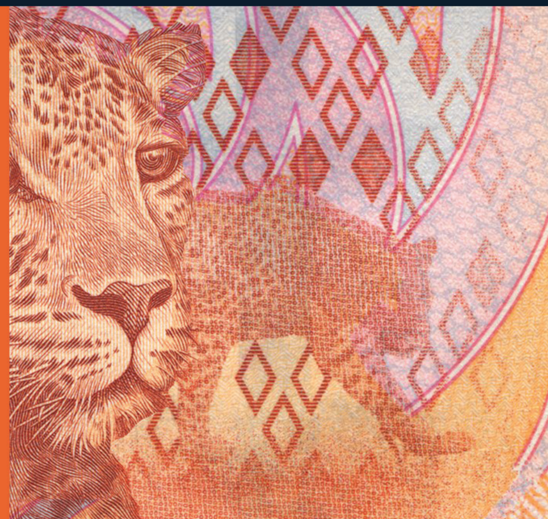
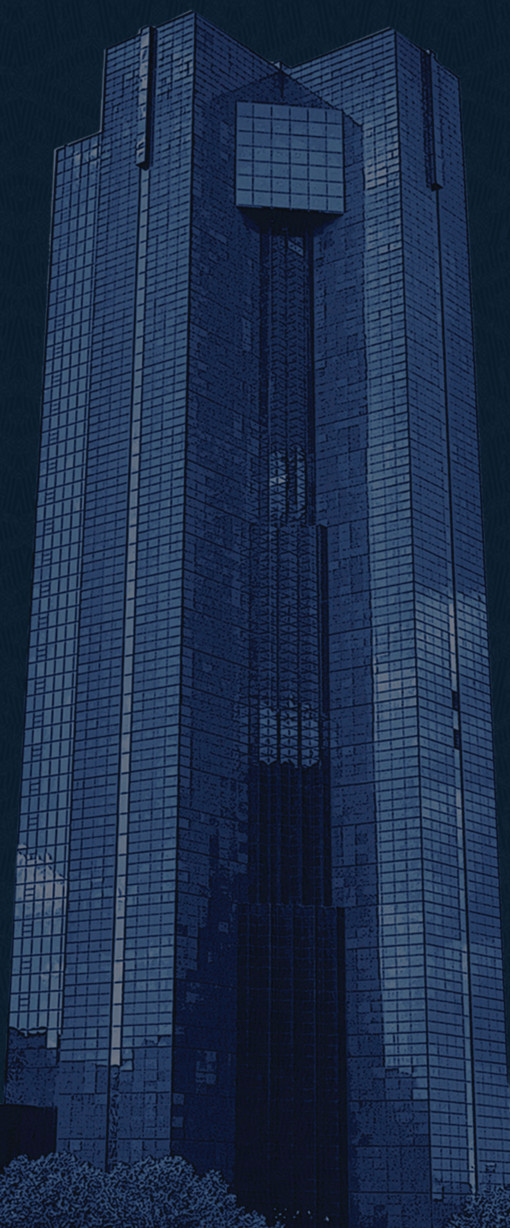
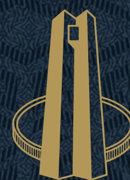
Annual Economic Report

2013







South African Reserve Bank

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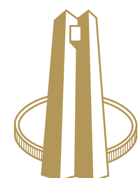

South African Reserve Bank

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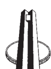
ISSN 0081-2528



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Annual Economic Report

Introduction

The *Annual Economic Report* provides the broader economic context to the address by the Governor of the South African Reserve Bank (the Bank) at the annual meeting of shareholders. The focus in this review of economic events is on the calendar year 2012 and the first half of 2013, going beyond the Bank's financial year. Apart from tracing the evolution of a wide range of economic indicators, attention is also given to institutional, legislative and regulatory changes introduced during the period under review that have a bearing on the economy and its functioning.

During 2012 and the first half of 2013 the global economy continued to function under the cloud of a global financial crisis that had its origin more than five years earlier and yet had not been adequately resolved, with the focus widening from the stability of the financial system to fiscal sustainability and sovereign debt issues. Global output growth continued to disappoint, particularly in the developed economies, despite the continuation of extraordinarily expansionary monetary policies. Part of the reason for the lack of momentum in economic activity was the fact that fiscal policy settings were generally tightened over the period, although in a number of instances tax revenue remained suppressed on account of subdued economic activity to such an extent that not much progress could be made in reducing the fiscal deficit and turning around the unsustainable pace of increase in government debt.

A number of events were prominent in shaping the course of the global economy in the past 18 months:

- In July 2012 the President of the European Central Bank (ECB) reassured the market that the ECB would do "whatever it takes" to preserve the euro, leading to a narrowing of risk premiums on non-core European government bonds and reduced strain on the public finances of the countries involved.
- In December 2012 the Federal Reserve in the United States (US) redirected its assurances regarding the maintenance of an expansionary monetary policy, linking the consideration of monetary policy tightening not to a likely timeframe as had been the case previously, but to the state of the economy: Consideration of tightening would not commence before the US unemployment rate had fallen below 6,5 per cent or inflation had risen above 2,5 per cent. Quantitative easing was also clarified by the announcement of a monthly flow rate of purchases of bonds by the Federal Reserve.
- Towards the end of 2012 Japan introduced a suite of measures aimed at far more aggressive stimulation of the economy than before, thereby providing further support to the global recovery.
- Confidence in Europe was undermined when the Cypriot financial crisis intensified in March 2013 with a bailout being announced, which initially would have involved a levy on all bank deposits as part of the package; this was subsequently softened.
- A further significant development was the deceleration in the growth rate of the Chinese economy which came to the fore in the early part of 2013, contributing to a softening in the international prices of a range of commodities.
- In May 2013 the initial "tapering" comments by the Chairman of the Board of Governors of the Federal Reserve System brought about a significant decline in financial asset prices.

Closer to home, the announcement that South African government bonds would be included in Citi's World Government Bond Index (WGBI) from October 2012 led to pre-emptive buying by investors in the months preceding the inclusion, contributing to lower yields. This was later on partly negated when South Africa's sovereign credit ratings were downgraded, not least due to the labour turmoil and loss of life at Marikana in August 2012, and the subsequent deterioration in labour relations in general.

South Africa experienced a pedestrian rate of economic growth in 2012 and the first quarter of 2013, reflecting both supply-side constraints and weaknesses in aggregate demand. The tertiary sector continued to record the strongest and most consistent pace of growth, whereas the primary sector displayed considerable output volatility as mining production was dragged down on a number of occasions by labour-related shutdowns of operations. Economic activity in the secondary sector also fluctuated somewhat from quarter to quarter as producers encountered a number of headwinds including industrial action, energy constraints, fierce competition from abroad and fire damage to a large steel mill.

Growth in real gross domestic expenditure generally exceeded that in real gross domestic product in the period under review. Nevertheless, the pace of growth in real final household consumption expenditure slowed significantly over the period, consistent with the slowdown in the household sector's real disposable income. Household purchases of durable and semi-durable goods continued to record stronger growth than purchases of non-durables and services, driven by advances in technology, decreases in real prices and the comparatively low interest rates on instalment sale finance.

Real consumption expenditure by government maintained a sturdy overall growth rate in 2012 and the first quarter of 2013, although the acquisition of lumpy military equipment resulted in considerable quarter-to-quarter volatility. However, the strongest and most consistent driver of domestic expenditure over the period was fixed capital formation, with public corporations and general government registering much stronger increases than the private sector. In the private sector real outlays by mining and manufacturing firms rose somewhat, but otherwise capital expenditure growth was subdued. In the public sector Eskom and Transnet effected strong increases in infrastructure-related spending.

The balance of payments reflected the buoyancy in domestic expenditure, particularly in capital spending and purchases of consumer durables and semi-durables – all items with a high import content. Imports accordingly rose briskly. Export volumes increased slowly, although the shift of South African exports towards the faster-growing markets of Africa and Asia continued. The favourable terms of trade assisted the moderation of the deficit on the trade account and current account. Nevertheless, the shortfall on the current account of the balance of payments exceeded 6 per cent of gross domestic product in the final three quarters of 2012, before receding to just below 6 per cent in the first quarter of 2013.

Financial inflows continued on a scale that was adequate to finance the shortfall on the current account of the balance of payments. In 2012 the direct investment inflow from foreign investors into South Africa was approximately equal to the direct investment outflow from South African investors starting or expanding their businesses in other parts of the world, including Africa. Net inflows of portfolio investment and especially other investment capital were recorded during the year. In 2012 the portfolio investment inflow was in the form of debt rather than equity securities and continued to reflect yield differentials which favoured South African debt securities, apart from the WGBI inclusion referred to earlier. In the other investment category, foreign loans extended to the South African banking sector represented the bulk of the inflow over the period.

The effective exchange rate of the rand trended lower in 2012 and the first half of 2013. It depreciated considerably in May and June 2013 with the release of worse-than-expected economic growth data, lower international prices of key South African export commodities, and labour turmoil which raised concerns that South Africa's export potential would be undermined.

Inflation receded from above-targeted levels in the early months of 2012 to within the target range from May 2012, with the subdued pace of economic activity and associated sizeable output gap moderating the inflationary pressures arising from various shocks such as the largely temporary acceleration in international grain prices in the second half of 2012. Wage increases continued to exceed consumer price inflation, but allowing for the fairly modest pace of labour productivity increases, unit labour cost increases remained broadly aligned with the upper limit of the inflation target range. Over the past year employment edged higher but not sufficiently to make inroads into unemployment, with approximately a quarter of the workforce remaining unemployed.

Banks' loans and advances to the domestic private sector rose at high single-digit rates throughout the past year and a half, its pace of increase moderately higher than the concurrent rate of inflation. Mortgage lending remained very slow, consistent with the subdued real-estate market, while instalment sale credit and leasing finance – linked to purchases of durables – registered firm increases over the period. The very rapid growth in general loans to households (unsecured lending), which had been a key feature of the period since 2010, started to lose momentum in the past year. Many of the consumers in that market had reached debt levels which precluded access to further loans, and the pace of increase in these loans dwindled accordingly.

Apparently defying the reluctant pace of real-sector growth, South African share prices rose further in the past 18 months and on several occasions broke previous records. Key indicators of house prices started edging higher over the period, in some cases even reaching a double-digit pace of increase. Bond yields trended lower for most of the period as economic activity remained lustreless and inflation reasonably contained, while bond yields in international markets also softened. However, both international and domestic bond yields rose abruptly in May and June 2013 following fears of reduced quantitative easing in the US and of an exchange rate-induced acceleration in inflation in South Africa.

During 2012 the National Development Plan (NDP) was adopted by the Cabinet and by the ruling political party to guide economic policy over the period to 2030. The process of structurally aligning government's budget with the NDP was started during the year under review. Providing a countercyclical boost to the economy, the fiscal deficit ratio of the general government remained of broadly the same magnitude in 2012/13 when compared with the previous fiscal year. However, the infrastructure drive by various public corporations resulted in a marked increase in the corporations' borrowing requirement, and in a notably higher overall public-sector borrowing requirement.

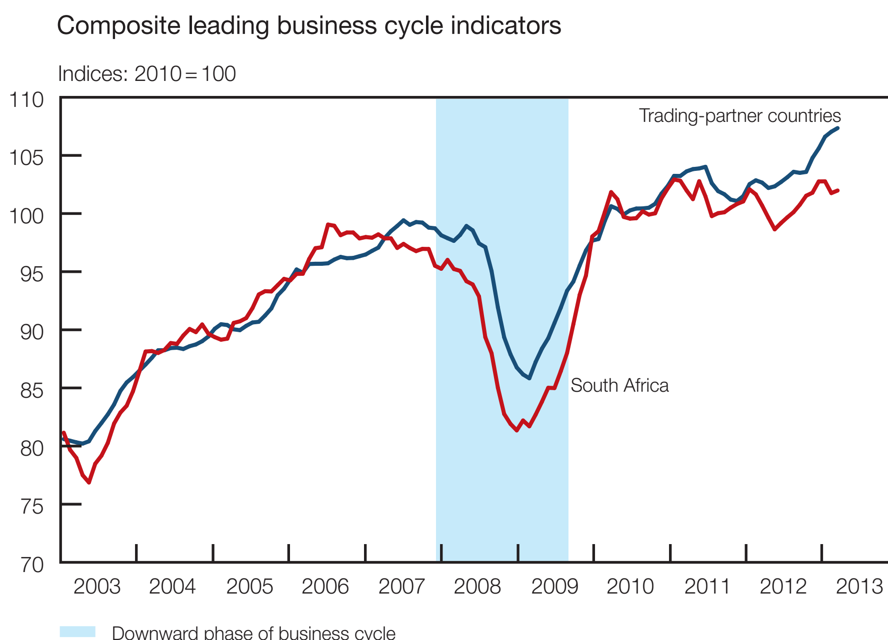
Monetary policy remained accommodative during the past 18 months as aggregate production continued to fall below the economy's potential and as inflation moderated to within the target range from May 2012 onwards. The Bank's Monetary Policy Committee (MPC) adjusted the policy rate once over this period, reducing the repurchase rate from 5,5 per cent to 5,0 per cent in July 2012 to give support to the fragile domestic economic recovery. This resulted in a marginally negative real repurchase rate.

Domestic economic developments

Subsequent to the initial economic improvement following the global financial crisis in 2008/09, the world economy has been characterised by a sustained period of economic uncertainty and lacklustre output growth. The domestic economic recovery has been highly synchronised with the uptick in global economic activity, most clearly visible in the fairly good correlation between the South African composite leading business cycle indicator and a composite leading business cycle indicator of South Africa's trading-partner countries.[1] Since mid-2010 the South African composite leading business cycle indicator has trended broadly sideways, consistent with the uneven and sluggish output growth observed over the period.

1 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.

Encouragingly, the composite leading business cycle indicator for South Africa's trading-partner countries has picked up notably in the opening months of 2013, as indicated in the graph.

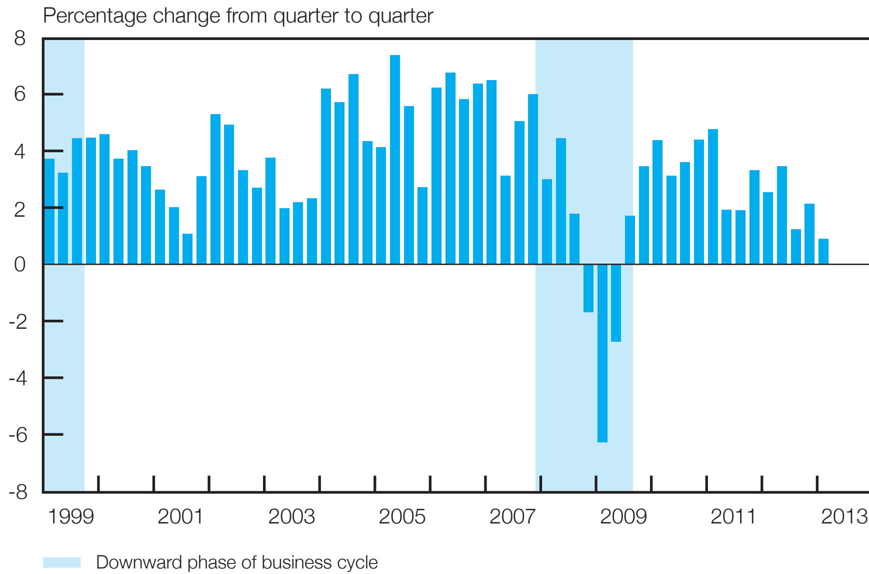


Domestic output[2]

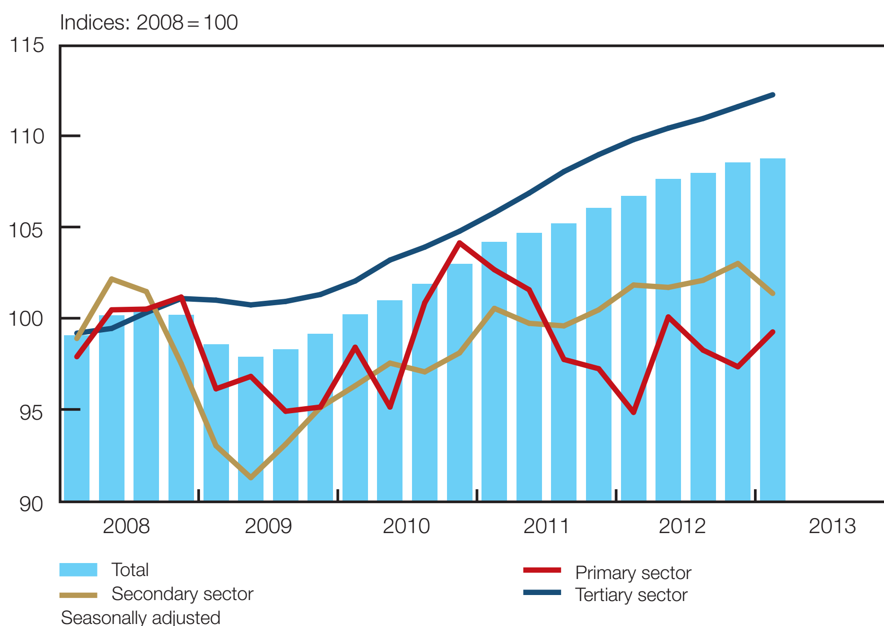
2 The quarter-to-quarter growth rates referred to in this section are based on seasonally adjusted data.

The slackening in *real gross domestic product* growth which set in from the second quarter of 2012 intensified in the first quarter of 2013 when growth decelerated to an annualised rate of 0,9 per cent – the lowest rate of increase since the second quarter of 2009. This disappointing performance can be attributed to a range of factors, including widespread labour unrest, production disruptions in a number of industries, rising inflation expectations, falling commodity prices, electricity supply constraints, hesitant domestic and foreign investor confidence and pessimism about the longer-term outlook for the economy. To achieve an overall growth rate of 2,4 per cent for the year 2013 as a whole, real gross domestic production will have to increase at annualised rates in excess of 3 per cent in each of the remaining three quarters of the year.

Following an increase of only 0,2 per cent in 2011, the real value added by the *primary sector* contracted by 2,2 per cent in 2012. The real output of the mining sector declined alongside a moderate recovery in agricultural production in 2012. The level of production in the primary sector surpassed its pre-recession peak in the third quarter of 2010 but declined once again in 2012, dragged down by protracted labour-related shutdowns of operations experienced in the mining sector.



Subsequent to a decline of 0,1 per cent recorded in 2011, real output of the *agricultural sector* increased by 2,3 per cent in 2012. This increase contributed 0,1 of a percentage point to overall annual economic growth over the period. Favourable weather conditions in most maize-producing areas in South Africa, combined with a larger area planted when compared with the 2010/11 production period, raised the maize crop by about 17 per cent in the 2011/12 production year. Early indications are that field crop production for the 2012/13 production season could be lower than in the previous production season.



Growth in the real value added by the *mining sector* decelerated from a recent peak of 5,7 per cent in 2010 to 0,3 per cent in 2011, before turning negative at a rate of 4 per cent in 2012.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sector	2010	2011	2012					2013
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sector	4,1	0,2	-9,5	24,0	-7,1	-3,7	-2,2	8,1
Agriculture	0,4	-0,1	4,8	9,3	7,4	10,0	2,3	-4,9
Mining	5,7	0,3	-15,1	30,9	-12,7	-9,3	-4,0	14,6
Secondary sector	4,4	2,9	5,5	-0,5	1,5	3,6	2,1	-6,2
Manufacturing	5,5	3,6	6,4	-0,8	1,2	5,0	2,4	-7,9
Electricity, gas and water	2,1	1,1	-0,8	-4,3	1,6	-2,2	-1,2	-3,0
Construction	0,7	0,5	5,1	3,4	3,3	0,2	2,5	0,9
Tertiary sector	2,5	3,8	3,1	2,3	1,9	2,4	3,0	2,4
Commerce	3,8	4,5	3,2	2,7	1,7	1,5	3,6	1,9
Transport and communication	2,0	3,1	2,4	2,2	1,1	1,9	2,3	2,2
Financial and other services	2,2	4,0	4,4	2,1	1,8	2,9	3,3	3,3
Non-primary sector	*2,9*	*3,6*	*3,7*	*1,6*	*1,8*	*2,7*	*2,8*	*0,2*
Total	3,1	3,5	2,5	3,4	1,2	2,1	2,5	0,9

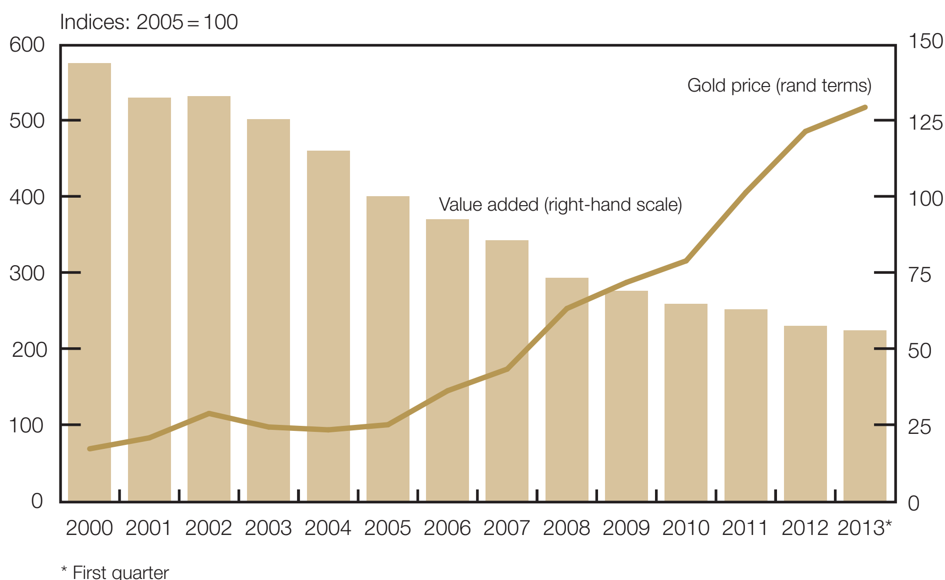
The contraction in mining output reflected lower production volumes in the gold, platinum, diamond and other mining industries. By contrast, production in the coal mining industry expanded in 2012, largely as a result of a new coal mine that came into operation during the period. The occurrence of widespread labour unrest that originated at one of South Africa's biggest platinum mines and swiftly spread to a number of gold, iron ore and coal mines shaved off a large chunk of the mining sector's output in 2012 – the decline in mining production in 2012 subtracted 0,2 of a percentage point from the overall growth in gross domestic product over the period.

Platinum mining, which accounts for around 25 per cent of total mining production, recorded the strongest decline in real output since 2008. The decrease in platinum production in the first half of 2012 largely reflected a six-week shutdown of operations at a major platinum mine due to industrial action. According to the platinum industry, production volumes dropped by around 2,4 million tons of ore in the 2012 financial year, of which roughly 1,8 million tons was associated with the events at Marikana. The industry in 2012 continued to experience an escalation in costs, as well as widespread and violent labour unrest in an environment characterised by ongoing policy uncertainty and slowing global economic activity. The weaker international demand for catalytic converters countered the increase in demand for platinum jewellery by a fair margin over the period, contributing to the reduction in output.

With the exception of gold, which is considered to be a safe haven and of which the price is generally not dictated by industrial applications, commodity prices weakened in 2012. Real output of the gold-mining sector has contracted since 2002 and had more than halved by 2012. Gold production shrank by around 8 per cent in 2012, with the largest declines being recorded in the second half of the year. The depletion of mined mineral resources as well as increased cut-off grades associated with higher mining costs constrained production activity in 2012. Production was also hampered by illegal strike action and underground fires at some of South Africa's major gold mines in the second half of the year. The lower output of gold mines subtracted 1,2 percentage points from the growth rate in total mining in 2012.

Following a significant contraction in 2011, diamond production declined further in 2012, hampered by a lack of skilled workers at some mines and a lower quality of ore.

Despite industrial action restricting output in the second part of 2012, the production of iron ore proved to be fairly resilient during the period. Increased demand from China – the world's largest consumer of iron ore – contributed to increased production activity over the period.



Having increased at a rate of 2,9 per cent in 2011, the real value added by the *secondary sector* rose by only 2,1 per cent in 2012. Production in the manufacturing sector slowed alongside a contraction in the real value added by the sector supplying electricity, gas and water, while activity in the construction sector increased over the period.

Growth in the real value added by the *manufacturing sector* continued to slow in 2012. Following an increase of 5,5 per cent in 2010 and 3,6 per cent in 2011, manufacturing output growth moderated to a rate of 2,4 per cent in 2012 as a whole. Further to the drag caused by the subdued trading environment in Europe and anaemic growth in other parts of the world, structural problems, constrained raw material supplies and changing consumer spending behaviour affected the sector's performance in 2012. Slower growth over the period reflected negative contributions from the subsectors producing textiles, clothing, leather and footwear, glass and non-metallic mineral products, basic iron and steel, non-ferrous metal products and machinery, electrical machinery and furniture and other manufacturing. While output in most subsectors remained lacklustre during 2012, the subsectors producing chemical products and motor vehicles and parts raised their production volumes. Mining-related products accounted for up to 25 per cent of the output of the manufacturing sector in 2012. The disappointing performance of the mining sector therefore exacerbated the difficulties experienced by the manufacturing sector which was already negatively influenced by the global downturn.

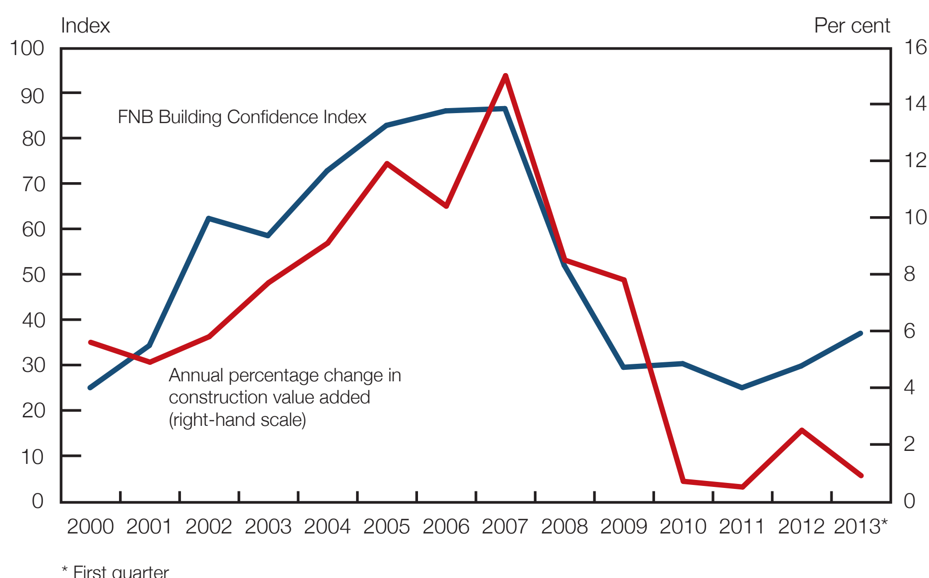
The manufacturing sector was characterised by a fairly erratic performance in the wake of the 2008 global financial recession and the simultaneous slowdown in domestic demand. Having initially contributed to the recovery in economic activity, the South African manufacturing sector encountered a number of headwinds of which industrial action, energy constraints and fierce competition from more competitive Asian producers, are only a few. Between 1995 and 2012 growth in manufacturing output averaged a mere 2,5 per cent per annum, thereby keeping pace with the overall economic growth rate but failing to provide the impetus required to significantly lift South Africa's growth performance. Value added by the manufacturing sector as a ratio of gross domestic product peaked at around 24 per cent in 1981 before declining steadily to 14 per cent in 2010 and 12 per cent in 2012. In 2011 and 2012 the manufacturing sector disappointingly added only 0,6 of a percentage point and 0,4 of a percentage point respectively to overall economic growth. In the first quarter of 2013 real manufacturing output contracted as a fire at a steel mill and refining maintenance held back production.

The real value added by the sector supplying *electricity, gas and water* contracted by 1,2 per cent in 2012 following an increase of 1,1 per cent in 2011. Eskom, South Africa's state-owned power utility, remained under pressure throughout 2012 to generate sufficient electricity to meet domestic demand from both households and companies. In the first half of 2012 the parastatal

initiated a buy-back programme to reduce the use of electricity by industrial and commercial users. Preventative maintenance on ageing power stations, usually implemented during summer periods, had to continue into the winter period of 2012 as unplanned outages further strained the already tight electricity grid. The supply of below-optimum grades of coal to some power stations, together with production disruptions in the transport and mining sectors in the second half of 2012, further impacted negatively on Eskom's electricity-generating capacity. The real value added by the electricity sector contracted further at an annualised rate of 3 per cent in the first quarter of 2013 reflecting, among other factors, buy-back agreements with certain major industrial users as well as unscheduled maintenance at a production unit during the period.

Real value added by the *construction sector* rose by 0,5 per cent in 2011 and 2,5 per cent in 2012, mainly due to stronger civil construction activity. Construction projects commissioned by Eskom, Transnet and Sanral continued apace while capital expenditure by provinces remained steady, indicative of the underlying momentum in the government's infrastructure programme. Residential building activity plunged by nearly a third between 2007 and 2011, but has subsequently started to recover. Non-residential building activity also edged higher in 2012. The real value added by the construction sector gained further momentum in the first quarter of 2013.

FNB building confidence and real value added in the construction sector



* First quarter

Growth in the *tertiary sector*, which constitutes around 60 per cent of total gross domestic product, lost some momentum in 2012 although still contributing 1,9 percentage points to the overall economic growth rate over the period. All the subsectors in the tertiary sector recorded slower growth in real value added in 2012, while the pace of growth in the first quarter of 2013 remained sluggish.

Growth in the real value added by the *trade sector* slowed to 3,6 per cent in 2012 from 4,5 per cent in the preceding year. This somewhat weaker performance reflected a slower pace of increase in the real value added by the motor trade and catering and accommodation subsectors. Growth in the retail trade subsector remained buoyant, while activity in the wholesale trade subsector improved over the period.

Growth in the real value added by the motor trade subsector was supported by the relatively low interest rate environment and strong demand for mainly passenger vehicles in 2012. Activity in the catering and accommodation subsector remained muted over the period. Growth in retail trade was maintained in both 2011 and 2012 despite consumer spending power being partly eroded by rising costs and restrained access to credit. By contrast, the real value added by the wholesale trade subsector increased notably over the period buoyed especially by sales of textiles, clothing and footwear and construction and building materials.

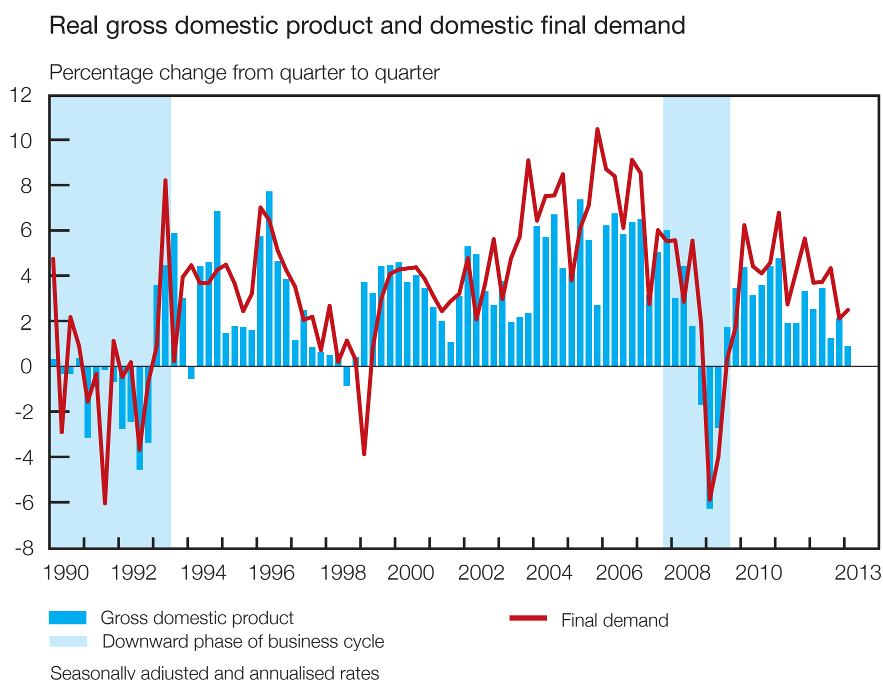
Following an increase of 3,1 per cent in 2011, the real value added by the *transport and communication* sector moderated to a growth rate of 2,3 per cent in 2012. Slower growth in the transport subsector could largely be attributed to industrial action in road freight-transport services in the second half of 2012. Increased input costs such as fuel and electricity had a negative impact on the performance of the sector. By contrast, the real value added by the communication subsector remained lively due to an increased number of subscribers and higher demand for data.

Growth in the real value added by the *finance, insurance, real-estate and business services sector* decelerated from a rate of 4 per cent in 2011 to 3,3 per cent in 2012. The sector's contribution to growth in gross domestic product accordingly moderated slightly from 0,8 of a percentage point in 2011 to 0,7 of a percentage point in 2012. This moderation stemmed mainly from lower trading volumes in the equity market. By contrast, activity in the banking sector remained buoyant as a growing number of customers gained access to banking facilities over the period.

The real output of the *general government* grew by 3,1 per cent in 2012, slower than the rate of 3,9 per cent recorded in 2011. The slower growth could be ascribed to a moderation in employment gains within the sector.

Domestic expenditure

Growth in *real gross domestic expenditure,* being cyclically more sensitive than production, increased at an average annualised rate of 4,4 per cent in the current upward phase of the business cycle that commenced in September 2009. This was slightly higher than the growth of 4 per cent attained in domestic final demand over the same period. Growth in both aggregates outpaced the average annualised rate of 2,9 per cent recorded in real gross domestic production since September 2009.



Following an increase of 4,4 per cent in 2010, growth in real gross domestic expenditure accelerated to 4,6 per cent in 2011, before slowing to 4,1 per cent in 2012. This relatively firm growth primarily reflected a moderation in real final consumption expenditure by households and real inventory investment, which was partly offset by an acceleration in real fixed capital formation.

Real gross domestic expenditure

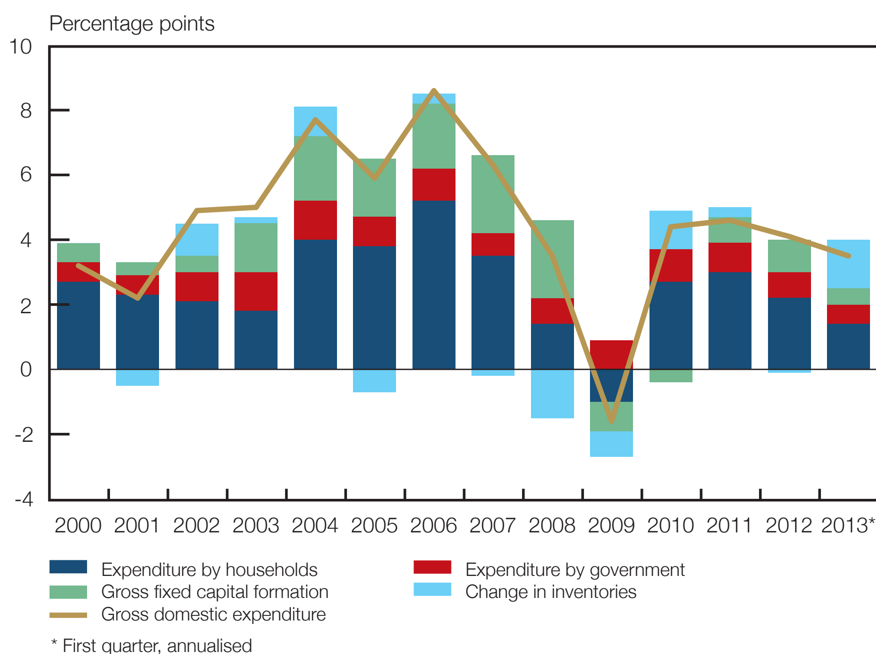
Percentage change at seasonally adjusted annualised rates

Component	2010	2011	2012					2013
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Final consumption expenditure								
Households	4,4	4,8	4,0	3,2	2,7	2,4	3,5	2,3
General government	5,0	4,6	1,9	3,7	8,3	-0,7	4,2	3,0
Gross fixed capital formation	-2,0	4,5	4,6	5,4	5,6	4,3	5,7	2,5
Domestic final demand	3,3	4,7	3,7	3,7	4,3	2,1	4,0	2,5
Change in inventories (R billions)*	-1,4	5,1	5,9	6,3	5,1	-4,1	3,3	4,0
Gross domestic expenditure	4,4	4,6	4,4	4,4	4,1	-0,9	4,1	3,5

* At constant 2005 prices

Despite the moderation in real final consumption expenditure by households and real inventory investment during 2012, growth in both aggregates collectively contributed 2,1 percentage points to the growth in real gross domestic expenditure. This contribution increased further to 2,9 percentage points in the first quarter of 2013.

Contributions to growth in real gross domestic expenditure



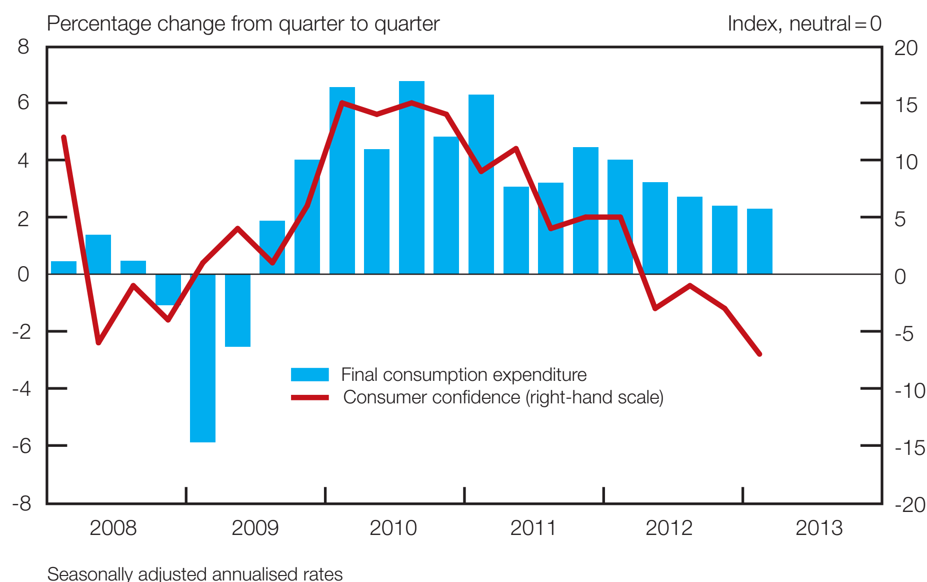
* First quarter, annualised

Real final consumption expenditure by households

Although the average share of *final consumption expenditure by households* in gross domestic product increased from 59,8 per cent in 2011 to 60,4 per cent in 2012, growth in real consumption expenditure moderated from 4,8 per cent in 2011 to 3,5 per cent in 2012. This moderation continued in the first quarter of 2013.

In 2012 and early 2013 expenditure by households was constrained by a range of factors, including:

– a moderation in growth in disposable income;
– persistently high unemployment rates;
– escalating administered prices;
– relatively high household indebtedness; and
– waning consumer confidence levels – in the first quarter of 2013 consumer confidence registered its lowest level in nine years.



Having recorded strong growth of 15,8 per cent in 2011, households' real consumption expenditure on *durable goods* gradually lost momentum and slowed to 11 per cent in 2012 and 5,4 per cent in the first quarter of 2013 – the slowest rate of increase since the second quarter of 2009. Lower spending on durable goods reflected the increased financial stress experienced by households due to rising indebtedness. Real outlays on furniture and household appliances, an important component of durable goods, receded during 2012, while real expenditure on transport equipment increased at a slightly slower pace than in 2011. By contrast, real expenditure on computer and related equipment continued to advance at a vigorous pace as prices of these items remained competitive.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

Component	2010	2011	2012					2013
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods	18,8	15,8	8,1	8,9	7,8	6,1	11,0	5,4
Semi-durable goods	3,6	5,9	6,1	6,8	6,2	5,1	6,2	6,2
Non-durable goods	1,8	3,1	2,5	2,2	1,7	2,3	2,5	1,4
Services	4,0	3,5	3,6	1,7	1,3	0,8	1,8	1,1
Total	4,4	4,8	4,0	3,2	2,7	2,4	3,5	2,3

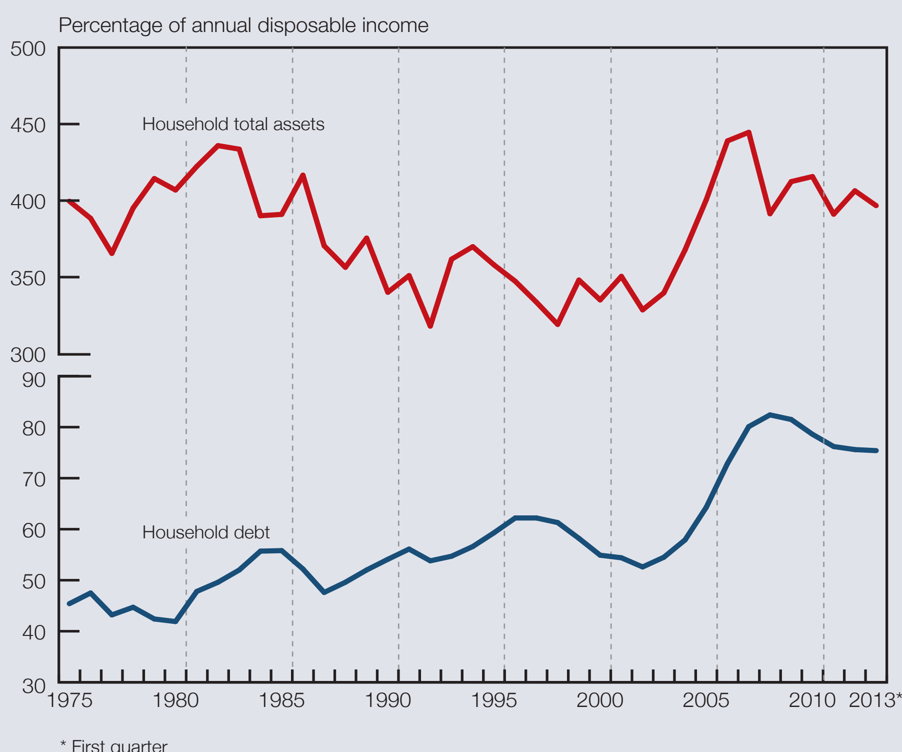
Growth in households' real expenditure on *semi-durable goods* accelerated progressively from 3,6 per cent in 2010 to 5,9 per cent in 2011 and 6,2 per cent in 2012. The increase in expenditure continued at an annualised rate of 6,2 per cent in the first quarter of 2013. Real outlays, especially on clothing, footwear and household textiles, contributed to the increased spending as consumers took advantage of the relatively low price increases of these items.

Real final consumption expenditure on *non-durable goods* decelerated to 2,5 per cent in 2012, with the pace of increase moderating even further in the first quarter of 2013. In the case of petroleum products real purchases by households in fact contracted in 2012, driven by substantial increases in the price of petrol. This was the first such contraction since 2008.

Real spending by households on *services* increased at a rate of 1,8 per cent in 2012, that is, at a much slower pace than in 2011. Spending on medical and financial services moderated, while expenditure on miscellaneous services declined. Expenditure by visitors in South Africa exceeded spending by South African residents in the rest of the world over the period. This was partly driven by the lower exchange value of the rand that made travelling to South Africa more affordable, adding to the country's attractiveness as a destination for international holidaymakers. During the first quarter of 2013, annualised growth in real expenditure on services weakened to 1,1 per cent.

Box: Household balance-sheet developments

An analysis of the household balance sheet over the period since the onset of the global financial crisis in 2008 shows that households were successful in broadly restoring their financial position, although they have not fully deleveraged. The net wealth of households initially fell back from R4 611 billion in the middle of 2008 to R4 128 billion in the first quarter of 2009; it subsequently recovered strongly, rising by 56 per cent to reach an all-time high of R6 452 billion in the first quarter of 2013. The value of households' assets increased on account of a recovery in the prices of financial assets, driven primarily by the buoyant performance of equity prices. The net wealth of households was further supported by an improvement in the value of non-financial assets, in particular from the second quarter of 2012 onwards as prices of dwellings started to recover.

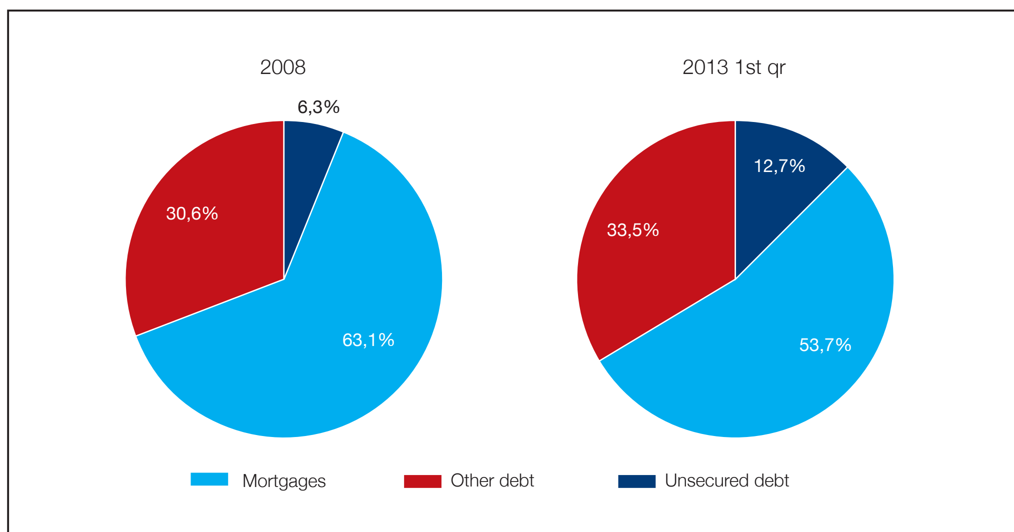


The total debt of the household sector increased at a more sedate pace than the value of their assets, thereby improving the sector's leverage position. The ratio of household debt to total assets improved from an all-time high of 22 per cent in the first quarter of 2009 to 19 per cent in the first quarter of 2013. This latter value nevertheless remained substantially higher than the low of 16 per cent recorded in the first quarter of 2002.

The improvement in the aggregate household balance sheet and the substantial deleveraging that took place in the past few years suggest that households are in a stronger financial position, poised to take advantage of opportunities that may for instance arise in the residential property market. However, behind the aggregates there are numerous individual households with widely varying financial and personal circumstances; some of these are overindebted and others have no debt at all. The aggregate numbers and ratios should therefore be treated with circumspection.

A structural shift in credit extension in favour of non-mortgage lending changed the composition of total household debt over time. Having peaked at the end of 2011, the pace of increase in non-mortgage credit slowed in 2012 and continued in the first quarter of 2013.

Composition of household debt



Growth in *real disposable income* moderated from 5,2 per cent in 2011 to 3,8 per cent in 2012, mainly due to a slower pace of increase in compensation of employees which accounts for more than 75 per cent of disposable income of consumers. Household income was furthermore affected by an increase in income tax in recent fiscal years. With a slower increase in total household debt from 2011 to 2012, the ratio of debt to disposable income slowed from 76,2 per cent in 2011 to 75,6 per cent in 2012 and stood at 75,4 per cent in the first quarter of 2013.

Consistent with the backdrop of relatively low and steady interest rates in South Africa, the ratio of debt-service cost to disposable income moderated from a revised 8,2 per cent in 2011 to 7,7 per cent in 2012 – a level it maintained in the first quarter of 2013.

Real final consumption expenditure by general government

Growth in *real final consumption expenditure* by *general government* slowed to 4,2 per cent in 2012 from 4,6 per cent in 2011. However, as a ratio of gross domestic product government consumption expenditure increased from 21,1 per cent in 2009 to 22,4 per cent in 2012. Spending on compensation of employees, which accounts for more than half of the total final

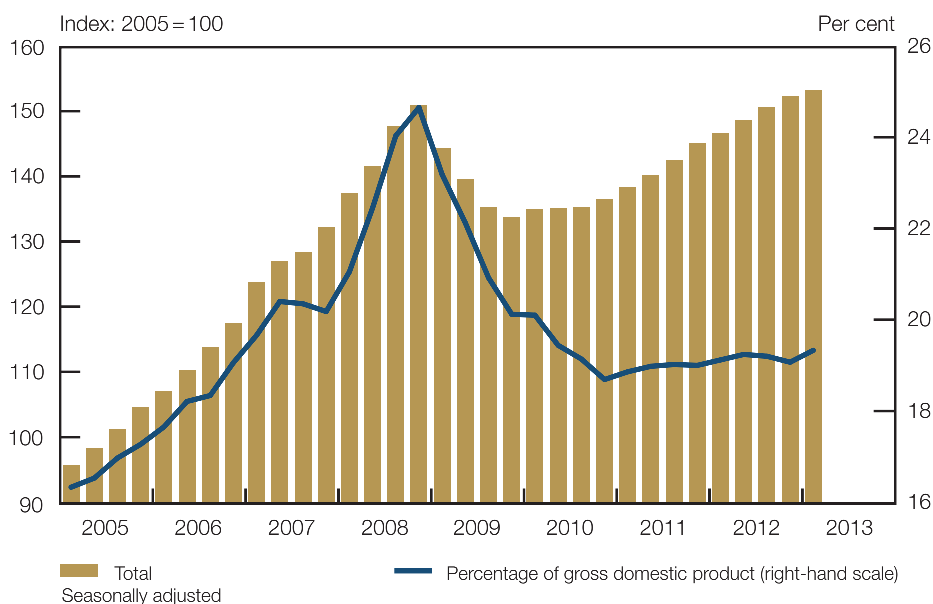
consumption expenditure by general government, moderated from 4,1 per cent in 2011 to 3 per cent in 2012 on account of efforts to contain the growth in government's wage bill. Temporary increases in spending on wages and salaries in 2011 could be ascribed to local elections and the National Census activities that took place during the period.

The rising share of non-wage goods and services in total spending by general government since 2003 could be linked mainly to government's strategic defence procurement programme. This programme, however, came to an end in September 2012. Over the past years, government has also aligned its planning and expenditure towards a proper functioning education and primary health care.

Real gross fixed capital formation

As gross fixed investment tends to lag developments in financial markets, the adverse impact of the global financial crisis in 2008 only became visibly from the first quarter of 2009. Real capital formation picked up from the first quarter of 2010 and by the fourth quarter of 2012 surpassed the highest level prior to the onset of the crisis.

Notwithstanding steady increases in real capital spending, the ratio of gross fixed capital formation to gross domestic product amounted to 19 per cent and 19,2 per cent in 2011 and 2012 respectively, inching higher to 19,3 per cent in the first quarter of 2013. All these values remained noticeably lower than the most recent peak of 23,1 per cent attained in 2008. Low business confidence levels, the fragile and uncertain domestic and global economic recovery together with surplus capacity probably inhibited further capital spending over the period.



The financial crisis was followed by a contraction in *real gross fixed capital formation* in 2009 and 2010; growth in capital spending thereafter accelerated again from 4,5 per cent in 2011 to 5,7 per cent in 2012 notwithstanding the ongoing instability in some international economies. Strong growth in public-sector investment more than neutralised a deceleration in private investment over the period.

Real gross fixed capital formation by *private business enterprises,* accounting for about 60 per cent of total fixed investment activities, increased at a slower pace in 2012. Apart from real capital outlays by the mining and manufacturing sectors, capital investment remained lacklustre in most sectors.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

Sector	2010	2011	2012					2013
	Year	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Private business enterprises	-0,5	4,6	2,5	2,7	2,8	3,8	3,9	2,8
Public corporations	-1,5	1,5	11,0	9,8	10,6	7,2	9,1	1,5
General government	-9,0	8,6	4,9	10,9	10,3	2,1	8,5	3,2
Total	**-2,0**	**4,5**	**4,6**	**5,4**	**5,6**	**4,3**	**5,7**	**2,5**

Despite the prolonged strike action during 2012 and volatile commodity prices, the mining sector continued to invest in construction works, machinery and other equipment, albeit at a much slower rate. Growth in capital investment by the mining sector decelerated from 6,9 per cent in 2011 to 4,2 per cent in 2012. Real capital outlays primarily occurred in the gold and platinum group metals subsectors, influenced in part by relatively high prices of these commodities.

The manufacturing sector made the largest contribution to growth in capital formation by private business enterprises in 2011 and 2012, affected by the steady increase in manufactured exports and the depreciation in the exchange value of the rand.

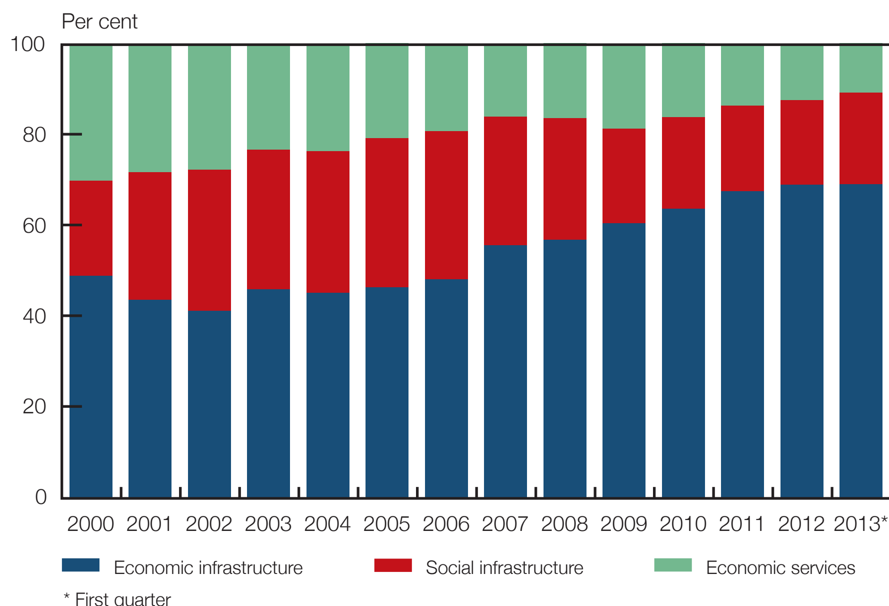
Capacity utilisation rates in the manufacturing sector, however, do not suggest a notable surge in investment expenditure in the near future. The utilisation of production capacity picked up slightly to a recent high of 82,6 per cent in the fourth quarter of 2012, but subsequently receded to 80,9 per cent in the first quarter of 2013 mainly due to insufficient demand.

Capital spending by *public corporations* continued at a firm pace throughout 2012, dominated by the electricity supply investment programme, as well as capital expansion by the transport and communication sector. Eskom continued to invest heavily in its two large coal-fired power plants, namely Medupi and Kusile; its pumped storage scheme; and its return-to-service power stations.

Transnet increased spending on bulk rail, general freight infrastructure and ports. The steady pace of increase in capital investment by Transnet during the past three years increased the capacity of South Africa’s bulk export railway lines with an additional 24 million tons, while the corporation procured 110 new locomotives for use on these lines. Maintenance had become an integral part of capital budgets, reflected in extensive upgrading and maintenance of Transnet’s general freight infrastructure and rolling stock.

Real capital spending by *general government* increased robustly by 8,6 per cent and 8,5 per cent in 2011 and 2012 respectively. The main contributor to government capital expenditure in 2012 was provincial government, which outpaced spending at both central and local government levels. Capital spending in 2012 focused on both economic infrastructure and social infrastructure, specifically public works, roads and transport.

Gross fixed capital formation of general government by function



* First quarter

Change in inventories

Real inventory investment continued to increase in 2012, albeit at a somewhat slower pace than in 2011. The accumulation of inventories was temporarily interrupted in the fourth quarter of 2012 but regained momentum in the first quarter of 2013.

Stock levels were depleted in the final quarter of 2012 as the production of gold, platinum and coal was disrupted by strike action in the mining industry. In addition, during that quarter real inventory holdings declined in the manufacturing sector following industrial action that interrupted activities at some of the country's refineries. However, for the year 2012 as a whole inventory investment in the manufacturing sector was positive and was underpinned by increased production levels. The ratio of industrial and commercial inventories to non-agricultural gross domestic product remained unchanged at 12,6 per cent in 2011 and 2012, but declined marginally to 12,4 per cent in the first quarter of 2013. Agricultural stocks-in-trade were also accumulated in 2012 as part of the large maize crop channelled into inventories.

Factor income

In a setting of fairly pedestrian real economic growth and inflation, growth in aggregate *nominal factor income* amounted to 8,8 per cent in 2011 and 8,3 per cent in 2012. In the first quarter of 2013 year-on-year growth in nominal factor income slowed to 6,9 per cent, as compensation of employees increased at a slower pace.

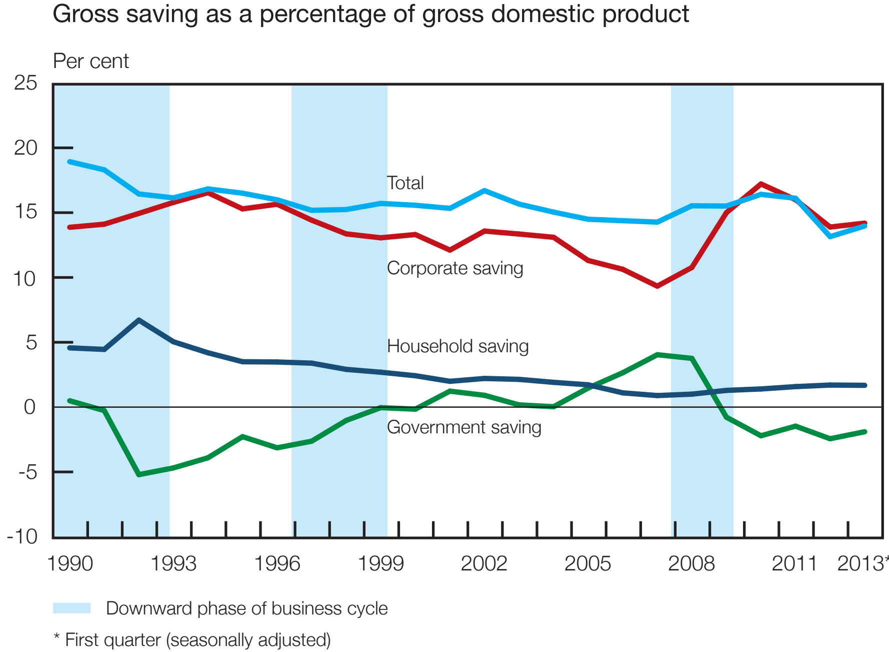
Measured over one year, growth in *compensation of employees* decelerated from 12 per cent in 2010 to 9,8 per cent in 2011. Industrial action in some sectors of the economy in 2012, with the accompanying loss of workdays and wages, caused growth in remuneration of employees to decelerate further to a rate of 8,8 per cent over the period. Underlying nominal wages and salaries increased at a steady pace in 2012, but this was partly offset by slower growth in the flexible component comprising bonuses, fees and commissions. The slower pace of increase in overall salaries and wages was mainly evident in the trade, transport and general government sectors. In the trade and manufacturing sectors a significant number of jobs were lost in the final quarter of 2012. The average wage settlements inched marginally lower from 7,7 per cent in 2011 to 7,6 per cent in 2012, while growth in employment remained subdued in 2012. Measured over one year, growth in compensation of employees decelerated further in the first quarter of 2013.

The rate of increase in the aggregate *gross operating surplus* moderated from 8,7 per cent in 2010 to 7,7 per cent in 2011 due to continued weak global economic conditions. Despite unfavourable developments and uncertainty in the global financial markets, the pace of change in the total gross operating surplus increased marginally to 7,8 per cent in 2012, mainly on account of increases in the operating surpluses of the agricultural, construction, trade and finance sectors. By contrast, the operating surpluses of the mining and manufacturing sectors were negatively affected by disruptive industrial action, safety stoppages, lower commodity prices and the electricity buy-back programme in 2012. In addition, low capacity utilisation as a result of insufficient demand, the shortage of skills in certain areas and inadequate raw materials further contributed to slower growth in gross operating surplus in the manufacturing sector. The share of operating surpluses in the total factor income also shrank from an average of 50 per cent between 2007 and 2011 to 48,2 per cent in 2012. Growth in the operating surpluses of business enterprises accelerated from 5,8 per cent in the fourth quarter of 2012 to 6,4 per cent in the first quarter of 2013 as some of the major sectors registered stronger growth in their gross operating surpluses.

Gross saving

The *national saving ratio* of South Africa amounted to an average of 16,5 per cent in the period 1990 to 1999 but lost momentum and slowed to an average of 15,2 per cent in the period 2000 to 2012. Saving ratios in excess of 16 per cent were recorded in 2010 and 2011 from where the ratio dropped to a low of 13,2 per cent in 2012 before recovering marginally to 14 per cent in the first quarter of 2013. The decline in the saving performance of the country in 2012 was caused by lower saving ratios of the general government and corporate sectors, while household saving increased somewhat.

Gross saving as a percentage of gross domestic product



* First quarter (seasonally adjusted)

The foreign financing ratio, which represents the shortfall in domestic financing (saving) of gross capital formation, increased from 17,4 per cent in 2011 to a high of 32,3 per cent in 2012 and 29,3 per cent in the first quarter of 2013. This shortage in domestic financing has remained above 25 per cent since the first quarter of 2012, indicating a significant dependency on foreign financing.

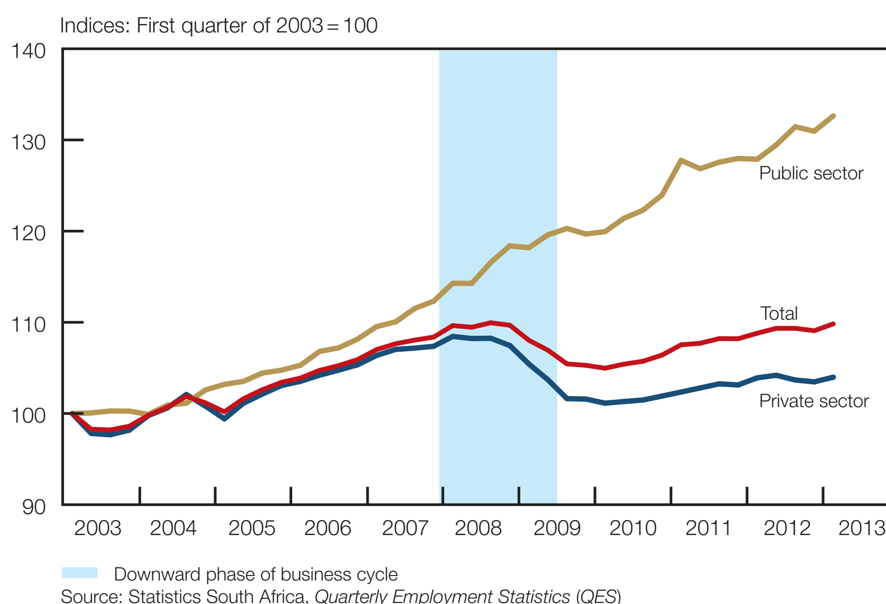
Gross saving by general government as a percentage of gross domestic product averaged 1,3 per cent from 2000 to 2009 but thereafter deteriorated to ratios of -1,5 per cent in 2011 and -2,4 per cent in 2012 before improving marginally to -1,9 per cent in the first quarter of 2013. Increased expenditure by general government in 2012 raised the dissaving by general government. In the first quarter of 2013 social benefit payments continued to increase at a firm pace, indicative of government's social support in view of the country's current high unemployment rate in excess of 25 per cent.

The gross saving ratio of the corporate sector declined from 16 per cent of gross domestic product in 2011 to 13,9 per cent in 2012. Slightly lower dividend declarations subsequently boosted the saving ratio to 14,2 per cent in the first quarter of 2013. Since the 1990s the corporate sector accounts for roughly 87 per cent of total gross saving in South Africa, thereby continuing to provide the bulk of domestic financing of capital formation.

Gross saving by the household sector increased marginally from 1,6 per cent of gross domestic product in 2011 to 1,7 per cent in both 2012 and the first quarter of 2013. These values remain low when compared with the average ratio of 4,1 per cent recorded between 1990 and 1999, but are close to the average ratio observed over the past decade. The low saving ratios are consistent with the close alignment of household consumption expenditure to disposable income.

Employment

Conditions in the domestic labour market weakened over the past year, characterised by a marked deterioration in the labour relations environment, which was often violent and had fatal consequences for some of those involved in mostly unprocedural industrial actions. Disconcertingly, these developments unfolded as employment growth moderated in response to a slowdown in output growth. Growth in real gross domestic product moderated to 2,4 per cent in 2012 from 3,8 per cent in 2011, while growth in total formal non-agricultural employment slowed from an average rate of 2,2 per cent in 2011 to 1,2 per cent in 2012, according to the *Quarterly Employment Statistics* (*QES*) survey conducted by Statistics South Africa (Stats SA).



Since the second quarter of 2010 – the start of the current upward phase in the employment cycle – to the first quarter of 2013, the South African economy created an estimated 374 900 formal-sector jobs following the loss of around 384 200 job opportunities during the preceding recession. However, employment growth lost considerable momentum from the middle of 2012; almost 88 000 employment opportunities were added in the formal non-agricultural sector of

the economy in the first half of 2012, while close to 14 000 jobs were shed in the second half of the year. Although the moderation in employment growth occurred in both the public and private sectors in 2012, job shedding occurred primarily in the private sector in the second half of 2012. Following some employment growth in especially the private services sector and the appointment of temporary staff by the Independent Electoral Commission for the execution of municipal by-elections, employment numbers increased somewhat in the first quarter of 2013.

The public sector increased its employment levels throughout the most recent downward phase in the business cycle in a countercyclical fashion and maintained a generally steady pace of job creation thereafter. During the current upward phase in the employment cycle the public sector added some 200 000 jobs, which are more than the 174 900 added by the private sector, up to the first quarter of 2013. Public-sector employment growth, however, moderated from 4,6 per cent in 2011 – the highest rate since 1975 – to 1,9 per cent in 2012. The share of public-sector employment in total formal non-agricultural employment rose consistently over the past four years, from 22,0 per cent in the fourth quarter of 2008 to 24,5 per cent in the fourth quarter of 2012.

Changes in enterprise-surveyed formal non-agricultural employment

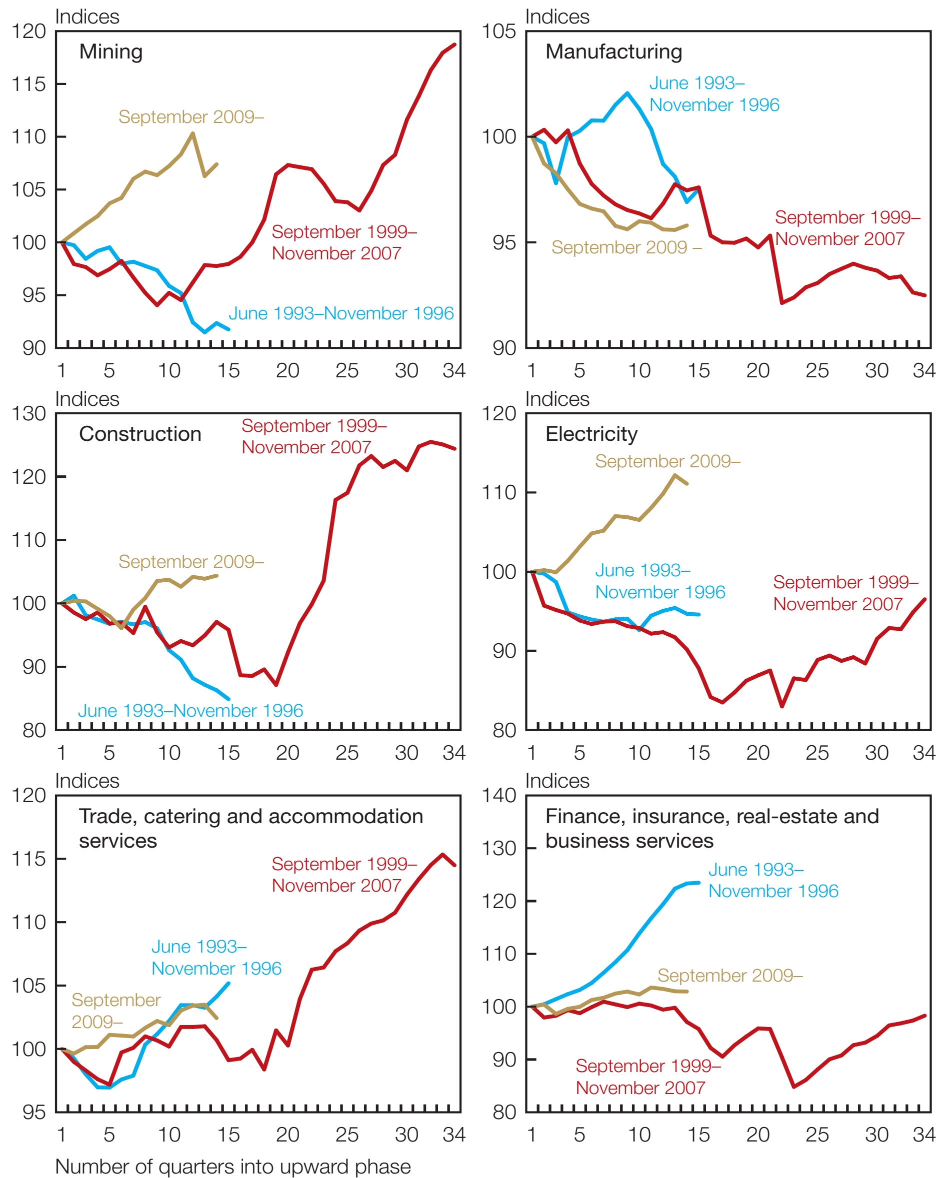
Sector	Annual average change (number)				Change over four quarters to 1st qr 2013		Cumulative job losses (-) gains (+) (numbers)	
	2009	2010	2011	2012	Number	Per cent	4th qr 2008 to 1st qr 2010	2nd qr 2010 to 1st qr 2013
Finance, insurance, real-estate and business services	-90 400	-40 200	43 800	15 300	9 200	0,5	-163 400	97 900
Manufacturing	-86 500	-42 100	-16 600	-2 900	-10 600	-0,9	-118 300	-38 500
Trade, catering and accommodation services	-67 600	-11 700	17 500	23 100	10 600	0,6	-75 700	57 900
Construction	-38 000	-23 700	14 100	8 300	3 800	0,9	-52 100	13 500
Total mining	-28 000	7 700	17 200	7 300	-8 700	-1,7	-35 900	23 200
Gold mining	-5 900	-3 900	-9 300	-5 200	-4 300	-3,0	-8 900	-21 300
Other mining	-22 000	11 600	26 500	12 600	-4 400	-1,2	-27 000	44 500
Electricity	-1 200	-200	2 300	2 200	1 400	2,2	-3 300	5 900
Private transport, storage and communication services	-6 800	4 600	3 100	3 100	-4 300	-1,6	-2 000	2 800
Community, social and personal services	10 800	5 700	5 300	2 100	3 200	0,8	13 400	12 300
Private sector	**-307 700**	**-99 900**	**87 300**	**58 600**	**4 500**	**0,1**	**-437 300**	**174 900**
Provinces	37 800	36 500	41 300	21 400	8 700	0,8	51 600	77 400
Local governments	11 000	10 700	10 000	7 300	13 300	5,2	15 000	29 200
National departments	6 900	1 600	19 400	14 500	10 800	2,4	-800	43 200
Other public-sector enterprises	500	-2 900	17 000	-14 100	27 400	20,5	-7 800	32 200
Public transport, storage and communication services	-300	-3 800	1 100	8 800	14 700	13,7	-4 900	18 100
Total public sector	**56 000**	**38 900**	**88 700**	**37 900**	**74 900**	**3,7**	**53 100**	**200 000**
Grand total	**-251 600**	**-61 000**	**176 000**	**96 400**	**79 400**	**0,9**	**-384 200**	**374 900**

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

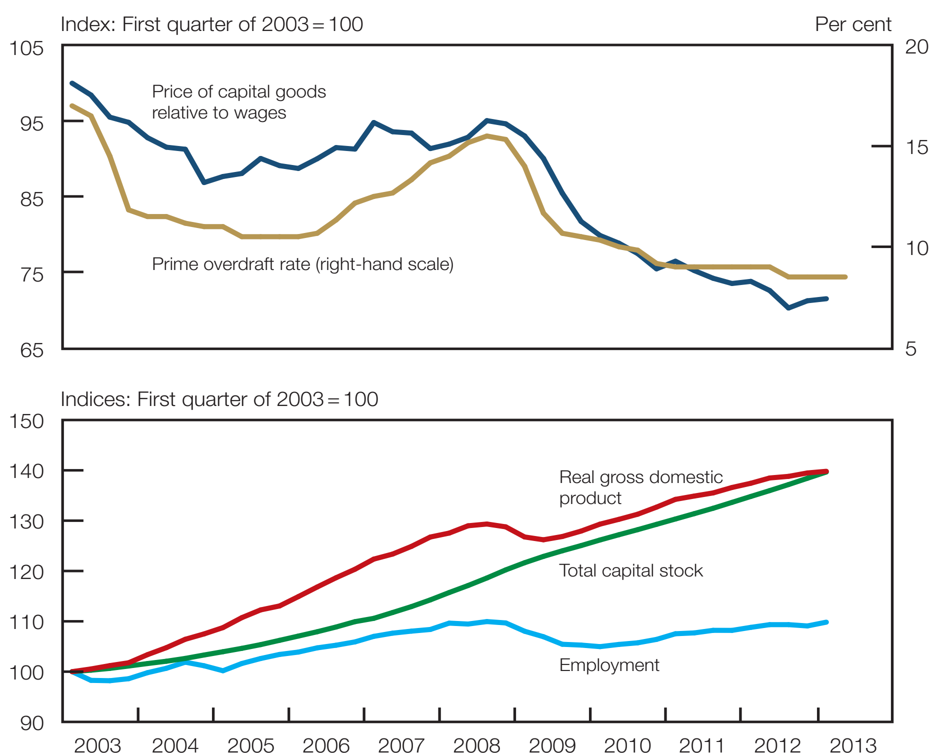
Private-sector employment increased by only 1,4 per cent in 2011, following two years of contraction. This rate of increase disappointingly slowed to 0,9 per cent in 2012. With the exception of the manufacturing and the gold-mining sectors, all other sectors registered employment gains in 2012, albeit at a slower pace than in 2011. The accompanying panel of graphs reveals that with the exception of the manufacturing sector and the finance, insurance, real-estate and business services sector, employment in all the formal private sectors of the economy has thus far recovered at a faster pace than during the previous two upward phases

of the business cycle. This is partly due to the severity of the most recent downward phase resulting in a high number of job losses. Despite the initial brisk recovery, a loss of momentum in employment growth in recent quarters is evident in most of the private sectors of the economy, as domestic structural constraints coupled with a renewed sluggishness in the global economic recovery, particularly in Europe, were reflected in the pace of employment growth.

Formal non-agricultural employment: Upward phase comparison



The resumption of growth in the economy since the third quarter of 2009, following the international financial crisis, occurred within an expansionary monetary policy environment as evidenced by the decline in interest rates, shown in the following graph. At the same time the relative price of capital goods moved lower, partly on account of technological advances. Within this environment the coherence between the production factors of capital and labour has shifted: whereas the capital stock has increased further since the resumption of domestic economic growth, there has been no expansion in the aggregate level of formal non-agricultural employment. In fact, the total capital stock increased by 10,7 per cent from the fourth quarter of 2008 to the fourth quarter of 2012, while the level of formal non-agricultural employment declined by 0,5 per cent over the same period, leading to increased capital intensity in production processes in the economy.

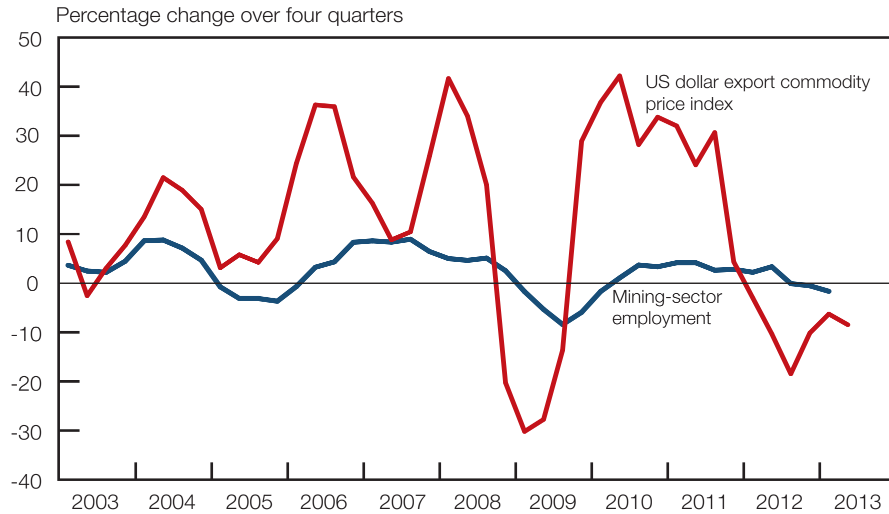


It is evident that with the exception of the manufacturing sector, where the level of capital stock essentially remained unchanged during the period 2009 to 2012, meaningful increases in the capital stock occurred in all the other sectors, with the most pronounced being in the electricity, gas and water sector (55,6 per cent); mining and quarrying sector (26,0 per cent) and the construction sector (25,9 per cent).

The most notable employment gains during the four years up to the end of 2012 occurred in the community, social and personal services sector, with a cumulative increase of 9,6 per cent over this period. Employment increases to a lesser extent also occurred in the mining and quarrying sector (3,8 per cent); electricity, gas and water sector (5,3 per cent); and the transport, storage and accommodation sector (5,7 per cent). These increases were to a large extent countered by job losses in the manufacturing sector (6,9 per cent); construction sector (5,0 per cent); finance, insurance, real-estate and business services sector (2,2 per cent); and the trade, catering and accommodation services sector (0,8 per cent). The job losses reflected a mix of factors, including not only the weakness of demand specific to various sectors, but also labour's own conduct in securing improved benefits and higher remuneration within a challenging environment.

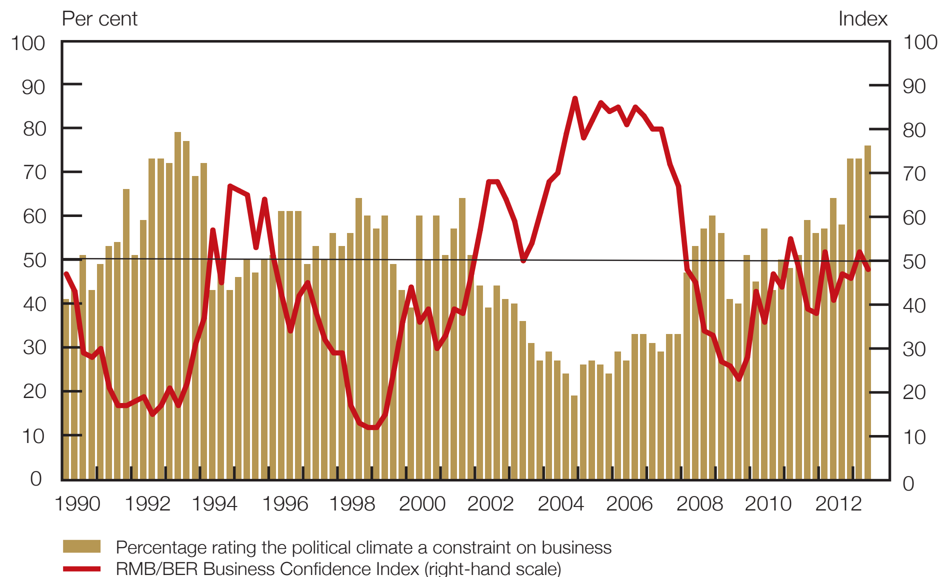
The South African economy has often been hindered by fairly lengthy and disruptive labour unrest in various economic sectors, to the detriment of output and employment creation. However, over the past year industrial action has become more pervasive, occasionally accompanied by increased violence. In August 2012, an illegal and violent strike at the Marikana platinum mine resulted in a number of fatalities, sparking similar unlawful wildcat strikes at numerous other mines. The strikes subsequently spread to other sectors of the economy, notably the road freight transportation sector and the agricultural sector in parts of the Western Cape. These developments contributed to the shedding of some 43 800 private-sector employment opportunities in the third and fourth quarters of 2012.

Supported in part by rising international commodity prices, 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, before slowing to 1,4 per cent in 2012 as falling commodity prices and the spate of unlawful strike action halted job creation in the sector. Around 19 500 mining jobs were lost in the third quarter of 2012, of which only 5 500 were reclaimed in the fourth quarter. Employment growth in the non-gold mining sector slowed from a brisk rate of 7,7 per cent in 2011 to 3,4 per cent in 2012, while labour paring continued for a fifth consecutive year in the gold-mining sector in 2012, at a rate of 3,6 per cent.



International prices of mining commodities have declined notably since the middle of 2011 on account of a renewed moderation in global economic activity. In view of possible further industrial action and safety-related work stoppages in 2013, profitability and job creation in the mining sector depend largely on foreign demand, particularly from China and Europe, as well as on the balance between production costs, the exchange rate of the rand and international commodity prices.

Subsequent to the events at Marikana, there has been a notable loss in business and investor confidence, followed by South Africa's sovereign credit rating being downgraded by two prominent rating agencies in October 2012. Concerns raised by the agencies included government's institutional strength, reduced fiscal space, the negative investment climate due to infrastructure shortfalls, relatively high labour costs despite high unemployment, and increased concerns about future political stability. These concerns relate to both political developments and a loss of competitiveness. The Bureau for Economic Research (BER) noted in its Manufacturing Survey for the second quarter of 2013 that the rating of the general political climate as a constraint on business activity had increased to its highest level since the third quarter of 1993 – the turbulent political period just prior to South Africa's first democratic elections. The accompanying graph shows the inverse relationship that exists between business confidence and perceived political uncertainty.



In the *World Economic Forum's Global Competitiveness Report 2012–2013*, South Africa was placed 52nd out of 144 countries, dropping two places from the previous year. Although South Africa ranked very high in areas related to financial market development, auditing and corporate governance, other critical areas were ranked very low. These were largely related to the quality of education, government regulation, labour-employee relations, hiring and firing practices, wage flexibility and the link between wages and productivity. These factors have contributed to a gradual loss of competitiveness, particularly in the goods-producing sectors of the domestic economy, and have constrained output and employment growth. As such, the manufacturing sector has been shedding jobs almost uninterruptedly from the middle of the 1990s to the first quarter of 2013. Despite failing to create employment after the 2008 global financial crisis, the pace of labour paring in the manufacturing sector has nevertheless receded in each successive year following the recession; from an annual average rate of 3,5 per cent in 2010 to 1,4 per cent in 2011 and to 0,3 per cent in 2012. Employment prospects in the manufacturing sector remain uncertain, with the employment sub-index of the Kagiso Purchasing Managers Index (PMI) remaining below the neutral level of 50 index points for 6 consecutive months up to May 2013. In addition, the manufacturing sector remains susceptible to renewed weakness in the global economy, particularly in Europe, through reduced exports. However, the recent depreciation in the exchange value of the rand could provide a fillip to manufacturing exporters.

In his National Budget Speech in February 2013 the Minister of Finance, taking the *National Development Plan* as his point of departure, acknowledged economic competitiveness as an imperative to growth and job creation. The economy's disappointing employment performance had prompted government to step up various initiatives in an effort to promote job creation, namely:

- a revised youth employment incentive, following inputs from various stakeholders;
- funding for the *Special Economic Zones (SEZ) Programme*, announced in 2012, to build world-class industrial parks, including a proposed employment incentive for SEZ's and possible tax incentives to enhance this initiative;
- the continuation of the *Manufacturing Competitiveness Enhancement Programme*, announced in 2012, with requests for grants already totalling R2,3 billion;
- continued simplification of the tax requirements for small-, medium- and micro-enterprises – a significant generator of employment in the economy;
- a renewed commitment to infrastructure spending, with R827 billion budgeted for various infrastructure projects over the next three years; and
- the *Industrial Policy Action Plan* (IPAP) 2013/2014, unveiled by the Minister of Trade and Industry, which aims to extend existing support programmes in the automotive, metals, agro-processing, clothing and textiles, as well as leather and footwear industries. In addition, IPAP includes action plans in support of green industries and renewable energy efficiency, and introduces a strategic focus on minerals and resources beneficiation.

Employment levels in the electricity-generation sector contracted marginally in 2009 and 2010. However, the sector's workforce expanded by 4,0 per cent and 3,7 per cent in 2011 and 2012 respectively, as Eskom's capacity-enhancing expansion continued. Following delays caused by labour unrest and poor contractor performance, the first units of the new Medupi power station are now expected to become operational and to deliver electricity to the national grid only in 2014. In addition, Eskom continues to experience challenges as the output produced by its power stations is volatile, necessitating maintenance during the winter months, thereby further constraining capacity and posing the risk of possible load shedding.

Employment creation in the tertiary sectors of the economy tapered off notably in recent quarters as employment growth in the finance, insurance, real-estate and business services sector – the largest formal-sector employer – moderated from 2,5 per cent in 2011 to 0,8 per cent in 2012. Conversely, employment growth in the trade, catering and accommodation services sector accelerated from 1,1 per cent in 2011 to 1,4 per cent in 2012 and to an annualised rate of 4,8 per cent in the first quarter of 2013. Disappointingly, the FNB/BER Consumer Confidence Index has deteriorated gradually over the past two years, reaching a nine-year low of -7 index points in the first quarter of 2013. In addition, the BER Retailer Confidence Index declined further to a level of 41 index points in the second quarter of 2013, in anticipation of slower growth in household

consumption expenditure. The low level of business and consumer confidence, coupled with relatively high levels of consumer indebtedness and rising consumer price inflation, could constrain meaningful employment gains in this sector.

The construction sector increased its employment levels by, on average, 2 per cent in 2012, following an increase of 3,5 per cent in 2011. Encouragingly, the FNB/BER Civil Confidence Index increased markedly to a level of 51 index points in the first quarter of 2013 – its highest level in four years. Despite government's continued commitment to infrastructure spending boding well for construction activity and job creation over the medium to longer term, the uncertainty in the mining sector seems likely to constrain private-sector demand for construction work in the short term.

Key labour market indicators

Thousands

	Average for 2010	Average for 2011	Average for 2012	Mar 2013	Actual change 2011 on 2010	Actual change 2012 on 2011
Population: 15–64 years	**32 007**	**32 494**	**32 959**	**33 240**	**486**	**465**
Labour force	**17 393**	**17 662**	**18 064**	**18 222**	**269**	**402**
Employed	**13 061**	**13 265**	**13 523**	**13 621**	**204**	**258**
Formal sector (non-agricultural)	9 123	9 367	9 589	9 586	245	221
Informal sector (non-agricultural)	2 159	2 172	2 148	2 192	12	-23
Agriculture	639	614	660	739	-25	46
Private households	1 140	1 113	1 126	1 105	-27	13
Unemployed	**4 332**	**4 397**	**4 541**	**4 601**	**65**	**144**
New entrants to the job market	1 840	1 939	1 992	2 019	99	53
Job losers	1 393	1 328	1 403	1 399	-65	76
Other	1 099	1 131	1 146	1 183	31	16
Not economically active	**14 614**	**14 832**	**14 895**	**15 017**	**218**	**63**
Discouraged workers	1 998	2 237	2 268	2 330	240	31
Other	12 617	12 595	12 627	12 688	-22	32
Rates	Per cent				Percentage points	
Unemployment rate	24,9	24,9	25,1	25,2	0,0	**0,2**
Youth unemployment (15–24 age group)	50,5	49,8	51,5	52,9	-0,7	**1,7**
Employed/Population ratio (absorption rate)	40,8	40,8	41,0	41,0	0,1	**0,2**
Labour force participation rate	54,4	54,4	54,8	54,8	0,0	**0,4**

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

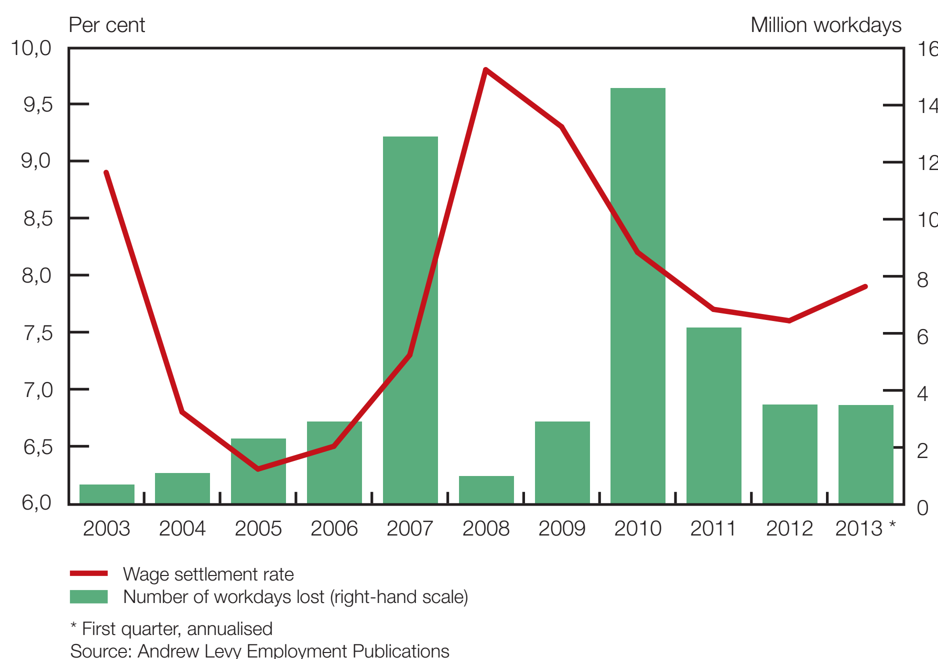
The lacklustre recovery in employment is corroborated by Stats SA's household-based *Quarterly Labour Force Survey* (QLFS). According to this survey – which apart from formal-sector employment also includes employment in the agricultural and informal sectors – an estimated 1 052 000 jobs were lost between the fourth quarter of 2008 and the third quarter of 2010. By the first quarter of 2013, only 646 000 of these employment opportunities had been regained. In addition, the number of discouraged work-seekers has increased continuously since the inception of the QLFS in 2008. Despite the growth in the number of discouraged work-seekers tapering off in recent quarters, it nevertheless remained at an elevated level of 2,3 million people in the first quarter of 2013. Employment growth has not been sufficient to offset growth in the labour force in recent years, resulting in South Africa's official unemployment rate hovering around the 25 per cent level since 2010. The official unemployment rate amounted to 25,2 per cent in the first quarter of 2013, unchanged from a year earlier.

Similar to domestic unemployment, global unemployment remained stubbornly high in 2012. According to the *Global Employment Trends 2013* report of the International Labour Organization (ILO), the acceleration in global output growth is unlikely to be sufficient to prevent a further deterioration in unemployment in 2013. Global unemployment rose to 197,3 million in 2012, an increase of 4,2 million during 2011 and 28,4 million above the level in 2007, the year preceding the global financial crisis.

Labour cost and productivity

Growth in nominal remuneration per worker in the formal non-agricultural sector of the economy quickened marginally from 7,2 per cent on average in 2011 to 7,5 per cent in 2012. Headline consumer price inflation accelerated from 5,0 per cent to 5,6 per cent over the same period, allowing the real remuneration per employee to continue rising by roughly 2 per cent per annum. Nominal wage growth accelerated in both the public and private sectors, amounting to 7,9 per cent and 7,3 per cent respectively in 2012. In the private sector, average wage increases above the upper limit of the inflation target range were recorded in all but the non-gold mining sector.

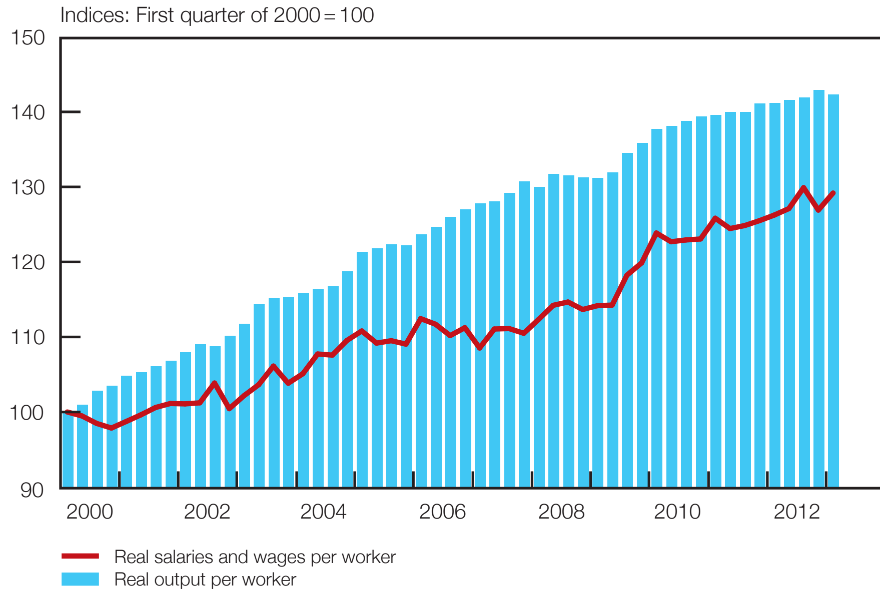
Wage settlement rates and number of workdays lost



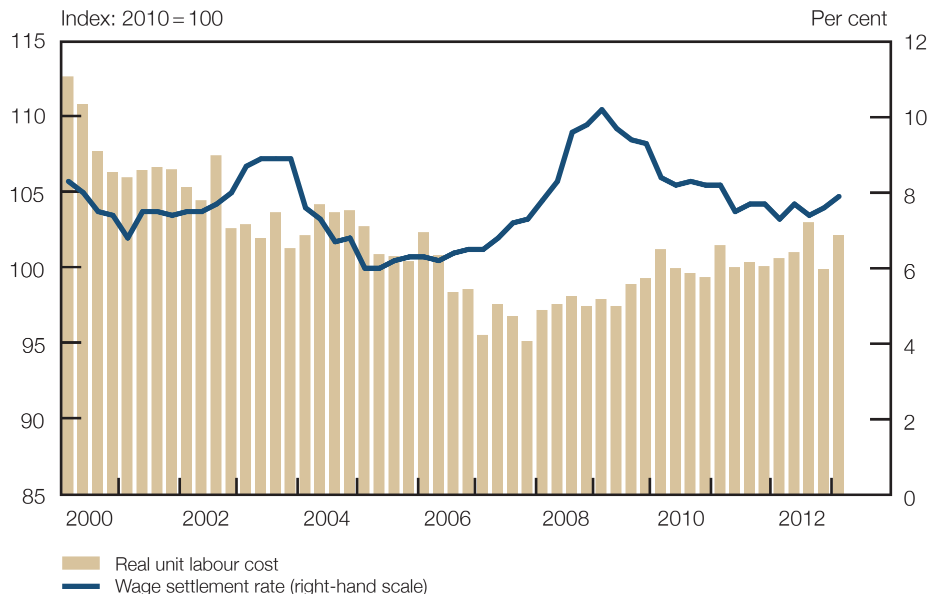
* First quarter, annualised
Source: Andrew Levy Employment Publications

According to Andrew Levy Employment Publications, wage settlement rates in collective bargaining agreements remained broadly unchanged at 7,7 per cent in 2011 and 7,6 per cent in 2012, before accelerating somewhat to 7,9 per cent in the first quarter of 2013. Despite the fairly widespread labour unrest that occurred during the second half of 2012, the number of working days lost due to industrial action decreased substantially from 6,2 million in 2011 to 3,5 million in 2012. A number of multi-year agreements were negotiated in 2010 and 2011, contributing to an increased number of working days lost due to industrial action in those years and thus facilitating the decline in 2012. More recently, the number of working days lost due to industrial action increased to 875 000 in the first quarter of 2013, compared with 700 000 in the corresponding period in 2012. A number of multi-year wage agreements are due to be negotiated in 2013, which in the current labour relations environment could result in the number of working days lost due to industrial action remaining fairly high.

The rate of increase in labour productivity in the formal non-agricultural sector amounted to 1,2 per cent in both 2011 and 2012. With labour productivity rising at a steady pace, the acceleration in remuneration growth resulted in a quickening in total formal non-agricultural nominal unit labour cost increases from 5,9 per cent in 2011 to 6,3 per cent in 2012.

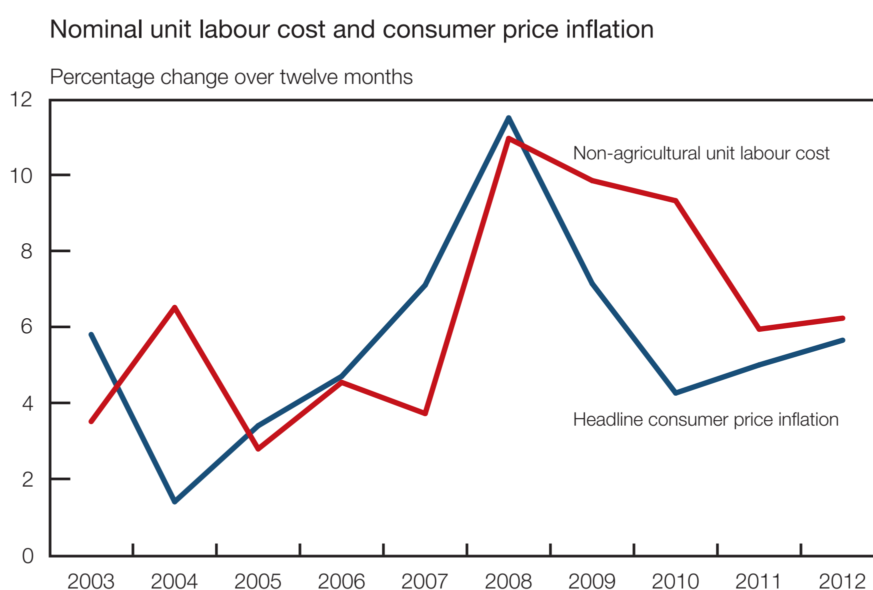


The accompanying graphs indicate that productivity growth over the past twelve years has occurred at a faster pace than increases in real salaries and wages per person, that is, at 2,8 per cent compared with 2,1 per cent per annum. Consequently, real unit labour cost decreased on average by 0,6 per cent per annum from 2000 to 2012, indicating that cost pressures emanating from the labour market during this period were not in excess of general inflation pressures in the economy.



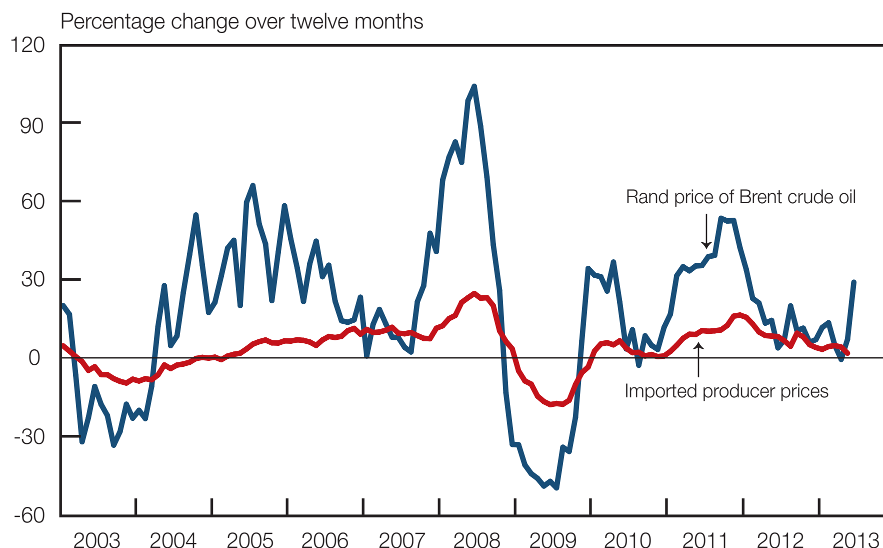
Prices

Against a backdrop of subdued global economic growth in the second half of 2012 and the opening months of 2013, international inflationary pressures remained modest, particularly in advanced economies. The slowdown in global output growth resulted in generally lower international commodity prices in especially the second half of 2012. In addition, international food prices remained fairly stable at a high level throughout 2012, before increasing marginally in the first half of 2013. Despite the benign international inflation environment, domestic consumer price inflation has accelerated gradually since the middle of 2012. Factors that have and could possibly add to domestic inflationary pressure include the depreciation in the exchange value of the rand, high administered price inflation and wage increases in excess of inflation. Since 2009, annual increases in nominal unit labour cost have consistently exceeded headline consumer price inflation. Given the current volatile labour relations environment, inflation pressures emanating from high unit labour cost could increase, should wage increases continue to exceed consumer price inflation without a concomitant rise in productivity.

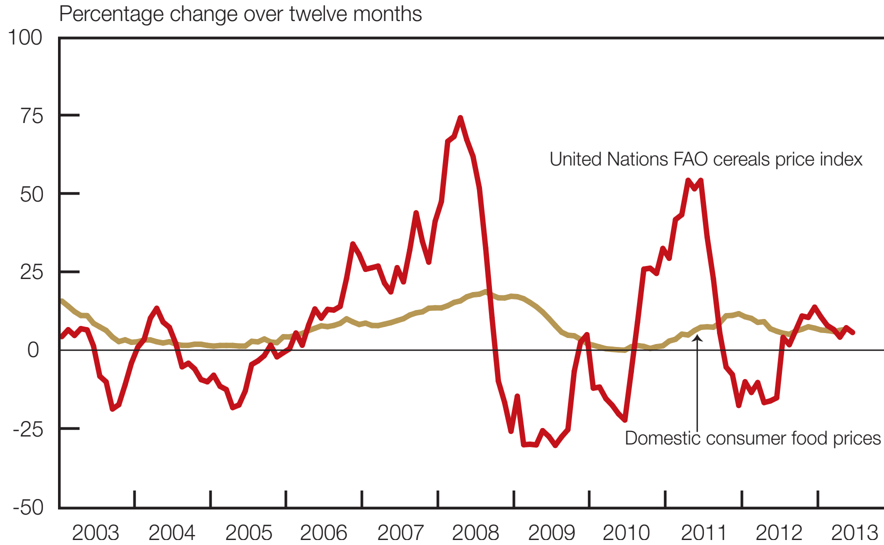


Following the decline in international commodity prices (in rand terms), headline producer price inflation moderated from a peak of 10,6 per cent in October 2011 to 5,2 per cent in December 2012. With the release of the January 2013 producer price inflation data, Stats SA applied a new methodology to calculate the producer price index. In line with international best practice, the headline index for domestic output was discontinued and replaced with five industry-specific producer price indices, namely (i) a final manufactured goods index; (ii) an intermediate manufactured goods index; (iii) an electricity and water index; (iv) a mining index; and (v) an agriculture, forestry and fishing index. Producer price inflation for final manufactured goods – the new headline measure – moderated further in the opening months of 2013, amounting to 4,9 per cent in May 2013. Likewise, producer price inflation for electricity and water, as well as for agriculture, forestry and fishing decelerated to 11,4 per cent and 0,4 per cent respectively in March 2013. Subsequently, both measures of producer price inflation quickened somewhat in May 2013. Producer price inflation for mining accelerated notably in the final months of 2012 and the opening months of 2013, before moderating to 5,7 per cent in May on account of lower mining commodity prices.

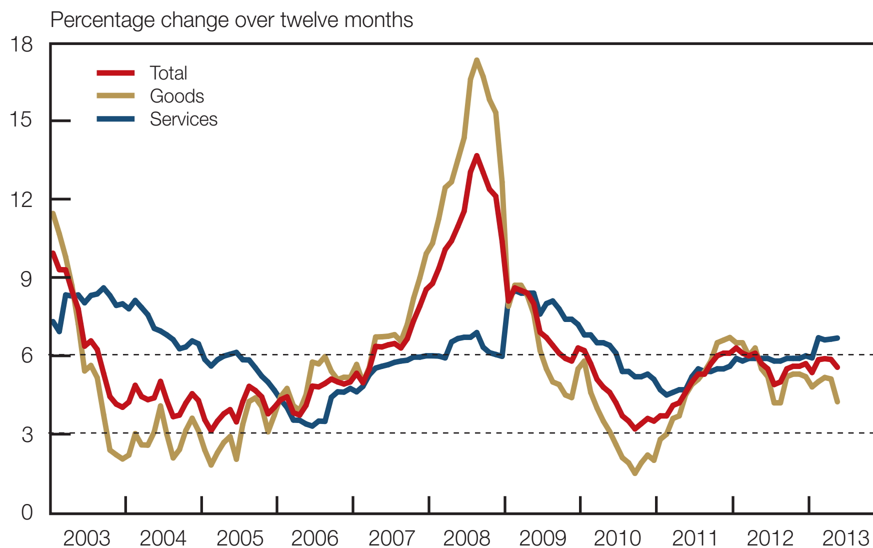
Producer price inflation for imported goods moderated notably to 3,3 per cent in January 2013 as price inflation of imported mining commodities decelerated markedly from a high of 51,2 per cent in November 2011 to 7,1 per cent in January 2013, on account of moderating international crude oil price inflation over the period. Subsequently, the twelve-month rate of increase in producer price inflation for imported commodities decelerated to 1,8 per cent in May 2013 as imported mining commodity price inflation moderated due to lower crude oil prices. In addition, imported agricultural commodity price inflation also slowed marginally in May 2013.



In the third quarter of 2012 adverse weather conditions in the northern hemisphere caused international cereal prices to increase notably; inclement weather in Russia led to a spike in international wheat prices, while a severe drought in the US Midwest resulted in lower global maize output, causing maize prices to increase dramatically. Domestic producer price inflation of grain responded quickly and accelerated to a twelve-month rate of 27,6 per cent in July 2012, before moderating notably towards the end of the year. In addition, producer price inflation of oil seeds peaked at 51,8 per cent in August 2012. Manufactured producer food price inflation responded to these international food price shocks and accelerated in the closing months of 2012, before moderating to 5,9 per cent in January 2013. Subsequently, final manufactured producer food price inflation picked up to 6,9 per cent in May 2013 as manufacturers passed through some additional cost pressures emanating from higher electricity prices and above-inflation wage increases. Agricultural producer price inflation moderated markedly in the opening months of 2013 as domestic maize crop estimates continued to exceed domestic demand. Nevertheless, producer price inflation for agricultural cereals and other crops again accelerated in April and May 2013.



Subsequent to moderating to 5,1 per cent in August 2012, consumer food price inflation accelerated briskly to 7,5 per cent in November 2012, as the uptick in producer food price inflation fed through to the consumer level, exacerbated by the depreciation in the exchange value of the rand throughout most of 2012. The acceleration in consumer food price inflation was fairly broad-based among the subcomponents of the consumer food price basket. Consumer food price inflation then eased somewhat in March 2013, largely due to slowing price inflation in bread, cereals and meat, before accelerating to 6,7 per cent in May, driven by a reversal in bread, cereals and meat price inflation, as well as higher vegetable prices, amid a renewed depreciation in the exchange value of the rand.



Targeted headline consumer price inflation breached the upper limit of the inflation target range in November 2011. It remained slightly outside the range for a six-month period before moderating to within the range from May 2012 and subsequently reaching a low of 4,9 per cent in July 2012. Thereafter, headline consumer price inflation accelerated gradually to 5,9 per cent in April 2013, before slowing somewhat to 5,6 per cent in May – marking the 13th consecutive month that targeted consumer price inflation remained within the inflation target range of 3 to 6 per cent.

3 For a more detailed discussion on the reweighting and rebasing of the consumer price index, refer to the text box on page 21 of the March 2013 *Quarterly Bulletin*.

In February 2013 Stats SA published a reweighted and rebased headline consumer price index, which was statistically linked to the previous headline consumer price index. For the first time since the inception of the consumer price index,[3] the weight of services within the consumer price basket now exceeds that of goods.

The moderation in headline consumer price inflation during the first half of 2012 resulted entirely from a deceleration in consumer goods price inflation. In particular, non-durable goods price inflation decelerated notably over this period as a result of a moderation in food and non-alcoholic beverages price inflation, and in petrol price inflation. More recently, consumer goods price inflation accelerated to 5,2 per cent in March 2013 as price inflation of semi-durable goods accelerated over this period. A notable slowdown in petrol price inflation then assisted in moderating consumer goods price inflation to 4,2 per cent in May 2013. However, the moderation in consumer goods price inflation could prove to be temporary as a sizeable increase in petrol prices in July 2013, due to the depreciation in the exchange value of the rand, should place upward pressure on goods price inflation.

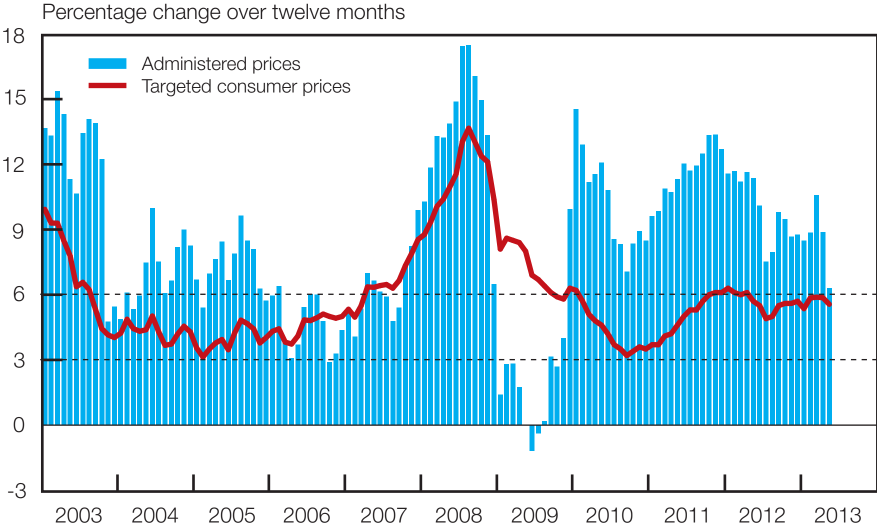
Consumer services price inflation roughly approximated the upper limit of the inflation target range throughout 2012 before it quickened to 6,7 per cent in February 2013 and remained around that level up to May. The acceleration in headline consumer services price inflation resulted largely from a marked acceleration in price inflation in the miscellaneous services category and, to a lesser extent, in recreation and cultural services. Within the miscellaneous services category, the pace of the increase in insurance services costs accelerated notably as the cost of health insurance in particular (with the largest weighting in the miscellaneous services category) increased at a brisk pace of 10,2 per cent in May 2013. Assisted by technology, price inflation of communication services remained fairly muted throughout 2012 and in the opening months of 2013, accelerating to 1,5 per cent in May 2013. Conversely, transport services price inflation moderated somewhat in the opening months of 2013, but nonetheless remained at an elevated level of 12,2 per cent in May 2012.

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 5,4 per cent in May 2013. Similarly, when also excluding the impact of electricity prices from the calculation, inflation accelerated steadily to 5,3 per cent over the same period. The gradual upward trend in the underlying measures of inflation could reflect the emergence of some pass-through of the depreciation in the exchange value of the rand to underlying inflation. However, the weakness of the current upward phase in the business cycle, along with steady increases in gross operating surpluses, could probably explain why no meaningful exchange rate pass-through to underlying consumer price inflation has been observed yet.

Although remaining above the upper limit of the inflation target range, twelve-month administered price inflation decelerated from a peak of 13,4 per cent in November 2011 to 7,5 per cent in July 2012, largely due to a deceleration in petrol price inflation. In addition, administered price inflation for housing services decelerated steadily over the past two years, as electricity price inflation in particular slowed notably. In 2012 Eskom decided to raise prices by 16 per cent, 9 per cent less than the 25 per cent allowed by the National Energy Regulator of South Africa (Nersa). Electricity price inflation nevertheless still amounted to 10 per cent in May 2013. Administered price inflation accelerated to 10,6 per cent in March 2013 before slowing again to 6,3 per cent in May, mostly on account of fluctuations in petrol price inflation. When the effect of petrol

and electricity price increases is excluded from the calculation of administered price inflation, the increase amounted to 8,3 per cent in May 2013. The continued high level of underlying administered price inflation adds to cost pressures in the economy, thereby constraining the economic expansion. Looking ahead, whereas Eskom initially applied for a 16 per cent increase in electricity prices in each of the five years starting in 2013, Nersa only approved 8 per cent per annum, which could assist in moderating administered price inflation somewhat over the next five years.

Targeted and administered consumer prices

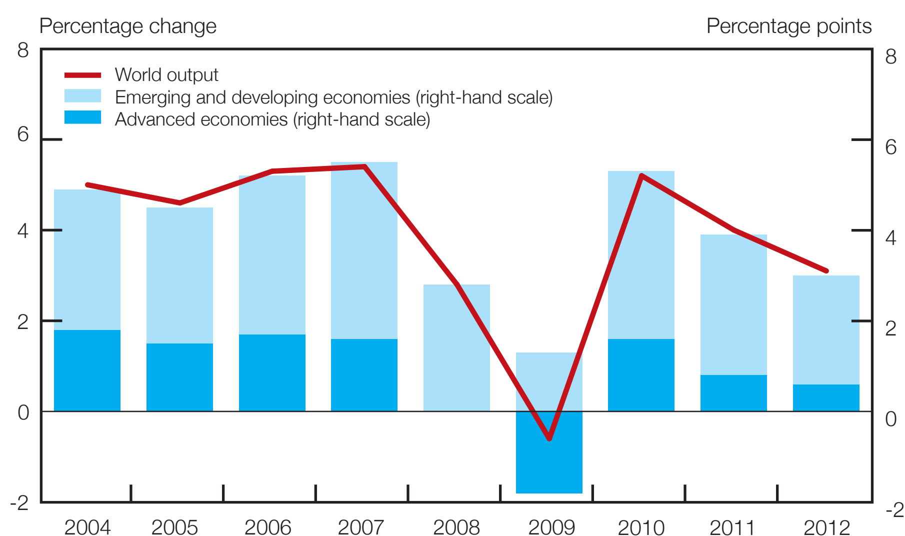


Foreign trade and payments

International economic developments

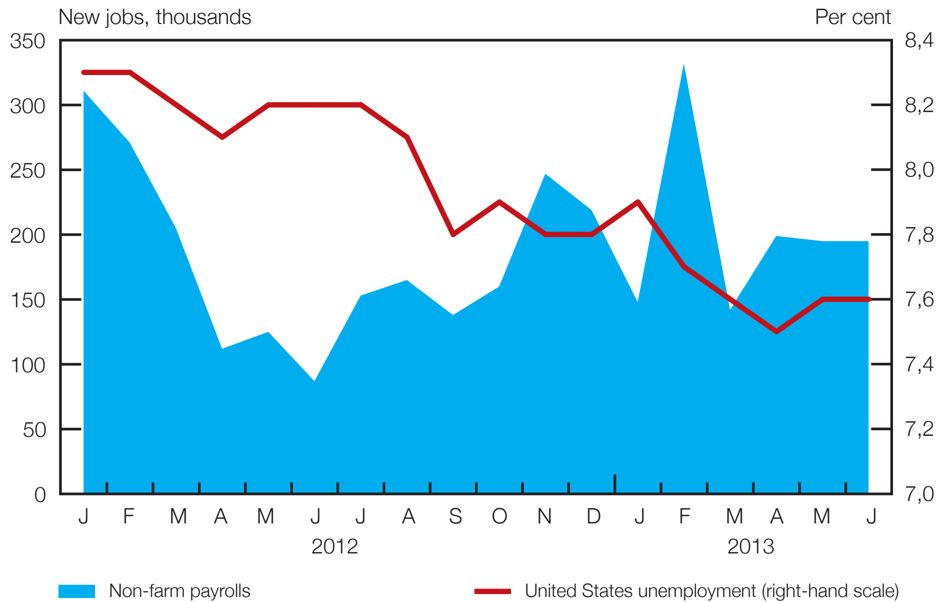
World economic growth moderated to 3,1 per cent in 2012 – its slowest pace since 2008 and 2009, with the outbreak of the global financial crisis. This deterioration in world growth occurred despite a further lowering of policy rates by several central banks in both advanced and emerging-market economies in the past 18 months. Central banks, especially in advanced economies with interest rates already at or close to zero, continued to ease monetary policy during this period by also implementing unconventional policy measures such as quantitative easing.

Economic growth in advanced economies slowed in 2012. As a group, advanced economies continued to make a smaller contribution to world output growth than emerging-market economies. The US and Japan recorded positive growth in 2012 and 2013, while output in the euro area contracted for the past six consecutive quarters. The perceived risk of a disorderly breakup of the euro area has, however, diminished in recent months.



The recovery in the US persisted through 2012 and the first half of 2013 despite fiscal policy uncertainty and deficit reduction measures (sequestration), with the private sector driving growth. The International Monetary Fund (IMF), however, projects that output growth for 2013 will be 1,7 per cent, marginally lower than the pace of increase in 2012. The IMF expects growth of 2,7 per cent in 2014, although a more carefully designed fiscal adjustment would have yielded about 3,0 per cent. The abrupt fiscal retrenchment has, however, sharply reduced the budget deficit as a percentage of gross domestic product, which the US Congressional Budget Office projects will amount to 4 per cent in 2013, down from 10,1 per cent in 2009. The unemployment rate has declined from a recent peak of 10,0 per cent in October 2009 to 7,6 per cent in May 2013, a level which has been maintained throughout the first half of 2013 despite job growth; more individuals entered or re-entered the labour force over the period. The Federal Reserve increased the transparency of its forward-looking communication from 12 December 2012, signalling that it would keep policy rates close to zero at least until unemployment declines to below 6,5 per cent (and provided the inflation forecast is less than 2,5 per cent), a threshold that will likely only be reached in 2015. Favourable indications from the labour market, however, raised expectations that quantitative easing could possibly be tapered this year. Inflation remained muted at 1,7 per cent for 2012.

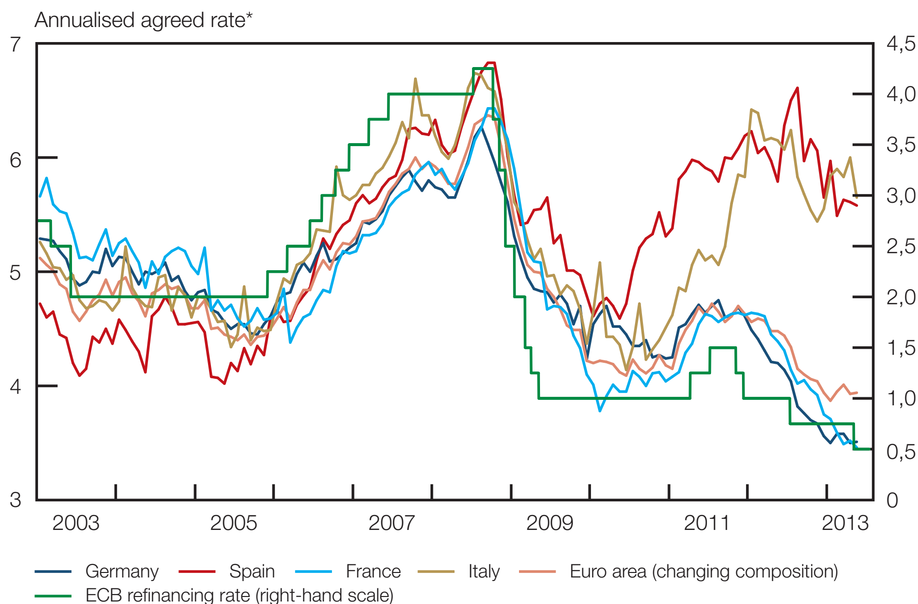
United States unemployment and job creation



Output in the euro area contracted in 2012, declining by 0,6 per cent. Germany – the region's largest economy – registered subdued but positive growth over the period. Belgium, the Netherlands and Ireland fell into recession towards the end of 2012 while significant weakness remained in the southern European states of Greece, Italy, Portugal and Spain. The ECB expects the economy to contract by 0,6 per cent in 2013 before accelerating to a positive growth rate of 1,1 per cent in 2014.

Many euro area member states have continued to frontload fiscal austerity, and yet some (including France and Italy) are struggling to meet the deficit targets prescribed by the so-called "fiscal compact" and will likely be granted exemptions. Peripheral Europe also remains constrained by the need to adjust wages and prices in order to regain international competitiveness.

Breakdown in the euro area monetary policy transmission mechanism



* New loans to non-financial corporations. 1- to 5-year maturity up to €1 million

Despite a cumulative 100 basis-point reduction in policy rates since July 2011, monetary policy has provided limited stimulus to growth in peripheral countries due to the weakening of the monetary policy transmission mechanism resulting in a significant gap between lending rates in different parts of the euro area. Policy uncertainty remained elevated in the euro area throughout 2012 and 2013 with the Cypriot banking crisis (and particularly the short-lived decision to bail-in even insured depositors) undermining confidence in policy-makers.

European leaders have, however, achieved some policy successes, most notably the ECB's Outright Monetary Transactions (OMT) programme announced in September 2012, which has lowered bond spreads between Germany and the periphery by between 26 and 60 per cent. Although recipient member states are required to accept supervised reforms to qualify for OMT, by mid-2013 none had applied and the ECB had yet to purchase any assets under the programme. Instead, the programme's efficiency has stemmed basically from the credibility of the central bank's promise to keep sovereign bond yields in check. Other important initiatives during 2012 were the introduction of a single supervisory mechanism for banks, steps towards a more complete union, including the fiscal compact, and reforms via the European Stability Mechanism to break the vicious cycle between sovereigns and banks.

The substantial economic weakness in the euro area since the latter part of 2011 has resulted in lower inflation outcomes in the region as a whole, with overall consumer price inflation moderating from 3,0 per cent in November 2011 to 1,4 per cent in May 2013. Greece has experienced deflation, with consumer goods and services prices falling in March and April 2013. The ECB expects inflation to remain muted and below its 2 per cent target in 2013 and 2014, as energy and food price increases slow.

Economic activity in the United Kingdom (UK) contracted in the second and fourth quarters of 2012, ending the year with slight positive annual economic growth of 0,3 per cent. The 2012 London Olympic Games provided a temporary boost to economic activity, partly counteracting the adverse impact of weak foreign demand and resolute fiscal retrenchment. The IMF projects a tepid economic recovery with growth accelerating to 0,9 per cent in 2013 and 1,5 per cent in 2014. Inflation averaged 2,8 per cent in 2012 and is expected to be fractionally lower in 2013; it has been consistently off the 2,0 per cent inflation target since December 2009. Employment growth in the UK has been surprisingly resilient, given weak economic conditions, and the labour force participation rate has remained higher than in previous recessions. The Bank of England (BoE) is providing support to the economy, keeping its policy rate unchanged at 0,5 per cent and increasing its purchases of assets by £100 billion in 2012 to a total of £375 billion. The BoE also introduced the Funding for Lending Scheme in July 2012.

Economic activity in the Japanese economy improved slightly in 2012, with growth accelerating by 1,9 per cent compared with a contraction of 0,6 per cent in 2011. Consumer goods and services prices in Japan rose in the first five months of 2012, but deflation re-emerged in subsequent months. For the year as a whole, the consumer price index remained unchanged as it registered zero inflation in 2012, compared with 0,3 per cent deflation in 2011.

Japan reached a critical juncture in its growth path at the end of 2012, with the re-election of Prime Minister Shinzo Abe and the announcement of a new and extremely bold economic strategy (termed Abenomics) intended to restore Japanese growth. Abenomics consists of three "arrows": fiscal stimulus worth about US$210 billion, monetary stimulus in pursuit of a 2 per cent inflation target and structural reforms affecting sectors such as the labour market, energy policy and health care. The impact of the new strategy gave rise to a depreciating yen, stock market gains to five-year highs and growth at a rate of 4,1 per cent in the first quarter of 2013. The second quarter was, however, characterised by much higher volatility with bond yields rising unexpectedly and the Nikkei losing some of its gains. The stakes for Abenomics are very high, with the risks of radical policy initiatives in the context of an enormous debt burden matched only by the dangers of persistent stagnation.

Abenomics and volatility in Japanese financial markets

Source: Bloomberg

In 2012, the growth momentum also slowed in emerging-market and developing economies, more especially in Brazil, Russia, India and China. Emerging European economies have suffered from their exposure to advanced Europe and the associated low capital inflows to the region. As a result of these downside risks, Hungary moved into recession with output contracting in 2012, while Turkish real growth came in very low. Although Russian growth was resilient at 3,4 per cent in 2012, it slowed markedly in the second half of the year owing to dry weather conditions and poor harvests.

Consumer price inflation in emerging Europe moderated to 5,3 per cent in 2012, lower than 5,8 per cent a year earlier. Inflation remained rampant in Russia, Turkey and Romania, all of which missed their inflation targets in 2012, with Turkish inflation being especially high at 8,9 per cent – well above the year-end target of 5 per cent. Most central banks in the region eased monetary policy in 2012 and the first half of 2013, except for Russia which increased its policy rates due to concerns about high inflation.

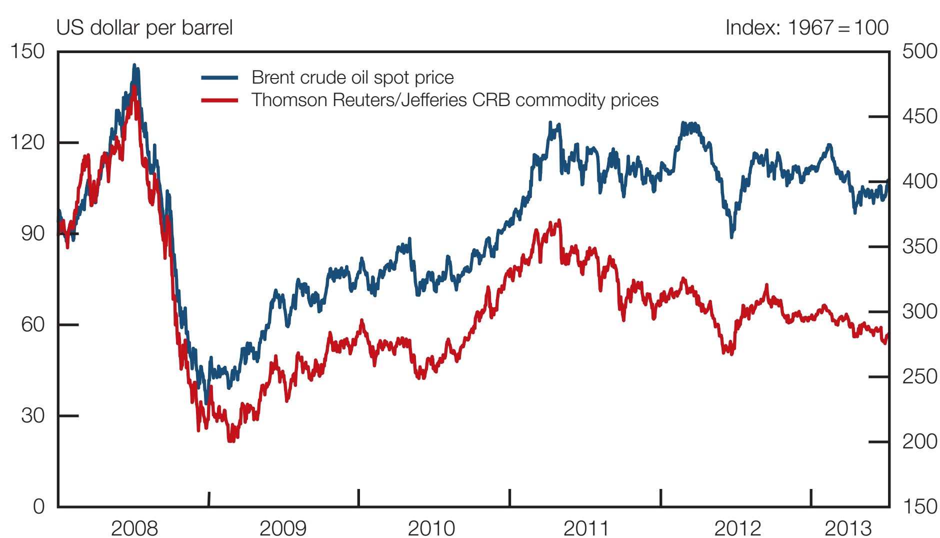
Growth in emerging Asia abated in 2012, mainly due to slower growth in China and India. Growth in China was somewhat constrained by structural changes to the growth model being applied, that is, changing the focus from exports and investment to a more consumption-orientated approach, contributing to economic growth slowing to 7,8 per cent in 2012, its lowest rate since 1999. The challenges of rebalancing, together with other structural constraints such as an ageing population and environmental concerns, hampered growth in the country and the region as a whole. The People's Bank of China has responded to lower inflation and sluggish growth by reducing interest rates by a cumulative 56 basis points, the first reduction since 2008, and lowering reserve requirements.

Growth in India slowed significantly from 7,7 per cent in 2011 to 4,0 per cent in 2012, with weak external demand, below-average monsoon rains and subdued investment growth contributing to the disappointing economic performance. Inflation in India has slowed from double-digit rates in 2011 to 4,7 per cent in May 2013, permitting the Reserve Bank of India to support growth by lowering interest rates by 50 basis points in 2012 and a further 75 basis points in 2013.

Growth in Brazil disappointed, amounting to only 0,9 per cent in 2012. The unemployment rate continued to be very low at around 5 per cent, but inflation exceeded the upper limit of the tolerance band of the target (6,5 per cent) in 2013, prompting the central bank to raise interest rates after a sustained period of monetary easing. The growth outlook for the country is negative with commodity prices impacting negatively on the terms of trade alongside a decline in consumer demand. Argentina also recorded disappointing growth of 1,9 per cent in 2012, with official consumer price inflation accelerating to 11 per cent at the start of 2013. Growth in Venezuela amounted to 5,6 per cent in 2012, aided by the expansionary fiscal policy applied prior to the October 2012 election. The economy is, however, expected to recede into a recession in 2013. High inflation, rising to 27,9 per cent in April 2013, holds risks of hyperinflation, with shortages already having become widespread. Growth was more resilient in the region's more market-oriented economies, down slightly from 2011 levels in Chile, Colombia, Peru and Mexico.

Real output growth in sub-Saharan Africa was robust at 4,9 per cent in 2012, one of the world's strongest regional performances, and is projected to increase to 5,1 per cent in 2013. Impressive growth in the Southern African Development Community region was recorded in Angola (8,4 per cent), Mozambique (7,5 per cent) and Zambia (7,3 per cent). Inflationary pressures moderated slightly in 2012, with average inflation amounting to 9,1 per cent, slightly lower than 9,3 per cent in 2011. Inflation is expected to decelerate further to 7,2 per cent in 2013 and seems to be generally well-contained in most parts of the continent.

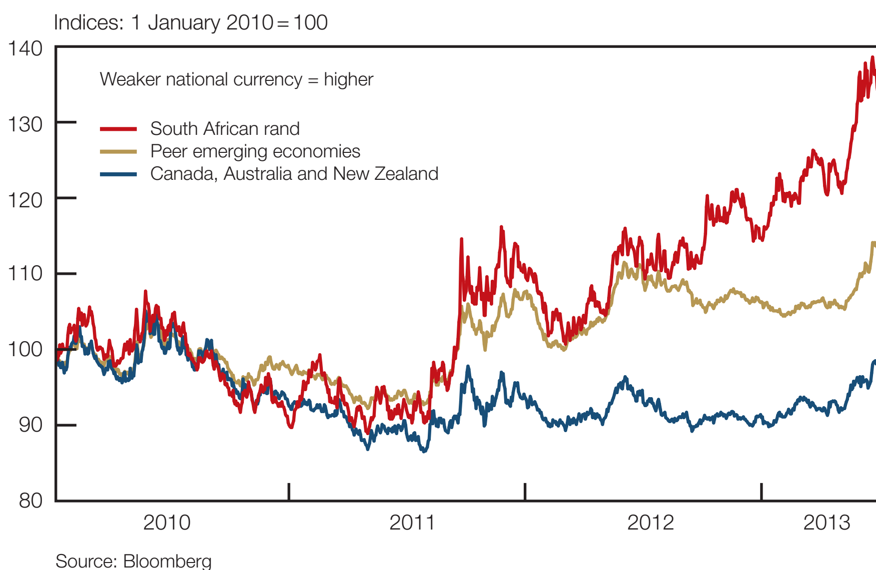
Global commodity prices reached a recent peak in April 2011 before declining by almost 25 per cent towards the end of June 2013. Energy prices have been volatile, with Brent crude oil prices rising to a recent peak of US$127 per barrel in February 2012 before decreasing significantly to levels below US$90 per barrel in June 2012. This sharp decrease in oil prices was due to concerns about the global economic recovery, the European debt crisis and weaker-than-expected growth in emerging economies, especially China. Prices rebounded to levels around US$118 per barrel in mid-September as a result of sanctions on Iran and Hurricane Isaac threatening oil production in the Gulf of Mexico. Oil prices became extremely volatile in the following period, decreasing to below US$107 per barrel in early December 2012 before surging to around US$118 per barrel in mid-February 2013, thereafter reverting to levels above US$105 per barrel in July 2013. The decline in oil prices once again reflected concerns about global economic growth and weak industrial survey data from the US coupled with a slowdown in Chinese growth.



Movements in the exchange rate of the South African rand were highly correlated with the currencies of advanced commodity-exporting economies (Australia, Canada and New Zealand) and a selected number of peer emerging economies[4] (including many commodity exporters) in 2010 and the first half of 2011. The exchange rate of the rand and peer emerging-markets currencies, however, started to depreciate rapidly in mid-2011 as the crisis in the euro area intensified, with the co-movement persisting until August 2012. The movement of the rand has since also deviated from the other peer emerging-economy currencies as it became sensitive to domestic factors, including concerns about labour unrest especially in the mining sector in August 2012 as well as the sovereign credit rating downgrade of the country in September.

4 Including Hungary, India, Brazil, Colombia, Indonesia, Turkey, Poland, Philippines, Thailand, Malaysia, Mexico, Russia, Chile, Peru and Korea.

Exchange rate of the rand and various currency groupings against the US dollar



Source: Bloomberg

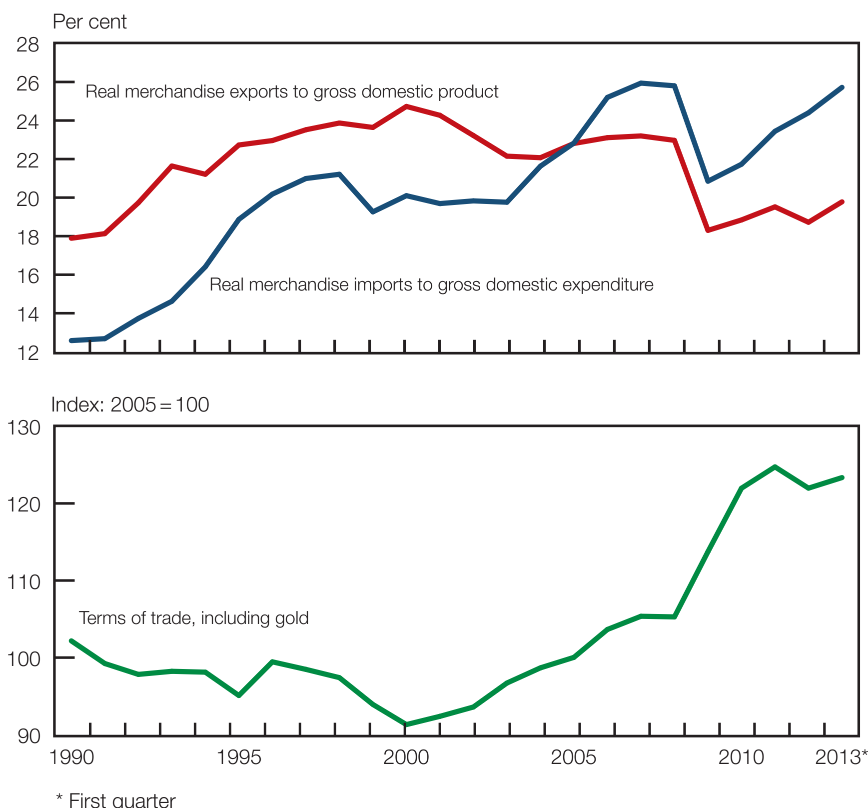
The value of the rand was also adversely affected by the widening of the deficit on the current account of the balance of payments and the plummeting gold price in May 2013.

Current account[5]

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

South Africa's trade patterns and volumes changed notably during the past decade. These changes were brought about by, among other factors, the uneven growth performance of the country's most important trading-partner countries in the aftermath of the most recent recession, substantial infrastructure development projects and a number of trade agreements concluded to promote international trade. According to the World Economic Forum's *Global Enabling Trade Report* that measures the factors, policies and services that facilitate merchandise trade across borders and by destination, South Africa's ranking improved from 72 in 2010 to 63 (out of 132 countries) in 2012. This ranking has placed South Africa ahead of other emerging-market economies such as Brazil, India and Russia; in southern Africa the domestic economy was ranked third behind Mauritius and Botswana.

Notwithstanding various policy measures to enhance external competitiveness, to promote trade, and to raise the country's growth performance, the South African economy has become more dependent on surplus saving from the rest of the world to finance the much-needed increase in gross fixed capital formation. The country's import penetration ratio (i.e., the extent to which the country relies on merchandise imports to satisfy domestic expenditure) increased sharply between 2003 and 2008 before receding temporarily in 2009. Subsequently, this ratio regained its upward momentum and surpassed the most recent peak in 2008 in the first quarter of 2013.



Owing to notably stronger growth in import volumes surpassing that of merchandise exports, the trade balance switched from a surplus in 2003 to a deficit in the subsequent years up to 2008. The trade balance temporarily switched back to a surplus from 2009 to 2011 due to lower domestic demand before moving into a deficit in 2012 and the first half of 2013. During this period, the relatively slower growth in the volume of merchandise exports was partly cushioned by the favourable terms of trade which trended upwards from 2001 to 2011. During 2012, however, the terms of trade weakened somewhat before recovering slightly in the first half of 2013.

Balance of payments on current account

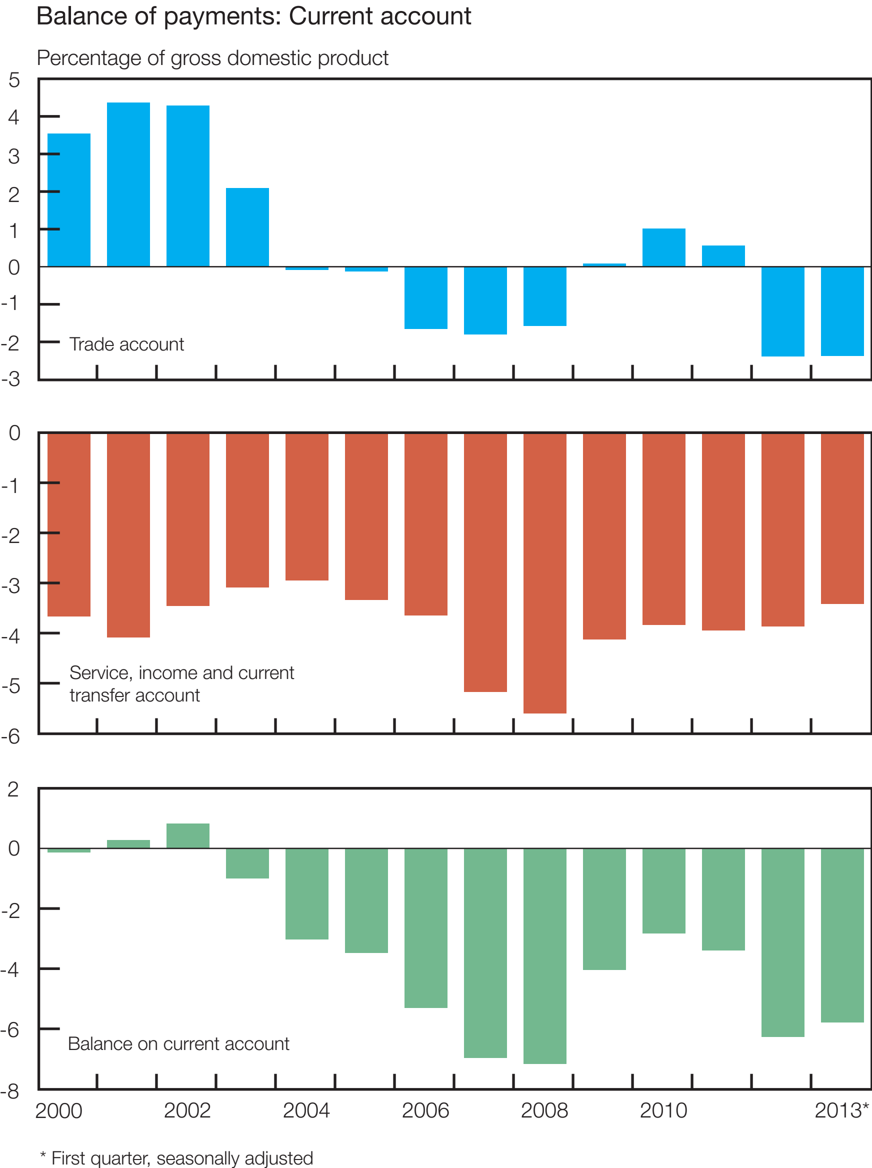
R billions

	2008	2009	2010	2011	2012	2013 1st qr*
Merchandise exports	655,8	503,7	565,9	671,2	696,2	800,1
Net gold exports	48,5	52,8	59,5	75,3	71,1	69,9
Merchandise imports	-739,9	-554,2	-598,2	-730,1	-842,8	-948,2
Trade balance	**-35,6**	**2,3**	**27,2**	**16,4**	**-75,5**	**-78,2**
Net service, income and current transfer payments	-126,3	-99,4	-102,2	-115,2	-122,1	-112,7
Balance on current account	**-161,9**	**-97,1**	**-75,0**	**-98,8**	**-197,6**	**-190,9**
As a percentage of gross domestic product	*-7,2*	*-4,0*	*-2,8*	*-3,4*	*-6,3*	*-5,8*

* Seasonally adjusted and annualised

The deficit on the services, income and current transfer account of the balance of payments has remained relatively stable at around 4 per cent of gross domestic product during the past decade. In the past four years, this ratio benefited from a notable influx of foreign tourists

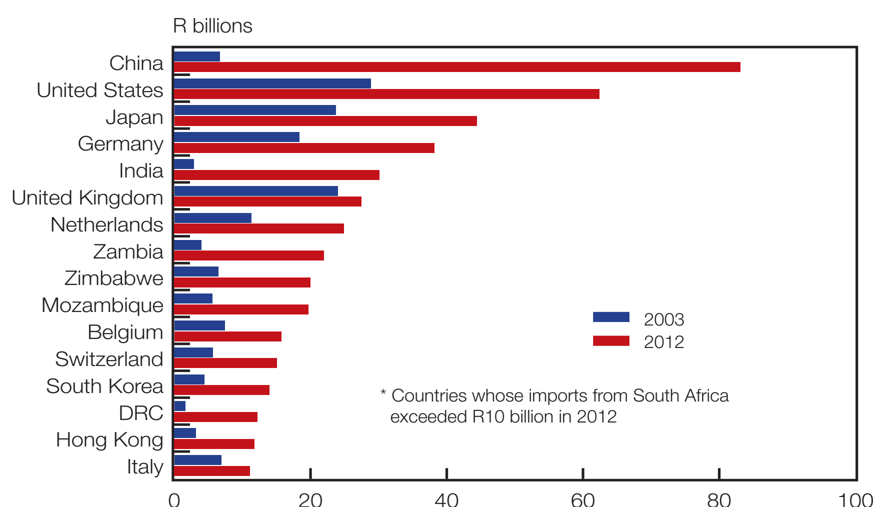
following the successful hosting of international sport events like the FIFA World Cup Soccer tournament and various international conferences, among others. The higher level of travel receipts partly offset sizeable dividend payments to non-resident shareholders and increased revenue payments to other member countries of the Southern African Customs Union (SACU) over the period. Although the shortfall on the "services account" improved in the first quarter of 2013, the size of the shortfall continued to weigh heavily on the balance on the current account of the balance of payments. Affected by the developments on the trade and services account, the deficit on the current account widened considerably during the period 2003 to 2008 before moderating somewhat in 2009 and 2010. Notwithstanding the further deterioration in the balance on the current account in 2011 and 2012, the deficit is expected to narrow marginally in the first half of 2013.



The value of merchandise exports advanced steadily from 2003 up to the first half of 2013 with brief interruptions in 2009 and 2010. The increase in export proceeds could largely be attributed to higher rand prices of merchandise exports alongside an increase, albeit at a much slower pace, in export volumes over the period.

The volume of exports advanced at a fairly subdued pace between 2009 and the first half of 2013, despite various policy measures aimed at assisting exporters in gaining international market share through preferential trade agreements and the expansion of infrastructure

development. South Africa has concluded a number of preferential trade agreements with various countries and regions, including the Trade, Development and Cooperation Agreement (TDCA) with the European Union, the African Growth and Opportunity Act (AGOA) and the Generalised System of Preferences (GSP). Moreover, the country became the first developing country to have concluded a free trade agreement with the European Union. In addition, South Arica joined the BRIC group of countries in 2011, nowadays known as BRICS. As a result of these arrangements, the country's trade patterns with the rest of the world changed notably over the past decade.

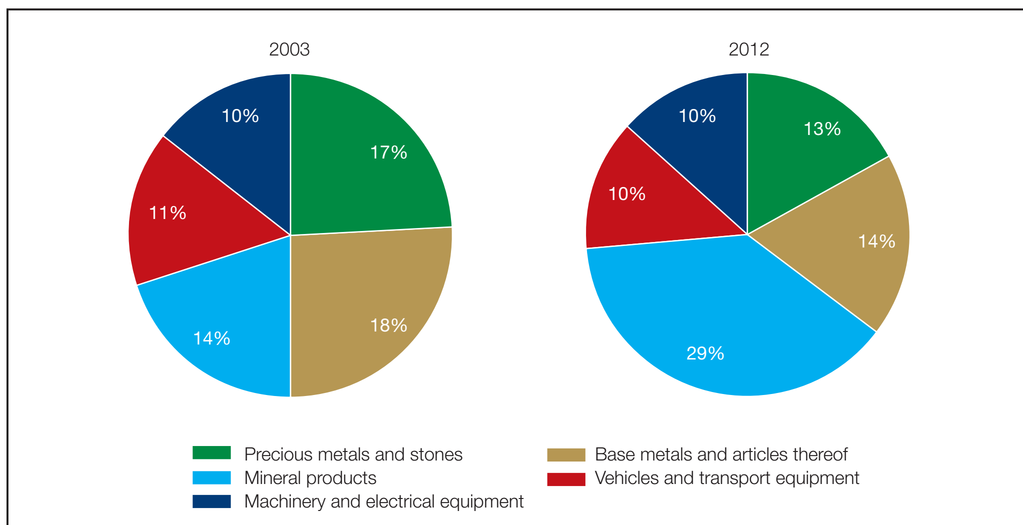


Trade with the Asian region increased notably in recent years as China became South Africa's largest trading partner in 2009 and India the sixth largest in 2010. Relative to total merchandise exports, the level of South African exports to China rose from 2,5 per cent in 2003 to 11,6 per cent in 2012. Simultaneously, the country's trade with India expanded significantly buoyed by increased demand for, among others, locally produced gold, jewellery and coal. The sustained recovery in the US economy further boosted export proceeds in 2012 and the first half of 2013. South African trade with Europe increased considerably during the period 2003 to 2008 but thereafter remained muted due to sluggish economic growth in some European countries. Nonetheless, Germany, the UK and the Netherlands continued to be important destinations for South African mining products such as platinum and base metals primarily used in the production of catalytic convertors. These countries also emerged as key consumers of domestically produced manufactured goods such as machinery and electrical equipment, as well as vehicles and transport equipment. At the same time, the African continent emerged as an important export destination for South African mining and manufactured goods. Exports to the African region, comprising mainly mineral products and base metals and articles of base metals; machinery and electrical equipment; vehicles and transport equipment; as well as chemical products, are expected to remain buoyant in 2013, consistent with the anticipated firm economic growth in the region.

Over and above variations in the geographic destination of merchandise exports, the composition of exports also changed during the past decade. The accompanying graph highlights some of the main changes in selected subcategories of exports over the period. As a result of an increase in global demand for South African mineral products alongside higher international prices, the share of mineral products (which includes coal and iron ore) surpassed those of base metals and precious metals and stones to become South Africa's most important contributor to exports during the period 2008 to 2013, having been ranked the third most important in 2003. Base metals shifted, instead, to become the second largest contributor to exports as its contribution to the total value of merchandise exports decreased only marginally over the period.

Composition of South Africa's merchandise exports

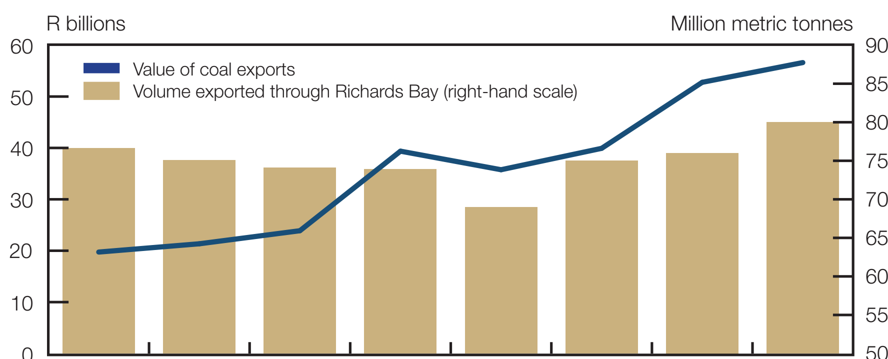
Percentage of total



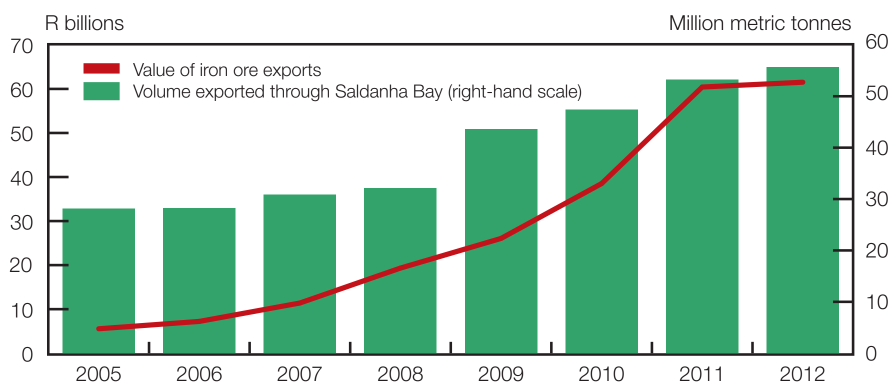
Precious metals and stones ranked as the country's third largest export-earning category in 2012. In total, the top five export subcategories accounted for approximately 77 per cent of the value of total merchandise exports in 2012, compared to roughly 70 per cent in 2003.

The value of these commodities has over time been affected by movements in international commodity prices as well as demand and supply factors. Apart from fairly lacklustre foreign demand, production has been adversely affected by domestic supply constraints such as infrastructural bottlenecks, tension in the labour market and escalating input costs. In this regard, the upgrading of domestic infrastructure to ease bottlenecks at domestic harbours has been of critical importance. The capacity to handle coal at Richard's Bay was consequently increased, allowing for 80 million metric tonnes to be exported in 2012 with the scope to handle an additional 10 million metric tonnes.

Richards Bay bulk cargo and coal exports



Saldanha Bay bulk cargo and iron ore exports

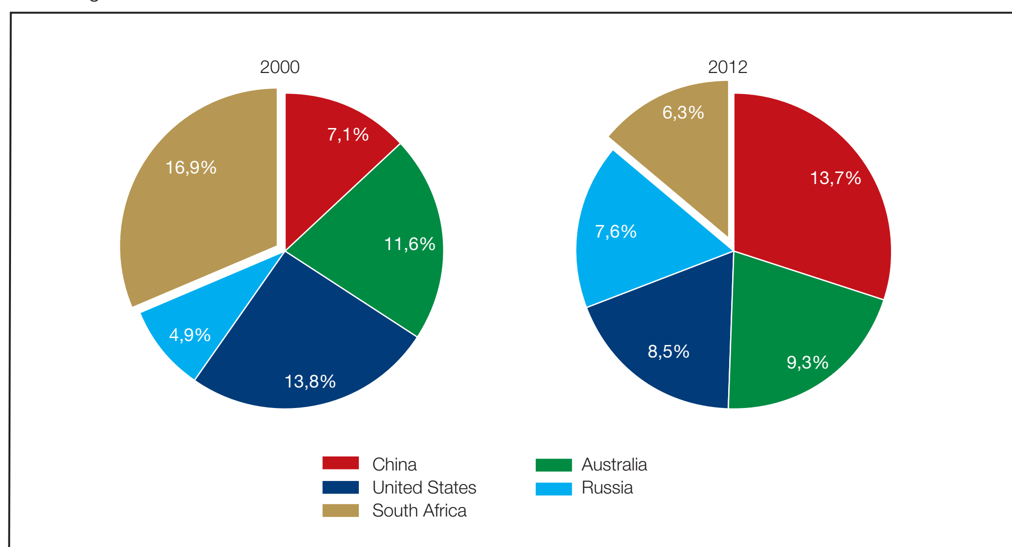


The capacity to handle iron ore at Saldanha Bay is envisaged to be expanded to 80 million metric tonnes by 2018, from the current 55 million metric tonnes. Exports in general are expected to benefit from expansions at the Durban port over the next seven years.

South Africa has recorded a secular decline in the production of gold since the early 1990s and lost its status as the world's largest gold producer to China in 2007. Moreover, the country slipped to become the fifth largest gold producer in the world in 2012, having been ranked fourth in 2011. Production continues to be negatively affected by the increasing depth of mining, lower grade of ore milled and an escalation in input costs. Consequently, the volume of net gold exports contracted almost unabatedly over the past two decades. Over and above the long-term infrastructural challenges faced by the gold mining industry, production in the past 18 months was also hindered by industrial action.

Share of world gold production

Percentage of total

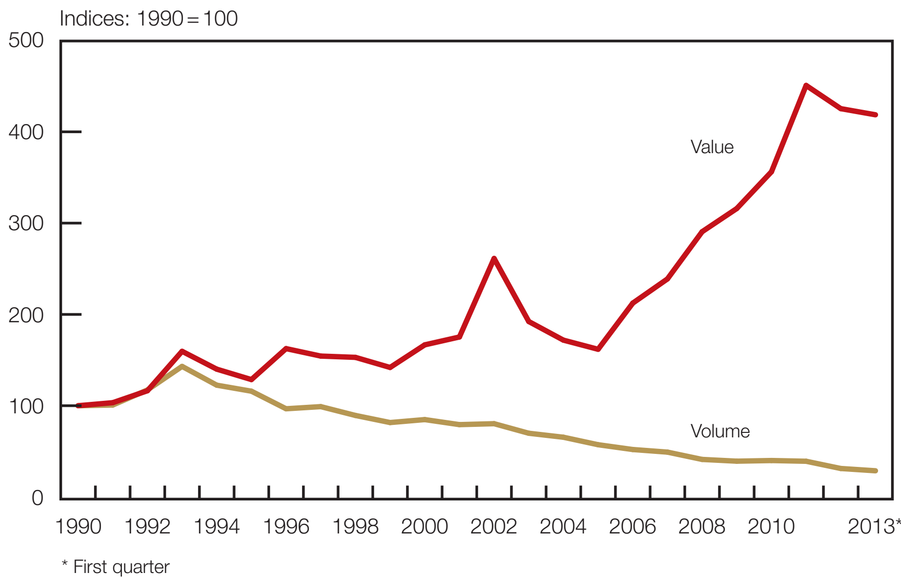


Source: US Geological Survey, Mineral Commodity Summaries

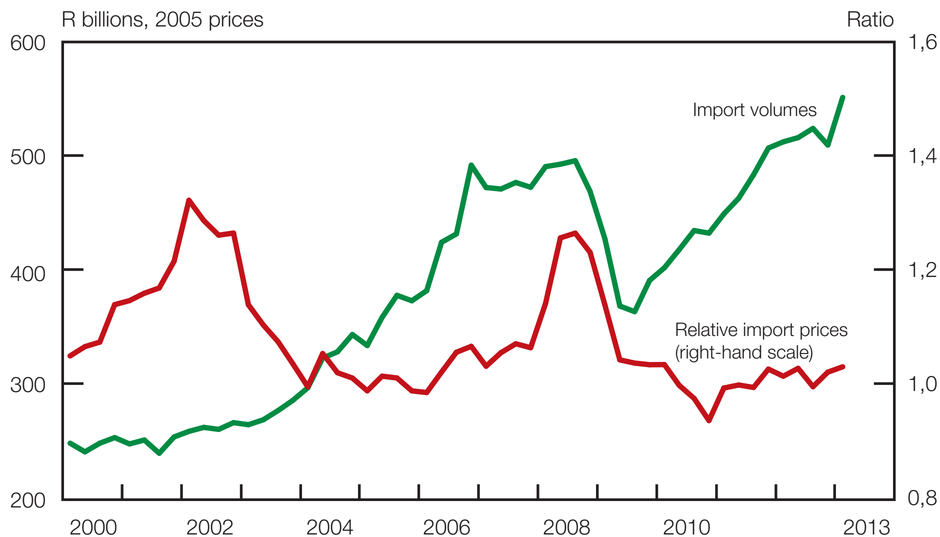
Notwithstanding the dwindling volume of net gold exports, domestic gold producers benefited from a surge in the international price of gold since 2006. Further to demand and supply conditions, the price of gold benefited during the past few years from the ongoing uncertainty in global financial markets as well as geopolitical tensions.

The price of gold on the London market, which averaged US$310 per fine ounce in 2002, rose steadily to US$1 668 per fine ounce in 2012. In rand terms, the price of gold advanced at an even faster pace due to the depreciation in the exchange value of the rand over the period. The upward trend in the US-dollar price of gold, however, lost some momentum in late 2012 and the first half of 2013 partly on account of expectations of less buoyant global demand and lower inflation.

Owing mainly to strong domestic demand, import volumes increased at a steady pace during the period 2010 to 2012. Having contracted by no less than 20,5 per cent in 2009, growth in merchandise import volumes amounted to 8,9 per cent in 2010 and 12,8 per cent in 2011, before moderating somewhat to 8,4 per cent in 2012. Where foreign suppliers satisfied about 20,8 per cent of real aggregate domestic demand in 2009, this share rose to 24,4 per cent in 2012. The rising trend in South Africa's import penetration ratio could in part be attributed to imported goods substituting domestically produced goods following the decline in the relative prices of imported goods subsequent to the appreciation in the exchange rate of the rand in 2010.



Moreover, a change in the composition of exports in favour of certain categories of manufactured goods, which require a higher proportion of imported intermediate goods, probably also contributed to the surge in import volumes.



Although manufactured goods remained the largest component of merchandise imports in value terms, it declined as a ratio of total merchandise imports from 73,9 per cent in 2003 to 66 per cent in 2012. The three main subcategories of manufactured imports, which jointly account for roughly 75 per cent of the total import value of manufactured goods, are machinery and electrical equipment, vehicles and transport equipment, and chemical products.

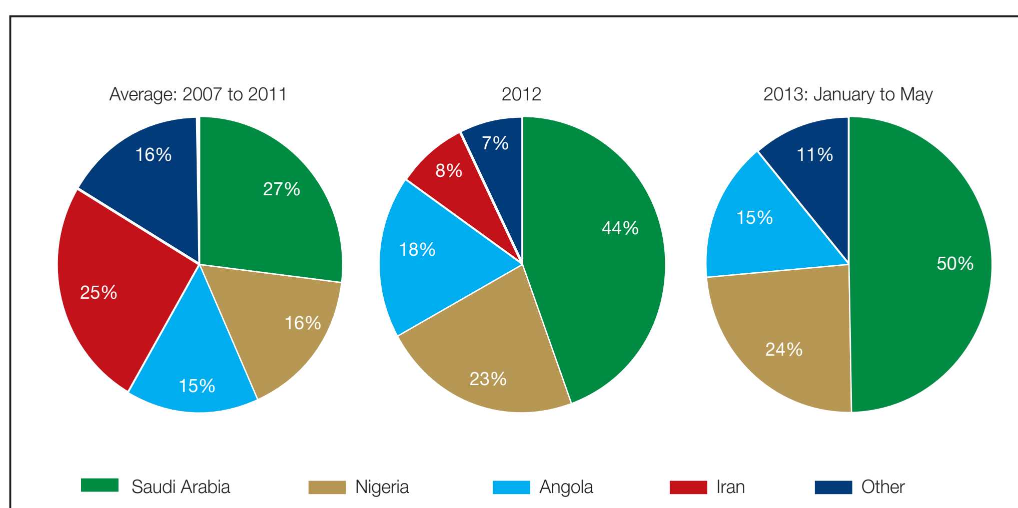
Composition of South Africa's total merchandise imports

Per cent

	2003	2008	2012
Mining	18,5	29,4	28,2
Mineral	*12,4*	*23,3*	*22,7*
Manufacturing	73,9	65,3	66,0
Machinery and electrical equipment	*26,6*	*25,1*	*23,5*
Vehicles and transport equipment	*19,5*	*16,1*	*16,5*
Chemical	*9,8*	*8,7*	*9,0*
Agriculture	3,6	3,5	4,4
Other (unclassified and balance of payments adjustments)	3,9	1,8	1,4

The value of imported mining products, which accounted for 18,5 per cent of the total value of merchandise imports in 2003, increased to 29,4 per cent in 2008 before contracting to 28,2 per cent in 2012. Mineral products contributed about 22,7 per cent to the value of total merchandise imports and 80 per cent to the value of total mining imports in 2012. The bulk of these imports reflect crude oil imports mainly originating from Saudi Arabia, Nigeria and Angola. Prior to July 2012, South Africa also sourced a significant amount of crude oil imports from Iran. However, since the imposition of sanctions on Iran, South Africa had to find alternative crude oil suppliers. These include those located in Western Africa, particularly in Ghana, Gabon and Equatorial Guinea. The sourcing of crude oil from these countries contributed to an increase in South Africa's trade with the African continent.

Crude oil imports by country of origin



An analysis of imports according to the stage of production shows that intermediate and capital goods dominate. These two categories contribute, on average, about 80 per cent to the total value of merchandise imports. The imports of capital, intermediate and consumption goods have been showing a broad upward trend since 2003. The significant rise in the value of intermediate imports in 2008 largely reflected the impact of higher crude oil imports which increased by about 53 per cent during the year. High international prices of oil earlier in the

year, together with the depreciation in the external value of the rand later in the year, more than fully counterbalanced the decline in crude oil import volumes in 2008. Strong economic growth and infrastructure expansion projects, including those related to the 2010 Soccer World Cup tournament, contributed significantly towards the surge in the importation of capital goods prior to and including 2008. Following poor global and local economic activity levels, imports dropped notably in 2009 but all three categories rebounded in 2010 with the most pronounced recovery witnessed in the imports of consumer goods. In fact, while all three categories have been increasing since 2009, the imports of consumption goods seemed to be rising slightly faster than the other two categories.

The traditional deficit on the services, income and current transfer account remained relatively stable at around 4 per cent of gross domestic product during the past decade despite having narrowed marginally in 2012. The sizeable deficit in 2012 could mainly be ascribed to a significant increase in net current transfer payments to other member countries of SACU, which more than offset lower net payments for services largely emanating from increased net travel receipts.

Balances: Components of services, income and current transfer account

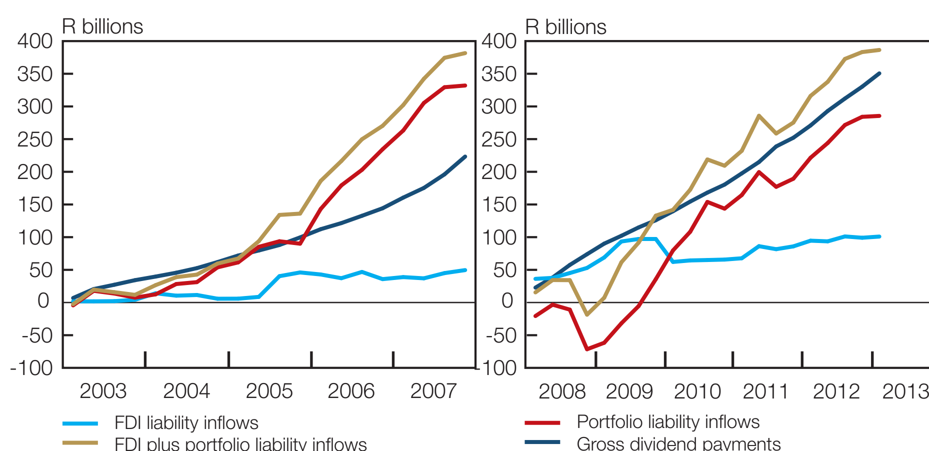
Percentage of gross domestic product

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

Deficit – surplus +

Gross dividend payments to non-resident investors rose somewhat during the past four years. Although gross dividend payments and inward equity investment are not necessarily symmetrical, an analysis of developments over the past decade provides some noteworthy findings. According to the left panel of the accompanying graph depicting the period 2003 to 2007, the combined cumulative value of inward equity investment into South African (direct and portfolio equity flows) exceeded the magnitude of dividend payments by a fair margin. By contrast, this gap narrowed significantly in the subsequent period 2008 to 2012 (right-hand panel). Dividend payments remained relatively high notwithstanding fairly subdued domestic economic conditions.

Cumulative capital flows and dividend payments



Financial account

Despite the heightened volatility in cross-border financial flows since the onset of the global financial crisis, South Africa managed to attract net capital inflows on the financial account of the balance of payments. The composition of these inflows, however, changed during the past few years as the country relied less on inward portfolio investment but more on direct investment flows, third-party loan financing and increased deposit holdings of non-resident investors as well as deposit holdings of South African banks abroad to finance the shortfall on the current account of the balance of payments.

Net financial transactions not related to reserves

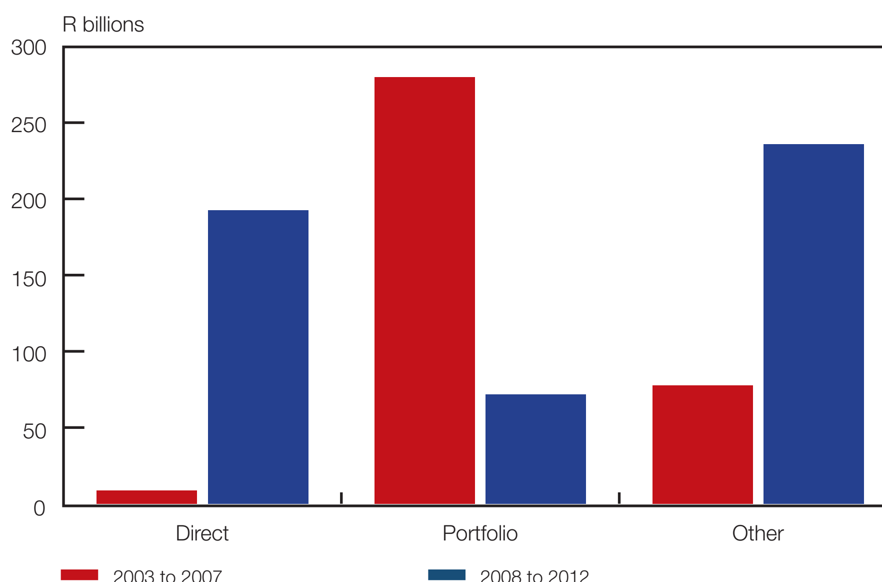
R billions

	Cumulative 2003–2007	2008	2009	2010	2011	2012	Cumulative 2008–2012
Liabilities							
Direct investment	89,5	74,4	45,5	9,0	43,6	37,5	210,0
Portfolio investment	332,0	-71,5	107,2	107,9	45,9	94,6	284,1
Other investment	177,7	47,7	-39,9	7,9	43,0	65,7	124,4
Assets							
Direct investment	-80,9	25,9	-9,8	0,6	1,9	-35,9	-17,3
Portfolio investment	-52,1	-63,3	-13,5	-33,4	-62,2	-40,0	-212,4
Other investment	-100,1	83,0	23,7	-22,1	-13,4	40,3	111,5
Total financial transactions*	487,7	187,7	113,9	106,0	131,3	206,3	745,2
Financial transactions as a percentage of gross domestic product	*6,1*	*8,3*	*4,7*	*4,0*	*4,5*	*6,5*	*5,6*

* Including unrecorded transactions

An analysis comparing the composition of cumulative gross inward capital flows into South Africa during the period 2003 to 2007 with similar flows in the period 2008 to 2012 (after the financial crisis) seems to suggest a smaller reliance on inward portfolio investment. During the year prior to the onset of the financial crisis, the cumulative net capital inflows related to portfolio investment far exceeded the sum of direct and other investment flows. Inward direct investment flows into the country gained momentum between 2008 and 2012 as South Africa offered attractive direct investment opportunities for non-resident investor-companies whereas growth in key developed economies was stunted.

Composition of net capital flows



In addition, the relatively higher yields offered by the South African banking sector and an increase in demand for loan financing lifted the inward capital flows of the other investment category during 2008 and 2012. Notable also was an increase in other investment loans extended to the public sector to finance infrastructure development. The combined net inflows from these categories were much higher than the net inflows registered in the category for portfolio investment over the period. The latter was affected by the risk-averseness of global investors amid uncertainty in the global financial markets. During the first quarter of 2013, the composition of capital inflows resembled that of 2008 to 2012.

Net foreign direct investment

Cumulative inward direct investment increased from R89,5 billion during the period 2003 to 2007 to R210,0 billion during the period 2008 to 2012. The bulk of the foreign direct investment inflows during the period 2008 to 2012 was channelled into the banking, telecommunications, wholesale and mining sectors. The geographical presence of South African companies' direct investment subsidiaries in the African region alongside unique expertise attained over time in these markets on the continent most probably helped to attract foreign direct investment capital, often involving the acquisition of a significant interest in an existing enterprise rather than greenfield investment.

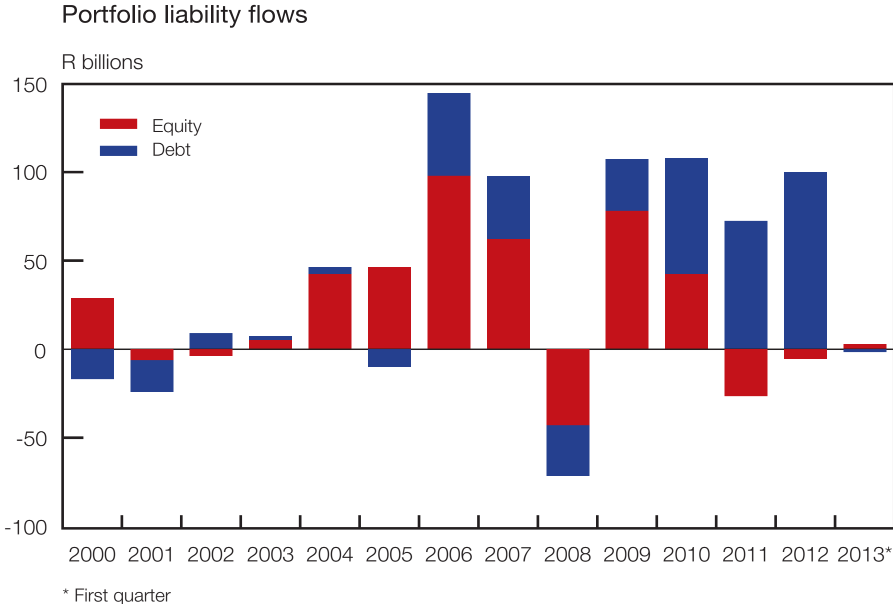
Cumulative outward direct investment flows, on the contrary, declined from R80,9 billion during the period 2003 to 2007 to R17,3 billion during the period 2008 to 2012. Whereas foreign direct investment abroad increased consistently during the period 2003 to 2007, capital inflows were recorded in subsequent years as domestic investors reduced their equity stake in entities abroad. However, South African companies increased their outward investment during 2012 to a level close to that of 2006 in search of high-yielding investments, partly on the African continent.

Net portfolio investment

Cumulative inward portfolio investment liabilities decreased somewhat during the period 2008 to 2012 compared with the cumulative inflows recorded during the period 2003 to 2007. In addition to a marginal slowdown in inward portfolio investment since 2008, the composition of these flows has also switched from equity to debt securities. The global suppression of yields and the consequent widening of the interest rate differential have raised the attractiveness of South African debt securities, while below-potential economic growth may have made international investors more risk-averse towards investment in equity securities.

The investment inflows into debt securities, mainly rand-denominated bonds, were partly supported by South Africa's inclusion in the Citi World Government Bond Index in October 2012, which was preceded by front-running and position-taking by some investors.

Portfolio liability flows



* First quarter

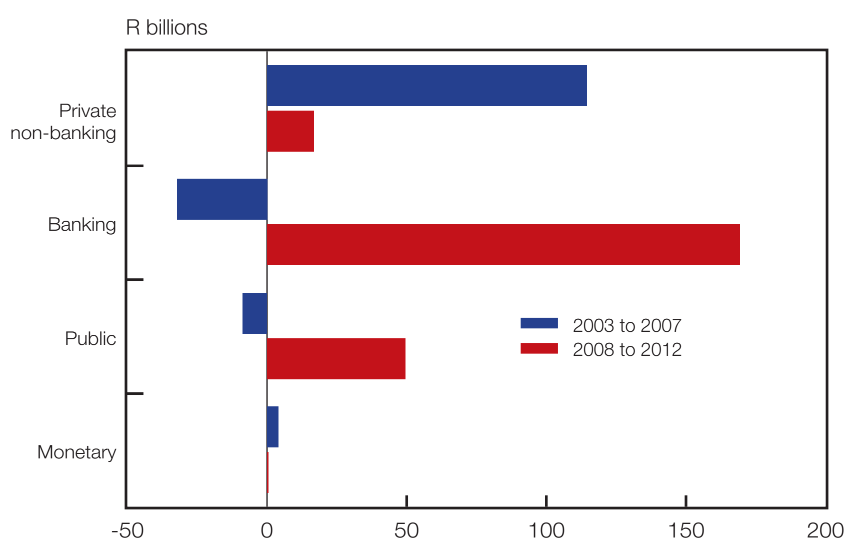
In addition, the issuance of international bonds from 2009 into the first half of 2013 further complemented the inward portfolio flows over the period. On a net basis, South African institutions have issued R10,2 billion, R12,4 billion, R27,1 billion and R8,3 billion respectively in the four years up to 2012. The higher value of these issuances in the more recent years reflected the increasing size of funding required to finance the infrastructure projects. Investors' sentiment was, however, partly negated towards the end of 2012 and in early 2013 by the downgrading of the country's sovereign credit ratings, partly related to protracted labour unrest in various sectors of the economy.

Outward portfolio investment increased during the period 2008 to 2012 as South African individuals and institutional investors continued to diversify their portfolios, especially during periods of exchange rate stability and relative strength of the exchange value of the rand. On a net basis, portfolio investment inflows are expected to moderate further into the first half 2013.

Net other investment

South Africa recorded net other investment inflows to the value of R235,9 billion from 2008 to 2012. Short-term foreign loans extended to the South African banking sector as well as the repatriation of offshore deposit holdings represented the bulk of these inflows, followed by long-term loans granted to the public sector. This stood in contrast to the preceding period, 2003 to 2007, when loans extended to the non-private banking sector dominated net other investment inflows. Early indications are that net other investment inflows will continue in the first half of 2013.

Net other investment capital flows by sector



Foreign debt

South Africa's foreign debt rose substantially from 2011 to 2012 due to increases in both foreign-currency and rand-denominated debt. The ratio of external debt to gross domestic product accordingly deteriorated over the period, aggravated by the moderation in the economic growth rate. Nonetheless, South Africa's debt ratios compare reasonably well with those of its peers.

During the past few years, the increase in South Africa's foreign debt has partly demonstrated the gradual rise in the economic activity of the public sector and its important role in sustaining the domestic economy. Long-term public-sector foreign debt increased visibly by US$53,6 billion from December 2002 to December 2012.

Foreign debt of South Africa

US$ billions at end of period

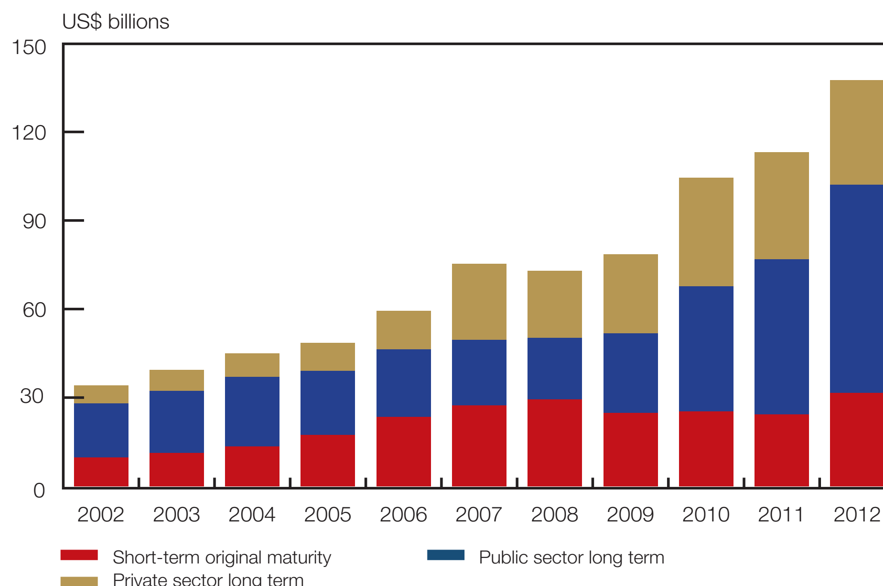
	2008	2009	2010	2011	2012
Foreign currency-denominated debt	**44,1**	**42,1**	**45,2**	**50,8**	**57,2**
Bearer bonds	13,9	15,4	16,5	20,9	22,5
Other	30,2	26,7	28,7	29,9	34,7
Public sector	5,3	5,7	6,5	7,6	9,0
Monetary sector	12,8	10,6	10,3	9,9	13,8
Non-monetary private sector	12,1	10,4	11,9	12,4	11,9
Rand-denominated debt	**28,8**	**36,5**	**59,3**	**62,3**	**80,3**
Bonds	8,0	11,6	24,7	30,3	44,8
Other	20,8	24,9	34,6	32,0	35,5
Total foreign debt	**72,9**	**78,6**	**104,5**	**113,1**	**137,5**
As a percentage of gross domestic product	*26,6*	*27,5*	*28,8*	*28,1*	*35,8*
As a percentage of total export earnings	*70,1*	*95,9*	*100,4*	*90,9*	*120,1*

The steady accumulation of debt by the public sector occurred as a result of the attractiveness of domestic fixed interest-bearing securities amid higher yield, a relatively contained inflation rate and the inclusion of South African government bonds in the World Government Bond Index. The stock of rand-denominated bonds held by non-resident investors rose from US$2,8 billion at the end of December 2002 to US$41,4 billion at the end of December 2012. In addition, the public corporations issued a series of international bonds with the proceeds mainly utilised to fund the upgrading of the country's energy and road infrastructure. South Africa's outstanding foreign currency-denominated bonds increased from US$7,8 billion at the end of December 2002 to US$22,4 billion at the end of December 2012. The outstanding long-term private-sector debt also increased from 2002 to 2012, albeit at a slower pace, on concerns of the sector about the global economic outlook and the unattractive conditions of global loan financing, especially from 2009.

South Africa's short-term foreign currency-denominated debt (i.e., debt with an original maturity of less than one year and other foreign currency-denominated debt maturing within the next twelve months) rose marginally to 39,6 per cent of total foreign currency-denominated debt at the end of 2012 from 37,8 per cent at the end of 2011, partly reflecting an increase in short-term loans of the banking sector that coincided with a rebound in the value of merchandise imports.

The widening of the country's current-account deficit, widespread labour unrest in the mining sector and slower pace of economic growth caused the three major international credit rating agencies to downgrade South Africa's sovereign credit ratings in 2012 and early 2013 to BBB and Baa1 investment grade, placing the country on par with Brazil and Russia but still above Greece, Hungary, Egypt and India. South Africa's sovereign debt has been consistently rated as an investment grade without a downgrade since 2000. While these downgrades could impact on the domestic cost of borrowing in the international market, the national government successfully issued a US$1,5 billion 12-year international bond in January 2012 at a relatively low coupon rate of 4,67 per cent, the lowest since 2006. This was followed by several bond issuances during the remainder of 2012 and the first half of 2013.

Stock of external debt by borrower type and maturity



International reserves and liquidity

After increasing visibly by R32,7 billion in 2011, South Africa's overall balance-of-payments position increased at a much reduced pace of R9,0 billion in 2012. The country's net reserves declined by R14,0 billion during the first six months of 2013.

South Africa's gross gold and other foreign-exchange reserves increased from US$48,9 billion at the end of 2011 to US$50,7 billion at the end of 2012. However, the gross gold and foreign-exchange reserves declined to US$47,0 billion at the end of June 2013 following the repayment of an international bond by the National Treasury over the period. The level of import cover (i.e., the value of gross international reserves relative to the value of imports of goods and services and income payments) increased from 7,2 weeks in the fourth quarter of 2003 to 21 weeks in the third quarter of 2009, but declined to 19,3 weeks in the first quarter of 2013.

The international liquidity position fluctuated during 2012, but remained roughly unchanged at US$47,9 billion from the end of 2011 to the end of 2012, decreasing to US$44,6 billion at the end of June 2013.

Exchange rates

The nominal effective exchange rate of the rand has recorded several episodes of abrupt movements during the past two decades. The exchange rate of the rand depreciated sharply during the period 1997 to 2002, and made itself felt in the current-account balance. From 2003 to 2005, the effective exchange rate of the rand appreciated notably, before declining again between 2006 and 2008 and from 2011 throughout the first half of 2013.

The flexible exchange rate system and liquidity in the domestic market for foreign-exchange allowed some degree of volatility in the domestic currency. The heightened volatility in the exchange rate of the rand was noted during the period leading up to the global financial crisis in 2008 and part of 2009. The level of volatility in the domestic currency moderated somewhat as the uncertainty in the global financial market subsided in 2010. The resurgence of the financial crisis in the euro area and risk association with investment in emerging-market economies affected the exchange rate of the rand in 2011. Alongside the impact of the banking sector crisis in Cyprus during the first half of 2013, unfavourable developments in the domestic economy

added to the volatility of the domestic currency over the period. In general, since 2008, the volatility of the exchange rate of the rand seems to be more pronounced during periods of domestic currency depreciation.

Exchange rates of the rand

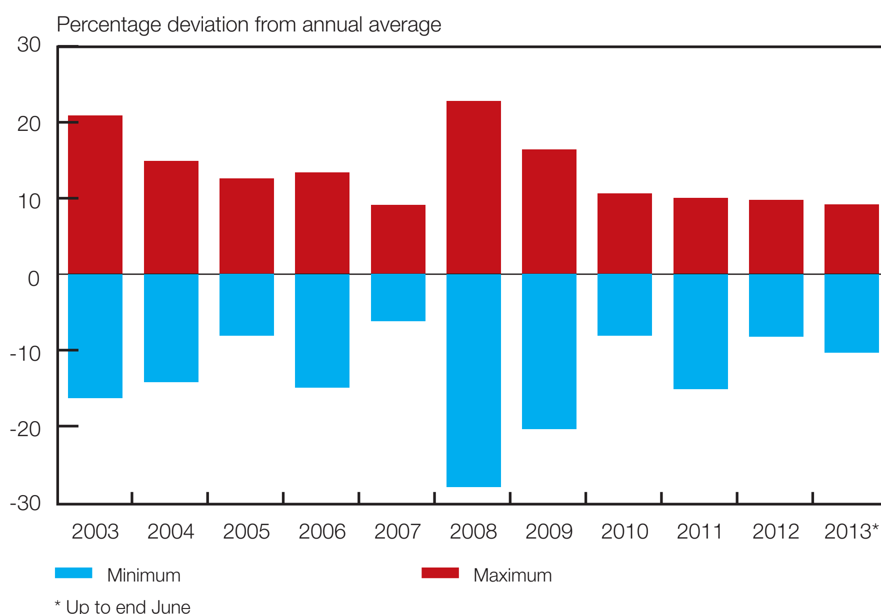
Percentage change

	31 Dec 2010 to 30 Jun 2011	30 Jun 2011 to 31 Dec 2011	31 Dec 2011 to 30 Jun 2012	30 Jun 2012 to 31 Dec 2012	31 Dec 2012 to 30 Jun 2013
Weighted average*	-6,4	-11,9	-0,6	-4,1	-12,1
Euro	-10,0	-6,5	0,6	-6,7	-13,9
US dollar	-2,3	-16,6	-2,1	-2,1	-14,9
Chinese yuan	-4,2	-18,8	-1,2	-4,0	-16,1
British pound	-5,5	-13,4	-3,4	-5,4	-9,7
Japanese yen	-3,5	-19,5	0,3	6,0	-2,2

* Against a basket of 15 currencies

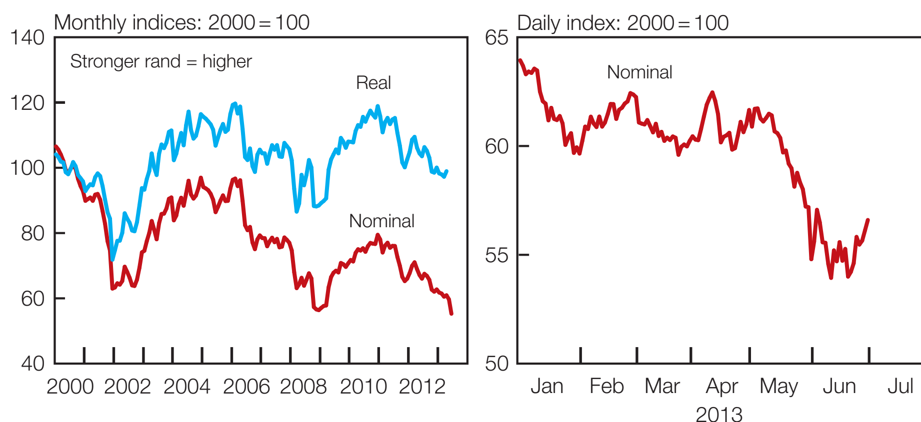
The movements in the exchange rate of the rand to a large extent tracked that of the euro, especially after the global financial crisis. However, this relationship weakened during the second half of 2012 as domestic factors weighed on the rand. The nominal effective exchange rate of the rand reached four-year lows in May and June 2013 following the release of worse-than-expected domestic economic growth data, a decline in the international prices of gold and platinum, and labour turmoil which raised concerns about the export potential of the South African mining sector.

Rand/US dollar exchange rate variability



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 receded by a further 2,4 per cent in 2012 and continued its downward trend during the first half of 2013. South African exporters' competitiveness in foreign markets has improved during the past two years as a result of the depreciation of the exchange rate of the rand and lower inflation in domestic producer prices.

Effective exchange rates of the rand



The average net daily turnover in the domestic market for foreign exchange almost doubled from US$10,0 billion in 2003 to US$19,4 billion in 2012. The attractiveness of trading and investment in South African equity and debt securities was also reflected in an increase in the transactions against the rand from US$7,7 billion to US$15,0 billion over the same period. There has also been a significant increase in the average daily net turnover in third currencies from US$2,3 billion to US$4,4 billion over this period. The value of transactions in which non-residents participated more than doubled from US$6,6 billion per day in 2003 to US$13,5 billion per day in 2012.

Monetary developments, interest rates and financial markets

Structural and regulatory issues

Recent regulatory and legislative reforms in the South African financial sector focused on enhancing the regulatory framework and market infrastructure, and on new product offerings. The key developments are outlined below.

In July 2012 the JSE Limited (JSE) moved its equity market trading activity onto Millennium Exchange™ after concluding a licence agreement with a technology solutions provider. Consequently, the JSE's trading system relocated from London, where the trading engine had been situated for ten years, to the JSE building in Johannesburg.

The Commodity Derivatives Division (CDD) of the JSE expanded its foreign-referenced commodity product range when it introduced Quanto contracts in July 2012. The product provides market participants with the flexibility of accessing international commodity markets while trading in local currency. This buffers participants against exchange rate fluctuations. Since their launch, these offerings have gained immense popularity, with 14 such contracts having been listed on the local bourse by the end of June 2013.

Safcom, South Africa's clearing house for exchange-traded derivatives, achieved global standard of risk management by complying with the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO) requirements in December 2012. Being compliant with these global standards and the Group of Twenty (G-20) recommendations, and pursuant to the new Financial Markets Act, 2012 (Act No. 19 of 2012) which came into operation on 3 June 2013, the JSE plans to launch an onshore over-the-counter (OTC) clearing service. This initiative, together with the Act's framework for regulating OTC derivatives domestically, will obligate the central reporting of all OTC derivatives contracts through trade repositories.

In March 2013 Safcom further announced the promulgation of new rules relating to the establishment of a derivatives market default fund. The fund is aimed at reducing clearing members' exposure to counterparty credit risk when clearing through Safcom. These developments will not only assist in reducing systemic risk in the domestic derivatives market, but will also potentially uplift the credibility of the local market as a foreign investment destination.

The JSE implemented a methodology change to the FTSE/JSE Africa Index Series with effect from 15 March 2013, in line with a global change to index methodology applied by the FTSE Group. The indices are now constructed with individual share prices weighted according to actual free float rounded up to the next 1 per cent, rather than with a banded free float.

On 25 March 2013 the JSE published additional listing requirements which make provision for the listing of a special purpose acquisition company (SPAC). SPACs are companies that do not have any assets that would qualify them for a normal listing. The SPAC requirements therefore aim to facilitate the primary capital-raising process to enable the acquisition of viable assets within a period of two years, in pursuit of a listing on the Main board or AltX.

The Credit Rating Services Act, 2012 (Act No. 24 of 2012) (CRSA) came into effect on 15 April 2013, ensuring that South Africa is in line with international and G-20 regulatory requirements for credit rating agencies. The Financial Services Board (FSB) has been tasked with administering the CRSA and with the supervision of the credit rating agencies. In order to perform credit rating services or issue a credit rating in South Africa, entities have been given until 17 December 2013 to register in terms of section 5 of the CRSA.

The Equity Derivatives Division of the JSE launched exchange-traded Contract for Difference (eCFD) instruments in May 2013. The newly listed instruments aim to eliminate counterparty default risk, while providing exposure to the liquid underlying equity market. eCFDs will potentially afford participants with more trading flexibility and complement trade in single stock futures, thus providing participants with a wider choice of instruments.

As from 1 July 2013 the South African government moved away from a blanket tax exemption on interest payable to non-residents and introduced a withholding tax on interest at a rate of 15 per cent. However, withholding tax exemptions will apply to interest paid or accrued to non-residents from (i) bonds issued by government (national or local government), (ii) listed debt instruments, (iii) any debt owed by a domestic bank or the South African Reserve Bank (SARB), Development Bank of Southern Africa (DBSA) or Industrial Development Corporation (IDC), (iv) domestic dealer and brokerage accounts, and investment schemes, and (v) in respect of bills of exchange, letters of credit or similar instruments.

The CDD of the JSE announced its intentions to expand its commodity derivatives product range to include Zambian grain derivative contracts, to be traded and cleared in US dollar. Aimed to be introduced by the end of July 2013, the offering is envisaged to promote price risk management, improve price discovery, and increase South Africa's reputation as Africa's investment hub.

Further legislative and regulatory changes affecting financial markets were announced in the Budget of the national government for fiscal 2013/14 and included the following:

– The government will introduce 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
R2 030	31 January 2030	I2046	31 March 2046
R2 032	31 March 2032		
R2 037	31 January 2037		
R2 044*	31 January 2043		
	31 January 2044		
	31 January 2045		

* The maturity value is split equally over the three maturity years

– To encourage non-retirement savings, government intends to proceed with the implementation of tax-preferred savings and investment accounts to the effect that all flows accrued into these accounts and any withdrawals would be exempted from tax. Such accounts would have an initial annual contribution limit of R30 000 and a lifetime limit of R500 000, to be increased regularly in line with inflation. This will be phased in over two years. In the meantime, the annual domestic interest and dividend income tax exemption threshold was raised from R22 800 to R23 800 for taxpayers under the age of 65, and from R33 000 to R34 500 for taxpayers aged 65 and over, effective from 1 March 2013.

– The tax-free threshold for small business corporations was increased from R63 556 to R67 111, and taxable income up to R365 000 will be taxed at a rate of 7 per cent. A new tax bracket for taxable income up to R550 000 was introduced at a rate of 21 per cent. For taxable income above R550 000, the normal corporate tax rate of 28 per cent applies. These amendments came into effect on 1 April 2013.

– South Africa started implementing a local Real Estate Investment Trust (REIT) regime for the listed property sector on 1 April 2013. The new REIT structure will bring the South African listed property sector in line with international standards. All property companies that had been listed on the JSE prior to 1 April 2013 either as property loan stocks or property unit trusts are to be converted to the new REIT structure and new listings in this sector will have to comply with the JSE REIT listing requirements published on 28 March 2013. When South African listed property funds convert to this system, South Africa will be the eighth largest REIT market globally.

– The National Treasury outlined several legislative measures regarding reforming the taxation of trusts. These proposals were made to curtail tax avoidance associated with trusts and will not be extended to trusts established for the needs of minor children and disabled people. Taxable income and loss (including capital gains and losses) on discretionary trusts will be calculated fully at trust level with distributions serving as deductible payments on current taxable income. Trading trusts will similarly be taxable at the entity level, with distributions serving as deductible payments on current taxable income. A trust will be viewed as a trading trust if it either conducts a trade or if beneficial ownership interests in these trusts are freely transferable.

As part of ongoing regulatory changes in the South African financial sector, the National Treasury and FSB outlined further reforms and policy proposals affecting non-bank financial institutions in 2012 and 2013. These reforms are, among other things, expected to ensure consumer protection, increase retirement savings and promote financial stability through strengthening financial sector regulation.

The Financial Regulatory Reform Steering Committee, comprising the National Treasury, the SARB and the FSB, released the proposed implementation framework for the Twin Peaks model of financial regulation for public comment on 1 February 2013. According to this document, the SARB will be responsible for prudential regulation and supervision, and will be allocated new powers with respect to the regulation of financial markets infrastructure, such as exchanges and clearing houses. The FSB will be responsible for market conduct regulation, which entails consumer protection and promotion of confidence in the financial sector. The SARB has been identified as a financial crisis management and resolution authority in South Africa. This is consistent with its responsibility for ensuring financial stability, managing money-market liquidity and supervising South Africa's micro- and macroprudential policy. The first phase of the Twin Peaks model is expected to be implemented in 2013/14, while the second phase will be implemented over the medium term.

The international Financial Stability Board published a report on the peer review of the South African financial sector on 5 February 2013. The report examined the progress made in implementing reforms that are relevant for the broader Financial Stability Board membership, which mainly includes inter-agency co-ordination and regulation of the OTC derivatives market. The report welcomed the current reforms in South Africa to streamline responsibilities of the financial sector regulators and to elevate the importance of market conduct regulation.

In its endeavour to promote and improve savings in the country, the National Treasury in September and October 2012 released four technical discussions papers on (i) enabling better income at retirement, (ii) preservation, portability and governance, (iii) incentivising non-retirement savings, and (iv) improving tax incentives for retirement savings, for public comment. These documents outlined policy options on how to encourage pre- and post-preservation of retirement income, improve retirement fund governance, simplify the taxation of retirement contributions and reform the retirement annuities market.

An updated discussion document on retirement reform proposals was released for further consultation in the 2013 Budget Review. These reforms, which are also intended to complement the Twin Peaks model, propose that retirement funds be required to identify a preservation fund for transferring members' pension balance when benefits are withdrawn before retirement. This condition will also be applicable to payments from divorce settlements, but vested rights will be protected. The existing rules on preservation funds will be relaxed to allow for one withdrawal per year, but the amount will be limited.

Furthermore, consideration will be given to relax preservation requirements for retirement annuity funds by allowing individuals with retirement annuity funds to transfer their balances to preservation funds, if they wish to do so. To encourage post-retirement savings and annuitising, it is proposed that the means test for the old-age grant be phased out in the medium term, while provident funds will have the same tax dispensation as that of pension funds. The official pension funds (Government Employees Pension Fund (GEPF) and other public-sector funds) will be brought into the purview of the Pension Funds Act, 1956 (Act No. 24 of 1956).

Following the adoption of the Solvency Assessment Management (SAM) framework for the South African insurance sector, the FSB conducted and released the results of its first and second quantitative impact studies. An economic impact study and third quantitative impact study (QIS3) are scheduled to take place in 2013. The purpose of the economic study is, *inter alia*, to establish the costs and benefits that the adopted framework may have on the behaviour of insurers and the impact such change may have on financial regulation and the economy. The implementation of SAM was postponed to 1 January 2016, thus allowing the findings from the economic impact study to be taken into account in the production of the final quantitative impact study. Meanwhile, the Insurance Laws Amendment Bill is expected to affect the SAM interim measures, while the appropriate tax regime to be applied under SAM is currently being discussed by authorities.

In line with the G-20 recommendations, wherein a commitment was made to expand and enhance regulatory scope to include hedge funds, the FSB and National Treasury released a proposed framework for regulating hedge funds in South Africa for public comment by mid-September 2013. It is proposed that the industry be regulated within the existing Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) (CISCA) and be split into restricted and retail hedge funds – the latter of which will only be available to the general public. In January 2013 the Association for Savings and Investment South Africa (ASISA) brought into effect the new classification standard for South African collective investment portfolios. The structure requires that funds be classified in terms of geographic exposure and underlying asset class, which will make it easier for investors to compare funds' performance within and across categories.

The GEPF became a member of the Global Real Estate Sustainability Benchmark (GRESB) in March 2013. This will assist the GEPF in making informed decisions regarding its property investments and allow it to be part of the global initiative to improve the sustainability of the global property sector. The GRESB measures the environmental performance of real estate investment vehicles for both listed and private property funds.

The South African banking sector operated in a challenging macroeconomic environment during the past 18 months as output and employment disappointed, reinforcing the subdued household and business sentiment. The challenging conditions were reflected in sluggish growth in banking business and the downgrading of the credit ratings of some major banks by international rating agencies, trailing a sovereign credit rating downgrade of South Africa. Despite these developments, the banking sector remained sound, stable and profitable while the quality of banks' assets continued to improve.

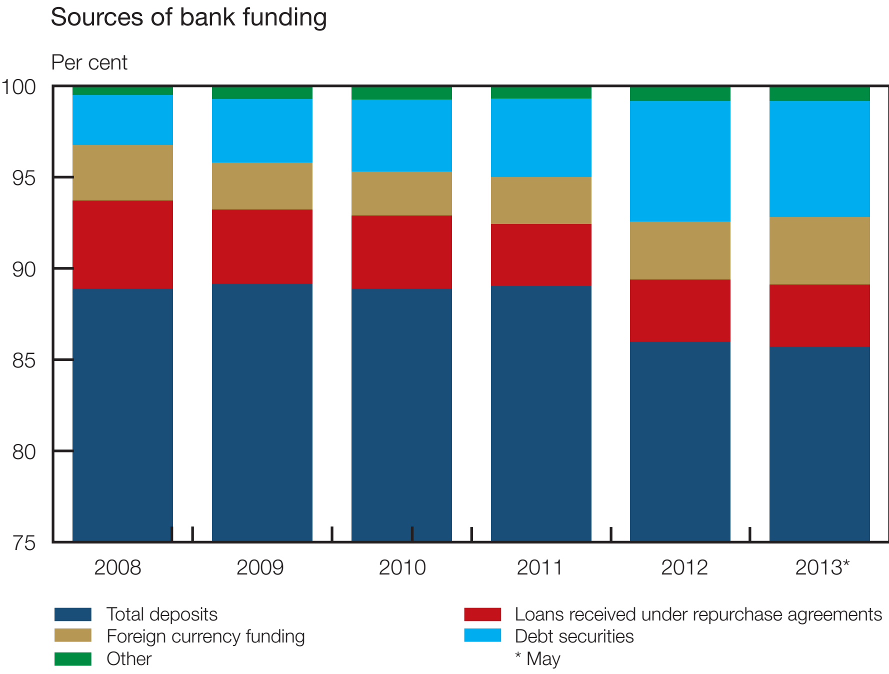
The banking sector continues to be dominated by four large banks, which together account for 84 per cent of the total assets of the South African banking sector. The number of locally registered banks in South Africa increased from 30 in May 2012 to 32 in May 2013 due to the entry of a new mutual bank and a branch of a foreign bank. The number of foreign banks with approved local representative offices in South Africa declined to 39 at the end of May 2013, down from 43 at the end of May 2012.

Size of the South African private banking sector

	May 2012		May 2013	
	Number of institutions	Total assets (R billions)	Number of institutions	Total assets (R billions)
Locally controlled banks	10	2 532	10	2 765
Foreign-controlled banks	6	753	6	795
Mutual banks	2	1	3	2
South African branches of foreign banks	12	189	13	204
Total registered banks	**30**	**3 475**	**32**	**3 766**

Banks continued to consolidate their market share, launch new and innovative savings and investments products, expand their business and spread their footprint across the continent. For instance, in November 2012 a large bank acquired the private label storecard portfolio of a large retailer. Furthermore, in April 2013 regulatory approval was obtained by a large banking group to merge the bulk of the African operations of its main shareholder with its own operations.

The Basel III capital-adequacy framework was successfully phased-in in South Africa in January 2013 when all banks met the prescribed minimum requirements in terms of Common Equity and Tier 1 capital-adequacy ratios. The banking sector also made some progress in preparation for its compliance with the Basel III liquidity coverage and net stable funding ratios, scheduled for 2015 and 2018 respectively. To this effect the banks have strengthened their liquidity positions in recent years and reorganised their funding strategy. Banks' funding from domestic deposits diminished from 91,0 per cent of total funding in 2005 to 86,2 per cent in May 2013 as interbank deposits – considered to be an unstable source of funding in the new global regulatory framework – declined. At the same time, the banking sector continued to issue bonds both domestically and internationally. Securitisation activity, which has the potential to mitigate maturity mismatches in funding and lending activity, was slow in 2012 with only R0,3 billion in assets securitised compared with R4,0 billion in 2011.



In the wake of the 2008 global financial crisis, the South African authorities embarked on a range of initiatives to strengthen the financial sector regulatory framework, enhance the supervisory powers of the regulators, address consumer indebtedness, and intensify their goal for formal financial inclusion for all South Africans. Some of these developments are discussed below.

In November 2012 the National Treasury and the Banking Association of South Africa agreed to review lending affordability rules and reduce wage garnishing. Subsequently the Banking Association announced its intention to tighten rules on unsecured lending in an effort to address the issue of mounting bad debts. This would include tougher rules related to lending affordability and stricter criteria that need to be adhered to before garnishee orders can be issued on workers' salaries in cases of delinquent payments. Some of these issues are covered in the National Credit Act Policy Review Framework which aims to address ineffective and inefficient legislative provisions; enhance the institutional enforcement framework; and provide mechanisms for dealing with debt to assist consumers that experience financial difficulties. The draft Framework, together with proposed amendments to the National Credit Act, 2005

(Act No. 34 of 2005) was published for comment by the Minister of Trade and Industry in June 2013. The amendments to the National Credit Act aim to improve the interpretation of certain definitions in the Act; to tighten measures relating to debt counsellors and their conduct; and to empower the National Credit Regulator to suspend certain reckless credit agreements.

In June 2013 the National Credit Regulator released a public notice of its intention to issue affordability assessment guidelines in terms of the National Credit Act, 2005 (Act No. 34 of 2005). The guidelines would assist credit providers in conducting proper assessments of the consumers' ability to repay in credit applications and to combat consumer over-indebtedness as well as reckless lending.

The Department of Trade and Industry and the National Credit Regulator presented its findings and recommendations on the proposed Credit Information Amnesty in June 2013 with the intention of addressing the problem of consumer credit impairment which continued to prevail despite a credit amnesty in 2006/07. After a consultative process with relevant stakeholders in the industry, the study leaned towards an approach of responsible amnesty in respect of some credit information, such as paid-up judgments and adverse information listings. To ensure successful implementation of the proposed amnesty on 1 October 2013, some legislative amendments to the National Credit Act were recommended, followed by on-going monitoring and evaluation thereafter.

The Banks Amendment Bill was tabled in Parliament in December 2012. The aim of the Bill is to align the provisions of the Banks Act to the Companies Act, comply further with the requirements of the Basel Committee on Banking Supervision, and align the Banks Act with changing supervisory market developments and practical considerations. In addition, amendments to the Regulations Relating to Banks were issued by the Minister of Finance on 12 December 2012. The Regulations, which took effect in January 2013, enabled the implementation of the provisions of the Basel III framework in South Africa. This will be phased in with full implementation by 2018, consistent with the timelines determined by the Basel Committee.

In order to address the new Basel III requirements related to the holding of high-quality liquid assets, the Bank used one of the national discretion options by providing a committed liquid facility from which commercial banks can draw funds in times of liquidity stress. The facility was made available to all South African banks, effective from 1 January 2013, to help ensure that banks will be able to meet the required liquidity coverage ratio in times of inadequate supply of qualifying instruments.

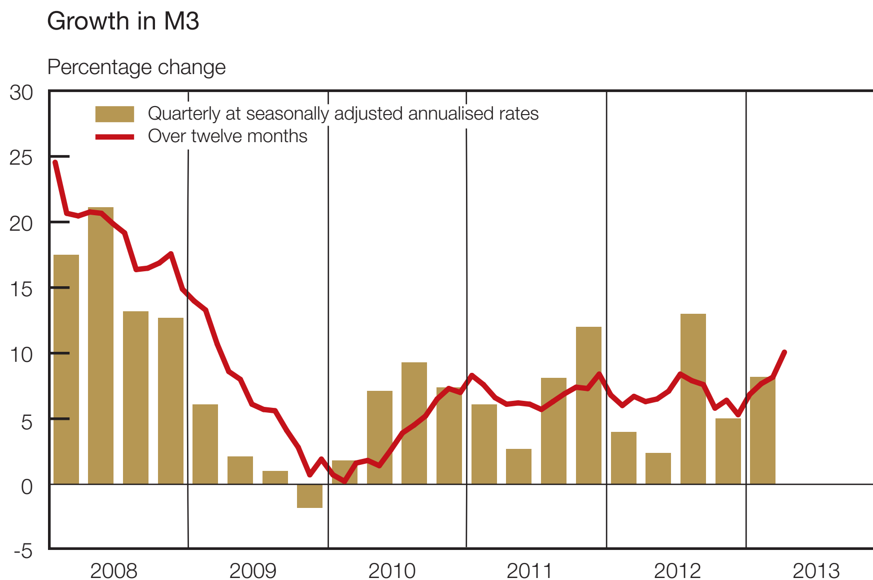
The Financial Services Laws General Amendment Bill was tabled in Parliament in September 2012. The Bill aims to amend and effect improvements to certain provisions in eleven financial sector laws in order to close regulatory gaps highlighted after the 2008 financial crisis by the Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund and World Bank, and to align these laws with the 2008 Companies Act and other legislation.

A review by the Financial Markets Liaison Group of the processes and procedures underlying the calculation of domestic money-market reference rates, including the Johannesburg Interbank Average Rate (Jibar), found no fundamental concerns around the Jibar determination process. The review was initiated in 2011 but received considerable public attention in 2012 against the backdrop of criticism regarding the trustworthiness of London benchmark interbank rates. Recommendations to strengthen the governance process for determining Jibar rates were incorporated in "The Jibar Code of Conduct, Governance Process and Operating Rules" which became effective from 1 March 2013.

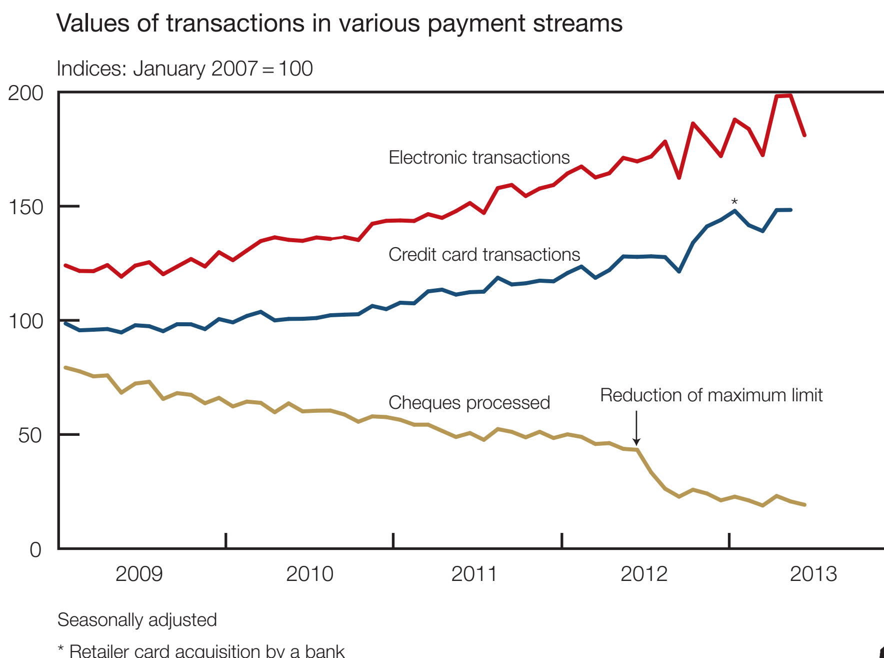
Following the publication of the phase II Draft Financial Sector Code (FS Code) for public comment in March 2012, the FS Code was finalised and gazetted as a sector code in terms of the Broad-Based Black Economic Empowerment (B-BBEE) Act, 2003 (Act No. 53 of 2003) in November 2012. In terms of the FS Code the financial sector has committed to provide R122 billion in funding to finance transformational infrastructure, affordable housing, black small, medium and micro enterprises, black farmers and B-BBEE transactions in all sectors of the economy. The implementation date of the FS Code was backdated from January 2012 and allowed financial institutions which had applied or signed verification agreements prior to this period to be measured in terms of the Act's existing Generic Codes of Good Practice.

Money supply

During the past three and a half years growth in the broadly defined money supply (M3) was characterised by a post-financial-crisis recovery phase in 2010, followed by two and a half years during which growth trends remained fairly subdued when compared to the buoyancy experienced in the years prior to the impact of the global crisis. Following the crisis growth in M3 fell to barely positive levels in 2009 alongside the domestic and global contraction. The initial recovery phase in 2010 involved a return to annual M3 growth rates above 6 per cent, but money supply then lost some momentum. M3 growth fluctuated sideways from 2011 to date at year-on-year rates generally between 6 and 9 per cent, broadly reflective of the slow and uneven recovery in economic growth.



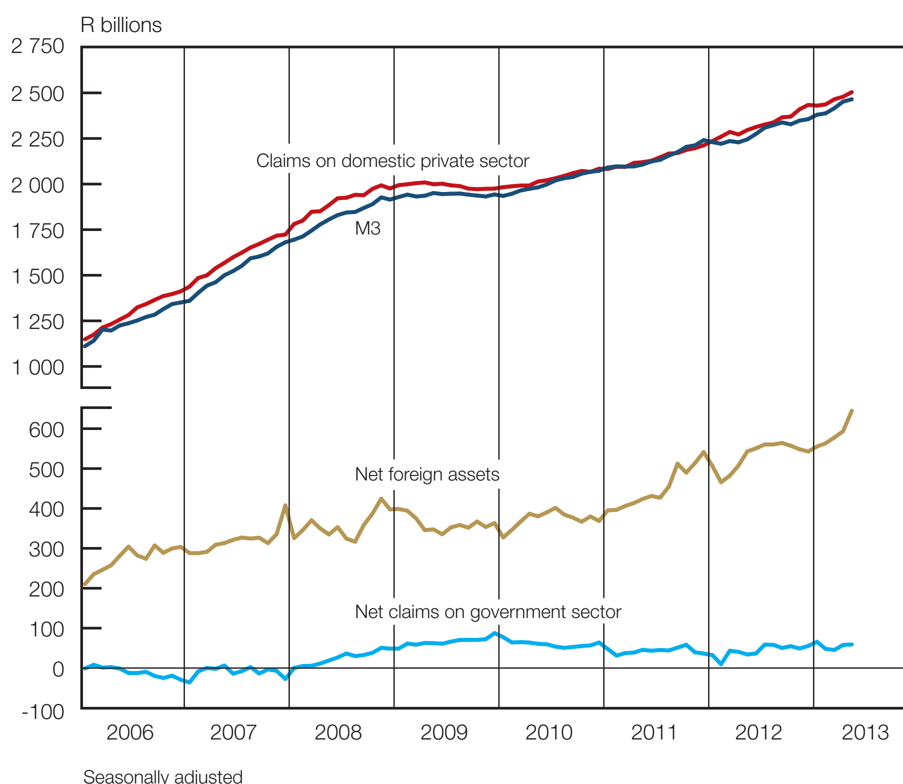
While notes and coin in circulation continue to fulfill an important transactional function in the payment system, electronic means of payment are rising in popularity. Electronic transactions reached a historic high in May 2013 and have increasingly displaced cheque transactions which have been on a declining trend in recent years, especially after the maximum payment limit on cheque transactions was reduced from R5 million to R0,5 million from July 2012. This formed part of a range of measures introduced by the authorities to reduce fraud and settlement risk in the economy.



Seasonally adjusted

* Retailer card acquisition by a bank

The main statistical counterparts of change in M3 over the past 18 months were claims on the private sector, supported by an increase in net claims on the government sector. The increase in claims on the private sector during this period can mostly be attributed to the rapid growth in general loans and instalment sale credit and leasing finance. This contrasted with preceding years when mortgage advances dominated the increase in claims on the private sector. Net claims on the government sector increased in the past year, despite the slower accumulation of government securities by the banking sector. There was a rapid decline in the growth of government deposits. The rise in M3 was to some extent constrained by a decline in net other assets and liabilities, while net foreign assets continued to rise.



Box: Trends in foreign assets and liabilities of private-sector banks

Banks' foreign assets generally exceed their foreign liabilities by a significant margin. The foreign liabilities of private-sector banks increased from around R70 billion in 2003 to R369 billion in May 2013. The two largest components within foreign liabilities are derivatives and foreign funding, with a share of 37 per cent and 22 per cent of total foreign liabilities, respectively.

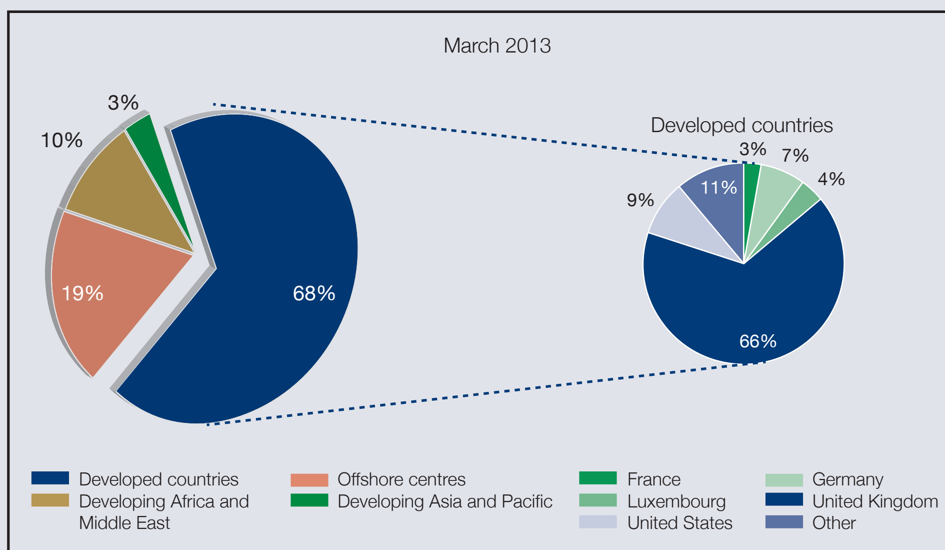
Foreign assets increased from R128 billion in 2003 to R514 billion in May 2013. Growth in banks' foreign assets was influenced by a few large foreign direct investment transactions between 2005 and the middle of 2008, such as the acquisition by a British bank of a controlling interest in a major South African bank in 2005, the acquisition of a significant share of a South African cellular company by a non-resident company in 2006, and the purchase by a Chinese bank of a 20 per cent stake in another major bank in the first half of 2008. Deposits with, and loans and advances to, foreign banks currently constitute the largest part of foreign assets with a share of 32 per cent in the total, with derivate instruments issued by non-residents as the second largest category at 29 per cent.

Both foreign assets and liabilities peaked at the height of the financial crisis in 2008 when the share of derivative instruments in foreign liabilities and assets reached a maximum of 53 and 54 per cent respectively. The foreign exposure of banks displayed a more moderate growth trend in the aftermath of the financial crisis with movements in the exchange rate of the rand impacting on growth patterns, mainly due to mark-to-market revaluations. However, when expressed in terms of US dollar, the foreign assets and liabilities of banks have remained largely unchanged between 2008 and 2013.

Foreign assets and liabilities of private-sector banks

International banks are the main counterparties to South African banks' foreign exposure. Foreign assets and liabilities are mainly denominated in US dollar, followed by the euro. However, in terms of country exposure the United Kingdom dominates, although the United States also features prominently.

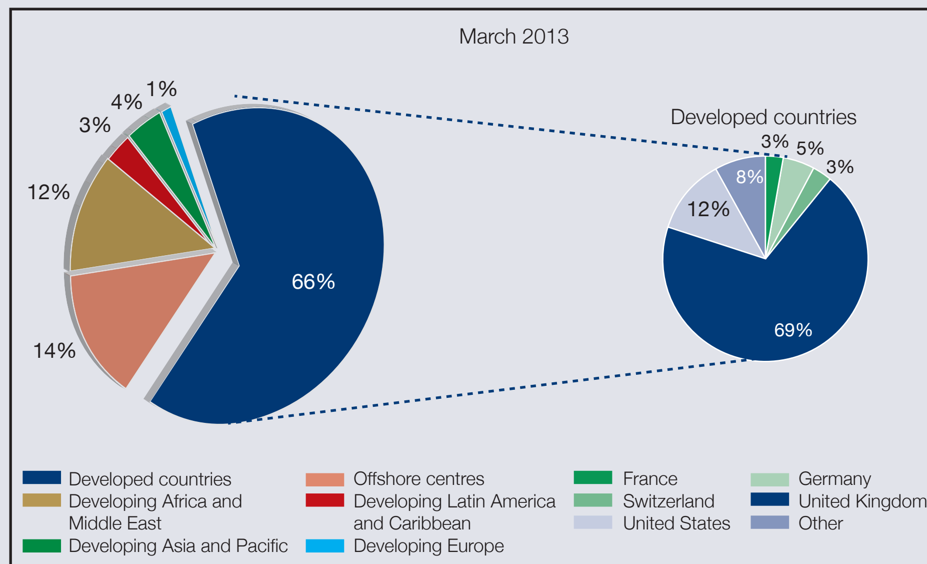
Contributions of selected regions and countries to total international liabilities



Cross-border liabilities are dominated by exposure to developed countries. Their share in total international liabilities shrank from 78 per cent in December 2010 to 68 per cent in March 2013.

Against this declining share, rapid growth in exposure to offshore centres and developing Africa and the Middle East was registered over the same period.

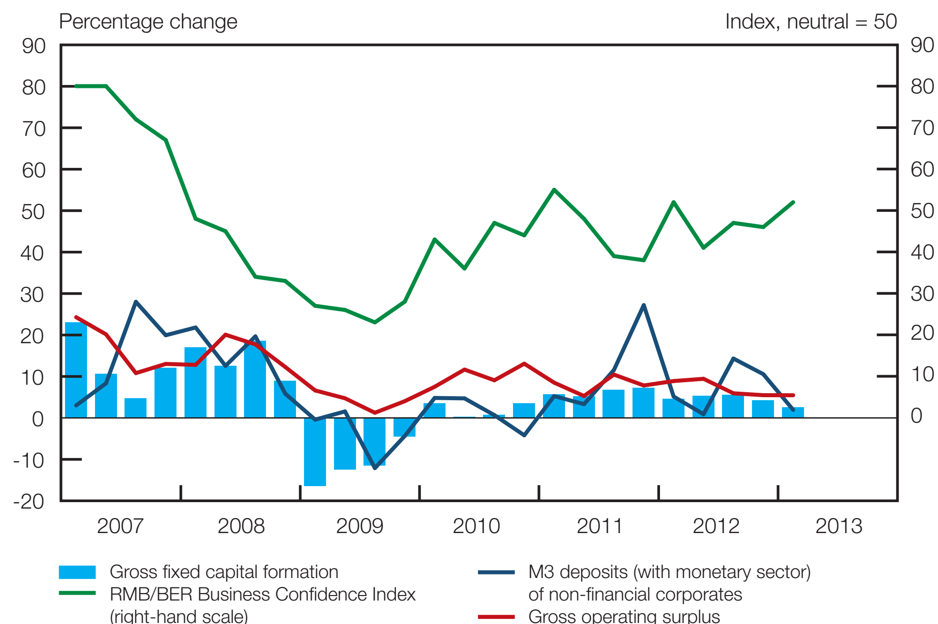
Contributions of selected regions and countries to total international claims



Cross-border assets or claims displayed a similar trend. The exposure of all banks located in South Africa to developed countries declined from 88 per cent in December 2010 to 66 per cent in March 2013. Exposure to developing countries increased significantly from 5,5 per cent to 20 per cent over the same period, with developing Africa and the Middle East gaining the most ground.

Corporate-sector deposits, which account for more than 70 per cent of private-sector deposits, increased robustly during 2010 but dwindled thereafter. The deposit holdings of non-financial companies initially recorded robust growth in the latter part of 2011, alongside improving commodity prices, but moderated somewhat in 2012 and early 2013.

Deposit growth of non-financial companies

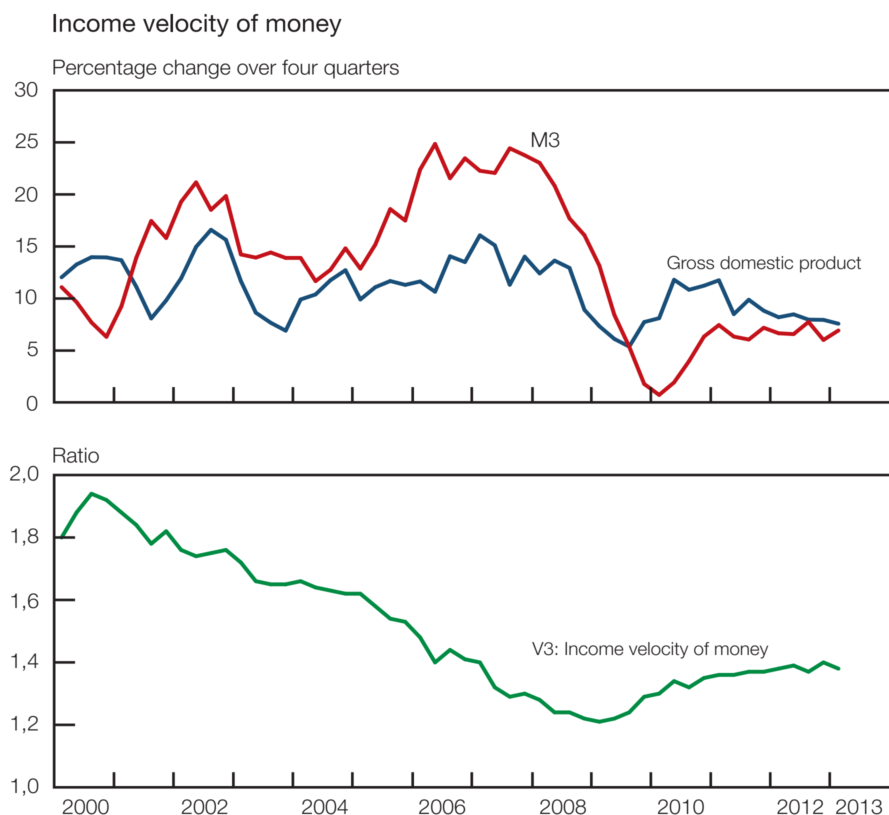


Growth in the deposit holdings of financial companies moderated from 2011 to 2012 but regained momentum in early 2013 when investors benefited from rising financial asset prices, with some again preferring the safety of bank deposits. Apart from the moderate downward impact of reclassification[6] of some deposit holdings into debt instruments in the first quarter of 2012, lacklustre growth in deposit holdings occurred against the backdrop of slowing growth in nominal gross domestic product in a sluggish domestic and global economic environment. However, the deposit holdings of the household sector continued to expand from their low base in 2010, alongside a moderate improvement in employment creation and further increases in households' nominal income and expenditure.

6 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.

In the five years to May 2013, the annual growth rate of the non-financial corporate sector deposits amounted to 4,5 per cent, much lower than the 17,1 per cent growth for the five years up to May 2008. In a similar manner the compound growth rate for deposits of financial companies (which include insurers, pension funds and unit trusts) declined from 26,3 to 6,6 per cent. On aggregate, the deposit holdings of financial companies continue to dominate total deposit balances held with the monetary sector.

The slow pace of M3 growth relative to growth in nominal gross domestic product since the upturn in economic activity led to a rising trend in the income velocity of circulation of M3. After remaining stagnant at record low levels of around 1,22 from the last quarter of 2008 through to the second quarter of 2009, the income velocity of circulation of M3 fluctuated higher to 1,40 in the fourth quarter of 2012, before declining to 1,38 in the first quarter of 2013.

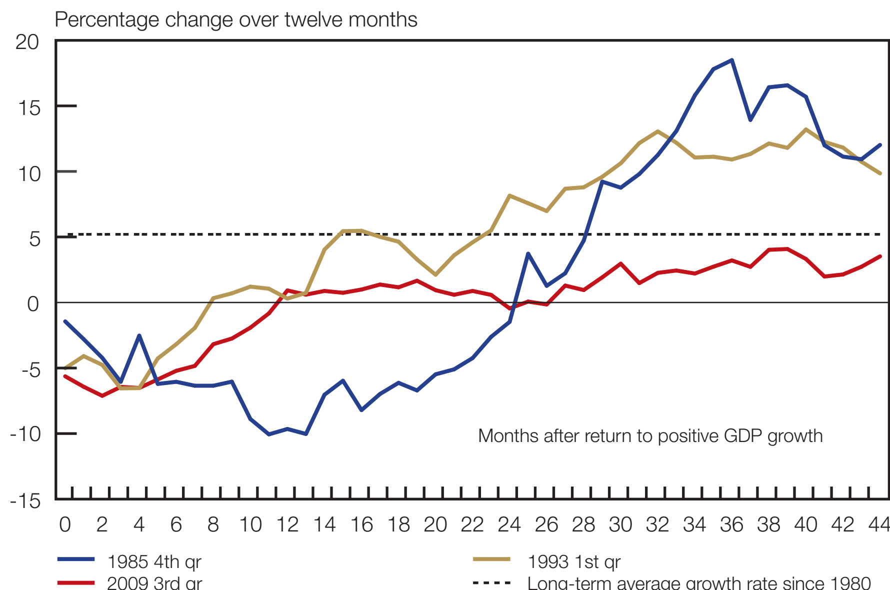


Credit extension

The 2008 global financial crisis was a catalyst for heightened banking regulation and the use of unconventional monetary policy measures by major developed countries, in an attempt to moderate the after-effects of the financial crisis, promote financial soundness and stimulate economic activity. These developments defined the boundaries within which credit developments evolved in the post-crisis recovery period, with some spill-over to the South African banking sector. For example, bank lending profiles and preferences have been influenced by the phasing in of the Basel III requirements. In addition, the introduction of the National Credit Act in 2007 had significant implications for credit providers and has since influenced the growth trends in selected subcategories of credit extension.

As from October 2009, year-on-year growth in total loans and advances receded into negative territory and remained there for seven consecutive months, whereafter a modest recovery set in. In the 17 months to May 2013, year-on-year growth in total loans and advances fluctuated around a relatively moderate average growth rate of 8,4 per cent.

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



On an inflation-adjusted basis the gradual revival in total loans and advances to the private sector was initially reasonably consistent with the upward trend observed during previous recovery phases, but the revival slowed throughout 2011 and 2012, despite a more accommodative monetary policy cycle, to remain well below the historical growth rates recorded at this stage of the business cycle.

A structural change in the composition of credit also emerged in the aftermath of the financial crisis, partly as a result of the differing rates of recovery across the various credit categories.

While the majority of credit categories decelerated to negative rates of growth by mid-2009, mortgage advances remained the exception. The twelve-month growth in mortgage advances decelerated from 30,1 per cent in January 2007 to 3,6 per cent in December 2009. Since then, growth in mortgage advances remained subdued up to May 2013, despite improvements across the majority of the other credit categories over the period. Growth in mortgage advances already started trending lower in 2007, as stricter lending criteria and higher deposit requirements by the banking sector started to restrain mortgage borrowing. Growth in mortgage advances was further constrained by a lacklustre property market, increased regulatory capital requirements, low margins for banks on long-term mortgage loans, and an overhang of housing inventory. As a result, the contribution of mortgage advances to overall growth in total loans and advances waned and as a consequence its share of the outstanding balance of total loans and advances declined from 53,8 per cent in 2009 to 47,5 per cent in 2012.

Growth in *general loans to households*, which mainly constitute unsecured lending, has been accelerating since mid-2010. The gradual phasing in of Basel III funding requirements probably contributed to banks' promoting shorter-term general loans to some level of popularity at the expense of mortgage business. The Net Stable Funding Ratio requirement, which will become a minimum standard by 2018, requires greater balance between banks' funding and lending profiles. This metric aims to promote structural changes in the liquidity risk profiles of institutions away from short-term funding mismatches and towards more stable, longer-term funding of assets and business activities.

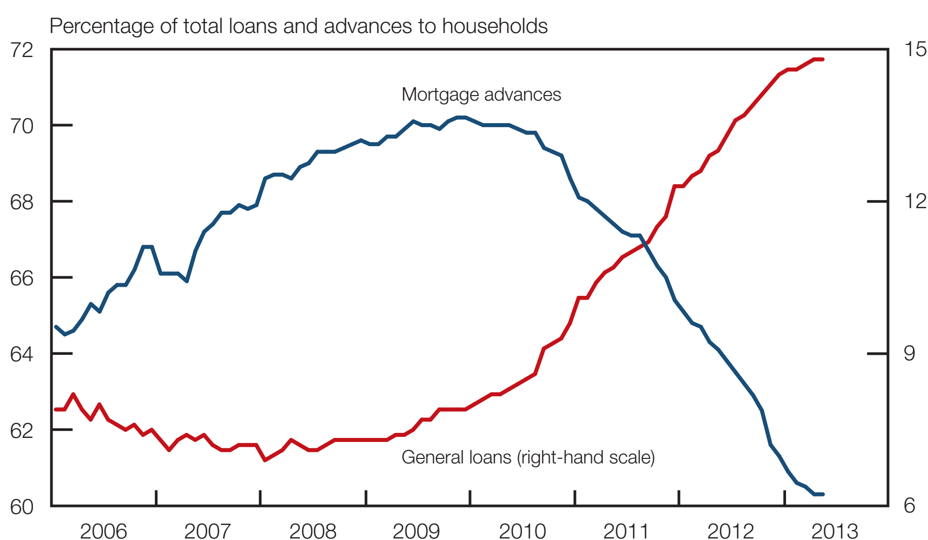
Composition of total loans and advances by type of credit

Type of credit	Change over five years (R billions)		Percentage of total loans and advances*	
	2002–2007	2007–2012	2007	2012
Household sector				
Instalment sale credit and leasing finance....	83,0	69,8	8,3	9,0
Mortgage advances....................................	375,6	202,0	35,9	34,5
Other loans and advances..........................	75,8	151,7	8,7	12,8
Overdrafts	*6,2*	*1,8*	*1,7*	*1,3*
General loans	*30,9*	*124,7*	*3,8*	*8,2*
Credit card advances	*38,7*	*25,2*	*3,2*	*3,4*
Total loans and advances to the household sector..	534,4	423,5	52,8	56,3
Corporate sector				
Instalment sale credit and leasing finance	43,4	-12,3	6,0	3,7
Mortgage advances....................................	192,2	33,2	16,1	13,0
Other loans and advances..........................	208,8	206,7	25,0	26,9
Overdrafts	*26,4*	*5,8*	*6,3*	*4,7*
General loans	*180,8*	*200,1*	*18,6*	*22,1*
Credit cards advances	*1,7*	*0,9*	*0,2*	*0,2*
Total loans and advances to the corporate sector..	444,5	227,6	47,2	43,7
Total loans and advances to the private sector	978,9	651,1	100,0	100,0

* Expressed as a percentage of outstanding balance of total loans and advances

Owing to the changing composition of credit demand by the household sector, general loans, expressed as a ratio of total loans and advances to households, more than doubled from just above 7 per cent in early 2009, to 14,8 per cent in May 2013, while mortgage advances fell back consistently from a high of 70,2 per cent in November 2009 to 60,3 per cent in May 2013.

Mortgage advances and general loans as a ratio of total loans and advances to households



The pricing model presented by the NCA for unsecured loans has played a major role in banks' increased appetite for unsecured loans where global and domestic monetary policy interest rates remain at an all-time low. Consumers take up general loans because of the ease of access to such loans; the growing impact of debt counselling; the preference for one loan rather than many; or an improved monthly cash flow due to term extension. Despite the robust growth in the unsecured lending market, a slowdown became evident towards the end of 2012 as most banks started to exercise greater restraint in order to manage their exposure to this market segment.

The corporate sector also increasingly opted to utilise general loans and as a result *other loans and advances* (inclusive of general loans, credit card advances and overdrafts) outperformed mortgage advances and became the dominant driver behind the overall increase in total loans and advances throughout 2011, 2012 and the first half of 2013. Whereas other loans and advances constituted 33,4 per cent of total loans and advances in 2009, it expanded to 39,8 per cent in 2012. From 2009 to 2012 the value of other loans and advances grew at a compound annual growth rate of 13,6 per cent, compared to only 2,8 per cent for mortgage advances over the same period.

After an extended downward phase in the aftermath of the financial crisis, *instalment sale credit and leasing finance* only returned to positive growth in late 2010. Twelve-month growth has since recovered from a record low of minus 6,1 per cent in November 2009 to a high of 14,0 per cent in April 2013. The substantial surge was driven by the instalment sale credit category with replacement demand, a competitive trading environment, new technology models introduced and low debt servicing costs providing impetus towards strong vehicle, furniture and appliance sales. Progressive changes in tax legislation relating to car allowances and travel claims, together with the introduction of the National Credit Act with its allowance for more lenient repayment terms on credit, has contributed to a waning in popularity of leasing finance. The share of instalment sale credit and leasing finance in total loans and advances amounted to 12,7 per cent in both 2009 and 2012.

In the five years to December 2007, credit extension to the household sector grew by R534 billion while that to the corporate sector grew by R445 billion. In the subsequent five years to 2012 the household sector dominated growth in total loans and advances with an overall increase of R424 billion, nearly double that of the corporate sector as corporate demand for bank credit remained modest in the post-crisis recovery phase. Weak domestic economic conditions which remained vulnerable to global uncertainty and shifting financial market conditions probably contributed to companies curtailing their spending and focussing on strengthening their balance sheets.

Bank loans and advances to companies compared to bond issuance and deposit growth

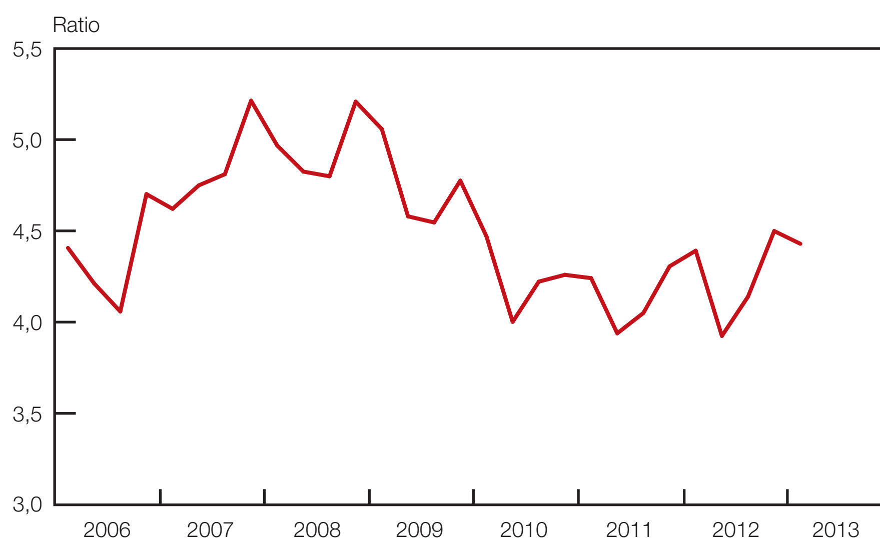
* Excluding government bonds. Source: JSE Limited

Alternative forms of financing available to companies, such as the issuance of debt securities due to the favourable interest rate environment coupled with high investor demand, probably also contributed to the reduced demand for bank credit. Nonetheless, the total outstanding value of bonds issued by private non-bank institutions on the JSE, which amounted to R109 billion in May 2013, remains small in comparison to the R1 012 billion outstanding balance on loans and advances to companies for the same period.

Because of the recovering growth in operating surpluses and subdued growth in bank loans and advances to companies,[7] the debt-to-income ratio of companies gradually improved from a peak of 5,2 in the last quarter of 2008 to a low of 3,9 in the second quarter of 2012. Since then corporate profits weakened somewhat while growth in companies' credit uptake fluctuated sideways, resulting in a moderate increase in the proxy for the debt-to-income ratio to 4,4 in the first quarter of 2013.

7 The gross operating surplus of companies represents the balance of funds available after intermediate consumption, labour input costs and other taxes on production have been deducted from the operating income of business enterprises. A debt-to-income ratio can be derived by dividing the loans and advances to companies by their gross operating surplus.

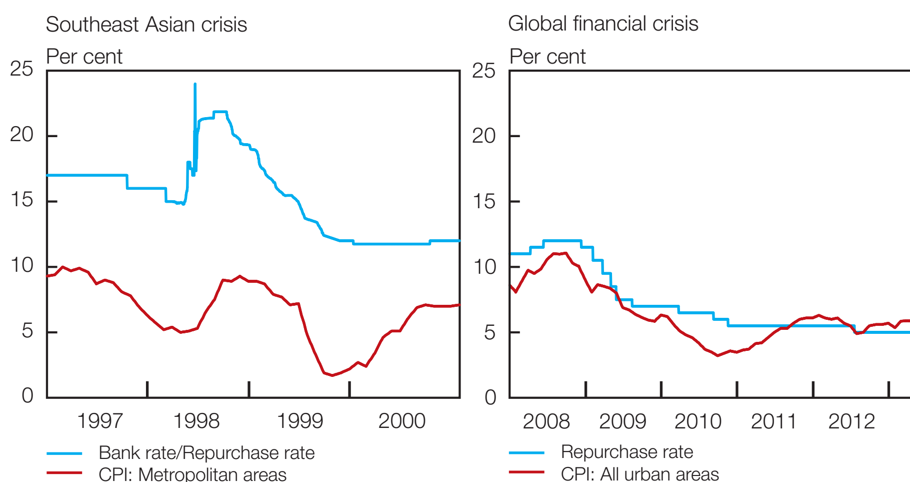
Loans and advances to companies as a ratio of their gross operating surplus



Interest rates and yields

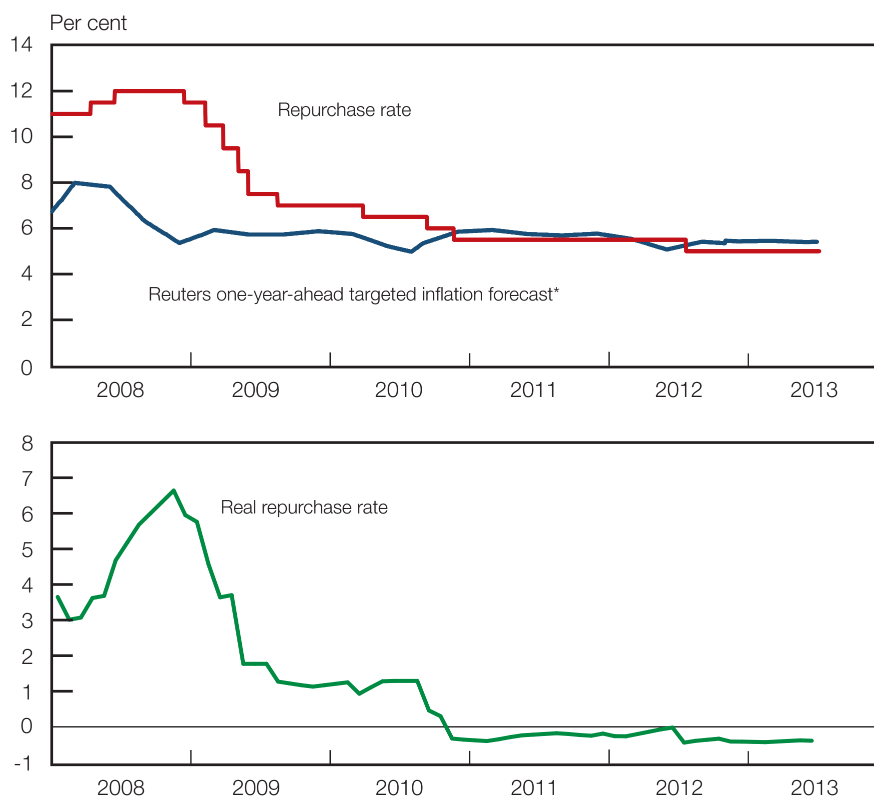
After having kept the policy interest rate unchanged for 20 months the Monetary Policy Committee (MPC) of the Bank lowered the repurchase rate to 5,0 per cent from 20 July 2012. This brought the policy rate to its lowest level since early in 1980. The more accommodative policy stance was brought about by concerns about continued slack in the domestic economy, aggravated by the knock-on effects of the protracted problems in the euro area.

Policy rates and inflation during crisis periods

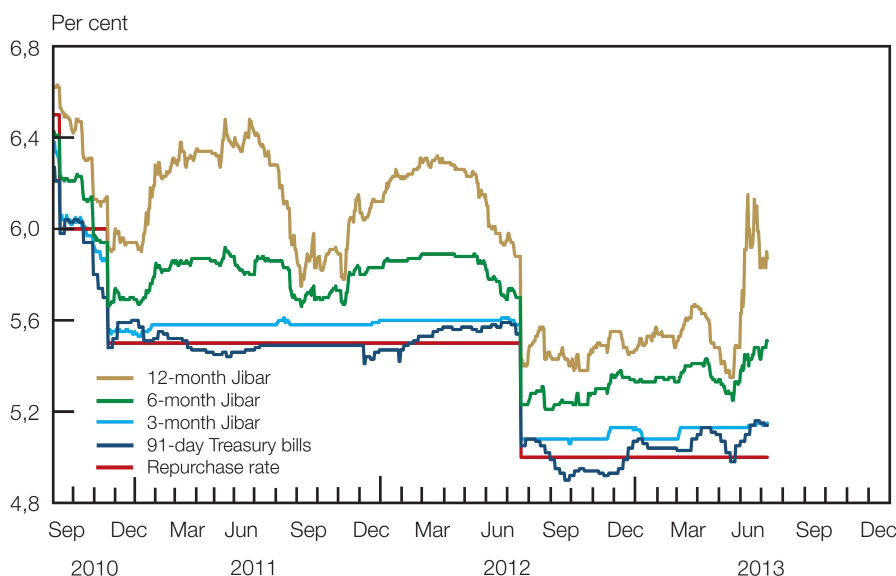


In the subsequent period to July 2013, the policy stance was deemed to be appropriately accommodative, given the persistence of a negative output gap. While global developments continued to affect South Africa's economic growth and inflation outcomes, the upside risks to inflation were to some extent neutralised by the general absence of demand pressures in the economy due to subdued economic growth prospects.

The broad direction of the monetary policy response to the after-effects of the global financial crisis did not differ substantially from the actions taken in the aftermath of the Asian financial crisis, when the policy rate was reduced to support the recovery of the domestic economy once inflation started moderating. A noticeable difference pertains to the magnitude of the real policy rates. The current accommodative stance has resulted in real interest rates that have been negative since November 2010. The lower real rates have lowered the real cost of borrowing as well as money-market investment returns for companies and households.



In the past 18 months fluctuations in money-market rates were relatively muted alongside the limited movement in the repurchase rate. While the degree of volatility varied across the different rates, short-term money-market rates were relatively stable, while longer-dated instruments on occasion discounted the possibility of policy tightening when the exchange value of the rand depreciated. This again occurred at the end of May 2013 when money-market rates rose sharply in response to a deterioration in inflation expectations emanating from the steep depreciation in the exchange rate of the rand. During this period the twelve-month Johannesburg Interbank Agreed Rate (Jibar) increased abruptly from 5,35 per cent on 21 May to 6,15 per cent on 11 June but improved somewhat to 5,84 per cent by mid-July when the exchange rate stabilised. The three-month Jibar, which generally serves as a benchmark rate for other money-market contracts, showed less volatility and essentially remained unchanged at 5,13 per cent for most of the first half of 2013. The rate on 91-day Treasury bills displayed an upward bias as it fluctuated higher from a recent low of 4,90 per cent at the end of September 2012 to 5,12 per cent on 13 July 2013.

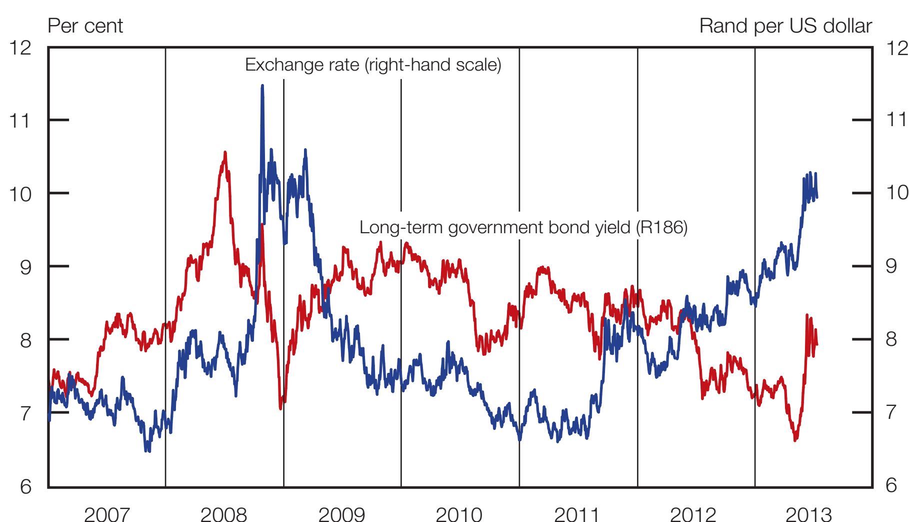


Forward rate agreements (FRAs), across the maturity spectrum, have generally been following a declining trend alongside the monetary accommodation cycle which started in late 2008. Sporadic inflation concerns interrupted the downward trend in these forward-looking rates in early 2011 and again in early 2012. However, FRA rates followed the repurchase rate lower in July 2012 before starting to fluctuate higher during the final months of 2012 when the depreciation of the exchange rate of the rand started to impact on inflation prospects. The upward trend extended into 2013 as the market increasingly priced out any likelihood of further monetary policy easing, followed by a sharp rise in especially longer-term forward rates from the end of May when the rand depreciated further. Since then forward rates moderated lower, with the 9x12 month FRA declining from 6,54 per cent on 11 June 2013 to around 5,8 per cent by mid-July.

Consistent with the orderly conditions that prevailed in the interbank lending market, 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 fairly stable for most of 2012 before adjusting lower in response to the change in the repurchase rate on 20 July 2012. The overnight FX rate, together with the Sabor rate, fluctuated well within the standing facility limits during the first six months of 2013, reflecting the efficiency of the interbank market during this period. The rates respectively stood at 5,05 and 4,81 per cent on 12 July 2013.

Alongside the reduction in the repurchase rate on 20 July 2012, the predominant rate on mortgage loans declined by 50 basis points to 8,50 per cent, recording its lowest level since early 1974. Other deposit and lending rates offered by banks also trended lower and have since remained fairly closely aligned with the unchanged policy rate.

After a significant run in the bond market with bond yields reaching record lows, the scenario changed from May 2013 as bond yields rebounded. The daily average *yield on the R186 government bond* (maturing in 2025/26/27) declined prominently from 8,38 per cent on 1 June 2012 to 7,53 per cent on 1 October 2012, the date of the inclusion of South African government bonds in Citi's World Government Bond Index (WGBI), before declining further to an all-time low of 6,61 per cent on 3 May 2013. This followed strong demand by non-residents for local bonds, increased global liquidity and better-than-expected inflation outcomes. Thereafter, the yield on the R186 government bond rose to 7,93 per cent on 11 July 2013, following the depreciation in the exchange value of the rand, higher inflation expectations and the sell-off of local bonds by non-residents. Similarly, international bond yields trended higher from May 2013.



The reversal in bond market yields from May 2013 was also evident in the *break-even inflation rate*. This proxy for expected long-term inflation, calculated as the differential between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds within the ten-to-thirteen-year maturity range, initially decreased by 57 basis points from 8 October 2012 to 3 May 2013. Inflation expectations subsequently picked up and the break-even inflation rate increased by 21 basis points to 6,17 per cent on 11 July.

Yields on South African government bonds – both those denominated in rand and in US dollar – have increased since May 2013. The *currency risk premium*[8] on South African government bonds narrowed from 438 basis points in November 2012 to 327 basis points in April 2013, and even further to 250 basis points in June as the US dollar-denominated yield increased more pronouncedly. The JPMorgan Emerging Markets Bond Index Plus (EMBI+)[9] spread above US government bonds narrowed from a recent high of 419 basis points in May 2012 to 278 basis points in April 2013, before widening to 342 basis points in June. Similarly, the *sovereign risk premium* over US government bonds on the South African government US dollar-denominated bonds in the eleven-year maturity range decreased from an average of 238 basis points in May 2012 to 170 basis points in May 2013, before widening to 226 basis points in June.

8 The differential between the South African government bond yield on rand-denominated debt issued in the domestic market and the yield on South African government US dollar-denominated bonds issued in the United States, both in the eleven-to-thirteen-year maturity range.

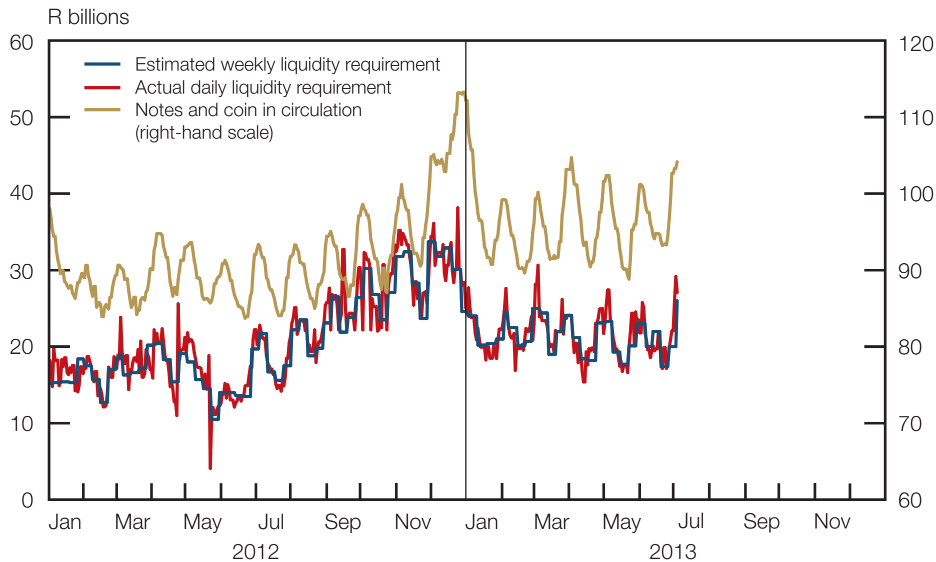
9 EMBI+ measures total returns on US dollar-denominated debt instruments of emerging-market economies.

Money market

The money market liquidity requirement of private-sector banks widened in 2012 and the early months of 2013, influenced in particular by re-balancing by banks to ensure their adherence to the statutory reserve requirements and by short-lived seasonal surges such as over the end-of-the-year festive season and during the Easter holidays when demand for liquidity increased.

Liquidity requirement

R billions



On average, the daily liquidity requirement ranged between R12,1 billion and R38,2 billion between June and December 2012, and between R15,4 billion and R30,6 billion in the first six months of 2013, representing a somewhat narrower dispersion of values than previously. 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 –)

	2012		2013
	Jan–Jun	Jul–Dec	Jan–Jun
Notes and coin in circulation	9,4	-20,2	9,3
Required cash reserve deposits	-3,7	-2,9	-2,7
Money-market effect of SARB* foreign-exchange transactions	2,1	6,8	14,9
Government deposits with the SARB*	0,3	-6,8	3,5
Use of liquidity management instruments	2,1	11,7	-5,2
Reverse repurchase transactions	-0,3	1,7	-2,2
SARB* debentures	2,4	10,0	-3,0
Other items net	-12,8	6,5	-15,2
Banks' liquidity requirement (decrease + increase –)	-2,6	-4,9	4,6

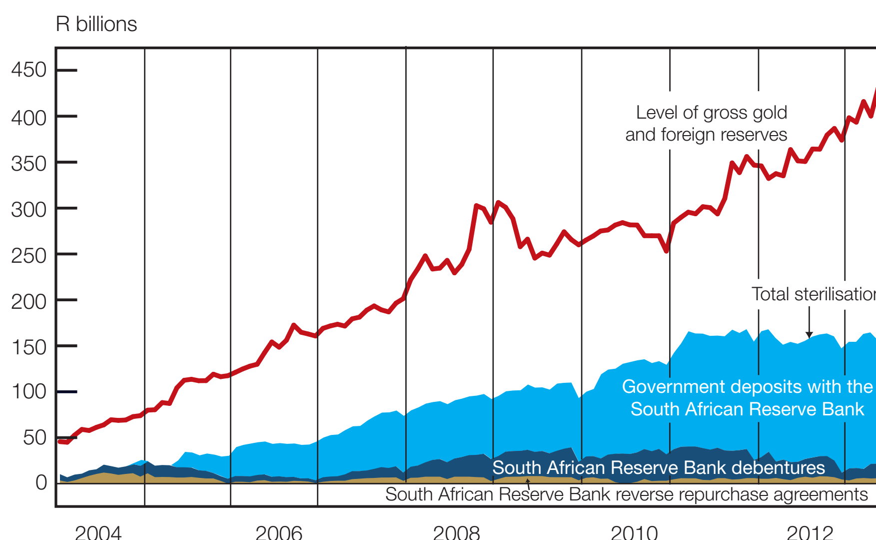
* SARB: South African Reserve Bank

An increase in notes and coin in circulation outside the Reserve Bank, resulting from a greater demand for cash by the public, has a contracting effect on money-market liquidity, and vice versa. For the period July 2012 to June 2013 notes and coin in circulation drained liquidity to the amount of R10,9 billion from the money market.

In terms of the Banks Act, 1990 (Act No. 94 of 1990) and the Regulations relating to Banks, commercial banks are required to hold 2,5 per cent of their total liabilities, as adjusted, in cash on their cash reserve accounts with the Bank. Commercial banks have access to their cash reserve balances on a daily basis as long as they comply with the statutory cash reserve requirement on an average basis over each maintenance period which covers a period of fourteen working days. In the twelve months to June 2013 private banks' required cash reserve deposits with the Bank drained liquidity to the amount of R5,6 billion.

In the twelve months to June 2013 foreign-exchange transactions by the Bank for reserve accumulation and other purposes served to inject liquidity in the amount of R21,7 billion. Part of the increase was offset by a rise of R3,3 billion in government deposits with the Bank. Government deposits with the monetary authority served to drain liquidity from the money market by diverting these funds away from the Tax and Loan accounts with private-sector banks. In total, foreign exchange reserves of the Bank amounted to R421 billion at the end of June 2013.

As part of its monetary operations, the Bank conducts fixed-rate repurchase auctions, or issues its own debentures to drain surplus liquidity from the market. The rate at which the main repurchase auctions are conducted is determined by the MPC. Reverse repurchase transactions by the Bank served to drain liquidity to the value of R0,5 billion during the twelve-month period to June, while SARB debentures to the value of R7,0 billion were allowed to mature, thereby easing liquidity in the market. At the end of June 2013 the outstanding balance on SARB debentures stood at R10,4 billion while reverse repurchase transactions stood at R6,8 billion.



Bond market

Net issues of fixed-interest securities in the South African *primary bond market* increased from R199 billion in 2011 to an annual record high of R269 billion in 2012. As indicated in the accompanying table, national government remained responsible for the bulk of net issuances in the bond market. This also showed in the amounts allotted at the weekly government bond auctions, which rose from around R2,9 billion in March 2013 to around R3,2 billion from April, reflecting the government's larger projected budget deficit. Given the redemption of the R189 inflation-linked government bond in March 2013, net issues of R78,2 billion by the public sector in the first half of 2013 were lower than the R95,6 billion raised in the same period of 2012.

Net issuances of bonds and commercial paper by issuer

R billions

	2011	2012	January to June 2013	Amount in issue as at 30 June 2013
National government	149	176	63	1 089
Public enterprises	10	15	13	218
Local governments	-1	-0,3	2	16
Banks	31	55	-0,2	235
Non-bank private companies	7	28	9	103
Securitisation	1	-2	6	80
Non-residents	2	-2	-1	6
Total	199	269	92	1 747

Net bond issuances of R80 billion by the private sector in 2012 were more than double those recorded in 2011 and were dominated by net issues by banks. This changed in the first half of 2013, when bond funding activity was mostly driven by non-bank private companies. However, net issuances of R15,4 billion by companies in the private sector in the first six months of 2013 were lower than the R48,3 billion raised in the same period of 2012. The total nominal value of debt securities listed on the JSE increased by 19 per cent in 2012 and by a further 6 per cent in the first six months of 2013 to reach R1,7 trillion at the end of June.

As shown in the accompanying table, trade in national government bonds was responsible for no less than 95 per cent of total turnover in the *secondary bond market.* After the daily average turnover increased from R91 billion per day in 2011 to R101 billion in 2012, it waned to R97 billion per day in the first half of 2013. As the increase in the value of bonds listed exceeded that of the value traded, the liquidity[10] in the bond market decreased from a ratio of 15,1 times per annum in 2011 to 13,8 times in 2012 before further decreasing to an annualised liquidity ratio of 12,3 times in the first half of 2013. After the All-Bond Index (ALBI) increased consistently from November 2012, it recorded its first monthly loss in May 2013, in line with the weaker rand and the sell-off of local bonds by non-residents. The ALBI has declined by 1 per cent thus far in 2013.

10 The nominal value of bonds traded relative to the nominal amount in issue, measured in times traded per annum.

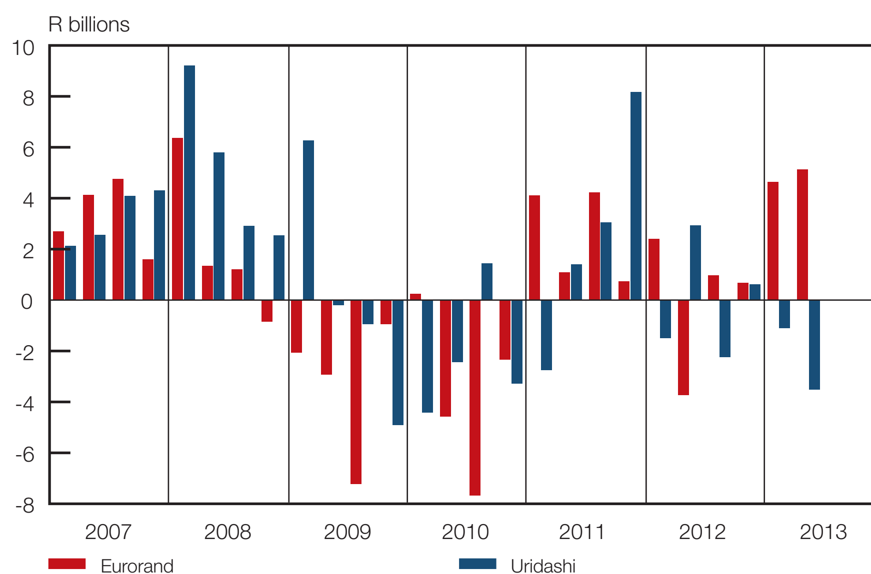
Turnover in the secondary bond market across issuers

R billions

Bonds issued by:	2011	2012	January to June 2013
National government	21 703	23 997	11 422
Public enterprises	595	590	237
Local governments	18	22	18
Private companies	566	665	322
Total	22 882	25 274	11 999

The issuances of rand-denominated bonds by non-residents in the *European and Japanese Uridashi bond markets* were adversely affected by concerns over the European debt crisis, the faltering global economic recovery and the downgrading of South Africa's sovereign credit rating in 2012. Net issuances of rand-denominated bonds in both markets amounted to only R0,1 billion in 2012, compared with R20,0 billion recorded in 2011. Non-resident interest in issuing rand-denominated bonds in the European bond markets, however, rebounded strongly in 2013. Net issues of R9,8 billion were recorded in the six months to June 2013, compared with net issues of only R0,3 billion registered in the whole of 2012. New issuances of rand-denominated bonds in the Japanese Uridashi bond market continued at a slower pace in 2013, giving rise to net redemptions of R4,6 billion in the first six months of 2013, compared with net issues of R1,4 billion in the same period of 2012. As a result, total net issues of R5,2 billion in both markets were recorded in the first half of 2013.

Net issues of rand-denominated bonds in the European and Uridashi bond markets



Following the announcement in April 2012 of the possible inclusion of South African government bonds in the WGBI and the subsequent confirmation in June 2012, net purchases of local bonds by *non-residents* soared to R28,6 billion in the second quarter of 2012 and R28,8 billion in the third quarter. Since the actual inclusion of the local government bonds in the WGBI on 1 October 2012, net purchases remained around R10,6 billion in the fourth quarter of 2012 and R9,9 billion in the first quarter of 2013, weighed down by unrest in the mining sector and the downgrading of South Africa's sovereign credit rating. After net purchases of R9,7 billion in April 2013, non-residents reduced their holdings of local bonds by R17,4 billion in May and June – their first monthly net sales since May 2012 – on speculation that a weakening rand would stoke inflation. Non-residents currently own about 37 per cent of government bonds issued in the domestic bond market.

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 R78,1 billion in 2012. This was 11 per cent lower than the amount raised in 2011. In line with the subdued economic growth, equity funding of R34,1 billion raised in the first half of 2013 was 21 per cent lower than the equity capital raised in the corresponding period of 2012. Companies with primary listings on the JSE accounted for 65 per cent of total capital-raising activity in 2012, with this contribution increasing to 75 per cent in the six months to June 2013.

The total *number of listed companies* on all boards of the JSE decreased from 406 at the end of 2011 to 400 at the end of 2012 as the number of delistings had exceeded the number of new listings. This pattern continued in the first half of 2013, bringing the total number of companies listed on the JSE to 394 at the end of June. The listings breakdown across the different boards for 2013 is shown in the accompanying table.

Listings breakdown on the JSE Limited, January to June 2013

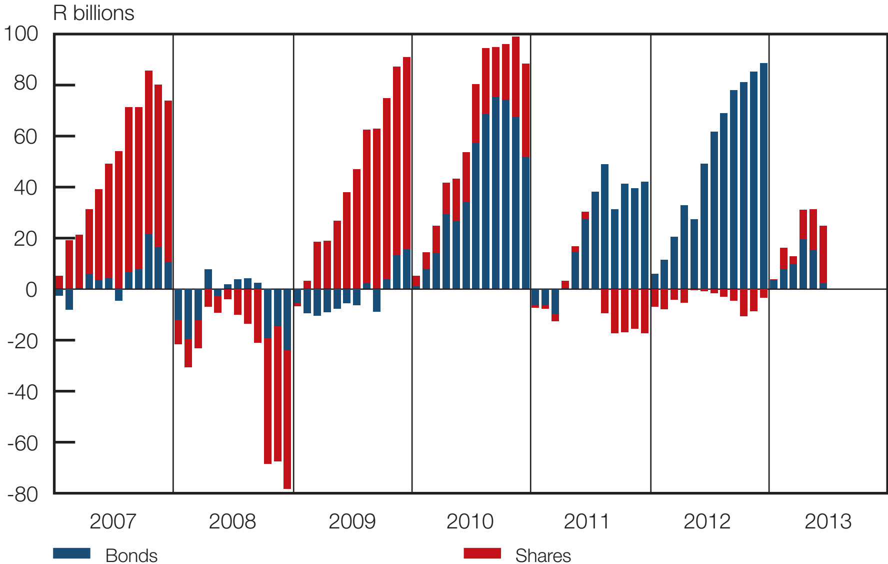
	Alt[x]	Venture and Development Capital boards	Main board	Total
New listings	2	0	1	3
Transfers (in)	0	0	1	1
Delistings	3	0	6	9
Transfers (out)	1	0	0	1
Total, 30 June 2013	61	5	328	394

Total *turnover* on the JSE increased by only 4 per cent from R3,3 trillion in 2011 to R3,4 trillion in 2012. Boosted by higher volumes traded and higher share prices, turnover was 22 per cent higher in the first half of 2013 when compared with the same period of 2012 and included an all-time high monthly turnover of R393 billion recorded in May 2013. The total *market capitalisation* of the JSE benefited from the amplified share prices, increasing from R8,4 trillion in April 2013 to an all-time high of R9,1 trillion in May, before declining to R8,6 trillion in June. As market capitalisation increased more pronouncedly than turnover, market liquidity[11] decreased from 48 per cent in 2011 to 41 per cent in 2012. This changed in the first half of 2013 as liquidity in the secondary share market rebounded to 50 per cent, in conjunction with the significant increase in turnover.

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

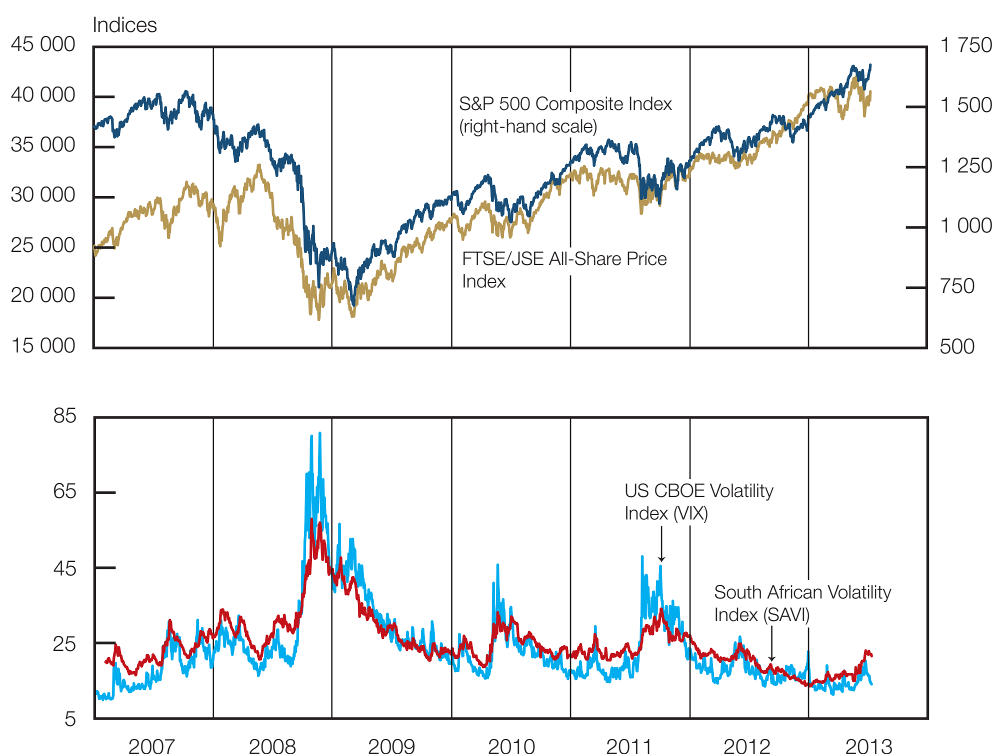
After recording net sales of local shares for two consecutive years amounting to R17,2 billion in 2011 and R3,4 billion in 2012, *non-residents'* interest in the local share market strengthened in 2013. Non-residents increased their holdings of domestic shares by R3,0 billion in the first quarter of 2013, despite recording net sales of R5,4 billion in March. This positive trend continued in the second quarter as non-residents increased their exposure to local shares with net purchases of R19,7 billion – the largest quarterly net purchases since the third quarter of 2009. The reallocation of investment portfolios from debt securities to the shares asset class was in line with the slump in bond markets globally and the depreciation in the exchange value of the rand. Non-residents currently own about 21 per cent of the equities listed on the JSE.

Non-resident annual cumulative net transactions in local securities



Together with lower expected volatility in the equity market as measured by the South African Volatility Index, domestic share prices reached successive record highs in 2012 and 2013. This was despite the subdued economic growth, high historical price-earnings ratios and elevated price-to-sales ratios. The *FTSE/JSE All-Share Price Index* (Alsi) breached the 40 000 index points level in 2013, increasing by 48 per cent from a recent low of 28 391 index points on 8 August 2011 to a new all-time high of 42 016 index points on 31 May 2013. This was as a result of, among other things, the depreciation in the exchange value of the rand, higher international equity prices and positive global market sentiment. Subsequently, the Alsi tracked global equity markets and international commodity prices lower, declining by 4 per cent to 40 543 index points on 11 July, mainly on concerns that the major central banks may scale back their bond-buying or monetary stimulus programmes. In US dollar terms, the Alsi, however, declined by 0,4 per cent from 8 August 2011 to 11 July 2013, while the US Standard & Poor's (S&P) 500 Composite Index reached all-time high levels as it rose strongly by 50 per cent over the same period.

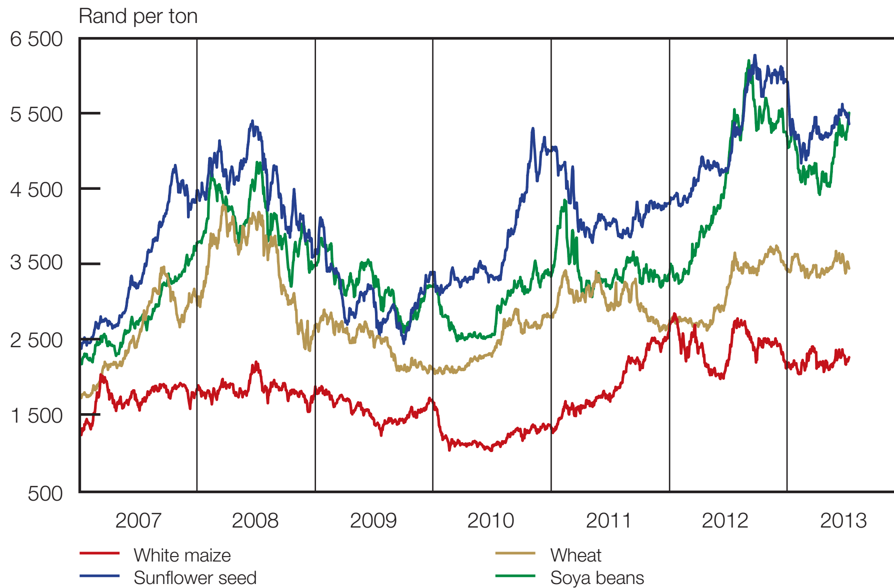
Share prices in local currency and volatility in equity markets



Market for exchange-traded derivatives

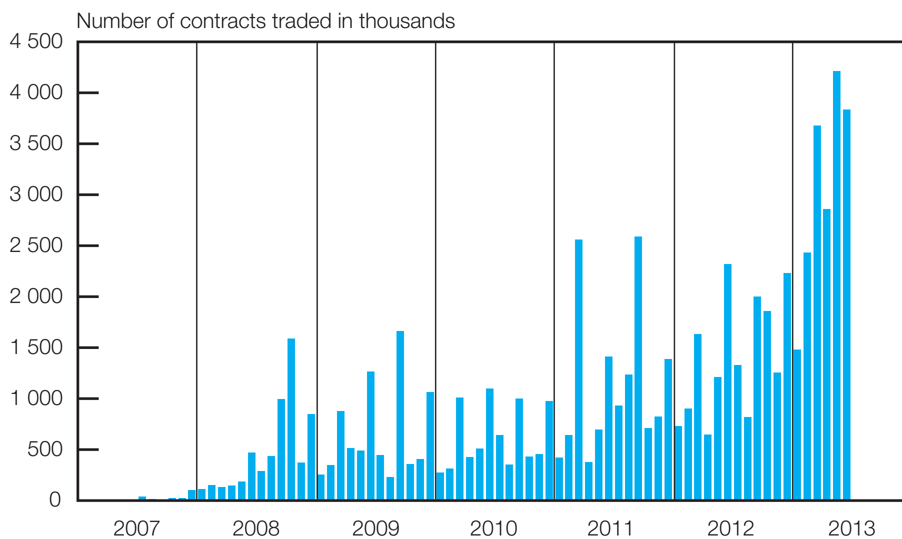
Trading volumes increased by 13 per cent in 2012, and by a further 2 per cent if the 1,5 million *commodity futures and options* contracts traded on the JSE during the first six months of 2013 is compared with the number traded in the corresponding period of 2012. This was amid higher grain prices globally in 2012. International grain prices increased during most of 2012, largely as a result of bad weather conditions and strong demand for grain, before declining in the first half of 2013. Domestic agricultural prices declined in concert with international prices, despite the depreciation in the exchange value of the rand.

Local grain prices



Since the launch of *currency derivatives* in June 2007, these products have become a useful tool to hedge against adverse developments in the foreign-exchange market, with notable growth experienced in trading activity, value traded and new products listed in this market. In 2011 the product range was broadened through the development of more flexible and participant-customised products, namely 'can-do' and 'any-day' contracts. The depreciation in the exchange value of the rand contributed to record-high trading volumes in the currency derivatives market in 2013. The 18,5 million contracts traded in the first half of 2013 was 149 per cent more than the volume traded in the corresponding period of 2012. Of the total trading activity in currency derivatives, trade in US$/R contracts accounted for 80 per cent thus far in 2013.

Trading activity in currency derivatives on the JSE



Turnover in all derivatives traded on the JSE during 2012 and the first half of 2013 is indicated in the accompanying table.

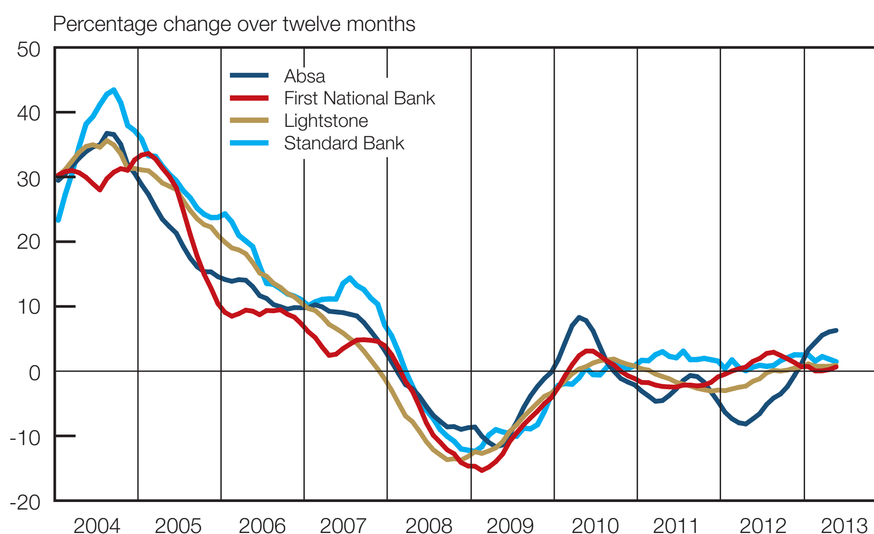
Turnover in exchange-traded derivatives

	Value		Change over one year	
	2012 (R billions)	Jan–Jun 2013 (R billions)	2012 (Per cent)	Jan–Jun 2013 (Per cent)
Equity derivatives	4 325	2 486	-0,1	18
Equity index	4 059	2 403	-1	19
Single stock	266	83	26	-5
Warrants	1	0,3	-50	-25
Commodity derivatives	511	255	29	15
Maize	314	143	29	8
Wheat	88	47	31	23
Currency derivatives	157	179	24	154
US dollar/Rand	116	140	10	185
Interest rate derivatives	325	273	46	96
Bonds	256	232	90	123
Index	69	41	-22	16

Real-estate market

In line with low growth in mortgage advances, residential property sale-in-execution notices issued by banks were also subdued in the past two years when compared with the high levels reached in 2009. Although nominal house prices on a year-on-year basis showed growth rates of between 7 and 12 per cent by the end of the first half of 2013, in real terms – adjusted for consumer price inflation – all property barometers shown in the accompanying graph portrayed growth rates of 6 per cent and lower over this period. Alongside a moderate acceleration in nominal house prices, activity in the construction of new houses has increased more pronouncedly thus far in 2013. The nominal value of residential buildings completed recorded a year-on-year increase of 19 per cent in the first four months of 2013, compared with growth of 8 per cent in 2012 and 2 per cent in 2011.

Real house prices



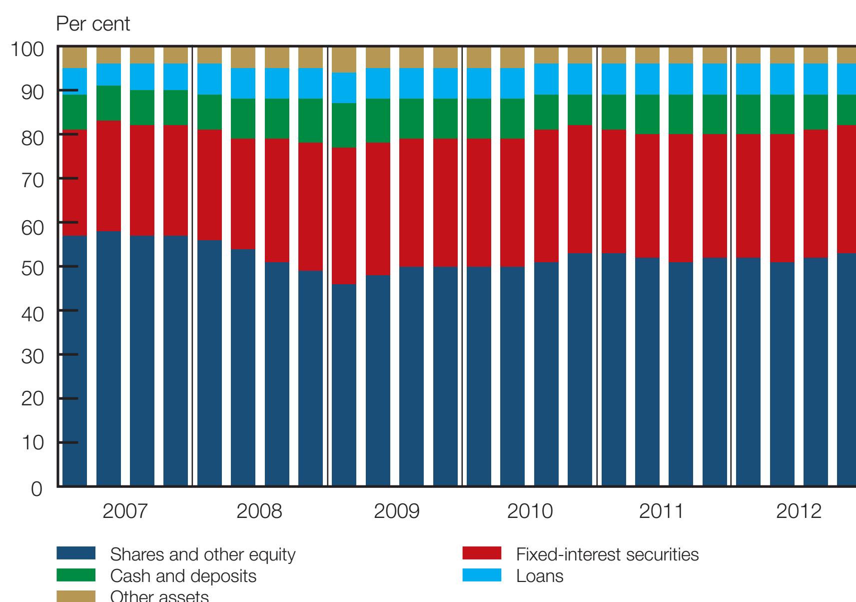
Non-bank financial intermediaries

The consolidated balance sheet of non-bank financial institutions[12] increased by 17 per cent from R5,1 trillion in 2011 to R6,0 trillion in 2012, outpacing the growth rate of 7 per cent from 2010 to 2011. These institutions' total assets of R6,3 trillion in the first quarter of 2013 were supported by new cash inflows which contributed to higher asset prices. The average annual growth rate in total assets for the period 2008 to 2012 amounted to 12 per cent, with the industry playing an important role in providing funds needed to support economic growth. Expressed as a ratio of gross domestic product, the total assets of non-bank financial institutions increased by a notable 14 percentage points from 2011 to 191 per cent in 2012. By contrast, the ratio of banking sector assets to gross domestic product fell by 1 percentage point to 116 per cent over the same period.

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

The rapid growth in total assets of these institutions was mainly due to the Public Investment Corporation and unit trusts, whose assets had increased by 22 per cent and 23 per cent from 2011 to 2012. Insurers' assets rose by 14 per cent to R1,9 trillion over the same period.

The non-bank financial intermediaries' holding of shares as a percentage of total assets increased from 52 per cent in 2011 to 53 per cent in 2012. Exposure to this asset class was some 4 percentage points below the high of 57 per cent recorded in 2006, despite substantial increases in the equity prices over the same period. The protracted weak economic recovery and changes in the regulatory landscape, such as the Regulation 28 stipulations and Solvency Assessment and Management regime (SAM), which place investment limits on retirement funds and more stringent capital-adequacy requirements on risky assets for insurers, are likely to impact on equity holdings of these intermediaries in the future. Similarly, further increases in share prices, a rebound in economic activity and prospects of higher company earnings may support an increase in equity holdings.



Holdings of fixed-interest securities rose from 28 per cent of the balance sheet in 2011 to 29 per cent in 2012. The demand for this asset class was mostly from insurers and pension funds. The ratio of fixed-interest securities to total assets averaged 29 per cent for the period 2008 to 2012. However, a higher rate of inflation and an increase in bond yields are likely to impact on investment into this asset class.

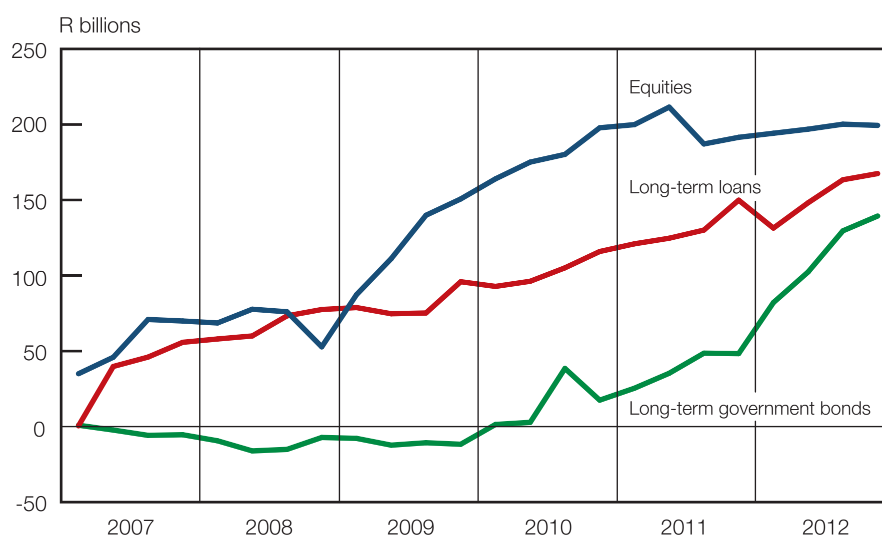
The proportion of funds held in cash and near-cash instruments to total assets fell from 9 per cent in 2011 to 7 per cent in 2012 on the back of lower interest rates. The reallocation of funds

from cash probably reflects improved investors' sentiment, as this happened despite somewhat increased volatility in the financial markets. The total value of loans extended by these institutions amounted to R396 billion in 2012. Although the loan book of this sector is relatively small when compared to that of the banking sector, it accounted for 7 per cent of the industry's total assets in both 2011 and 2012. This indicates the ongoing role of non-bank financial intermediaries in extending credit to households and companies to finance both consumption and capital expenditure.

Flow of funds

Funds sourced from *non-residents* increased in 2012, in tandem with the larger financing requirement of the domestic economy. At R197 billion, non-residents' augmentation of the domestic gross savings was twice the amount recorded in 2011. Long-term government bonds and loans were the primary instruments for channelling funds to the local economy, as non-residents generally preferred high-yielding emerging-market financial instruments. Non-residents bought R91 billion of long-term government bonds and extended loans amounting to R124 billion in 2012.

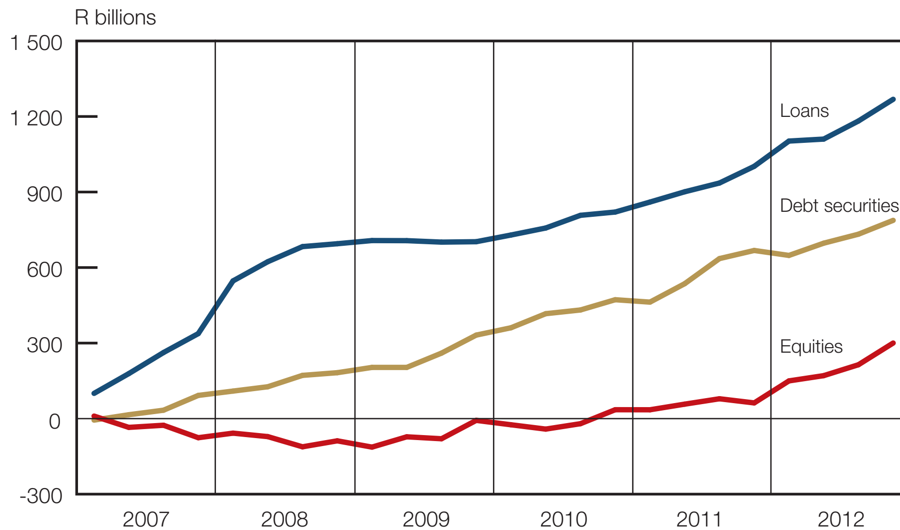
Cumulative foreign funding by instrument



Total flows into *financial intermediaries*[13] grew steadily from a low of R301 billion in 2009 to R692 billion in 2012 as the economy gradually recovered from the global financial crisis. Although the extension of loans improved somewhat from the extreme lows registered in the aftermath of the crisis, mortgage lending remained sluggish. From 2009, financial intermediaries effectively switched to debt securities and equity as their main form of directing funds into the economy.

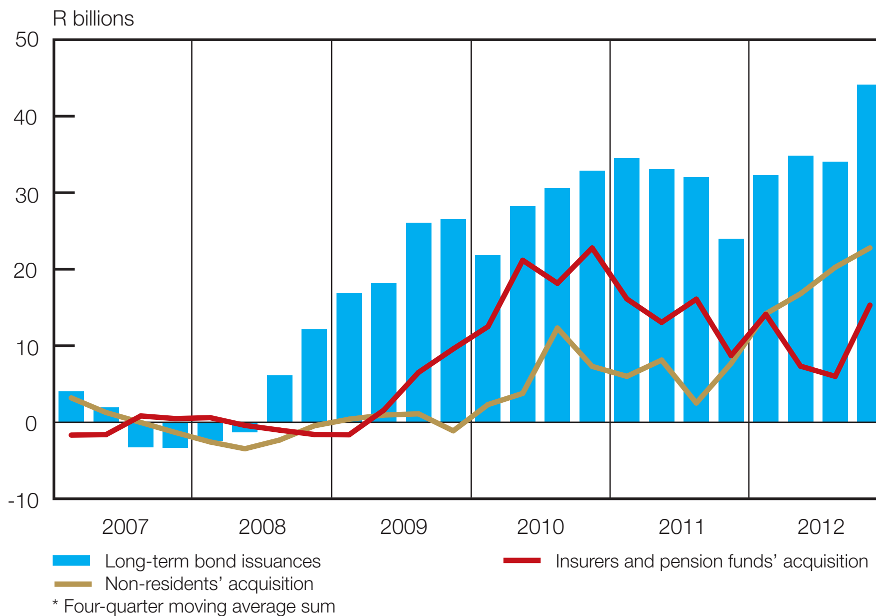
13 Comprising the monetary authority, banks, insurers, pension funds and other financial institutions.

Cumulative financial intermediation by type of instrument



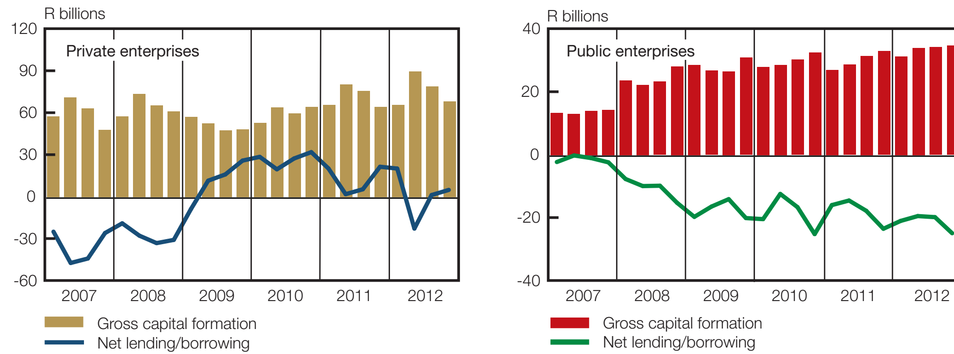
Revenue collection by the *general government* sector continued to fall short of expenditure in 2012, reflecting the government's countercyclical fiscal stance. Consequently, the general government sector recorded a deficit of R194 billion in 2012, which was mainly financed through the issuance of long-term paper. In particular, non-residents and domestic insurers and pension funds collectively purchased R152 billion worth of long-term government bonds over the period.

General government funding activity*



In 2012 the *corporate business sector* undertook R436 billion worth of gross capital formation. Infrastructure spending continued as private business enterprises embarked on construction work, purchasing machinery and equipment, while their public corporation counterparts' capital outlays went mainly into power plants and road networks. Private businesses' capital spending was financed by a combination of instruments, including equity issuance, loans and own funds. Public enterprises funded their infrastructure projects mainly through borrowing.

Corporate business enterprises: Capital formation and financial positions



Households' net acquisition of financial assets amounted to R136 billion in 2012, their cash and deposits increasing by R72 billion and their interest in retirement and life funds by R71 billion. However, a faster pace of net incurrence of financial liabilities resulted in households reporting a financing deficit of about R10 billion in 2012. The household sector took up R125 billion in loans, including mortgage loans amounting to R25 billion. Overall, conditions in the market for loanable funds remained relatively tight in 2012 as market players remained cautious.

Public finance

Fiscal policy stance

Following a process that started in 2009 with the release of The Green Paper on National Strategic Planning and Public Consultations, the National Planning commission was formed and assigned the role of developing a long-term vision and a broad strategic plan to achieve a future South Africa free of poverty and inequality. The mandate of this commission was to take a broad, cross-cutting, independent and critical view of a future South Africa, and to map out a path to achieve those long-term development objectives. The commission commenced with its work which culminated in the Minister for Planning in the Presidency handing the National Development Plan over to the State President at the joint sitting of the two houses of Parliament on 16 August 2012. All the parties in Parliament embraced the NDP and the vision for 2030 that it presented, while the ruling party also adopted the plan at its conference in December 2012.

On 27 February 2013 the Minister of Finance presented the National Budget to Parliament. The budget was tabled against the background of the new strategic framework for growth and development but without departing from the objective of fiscal sustainability. The 2013 Budget and future budgets would ensure that the strategic plans of national departments and their medium-term expenditure plans remained aligned with the realisation of government's objectives, using the NDP as its point of reference.

The major part of implementing the NDP would centre on proper planning, building public-sector capacity and enhancing accountability chains. The subsequent medium-term strategic framework would then identify the NDP priority objectives and actions over the next five-year term of government. The prioritised objectives would be reflected in departmental strategic plans, with key actions outlined in annual performance plans. In turn, departments and ministries would be held accountable by executive authorities and Parliament for meeting these objectives.

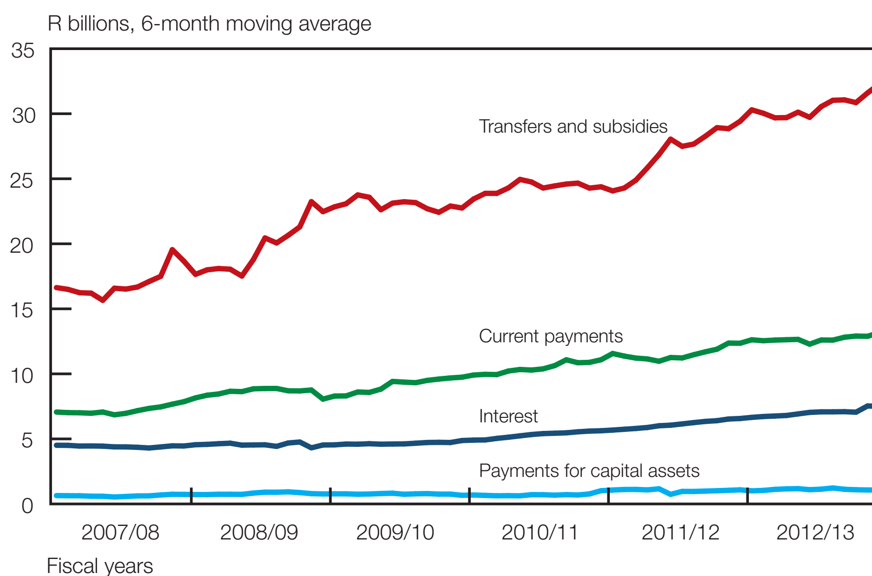
It should be noted that, should the economic environment deteriorate, realising government's fiscal objectives would require that spending and revenue plans be reconsidered. This would require containment of the deficit and debt stabilisation by trimming the medium-term expenditure plans. At the same time, government would ensure that national development is financed in a fiscally responsible manner, so that future generations inherit a healthy, growing economy that continues to create jobs but without carrying forward an unbearable debt burden.

Improved economic performance would be supported by strong capital investment by the public sector, additional electricity-generating capacity, water supply and rail capacity upgrades, relatively stable inflation, and low interest rates. Steps to expand employment, the provision of greater policy certainty, an improvement in education and training outcomes, and the acceleration of infrastructure investment to strengthen regional linkages were all seen as requirements for more rapid growth. In the light of these requirements, the proposed Medium-Term Expenditure Framework would have to take into account the prevailing fiscal constraints. The proposed disciplined spending trajectory and projected improved economic growth over the medium term would ensure sustainability of public finances.

In order to ensure the sustainability of government's fiscal activities, the 2013 Budget contained additional measures to control spending, thereby reducing real expenditure growth to an average of 2,3 per cent per annum over the next three years, relative to the 2,9 per cent indicated in the *Medium Term Budget Policy Statement (MTBPS) 2012*. The consolidated budget deficit was expected to decline from 5,2 per cent of gross domestic product in fiscal 2012/13 to 3,1 per cent in the outer year of the medium-term budget period. At the same time, the ratio of national government's gross loan debt to gross domestic product would stabilise at around 45 per cent in fiscal 2015/16 and then decline in subsequent years. This fiscal approach would require government departments to be more efficient in the use of public funds, allocating resources to strengthen service delivery.

National government expenditure

The 2012 Budget provided for national government expenditure to be focused on developing infrastructure, supporting job creation and improving local government services. Education, health care and social protection would continue to absorb the largest share of government's resources. The bulk of national government spending would consist of transfers to provincial governments – equitable share and conditional grants earmarked for specific purposes. These grants have grown strongly over the past decade and constitute the main source of revenue for provincial governments.



National government budgeted for a firm increase in spending in fiscal 2012/13, but the unaudited outcome of national government expenditure indicates an increase at a slower pace when compared with both the outcome of the previous fiscal year and the budget projections. Preliminary data indicate that national government expenditure totalled R962 billion in fiscal 2012/13, recording a year-on-year rate of increase of 8,4 per cent. The preliminary outcome was below the original budgetary provision and less than the revised estimate presented to Parliament by the Minister of Finance in February 2013. The growth in expenditure has averaged 12,7 per cent in the past ten years. As a ratio of gross domestic product, national government spending remained broadly unchanged at 29,9 per cent in both fiscal 2011/12 and 2012/13.

Spending by national government was mainly driven by an increase in voted amounts, consisting of current payments, transfers and subsidies, along with payments for capital assets. The Justice, Crime Prevention and Security Cluster accounted for the bulk of current payments. The increase in current payments by this cluster was driven by the Departments of Defence and Military Veterans, Justice and Constitutional Development, and Police. The last-mentioned department contributed just more than half of total current payments of this cluster. Increased spending by these departments resulted from the changes made to cost-of-living adjustment bonuses.

In fiscal 2012/13 total transfers and subsidies paid by national government recorded an increase of 7,9 per cent year on year, with the Social Services Cluster contributing the highest proportion. The increase in transfers by this cluster emanated from the Departments of Education, Health and Social Development. Transfers and subsidies paid by the departments responsible for education increased by 11,2 per cent year on year, and were mainly to improve the quality of learning in schools and to provide financial support to universities. The firm increase of 8,7 per cent in transfers by the Department of Social Development was mainly to provide income support to vulnerable groups.

Interest paid on national government debt equalled R88,1 billion in fiscal 2012/13, or 15,3 per cent more than in fiscal 2011/12. The increase was underpinned by the higher stock of domestic government bonds and Treasury bills outstanding on account of the sizeable fiscal deficit. Interest payments were originally budgeted to amount to R89,3 billion or increase by 16,9 per cent in fiscal 2012/13. It was revised slightly lower to amount to R88,7 billion in the *Budget Review 2013*. As a ratio of gross domestic product, interest costs amounted to 2,7 per cent, broadly the same as the ratio recorded a year earlier. This ratio is less than half the ratios reported in fiscal 1997/98 and 1998/99, when interest rates were comparatively high.

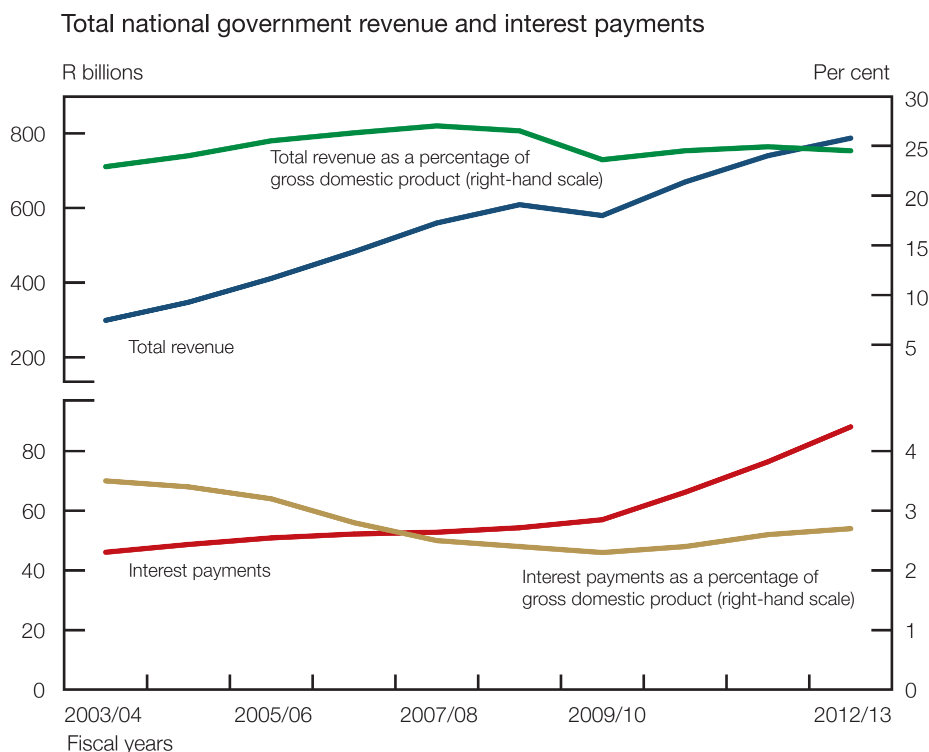
In fiscal 2012/13, the provincial equitable share of nationally raised revenue amounted to R313 billion or 7,3 per cent more than in the previous fiscal year, much higher than the originally budgeted increase of 5,9 per cent. Higher equitable share transfers to provinces reflected government's commitment to improved service delivery in the health and education sectors. Relative to gross domestic product, the provincial equitable share amounted to 9,7 per cent in 2012/13, in line with the trends seen since 2009/10. These transfers remain the major source of provincial revenue, given the much smaller revenue tax base in relation to the national and local spheres.

National government revenue

While the South African economy has continued to grow since the 2009 recession, the moderate pace of economic growth has adversely affected revenue performance. The revenue underperformance was largely the result of weak economic growth during the second half of 2012, as the economy had to cope with labour unrest and lower commodity prices. The continued downgrading of economic growth in South Africa's major trading partners was also unhelpful.

Total national government revenue amounted to R787 billion in fiscal 2012/13, or a year-on-year rate of increase of 6,3 per cent. This preliminary outcome, while falling short of the original budget, was still about R5 billion higher than the revised projections in the *Budget Review 2013*. National government revenue was originally budgeted to increase at a rate of 8,0 per cent and total R799 billion in fiscal 2012/13.

Total national government revenue and interest payments



National government revenue as a ratio of gross domestic product amounted to 24,5 per cent in fiscal 2012/13, slightly lower than the 24,9 per cent recorded in fiscal 2011/12. Net tax revenue as a ratio of gross domestic product was 24,0 per cent, broadly unchanged from the ratio recorded in the previous year. The tax burden has remained at these levels over the past three fiscal years, having reached a high of 26,4 per cent in fiscal 2007/08, the year in which government collected more taxes than budgeted for and recorded a budget surplus.

Before fiscal 2008/09, buoyant domestic economic conditions caused national government receipts to outperform originally budgeted projections in each of the fiscal years from 2000/01, with the exception of 2003/04, when the actual revenue outcome fell short of the budgeted projections. During fiscal 2003/04, the strength of the rand exchange rate had a ripple effect on mining and other export-orientated companies, negatively affecting their export proceeds, profitability and thus their tax payments.

In 2012/13 taxes on income, profits and capital gains – a major contributor to national government revenue – rose by less than the rate of increase anticipated in the budget estimates. This lower increase was the result of a weaker economy, job losses – which occurred particularly in the third quarter of fiscal 2012/13 – and generally lower wage settlements and bonuses. Collections from both corporate and personal income taxes fell short of originally budgeted projections.

14 Formerly Motor Industry Development Programme (MIDP).

Value-added tax (VAT) – the main component of taxes on goods and services – recorded a firm increase in fiscal 2012/13, and collections exceeded the originally budgeted amount. Strong growth in fuel levy and excise duties collected also contributed to the higher increase in taxes on goods and services. Domestic VAT recorded an increase of 10,1 per cent year on year, with small and medium-sized vendors contributing more than the large business vendors. Import VAT also showed a strong increase due to higher import volumes of machinery, vehicles and parts for the Automotive Production and Development Programme[14] (APDP). VAT refunds increased at a moderate rate of 5,9 per cent year on year, compared with a rate of 26,4 per cent in fiscal 2011/12. The labour unrest in the mining sector resulted in lower intermediate input costs and, to a lesser extent, constrained capital expenditure as production stalled in this sector. These developments had a significant impact on overall VAT refunds as mining is a major contributor to VAT refunds.

Receipts from taxes on international trade and transactions increased firmly in 2012/13. Customs duty collections rose notably, mainly due to the increase in imports of vehicles, beverages and tobacco products, buoyed by strong domestic demand.

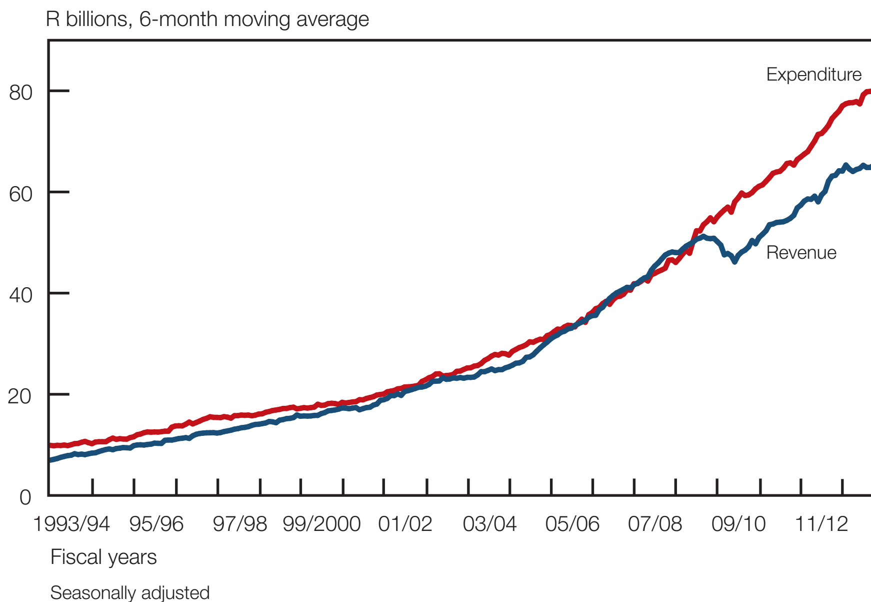
Transfers to South Africa's partners in the Southern African Customs Union amounted to R42,2 billion in fiscal 2012/13, the same as the originally budgeted amount. These payments almost doubled from the low base set in the previous fiscal year, following the global economic downturn.

Non-tax revenue amounted to R15,5 billion in fiscal 2012/13 – a decline of 19,3 per cent – which resulted mainly from the decline in collections of mineral and petroleum royalties as a result of lower profits recorded by mining companies.

National government deficit

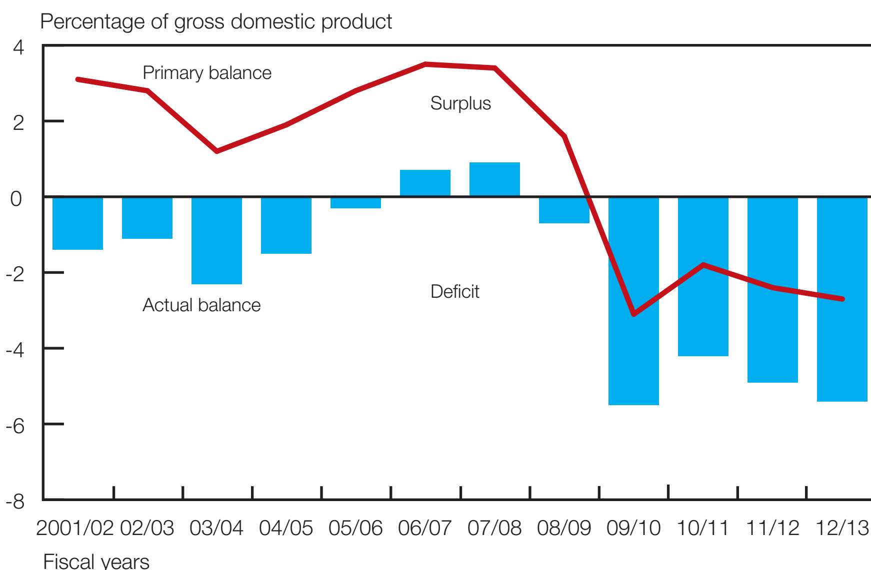
Fiscal 2012/13 was the fourth successive year of comparatively large deficits, following the onset of the global economic crisis, and the associated substantial reduction in revenue and upward adjustment in spending associated with the change in the economic outlook. In fiscal 2012/13 the continued lack of economic vigour resulted in a cash-book deficit before borrowing and debt repayment of R175 billion, or R27,6 billion higher than the cash-book deficit recorded in fiscal 2011/12. The cash-book deficit was originally budgeted to amount to R168 billion in fiscal 2012/13, but was revised upwards to R183 billion in the *Budget Review 2013*. As a ratio

of gross domestic product, the cash-book deficit amounted to 5,4 per cent in fiscal 2012/13, equivalent to the ratio recorded in fiscal 2009/10, when the full impact of the Great Recession first became visible in the public finances.



As an indicator of the sustainability and expansionary effect of fiscal policy, the primary balance,[15] or non-interest balance, is useful to augment both the conventional budget deficit and the government's current balance. The primary balance reached a deficit of R87,0 billion in fiscal 2012/13, equivalent to 2,7 per cent of gross domestic product and slightly higher than the ratio of 2,4 per cent recorded in the previous fiscal year. In the years preceding 2009/10, national government had been recording primary surpluses. 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. Budget 2013 allows for the primary deficit to narrow to average 1,5 per cent of gross domestic product over the medium term to 2015/16.

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



National government financing and debt

Government's debt management strategy is intended to keep the cost of debt low, ensure access to global and domestic markets, diversify funding instruments, and encourage the growth of South Africa's liquid capital market. Fiscal policy seeks to ensure that debt levels remain sustainable.

The net borrowing requirement recorded in fiscal 2012/13 was financed through the issuance of Treasury bills and domestic government bonds. National government continued to rely on domestic funding, with domestic debt accounting for the lion's share of government's total debt portfolio.

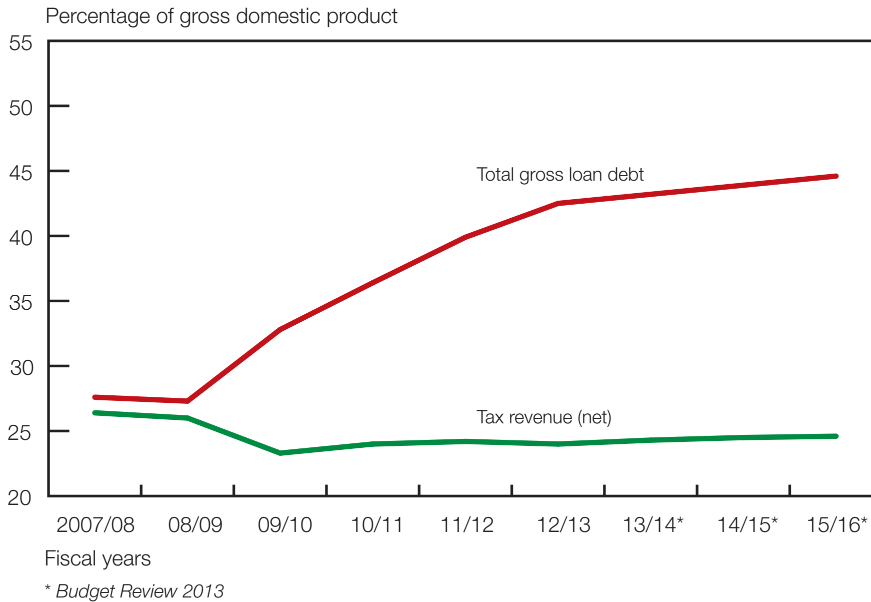
The net outcome of national government cash-flow revenue and expenditure was a cash-flow deficit of R123 billion in fiscal 2012/13 – much smaller than the cash-book deficit of R175 billion mentioned earlier. Given that 31 March 2013 fell over a long weekend, the significant difference between the cash-book deficit and cash-flow deficit stemmed from the expenditure side, owing to outstanding transfers of R34,4 billion. After accounting for extraordinary transactions and the profit on revaluation of maturing foreign debt, the net borrowing requirement totalled R122 billion in fiscal 2012/13. This net borrowing requirement could be compared with a borrowing requirement of R136 billion recorded in fiscal 2011/12.

Government comfortably raised R22,6 billion from domestic short-term financing sources (i.e., Treasury bills and loans from the Corporation for Public Deposits) and R120 billion from government bonds in fiscal 2012/13. Net issues of inflation-linked bonds worth R23,5 billion were recorded in the fiscal year under review, bringing the outstanding balance on these instruments to R244 billion at the end of fiscal 2012/13. Since August 2012, redemptions of retail bonds have exceeded issuances, due to a higher volume of scheduled redemptions on these instruments.

In fiscal 2012/13 the *R201* and *R206* bonds were partly redeemed and switched to bonds with longer-dated maturities. On 31 March 2013 National Treasury redeemed the remaining balance of R27,3 billion on the *R189* inflation-linked bond. However, as this date fell over a long weekend, the cash-flow transaction was only effected on 2 April 2013. Before the end of March 2013, R30,3 billion of the *R189* bond had already been redeemed and switched into other inflation-linked bonds. Government's bond-switch programme mitigates refinancing risk – the risk that government will not be able to raise the funds to repay debt at any scheduled redemption point, or will have to do so at very high cost – by switching short-term into longer-term debt.

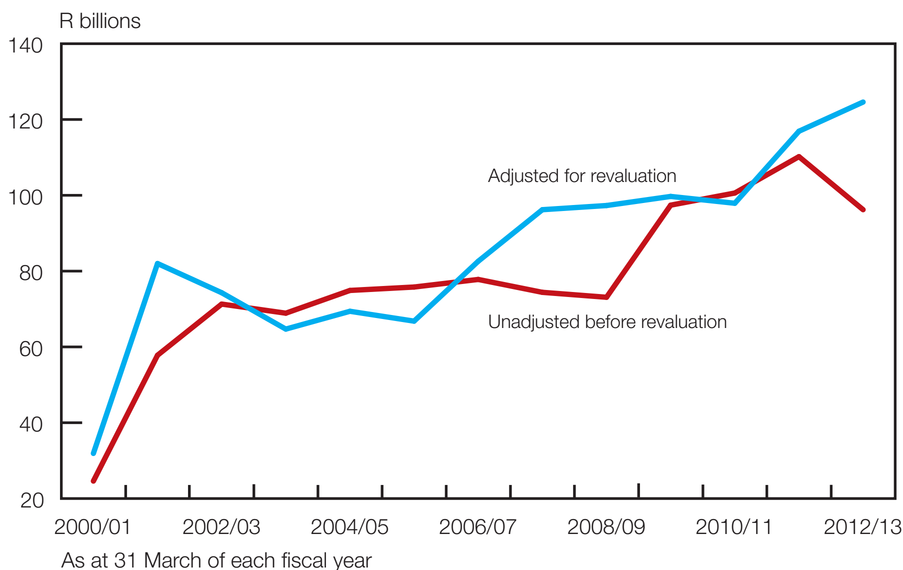
In fiscal 2012/13 national government recorded net redemptions of foreign bonds and loans to the value of R14,0 billion. Between fiscal 2013/14 and 2015/16, national government plans to borrow some US$1,5 billion a year in the international markets to maintain benchmarks in major currencies and meet part of its foreign currency commitments. Government was also preparing to enter the sukuk (Islamic bond) market to diversify funding options.

Total gross loan debt and tax revenue of national government



Total gross loan debt, consisting of domestic and foreign debt, increased from R1 188 billion to R1 366 billion between March 2012 and March 2013. Domestic debt continued to account for about 90 per cent of total gross loan debt and foreign debt for only 10 per cent which, to a large extent, shielded government from adverse exchange rate movements. The gap between the outstanding balance on foreign debt valued at historical exchange rates and foreign debt valued at prevailing exchange rates widened considerably in fiscal 2012/13 due to the depreciation of the domestic currency against other currencies. This large gap was also evident in fiscal 2001/02, and between fiscal 2007/08 and 2008/09 due to adverse exchange rate fluctuations.

Foreign debt of national government



General government finance

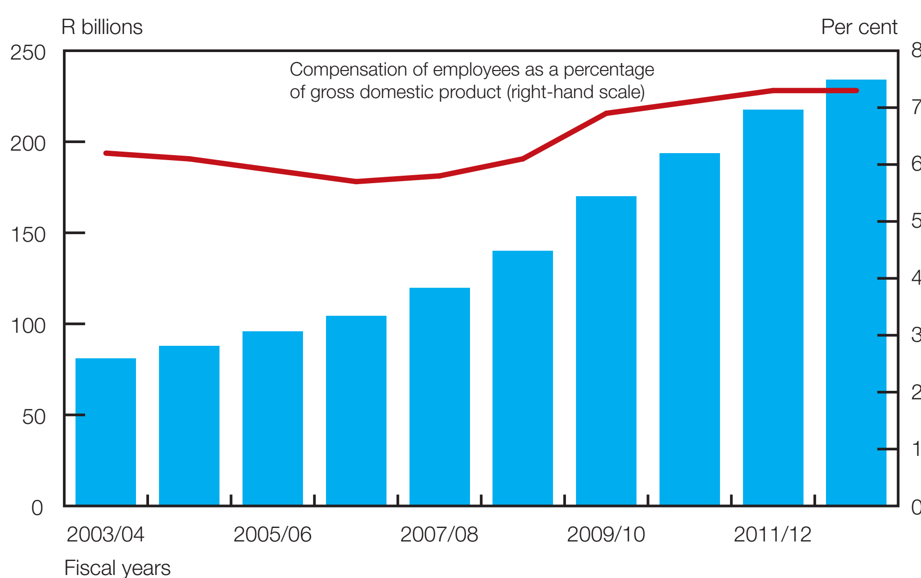
In the past year government's continued growth-supportive countercyclical fiscal policies and direction of financial resources towards capital expenditure were reflected in the finances of the consolidated general government (i.e., consolidated central, provincial and local governments). Net investment in non-financial assets recorded a year-on-year rate of increase of 6,1 per cent to amount to R92,0 billion in 2012/13. A sizeable cash deficit of R143 billion was recorded by consolidated general government, relative to the average of R118 billion recorded in the three preceding fiscal years. The widening of the general government deficit was mainly on account of a higher shortfall at national government level. This *deficit* would have been worse if it were not for the *surpluses* recorded by all other levels of general government.

Compensation of employees remained the largest component of total spending by general government, accounting for an average of 34,7 per cent of total expenditure over the five fiscal years to 2012/13. Over the medium term, government planned to moderate growth in employee compensation, progressively reduce capital underspending, accelerate rollout of infrastructure, and eliminate waste in the goods and services budgets. Government would also continue to monitor growth in state employment, which had been a major contributor to the increasing wage bill over the past five fiscal years, to ensure that budget objectives are met.

For fiscal 2012/13, preliminary *Provincial Revenue Fund Statements* indicate that provincial governments' financial activities resulted in a cash surplus of R6,2 billion – slightly higher than the cash surplus of R5,9 billion recorded in the preceding fiscal year. Capital spending by provincial governments amounted to R43,5 billion – some 1,8 per cent more than in 2011/12 in nominal terms, though a decline in real terms. The underspending in this category related to imperfections in the integration of infrastructure planning, and weaknesses in supply chain, risk and especially project management which were accentuated by skills deficiencies in general.

Provincial government compensation of employees accounted for the bulk of provincial government expenditure, amounting to R234 billion in fiscal 2012/13. Spending in this category was 7,6 per cent higher than in fiscal 2011/12. As a ratio of gross domestic product, compensation of provincial government employees remained broadly unchanged at 7,3 per cent between fiscal 2011/12 and 2012/13.

Provincial government compensation of employees



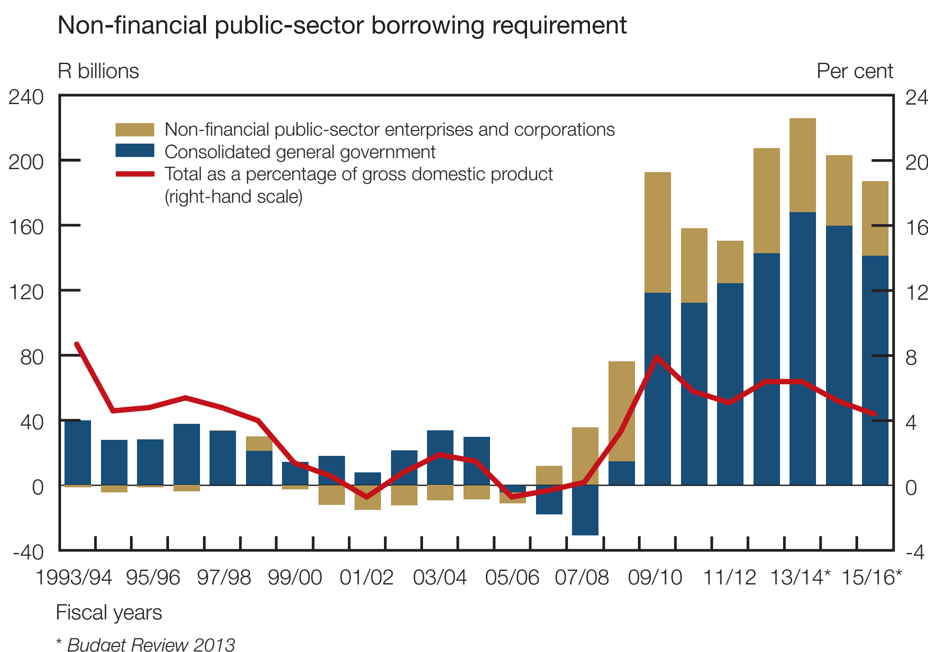
Preliminary data indicate that consolidated local governments recorded an estimated cash *surplus* of R4,9 billion in fiscal 2012/13, a turnaround from a cash *deficit* of R2,4 billion recorded in the preceding fiscal year. The last time local governments recorded a cash surplus was 16 years ago during fiscal 1995/96. This positive financial position of local governments was on account of a considerable increase in total municipal revenue that outpaced the increase in total expenditure. The slowdown in municipal expenditure can be attributed to, among other things, funding shortfalls, inefficient supply-chain management, and lack of capacity to plan and implement infrastructure and service delivery projects.

Total receipts of local governments recorded a year-on-year rate of increase of 13,9 per cent to amount to R267 billion in fiscal 2012/13. The increase in municipal receipts was mainly driven by higher own revenue collections from sales of water and electricity, together with higher collections of municipal property rates. During the period under review, local governments also received a year-on-year increase of 19,5 per cent in intergovernmental transfers amounting to R83,8 billion, which included a total of R9,0 billion received from national government as part of the general fuel levy sharing agreement with metropolitan municipalities.

Non-financial public-sector borrowing requirement

Over the past fiscal year the finances of the broader public sector were decidedly more expansionary. In a quest to support the economic recovery, general government incurred a somewhat larger deficit, while the non-financial public enterprises and corporations' financial shortfall more than doubled over this period as their infrastructure investment drive gained momentum.

The above developments resulted in a considerable widening of the deficit of the non-financial public sector in fiscal 2012/13. The non-financial public-sector borrowing requirement amounted to R207 billion in fiscal 2012/13 – or R57 billion more than the deficit recorded in 2011/12. As a proportion of gross domestic product the non-financial public-sector borrowing requirement rose to 6,4 per cent in the fiscal year under review, compared with 5,1 per cent in fiscal 2011/12.



In fiscal 2012/13, non-financial public enterprises and corporations, including major state-owned companies,[16] recorded a preliminary cash deficit of R64,5 billion, more than double the cash deficit recorded in the previous fiscal year. This sizeable deficit could be attributed to higher infrastructure-related capital spending.

16 Legal entities created by government in order to participate in commercial activities of government's behalf. A state-owned entity can either be wholly or partially owned by government. Examples are Eskom, The South African National Roads Agency Limited (Sanral) and Transnet.

The *Budget Review 2013* projected that total public-sector infrastructure spending would increase at a year-on-year rate of 22,9 per cent to amount to R256 billion in fiscal 2012/13. It was further estimated to add up to R827 billion over the three-year Medium-Term Expenditure Framework (MTEF) period. Spending by consolidated general government at R430 billion would account for just over half of this total, and would be driven by increased capital budgets at the provincial and local government levels.

Preliminary estimates indicate that net investment in non-financial assets by non-financial public enterprises and corporations amounted to R124 billion in fiscal 2012/13, some R22,7 billion higher than in the previous fiscal year. Infrastructure spending by these entities was estimated to total R397 billion over the MTEF period – some 48 per cent of the total public-sector infrastructure spending. The major public corporations – mainly Eskom and Transnet – would account for 82,9 per cent of this spending. The *Budget Review 2013* signalled that major infrastructure projects to the tune of R3 592 billion were in progress or planned.