	6	753
Mutual banks	2	1	2	1
South African branches of foreign banks	12	180	12	189
Total registered banks	30	3 071	30	3 475

Since the implementation of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) effected in February 2008 as part of government's financial inclusion initiatives, only two institutions have met the criteria set by the Registrar of Co-operative Banks to qualify as co-operative banks out of the total of 18 institutions that were eligible to apply for registration at the end of June 2012.

The quality of banks' assets improved during the period under review, with impaired advances as a percentage of total gross loans and advances declining from 5,8 per cent in April 2011 to 4,7 per cent in December and further to 4,6 per cent in May 2012. Nonetheless, impaired advances remained high when compared to other developing countries.

Non-performing loans* in selected emerging-market countries

Percentage of total gross loans and advances



Source: International Monetary Fund, *Financial Soundness Indicators*

* Definitions of asset quality in loan portfolios may vary across countries

Owing to the high level of consumers in distress, the government reached an agreement with banks and some retailers to restructure, in a trial programme, the outstanding debt of consumers with impaired credit records undergoing debt counselling. The testing phase, which will be implemented from the end of June 2012, will lower the interest rate levied on the outstanding debt to the repurchase rate, with a further possibility to reduce the rate to zero in cases where consumers still experienced difficulties in honouring their payment obligations.

The Banking Association South Africa revised the Code of Banking Practice, effective from January 2012, to account for changes to the Consumer Protection Act of 2008 and the National Credit Act of 2005, and also addresses some of the recommendations made during the 2008 Banking Enquiry of the Competition Commission. Among other things, the code strives to ensure good banking practices, transparent products and services, and foster confidence in the banking system.

In conjunction with the Department of Home Affairs, the banking sector through the Banking Risk Information Centre pioneered an online fingerprint verification system in November 2011. The aim of the system is to ensure the security of consumers' deposits and investments by curbing identity-related fraud and corruption.

Following the successes of the provision of R42 billion in affordable housing finance to the lower-income population in terms of the Financial Sector Charter, the government introduced several further initiatives aimed at addressing the housing backlog in South Africa. Phase 2 of the draft Financial Sector Code was gazetted by the Minister of Trade and Industry for public comment in March 2012. The draft code introduces two new elements, empowerment financing and access to financial services, into the measurement of broad-based black economic empowerment, with the intention to broaden the transformation process in the financial sector.

Significant progress was made during the year to promote financial market stability through strengthening of the financial-sector regulatory framework and supervision. Of notable importance was the approval by Cabinet in February 2012 of the draft Financial Services Laws General Amendment Bill. The Bill aims to address inconsistencies in current legislation and legislative gaps highlighted after the 2008 financial crisis. It will amend eleven financial-sector laws, which include the Short-term and Long-term Insurance Acts, 1998; the Pension Funds Act, 1956; and the South African Reserve Bank Act, 1989. The Bill seeks to close gaps in South Africa's adherence to international standards for financial regulation, align financial-sector legislation with the Companies Act, 2008 and eliminate overlaps caused by the Consumer Protection Act, 2008, Companies Act, 2008 and Competition Commission Act, 2009.

Prudential regulation was further broadened by the establishment of the Financial Stability Oversight Committee, chaired jointly by the Governor of the South African Reserve Bank and the Minister of Finance.

Money supply

Having accelerated notably in the second half of 2010, growth in the broadly defined money supply (M3) subsequently fluctuated in a fairly narrow, single-digit range during 2011 and the early months of 2012. The fairly modest growth in money supply during the past year was consistent with the generally moderate pace of recovery in real and financial economic activity, and muted interest return on deposits. In 2011 twelve-month growth in M3 moderated from 8,2 per cent in January to 5,6 per cent in July before reaccelerating to 8,3 per cent in December. The improved M3 growth performance during the second half of 2011 partly reflected strong turnover and rising prices in the financial markets, improved production and expenditure, generally rising inflation, and an improvement in employment creation. Growth in money supply again moderated in the early months of 2012, reflecting a deceleration in production and expenditure, while a minor part of the deceleration was also due to technical adjustments to the BA 900 survey forms, implemented from January 2012.[5]

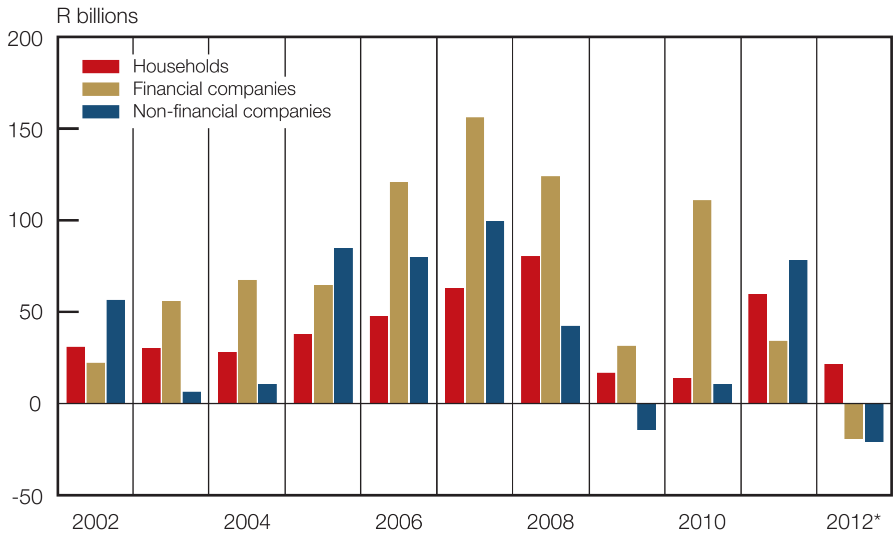
5 Amendments to the BA 900 survey became effective in January 2012, and had a moderate impact on the historical comparability of data. The essential underlying trends in the data remain unchanged, while it is estimated that the amendments resulted in a sustained decline of 0,6 per cent in the level of M3.

Notes and coin in circulation outside the central bank recorded a pronounced increase in 2011. Apart from the normal transactions demand for cash, the sharp year-on-year rise is partly explained by banks' in-house sorting of banknotes following the introduction of a 0,25 per cent levy in July 2010. The levy is charged to commercial banks for banknote deposits and withdrawals at the Bank. Further revisions to the Bank's cash management strategy were implemented from around October 2011 with the focus on the decentralisation of banknote processing to commercial banks.

A sectoral analysis of deposits indicates that growth in the broad M3 holdings of the corporate sector steadily outpaced that of households during the past ten years. Deposit growth of the corporate sector, especially financial companies, accelerated notably from 2005, and contributed to the period of exceptional growth in money supply in 2006 and 2007 when year-on-year growth in M3 hovered around 23 per cent. This period was also associated with high growth in fixed investment and generally buoyant economic conditions. Some moderation set in in 2008, but the full effect of the post-Lehman Brothers recession only came to the fore in 2009 with household and financial company deposits growing very little, and deposit holdings of non-financial companies actually contracting during this period. After the recession, the financial companies component recorded the fastest growth, particularly in 2010.

Deposits of non-bank financial companies increased by 152 per cent from December 2005 to May 2012, bolstered by strong growth in money-market unit trusts during this period. Over the same period, the deposit holdings of non-financial companies rose by 70 per cent, while that of households increased by 88 per cent.

Deposit growth of households and companies

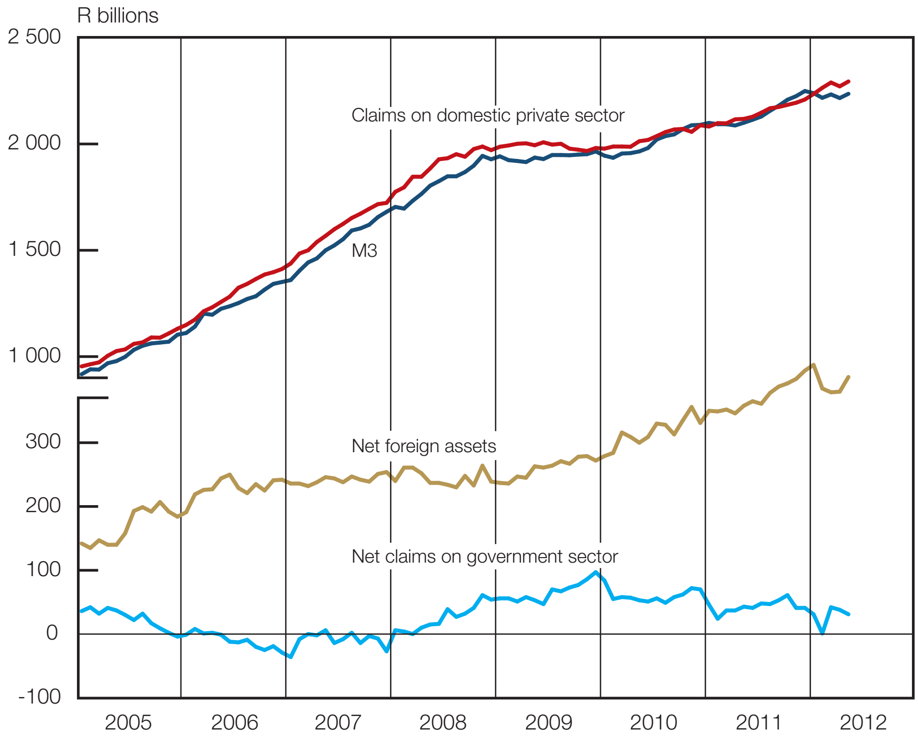


* January–May 2012

More recently, the growth over twelve months in deposit holdings of the household sector followed a firm upward trend from May 2011 to reach a three-year high of 13,4 per cent in May 2012, supported by growth in real income and employment. However, growth over twelve months in the deposit holdings of the corporate sector decelerated gradually from 10,3 per cent in January 2011 to 7,4 per cent in December and further to 3,9 per cent in May 2012. Within the corporate sector, financial companies were mainly responsible for the slowdown in deposits.

As reflected in the accompanying graph, the main statistical counterpart of the change in M3 in the twelve-month period to May 2012 was claims on the domestic private sector, supported by an increase in net foreign assets. The increase in claims on the private sector reflected rising bank loans and advances to the private sector. Net foreign assets increased, resulting from stronger growth in foreign assets compared to more subdued growth in foreign liabilities during the period under review. The rise in M3 was to some extent dampened by a decline in net claims on the government sector and net other assets and liabilities.

M3 and its statistical counterparts



Seasonally adjusted

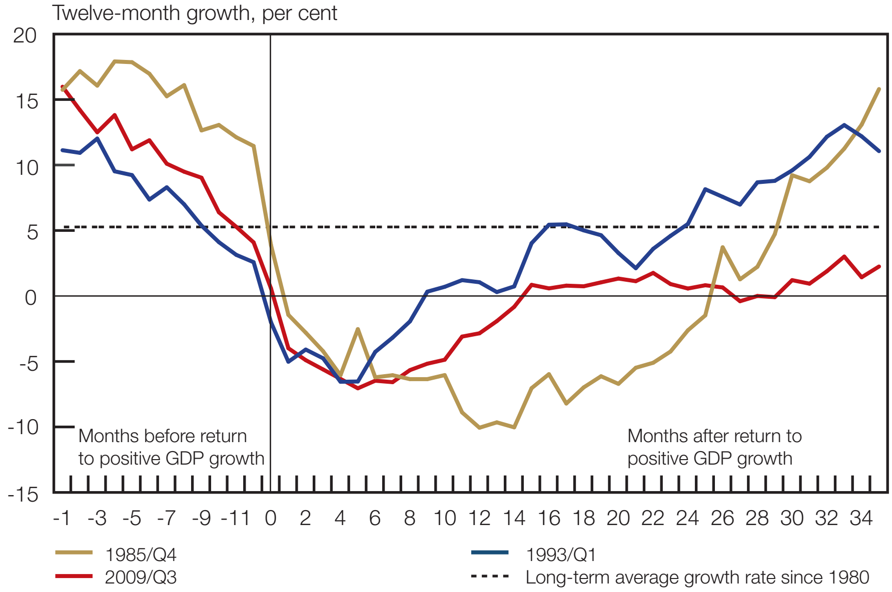
The pace of recovery in money supply growth since the economic contraction in 2009 has been slower than that of the nominal gross domestic product, leading to a rising trend in the income velocity of circulation of M3. The income velocity of circulation of M3 increased from a low of 1,22 in the second quarter of 2009 to 1,39 in the third quarter of 2011 and remained at this level to the first quarter of 2012.

Credit extension

Banks' total loans and advances extended to the private sector have gained traction over the past 18 months. Year-on-year growth in loans and advances recovered from negative growth in early 2010 to levels of around 6 per cent by April 2011, whereupon it fluctuated broadly sideways for the subsequent seven months. Growth picked up to 7,4 per cent in December 2011 and reached 9,2 per cent by March 2012, although it then moderated to 8,0 per cent in May. Despite the slight upward trend over the past year, the current recovery in credit extension lagged similar recovery growth paths that prevailed after previous recessions in the South African economy. On an inflation-adjusted basis, growth in credit extension fluctuated higher from minus 0,4 per cent in September 2011 to a positive 2,3 per cent in May 2012 but remained well below the recovery paths of 1993 and 1985, reflecting the hesitant and vulnerable domestic economy, tighter credit conditions, and directionless property market, all against the background of global uncertainty.

The current modest revival in credit extension occurred without meaningful growth in *mortgage advances.* Year-on-year growth in mortgage advances receded from 4,8 per cent in November 2010 to a historical low of 1,9 per cent in November 2011 and remained virtually flat at around 2 per cent in the early months of 2012. Mortgage lending remained constrained from the supply side by the weak profitability of such loans, given tight interest margins and relatively

Historical trends in inflation-adjusted loans and advances around recessionary periods



high levels of impaired advances, alongside prospective borrowers' muted expectations of a significant recovery in real-estate prices. Capital repayments on existing mortgage bonds also increased relative to new loans paid out since the second half of 2010, and accelerated during the course of 2011 and 2012, partly contributing to the moderate growth in the outstanding level of mortgage advances.

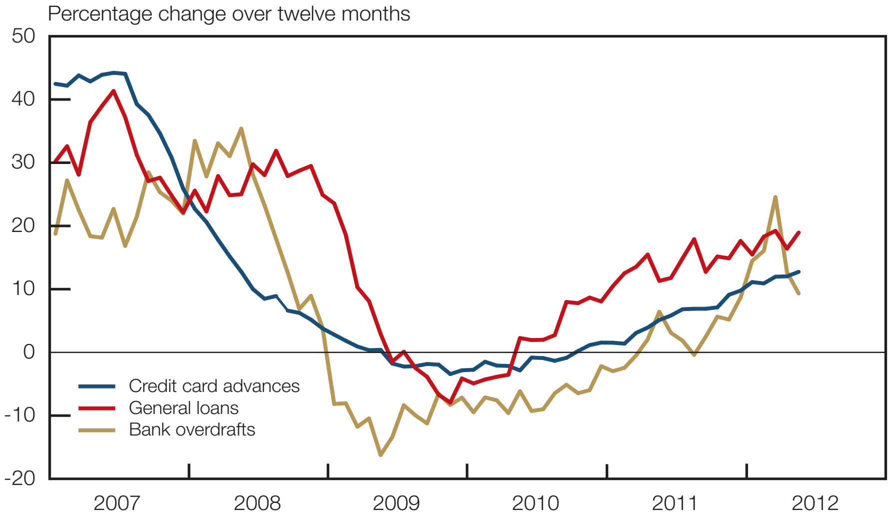
Credit aggregates: Outstanding balance

Component	May 2011 (R billions)	May 2012 (R billions)	Change (Per cent)
Mortgage advances	1 053	1 077	2,2
Instalment sale credit and leasing finance	247	270	9,3
Other loans and advances	684	798	16,6
Overdrafts	131	143	9,3
Credit card advances	58	66	12,7
General advances	495	589	19,0
Total loans and advances	**1 985**	**2 144**	**8,0**
Of *which*: To household sector	1 136	1 220	7,5
To corporate sector	849	924	8,8

The category *other loans and advances* was the main contributor to the growth in total loans and advances during 2011, accounting for 70 per cent of the increase in loans and advances for the year as a whole. Robust growth in other loans and advances emanated from a strong uptake of general loans by the corporate and household sectors, buoyed by the active promotion of these types of loans by certain banks. In the early months of 2012 general loans, which include unsecured lending by banks to the household sector, continued to account for the bulk of the increase in other loans and advances, albeit at a marginally slower pace than before. (A more comprehensive analysis is provided in the accompanying box.) After lagging behind credit card advances and general loans for an extended period, twelve-month growth in overdrafts, particularly to the corporate sector, rebounded to reach 24,5 per cent in March, up from a recent negative growth rate of 2,4 per cent in February 2011. Growth in overdrafts again moderated to 9,3 per cent in May.

Growth in *instalment sale credit and leasing finance* gained further momentum in the past year and reached 9,3 per cent in May 2012, largely on account of the instalment sale credit category, which continued to benefit from elevated motor vehicle sales.

Other loans and advances to the private sector

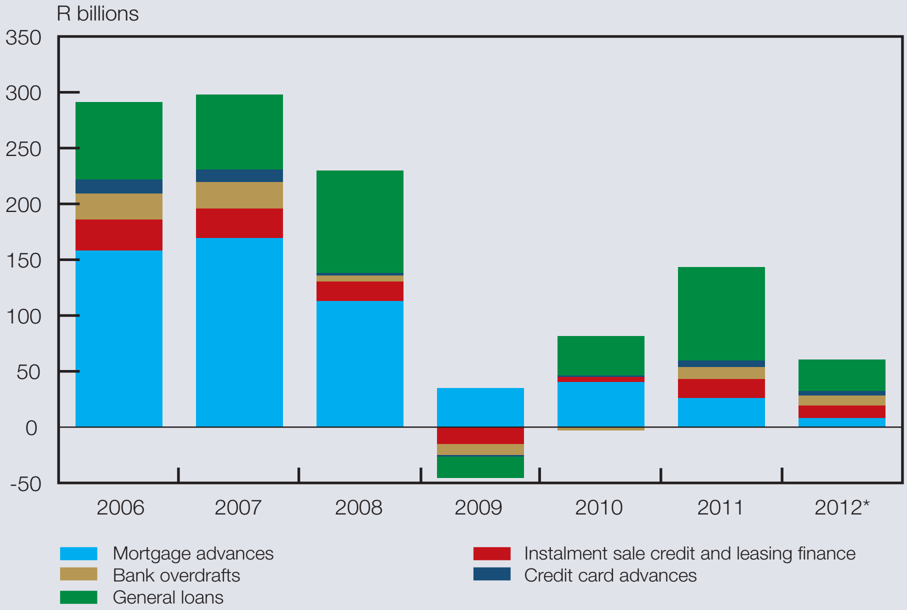


Box 1: Recent trends in the drivers of bank credit extension

With the international financial crisis exerting downward pressure on economic activity, the South African economy experienced a downswing in the business cycle from December 2007 to August 2009. This was reflected in negative real economic growth in 2009 and an absolute decline in all types of credit extended by banks, with the exception of mortgage advances. The subsequent recovery has brought new patterns of credit extension to the fore. This box looks at the changes in a number of trends in the drivers of credit extension by banks during the current upward phase of the business cycle, with a particular focus on general loans to households.

The first discernible trend since 2009 has been the relegation of mortgage advances from the largest contributor to overall growth in the outstanding balances of banks' total loans and advances to the domestic private sector to second place as from 2011 and the rise of general loans to first place (Figure B1).

Figure B1 Growth in banks' total lending by type

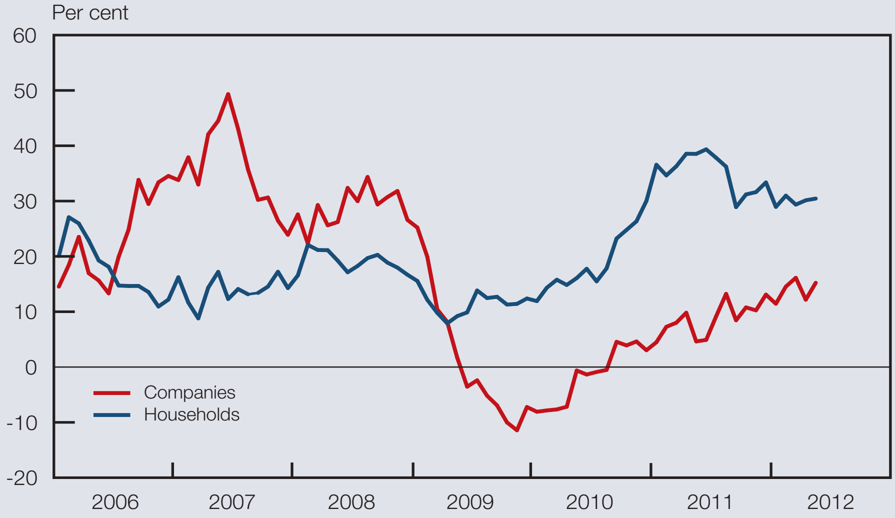


* January–May 2012

In 2011, general loans increased by R84 billion compared to an annual average of R76 billion from 2006 to 2008. From a lenders' perspective this was facilitated by the higher interest rates and risk-adjusted returns on general loans than on mortgage lending in recent years.

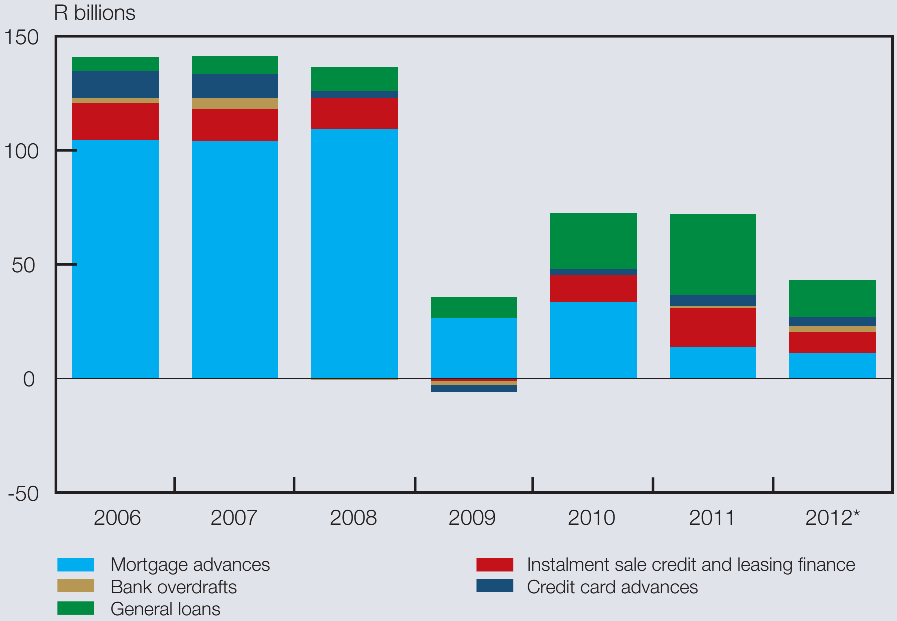
The second trend has been a switch in the contribution to growth in general loans from companies to households as from May 2009 (Figure B2). Year-on-year growth in general loans to companies at first decelerated and then contracted during 2009 only to record positive rates of increase as from September 2010 and only breaching the double-digit mark again from August 2011. In contrast, the year-on-year rate of growth in general loans to households, which are generally regarded as unsecured lending, accelerated to a high of 39 per cent in June 2011 before slowing to a still high 30 per cent in May 2012.

Figure B2 Growth in general loans by sector



These two trends, namely the increased contribution of general loans to overall bank credit and the increased demand by households for this type of credit and other forms of unsecured borrowing, led to a change in the composition of bank credit extended to households (Figure B3). As from 2011, general loans made the largest contribution to the annual increase in

Figure B3 Growth in banks' lending to households by loan type

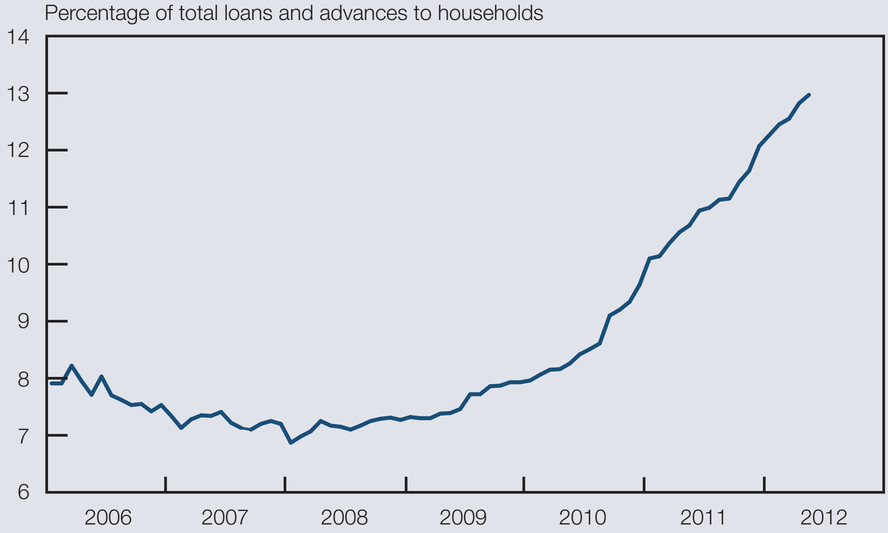


* January–May 2012

household debt to banks and growth in the instalment sale credit and leasing finance category exceeded growth in mortgage advances for the first time on record. Growth in vehicle sales boosted growth in instalment credit and leasing finance while overdrafts, credit card advances and general loans increasingly financed other credit-driven consumption expenditure. With low mortgage interest rates and a weak property market, credit extension is currently driven by borrowers' creditworthiness and income rather than by collateral.

These trends have led to concerns about the strong growth in general loans to households (so-called unsecured borrowing). This trend is closely monitored as the ratio of general loans to households to total loans and advances to households has increased from levels below 8 per cent up to late 2009 to 13,0 per cent in May 2012 (Figure B4). In value terms, general loans to households amounted to R158 billion in May 2012. However, the continuation of the growth trend in general loans to households in the formal banking environment will automatically be constrained by both household income and the amount of outstanding general loans already accessed, which will limit access to new loans since loan affordability is a key parameter considered in the granting of loans. Changes in the level of interest rates will also affect the affordability of existing and new loans.

Figure B4 General loans to households



The trends discussed above may also partly be a reflection of the early stages of the banking sector's balance sheet restructuring to comply with the liquidity coverage ratio required by the Basel III framework. The framework, among other things, requires a more closely matched maturity structure between banks' funding liabilities and assets. With funding currently biased towards the short term and lending towards the long term, the promotion of general lending by banks with its greater short-term focus at a time when growth in long-term mortgage advances is stagnating, serves to reduce the maturity mismatch.

A large portion of the growth in credit extension during the past decade was directed towards the corporate sector. The impact of the global recession, alongside the contraction in domestic economic activity and progressive tightening of monetary policy up to mid-2008, had a pronounced detrimental impact on credit extended to companies. Year-on-year growth in credit extension to the corporate sector fell sharply from near-record levels in mid-2007 to negative growth during 2009, while year-on-year growth in credit extension to households also decelerated but remained positive during this period. In the subsequent recovery from 2010 the household sector initially took up more credit than the corporate sector, but these roles were reversed in the past year as companies borrowed more and simultaneously stepped up their capital formation activity.

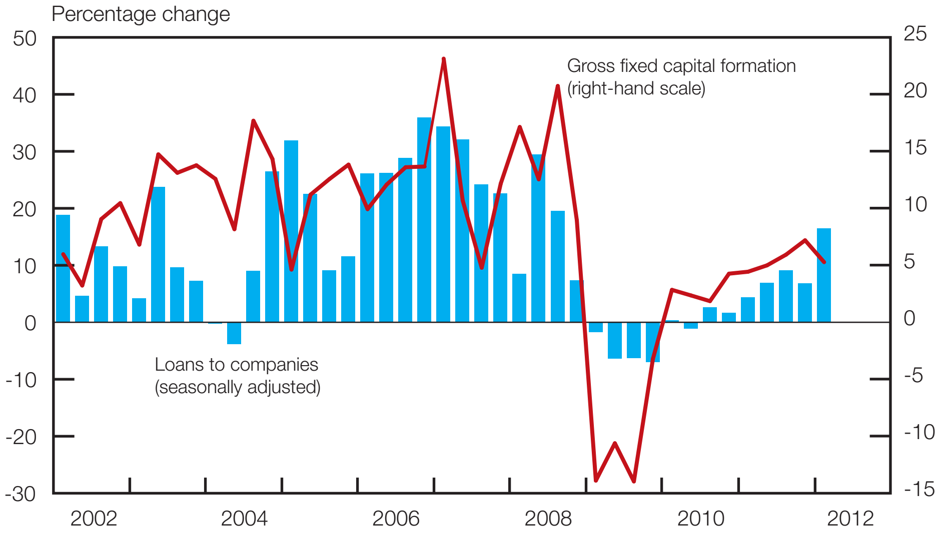
On a sectoral basis, the strongest growth in bank credit over the past year was recorded in credit extended to the manufacturing, mining and agricultural sectors, as depicted in the accompanying table. Nevertheless, the highest absolute amount of credit exposure was to the household sector, followed by the financial intermediation and insurance sector.

Sectoral distribution of credit

Sector	March 2011 (R billions)	March 2012 (R billions)	Change (Per cent)
Agriculture, hunting, forestry and fishing	11	55	410,9
Mining and quarrying	13	64	388,3
Manufacturing	18	107	473,1
Electricity, gas and water supply	26	28	8,2
Construction	21	16	-25,0
Wholesale and retail trade, hotels and restaurants	90	102	14,2
Transport, storage and communication	82	94	15,2
Financial intermediation and insurance	534	562	5,2
Real estate	209	190	-9,3
Business services	94	107	13,2
Community, social and personal services	180	237	31,5
Private households	1 137	1 233	8,4
Other	199	143	-27,7
Total	2 615	2 939	12,4

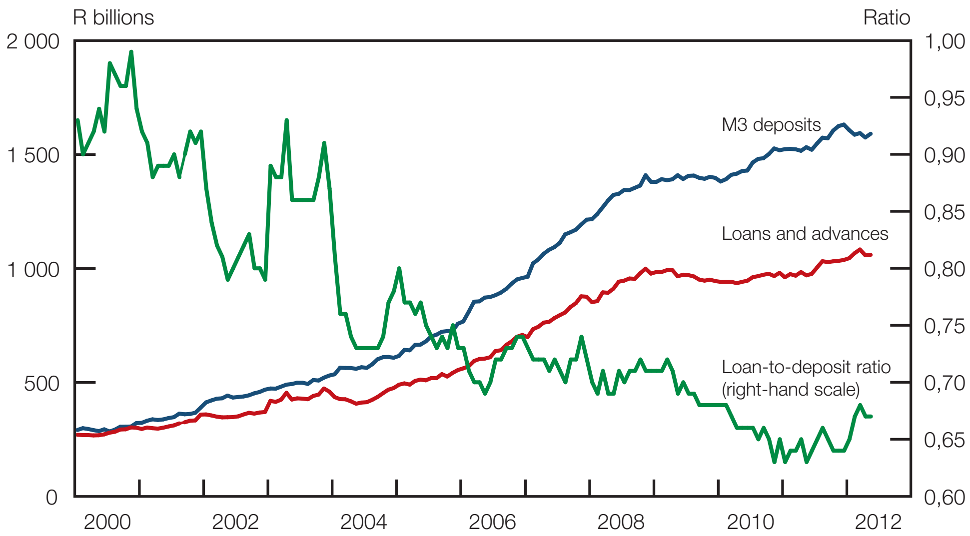
The uptake of credit by the corporate sector accelerated during 2011 and surpassed that of the household sector to become the dominant driver of credit extension from the latter part of 2011. Measured over twelve months, growth in credit extended to the corporate sector gained significant ground from 8,7 per cent in January 2012 to as high as 12,2 per cent in March 2012, before moderating to 8,8 per cent in May. The extension of loans and advances to the household sector rose at rates of around 7 per cent over the same period.

Growth in loans and advances to companies



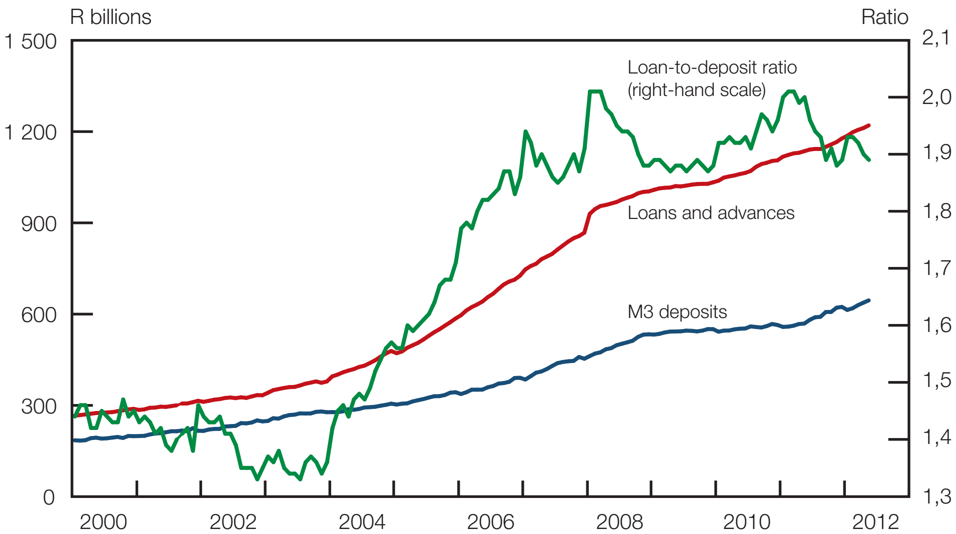
Owing to the trends in their deposit and loan growth in recent years, the loan-to-deposit ratio of companies has declined rather substantially since 2000. Corporate behaviour has been rather conservative, with the sector's holdings of deposits rising more rapidly than its bank loan liabilities in recent years. From a ratio of nearly one-to-one towards the end of 2000, the ratio of loans to deposits receded to as low as 0,63 in January 2011, before fluctuating moderately higher to 0,67 in May 2012, as a recovery in capital formation started to support borrowing by companies. Generally, favourable commodity prices feeding into higher operating surpluses of companies, together with a structural shift favouring money-market unit trusts, contributed to the rising corporate deposit balances.

Loan-to-deposit ratio of companies



Contrary to the declining trend in the loan-to-deposit ratio of companies, the ratio for households increased rapidly from early 2004 to reach a peak of 2,0 in March 2008 as loans to households were the predominant driver of credit growth. In the aftermath of the recent recession, credit to households moderated and the ratio declined somewhat to 1,87 in November 2009. It again increased to just above a two-to-one ratio in early 2011 but moderated to 1,89 in May 2012 following improved growth in household deposits.

Loan-to-deposit ratio of households

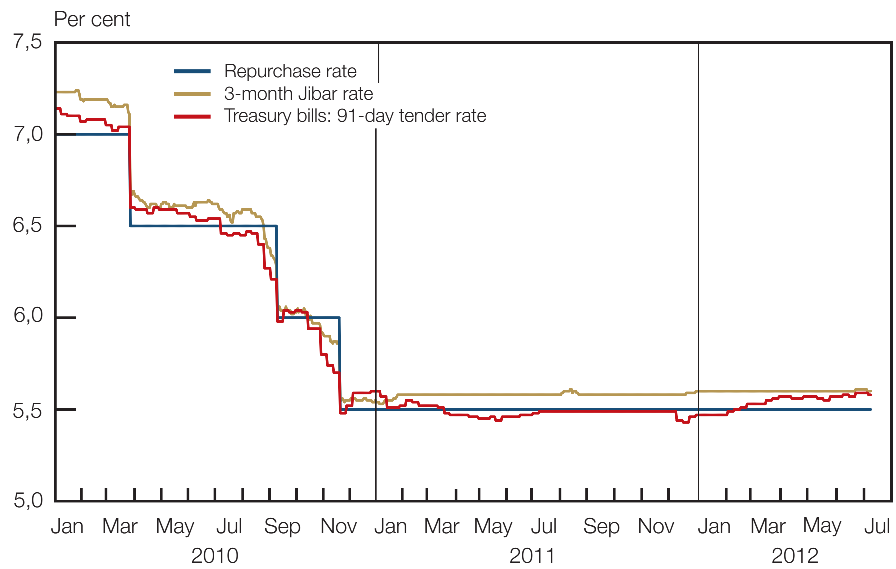


Interest rates and yields

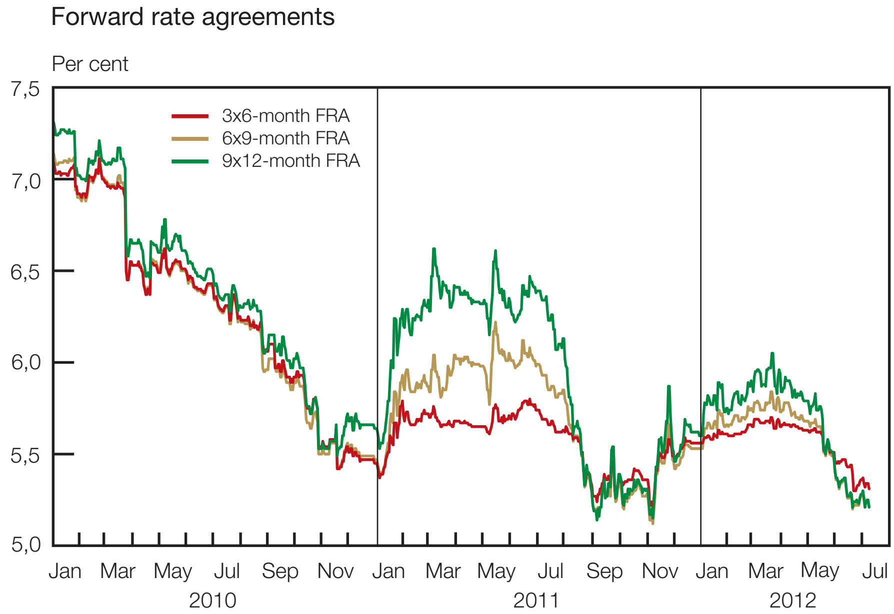
Having reduced the repurchase rate to 5,50 per cent in November 2010, the Monetary Policy Committee (MPC) of the Bank kept the policy rate unchanged throughout all its meetings in 2011 and the first half of 2012. While the inflation trajectory was generally rising during this period, this was predominantly due to cost-push factors, most notably oil, food and electricity prices. Given the large domestic output gap and growing global uncertainties, projected inflation 18 to 24 months ahead remained inside the target range. Temporary overshooting of the target range over shorter time horizons could accordingly be accepted without tightening monetary policy. While volatility of the exchange rate of the rand continued to cloud the inflation outlook, at the May 2012 meeting of the MPC the inflation forecast was revised lower and seen to have peaked at 6,1 per cent in the first quarter of 2012. Inflation was expected to average 6,0 per cent in the second quarter of 2012 and thereafter to follow a gradually declining trend while remaining within the target range up to the end of 2014.

Money-market rates were relatively stable in the second half of 2011 and the first half of 2012, largely emulating the unchanged repurchase (repo) rate; for example, the three-month Johannesburg Interbank Agreed rate (Jibar) essentially remained unchanged at 5,58 per cent in 2011, with a marginal increase to 5,61 per cent in June 2012, before reverting to 5,58 per cent in early July. By contrast, the rate on 91-day Treasury bills displayed some volatility and increased by a cumulative 11 basis points from 22 December 2011 to mid-July 2012.

Money-market rates

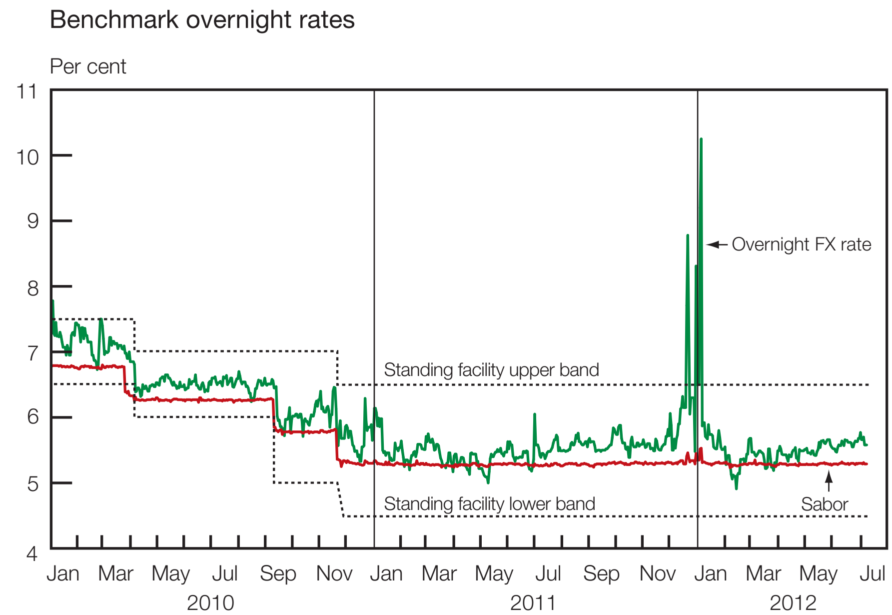


After displaying some tentative signs of bottoming between September and November 2011, rates on forward rate agreements (FRAs) trended higher across the maturity spectrum alongside heightened volatility in the global financial markets. FRA rates rose notably during the first three months of 2012 as investors' assessment of inflation prospects worsened, but subsequently these increases were reversed as inflation outcomes improved alongside a deterioration in global growth prospects and a decline in the prices of most commodities.



The interbank lending rates such as the South African Benchmark Overnight Rate (Sabor) on deposits and the implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) remained stable for most of 2011, despite occasional spikes emanating from heightened seasonal demand during the festive period. The overnight FX rate quickly normalised and, together with the Sabor rate, fluctuated well within the standing facility rate limits during the first seven months of 2012, reflecting the efficiency of the interbank market. The rates stood at 5,68 and 5,29 per cent, respectively on 13 July 2012.

In line with the unchanged repurchase rate both the prime overdraft rate and the predominant rate on mortgage loans have remained unchanged at 9,00 per cent since November 2010.

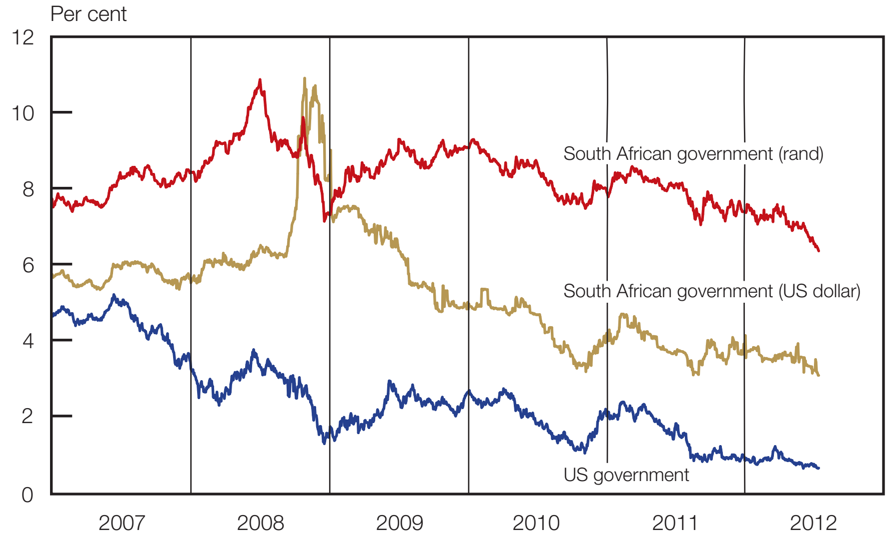


The daily average *yield on the R203 government bond* (maturing in 2017) generally trended lower over the past year. It nevertheless increased from a low of 7,04 per cent on 6 September 2011 to a recent high of 7,68 per cent on 25 November, in response to the depreciation in the exchange value of the rand and the release of higher-than-expected consumer inflation data. The bond yield then fell to an all-time low of 6,35 per cent on 12 July 2012 as a result of, among other things, favourable inflation data, strong demand by non-residents for local bonds and the news that domestic government bonds would be included in the Citigroup WGBI.

6 The differential between South African government bond yields on rand-denominated debt in the five-year maturity range issued in the domestic market and on dollar-denominated debt issued in the United States.

On balance, bond yields barely reacted to the downgrade of South Africa's sovereign debt outlook to negative by a rating agency on 28 March 2012. Investor sentiment remained positive towards local bonds, mindful of South Africa's solid investment grade credit rating and comparatively low levels of sovereign and foreign debt. During the past year yields on US government bonds (denominated in dollar) decreased notably. Along with low US bond yields, the yield on the dollar-denominated South African government bond also declined but to a lesser extent than the yield on the rand-denominated South African bond, resulting in the *currency risk premium*[6] on South African government bonds narrowing somewhat from November 2011 to June 2012.

Government bond yields



7 The differential between the yields at the extreme long and short ends of the curve.

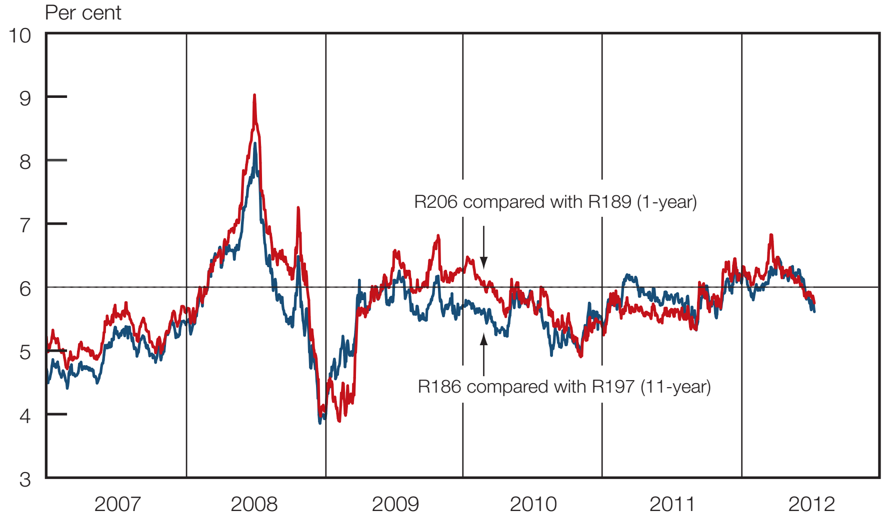
From September to December 2011 the level of the *yield curve* moved higher across all the maturities on inflation concerns – with the exception of the extreme short-end of the curve, which remained anchored to the unchanged repurchase rate. Thereafter, the yield curve moved lower to mid-July 2012, with a downward slope in the 0–2 year maturity category. The *yield gap*[7] therefore narrowed from 379 basis points on 14 December 2011 to 290 basis points on 12 July 2012.

As the differential between nominal yields on conventional bonds and real yields on inflation-linked government bonds widened – with the real yield on the R189 bond turning negative in November 2011 – *break-even inflation rates* fluctuated higher from September 2011 to March 2012. This proxy for expected inflation over a time horizon of one year fluctuated higher from 5,33 per cent on 6 September 2011 to 6,83 per cent on 20 March 2012. Similarly the break-even inflation rate in the 11-year maturity category increased from 5,32 per cent to 6,31 per cent over the same period. Subsequently, as the nominal yields declined considerably and the real yields moved on balance broadly sideways, the break-even inflation rates for both maturities declined to below the 6 per cent level from the middle of June, signifying a more favourable inflation outlook.

8 EMBI+ measures total returns on US dollar-denominated debt instruments of emerging markets.

The JP Morgan Emerging Markets Bond Index Plus (EMBI+)[8] spread above US government bonds narrowed from a recent high of 422 basis points in September 2011 to 362 basis points in June 2012 as investors' confidence in the financial markets of emerging markets continued to improve, given the weak and uncertain market conditions in many developed countries. Similarly, the *sovereign risk premium* on the South African government US dollar-denominated bonds in the five-year maturity range trading in international markets decreased from a high of 289 basis points in January 2012 to 262 basis points in June.

Break-even inflation rates

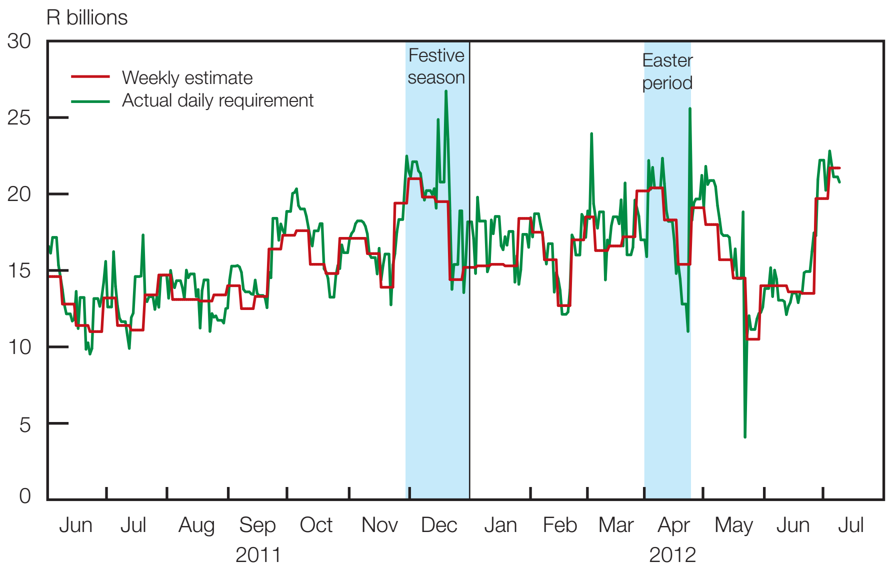


Money market

In addition to the changes in the monetary policy operational procedures of the Bank, implemented between August 2010 and March 2011, further changes were effected from March 2012 to improve the effectiveness and efficiency of the refinancing system. These changes include allocation for the amounts tendered by banks in the weekly main repo auctions on a pro rata basis, up to the announced average daily liquidity requirement for the week in instances where the auction is over-subscribed; holdings of two- and five-day main repurchase transactions during the week of the MPC meetings; and the issuance of SARB debentures and reverse repo transactions with 7 and 14-day maturities. The impact of these amendments has been favourable, with less undersubscribed auctions and noticeable demand for SARB debentures in the 7 and 14-day maturity ranges.

During 2011 and the early months of 2012, the daily liquidity requirement of private-sector banks widened on occasion, influenced in particular by re-balancing by banks to ensure their adherence to the statutory reserve requirements at the end of the monthly maintenance period and short-lived seasonal surges such as over the end of the year festive season and during the Easter holidays when demand for liquidity increased.

Actual and expected liquidity requirement



Notwithstanding these temporary occurrences, the daily liquidity requirement fluctuated, on average, within generally orderly ranges of between R9,5 billion and R26,7 billion between June and December 2011, and between R4,1 billion and R25,6 billion in the first six months of 2012.

Private-sector banks utilised their cash reserve accounts, standing facilities and supplementary repurchase transactions intermittently to accommodate variations in the daily liquidity requirement. The statistical counterparts influencing money-market liquidity conditions during the period under review are illustrated in the accompanying table.

Money-market liquidity flows

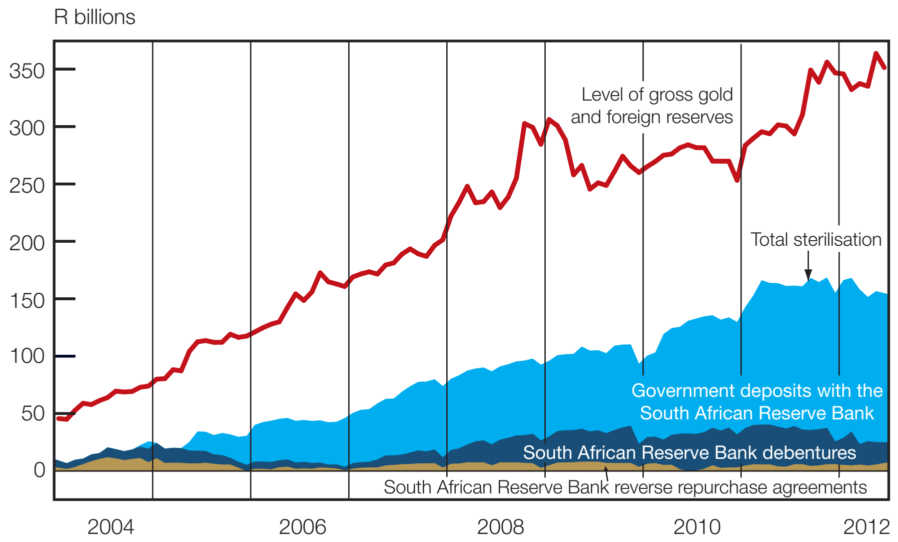
R billions (easing + tightening –)

	2011		2012
	Jan–Jun	Jul–Dec	Jan–Jun
Notes and coin in circulation	1,5	-20,4	9,4
Required cash reserve deposits	-2,3	-2,5	-3,7
Money-market effect of SARB* foreign-exchange transactions	56,5	1,7	2,1
Government deposits with the SARB*	-52,2	-5,1	0,3
Use of liquidity management instruments	-5,1	11,2	0,2
Reverse repurchase transactions	-0,7	-2,3	-2,2
SARB* debentures	-4,3	13,4	2,4
Other items net	5,0	13,1	-10,9
Banks' liquidity requirement (decrease + increase –)	3,4	-2,0	-2,6

* SARB: South African Reserve Bank

In the twelve months to June 2012, notes and coin in circulation and required cash reserve deposits with the Bank drained liquidity to the amount of R17,2 billion from the money market. After increasing significantly in the first half of 2011 and offsetting some of the excess liquidity emanating from foreign-exchange transactions by the Bank for reserve accumulation purposes, government deposits with the Bank recorded relatively minor changes in the subsequent months to June 2012. Reverse repurchase transactions by the Bank in the latter part of 2011 and first half of 2012 also served to tighten liquidity conditions during the period under review.

Level of gross reserves and sterilisation balances

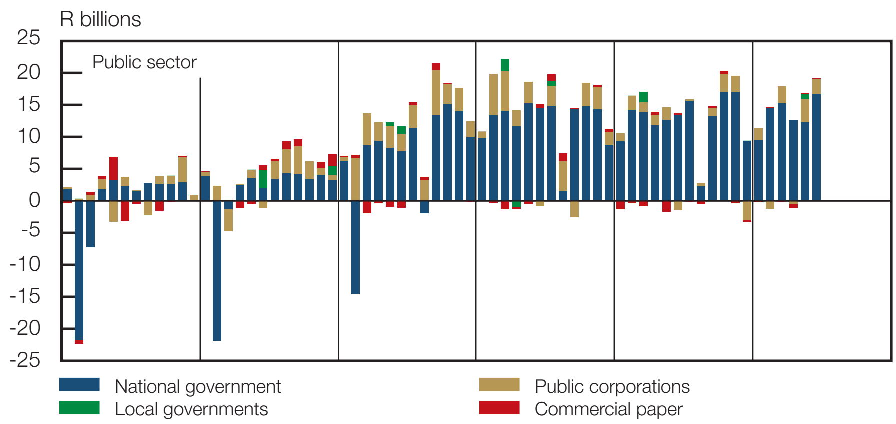


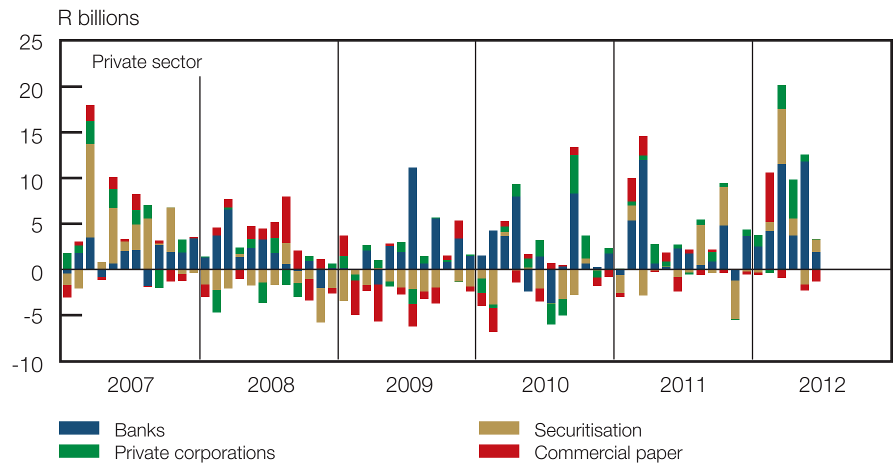
Capital redemption and coupon interest payments on various government bonds amounted to R65,9 billion during the period July 2011 to June 2012, with R0,6 billion of this amount having accrued to the Bank.

Bond market

Net issuances of bonds in the *primary bond market* remained sturdy in 2011 and thus far in 2012. This was consistent with government's countercyclical fiscal policy along with a general rise in fixed capital formation in recent years. While net issues by the public sector continued at a steady pace, net issuances by the private sector were erratic with the only constant thread over time being the funds raised by banks. As securitisation remained out of favour and net issues by private corporations remained rather low, banks' net issues (including commercial paper) of R31 billion in 2011 contributed the bulk of total net issues by the private sector of R39 billion during the year.

Net issues in the primary bond market



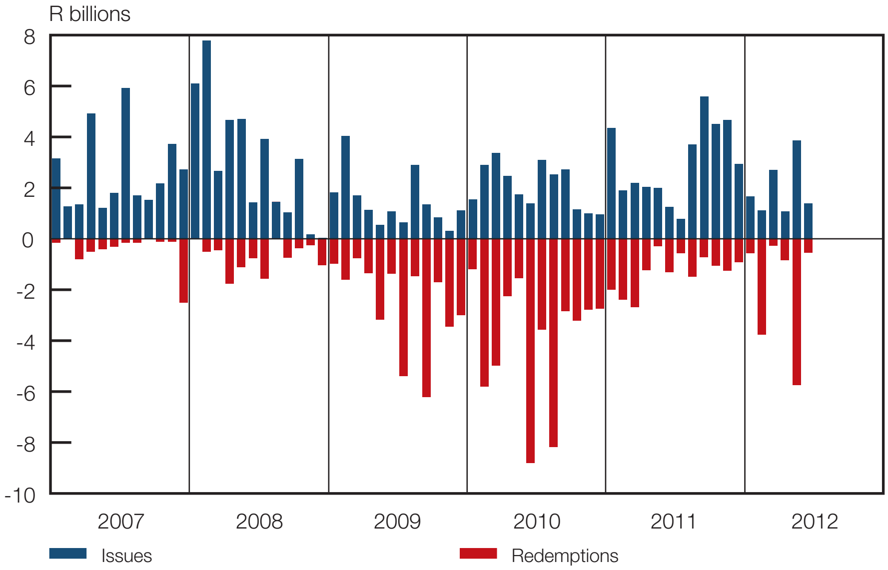


Led by the banks, the private sector stepped up issuance activity in the first half of 2012, such that the total private-sector net issues of R56 billion during this period were more than the net issues recorded in 2011 as a whole. Net issues by the public sector (including commercial paper) amounted to R159 billion in 2011 and R88 billion in the six months to June 2012, with national government continuing to be the largest contributor to these amounts. The total outstanding nominal value of all debt securities listed on the JSE increased by 17 per cent in 2011 and by a further 10 per cent thus far in 2012 to reach R1 515 billion at the end of June.

While public corporations have raised no funds internationally thus far in 2012, National Treasury raised R12,0 billion through the issuance of a US$1,5 billion 12-year bond in January 2012, following the US$750 million 30-year bond issued in March of the preceding year.

After recording net redemptions in 2009 and 2010, gross issues of rand-denominated bonds by non-residents in the *European and Japanese Uridashi bond markets* exceeded gross redemptions in 2011, resulting in net issues of R20,0 billion over the period. While issuances in the Japanese Uridashi bond market remained broadly on the same level, issuance activity in the European bond markets more than doubled in 2011 when compared with 2010. Although rand-denominated bond issuances by non-residents continued steadily in 2012, they were at a somewhat lower level, possibly in part as a result of fragile market conditions amid the political and financial problems in Europe, and the downgrading of sovereign debt credit ratings in Japan and a number of European countries. In the first half of 2012 net issues of rand-denominated bonds in both markets amounted to R0,1 billion.

Rand-denominated bond issuances in the European and Uridashi bond markets



Turnover in the *secondary bond market* rose strongly as the monthly average turnover in 2011 was 23 per cent higher than in 2010, increasing by a further 9 per cent in the first half of 2012. This was in response to both higher volumes traded and lower bond yields. After recording the highest return among asset classes with an increase of 9 per cent in 2011, the All-Bond Index (Albi) continued to be the highest performing asset class – consistent with lower bond yields – and recorded an increase of 8 per cent thus far in 2012 to reach an all-time high level in June 2012. This performance was partly boosted by the strong demand for local bonds by non-residents.

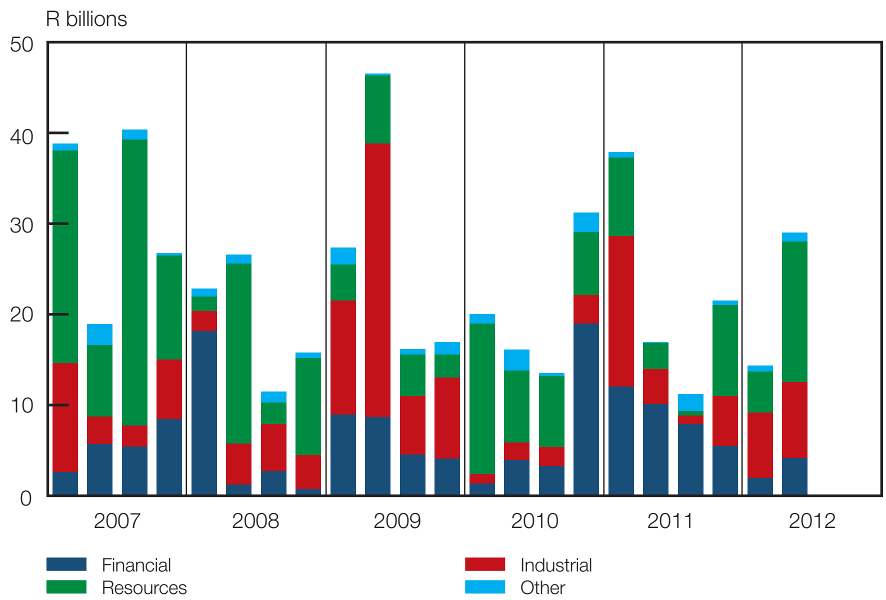
Albeit somewhat lower than the all-time annual high net purchases of R52 billion recorded in 2010, *non-residents* sustained their strong presence in the domestic bond market. They increased their exposure to the local bond market by R42 billion in 2011 and by a further R49 billion during the first half of 2012. This was despite the recent downward revision in South Africa's sovereign risk outlook. As the tentative recovery in the aftermath of the global financial meltdown and across-the-board downward revision of economic growth prompted lower interest rates globally, non-residents turned to emerging markets for higher yields. The reallocation of investment portfolios out of the traditional share asset class to debt securities was informed by a search for higher returns and safe havens as the European sovereign debt problems intensified. The inclusion of South African government bonds in Citigroup's benchmark WGBI is set to increase South Africa's prominence as a destination for foreign investment in the near future, facilitating access to funding.

Share market

The total value of *equity capital raised* in the domestic and international primary share markets by companies listed on the JSE amounted to R88 billion in 2011, which was 8 per cent higher than the amount raised in 2010. Equity funding contracted from R38 billion in the first quarter of

2011 to R14 billion in the first quarter of 2012 alongside heightened risk aversion due to economic growth concerns and the sovereign debt crisis in Europe, before improving somewhat to R29 billion in the second quarter. Companies with primary listings on the JSE accounted for 71 per cent of the total capital raising activity in 2011 and continued to dominate activity at 62 per cent in the six months to June 2012. In 2010 companies in the resources sector dominated equity funding, contributing 49 per cent of total capital raised. This changed in 2011 when the financial sector dominated activity at 41 per cent, while thus far in 2012 the resources sector was again responsible for the bulk of the equity funding at 46 per cent of the total capital raised.

Equity capital raised by sector



The total *number of listed companies* on all boards of the JSE increased from 405 in January 2011 to 411 in August, whereafter it receded to 401 in June 2012 as only 7 new listings against 17 delistings occurred in the ten months to June 2012. The listings breakdown for 2012 across the different boards is shown in the accompanying table.

Listings breakdown on the JSE Limited, January to June 2012

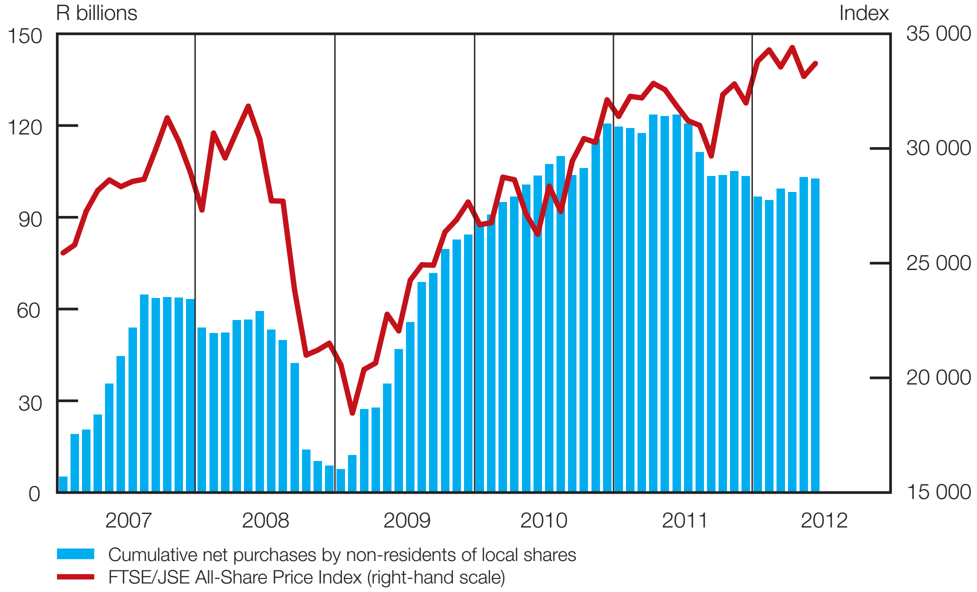
	Alt^{x}	Venture and Development Capital boards	Main board	Africa board	Total
New listings	0	0	3	0	3
Transfers (in)	1	0	4	0	5
Delistings	2	0	6	0	8
Transfers (out)	2	1	0	2	5
Total (June 2012)	63	5	333	0	401

The prolonged upward trend of share prices contributed to a progressive increase in the monthly average *turnover* in the secondary share market from R249 billion per month in 2010 to R274 billion in 2011 and R291 billion per month in the first half of 2012. The total *market capitalisation* of the JSE also benefited from elevated share prices as it reached an all-time high of R7,5 trillion in April 2012, some 17 per cent higher than the recent low of R6,4 trillion recorded in September 2011. Subsequently, the market capitalisation declined by 2 per cent to R7,4 trillion in June. As market capitalisation increased somewhat more than turnover, market liquidity[9] decreased from 48 per cent in 2011 to 47 per cent in the first half of 2012.

9 The liquidity ratio on the JSE is calculated as annualised turnover of shares as a percentage of market capitalisation.

In a year dominated by a series of unfavourable financial market events and trends, 2011 saw *non-residents* reducing their exposure to the domestic share market with net sales of R17,2 billion. Non-resident investors' net sales of local shares continued in 2012 as the euro area's debt woes intensified with doubt about Greece's continued participation in the single-currency zone and contagion fears for Spain, Portugal and Italy. Net sales of local shares by non-residents came to a cumulative R0,9 billion during the first half of 2012, despite the recent surge in domestic share prices. However, non-residents' participation rate in the share market remained around the 15 per cent level in both 2011 and 2012.

Net purchases of shares by non-residents and share prices



South African share prices trended higher as the *FTSE/JSE All-Share Price Index (Alsi)* increased from a recession low of 17 814 index points – reached on 20 November 2008 amid the global financial crisis – to an all-time high of 34 788 index points on 20 June 2012, boosted by rising global investor appetite, higher global equity prices and favourable commodity prices. Amid this general upward trend, share prices dipped noticeably during two periods, namely April to June 2010 and February to August 2011. In both periods the decline in share prices was partly a result of concerns regarding the European debt crisis. In 2012 the euro area debt crisis escalated further as more European countries moved into recession and a range of credit ratings were downgraded. From its June high, the Alsi declined by 4 per cent to 12 July as share prices reacted to the incessant political and financial turmoil in Europe, lower commodity prices, and the recent downgrade of Japan's credit rating by a rating agency.

Market for exchange-traded derivatives

Given the average increase of 12 per cent and 5 per cent in the underlying share prices in 2011 and the first half of 2012, the value traded in equity index contracts continued to account for the bulk of total turnover on the Equity Derivatives Division of the JSE, boosting total turnover over these periods. Increased participation by non-residents in the domestic *equity derivatives market* also contributed to higher turnover as their participation, in terms of open contracts, increased from an average of 20 per cent in 2010 to 25 per cent in 2011 and further to 32 per cent in the six months to June 2012.

Trading activity in *commodity futures and options contracts* on the Commodity Derivatives Division of the JSE increased by 24 per cent in 2011 compared with 2010, alongside generally elevated domestic agricultural commodity prices. The rise in agricultural commodity prices was amid higher Brent crude oil and international commodity prices in 2011. It was also supported by the Crop Estimates Committee's 2011 final crop figures, which were lower than the last estimated figures, reflecting pressure on local grain supply. Except for maize prices – which declined after reaching all-time-high levels in January 2012 – grain prices remained elevated in 2012 as local crop projections for 2012 were continuously reduced from the March 2012 production estimate report. This, together with higher volumes traded on the Commodity Derivatives Division, translated into higher turnover thus far in 2012 compared with the same period in 2011.

Trading activity on *Yield-X*, the interest rate and currency derivatives market of the JSE, reached record-high levels in 2011, contributing to all-time-high turnover. Activity in interest rate derivatives contracts on Yield-X gained popularity, rising by 54 per cent in 2011 when compared with 2010, as investors tracked investments yielding favourable rates of return. The number of currency contracts traded also increased by 84 per cent over the same period in conjunction with the fickle foreign-exchange market. While the number of currency futures and options contracts traded accounted for 89 per cent of the total number of contracts traded in the first half of 2012, trade in interest rate derivatives accounted for 53 per cent of the total value traded over the same period.

Despite the positive underlying share market, *warrants* activity on the JSE struggled to maintain favour as the number of warrants traded receded by 13 per cent in 2011 compared with 2010. Demand waned further in the first half of 2012. Warrants issued over constituents in the resources sector dominated trade at 72 per cent of the total number of warrants traded in the six months to June 2012. Turnover in all derivatives traded on the JSE during 2011 and the first half of 2012 is indicated in the accompanying table.

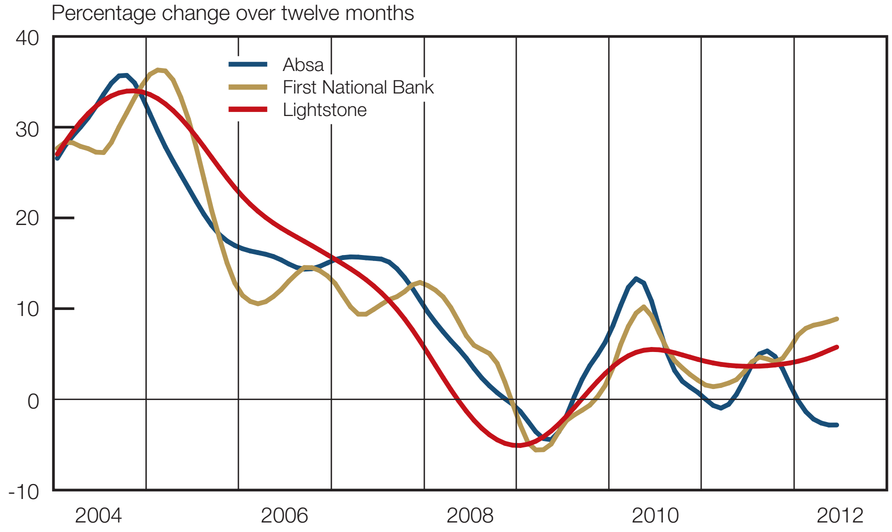
Turnover in exchange-traded derivatives

	Value		Change over one year	
	2011 (R billions)	Jan–Jun 2012 (R billions)	2011 (Per cent)	Jan–Jun 2012 (Per cent)
Equity futures and options on futures	4 327	2 112	19	3
Equity index	4 115	2 024	22	5
Single stock	212	87	-26	-30
Dividend	1	0,2	-25	-51
Warrants	1	0,3	-18	-33
Commodity futures and options	395	222	73	37
Maize	243	132	77	49
Wheat	67	38	24	18
Interest rate and currency derivatives	325	198	9	35
Currency	103	59	110	28
Interest rate	134	104	98	111
Index	88	35	-52	-32

Real-estate market

The real-estate market remained subdued over the past 18 months, with fairly low activity levels, lustreless prices and, consequently, little impact on household net wealth. There was a divergence in trends after November 2011 in the house price indices compiled by different institutions due to varying methodologies used in compiling the indices, as well as differences in data sources and market strategies. Although two housing barometers recently reflected a moderate acceleration in house prices, increases were still subdued compared with house price inflation in the boom period 2003 to 2007. House prices most recently remained under pressure due to sluggish economic growth, high unemployment and still-high levels of household debt. Moderate signs of stabilisation in the fixed property market were evidenced by a slight reduction in the average time properties remained on the market; in the second quarter of 2012 this amounted to 17 weeks compared with 19 weeks in the first quarter of 2011.

House prices



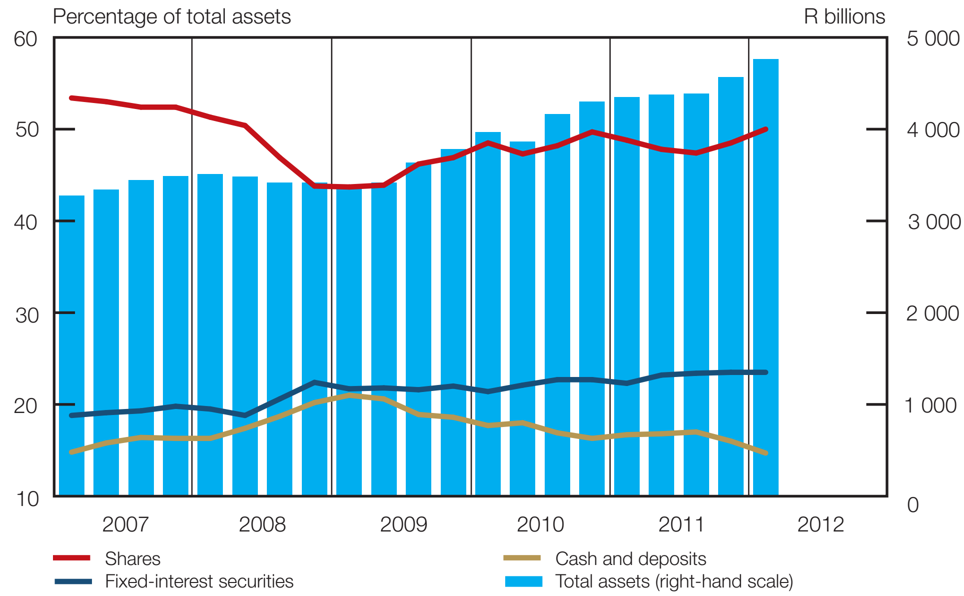
Non-bank financial intermediaries

10 Consisting of pension and provident funds, insurers and unit trusts.

Supported by an improvement in economic activity and a general increase in asset prices, the balance sheet of non-bank financial institutions[10] grew by 6 per cent from 2010 to R4,6 trillion in 2011, before reaching R4,8 trillion in March 2012. However, as a ratio of gross domestic product, total assets fell by 8 per cent from 2010 to 154 per cent in 2011 – the lowest level since 2008. This indicates a slight moderation in the role of contractual savings in the economy, amid the ongoing international financial turbulence.

The increase in the assets of these institutions took the form of an increase in holdings of fixed-interest securities, which grew from 22 per cent of the balance sheet in the first quarter of 2011 to 23 per cent in the fourth quarter. This bodes well for fixed-capital expenditure, as infrastructural projects, especially in the public sector, are largely financed through the issuance of debt instruments.

Asset holdings of selected non-bank financial intermediaries



Holdings of bonds issued by state-owned enterprises and central governments accounted for 68 per cent of total fixed-interest securities in 2011. However, adjusting for market revaluation effects, these investors were net buyers of bonds amounting to R81,7 billion in 2011.

Alongside continued volatility in global financial market conditions due to the European debt crisis, holdings of equity fell by 2 per cent of total assets from the final quarter of 2010 to 48 per cent in the same period of 2011, before increasing to 50 per cent in the first quarter of 2012, as share prices remained elevated. Although negligible, holdings of unlisted shares by these intermediaries at R50 billion in 2011, represented an important source of funding for capital expenditure in the private sector.

Funds invested in cash and cash-equivalent instruments declined slightly from 2010 to 15 per cent of total assets in 2011, as corporate investors in the unit trusts industry reduced their exposure to money-market funds substantially.

Net inflows[11] to non-bank financial institutions fell by 6 per cent from 2010 to R169 billion in 2011. The decline was more pronounced in savings flows to the unit trust industry, while flows to longer-term contractual savings institutions increased by 35 per cent to R125 billion over the same period.

11 Measured as net sales of unit trusts and domestic current income surplus of pension and provident funds and insurers.

Public finance

Fiscal policy

South Africa's macroeconomic framework pivots around countercyclical fiscal policies to support growth and investment, alongside monetary policies creating an environment of stable and low inflation to protect the living standards of low-income households and workers. Budget policy is guided by the principles of countercyclicality, sustainability and intergenerational fairness, as expressed in South Africa's fiscal guidelines.

The National Budgets for both 2011/12 and 2012/13 continued to be broadly expansionary. The outcome for 2011/12 was closely aligned with what had been budgeted. The challenges of job-creating growth and poverty reduction continued to feature prominently when the Minister of Finance presented the 2012/13 National Budget to Parliament on 22 February 2012. The Budget gave effect to the fiscal policy stance outlined in the *MTBPS 2011*, setting out steps to support the economy, strengthen infrastructure investment and improve the public service performance but also gradually to narrow the budget deficit. Uncertainty and restrained growth for the global economy marked the tabling of the Budget, as the euro area debt and banking-sector problems continued to undermine global economic growth prospects.

Countering these international headwinds, the Budget was bold enough to include a special focus on infrastructure plans, signalling a renewed public-sector investment drive as a foundation for long-term growth, employment creation and development. The support for existing expenditure programmes would be maintained along with the gradual consolidation of the fiscal position to ensure the long-term health of the country's public finances, initiating a shift in the composition of expenditure towards investment. Furthermore, well-maintained network infrastructure was recognised as a precondition for a globally competitive economy. Moreover, economic infrastructure would allow businesses to grow and access new markets by providing critical input such as water, power, telecommunications and access to technology. The importance of an appropriately skilled workforce was also emphasised and given effect through government's expenditure programme.

Over the medium term the deficit would be reduced and public debt stabilised. The budget deficit was expected to fall from 4,9 per cent of gross domestic product in 2011/12 to 3,6 per cent in 2014/15. As the economy improves, fiscal consolidation would be introduced gradually, avoiding the social and economic dislocations associated with more rapid adjustments. The consolidation process would take into account the rising financing needs of state enterprises and private-sector investment.

National government expenditure

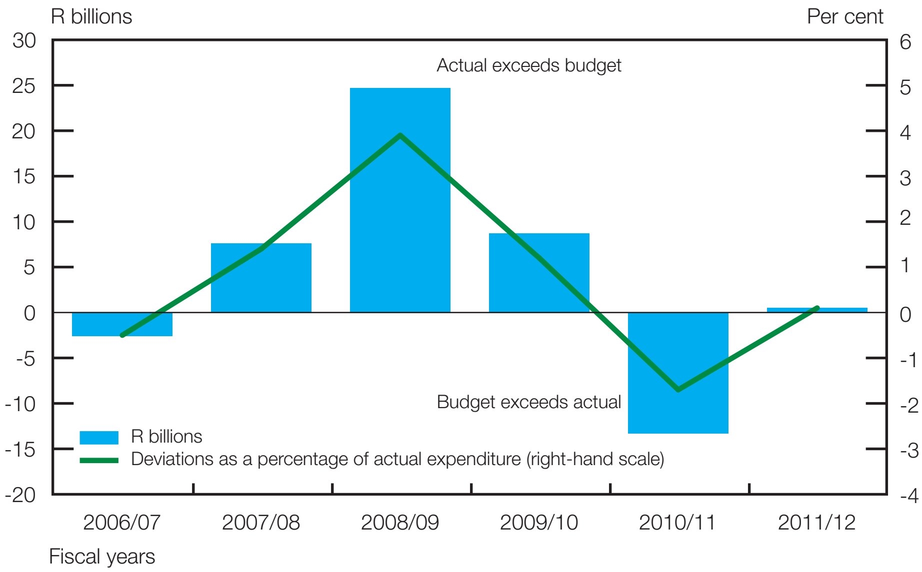
National government budgeted for a firm increase in expenditure in fiscal 2011/12 as part of its expansionary fiscal policy stance, and the actual expenditure outcome for the fiscal year was closely aligned with the budget projections. In fiscal 2011/12 the drive to prioritise capital expenditure, promote effective public service delivery and ensure that government spending contributed to economic growth within a sustainable debt trajectory started to gain traction. While national government's direct contribution to capital spending was small, other spheres of government and the public enterprises remained at the centre of the public sector's capital expenditure drive, partly funded through higher transfer and subsidy payments by national government.

The *Statement of National Revenue, Expenditure and Borrowing* indicated that national government expenditure amounted to R889 billion in fiscal 2011/12, representing a year-on-year rate of increase of 13,4 per cent when compared with the previous fiscal year. This raised national government spending to 29,4 per cent of gross domestic product from 28,5 per cent recorded a year earlier. Over the past three fiscal years national government expenditure recorded a year-on-year average annual rate of increase of 12,4 per cent. Looking ahead an average nominal growth rate of approximately 8,6 per cent was budgeted over the medium-term period to 2014/15.

In the past fiscal year, the government prioritised the improvement in the quality of education, enhanced efficiency in the public service and the support of indigent people through social grants. In fiscal 2011/12, transfers and subsidies increased by 17,1 per cent year on year, and contributed 68,9 per cent towards total voted expenditure. The social services cluster contributed most to the increase in transfers and subsidies through the Departments of Education, Health and Social Development.

Transfers by the Department of Basic Education more than doubled in 2011/12 and were mostly for building schools in order to eradicate inappropriate infrastructure. Strong increases in transfers and subsidies by the Department of Health were meant to support prevention programmes through the HIV/AIDS conditional grants to provinces. Further grants to provinces were earmarked for health infrastructure and to strengthen tertiary hospital services. The Department of Social Development accounted for 61,1 per cent of total transfers and subsidies by the Social Services cluster. This increase resulted from higher transfer payments to households, providing a safety net which currently has more than 15 million recipients – nearly one third of the population.

Differences between budgeted and actual national government expenditure



Interest paid on national government debt totalled R76,4 billion in 2011/12 – 15,4 per cent more than in fiscal 2010/11 – despite generally somewhat lower interest rates in the more recent years. Higher issuances of domestic and foreign government bonds and Treasury bills to finance the higher deficit contributed to these higher interest payments.

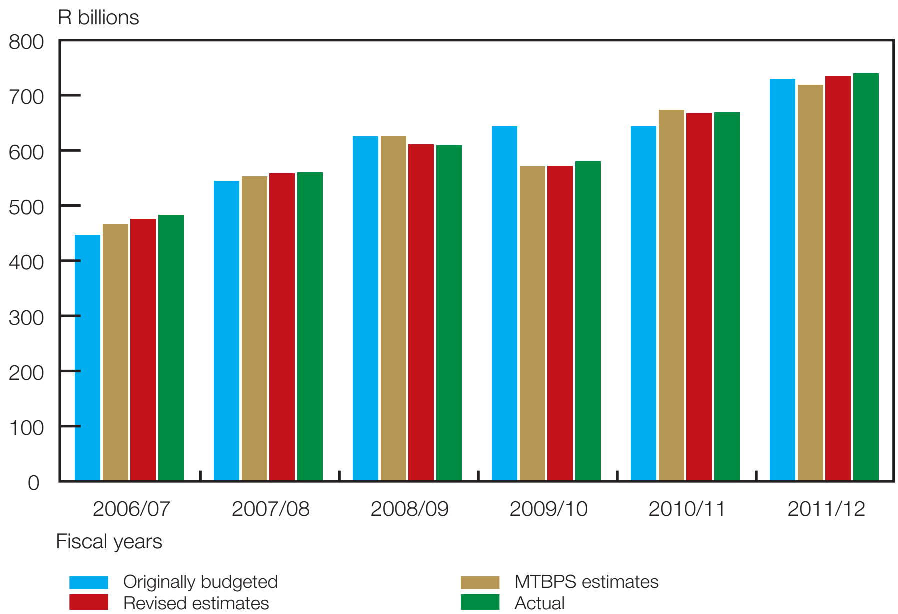
The provincial equitable share of nationally raised revenue increased by 10,0 per cent when compared with the previous fiscal year. Although these transfers exceeded original budget projections, they were in line with the revised estimates contained in the *Budget Review 2012*. Increased equitable share transfers to provinces were aimed at extending and improving service delivery outcomes in the health and education sectors.

National government revenue

Raising sufficient revenue to support projected expenditure on government's economic and social priorities at times requires adjustments to be made to the tax and expenditure framework over the medium to long term. The 2009 recession sharply reduced the income available for public expenditure, with the level of nominal tax revenues actually declining in 2009/10. However, revenues improved in 2010/11 and from this more normal base are expected to track economic growth broadly over the medium term. Proposed tax adjustments in the *Budget Review 2011* were intended to broaden the tax base in support of inclusive growth.

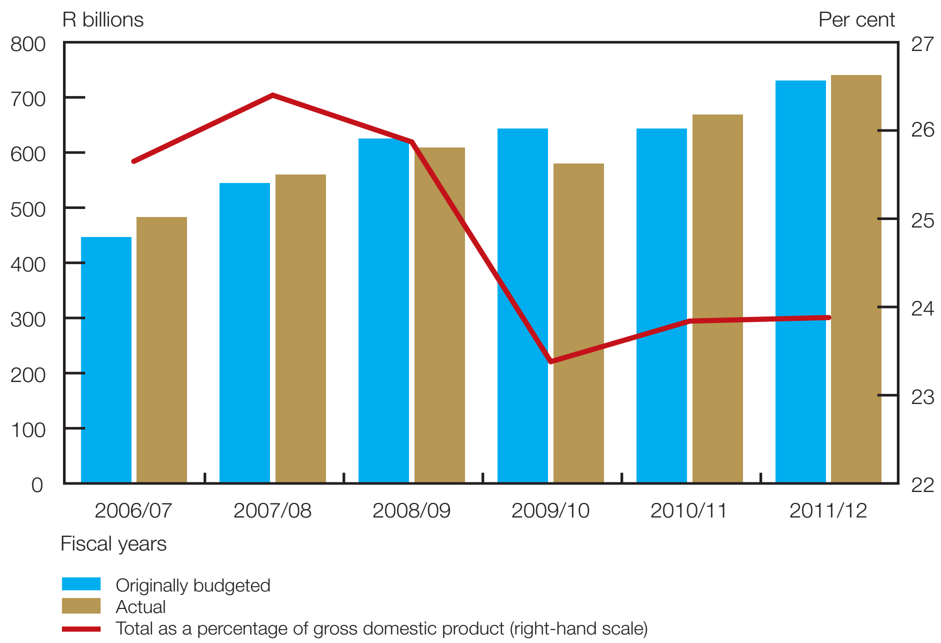
Amid a fragile global economic recovery, growth in tax revenue in South Africa remained firm and was driven by the recovery of corporate profits, resilient consumption and strong performances of import taxes. For fiscal 2011/12, revenue was originally budgeted to increase at a rate of 9,1 per cent and total R730 billion. However, it was revised downwards in the *MTBPS 2011* to amount to R719 billion, reflecting perceived weaker economic conditions at the mid-year point. The *Budget Review 2012* revised both the original and mid-year revenue projections upwards to R735 billion, signalling a positive turnaround in economic conditions. Expected collections increased in all the major tax categories, with only the relatively small category of taxes on property registering a contraction as activity in the real-estate market remained sluggish.

National government revenue



The actual national government revenue outcome for fiscal 2011/12 exceeded all three sets of budgeted expectations and amounted to R740 billion, or 10,5 per cent more than in the preceding year. The three main tax categories – personal income tax, corporate income tax and value-added tax (VAT) – contributed the lion's share of the positive outcome in tax collections.

National government tax revenue

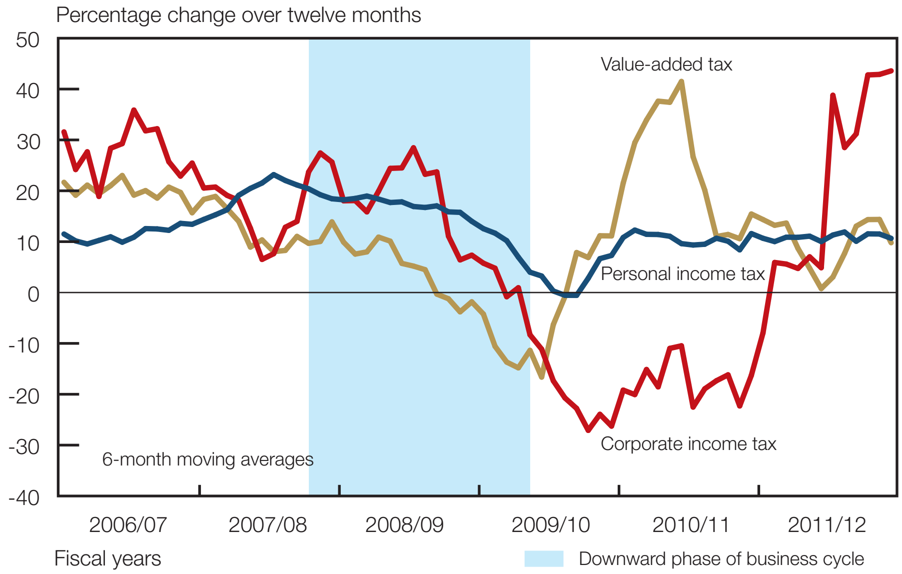


An improved culture of tax compliance and continued attention to enhancing tax collection efficiency also supported the strong revenue performance.

As a ratio of gross domestic product, national government revenue increased from 24,3 per cent recorded in the previous year to reach 24,5 per cent in fiscal 2011/12. This latter ratio was slightly below the 10-year average of 24,8 per cent. Over the medium term to 2014/15, national government revenue was projected to average 24,6 per cent of gross domestic product.

Personal income tax collections were supported by higher employment, above-inflation wage settlements in most sectors of the economy and higher bonus payouts, notwithstanding an increase in refunds. Nevertheless, collections in this category fell short of the originally budgeted amount.

Major components of national government revenue



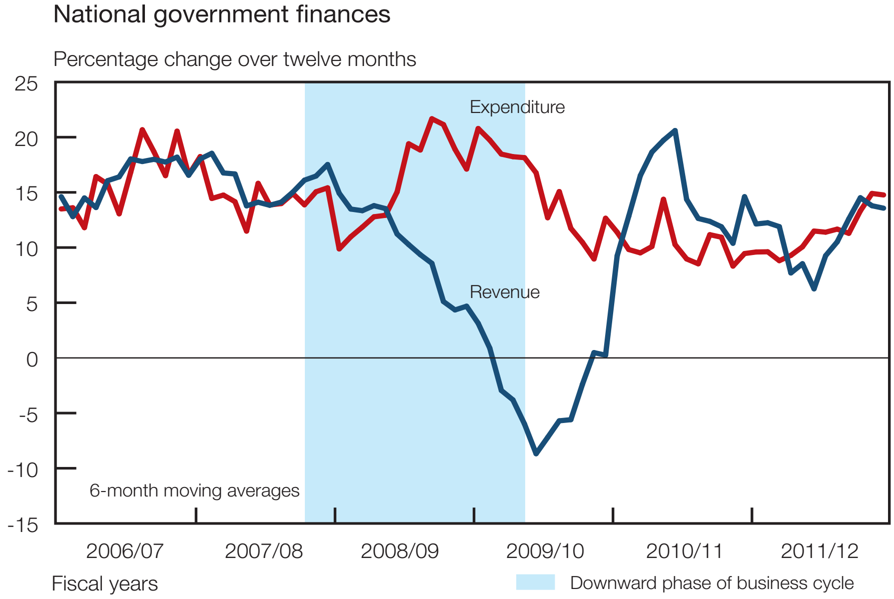
Corporate income tax showed signs of recovery and reverted to positive growth in fiscal 2011/12. Provisional corporate income tax payments by the coal mining and financial services sectors increased significantly, while company tax payments also benefited from stronger capital expenditure in various industries such as energy, manufacturing and agriculture. Investment spending is an important indicator of investor confidence in the future of the economy and its recovery is a welcome development after a long slump.

Taxes on goods and services rose further in the past fiscal year as higher consumption expenditure boosted VAT collections. Domestic VAT recorded a significant increase, influenced by growth in payments from the trade, finance, and electricity, gas and water sectors, while import VAT also rose considerably due to higher imports.,

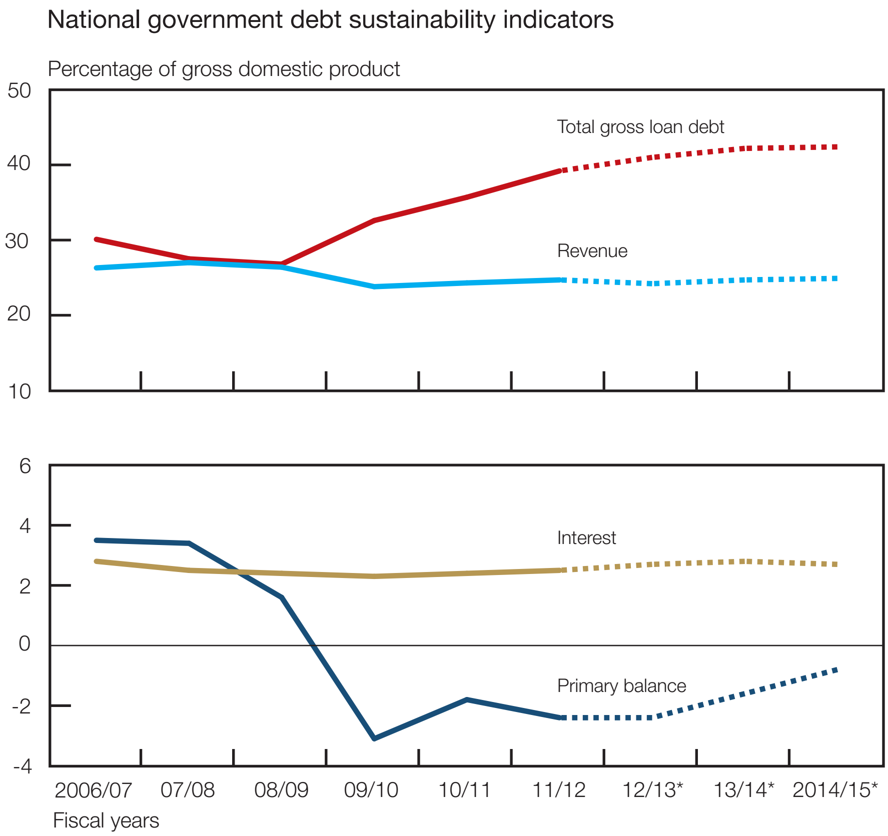
National government deficit

Following the global economic crisis, South Africa adopted a stimulatory countercyclical fiscal policy stance to lessen the short-term impact of the economic recession. This was facilitated by South Africa's strong fiscal position, reasonably low level of government debt and stable foreign reserve position before the recession.

During fiscal 2011/12, the increase in national government revenue was outperformed by the solid increase in government spending, leading to a widening of the cash-book deficit to R149 billion from R114 billion recorded a year earlier. As a ratio of gross domestic product, the cash-book deficit amounted to 4,9 per cent, higher than the deficit ratio of 4,2 per cent recorded in fiscal 2010/11. Over the medium term, slower growth in government spending, alongside rising revenue collections, was expected to strengthen the sustainability of the fiscus, although risks from the current global economic conditions cannot be ignored, as they could have a negative impact on revenue collections.



The primary balance – the budget balance excluding interest payments on government debt – reached a deficit of R72,5 billion, or 2,4 per cent of gross domestic product in fiscal 2011/12. This primary deficit ratio was higher than the ratio of 1,7 per cent recorded in the previous fiscal year, but lower than the ratio recorded in 2009/10. In the years prior to 2009/10, national government had been recording primary surpluses.



** Budget Review 2012*

This allowed government to run an effective countercyclical policy framework and also created the fiscal space for future years when the capacity to spend would have improved. Over the medium-term period to 2014/15, the primary deficit was expected to average 1,6 per cent of gross domestic product.

National government financing and debt

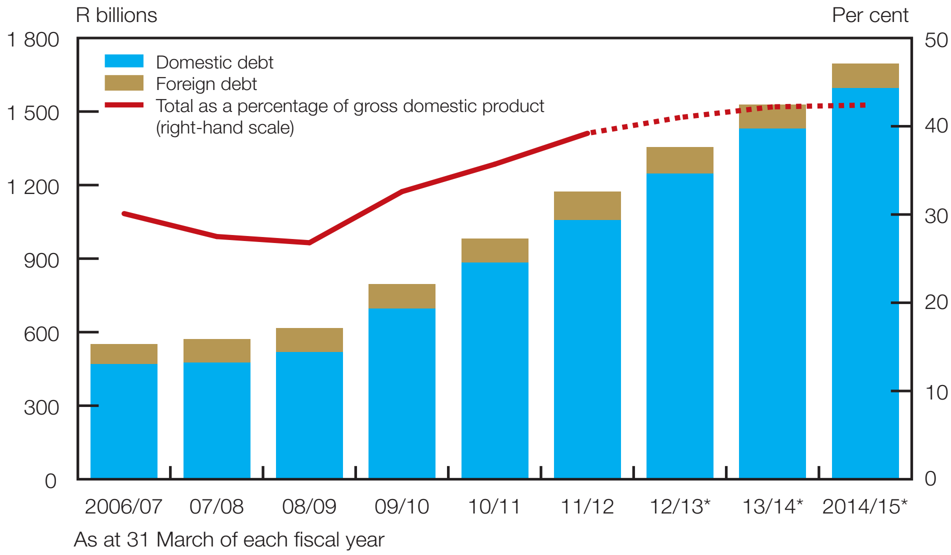
The higher budget deficit that followed the recession was primarily financed in the domestic financial market, facilitated by the prudent macroeconomic policies alongside deep and liquid financial markets. Domestic debt instruments used to finance the deficit comprised mainly fixed-income and inflation-linked bonds and Treasury bills.

Netting national government cash-flow revenue and expenditure yielded a cash-flow deficit of R145 billion in fiscal 2011/12, some R18 billion higher than the cash-flow deficit recorded in the preceding fiscal year. After adjusting for almost negligible extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R146 billion. This could be compared with a borrowing requirement of R127 billion recorded in fiscal 2010/11.

During fiscal 2011/12, government raised R19 billion from Treasury bills and short-term loans from the Corporation of Public Deposits, and a further R133 billion from domestic government bonds, of which R45 billion was inflation-linked bonds and R88 billion fixed income bonds. Since their inception in 2000, net issues of inflation-linked bonds have been brisk, bringing the total balance outstanding of these bonds to R207 billion on 31 March 2012. For the coming fiscal year, national government planned to introduce five new bonds, two fixed-income bonds and three inflation-linked bonds.

National government recorded net issues of foreign bonds and raised loans to the value of R10 billion during fiscal 2011/12. In January 2012, government issued a new US$1,5 billion marketable bond, raising R12,0 billion from the issuance of this 12-year bond at a coupon rate of 4,665 per cent. The sale of this bond was oversubscribed by 100 per cent of the bond's value, which reflected the high appetite for these bonds and the confidence of foreign investors in South African government debt securities.

Total gross loan debt of national government



* *Budget Review 2012*

Financing the budget deficit raised the total gross loan debt of national government from 35,7 per cent to 38,9 per cent of gross domestic product between March 2011 and March 2012. Domestic debt accounted for about 90 per cent of total gross loan debt throughout the fiscal year, with foreign debt accounting for the remainder. The low level of foreign debt reduces government's exposure to the risk of exchange rate fluctuations and reinforces the investment community's interest in South African bonds.

General government finance

In fiscal 2011/12 the consolidated general government (i.e., central, provincial and local governments) recorded a sizeable cash deficit of R137 billion. The weakening of the general government budget balance was mainly due to a higher deficit by national government which was, nevertheless, well below the originally budgeted projection and revised estimate stated in the *Budget Review 2012.*

Compensation of employees remained the largest component of current expenditure by government, accounting for 38,6 per cent of total spending at general government level. To begin the process of shifting the composition of expenditure towards increased capital investment, the 2012 Budget made allowance for a 5 per cent cost-of-living adjustment for government employees. This results in the real growth rate of spending on wages declining from an average of 9,4 per cent per annum between 2007/08 and 2010/11, to 1,0 per cent over the current Medium Term Expenditure Framework period.

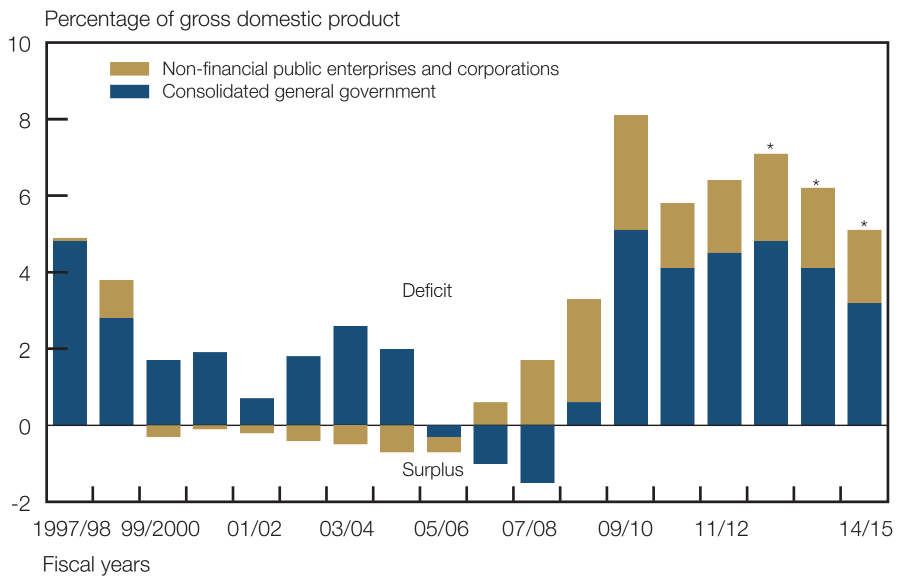
An analysis of the *Provincial Revenue Fund Statements* indicated that provincial governments recorded a cash surplus of R5,9 billion in fiscal 2011/12. Underspending on capital assets of 11,2 per cent in 2011/12 was responsible for the higher-than-normal cash surplus. Institutional challenges in provinces require structural remedial action. Persistent overspending on personnel costs reduces funds for infrastructure and service delivery. In this respect, new rules intended to govern aspects of infrastructure delivery are under consideration.

Local government recorded an estimated cash deficit of R10,0 billion in fiscal 2011/12, some R1,0 billion less than a year earlier, as cash receipts increased at a slightly stronger pace than total cash expenditure. Although the deterioration in municipal finances appears to be slowing, financial management in many municipalities still needs attention. At the same time, local government must strike the right balance between investing in new infrastructure, clearing backlogs and spending on maintenance to avoid the disruption of services.

Non-financial public-sector borrowing requirement

The borrowing requirement of the non-financial public sector amounted to R194 billion during fiscal 2011/12 – R36,1 billion higher than in fiscal 2010/11. As a ratio of gross domestic product, the non-financial public-sector borrowing requirement amounted to

Non-financial public-sector borrowing requirement



* *Budget Review 2012*

6,4 per cent in fiscal 2011/12, higher than the ratio of 5,8 per cent recorded in the previous year. National government was the main contributor to the larger borrowing requirement as transfers and subsidies to other levels of government showed a significant increase.

The *Budget Review 2012* projected that total public-sector infrastructure spending would amount to R227 billion during fiscal 2011/12 and total R845 billion over the medium term. Spending by public enterprises and corporations accounted for the bulk of total public-sector capital expenditure and amounted to R122 billion in fiscal 2011/12. This spending increased at an average annual rate of 11,7 per cent over the ten-year period prior to 1990, followed by 8,7 per cent from 1991 to 2000 before accelerating significantly to 20,6 per cent per annum between 2001 and 2011.

The capital infrastructure programmes of Eskom and Transnet are set to continue to have a major impact on the total non-financial public-sector deficit. To support the broader government infrastructure programmes, capital spending by these entities is expected to grow significantly over the next decade. Their borrowings are not expected to expand excessively, as their financing is expected to be supported by internal reserves and debt already raised in the capital markets, alongside higher revenue streams generated from increases in user charges and quantities produced. In the *Budget Review 2012* it was projected that the non-financial public entities' borrowing requirement would increase from R68 billion in fiscal 2011/12 to R74 billion in fiscal 2014/15.