An overview of the South African economy

October 2006

South African Reserve Bank

Contents

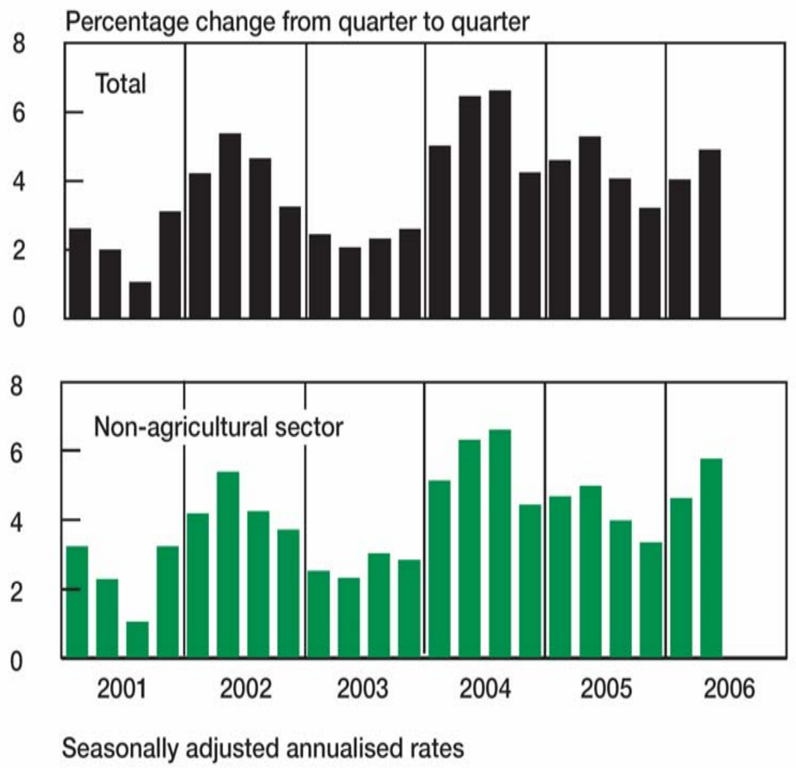
Salient features of the South African economy

- Growth in the South African economy continued to accelerate.
- Robust household spending was supported by increasing disposable income amid record high debt levels.
- Money-supply growth was exceptionally strong in the second quarter of 2006.
- The deficit on the current account continued to be financed by capital flows.
- Inflation started to increase following mounting price pressures, but remains within the target band.
- The SARB increased the repo rate by 50 basis points in both June and August 2006, to 8,0 per cent.
- Financial markets were affected by risk aversion towards emerging markets from May 2006.
- Government finances continued to be supportive of monetary policy.

Recent economic developments

Economic growth continued to accelerate

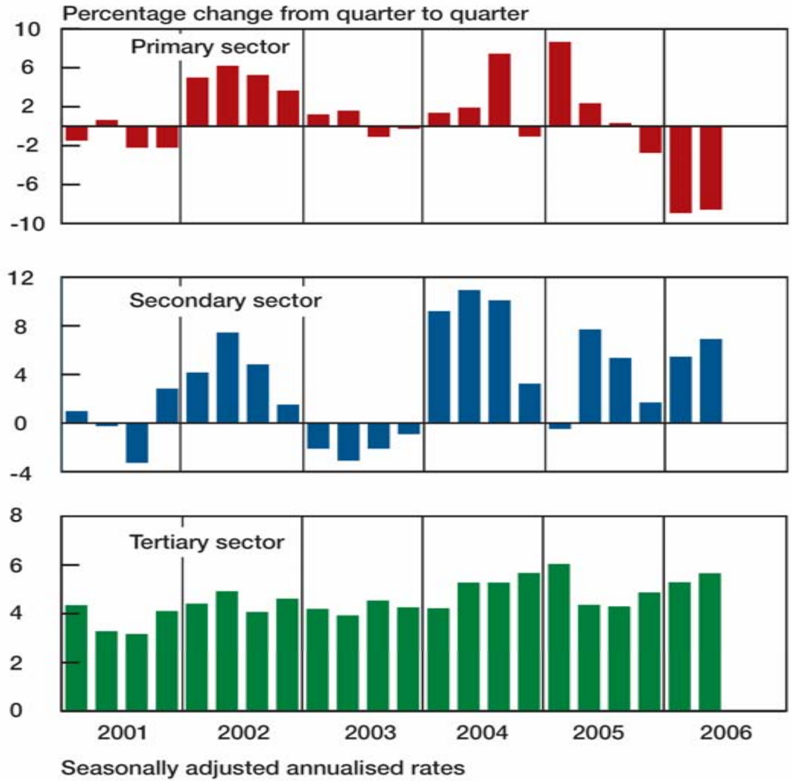
Real gross domestic product (GDP)



- *The South African economy grew by 4,9% in 2Q2006 from 4,0% in the previous quarter, the 27th uninterrupted quarter of economic expansion.*
- *Higher economic activity in the secondary and tertiary sectors more than offset the decline in the primary sector.*
- *Excluding agriculture, GDP increased at an annualised rate of 5, 8% in the second quarter.*
- *The South African economy grew by 5% in 2005, the highest since 1984.*

Strong momentum in the secondary and tertiary sectors

Real gross domestic product by sector



- *The primary sector contracted by 8,5% in 2Q2006, mainly due to a significantly smaller maize crop that was also harvested comparatively late. The mining sector grew at an annualised rate of 3% in 2Q2006, mainly due to vibrant activity in the platinum-mining sector.*
- *The secondary sector expanded by 7% in 2Q2006 from 5,5% previously, led by growth in the manufacturing (6%) and construction (14%) sectors.*
- *All major sectors in the manufacturing sector accelerated as domestic demand continued to surge alongside a more competitive external value of the ZAR.*
- *Value added by the tertiary sector increased marginally to 5,5% in 2Q2006 from 5,3% previously. This was due to increased activity in the trade and transport, storage and communication sectors.*

Strong momentum in the secondary and tertiary sectors

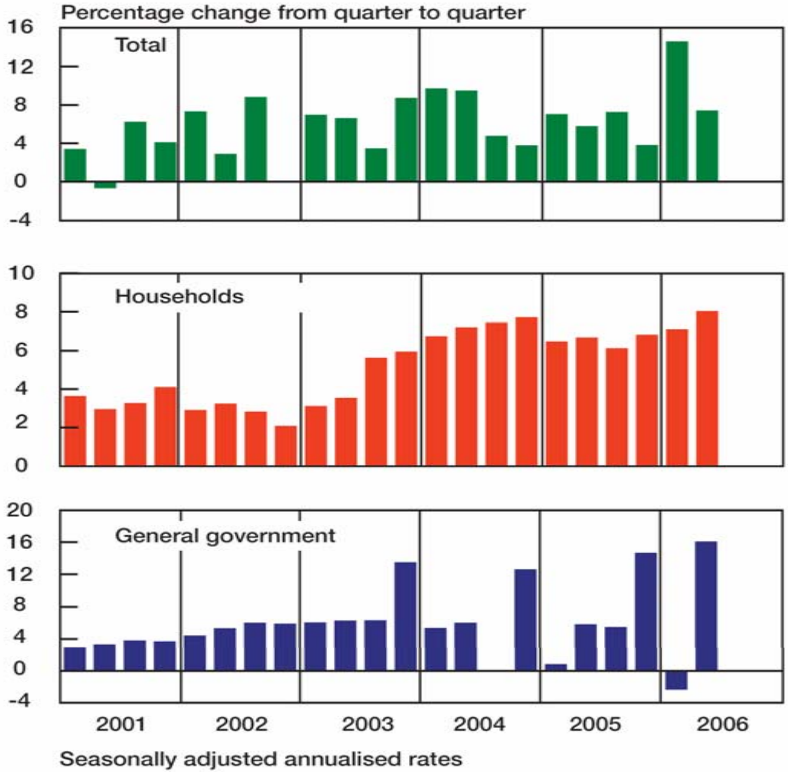
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sectors	2005 1st qr	2005 2nd qr	2005 3rd qr	2005 4th qr	2005 Year	2006 1st qr	2006 2nd qr
Primary sector	8¾	2¼	¼	-2¾	3¼	-9	-8½
Agriculture.................	6½	3	10¼	4	5½	-18¾	-33
Mining	9½	2	-3½	-5½	2½	-4½	3
Secondary sector	-½	7¾	5½	1¾	4½	5½	7
Manufacturing	-2¼	8	5½	-¼	4	4¼	6
Tertiary sector	6	4½	4¼	5	5¼	5¼	5½
Non-agricultural sector ..	*4¾*	*5*	*4*	*3¼*	*5*	*4½*	*5¾*
Total	4½	5¼	4	3¼	5	4	5

Domestic expenditure slowed in 2Q2006, but still expanded across all components

Real gross domestic expenditure (GDE)



- *Growth in GDE slowed from an annualised rate of 14,5% in 1Q2006 to 7,5% in the second quarter.*
- *Nevertheless, real growth in all the final demand components accelerated in the second quarter.*
- *Growth in consumption expenditure by households accelerated by 8,0% in the second quarter from 7,0% previously, the highest rate of increase since 1995.*
- *Following the 2,3% contraction in consumption expenditure by the general government in Q12006, expenditure increased by 16,0 % in the second quarter.*
- *Government expenditure was mainly on non-wage goods and services, including the acquisition of an aircraft as part of its defence procurement programme.*

Domestic expenditure slowed in 2Q2006, but still expanded across all components

Real gross domestic expenditure

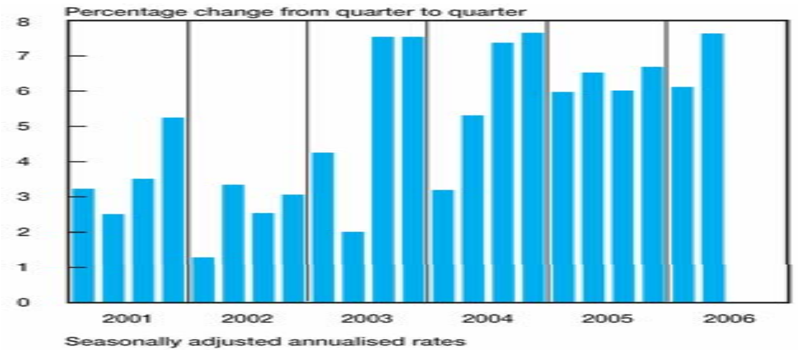
Percentage change at seasonally adjusted annualised rates

Components	2005					2006	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure by households	6½	6¾	6	6¾	7	7	8
Final consumption expenditure by general government	¾	6	5½	14¾	5½	-2¼	16
Gross fixed capital formation	10¾	5½	8¼	8½	9¼	10¾	11¼
Change in inventories (R billions)*	12,3	6,1	13,3	2,3	8,5	12,9	14,9
Gross domestic expenditure	7	5¾	7¼	3¾	6	14½	7½

* At constant 2000 prices

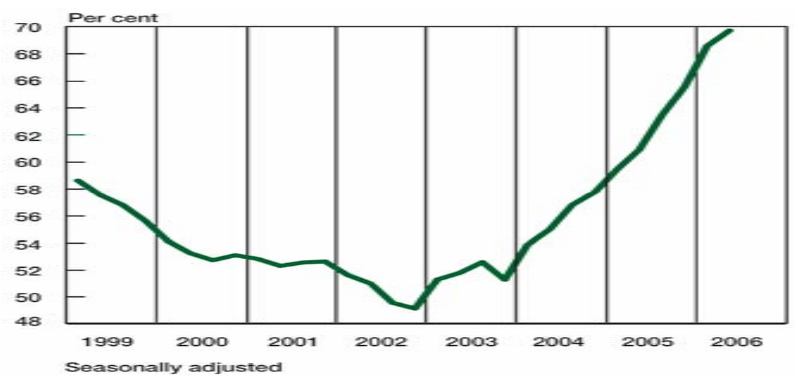
Further increases in households’ disposable income, but also more debt

Rising real household income



- *The buoyant household spending reflected high consumer confidence, relatively low interest rates, a decline in the prices of semi-durable goods and a further increase of 7,5% in real disposable income in 2Q2006.*
- *Households’ real disposable income benefited from an increase in salaries and wages, tax reductions announced in the 2006/07 Budget and transfers received from government.*

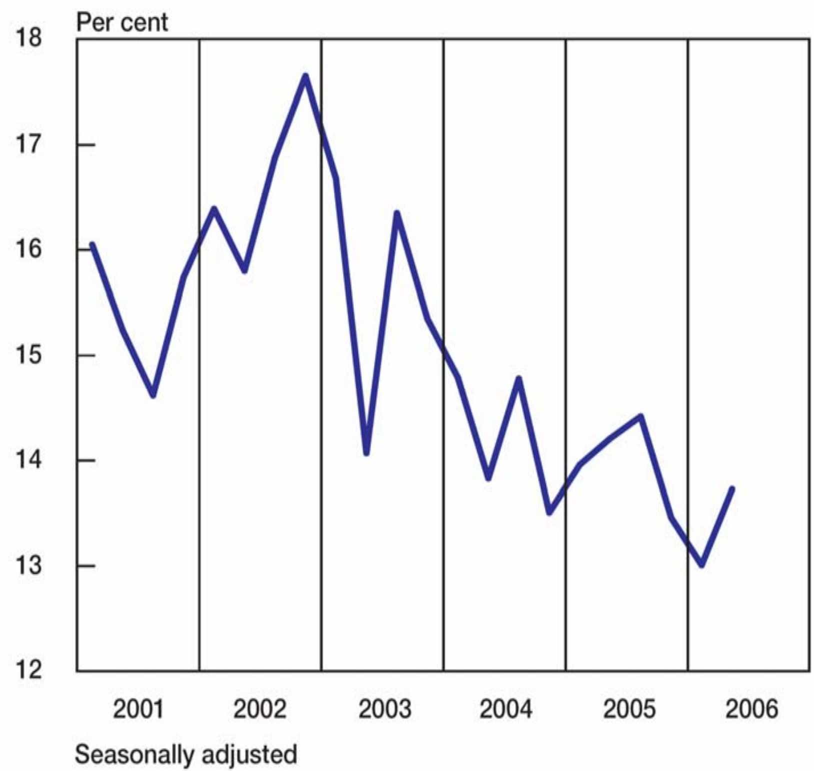
Household debt as percentage of disposable income



- *With growth in real household consumption exceeding growth in real disposable income, household savings inched lower and household debt continued to increase.*
- *Household debt as a percentage of disposable income increased to 69,7% in 2Q2006 from 61% a year earlier.*

The national savings ratio increased moderately in the second quarter

Gross savings as percentage of GDP



- *The national savings ratio increased moderately to 13,75% in 2Q2006 from 13,0% in the previous quarter.*
- *This can mainly be attributed to higher savings in the corporate sector, which more than offset the weaker savings originating from the household and government sectors.*
- *Gross savings by the corporate sector as percentage of GDP increased from 10% in 1Q2006 to 11,75% in the second quarter.*
- *The gross savings ratio of the household sector declined further from 1,75% in 2Q2006 to 1,5% in the second quarter.*
- *The government's gross savings ratio as percentage of GDP declined from 1,5% in 1Q2006 to 0,5% in the second quarter.*

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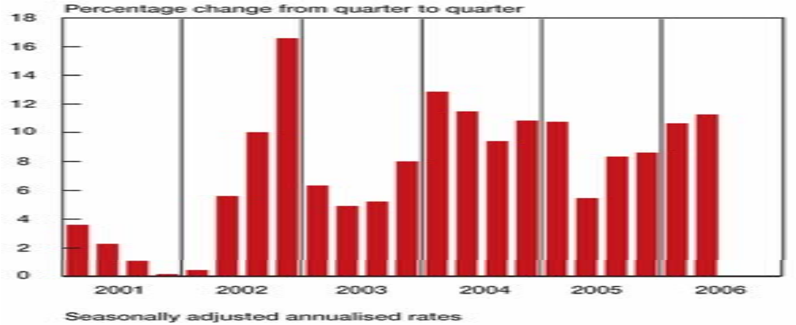
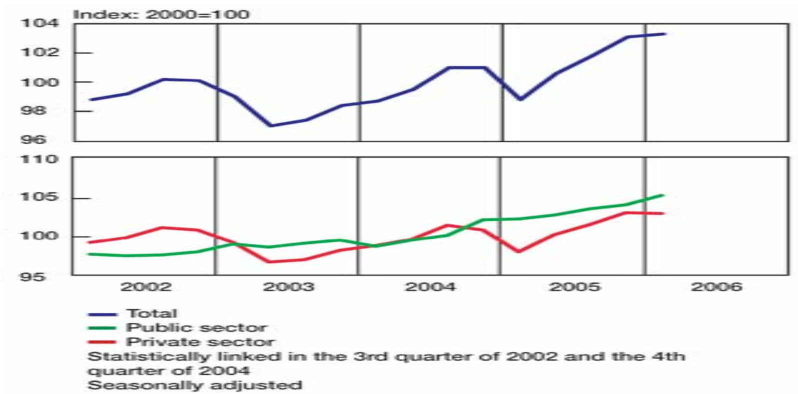
Increased capital formation and employment in all sectors

Real gross fixed capital formation



Sectoral employment trends

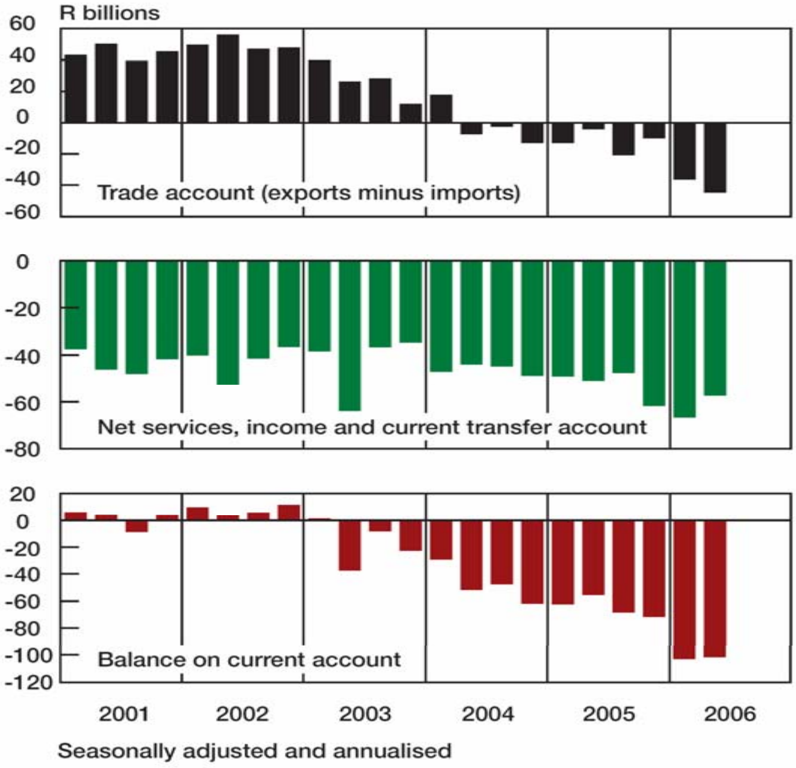


- *The growth in real gross fixed capital formation rose further from 10,5% in 1Q2006 to 11,25% in the second quarter.*
- *Solid increases in real outlays on capital goods were recorded by all three institutional sectors, i.e private business enterprises, public corporations and general government.*
- *The ratio of gross fixed capital formation to GDP increased from 18% in 1Q2006 to 18,8% in the second quarter.*
- *Employment in the non-agricultural sector sustained an upward trend, though at a slower pace than in the first quarter.*
- *Job losses in a number of sectors caused the overall level of private sector employment to decline somewhat in the first quarter of 2006.*
- *Employment in the public sector continued to increase by 1,2% in the first quarter of 2006 for the eighth consecutive quarter.*
- *The unemployment rate declined from 26,7% in the last quarter of 2005 to 25,6% in 1Q2006.*

External Account Developments

The trade deficit continued to widen as strong demand fuelled imports

Balance of payments: Current account



- *A substantial increase in the value of merchandise exports in 2Q2006 was more than offset by the even stronger increase in the value of merchandise imports. As a result, the trade deficit increased to R44,4 billion in 2Q2006 from R36,5 billion in the previous quarter.*
- *The value of exports increased by 12,5% in 2Q2006 on account of higher demand and higher ZAR prices of manufactured and mining exports. In addition to higher commodity prices, the improved competitive position of domestic producers contributed to the performance of the export sector.*
- *The value of imports increased by more than 13,0% in 2Q2006 and could partly be attributed to the importation of crude oil and refined petroleum products due to refinery maintenance.*
- *A decline of almost R10,0 billion in net service, income and current transfer payments to non-residents, to R57,3 billion, caused the current account deficit to narrow to R101,7 billion in 2Q2006.*

The trade deficit continued to widen as strong demand fuelled imports

Balance of payments of current account

Seasonally adjusted and annualised
R billions

	2005					2006	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	281,1	326,7	337,3	337,6	320,7	322,5	362,8
Net gold exports........................	24,9	25,9	26,0	31,3	27,0	29,3	33,7
Merchandise imports..................	-319,0	-356,8	-384,0	-378,9	-359,7	-388,3	-440,9
Trade balance...........................	-13,0	-4,2	-20,7	-10,0	-12,0	-36,5	-44,4
Net service, income and current transfer payments	-49,2	-51,0	-47,7	-61,6	-52,4	-66,6	-57,3
Balance on current account	-62,2	-55,2	-68,4	-71,6	-64,4	-103,1	-101,7

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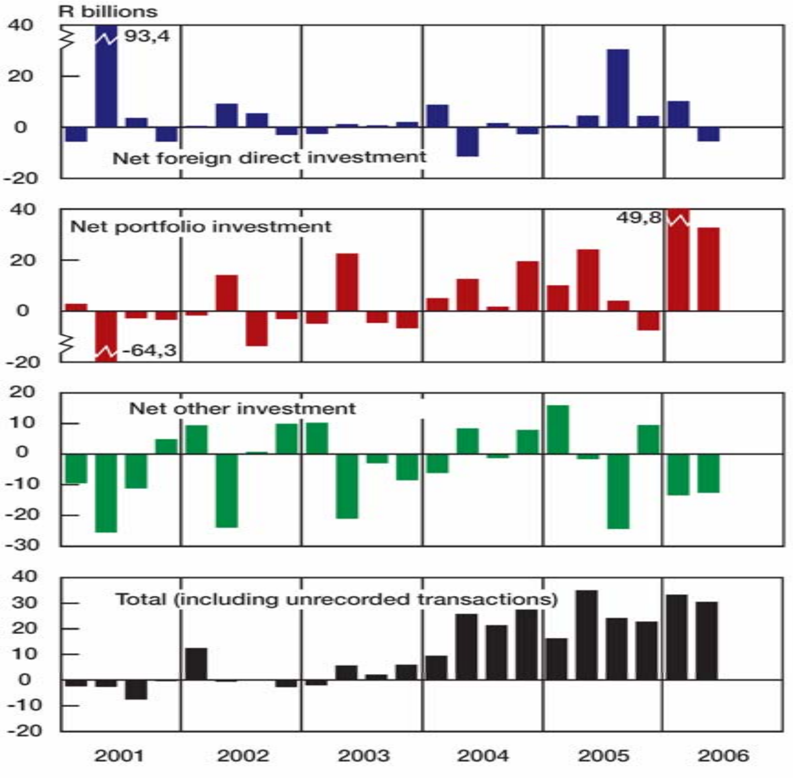
Sizeable portfolio inflows more than offset investment outflows

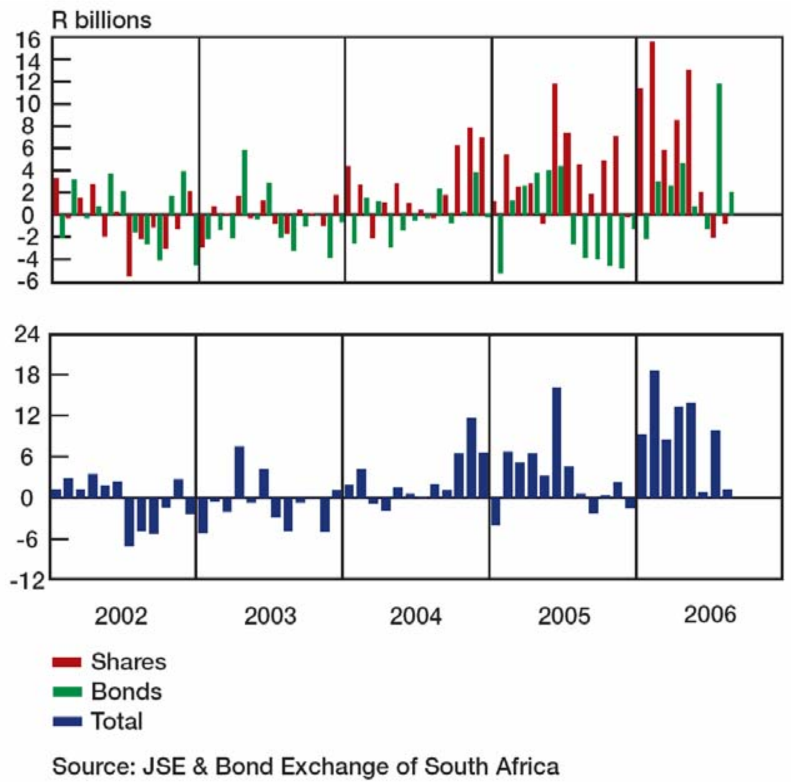
Financial account



- *Risk aversion towards emerging-market economies in the latter part of the second quarter caused the surplus on the financial account to narrow slightly to R30,5 billion in 2Q2006 from R33,4 billion in 1Q2006.*
- *Net foreign direct investment amounted to an outflow of R8,7 billion in 2Q2006 compared to an inflow in the first quarter.*
- *High inward portfolio investment of more than R50,0 billion recorded in the first quarter moderated to R36,0 billion in the second quarter.*
- *An outflow of R36,0 billion in net other investment was recorded during the second quarter, mainly due to increased foreign currency deposits and loans and advances extended to foreign banks.*

Non-resident purchases and sales of South African financial assets

Non-resident investors’ net purchases of bonds and equities



- *Non-resident investors bought net amounts of R32,0 billion and R50,0 billion of South African equities and bonds in 2004 and 2005, respectively.*
- *Non-resident investors bought a net R58,0 billion worth of equities in the year to 29 September 2006. Over this period, they bought a net R20,0 billion worth of bonds.*

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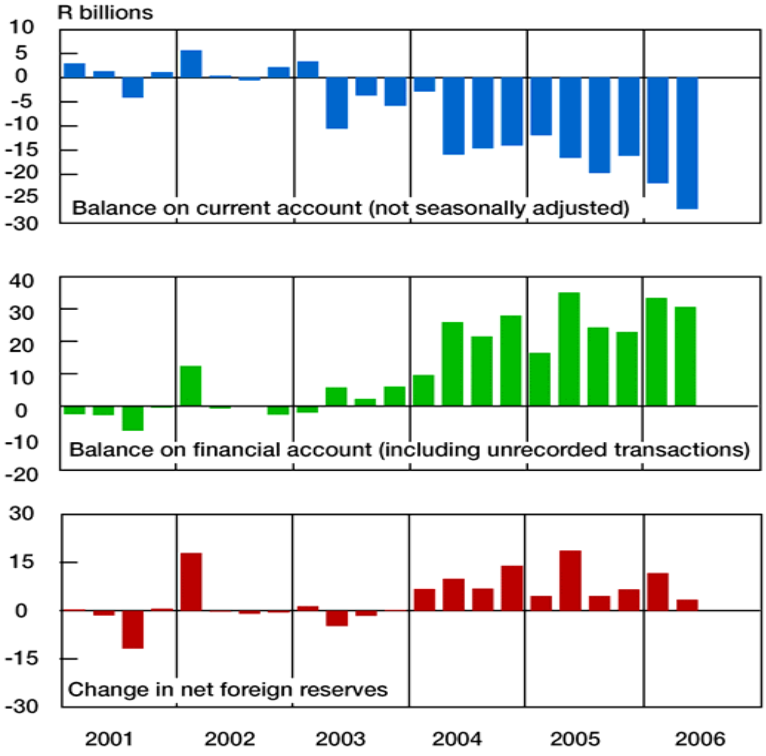
Capital flows continued to finance the deficit on the current account

Balance of payments: Overall balance



- *The deficit on the current account narrowed marginally from R103,1 billion at the end of the first quarter to R101,7 billion at the end of the second quarter of 2006.*
- *Risk aversion towards emerging markets, in general in the latter part of the second quarter of 2006, contributed to the shrinking surplus on South Africa's financial account with the rest of the world.*
- *The surplus on the financial account declined by almost R3,0 billion to R30,5 billion in the second quarter.*
- *The surplus on the financial account (including unrecorded transactions) as percentage of GDP accordingly declined to 7,4% in the second quarter.*

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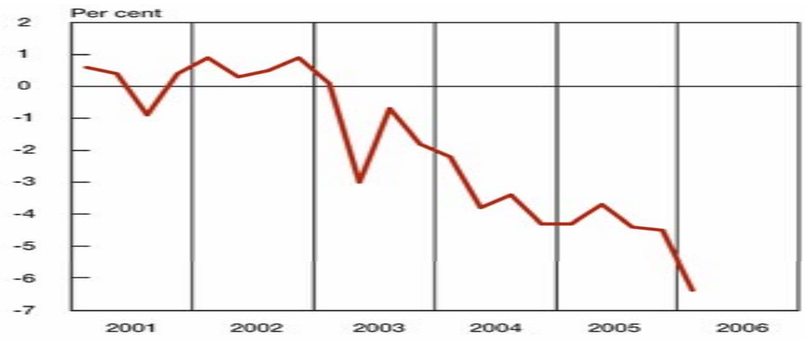
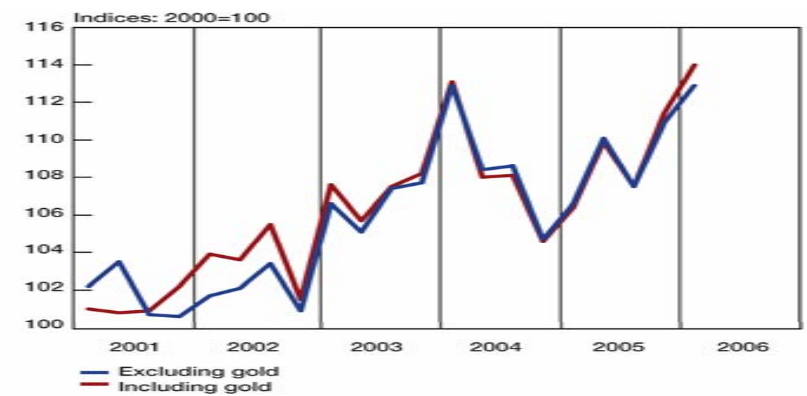
Terms of trade continued to improve

Ratio of current account balance to GDP



- *The current account deficit narrowed to 6,1% of GDP in 2Q2006 from 6,4% in the previous quarter.*

Terms of trade



- *Following a deterioration in 3Q2005, South Africa's terms of trade rebounded in the fourth quarter, a trend which continued in the first half of 2006.*
- *This improvement could be attributed to higher export prices owing to higher commodity prices, while import prices declined.*

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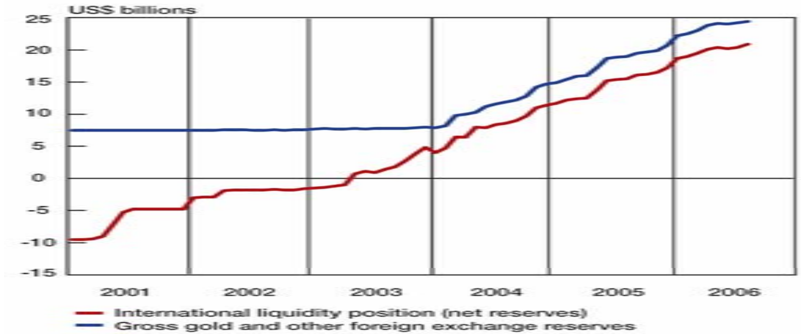
Official reserves continued to increase

Gold and foreign exchange reserves



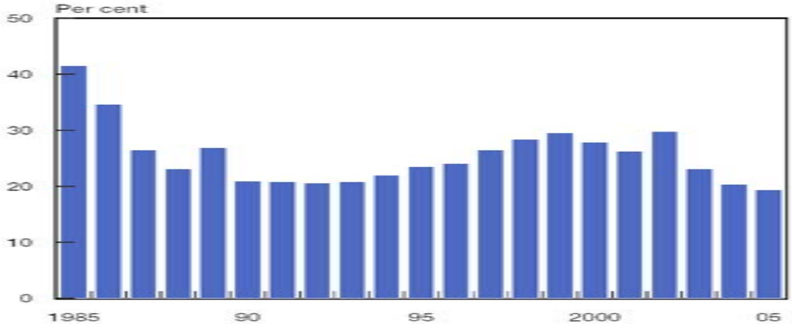
- *Official gross gold and foreign exchange reserves increased by USD5,5 billion over the past 12 months, to USD24,4 billion at the end of August 2006.*
- *The international liquidity position (net reserves) increased by USD5,4 billion to USD20,9 billion over the same period.*

Imports covered by international reserves

- *Official gross reserves covered 15 weeks' worth of imported goods and services at the end of June 2006.*
- *This ratio has more than doubled since the end of 2003.*

Modest foreign debt commitments

Total foreign debt as percentage of GDP



- *South Africa's foreign-debt-to-GDP ratio declined to below 20,0% in 2005.*
- *Compared to other developing countries, South Africa's outstanding foreign debt commitments are modest.*

Ratio of foreign debt to gross domestic product

Per cent

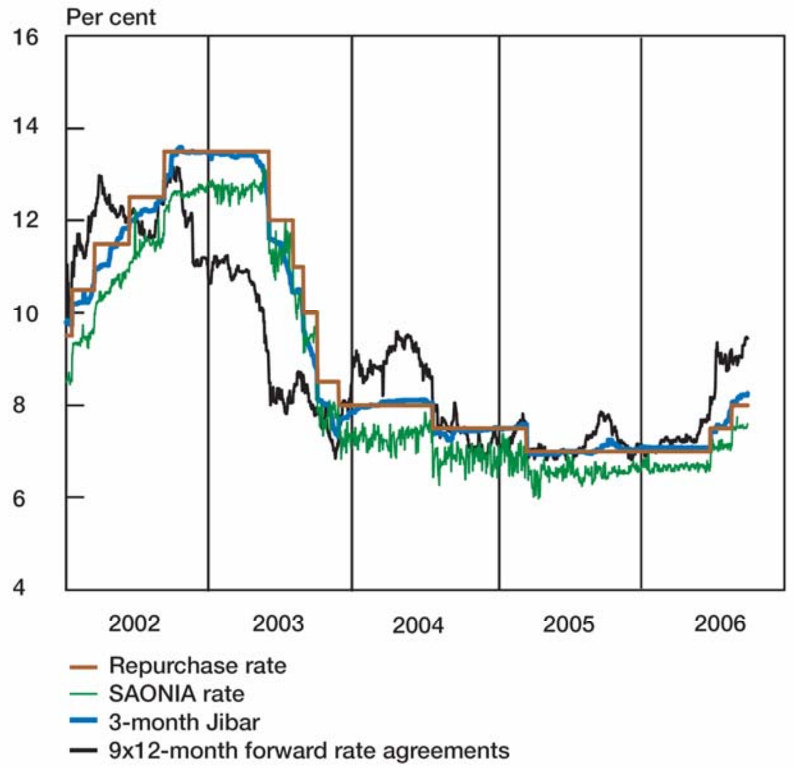
	2001	2002	2003	2004	2005
Africa	58,3	57,7	51,6	44,3	35,2
Sub-Saharan Africa	62,3	61,6	54,9	47,7	37,8
South Africa	**26,2**	**29,7**	**23,0**	**20,2**	**19,3**
Central and Eastern Europe	52,8	53,1	53,9	53,4	49,8
Commonwealth of Independent States	47,0	43,2	42,0	36,4	33,3
Developing Asia	27,2	25,1	23,2	21,6	20,9
Middle East	47,5	48,3	44,8	41,5	36,1
Western Hemisphere	40,9	47,0	47,5	41,9	33,3

Source: IMF *World Economic Outlook*, April 2006

Monetary Policy and Inflation

Money-market rates increased in anticipation of further monetary policy tightening

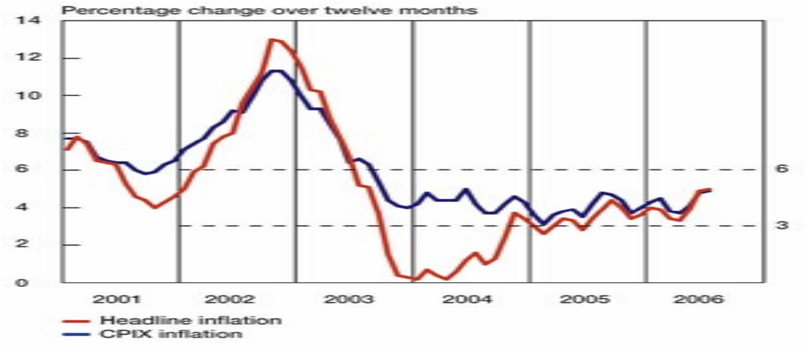
Money-market interest rates and repo rate



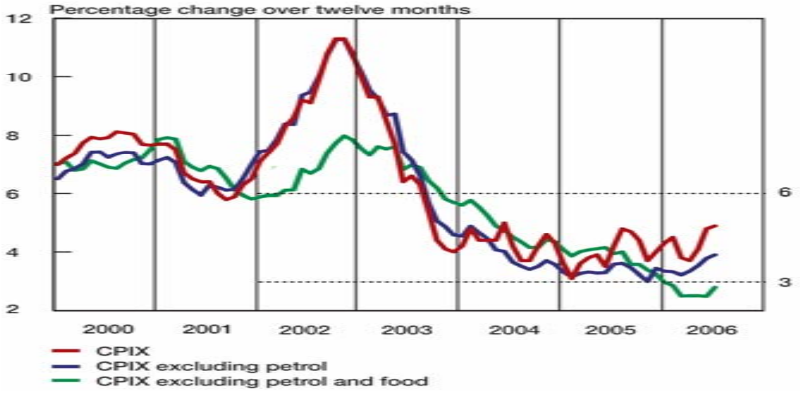
- *In line with the easing cycle in monetary policy in South Africa, money-market rates and rates on derivatives declined significantly over the past four years.*
- *The three-month Jibar declined from around 13,0% in January 2003 to around 7,0% in June 2006, whereafter it increased to 8,3% on 29 September.*
- *Following three years of monetary policy easing, the repo rate was increased by 50 basis points to 7,5% on 8 June 2006 and to 8,0 per cent on 3 August.*
- *This was in response to a deterioration in risks to the inflation outlook brought about by the depreciation of the ZAR, uncertainties regarding oil prices, exceptionally strong growth in household consumption and the widening of the current account deficit.*

CPIX inflation increased in recent months, but remained in the target band

Headline consumer inflation and CPIX



CPIX: Excluding food and energy prices



- *CPIX declined from 11,3% in November 2002 to 3,1% in February 2005, but increased to 5,0% in August 2006.*
- *CPIX has been within the target band for 35 consecutive months, which also helped to anchor inflation expectations.*
- *Price pressures started mounting due to increases in oil prices, domestic food prices, sustained strong consumer demand and the depreciation of the ZAR.*

- *Excluding petrol and food prices from the CPIX basket, inflation was below the lower end of the target band.*

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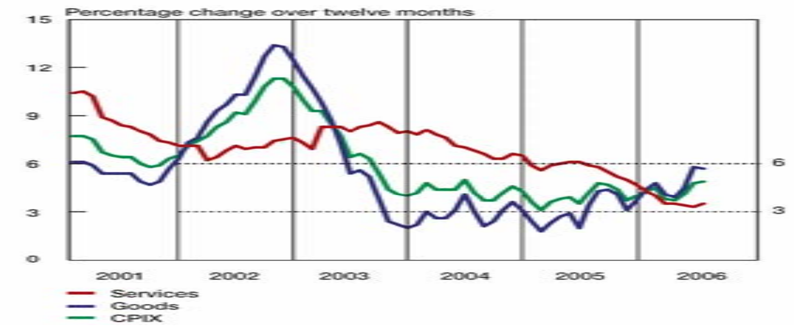
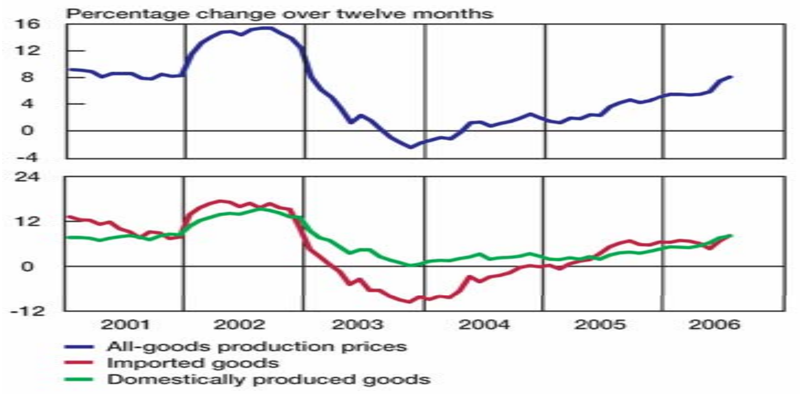
CPIX inflation increased in recent months, but remained in the target band

CPIX: Goods and services inflation



- *Services inflation remained close to the lower end of the inflation target band.*

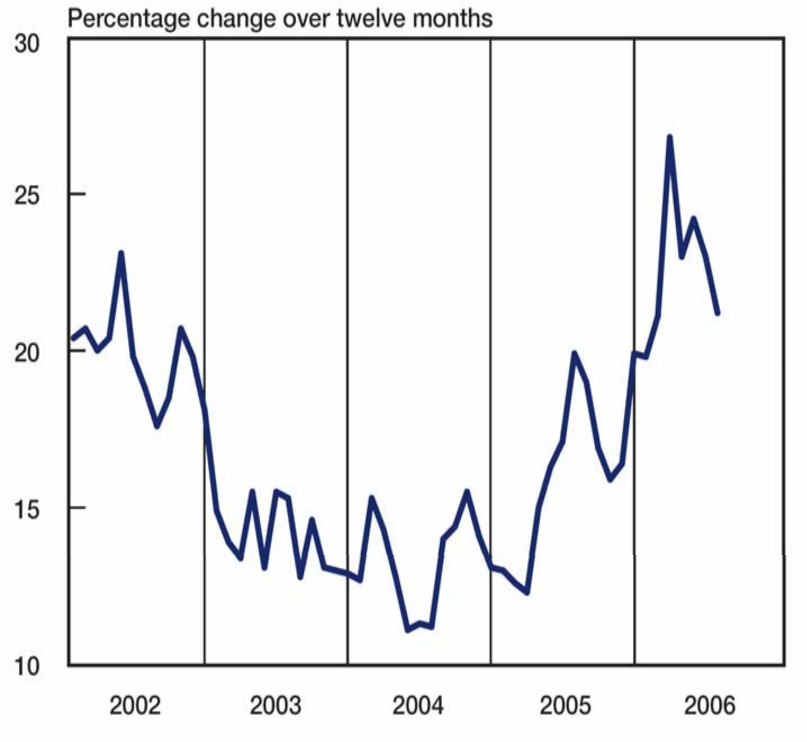
All-goods production prices



- *With both domestically produced goods (8,1%) and imported goods inflation (8,2%) accelerating, production prices (PPI) more than doubled from 3,6% in July 2005 to 9,2% in August 2006, mainly due to rising food and energy prices as well as electrical machinery.*

Growth in money supply was exceptionally strong in the first half of 2006

Growth in M3



- *M3 money supply and private-sector credit extension increased by 21,4% and 25,0%, respectively, in August 2006.*
- *Relatively low interest rates, buoyant income and expenditure, lively conditions in financial markets and the generally rising trend in asset prices contributed to these brisk increases.*

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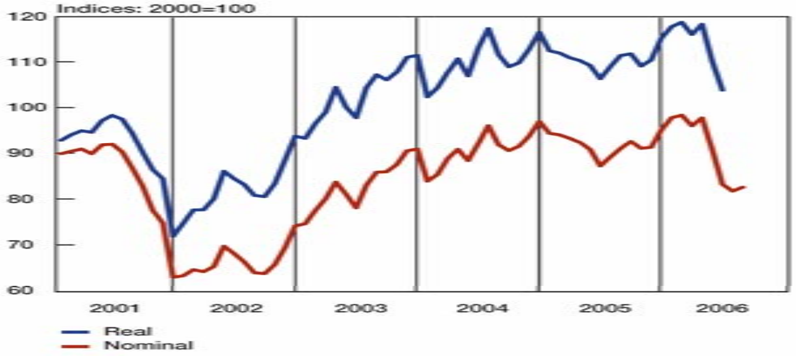
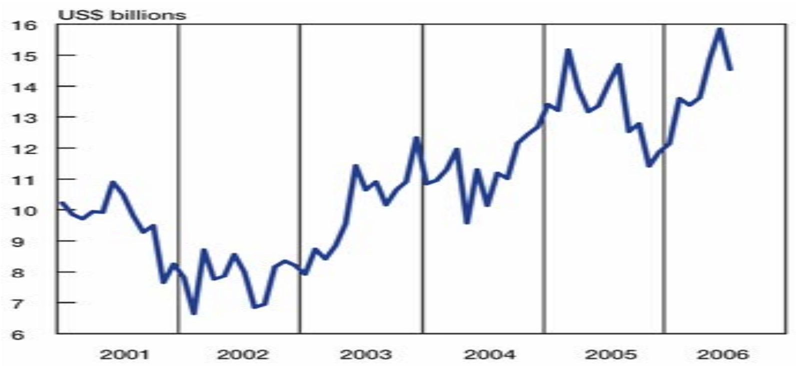
Financial Market Developments

The ZAR depreciated in the second quarter

Effective exchange rate of the ZAR



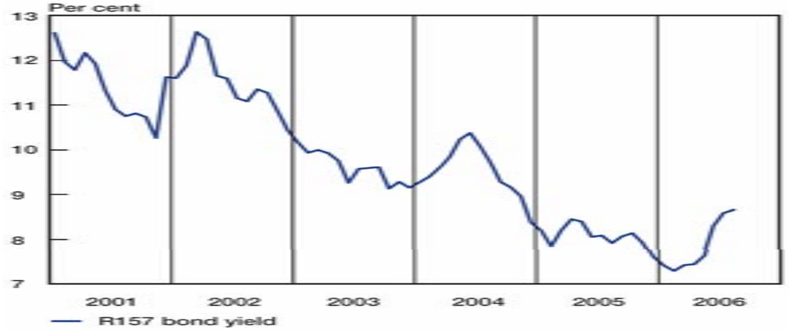
Average daily net turnover in the foreign exchange market



- *The nominal effective exchange rate (NEER) of the ZAR has increased by almost 24,0% from the end of 2001 until 29 September 2006.*
- *The ZAR depreciated from the second week of May as a result of greater caution towards emerging-market currencies, a decline in the gold price and the widening of the current account deficit.*
- *During the first nine months of 2006, the NEER declined by 21,4%.*
- *In the year to 29 September, the ZAR has depreciated by 18,3% against the USD.*
- *The net average daily turnover against the ZAR has been increasing gradually since 2002, amounting to USD10,3 billion in August 2006.*

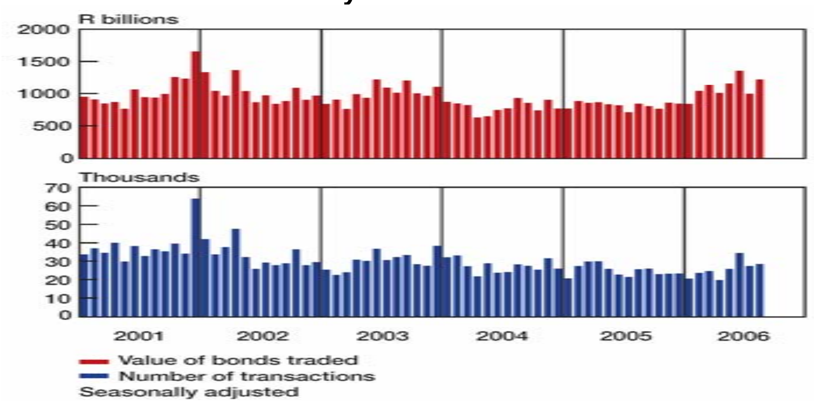
Bond yields increased, reflecting a depreciating ZAR and tighter monetary policy

Yield on long-term government bonds



- *Domestic yields had been on a declining trend over the past five years until the first quarter of 2006.*
- *In February 2006, the yield on the ten-year government bond (R157) recorded record low levels - close to 7% from around 13% at the end of 2001.*
- *The yield on the R157 bond increased to 8,61% by 29 September due to inflationary concerns, higher interest rates and the depreciation of the ZAR.*

Turnover in the secondary bond market



- *Annual turnover in the bond market amounted to approximately R8 trillion in 2004 and 2005.*
- *Turnover gradually increased during 2006, and reached R8,3 trillion in the year to 29 September, already exceeding the total turnover for 2005.*

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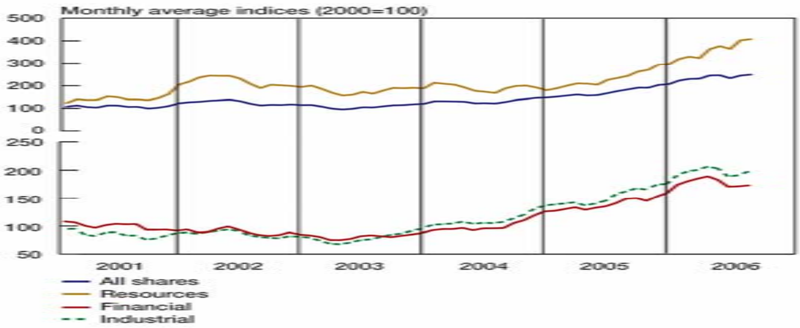
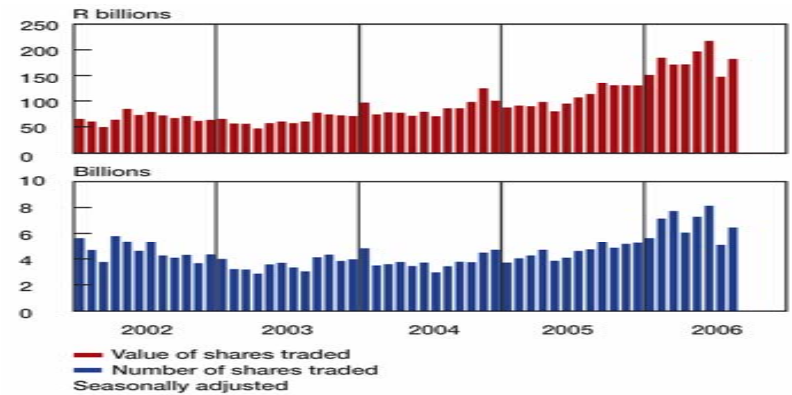
Equity market indices reached record high levels

Share prices



- *The domestic equity market has reached consecutive record high levels since the last quarter of 2004, owing to rising commodity prices and improving economic conditions.*
- *In 2005 and the first nine months of 2006, the Alsi improved by 43% and 24%, respectively.*

Turnover in the secondary share market

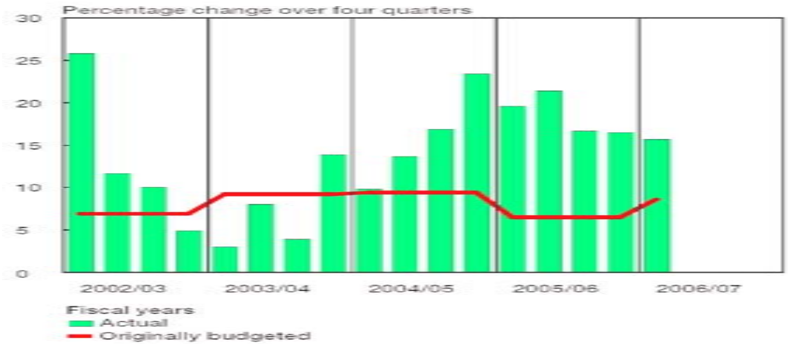


- *Turnover on the JSE increased substantially over the past six years, with the average monthly turnover reaching R185 billion in 2006.*
- *Turnover amounted to R1,3 trillion in 2005 but was already slightly higher for the year to 29 September 2006, at R1,6 trillion.*

Fiscal Policy Developments

Government revenue continues to exceed forecasts

Revenue of national government



National government revenue in fiscal 2005/06

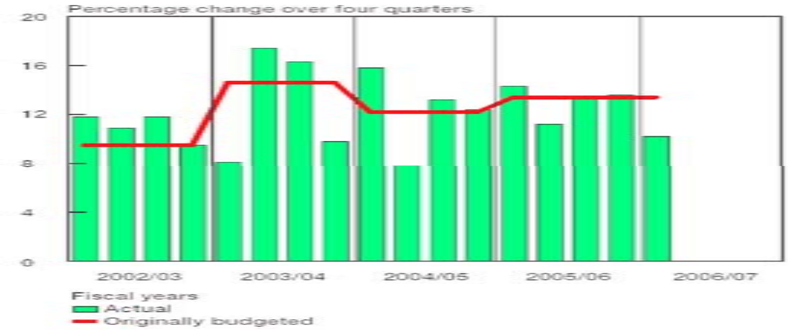
Revenue source	R billions	Percentage change	
	Actual	Originally budgeted	Actual*
Taxes on income, profits and capital gains	230,9	2,9	18,3
Payroll taxes	4,9	10,5	10,0
Taxes on property	11,1	9,0	23,6
Domestic taxes on goods and services	150,7	8,8	14,7
Taxes on international trade and transactions	18,2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

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

- *Actual government revenue exceeded budgeted revenue by a large margin over the past two fiscal years.*
- *For the 2005/06 fiscal year, revenue was 18,4% higher than the budget estimate.*
- *Strong economic growth resulted in higher tax collections, while growth in disposable income and continued improvement in tax collection processes also contributed to higher government revenue.*

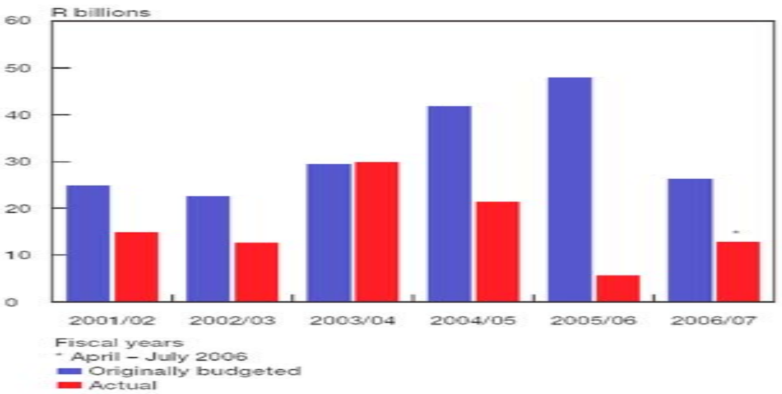
Government finances continued to be supportive of monetary policy

Expenditure by national government



- *Government expenditure amounted to R417 billion in the 2005/06 fiscal year, slightly less than budgeted.*
- *Owing to the fiscal policy aim of reconstruction and development, expenditure increased by almost 14% in 2005/06.*
- *This trend is expected to continue over the next three years, due to the government's infrastructural development programme, budgeted to amount to R72 billion.*

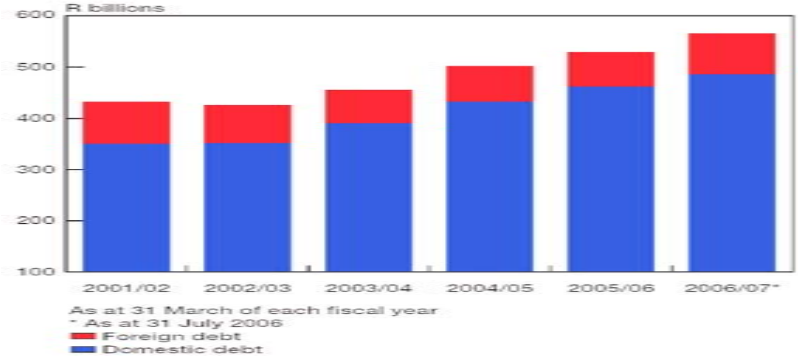
Deficit of national government



- *The budget deficit as a percentage of GDP declined to 0,5% in the 2005/06 fiscal year from a budgeted 3,1% in February 2005.*
- *However, it is estimated to increase slightly to between 1,5% and 1,2% over the next three years, due to a relatively more expansionary fiscal policy stance.*

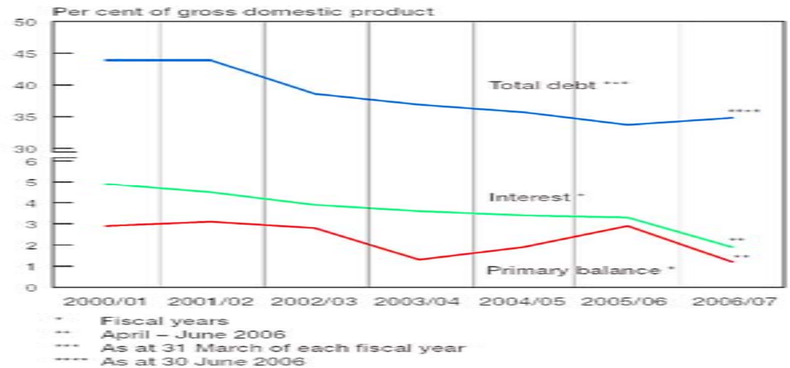
Government debt ratios remain moderate and stable

National government loan debt



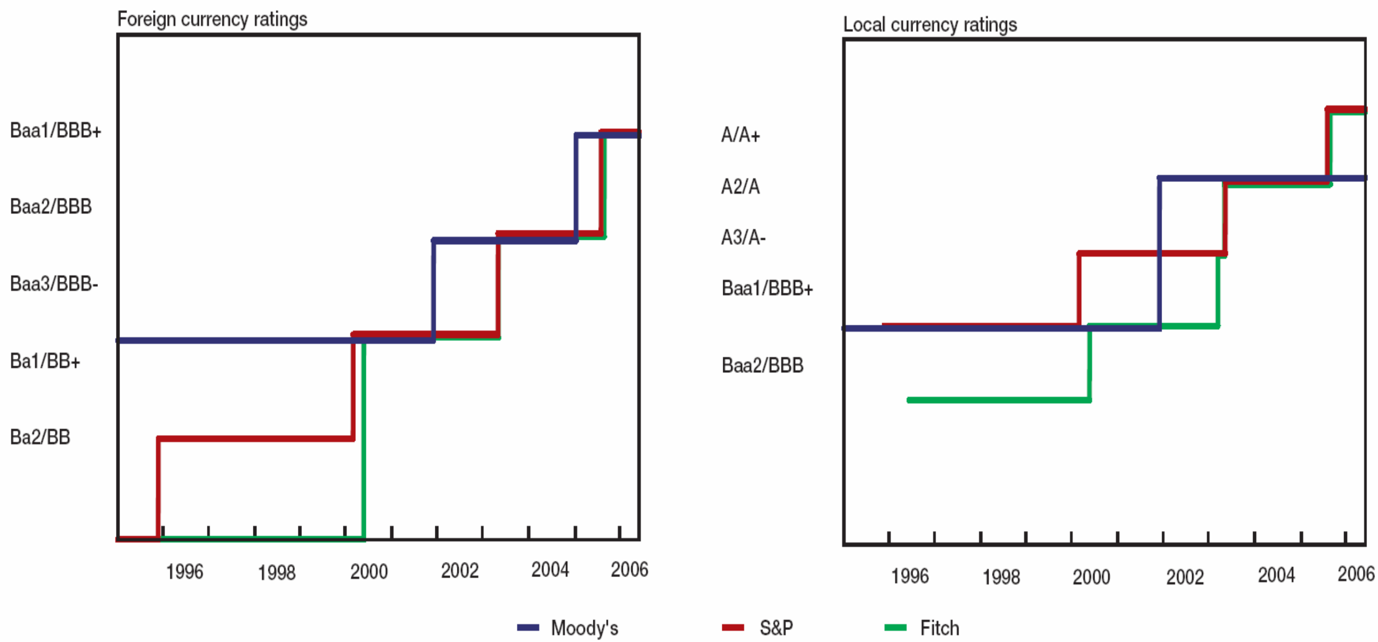
- *Government debt as percentage of GDP remained stable, consistent with the government's borrowing and debt sustainability strategy.*
- *The government's domestic debt as a percentage of GDP has averaged 32,0% since 2002, while foreign debt averaged 5,0%.*
- *On 30 March 2006, the National Treasury issued a ten-year euro-denominated bond at a yield of 4,6% - a spread of 82 basis points above the comparable German Bund.*

Deficit of national government



- *Prudent fiscal management contributed to lower interest cost and resulted in a lower borrowing requirement.*
- *The primary balance as percentage of GDP reached 2,9% in 2005/06.*
- *This also released additional resources for infrastructural and other essential spending.*

Sound macroeconomic policies are reflected in improved credit ratings



<u>South Africa's ratings outlook</u>

Moody's: Stable

S&P: Stable

Fitch: Stable

South African Reserve Bank

Key challenges

- Accelerated Shared Growth Initiative of South Africa (ASGISA)
- Employment generation and poverty reduction
- Overcoming skills constraints
- Continue to attract FDI to reduce dependence on volatile portfolio investment flows
- Infrastructure development
- Implementing a broader-based empowerment policy
- HIV/Aids
- Improvement in service delivery