Quarterly Bulletin

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South African Reserve Bank

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Introduction

In the final quarter of 2007 and in early 2008, global economic prospects continued to be tainted by the disruptions which originated in the United States (US) sub-prime mortgage market and international markets for structured investment products. Key central banks continued to add liquidity to the financial markets in order to resolve the frictions in the flow of finance between financial institutions, and in the US the Federal Open Market Committee reduced the target level of its central policy interest rate on several occasions. Accordingly, the interest rates at which numerous financial products were reset in early 2008 were significantly less onerous for borrowers than a mere six months earlier.

Global growth seemed to have lost momentum in the final quarter of 2007, but was nevertheless buoyed by the performance of emerging-market economies. In fact, economic growth projections for the African continent also provided for further acceleration in both 2007 and 2008. However, global energy and food price inflation continued apace, presenting a challenge to monetary policy-makers in most parts of the world.

In South Africa real economic growth in 2007 came to around 5 per cent for the fourth year in succession. Growth picked up somewhat in the fourth quarter of the year as manufacturing output, in particular, recovered following a decline in the third quarter. Real production in the construction sector also rose briskly in the fourth quarter, reflecting strong civil construction and non-residential building activity. Agricultural output expanded rapidly, partly on account of higher livestock production, while real value added in the finance sector also retained firm upward momentum. By contrast, mining output was held back in the quarter by the temporary closure of some mining shafts. In the trade sector the real value added also reflected slower growth in sales volumes in the fourth quarter of 2007.

Viewed from the expenditure side, growth in real final consumption expenditure by households continued its deceleration in the fourth quarter of 2007, moderated by the effect of cumulatively higher interest rates. The slowdown was broad-based, with only expenditure on semi-durable goods – particularly clothing and footwear and vehicle tyres, parts and accessories – recording strong growth during the quarter concerned. Real final consumption expenditure by government also rose at a much slower pace in the fourth quarter compared to the third quarter.

Real fixed capital formation continued rising briskly in the fourth quarter of 2007. Public corporations vigorously stepped up their capital expenditure, underpinned by lively investment activity in the electricity, transport and communication sectors. Robust increases in real capital formation were also recorded by the private sector – in particular in mining and manufacturing. On account of the strength of fixed capital formation, the pace of increase in real domestic final demand broadly matched that of real gross domestic product in the fourth quarter of 2007.

Real inventory investment, by contrast, turned negative in the fourth quarter of 2007 following an uninterrupted 25 quarters during which inventories had continued to rise. Reductions in inventories were recorded in most sectors, with mining being the most prominent. Manufacturing inventories also contracted somewhat, but in the trade sector stocks edged higher, probably due to unexpectedly subdued domestic demand.

Export volumes rose strongly in the final quarter of 2007, led by mining products where inventories were run down in order to satisfy export demand, while export prices benefited from a revival of commodity prices. Real imports remained high but essentially moved sideways in the fourth quarter, while average import prices rose somewhat, reflecting the higher price of crude oil and rising prices in South Africa's trading-partner countries. These developments resulted in a significant narrowing of the country's trade deficit in the fourth quarter of 2007. This was only partly countered by a further increase in dividend and interest payments to non-residents, resulting in a moderation in the fourth-quarter deficit on the current account of the balance of payments. For 2007 as a whole, the said deficit amounted to 7,3 per cent of gross domestic product – the highest annual level since 1971.

Since 2004 the current-account deficit has been largely financed by inward portfolio investment. While on an annual basis this remained true in 2007, inward portfolio investment slowed abruptly in the final quarter of the year, and the dominant form of foreign finance during that quarter was the repatriation of some of the South African banking sector's foreign-currency deposits, possibly encouraged by the prevailing uncertainties in the global financial markets and interest rate differentials in favour of South Africa. Direct investment outflows during the fourth quarter of 2007 included the acquisition of foreign entities by a South African media company and a medical group. Nevertheless, the net inflow of funds from abroad was again sufficient to enable the South African Reserve Bank (the Bank) to accumulate more foreign exchange. Despite fairly significant short-term fluctuations, the nominal effective exchange rate of the rand depreciated only slightly during the final quarter of 2007, and by less than 4 per cent during the year as a whole.

However, the sentiments regarding the prospects of economic growth for export volumes arising from electricity shortages in early 2008 weighed noticeably on the exchange value of the rand. Against a basket of currencies the rand, on balance, depreciated by nearly 14 per cent over the two months to the end of February. Alongside rising international prices of petroleum and food, this continued to cloud inflation prospects.

CPIX inflation accelerated further in recent months, and in January 2008 reached a twelve-month rate of 8,8 per cent – the highest rate since early 2003. Food prices recorded double-digit rates of increase, with the price of petrol also stoking the inflation fire. While the underlying CPIX measure which excludes food and petrol continued to record twelve-month inflation of less than 6 per cent, this measure has been accelerating most recently. Production price inflation added to the unsatisfactory picture, recording rates of increase well above those of consumer prices. Wage settlements also drifted higher during 2007, although not to the extent of being entirely irreconcilable with the inflation target of 3 to 6 per cent.

Observing the continuous deterioration in a number of exogenous drivers of inflation, and mindful of the need to brake any endogenous inflationary spiral which might be ignited by these forces, the Bank's Monetary Policy Committee raised the repurchase rate by 50 basis points at each of its meetings in June, August, October and December 2007. This followed an identical pattern in 2006, and brought the cumulative increase in the repurchase rate since early June 2006 to 400 basis points. Other short-term interest rates rose in conformity with the policy rate.

Banks' loans and advances to the domestic private sector gradually started to respond to the tighter monetary policy stance. Growth in most credit categories moderated significantly in the second half of 2007, with the pace of increase in mortgage advances, for example, losing momentum alongside slower house price inflation and a lengthening of the average period that a house remained in the market before being sold. Growth in the broad M3 monetary aggregate similarly decelerated in the second half of 2007. The income velocity of circulation of M3 nevertheless remained at a record low in the final quarter of 2007.

Turnover in the financial markets remained buoyant, and domestic longer-term interest rates trended higher during the four months to the end of February 2008, probably reflecting greater caution regarding prospects for inflation. The share market remained very lively. Share prices reached a peak in October 2007 and subsequently fell back as global share markets receded and domestic prospects were reassessed critically. However, record high commodity prices in early 2008 bolstered the prices of resources shares – partly on account of an expected curtailment of precious metals production in South Africa due to electricity rationing – and contributed to a significant recovery in South African share prices.

The Budget which was presented to Parliament in February 2008 provided for substantial increases in government expenditure to enhance growth and overcome key infrastructure bottlenecks, while at the same time further extending social security. The corporate income tax rate was also reduced. It was projected that the national government would continue to run modest financial surpluses over the next three years, but that the broader public sector would revert to financial deficits as infrastructure spending gained further momentum.

Domestic economic developments

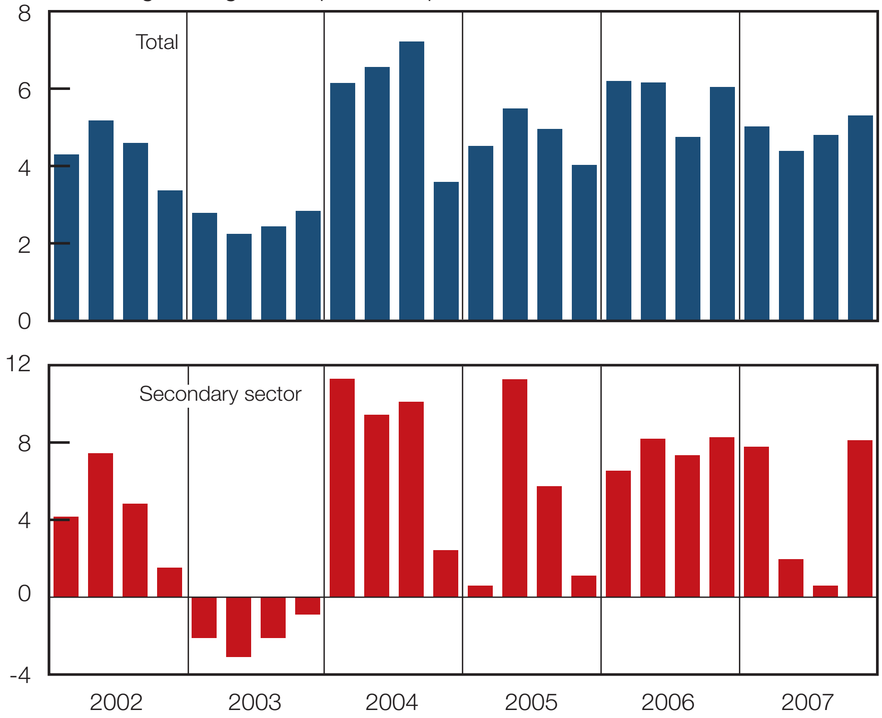
Domestic output[1]

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

Economic activity in South Africa expanded further with real growth accelerating from a revised annualised rate of 4,8 per cent in the third quarter of 2007 to 5,3 per cent in the fourth quarter. The stronger quarter-to-quarter growth in the fourth quarter reflected a marked acceleration in growth in real value added by the secondary sector, while growth in the real value added by both the primary and tertiary sectors slowed over the period.

Real gross domestic product

Percentage change from quarter to quarter



Seasonally adjusted annualised rates

Real economic growth for 2007 as a whole amounted to 5,1 per cent, slightly lower than the rate of 5,4 per cent recorded in 2006. In the non-agricultural sector of the economy, growth slowed from 5,7 per cent in 2006 to 5,3 per cent in 2007.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2006					2007				
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sector	-6,3	-2,6	-3,0	4,9	-2,5	-5,4	0,2	4,5	1,6	-0,4
Agriculture	-14,8	-17,5	-9,8	-5,3	-7,9	3,9	9,0	5,8	10,5	0,3
Mining	-2,4	4,3	-0,2	9,1	-0,1	-8,8	-3,1	4,0	-1,7	-0,6
Secondary sector	6,5	8,2	7,3	8,3	6,2	7,8	2,0	0,6	8,1	5,8
Manufacturing	5,2	6,8	6,0	7,6	5,2	4,5	-0,1	-2,5	8,2	3,9
Tertiary sector	7,7	6,3	4,8	5,4	6,1	5,6	5,9	6,8	5,1	5,7
Non-agricultural sector	*6,7*	*6,6*	*5,1*	*6,3*	*5,7*	*5,1*	*4,3*	*5,1*	*5,4*	*5,3*
Total	6,2	6,2	4,8	6,0	5,4	5,1	4,4	4,8	5,3	5,1

Growth in real value added by the *primary sector* slowed from an annualised rate of 4,5 per cent in the third quarter of 2007 to 1,6 per cent in the fourth quarter due to a contraction in mining production which, in part, neutralised a solid increase in agricultural production over the period.

Partly reflecting higher livestock production, growth in the real value added by the *agricultural sector* accelerated from an annualised rate of 5,8 per cent in the third quarter of 2007 to 10,5 per cent in the fourth quarter. Real value added by the agricultural sector switched from a decline of 7,9 per cent in 2006 to an increase of 0,3 per cent in 2007.

Real output by the *mining sector* declined at an annualised rate of 1,7 per cent in the fourth quarter of 2007, following an increase of 4,0 per cent in the third quarter. This decline can mainly be ascribed to a contraction in output volumes of gold and diamonds as well as a slowdown in platinum production. The temporary shutdown of shafts due to safety concerns following a sudden increase in fatalities earlier in 2007 and a one-day industry-wide mineworker strike affected production materially in the mining sector in the fourth quarter of 2007.

For 2006 and 2007 as a whole, real value added by the mining sector contracted by 0,1 per cent and 0,6 per cent, respectively. In addition to the unscheduled closure of certain mining operations due to safety reasons and industrial action, the secular decline in the production of gold continued in 2007.

Growth in real value added by the *secondary sector* accelerated significantly from an annualised rate of 0,6 per cent in the third quarter of 2007 to 8,1 per cent in the fourth quarter. This increase can mainly be attributed to buoyant growth in the manufacturing sector while growth in real value added by the construction sector broadly maintained its momentum.

After having contracted at an annualised rate of 2,5 per cent in the third quarter of 2007, real production by the *manufacturing sector* expanded at a rate of 8,2 per cent in the fourth quarter. This robust growth can mainly be attributed to the recovery in the subsector manufacturing motor vehicles, parts and accessories, which had been adversely affected by industrial action in the third quarter of 2007. Notably stronger growth was also observed in the subsector manufacturing petroleum, chemical, rubber and plastic products. The enhanced performance of the manufacturing sector contributed about 1 percentage point to real economic growth in the fourth quarter of 2007, having subtracted a 0,4 percentage point in the preceding quarter. Capacity utilisation in manufacturing accordingly increased marginally further from 85,8 per cent in the third quarter to 86,1 per cent in the final quarter of 2007.

Measured on a calendar-year basis, growth in real value added by the manufacturing sector decelerated from 5,2 per cent in 2006 to 3,9 per cent in 2007. Several factors contributed to the slower annual growth in real manufacturing production including the fairly strong real external value of the rand, which weakened the international competitiveness of the South African industry and encouraged import substitution, the slowdown in household consumption expenditure, capacity constraints, a shortage of skilled and semi-skilled labour and relatively high input costs.

The real value added by the sector supplying *electricity, gas and water* declined at an annualised rate of 1,8 per cent in the fourth quarter of 2007, following an increase at a rate of 3 per cent in the third quarter. In the latter part of the fourth quarter, less energy was produced due to capacity constraints and an apparent shortage of coal at certain power stations. However, for the year as a whole, real value added rose by 3,2 per cent in 2007 compared with a rate of 3 per cent in 2006. In 2007 the volume of electricity imported rose considerably more than the volume of electricity exported.

Growth in real value added by the *construction sector* remained brisk at an annualised rate of 14,2 per cent in the fourth quarter of 2007, slightly lower than the rate of increase of 14,7 per cent registered in the third quarter. Buoyant civil construction and non-residential building activity continued to underpin the sustained high pace of growth. Annual growth in real value added by the construction sector accelerated from 14,7 per cent in 2006 to 18,1 per cent in 2007 as civil construction works benefited from new infrastructure developments alongside the upgrading of existing infrastructure.

Growth in real value added by the *tertiary sector* decelerated from 6,8 per cent in the third quarter of 2007 to 5,1 per cent in the fourth quarter. Slower growth posted by the trade, the transport, storage and communication and the finance, insurance, real-estate and business services subsectors was only partly offset by somewhat stronger activity by general government over the period.

Contrary to the acceleration in overall economic growth, growth in real output of the *trade sector* slowed from an annualised rate of 4,5 per cent in the third quarter of 2007 to 2,1 per cent in the fourth quarter. This slower growth reflected a decline in real value added by the retail and motor trade subsectors in the fourth quarter of 2007. In addition, growth in real value added by the wholesale trade subsector slowed over the period. The slower growth recorded by the trade sector was in tandem with the moderation in household consumption expenditure over the period.

For the year 2007 as a whole, growth in the trade sector amounted to 5,0 per cent, substantially lower than the rate of increase of 7,0 per cent registered in 2006. Higher interest rates and the introduction of the National Credit Act moderated consumer demand and contributed to the slowdown in activity in the retail trade subsector during the second half of 2007. Similarly, new motor vehicle sales failed to match the record number of 714 000 vehicles (including sales by Amalgamated Motor Holdings) recorded in 2006; 676 000 new motor vehicles were sold in 2007.

Following an annualised increase of 4,4 per cent recorded in the third quarter of 2007, the growth in real value added by the *transport, storage and communication sector* slowed to 3,6 per cent in the fourth quarter. This was partly due to slower growth in the transport subsector as activity in the communication sector gained some momentum. For 2007 as a whole, the real value added by the transport, storage and communication sector was 5,2 per cent higher than in 2006.

Growth in real value added by the *finance, insurance, real-estate and business services sector* slowed from a revised rate of 12,3 per cent in the third quarter of 2007 to 8,5 per cent in the fourth quarter. This slowdown was concentrated in the financial services subsector, particularly the banking sector, as credit extension lost some momentum. Although quarterly growth fluctuated between 7,6 per cent and 12,3 per cent during 2007, annual growth in the real value added by this sector slowed from 8,6 per cent in 2006 to 8,3 per cent in 2007.

The real value added by *general government* increased at an annualised rate of 4,4 per cent in the fourth quarter of 2007, higher than the rate of 3,3 per cent attained in the third quarter. Overall growth in real value added by general government increased from 3,1 per cent in 2006 to 3,4 per cent in 2007. This was largely due to increased employment in the sector in 2007.

Growth in *real gross national income* slowed from 6,7 per cent in 2006 to 5,2 per cent in 2007. Although net primary income payments to the rest of the world increased, an improvement in the country's terms of trade was recorded in 2007. In both years, growth in real national income exceeded growth in real domestic production, signifying a further increase in South Africans' living standards.

Domestic expenditure

In contrast to domestic production which gained some momentum in the final quarter of 2007, growth in *aggregate real gross domestic expenditure* slowed from an annualised rate of 5,4 per cent in the third quarter of 2007 to a mere 0,2 per cent in the fourth quarter. The sustained vigorous growth in gross fixed capital formation was more than neutralised by a notable decline in inventory levels, aggravated by a simultaneous slowdown in growth in final consumption expenditure by households and government over this period.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

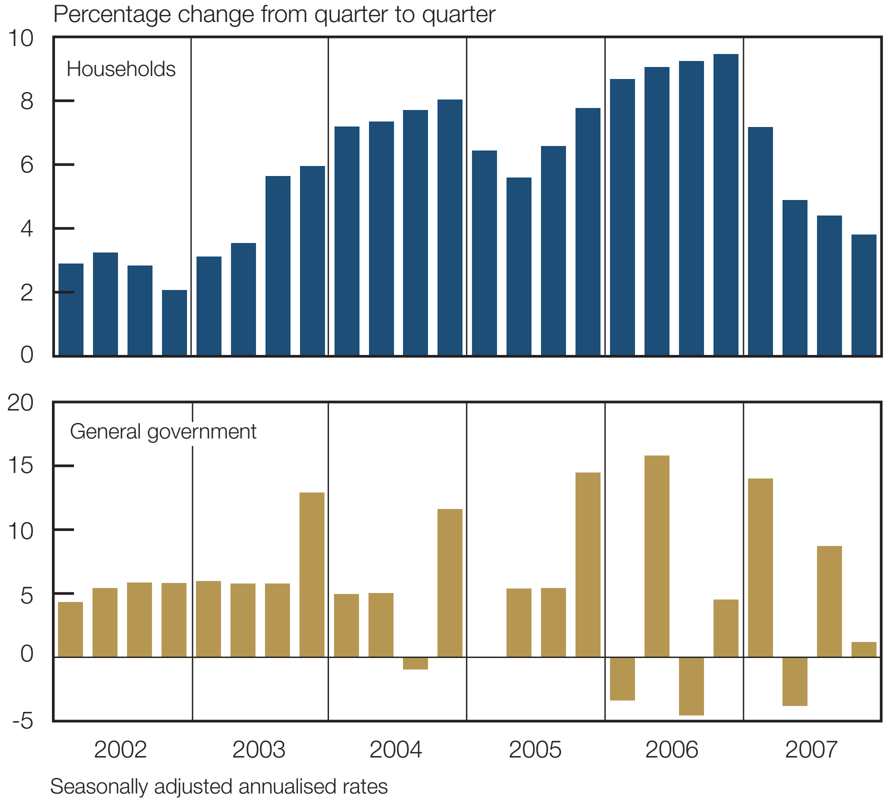
	2006					2007				
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure:										
Households..............	8,7	9,0	9,2	9,5	8,2	7,2	4,9	4,4	3,8	7,0
General government...	-3,4	15,8	-4,5	4,5	5,2	14,0	-3,8	8,7	1,2	5,0
Gross fixed capital formation	15,6	14,3	15,8	16,5	13,8	17,2	11,2	12,9	14,1	14,8
Domestic final demand ..	**7,5**	**11,2**	**7,7**	**9,8**	**8,6**	**10,2**	**4,4**	**6,7**	**5,3**	**8,0**
Change in inventories (R billions)*....................	19,1	13,7	8,8	24,4	16,5	12,9	9,1	6,5	-8,7	4,9
Gross domestic expenditure..................	**16,3**	**9,6**	**1,7**	**12,8**	**9,2**	**6,4**	**3,2**	**5,4**	**0,2**	**6,0**

* At constant 2000 prices

Growth in household expenditure continued to taper off from its recent peak in the fourth quarter of 2006. Having increased at an annualised rate of 7,2 per cent in the first quarter of 2007, growth in *real final consumption expenditure by households* slowed steadily from 4,4 per cent in the third quarter of 2007 to 3,8 per cent in the fourth quarter. The further moderation in the fourth quarter of 2007 reflected a substantial slowdown in real spending on both durable and non-durable goods which was only partly offset by increased demand for semi-durable goods and services over the period. For 2007 as a whole, real growth in household expenditure amounted to 7,0 per cent compared with an increase of 8,2 per cent in the preceding year.

Quarter-to-quarter growth in real expenditure on *durable goods* slowed from an annualised rate of 8,9 per cent in the third quarter of 2007 to 2,5 per cent in the fourth quarter. The moderation in growth in the fourth quarter of 2007 resulted from a sharp decline in the demand for personal transport equipment together with a further decline in real outlays on furniture and household appliances. In addition, consumers reduced their spending on most other subcategories of durable goods with the exception of recreational and entertainment goods.

Real final consumption expenditure by households and general government



Partly reflecting the progressively tighter monetary policy stance from the middle of 2006, spending on durable goods increased at a rate of 5,2 per cent in 2007 as a whole, considerably lower than the increase of 15,9 per cent recorded in 2006. With the exception of spending on recreational and entertainment goods, expenditure on all other subcategories of durable goods receded in 2007. Motor vehicle sales, in particular, contracted significantly over the period.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

	2006					2007				
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods...............	16,1	15,5	9,3	14,5	15,9	10,7	-15,7	8,9	2,5	5,2
Semi-durable goods	19,3	26,0	22,4	19,8	19,9	11,9	22,7	3,5	8,4	16,0
Non-durable goods	4,4	7,0	4,5	7,5	5,4	6,4	3,9	5,2	1,9	5,5
Services........................	7,0	3,5	8,9	5,9	4,9	5,0	6,0	2,9	4,0	5,4
Total	8,7	9,0	9,2	9,5	8,2	7,2	4,9	4,4	3,8	7,0

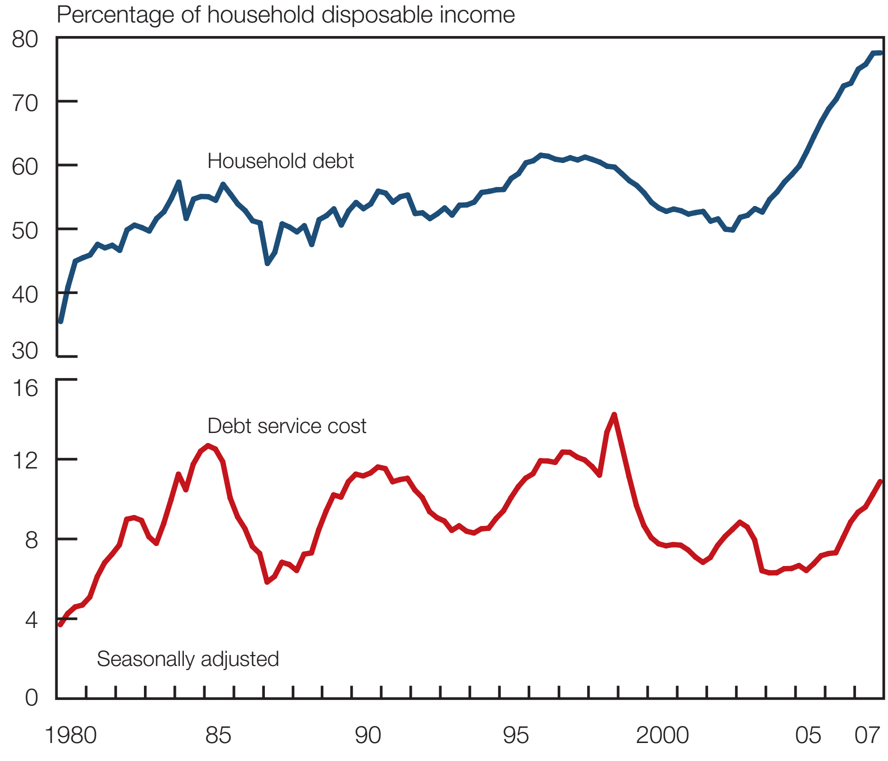
Growth in real household expenditure on *semi-durable* goods accelerated from 3,5 per cent in the third quarter of 2007 to 8,4 per cent in the fourth quarter. Increased spending on clothing and footwear as well as on vehicle tyres, parts and accessories was partly offset by a decline in growth in real outlays on household textiles, furnishings and glassware.

Following a brisk increase at an annualised rate of 5,2 per cent in the third quarter of 2007, growth in real expenditure on *non-durable goods* decelerated to only 1,9 per cent in the fourth quarter. This slower growth was visible in almost all subcategories of non-durable goods. A steady increase in the price of petrol and persistently high food prices in particular, contributed to a marked slowdown in expenditure on these products.

Real outlays by consumers on *services* increased at an annualised rate of 2,9 per cent in the third quarter of 2007, rising to 4,0 per cent in the fourth quarter mainly due to increased spending on transport and communication services over the period.

The household sector's *real disposable income* increased further in the fourth quarter of 2007, albeit at a slightly slower rate than in the preceding quarter. Reflecting the impact of higher interest rates and slower growth in real household consumption expenditure, growth in credit extension to households moderated slightly in the fourth quarter of 2007. The ratio of household debt to disposable income of households increased slightly from 77,5 per cent in the third quarter of 2007 to 77,6 per cent in the fourth quarter. Despite slower growth in household indebtedness, the ratio of debt service cost to the disposable income of households increased further over the period due to higher interest rates.

Household debt and debt service ratios



Real final consumption expenditure by general government rose at an annualised rate of 8,7 per cent in the third quarter of 2007 before decelerating to 1,2 per cent in the fourth quarter. The slower growth could mainly be ascribed to a decline in expenditure on goods and services by general government. Unlike in the previous quarter, no major armaments were acquired in the fourth quarter of 2007. Growth in real compensation of employees by government edged slightly higher in the fourth quarter of 2007 compared with the preceding three quarters.

Real gross fixed capital formation expanded further in the fourth quarter of 2007. Annualised growth in gross fixed capital formation accelerated from 12,9 per cent in the third quarter of 2007 to 14,1 per cent in the fourth quarter – the tenth consecutive quarter of double-digit growth registered from the beginning of the third quarter of 2005. The robust pace of capital spending in the fourth quarter of 2007 was mainly due to brisk capital investment by public corporations. Capital investment by both private business enterprises and general government also increased in the fourth quarter of 2007. For 2007 as a whole growth in real gross fixed capital formation amounted to a robust 14,8 per cent, higher than the rate of 13,8 per cent recorded in 2006.

Growth in real capital outlays by the *private sector* slowed from an annualised rate of 14,1 per cent in the third quarter of 2007 to 13,4 per cent in the fourth quarter. The moderation in growth mainly reflected slower activity by the commerce, transport and finance sectors, consistent with the slower growth in mortgage advances and a moderation in growth in final consumption expenditure by households. By contrast, there was an acceleration in real capital investment by the manufacturing sector.

Real gross fixed capital formation

Percentage change at seasonally adjusted annualised rates

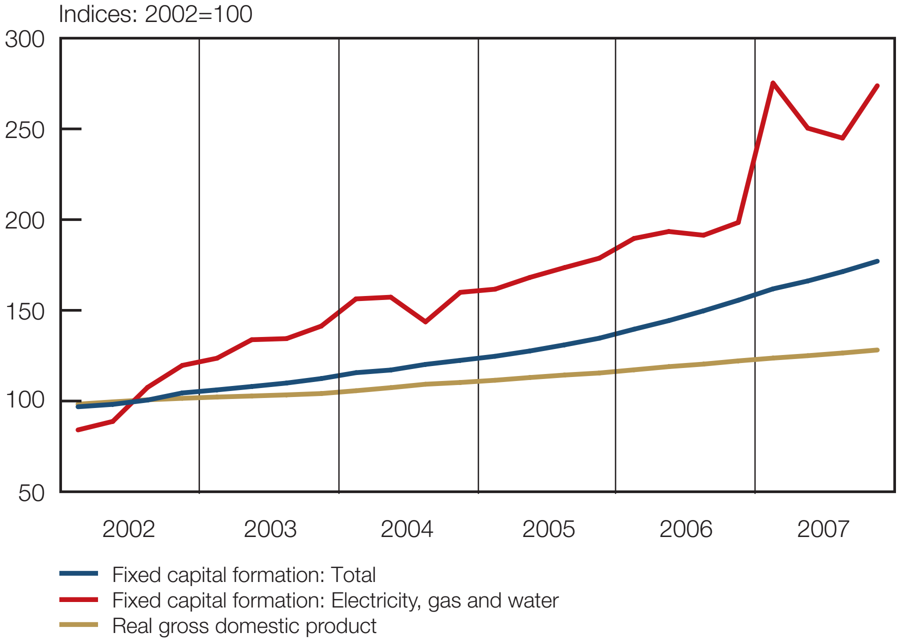
	2006					2007				
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private business enterprises....................	14,3	13,1	15,1	14,7	13,6	17,3	12,9	14,1	13,4	14,8
Public corporations........	15,9	15,2	16,6	25,3	15,3	81,2	14,9	17,7	30,3	32,6
General government	22,7	19,9	18,8	19,2	13,4	-21,3	-1,3	1,7	2,6	0,6
Total	**15,6**	**14,3**	**15,8**	**16,5**	**13,8**	**17,2**	**11,2**	**12,9**	**14,1**	**14,8**

The infrastructure investment programme continued to impact on growth in capital expenditure by general government and public corporations. Following a contraction in the first half of 2007, real capital expenditure by *general government* rose moderately in both the third and the fourth quarters. For 2007 as a whole, growth in real capital expenditure by general government slowed to a rate of 0,6 per cent, reflecting sluggish capital spending especially by smaller local authorities. A buoyant increase in real capital investment by *public corporations* in the fourth quarter of 2007 was underpinned by lively activity in the electricity as well as the transport and communication sectors. Increased spending by the electricity sector was prominent in the higher capital outlays on the Medupi power station and on the renewal of existing power stations. Operations to increase capacity at the country's ports continued in the fourth quarter of 2007 alongside the upgrading of certain freeways.

As seen in the accompanying graph, since 2003 growth in total gross fixed capital formation has exceeded growth in real gross domestic product by a considerable margin. Moreover, the growth momentum of investment spending by the electricity subsector was significantly stronger than that of the overall economy's fixed capital formation. Long lags characterise the process of increasing electricity production capacity.

After 25 consecutive quarters of increases, the level of inventories declined in the fourth quarter of 2007. Cutbacks in inventories were prominent in most of the production sectors of the economy. The mining sector recorded a reduction in inventories due to strike activity, the temporary closure of some shafts, and disruption by rain and logistical

Real gross fixed capital formation



problems which adversely affected production, the latter especially in coal mining. Manufacturing inventories also contracted somewhat. Simultaneously, there was an increase in accumulation of inventories in the wholesale, retail and motor-trade sector, probably due to subdued domestic demand. The overall decline in inventory investment subtracted 4,5 percentage points from growth in real gross domestic expenditure in the fourth quarter of 2007.

Factor income

The growth over four quarters in total *nominal factor income* accelerated from a revised rate of 13,9 per cent in the third quarter of 2007 to 14,2 per cent in the fourth quarter. This increase reflected stronger growth in both compensation of employees and gross operating surpluses of business enterprises. For 2007 as a whole, higher price and wage inflation left its mark and growth in total factor income amounted to 14,9 per cent, following growth of 12,8 per cent in 2006.

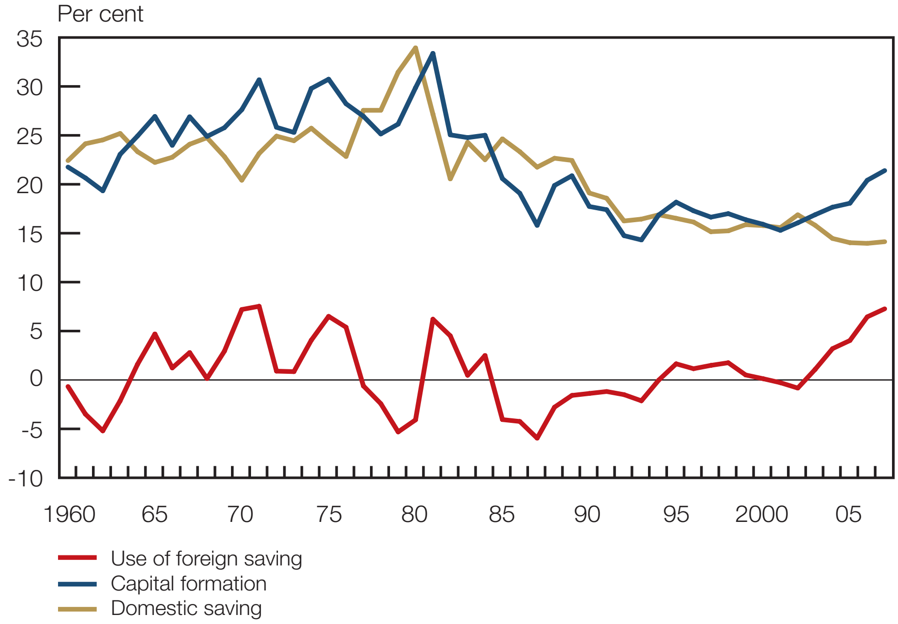
Measured over four quarters, the rate of growth in *compensation of employees* accelerated from a revised 12,0 per cent in the third quarter of 2007 to 12,3 per cent in the fourth quarter. The increase in compensation could mainly be ascribed to strong growth in the compensation of employees of the general government sector. On an annual basis, growth in aggregate employee remuneration accelerated from 10,6 per cent in 2006 to 11,7 per cent in 2007, due to both increased employment levels in the formal sector of the economy as well as higher wage settlement rates over the period.

Measured over four quarters, the rate of increase in *nominal gross operating surpluses* increased from 15,6 per cent in the third quarter of 2007 to 16,2 per cent in the fourth quarter mainly due to lively economic activity in the manufacturing and construction sectors. In addition, operating surpluses in the agricultural and mining sectors accelerated, in part due to the sustained strong increase in commodity prices. Growth in the overall gross operating surplus increased from 15,0 per cent in 2006 to 18,1 per cent in 2007, and the share of the operating surplus in total factor income accordingly rose from 50,1 per cent in 2006 to 51,5 per cent in 2007.

Gross saving

Gross saving relative to gross domestic product amounted to 13,5 per cent in both the third and fourth quarters of 2007. The saving ratios of all three main institutional sectors – the corporate sector, households and general government – remained broadly unchanged over the period. The national saving ratio for 2007 as a whole amounted to 14,1 per cent, marginally higher than the value of 14,0 per cent recorded in 2006 due to higher saving levels by general government. Notwithstanding the minor improvement in the national saving ratio, the country's dependence on foreign capital to finance gross capital formation increased from 31,6 per cent in 2006 to 34,0 per cent in 2007. This was the highest rate of dependency on foreign capital ever reached in South Africa owing to the sustained strong momentum in gross capital formation. The previous highest rate of dependency on foreign capital of 26,1 per cent was recorded in the early 1970s.

Gross capital formation and saving as percentage of gross domestic product



Gross saving by the *corporate sector* as a percentage of gross domestic product edged higher from 9,7 per cent in the third quarter of 2007 to 9,8 per cent in the fourth quarter. This resulted from stronger growth in the gross operating surpluses of enterprises that was almost fully offset by an increase in dividend payments in the fourth quarter. The corporate saving ratio decreased from 10,1 per cent in 2006 to 9,9 per cent in 2007.

The gross saving ratio of the *household sector* remained broadly unchanged at 1,4 per cent of gross domestic product in the fourth quarter of 2007, roughly the same ratio attained in the full calendar years 2006 and 2007.

Although the gross saving by *general government* as a percentage of gross domestic product was sustained at 2,4 per cent in the fourth quarter of 2007, the saving ratio increased from 2,4 per cent in 2006 to 2,9 per cent in 2007. This was mainly due to an increase in tax revenue collected which more than offset growth in recurrent expenditure.

Employment

The sustained expansion in overall economic activity continued to have a positive impact on employment. However, the pace of employment gains slowed considerably in recent quarters. In fact, from the second to the third quarter of 2007 aggregate employment in the formal non-agricultural sectors of the economy increased by a marginal 0,5 per cent when expressed at a seasonally adjusted and annualised rate – the lowest rate of increase in two-and-a-half years. The slowdown in employment growth in the third quarter of 2007 was due to job losses in the private sector, while further employment gains occurred in the public sector during this period.

According to the enterprise-based *Quarterly Employment Statistics* (QES) survey by Statistics South Africa (Stats SA), private-sector employment growth decelerated markedly from 3,3 per cent in the first quarter of 2007 to a rate of *decrease* of 0,6 per cent in the third quarter, while public-sector employment growth picked up significantly from an annualised rate of decrease of 1,0 per cent in the second quarter of 2007 to an increase of 4,9 per cent in the third quarter.

Employment losses in the private sector in the third quarter of 2007 were most pronounced in the community, social and personal services sector, as well as in the manufacturing and construction sectors. Employment gains were, however, fairly pervasive across all tiers of the public sector during this period, with meaningful increases occurring especially at provincial level and at some parastatal institutions.

Change in enterprise-surveyed formal non-agricultural employment, September 2007

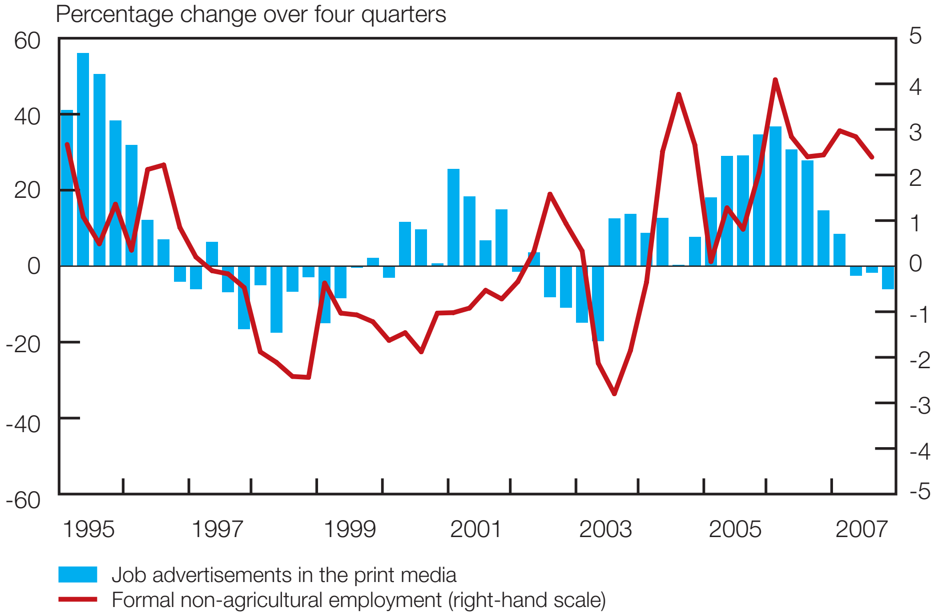
Sector	Over four quarters		Over one quarter*
	Number	Percentage	Percentage
Mining	37 790	8,1	4,9
Gold mining	9 160	5,7	4,9
Non-gold mining	28 630	9,5	4,8
Manufacturing	-15 270	-1,1	-3,0
Electricity supply	3 700	7,3	5,9
Construction	15 030	3,3	-2,0
Trade, catering and accommodation	59 940	3,6	-0,2
Transport, storage and communication	-3 520	-1,4	-0,9
Finance, insurance and real estate	61 310	3,5	0,6
Community, social and personal services	-31 090	-7,2	-5,8
Total private sector	**127 890**	**2,0**	**-0,6**
National, provincial and local government	59 640	4,1	5,2
Public-sector enterprises	6 920	3,0	3,4
Total public sector	**66 560**	**4,1**	**4,9**
Grand total	**194 450**	**2,4**	**0,5**

* Seasonally adjusted annualised rates

The Grant Thornton 2007 *International Business Report* for South Africa reported that, on a net balance, more than half of businesses reported an actual increase in employment in 2007 compared with 32 per cent in 2006. In fact, in 2007 61 per cent of businesses cited an increase in employment and 9 per cent a decrease. The survey is conducted among medium to large privately-owned enterprises in the manufacturing, construction, retail and services sectors.

The volume of job advertisement space in the print media, which has historically correlated well with formal non-agricultural employment, however decreased by as much as 8 per cent in the year to the fourth quarter of 2007.

Job advertisements and formal non-agricultural employment



Initially defying the deterioration in sentiment, the Investec Purchasing Managers Index (PMI) released by the Bureau for Economic Research (BER) indicated that the sub-index for employment in the manufacturing sector rose from a recent low seasonally adjusted 51,1 in September 2007 to 57 in December 2007. The BER *Manufacturing Survey* for the fourth quarter of 2007 also reported a pick-up in employment in this sector, with the majority of manufacturers reporting an increase in the number of factory workers. In the two months to February 2008 the PMI employment sub-index dropped sharply to 44,1, pointing to weaker employment conditions in the manufacturing sector.

According to the latest BER *Retail Trade Survey*, retailers' confidence levels deteriorated substantially in the fourth quarter of 2007 to their lowest levels in more than three years. The decline in confidence was ascribed to slower sales growth, lower overall profitability and an involuntary build-up of inventories. The growth rate in the number of people employed in the retail sector, according to this survey, fell steeply from the second quarter of 2007 to the third quarter before rebounding somewhat in the fourth quarter. This was corroborated in part by a contraction in employment growth in the *trade, catering and accommodation services sector,* as recorded by the QES, from an annualised rate of 5,1 per cent in the first quarter of 2007 to a rate of decrease of 0,2 per cent in the third quarter.

Employment in the *construction sector* decreased at a seasonally adjusted and annualised rate of 2,0 per cent in the third quarter of 2007, after it had increased at a rate of 16,5 per cent in the first quarter. The overall level of confidence in the residential and non-residential building sectors, as surveyed by the BER, remained high in the fourth quarter of 2007, despite tighter demand conditions which adversely affected residential building activity, leading to job shedding in this sector in the fourth quarter. Robust business conditions in the non-residential building sector, however, led to strong employment gains. A similar direction is indicated by the FNB/BER Civil Construction Index, which surveys the state of business conditions in the civil engineering industry with its focus on infrastructure-related construction activity in particular. This index recovered notably during the fourth quarter of 2007 after it had decreased sharply during the third quarter.

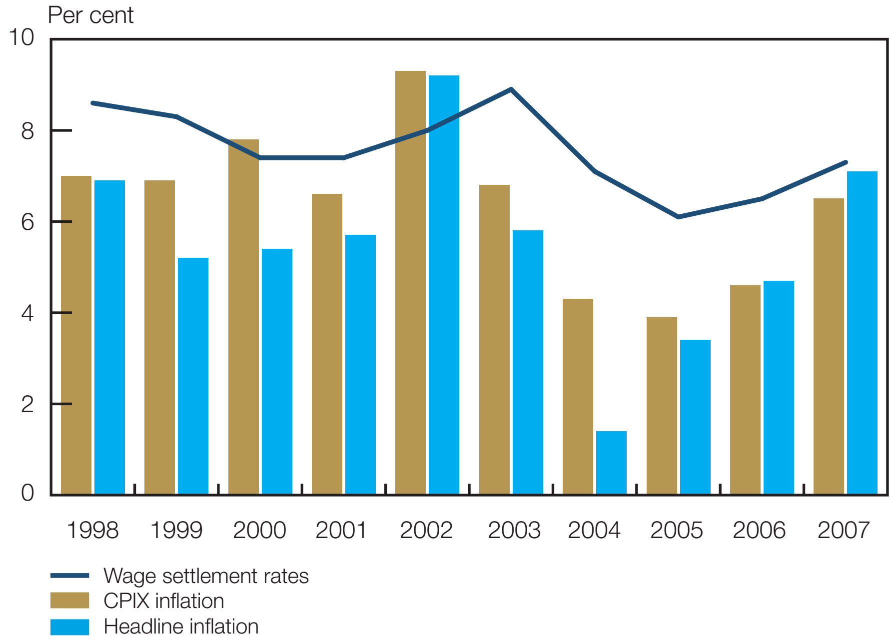
Following sustained high levels of electricity demand in the country, employment in the *electricity generation sector* rose from 50 900 in the third quarter of 2006 to 54 600 in the third quarter of 2007; an increase of 7,3 per cent. Furthermore, the sustained international commodity price boom encouraged the mining sector to expand existing operations, leading to an increase in employment at a year-on-year rate of 8,1 per cent in the third quarter of 2007. Employment in the non-gold mining sector, in particular, increased by as much as 9,5 per cent over the same period.

Labour cost and productivity

Growth in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy accelerated from a year-on-year rate of 4,9 per cent in the first quarter of 2007 to 7,5 per cent in the second quarter, rising further to 7,7 per cent in the third quarter. The year-on-year rate of increase in nominal remuneration per worker in the private sector continued to outpace that in the public sector in the third quarter of 2007. Average remuneration growth in the private sector remained at 7,6 per cent in both the second and third quarters whereas public-sector remuneration growth accelerated from 7,1 per cent in the second quarter of 2007 to 7,5 per cent in the third quarter. In the private sector, remuneration increases in excess of 6,0 per cent were recorded in all but the electricity and gold-mining sectors. In the public sector, the highest year-on-year remuneration increases in the third quarter of 2007 were registered in the national departments (10,7 per cent) and provincial governments (8,4 per cent).

Wage increases drifted higher in the wake of rising inflation. According to Andrew Levy Employment Publications (a private-sector labour consultancy), the average rate of wage settlements amounted to 7,3 per cent in 2007, compared with 6,5 per cent in 2006. Wage settlements ranged from 4,5 per cent in the transport sector to 12,0 per cent in the retail sector.

Wage settlements and consumer prices



In recent quarters, output growth outpaced employment gains in the economy. This led to an acceleration in economy-wide labour productivity growth from a year-on-year rate of 2,3 per cent in the second quarter of 2007 to 2,8 per cent in the third quarter. Owing to growth in compensation of employees which accelerated at a faster pace than the volume of non-agricultural production, the year-on-year growth in compensation of employees per unit of real gross domestic product accelerated from 4,4 per cent in the fourth quarter of 2006 to 6,5 per cent in the third quarter of 2007.

Prices

Following considerable progress made with the containment of price inflation between 2002 and 2004, annual CPIX inflation accelerated from 3,9 per cent in 2005 to 4,6 per cent in 2006 and 6,5 per cent in 2007, while headline inflation picked up from 1,4 per cent in 2004 to 7,1 per cent in 2007. After forty-three months in the inflation target range, year-on-year CPIX inflation breached the upper band of the inflation target range in April 2007, amounting to 6,3 per cent. Subsequently, CPIX inflation accelerated markedly to a year-on-year rate of 8,8 per cent in January 2008. This acceleration in inflation resulted primarily from higher food prices and intermittent steep increases in the international price of crude oil, leading to substantially higher domestic fuel prices. Various capacity constraints within a buoyant economy probably also imparted some momentum to the inflation process.

Consumer prices

2 In March 2008, Statistics South Africa released a producer price index based on a new basket and a change in methodology.

All-goods production price inflation[2] amounted to 10,0 per cent in 2007, significantly higher than in the preceding year. The acceleration occurred despite a general slowdown in year-on-year production price inflation during the second half of the year as imported goods price inflation moderated somewhat.

In fact, year-on-year *imported goods price inflation* decelerated from 11,7 per cent in May 2007 to 7,3 per cent in November. Price inflation slowed as the rate of increase in the prices of a broad range of imported manufactured products, namely chemicals, transport equipment, basic metals, electrical machinery, and wood and wood products, moderated over the period. In January 2008 year-on-year imported goods price inflation, however, accelerated to 12,3 per cent as the prices of imported agricultural food products increased by as much as 39,7 per cent over twelve months. At the same time, imported manufactured goods price inflation accelerated, largely driven by higher prices of manufactured food and chemical products. Marked increases in the price of crude oil together with the weakening in the external value of the rand contributed significantly to higher prices of petroleum products.

Production prices

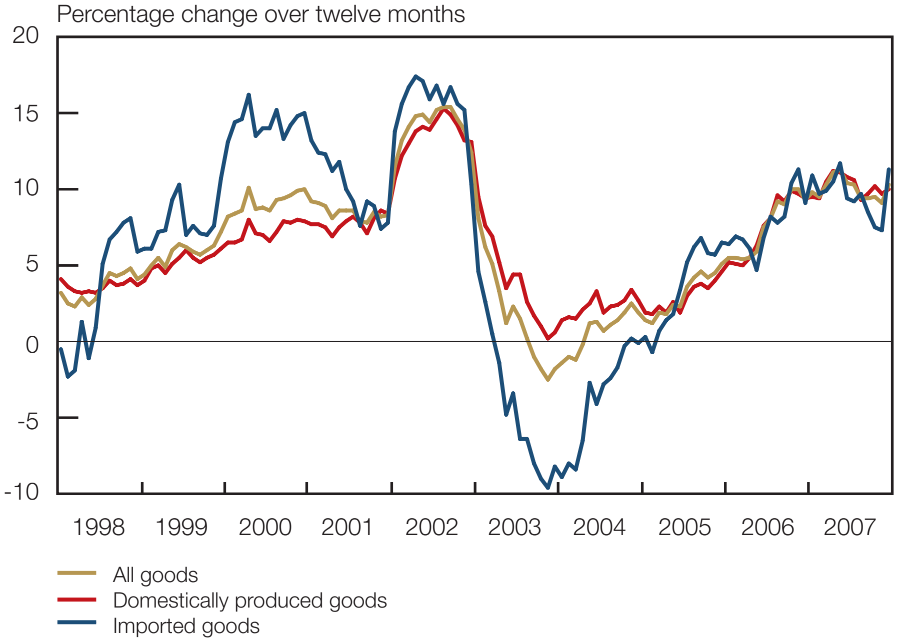
Quarter-to-quarter percentage change at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2006:	1st qr	6,3	2,3	3,9
	2nd qr	9,9	8,8	10,3
	3rd qr	16,2	20,7	18,9
	4th qr	6,5	9,7	6,6
	Year	**7,6**	**7,7**	**7,7**
2007:	1st qr	7,1	2,7	4,3
	2nd qr	14,8	9,8	14,4
	3rd qr	11,1	14,0	13,8
	4th qr	7,1	8,7	6,4
	Year	**10,1**	**9,6**	**10,0**

Domestically produced goods price inflation, which had risen to a year-on-year rate of 11,2 per cent in April 2007, decelerated to 9,3 per cent in August, primarily due to a slowdown in the rate of increase in the prices of mining products. It subsequently accelerated to 10,0 per cent in December 2007, affected largely by a surge in the agricultural food price category. Year-on-year agricultural food price inflation, even though it has been decelerating in recent months, remained well above the twenty-per-cent mark, contributing to the elevated level of domestically produced goods price inflation. In the year to October 2007, agricultural food price inflation rose to 27,9 per cent due to increases in the prices of grain products, particularly wheat, before

Production prices

Percentage change over twelve months



decelerating thereafter. At the manufacturing level, food price inflation also accelerated notably to a year-on-year rate of 18,5 per cent in December 2007. Higher inflation in the prices of petroleum and coal products as well as wood and wood products contributed materially to elevated levels of domestically produced goods price inflation. From January 2008 the headline measure of producer price inflation became the index of producer prices of domestic output in South Africa. Although not fully comparable with earlier values, the twelve-month rate of increase in this measure amounted to 10,4 per cent in January 2008.

Driven mainly by higher prices of domestically produced goods, year-on-year *all-goods production price inflation* doubled from 2005 to 2006 and accelerated further to reach a double-digit rate of 10,0 per cent in 2007. However, when the effect of rising energy and food prices is omitted, the resultant indicator of underlying all-goods production price inflation decelerated meaningfully to 5,2 per cent in the year to December 2007, from double-digit rates earlier in the year.

Food prices

Percentage change over twelve months

Period		Domestic production prices of food			CPIX consumer food prices
		Agricultural food	Manufactured food	Total	
2006:	**Year**	**17,6**	**7,3**	**11,5**	**6,7**
2007:	Jan	12,6	10,9	11,6	8,3
	Feb	15,6	10,0	12,4	7,9
	Mar	19,2	10,7	14,3	7,8
	Apr	17,9	11,7	14,3	8,6
	May	14,3	13,5	13,9	9,0
	Jun	15,2	15,0	15,1	9,4
	Jul	19,0	15,1	16,7	10,2
	Aug	22,9	14,9	18,4	11,3
	Sep	23,2	15,5	18,9	12,0
	Oct	27,9	17,5	22,0	12,4
	Nov	26,7	18,8	22,2	13,3
	Dec	25,7	18,5	21,6	13,9
	Year	**20,2**	**14,4**	**16,9**	**10,4**
2008:	Jan	25,6*	18,7*	21,5*	13,6

* Data not fully comparable between December 2007 and January 2008

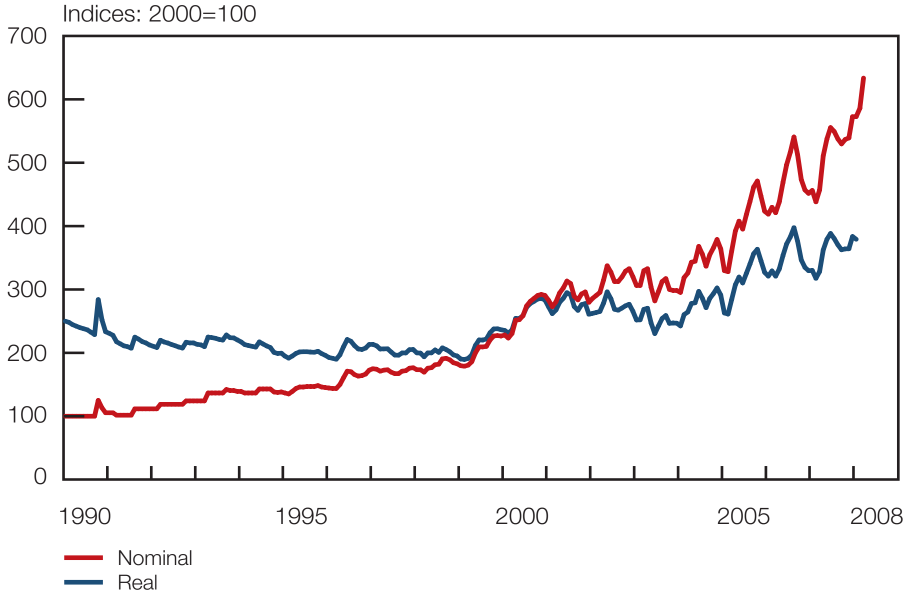
The differential between year-on-year *CPIX inflation* and the upper band of the inflation target range widened from a 0,3 percentage point in April 2007 to 2,8 percentage points in January 2008 as price pressures mounted. Increased price pressures were fairly pervasive as inflation in the prices of both goods and services accelerated during the course of 2007. Within the consumer goods basket, year-on-year increases in excess of 6 per cent occurred in January 2008 in the prices of food, water, alcoholic beverages and tobacco products as well as fuel and motor spares. In the services basket, year-on-year inflation in excess of 6 per cent was also recorded for domestic workers' wages, homeowners' cost, education, dry cleaning and hairdressing services prices over the period. The prices of furniture and equipment, however, fell in the year to January 2008.

Following the significant increase in the production prices of food, CPIX consumer food price inflation accelerated from 7,9 per cent in the year to February 2007 to 13,6 per cent in the year to January 2008. In fact, if food prices were to be excluded from the price index, CPIX inflation would have amounted to 7,0 per cent in the year to January 2008. Further excluding energy prices, CPIX inflation would have amounted to only

5,5 per cent in January 2008, even though this underlying rate of increase also accelerated during the course of the year.

Year-on-year *CPIX goods price inflation* also breached the upper limit of the inflation target range of 6 per cent in April 2007 and thereafter accelerated to 10,3 per cent in January 2008. Petrol price changes, in particular, accelerated from a rate of decrease of 0,5 per cent in August 2007 to a rate of increase of 23,2 per cent in January 2008. The quarter-to-quarter pace of increase in CPIX goods prices accordingly accelerated briskly from 5,6 per cent in the first quarter of 2007 to 10,6 per cent in the fourth quarter.

Nominal and real petrol prices



CPIX services price inflation accelerated moderately from a year-on-year rate of 4,6 per cent in January 2007 to 6,0 per cent a year later. Higher rates of increase in CPIX services prices were fairly pervasive, as already indicated, led by increases in homeowners' cost, domestic workers' wages, and education costs. When measured from quarter to quarter and expressed at an annualised rate, CPIX services price inflation almost doubled from 3,6 per cent in the first quarter of 2007 to 7,0 per cent in the fourth quarter.

Inflation in CPIX components

Annual average percentage changes

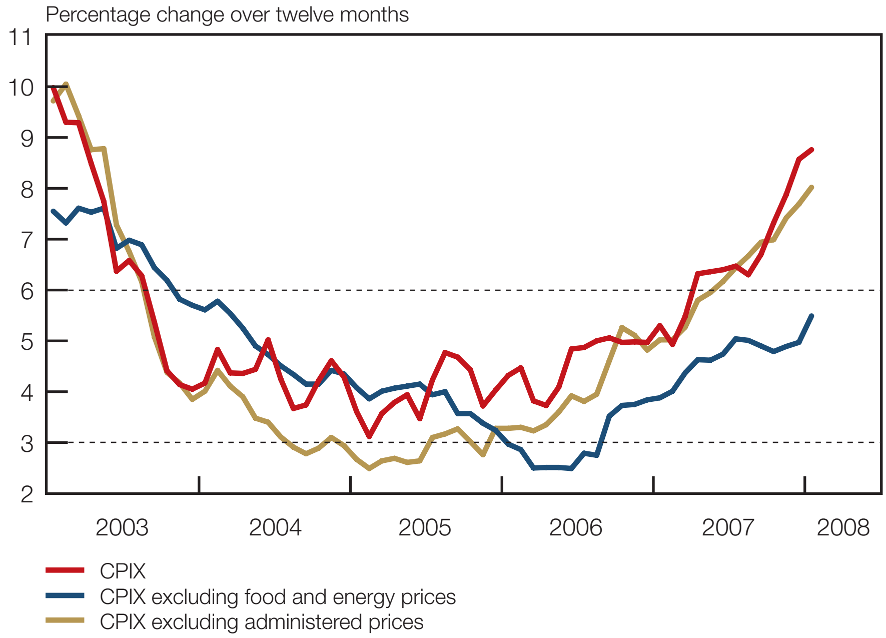
	Weights	2006	2007
Transport running cost	5,7	12,8	10,0
Food and soft drinks	26,9	6,6	10,1
Alcoholic beverages and tobacco	3,1	8,0	8,4
Total housing services	13,4	3,6	6,3
Services excluding housing and transport	***16,5***	***4,5***	***5,3***
Total other goods (not included elsewhere)	***17,5***	***3,5***	***5,5***
Total transport services	***3,9***	***2,8***	***3,9***
Vehicles	5,7	-0,7	0,4
Furniture and equipment	3,2	-1,4	-0,2
Clothing and footwear	4,1	-7,3	-8,1
Total CPIX	100,0	4,6	6,5

Bold italics denote values inside the inflation target range of between 3 and 6 per cent in 2007

During 2007, three components within the CPIX basket with a combined weight of 37,9 per cent remained within the official inflation target range of 3 to 6 per cent, while another four components with a combined weight of 49,1 per cent hovered above the inflation target range. The balance, with a contribution of 13 per cent, remained below the lower limit of the inflation target range.

Inflation in the prices of administered goods and services accelerated from a year-on-year rate of 4,6 per cent in February 2007 to 11,9 per cent in December, especially due to higher petrol prices. However, if petrol prices are excluded, administered prices would have increased at a year-on-year rate of 6,9 per cent in November and December 2007, almost on a par with increases during the second half of the year, but somewhat higher than increases in the first half of the year.

Measures of underlying inflation



According to the Inflation Expectations Survey conducted by the BER at the University of Stellenbosch, in late 2007 CPIX inflation was expected to decelerate to 5,9 per cent in 2008 and 5,6 per cent in 2009. Trade union representatives, however, were less optimistic about future inflation.

CPIX inflation expectations

Per cent, as surveyed in the fourth quarter of 2007

	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
Average inflation expected for:				
2007	6,3	5,8	5,8	**6,0**
2008	6,0	5,8	6,0	**5,9**
2009	5,1	5,7	6,0	**5,6**

Foreign trade and payments

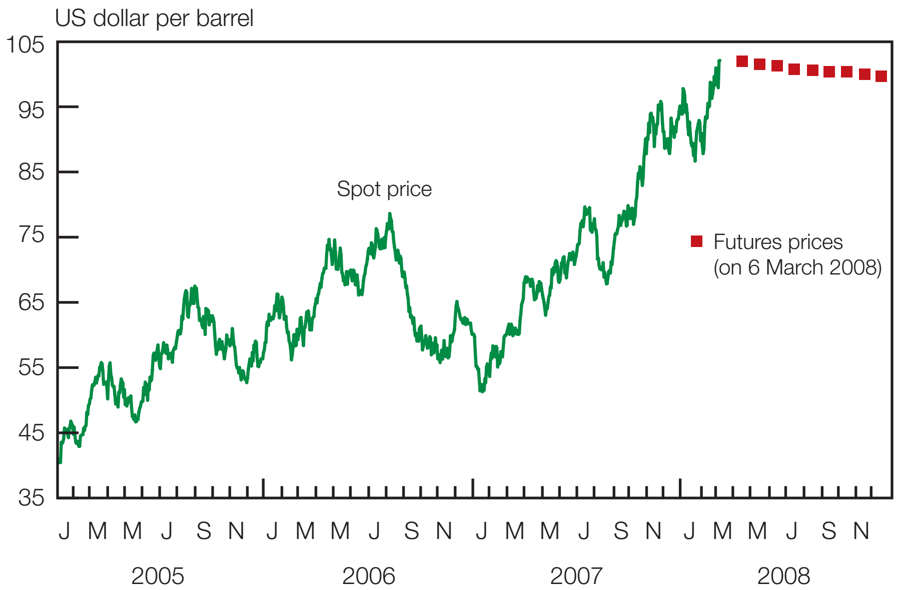
International economic developments

Global economic growth slowed significantly in the fourth quarter of 2007 following brisk activity in preceding quarters. Growth in world economic activity is furthermore expected to slow notably in 2008 in the wake of ongoing financial market turbulence and increased risk aversion. According to the IMF's most recent *World Economic Outlook Update*, global economic growth is projected to moderate from 4,9 per cent in 2007 to 4,1 per cent in 2008, a markdown of a 0,3 percentage point relative to previous forecasts. Overall, the balance of risks to the global outlook is tilted to the downside mainly due to the continued turmoil in financial markets that could further reduce domestic demand in advanced economies.

Real output growth in the United States (US) slowed markedly in the fourth quarter of 2007, following the continued contraction in residential investment, a rundown of inventories and a deceleration in exports. Recent economic data in the euro area indicated that real output growth moderated in the final quarter of 2007, mainly due to a contraction in consumer and government expenditure. Robust economic conditions in emerging-market economies continued to support global growth momentum. In China, real output growth accelerated slightly in the final quarter of 2007. The Chinese economy registered its fastest growth in thirteen years in 2007 – exceeding a rate of 10 per cent for the fourth consecutive year. Growth in Africa remained strong in 2007, underpinned by high commodity prices, improved economic policies and fairly limited exposure to international financial market turmoil.

Brent crude oil prices remained volatile throughout December 2007 and reached levels of around US$98 per barrel in early January 2008. Upward pressure on oil prices during the period stemmed mainly from underlying market tightness in combination with low inventory levels, violence in Nigeria, cold weather in the northern hemisphere, strong investor demand for commodities, news that central banks plan co-ordinated measures to improve liquidity in the global financial system and a Norwegian oil spill in the North Sea. The oil price subsequently trended downwards to levels below US$90 per barrel in the third week of January on concerns about a possible US recession and its impact on world oil demand. Crude oil prices, however, started to trend upwards in the second week

Brent crude oil prices



of February 2008, reaching levels of around US$95 per barrel in mid-February due to concerns about supplies from Venezuela. The latter half of February saw Brent crude oil prices increase further on speculation that the Organization of the Petroleum Exporting Countries (OPEC) would maintain production targets at its next meeting, on supply disruptions in Ecuador, the United Kingdom and Nigeria, as well as geopolitical concerns due to Turkey's incursion into northern Iraq and escalating tension between Iran and the West. Brent crude oil prices reached new record-high levels of around US$103 per barrel during the first week of March 2008 due to US-dollar weakness and an unexpected decline in US crude oil inventories, while OPEC decided to keep its output targets unchanged.

Headline consumer price inflation in most advanced and emerging-market countries accelerated from mid-2007, while core inflation rates also edged higher. US consumer price inflation rose briskly during the final quarter of 2007, underpinned by surging energy and food prices. However, excluding these items, core prices rose modestly despite a sharp increase in the cost of medical-care services. Strong short-term upward pressure on inflation in the euro area was visible in the fourth quarter of 2007. This increase was mainly due to strongly rising prices of energy and, to a lesser extent, processed food. The annual rate of change in Japan's consumer price index recently returned to positive territory, mainly reflecting past increases in the price of imported raw materials. In the final quarter of 2007, annual consumer price inflation accelerated in most emerging-market countries, largely due to higher food prices. With respect to different regions, annual consumer price inflation accelerated notably in emerging European countries such as the Czech Republic and Poland, emerging Asian countries such as Hong Kong, Taiwan and Thailand and emerging Latin American countries such as Chile and Peru.

Monetary policy is currently challenged by higher inflation and slower economic growth. Since the beginning of December 2007 monetary policy has been tightened in countries such as Australia, Chile, China, Poland, Russia, Sweden and Taiwan in response to rising inflationary pressures. By contrast, monetary policy has been relaxed in Canada, Hong Kong, Indonesia, Turkey, the United Kingdom and the United States. The US Federal Open Market Committee lowered its target for the federal funds rate by 25 basis points in December 2007, by 75 basis points on 22 January 2008 (between scheduled policy meetings) and by a further 50 basis points on 30 January 2008.

Current account[3]

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

Despite the sustained strong growth in fixed capital spending, South Africa's trade deficit almost halved from R52,0 billion in the third quarter of 2007 to R26,7 billion in the fourth quarter. The smaller deficit resulted mainly from a surge in the value of merchandise exports which more than offset a further moderate increase in the value of imported goods.

The reduction in the trade deficit in the fourth quarter of 2007 outweighed a further widening of the shortfall on the service, income and current transfer account with the rest of the world over the same period. As a result, the negative imbalance on the current account of the balance of payments contracted to R157,6 billion in the fourth quarter of 2007, bringing the deficit for the year as a whole to R145,0 billion. Although the current-account deficit increased from 6,5 per cent of gross domestic product in 2006 to 7,3 per cent in 2007, this ratio shrank from 8,1 per cent in the third quarter of 2007 to 7,5 per cent in the fourth quarter.

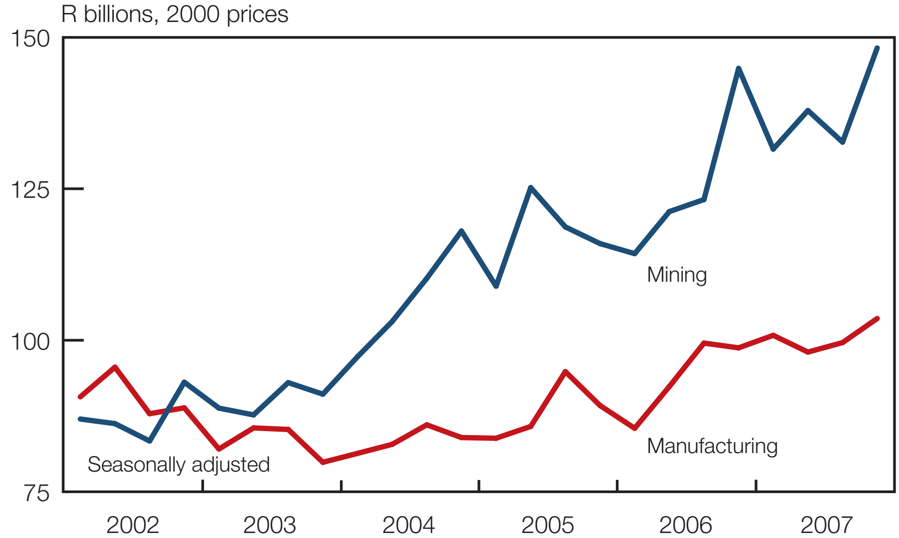
The value of *merchandise exports* advanced by 6,8 per cent in the fourth quarter of 2007 after having shown virtually no growth from the second to the third quarter. The improved performance of merchandise exports in the final quarter of 2007 primarily reflected a surge in the demand for South Africa's mining products; ongoing capacity building in the Chinese economy boosted the export volumes of especially base metals, articles thereof and coal. At the same time, the country registered a significant increase in the volume of exported vehicles and transport equipment. The increase in the number of vehicles exported largely reflected a step-up in production by a local motor vehicle manufacturer following the temporary ceasing of its operations due to the refurbishment of its manufacturing plant. Supply constraints in some export sectors forced local producers to partly run down inventories in order to meet international demand. Overall, the volume of merchandise exports escalated by 5 per cent in the fourth quarter of 2007. For the year as a whole, the volume of exports increased by 9,4 per cent – almost double the pace of growth in real gross domestic product.

Balance of payments on current account
Seasonally adjusted and annualised
R billions

	2006	2007				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	399,0	466,5	494,6	494,3	527,9	495,8
Net gold exports	35,5	37,3	36,3	41,0	45,1	39,9
Merchandise imports	-476,5	-554,6	-562,3	-587,3	-599,7	-576,0
Trade balance	**-42,0**	**-50,8**	**-31,4**	**-52,0**	**-26,7**	**-40,3**
Net service, income and current transfer payments	-70,3	-82,2	-94,7	-111,3	-130,9	-104,7
Balance on current account	**-112,3**	**-133,0**	**-126,1**	**-163,3**	**-157,6**	**-145,0**
As percentage of gross domestic product	*-6,5*	*-6,9*	*-6,5*	*-8,1*	*-7,5*	*-7,3*

In addition to the increase in the physical quantity of exports, export proceeds were also boosted by the revival of international commodity prices during the fourth quarter of 2007 following a brief interruption during the third quarter. The increase in commodity prices was to some extent countered by the appreciation in the average nominal effective exchange value of the rand, giving rise to a marginal increase of only 1,9 per cent in the rand price of merchandise exports in the final quarter of 2007. For 2007 as a whole, the average rand price of merchandise exports advanced by 14 per cent.

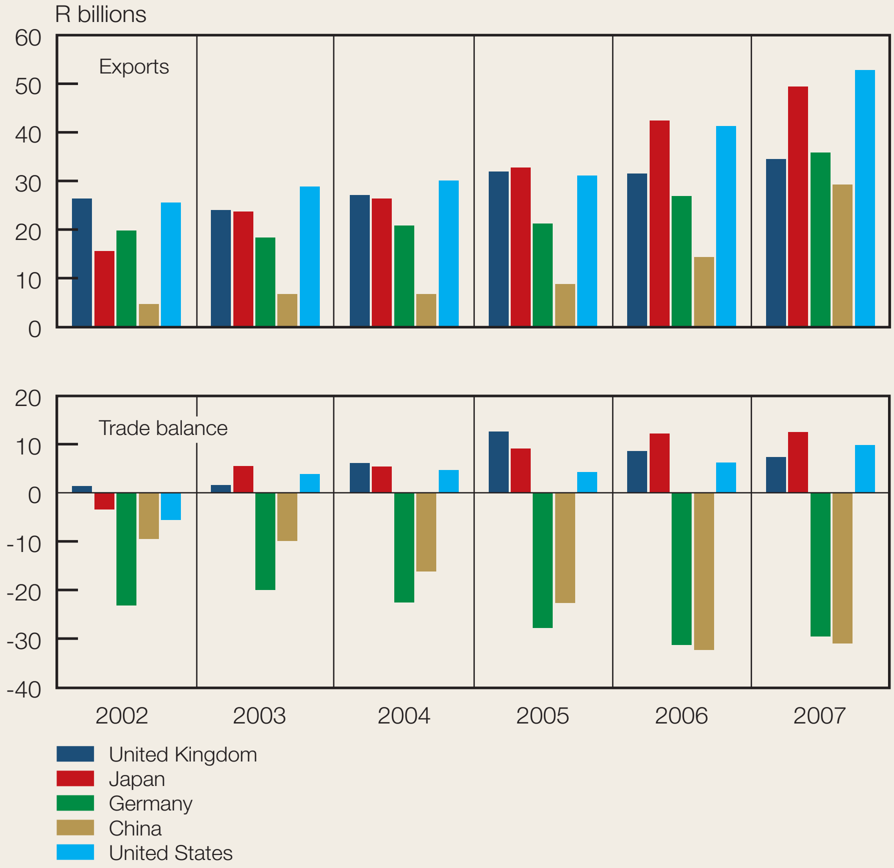
Volume of merchandise exports
R billions, 2000 prices



South African trade with selected countries

South Africa's overall foreign trade deficit narrowed from R42,0 billion in 2006 to R40,3 billion in 2007. Relative to gross domestic product, the deficit shrank from 2,4 per cent to 2,0 per cent over the same period.

South African trade with selected countries



Over time, South Africa has developed a strong trade relationship with a number of countries such as the United States (US), United Kingdom (UK), Japan and Germany, featuring strongly as export destinations and providers of imports. Recently, China has increased considerably in importance, as illustrated in the accompanying graph. The buoyant increase in exports to China reflects the sustained economic growth of that commodity-intensive economy, its rising demand for South African minerals and metals, and the high international prices of commodities.

Although South Africa's trade has recorded a surplus with the US, Japan and the UK over time, its trade surplus with the US improved visibly in 2007. This expansion could partly be attributed to an increase of 23 per cent in merchandise exports in terms of the Africa Growth and Opportunity Act. In 2007 the trade deficit with Germany narrowed, partly on account of higher exports of vehicles and transport equipment. The reduction in tariffs on trade in motor vehicles between South Africa and the European Union, the ongoing Motor Industry Development Programme and various contracts entered into by motor manufacturers were, among other factors, responsible for the increase in such exports. By 2007, vehicles and transport equipment comprised about 9 per cent of total merchandise exports to all countries.

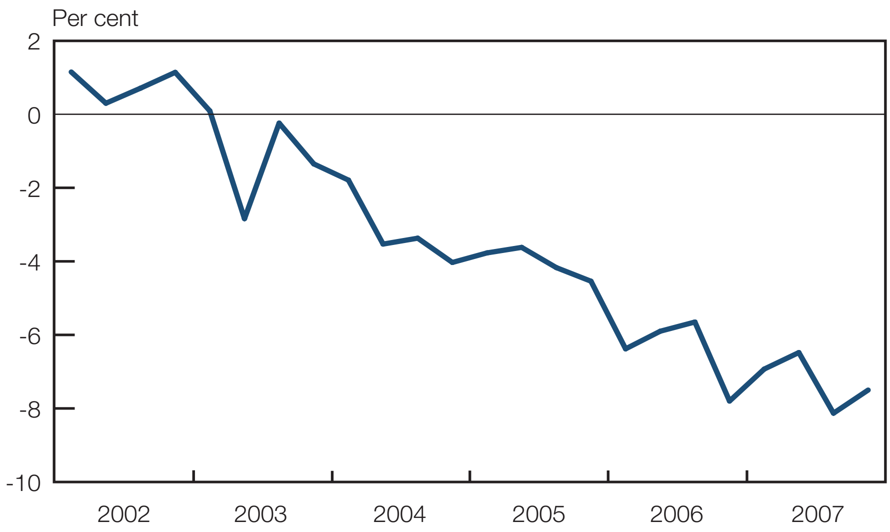
The export earnings of South African gold producers rose by 10,1 per cent to R45,1 billion in the fourth quarter of 2007, mainly due to a 8,7-per-cent increase in the average realised rand price of gold. The fixing price of gold on the London market rose by about 16 per cent from US$680 per fine ounce in the third quarter of 2007 to US$789 per fine ounce in the fourth quarter and further to US$923 per fine ounce in February 2008. The surge in the price of gold partly reflected the turbulence in financial markets following the sub-prime mortgage fallout in the US economy, a persistent rise in the international price of crude oil and other commodities, general inflation fears, and global demand and supply imbalances. In the fourth quarter of 2007 the physical quantity of net gold exports, however, remained broadly unchanged. For the year as a whole, the physical volume of gold exports shrank by a further 5½ per cent. In terms of production volumes South Africa remained only slightly ahead of China, the world's second largest gold producer in 2007. This contraction in export volumes in 2007 was in contrast with a 12½-per-cent rise in the nominal value of South Africa's gold exports over the year.

The value of *merchandise imports* increased by 2,1 per cent from the third quarter of 2007 to the fourth quarter mainly due to an increase in the rand price of imported goods; the volume of goods purchased abroad remained unchanged over the same period. The average rand price of merchandise imports advanced by 2 per cent in the final quarter of 2007 partly due to the higher international price of crude oil and steadily rising inflation in South Africa's most important trading-partner countries. Over the year, however, the value of merchandise imports rose firmly by 21 per cent as both the price and volume of imported goods increased.

Having advanced strongly in the third quarter of 2007, domestic demand for internationally produced goods slowed in the fourth quarter. The volume of merchandise imports moved sideways over the period despite an increase of 24 per cent in the physical quantity of crude oil imports. The subdued volume of non-oil imports mainly reflected a sharp drop in the subcategory for vehicles and transport equipment, while the import volume of other subcategories declined marginally. Notwithstanding the decline in the volume of merchandise imports, the country's import penetration ratio remained broadly unchanged in the fourth quarter of 2007 when compared with the average ratio of 27,5 per cent recorded in the first three quarters. While the volume of crude oil imports increased only marginally over the 2007 calendar year, the volume of non-oil imports advanced by about 11,7 per cent driven mainly by growth in gross fixed capital formation.

As already mentioned, the negative imbalance on the service, income and current transfer account continued to widen in the fourth quarter of 2007. The deficit amounted to R130,9 billion in the final quarter of 2007; for the year as a whole, the shortfall came to R104,7 billion or 5,3 per cent of gross domestic product. In 2006 this ratio amounted to 4,0 per cent. The further deterioration in the shortfall during the fourth quarter of 2007

Ratio of current-account balance to gross domestic product



could mainly be ascribed to an increase in gross dividend payments to non-resident investors, which coincided with lower dividend receipts from offshore investments accruing to South African investors. The steady increase in net dividend payments to non-resident investors echoed the country's economic performance over the past few years and accompanying high yields paid on investments made in South Africa. For 2007 as a whole, dividend payments to non-resident investors amounted to 3,6 per cent of gross domestic product. The shortfall on the *services account* was further exacerbated by increased interest payments by domestic private-sector companies on long-term loans obtained from parties abroad. Higher travel receipts from foreign tourists who visited the country during the festive season together with the foreign-exchange receipts for other services rendered to non-residents partially cushioned the deficit.

South Africa's terms of trade weakened further in the fourth quarter of 2007 as the international price of crude oil continued to increase at a faster pace than that of other international commodities. Measured on a yearly basis, the country's terms of trade improved somewhat.

Financial account

The financial account of the balance of payments recorded its largest ever inflow of capital in the 2007 calendar year. The net inflow of capital over the year could, to a large extent, be attributed to ample global liquidity and favourable economic conditions in emerging-market economies, including South Africa. The net inflow of capital in the fourth quarter of 2007 amounted to R54,1 billion, bringing the cumulative net inflow of capital to R192,6 billion for 2007 as a whole.

Net financial transactions not related to reserves

R billions

	2006	2007				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	-3,6	2,6	11,2	13,1	13,4	40,3
Portfolio investment	144,3	28,8	42,0	33,7	2,9	107,4
Other investment	64,2	2,8	19,8	33,9	5,1	61,6
Change in assets						
Direct investment	-45,4	-1,8	-10,2	-2,2	-7,8	-22,0
Portfolio investment	-15,0	-4,4	-6,4	-4,5	-8,9	-24,2
Other investment	-42,2	8,5	-15,8	-30,2	25,3	-12,2
*Total financial transactions**	*142,0*	*32,7*	*47,8*	*58,0*	*54,1*	*192,6*

* Including unrecorded transactions

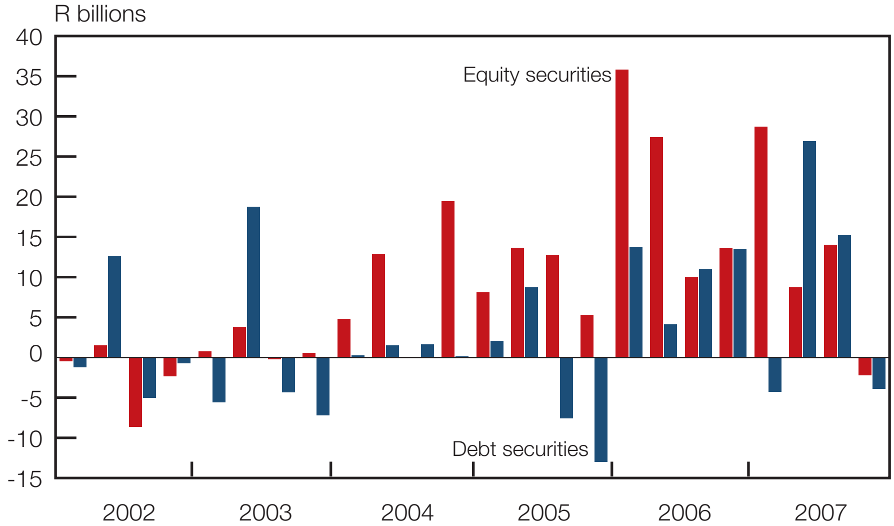
During his February 2008 budget speech, the Minister of Finance announced a further relaxation of exchange control measures. Such controls on institutional investors were replaced with a system of prudential regulation. The foreign exposure limit for pension funds and underwritten policies of long-term insurers was raised from 15 to 20 per cent of total retail assets, while the limit for collective investment schemes, investment managers and investment-linked business of long-term insurers was raised from 25 per cent to 30 per cent. South African banks would also be permitted to invest 40 per cent of their liabilities offshore (previously, 40 per cent of their regulatory capital). In order to streamline administration a single R500 000-per-annum discretionary allowance was introduced, in addition to the existing R2 million individual investment allowance. South African banks, trusts and partnerships were also granted permission to invest in offshore-linked instruments listed on the JSE Securities Exchange.

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded an inflow of R40,3 billion in 2007 following an outflow of R3,6 billion in 2006. Capital inflows were consistently registered from the first quarter of 2007 to the fourth quarter, when the country's foreign direct investment liabilities increased by R(13,4) billion. The inward movement of capital in the fourth quarter of 2007 was partly due to the acquisition of a South African platinum mining company by a non-resident investor.

Foreign portfolio investment into South Africa shrank to only R2,9 billion in the fourth quarter of 2007 from an inflow of R33,7 billion in the third quarter. The significantly lower portfolio inflows mainly stemmed from increased risk aversion by international investors following the turbulence in global financial markets. While uncertain about the magnitude of possible credit losses, non-resident portfolio investors also reduced their holdings of South African equity securities while accumulating debt securities. The much reduced inflow of portfolio investment capital in the fourth quarter of 2007 marked the lowest acquisition of South African securities since the fourth quarter of 2005, and limited the inflow of portfolio capital to R107,4 billion in 2007 compared with a much larger inflow of R144,3 billion in 2006.

Net portfolio investment flows



The inflow of other investment capital into the country declined to only R5,1 billion in the fourth quarter of 2007 from an inflow of R33,9 billion in the third quarter. The fourth quarter inflow mainly reflected an increase in short-term loans extended to and rand-denominated deposits made with the domestic banking sector, which more than countered a withdrawal of foreign-currency denominated deposits with South African banks.

South African-owned assets abroad

Outward direct investment recorded an outflow (i.e. an increase in direct investment assets) of R7,8 billion in the fourth quarter of 2007 despite a South African gold-mining company disposing of a number of its mining companies abroad. This capital inflow was, however, more than neutralised by a South African media company and a medical group which acquired foreign entities in related industries during the same period. For 2007 as a whole, the acquisition of foreign direct investment assets amounted to R22,0 billion compared with R45,4 billion in 2006.

Portfolio investment by authorised South African entities abroad amounted to R8,9 billion in the fourth quarter of 2007. This capital outflow reflected the acquisition of foreign portfolio assets by institutional as well as individual investors. In addition, the domestic banking sector also acquired foreign debt securities. The acquisition of foreign portfolio investment assets, which more than countered the increase in portfolio investment liabilities, resulted in a net outflow of portfolio investment capital in the fourth quarter of 2007. A net outflow of portfolio capital was previously observed in the fourth quarter of 2005.

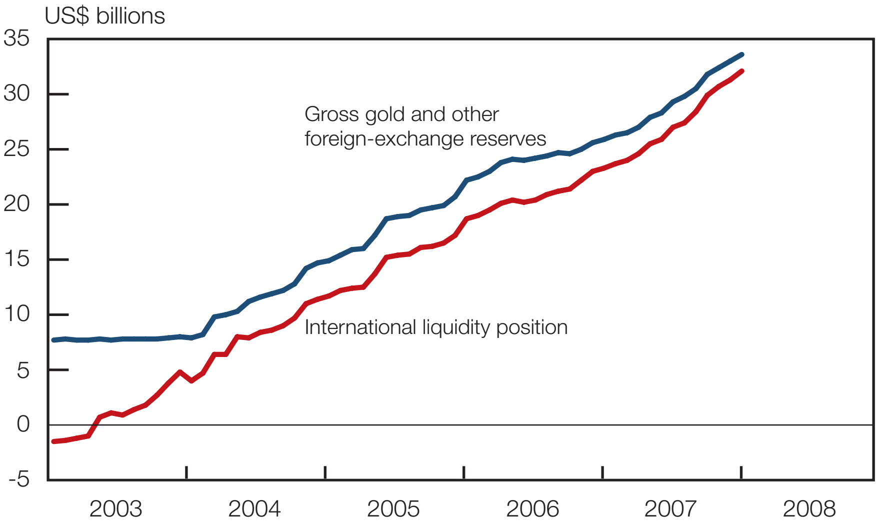
Other outward investment from South Africa switched to an inflow of R25,3 billion in the fourth quarter of 2007 from an outflow of R30,2 billion recorded in the third quarter. This inflow of capital was mainly brought about by the repatriation of part of the South African banking sector's foreign-currency deposits, possibly encouraged by the prevailing uncertainties in the global financial markets and interest rate differential in favour of South Africa. An increase in third-party loan finance extended by South African entities, however, in part offset the inward movement of capital. For 2007 as a whole, other investment-related capital outflows amounted to R12,2 billion, which was less than the outflow of R42,2 billion recorded in 2006.

International reserves and liquidity

The negative imbalance on the current account of the balance of payments was again more than countered by capital inflows on the financial account. South Africa's overall balance of payments (i.e. the change in the country's net international reserves due to balance-of-payments transactions) accordingly registered a surplus of R16,1 billion in the fourth quarter of 2007 following a surplus of R12,7 billion in the third quarter. The cumulative surplus for the year amounted to R47,8 billion compared with a surplus of R29,8 billion in 2006. The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services) increased from 12 weeks' worth at the end of December 2006 to 13½ weeks' worth at the end of December 2007.

Measured in US dollar, the value of the gross gold and other foreign reserves of the South African Reserve Bank (the Bank) increased from US$30,5 billion at the end of September to US$33,0 billion at the end of December 2007 and further to US$34,2 billion at the end of February 2008. From the end of 2006 to the end of 2007, the aforementioned reserves increased by US$7,4 billion. In addition, the utilisation of the Bank's short-term credit

Gross reserves and international liquidity position of the South African Reserve Bank



facilities declined further from US$2,3 billion at the end of September 2007 to US$1,8 billion at the end of December and further to US$1,5 billion at the end of February 2008.

The Bank's international liquidity position increased from US$28,4 billion at the end of September 2007 to US$31,3 billion at the end of December and further to US$32,7 billion at the end of February 2008.

Foreign debt

South Africa's total outstanding foreign debt increased by US$5,8 billion from the end of the second quarter of 2007 to the end of the third quarter. The increase in the country's external debt over the period was almost equally apportioned between foreign-currency and rand-denominated debt.

The outstanding debt of the banking sector rose noticeably during the third quarter of 2007 on account of the issuance of a euro-denominated bond by a domestic bank as well as an increase in foreign-currency denominated deposits with South African banks. Over the same period, the private non-banking sector increased its utilisation of foreign-loan facilities. The rise in the foreign-currency denominated debt was, however, partly countered by the redemption of a Japanese yen-denominated international bond by the South African government. The increase in rand-denominated foreign debt could mainly be attributed to an increase in foreign loans extended to the domestic banking sector.

Foreign debt of South Africa

US$ billions at end of period

	2006		2007		
	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Foreign-currency denominated debt	**35,3**	**35,8**	**34,9**	**39,6**	**42,8**
Bearer bonds	10,5	10,5	10,3	13,9	14,8
Public sector	4,8	5,2	5,2	5,5	5,6
Monetary sector	10,7	10,3	10,7	11,2	13,2
Non-monetary private sector	9,3	9,8	8,7	9,0	9,2
Rand-denominated debt	**21,9**	**23,6**	**22,7**	**26,6**	**29,2**
Bonds	6,3	7,5	6,1	7,1	6,8
Other	15,6	16,1	16,6	19,5	22,4
Total foreign debt	**57,2**	**59,4**	**57,6**	**66,2**	**72,0**

Measured in rand, South Africa's foreign debt increased from R464 billion at the end of June to R483 billion at the end of September 2007. The increase in rand terms occurred despite the appreciation of the exchange rate of the rand against the US dollar over this period.

Exchange rates

The nominal effective exchange rate of the rand displayed significant volatility when it registered, on balance, an increase of 3,8 per cent and 1,2 per cent in October and December, respectively, while declining by 5,1 per cent during November 2007. On balance, the exchange rate of the rand decreased by a further 0,4 per cent in the fourth quarter of 2007, mainly reflecting the resilience of the South African economy during the global financial market turmoil and risk aversion which began in August 2007. However, for the 2007 calendar year as a whole, the weighted average exchange rate of the rand declined, on balance, by 3,5 per cent compared to a decline of 15,4 per cent in 2006.

Exchange rates of the rand
Percentage change

	30 Mar 2007 to 29 Jun 2007	29 Jun 2007 to 28 Sep 2007	28 Sep 2007 to 31 Dec 2007	31 Dec 2007 to 29 Feb 2008
Weighted average*	**1,8**	**-0,5**	**-0,4**	**-13,5**
Euro	1,3	-2,1	-2,3	-14,1
US dollar	2,4	3,1	1,4	-11,1
British pound	0,1	1,8	2,9	-10,8
Japanese yen	7,0	-3,7	-1,4	-17,3

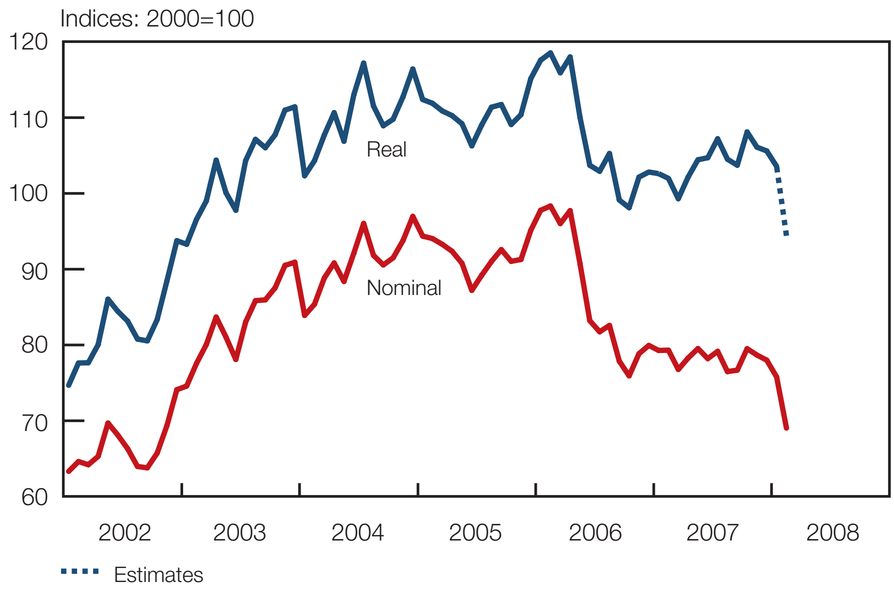
* Against a basket of 13 currencies

From the end of December 2007 to the end of February 2008, the weighted average exchange rate of the rand declined by a further 13,5 per cent on account of the continuing turmoil in international financial markets and concerns about the supply of electricity which clouded the outlook for exports and economic growth in South Africa. The depreciation was to some extent moderated by exceptionally high prices of precious metals as well as a sound Budget which was tabled in February.

The real effective exchange rate of the rand increased by 2,7 per cent from the end of 2006 to the end of 2007, suggesting a slight deterioration in the competitiveness of South African exporters over this period. This was more than fully reversed by exchange rate movements in the first two months of 2008.

The average net daily turnover in the domestic market for foreign exchange decreased marginally from US$17,4 billion in the third quarter of 2007 to US$17,1 billion in the fourth quarter as non-resident investors' interest in the South African equity and debt markets subsided. However, on a monthly basis the average daily turnover registered a peak of US$19,1 billion during the month of December 2007.

Effective exchange rates of the rand

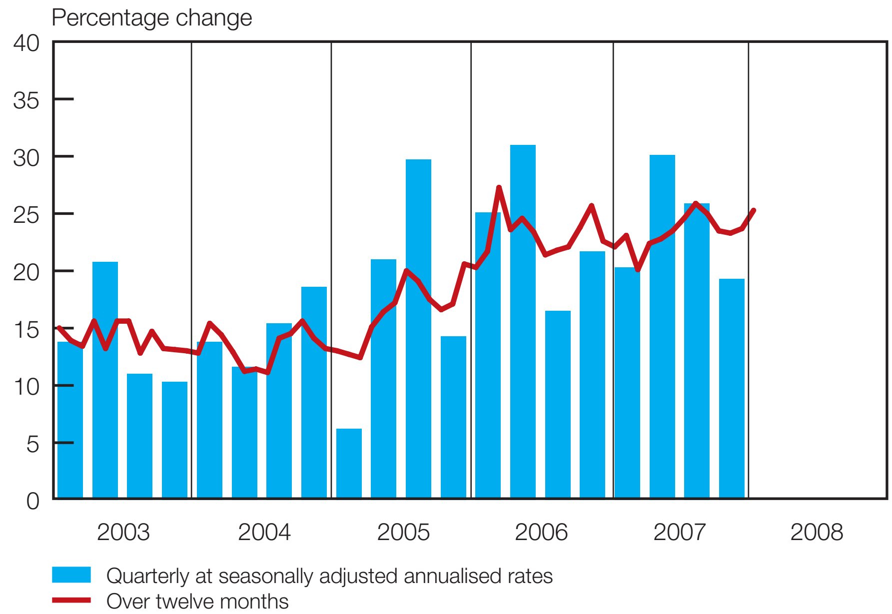


Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply, M3, continued at a robust pace during 2007, although some signs of moderation became evident towards the end of the year. This strong growth occurred against the backdrop of resilient domestic economic activity and the increase in domestic interest rates which raised the return on holding monetary assets relative to other asset classes. Muted investor appetite for riskier assets and the spill-over effect of turmoil in international credit and financial markets also supported the precautionary and yield-seeking motives for holding monetary assets.

Growth in M3



Year-on-year growth in M3, which had moderated somewhat towards the end of 2006 and early 2007, again accelerated during 2007 to register a high of 25,8 per cent in August, before receding to 23,6 per cent in December 2007. The growth rate rebounded to 25,2 per cent in January 2008. The quarter-to-quarter seasonally adjusted and annualised rate of growth in M3 decelerated more substantially from 30,1 per cent in the second quarter of 2007 to 19,3 per cent in the fourth quarter.

Growth in monetary aggregates
Per cent at seasonally adjusted annualised rates

	2007			
Component	1st qr	2nd qr	3rd qr	4th qr
M1A	22,5	36,7	6,8	8,4
M1	14,8	34,1	24,5	11,6
M2	8,1	26,1	33,8	15,5
M3	20,3	30,1	25,9	19,3

Growth in the narrow M1A monetary aggregate, which essentially consists of notes, coin and cheque deposits, exceeded the growth in M3 during the first half of 2007, but slowed significantly in the second half of the year. From the third quarter, money growth was concentrated in fixed and notice deposits as market participants locked in the higher yields on such deposits.

The overall increase in M3 during 2007 amounted to R319,0 billion compared with R248,2 billion in 2006. The household sector increased its M3 holdings by 16,1 per cent during 2007, alongside continued growth in disposable income. Simultaneously, the corporate sector increased its M3 deposit holdings by no less than 26,7 per cent. The non-bank financial institutions remained the strongest contributors to the growth in corporate-sector deposit holdings in 2007, a possible consequence of the strong increase in turnover in the financial markets as well as an enhanced awareness of the price risk attached to non-monetary assets.

The statistical counterparts of change in M3 are shown in the accompanying table. As is usually the case, the dominant counterpart to the increase in M3 in 2007 was the expansion in claims on the private sector. This came to a record high in 2007, reflecting robust growth in banks' private-sector loans and advances.

Counterparts of change in M3
R billions

	2007				
	1st qr	2nd qr	3rd qr	4th qr	Year
Net foreign assets	-11,1	20,0	0,9	2,0	11,9
Net claims on the government sector	26,3	-14,1	2,6	-17,9	-3,0
Claims on the private sector	74,9	69,9	88,0	76,7	309,5
Net other assets and liabilities	8,0	0,1	-10,7	3,2	0,6
Total change in M3	**98,1**	**76,0**	**80,8**	**64,1**	**319,0**

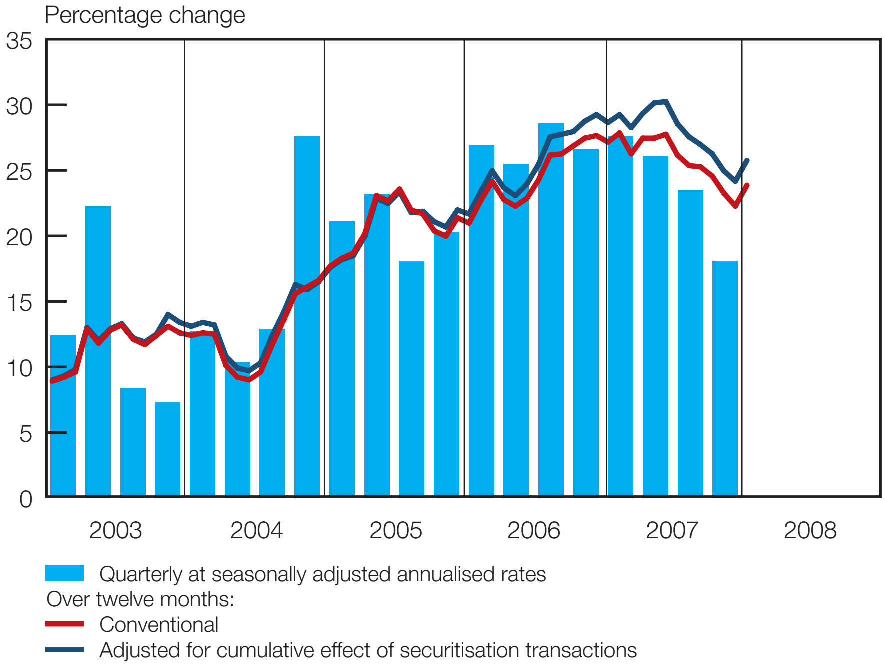
Despite some moderation in M3 growth during the last two quarters of 2007, it still outpaced the annualised growth in nominal gross domestic product. Accordingly, the income velocity of circulation of M3 reached a new low of 1,28 in both the third and fourth quarters of 2007.

Credit extension

Growth in banks' total loans and advances[4] extended to the private sector followed a downward trend in the last three quarters of 2007 and recorded a seasonally adjusted and annualised rate of 18,1 per cent in the final quarter of the year. Growth over twelve months reached a high of 27,8 per cent in February 2007, before decelerating to 22,2 per cent in December and 23,8 per cent in January 2008. The slowdown followed the gradual tightening of monetary policy since June 2006, accompanied by tighter lending standards set by the National Credit Act from June 2007. Adjusted for securitisation transactions, twelve-month growth in total loans and advances peaked at 30,2 per cent in June 2007 and moderated to 25,7 per cent in January 2008.

4 Total loans and advances to the domestic private sector consist of instalment sale credit, leasing finance, mortgage advances, overdrafts, credit card and general advances. The first three categories are referred to as asset-backed credit, while the last three categories together form part of other loans and advances.

Total loans and advances to private sector



Assets of the banking sector to the value of R35,5 billion were securitised in 2007, an increase of 77 per cent when compared to 2006. In 2007 this activity occurred mostly through the bundling of mortgage loans into securities. Securitised assets are removed from banks' balance sheets and therefore securitisation results in an artificial lowering of the key measures of credit growth for the banking sector.

Assets securitised

R billions

	Mortgage advances	Instalment sale and leasing finance	Other loans and advances	Total loans and advances
2005: Year	6,8	3,0	-	9,8
2006: Year	8,1	12,0	-	20,1
2007: 1st qr	8,7	-	-	8,7
2nd qr	0,7	10,0	-	10,7
3rd qr	0,7	-	2,1	2,8
4th qr	10,9	2,3	-	13,2
Year	21,1	12,3	2,1	35,5
2008: Jan	-	-	-	-

Growth in *mortgage advances* decelerated throughout 2007 as activity in the residential segment of the real-estate market lost some of its earlier momentum. Growth over twelve months in this credit category decelerated from a recent high of 30,9 per cent in October 2006 to 24,5 per cent in January 2008. Adjusted for securitisation transactions, growth in mortgage advances also declined from 31,0 per cent in October 2006 to 26,9 per cent in January 2008.

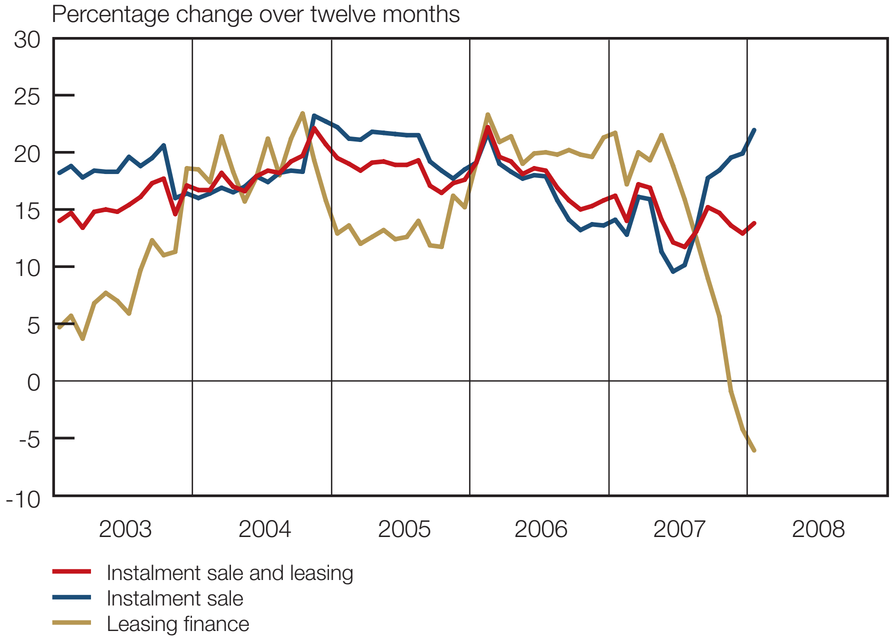
Following a further acceleration in the first half of 2007, *other loans and advances*, which are dominated by the corporate sector's use of overdrafts and general advances, visibly lost momentum in the second half of the year. Alongside firm business confidence and strong fixed capital formation, growth over twelve months in other loans and advances initially accelerated from 28,1 per cent in March 2007 to a high of 36,7 per cent in June. The growth rate then followed an overall downward trend as conditions tightened, receding to 22,5 per cent in December 2007, but subsequently accelerating to 27,2 per cent in January 2008.

Bank loans and advances to the domestic private sector

	Outstanding balance		
	End 2006 R billions	End 2007 R billions	Percentage change
Mortgage advances	685	854	24,7
Instalment sale credit and leasing finance	208	234	12,9
Other loans and advances	452	554	22,5
Overdrafts	107	131	20,0
Credit card advances	43	55	25,9
General advances	302	368	22,2
Total loans and advances	**1 344**	**1 643**	**22,2**
Of which: To household sector	726	868	19,5
To corporate sector	618	775	25,3

Growth over twelve months in *instalment sale credit and leasing finance*, which is mainly directed at financing expenditure on motor vehicles and other durable goods, decelerated, on balance, during 2007 albeit with sizeable fluctuations. These fluctuations partly reflected the positive impact of enhanced financing packages offered by motor vehicle retailers and private banks to lure customers. Conversely, extension of such credit was on occasion diminished by vehicle registration delays and supply problems due to industrial action at component suppliers, apart from a general decline in demand for vehicles. Growth in leasing finance in particular contracted significantly

Credit extension to private sector by type of credit

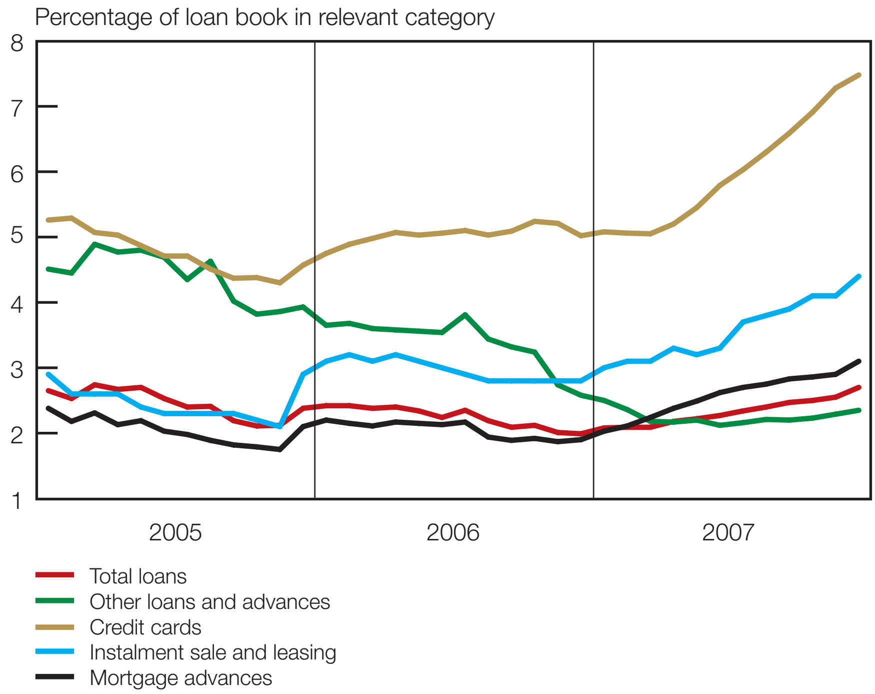


from June 2007 when banks showed a preference for promoting instalment sale finance following the full introduction of the National Credit Act. This Act provides for longer repayment periods on instalment loans to enhance affordability.

While credit extended to the corporate sector continued to grow at a brisk pace during 2007, the borrowing activity of the household sector eased noticeably.

Non-performing loans, that have been overdue for a period longer than 90 days, expressed as a percentage of total loans and advances started to trend upwards from low levels during 2007 as tighter credit conditions impacted on household finances. While the aggregate balance sheet of the household sector remained fairly sound, pockets of financial distress have been most evident in non-performing credit card debt, which increased from around 5 per cent of total credit card debt at the beginning of the year to 7,5 per cent at the end of the year.

Non-performing loans

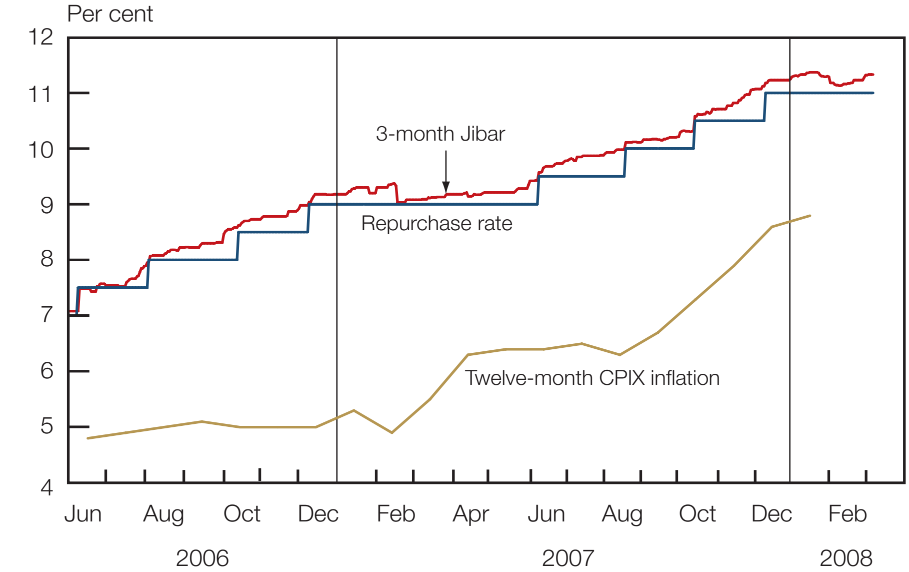


Interest rates and yields

The Monetary Policy Committee (MPC) increased the repurchase rate by 50 basis points at each of its four consecutive meetings from June to December 2007. This brought the repurchase rate to 11,0 per cent by the second week of December 2007. These increases were mostly the result of a deterioration in risks to the inflation outlook, in particular brought about by adverse developments in oil and food prices. At its January 2008 meeting the MPC, by contrast, left the repurchase rate unchanged. The MPC statements discussing developments underlying the December 2007 and January 2008 decisions are reproduced in full elsewhere in this *Bulletin*.

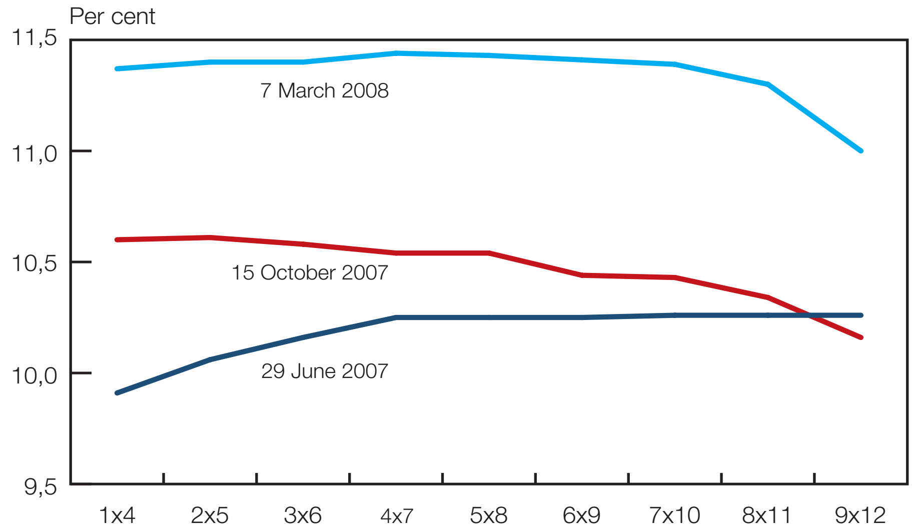
As illustrated in the graph on the following page, other money-market interest rates in general trended upwards during the fourth quarter of 2007, adjusting to the expected and actual increases in the repurchase rate. The three-month Johannesburg Interbank Agreed Rate (Jibar) recorded a recent high of 11,37 per cent on 16 January 2008, edging marginally lower to 11,33 per cent on 7 March.

Money-market rates and inflation



Rates on forward rate agreements (FRAs) followed an upward trajectory from October 2007 as market participants continued to expect a progressive tightening in monetary policy, congruent with the deterioration of the inflation outlook on account of a weaker rand and higher oil prices. After the announcement of an unchanged monetary policy stance at the January 2008 meeting of the MPC, the FRA rates declined somewhat as expectations of further rate increases moderated. More recently, the slope of the FRA curve indicated that market participants expect tight monetary conditions to continue in the forthcoming months.

Forward rate agreement (FRA) yield curves



During the latter part of 2007, the South African Benchmark Overnight Rate on deposits (Sabor) occasionally experienced some volatility but generally followed the repurchase rate higher. The Sabor increased by a cumulative 105 basis points from the beginning of October 2007 to the end of February 2008. Subsequently, the Sabor remained just above the lower standing facility rate of the Bank and stood at 10,69 per cent on 7 March 2008. The implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) fluctuated marginally above the Sabor, generally remaining within the standing facility limits as may be expected in a well-functioning and efficient overnight funding market. On 7 March 2008 this rate stood at 10,95 per cent.

Both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private-sector banks adjusted to the four increases in the repurchase rate during 2007. The rates were left unchanged at 14,5 per cent in January 2008.

The *predominant rate on twelve-month fixed deposits* with private-sector banks increased by a total of 180 basis points from 8,4 per cent in March 2007 to 10,2 per cent in February 2008. In real terms, using historical year-on-year increases in CPIX to adjust nominal rates, the twelve-month fixed deposit rate rendered investors an average rate of return before tax of 2,4 per cent in 2007. In January 2008 the real deposit rate decreased to 1,3 per cent as inflation accelerated.

The *standard interest rate* on loans granted by the government from the State Revenue Fund, as defined in the Public Finance Management Act, increased from 13 per cent to 14 per cent on 1 January 2008. The *official rate of interest* applicable to fringe benefit taxation, as defined in the Income Tax Act, was raised from 11 per cent to 12 per cent with effect from 1 March 2008.

On 7 December 2007 the *prescribed interest rates* as stipulated in the National Credit Act increased as indicated in the accompanying table.

National Credit Act maximum interest rates

Category	Maximum rate per annum Per cent
Mortgage agreements	28,1 to 29,2
Credit facilities	33,1 to 34,2
Unsecured credit transactions	43,1 to 44,2
Developmental credit agreements:	
For the development of a small business	43,1 to 44,2
For low-income housing (unsecured)	43,1 to 44,2
Short-term credit transactions	60
Other credit agreements	33,1 to 34,2
Incidental credit agreements	24

Interest rates on the *RSA government fixed-rate and inflation-linked retail bonds* are priced off the government bond yield curves. The table on the following page depicts how these rates have changed since June 2007.

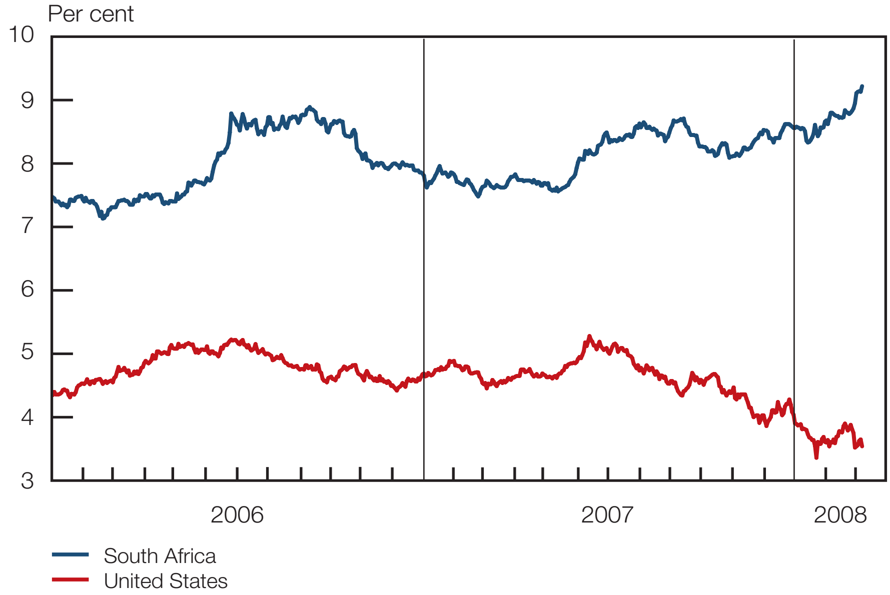
Interest rates on RSA fixed-rate and inflation-linked retail bonds

Per cent

Effective from	2-year bond	3-year bond	5-year bond
Fixed rate:			
1 Jun 2007	8,50	8,75	8,00
1 Jul 2007	9,00	8,75	8,50
1 Sep 2007	9,25	9,25	8,75
1 Oct 2007	9,50	9,75	10,00
1 Mar 2008	9,50	9,75	10,25
	3-year bond	5-year bond	10-year bond
Inflation linked:			
1 Jun 2007	2,75	2,75	2,75
1 Dec 2007	3,25	3,00	2,75

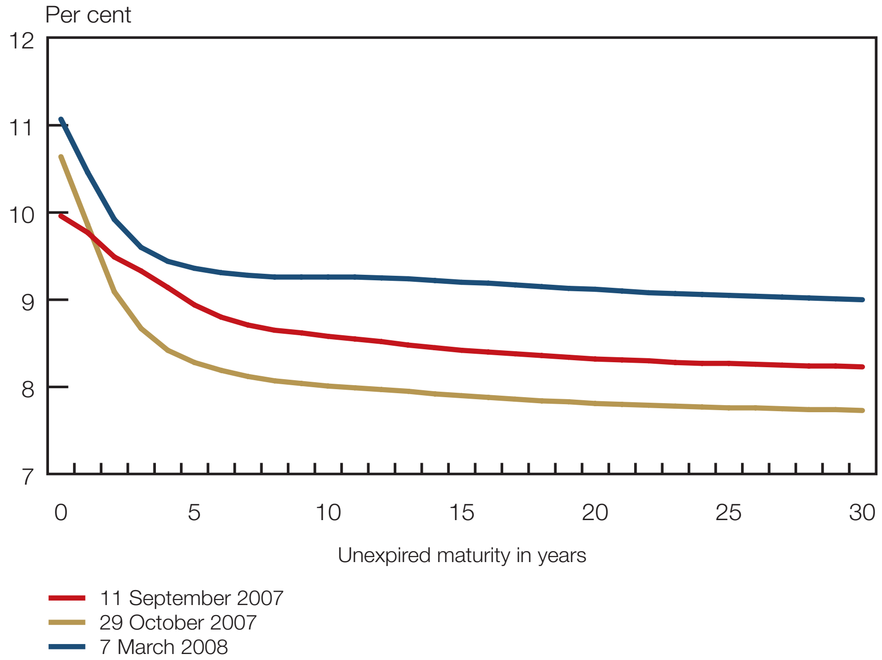
From a recent high of 8,71 per cent on 13 September 2007, the *daily average yield on the long-term R157 government bond* (maturing in 2015) declined to 8,09 per cent on 29 October due to, among other things, the appreciation in the exchange value of the rand. The bond yield then fluctuated upward to 9,21 per cent on 7 March 2008 in response to weakness in the exchange value of the rand, the release of worse-than-expected inflation numbers and the renewed uncertainty in global financial markets. By contrast, the daily closing yield on the US 10-year bond continued on a downward trend from 5,28 per cent on 13 June 2007 to 3,54 per cent on 7 March 2008. Consequently, the spread between the South African R157 bond yield and the US 10-year bond yield widened from 293 basis points on 13 June 2007 to 567 basis points on 7 March 2008.

Government bond yields



The level of the *yield curve* became more inverted from September 2007 to the end of October as the short end of the curve rose in accordance with the tightening of the monetary policy stance, while the medium-to-long portion of the curve moved lower alongside the stronger exchange value of the rand. Subsequently, the level of the yield curve moved upwards across all maturities to the beginning of March 2008 as bond yields increased in response to higher inflation expectations. The *yield gap*, computed as the difference between the yields at the extreme long and short ends of the curve, widened from a negative 173 basis points on 11 September 2007 to a negative 341 basis points on 15 January 2008, before narrowing to 207 basis points on 7 March.

Yield curves



The *break-even inflation rate* in the five-year maturity range fluctuated higher from a low of 4,96 per cent on 29 October 2007 to 6,36 per cent on 7 March 2008 as the yield on the conventional bond trended higher, prompted by a weaker exchange value of the rand, a higher international price of crude oil and inflation pressures, while the real yield on the inflation-linked government bond declined.

The *currency risk premium*[5] on South African government bonds widened from 238 basis points in September 2007 to 282 basis points in February 2008. This was as a result of a more significant increase in the yield on South African domestic rand-denominated bonds than in the yield on dollar-denominated South African bonds.

Following the global repricing of risk, the JPMorgan Emerging Markets Bond Index Plus (EMBI+)[6] spread widened from a low of 153 basis points in May 2007 to 291 basis points in February 2008. Likewise, the *sovereign risk premium* on South Africa's US dollar-denominated bond in the six-year maturity range trading in international markets widened from an average of 67 basis points to 242 basis points over the same period.

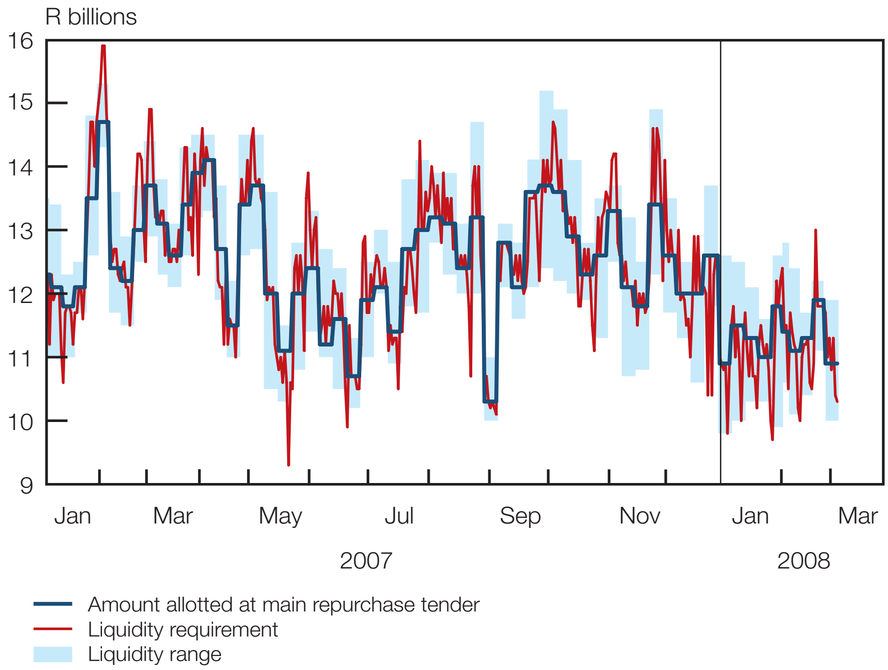
5 Measured as the differential between South African government bond yields on rand-denominated debt in the seven-year maturity range issued in the domestic market and South African dollar-denominated debt in the nine-year maturity range issued in the United States market.

6 EMBI+ measures total returns for external-currency denominated debt instruments of emerging markets.

Money market

During the fourth quarter of 2007 and the subsequent two months to February 2008, the daily liquidity requirement of the private-sector banks fluctuated between R9,7 billion and R14,7 billion, occasionally breaching the range within which the liquidity requirement is expected to move. This was mainly on account of fluctuations experienced in note flows and unexpected transactions in the accounts of other financial institutions held with the South African Reserve Bank. The liquidity provided by the Bank

Liquidity requirement, ranges and amount allotted



at the weekly main refinancing tender varied between R10,9 billion and R13,7 billion over the same period.

Banks continued to utilise their cash reserve accounts with the South African Reserve Bank as the main mechanism to square off their end-of-day liquidity positions, although standing and supplementary reverse repurchase facilities were also occasionally used.

The accompanying table depicts the statistical counterparts of money-market liquidity flows from October 2007 to February 2008.

Money-market liquidity flows

R billions (easing +; tightening -)

	Oct – Dec 2007	Jan – Feb 2008
Notes and coin in circulation	-7,2	5,3
Required cash reserve deposits	-4,1	-1,4
Money-market effect of SARB foreign-exchange transactions	14,2	2,7
Government deposits with SARB	-2,4	-1,7
Use of liquidity management instruments	6,0	-7,7
Reverse repurchase transactions	3,6	-3,5
SARB debentures	2,4	-4,2
Other items net	-3,6	2,8
Banks' liquidity requirement (decrease +; increase -)	**2,9**	**0,0**

The Bank's purchases of foreign exchange injected liquidity to an amount of R14,2 billion into the money market during the fourth quarter of 2007, compared with R14,0 billion in the third quarter. Four early repayments of US$250 million each were effected from September 2007 to February 2008 on a 5-year US$1,5 billion dual-currency syndicated term loan entered into in July 2005, mainly utilising occasions when the exchange value of the rand was relatively strong to acquire the necessary foreign currency. This reduced the outstanding balance on this loan to US$0,5 billion.

Further liquidity-boosting measures were mainly related to the Bank allowing reverse repurchase agreements and SARB debentures to mature without renewal. A significant proportion of the decrease of R6,0 billion in the total amount outstanding of these interest-bearing liquidity-draining instruments during the fourth quarter of 2007 occurred in December 2007, in anticipation of high banknote demand over the festive season.

Strong tightening effects were recorded on account of higher required cash reserve balances held with the Bank and increases in notes and coin in circulation due to high demand for cash during the festive season.

The nominal value of government bonds in the Bank's monetary policy portfolio increased marginally from R7,5 billion to R7,6 billion in the fourth quarter of 2007.

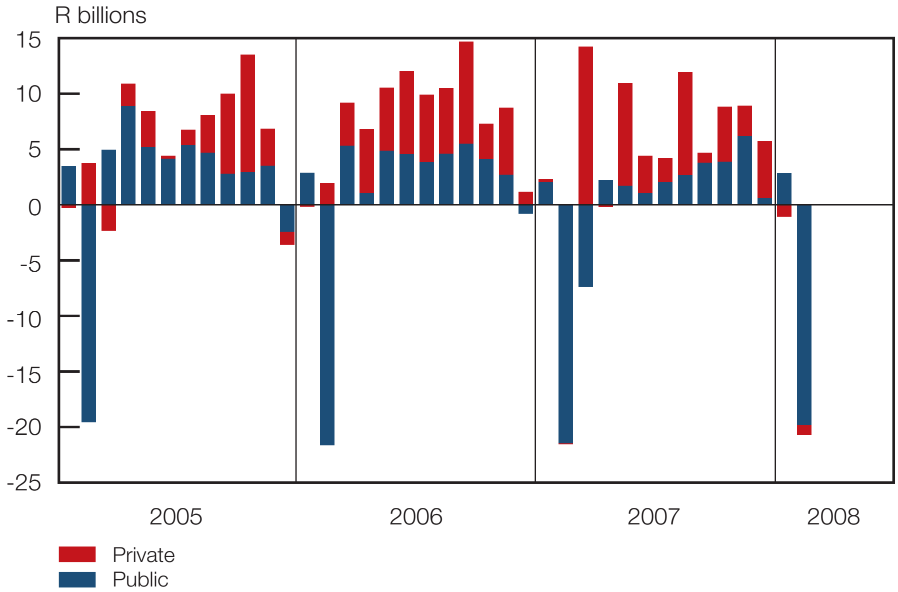
Bond market

In October 2007 the seatholders of the Bond Exchange of South Africa (BESA) voted in favour of demutualising the exchange. From the beginning of December 2007 the name of the exchange changed to Bond Exchange of South Africa Limited as it converted from a mutual association into a public company.

Funding by *public-sector borrowers* through the net issuance of fixed-interest securities in the domestic primary bond market amounted to R17,0 billion in 2006, after which net redemptions of R2,8 billion were recorded in 2007. In the first two months of 2008 the outstanding nominal value of public-sector loan stock listed declined by R17,0 billion to reach R495,5 billion at the end of February. The R195 – the second of the three tranches of the R194 government bond to be repaid – was redeemed on 28 February 2008. The capital redemption value of the bond amounted to R24,1 billion and coupon payments on this and other outstanding government bonds put a further R8,9 billion in cash in the hands of investors. The remaining tranche of the R194 bond, namely the R196, matures in 2009.

After increasing by a marked R56,0 billion in 2006, the outstanding nominal value of *private-sector loan stock* listed on BESA increased by a somewhat lower R52,0 billion to reach R217,3 billion at the end of 2007. Private-sector funding declined by R1,9 billion in the first two months of 2008.

Public and private-sector funding in bond market

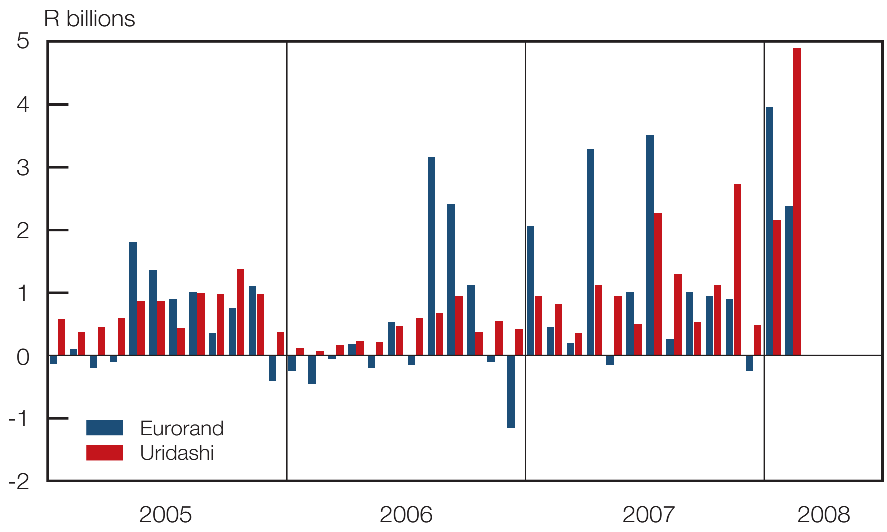


In January 2008, the National Treasury bought back R3,1 billion of the inflation-linked R198 bond (maturing on 31 March 2008) and offered for sale the R210 (maturing in 2028) and R202 (maturing in 2033) bonds for a total amount of R3,1 billion through the South African Reserve Bank.

The outstanding nominal value of *commercial paper* listed on BESA increased by R5,2 billion in 2007, before declining by R0,3 billion in the first two months of 2008 to a level of R45,1 billion at the end of February. The bulk of this amount consisted of banks' net issues of asset-backed commercial paper amounting to R42,4 billion, with the remainder being ordinary commercial paper issued by other private companies as well as public corporations. The total outstanding nominal value of all debt listed on BESA increased by R56,4 billion in 2007, much lower than the increase of R88,9 billion in 2006. It declined by R19,2 billion in the first two months of 2008, bringing the total outstanding nominal amount to R758,0 billion at the end of February. At current market prices the debt outstanding came to R828,5 billion.

In the *European bond markets* the interest of non-resident issuers in rand-denominated bonds escalated in 2007 and the beginning of 2008. Rand-denominated bond issues by residents and non-residents of R18,3 billion in 2007 were more than double the R9,1 billion raised in 2006. During 2007 issues exceeded redemptions by R13,2 billion compared with net issues of R5,0 billion in 2006. In the first two months of 2008, net issues amounted to R6,3 billion.

Net issues of eurorand and uridashi bonds



The issuance of rand-denominated bonds by foreign borrowers in the *Japanese Uridashi market* also increased significantly during 2007 and early 2008. The total nominal value of issues more than doubled from R4,8 billion raised in 2006 to R13,1 billion raised in 2007. In the first two months of 2008, the nominal value of these issues amounted to no less than R7,1 billion.

Trading activity in the domestic secondary bond market amounted to R16,2 trillion in 2007, some 19 per cent higher than the value traded in 2006. The value of turnover on BESA amounted to R3,5 trillion in the first two months of 2008 and included an all-time monthly high of R1,9 trillion in January. The most liquid government bond traded in 2007 was the R153 bond (maturing in 2010) with an annual turnover that was 63,2 times the issued amount. Incorporating all bonds, the liquidity ratio, measured as the nominal value of all bonds traded relative to the nominal value of all bonds listed, amounted to 17,8 in 2007.

Non-residents' holdings of South African debt securities increased by R20,0 billion in 2007, following net purchases of R34,1 billion in 2006. Net purchases of bonds amounting to R13,9 billion in October 2007 were followed by net sales of R5,3 billion and R5,8 billion in November and December, respectively. Non-residents continued to be net sellers of bonds on a significant scale during the first two months of 2008. Their net sales amounted to a record high of R12,5 billion in January 2008 and R5,9 billion in February. The increase in net sales of bonds was on the back of higher bond yields and higher inflation. Non-residents' participation in trading on BESA declined from an average of 19 per cent in 2007 to 15 per cent in February 2008 – its lowest level since March 2005.

Share market

The JSE Limited (JSE) launched 4 new indices during 2007. The FTSE/JSE International Benchmark Index has been designed to give domestic investors pure exposure to international markets by excluding all South African dual-listed companies. The FTSE/JSE Rafi 40 Index uses a company's fundamentals such as sales, cash flow, book value and dividends to weight the constituents within the index as opposed to using market capitalisation. The FTSE/JSE Alt^x 15 Index consists of the top 15 companies listed on the JSE's alternative exchange (Alt^x), ranked by market capitalisation. Lastly, the FTSE/JSE Shariah all-share index was established to be suitable for the Islamic investment community.

The *total value of equity capital raised in the domestic and international primary share markets* by companies listed on the JSE amounted to an annual record high of R124,9 billion in 2007, which was 42 per cent more than the R87,8 billion raised in 2006. Companies with primary listings on the JSE were responsible for 67 per cent of the total capital-raising activity in 2007. Funding of R74,2 billion by the resources sector accounted for more than half of total capital raised in 2007. Equity financing amounted to R5,2 billion in the first two months of 2008.

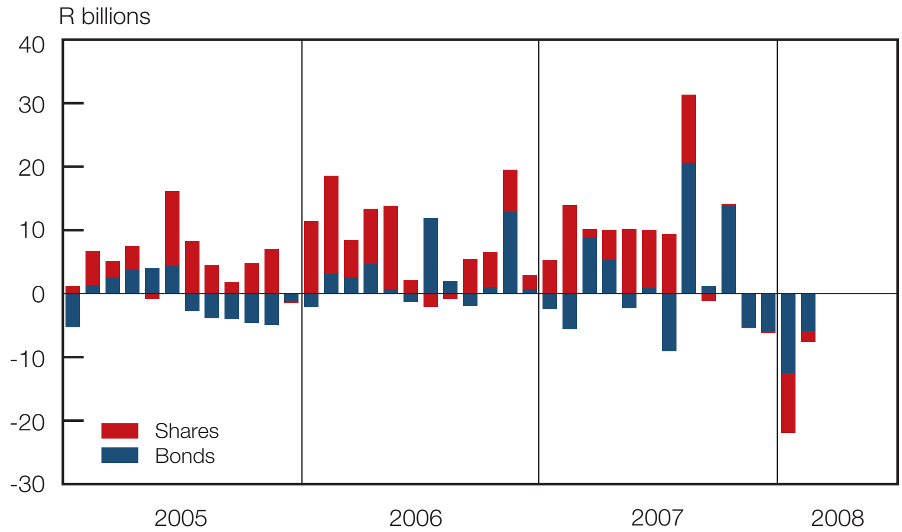
With share prices at high levels, new listings exceeded delistings in 2007 for the second year in a row. Total new listings increased from 36 in 2006 to 62 in 2007, while delistings increased from 24 to 40 over the same period. This was followed by only 2 new listings and 4 delistings in the first two months of 2008 as investor confidence and sentiment were somewhat negative.

Trading activity in the secondary share market was buoyant in 2007, boosted by the volatile share prices. The *value of shares* amounting to R3,0 trillion traded on the JSE in 2007 was 40 per cent more than the R2,1 trillion recorded in 2006. From a record-high daily average turnover of R13,2 billion in October 2007, turnover receded to R10,3 billion per day in December, before improving to R13,1 billion in February 2008.

The total *market capitalisation* of the JSE increased by 23 per cent from R5,0 trillion in December 2006 to an all-time high of R6,2 trillion in October 2007, before receding to R6,0 trillion in February 2008. Market liquidity, measured by the annualised turnover as a percentage of market capitalisation, increased from an average of 49 per cent in 2006 to 52 per cent in 2007 and continued higher to 61 per cent in the first two months of 2008.

Non-residents' interest in domestic shares was reflected in net purchases of shares worth a quarterly average of R21,2 billion in the first three quarters of 2007, before recording net sales worth R0,3 billion in the fourth quarter. For 2007 as a whole, the total net purchases of shares by non-residents amounted to R63,3 billion. Non-residents' appetite for domestic shares, however, abated further in 2008. Non-residents' net sales of shares amounted to an all-time high of R9,4 billion in January 2008 alongside volatility on domestic and international bourses. So far in 2008, non-residents' cumulative net sales of shares amounted to R11,2 billion compared with net purchases of R19,1 billion in the corresponding period of 2007. Despite their net selling position, non-residents' participation in the domestic share market increased from 20 per cent in November 2007 to 23 per cent in January 2008, before declining to 18 per cent in February.

Net purchases of shares and bonds by non-residents

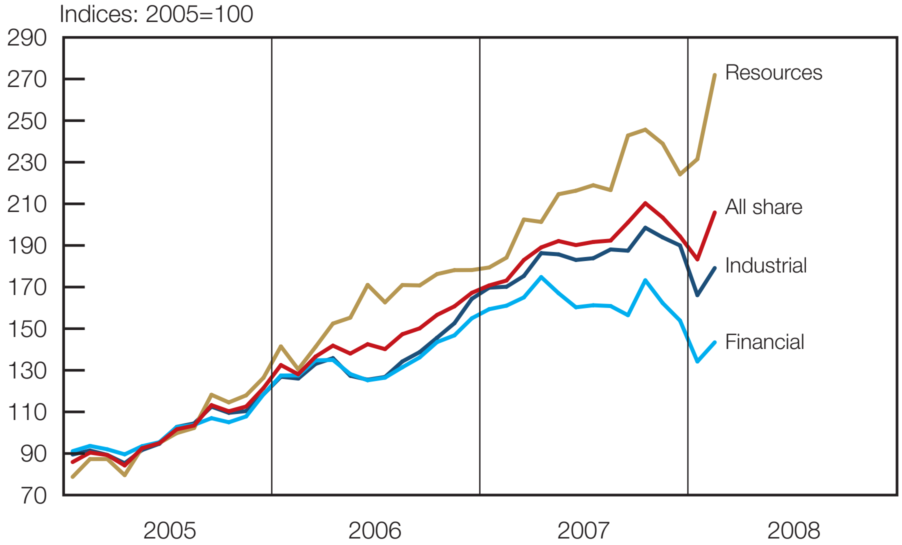


Transactions on the JSE and BESA

After reaching a new record high on 11 October 2007, the *all-share price index* of the JSE declined by 20 per cent to 23 January 2008, in tandem with weaker global markets. United States (US) sub-prime troubles continued to plague markets and speculation mounted that the global economy would decelerate as a result of a possible recession in the US. The all-share price index subsequently rebounded by 22 per cent to 7 March alongside record high commodity prices and as global markets recovered somewhat after the US Federal Reserve's unexpected cut in the benchmark overnight lending rate by 75 basis points during an unscheduled meeting. This was followed by another 50-basis-point cut at a scheduled regular policy meeting at the end of January. The Federal Reserve's decision was an attempt to stem turmoil in global markets as well as to calm investors and restore confidence in credit markets, as banks were increasingly compelled to restrict their lending operations due to concerns regarding escalating defaults on sub-prime mortgages. The disclosure of a €4,9 billion loss by a rogue trader at a French bank further unsettled markets. The US government proposed a US$150 billion short-term fiscal-stimulus package in an effort to restore investor confidence.

Supported by record-high commodity prices, especially those of gold and platinum, the resources index recorded a remarkable increase of 26 per cent in 2007 and a further 6 per cent in the first two months of 2008. Buoyant output prices seemingly countered the impact of the local electricity crises that hampered mining operations and led to a temporary shut-down of South African mines causing production losses. In 2007 industrial shares recorded a gain of 16 per cent while financial shares fell by 1 per cent due to concerns regarding spill-over effects from the US sub-prime mortgage meltdown on banking institutions. Rising interest rates and concerns regarding the effect of the National Credit Act also had a negative impact on the local banking sector. In the first two months of 2008 financial shares fell by 7 per cent as investor confidence was shaken by fears that leading global bond insurers could lose their crucial triple-A ratings, thereby triggering more losses at financial institutions following a rating downgrade.

Share prices



The all-share price index of the JSE, measured in US dollar terms, and the Morgan Stanley Capital International (MSCI) Emerging Market Index outperformed both the MSCI World Index and the FTSE All World Index in 2007, as emerging markets remained resilient due to solid economic growth and a strong earnings performance while growth in developed markets was easing. In US dollar terms, the all-share price index increased by 19 per cent in 2007 and the MSCI Emerging Markets Index rose by 36 per cent, while the FTSE All World Index and the MSCI World Index recorded increases of only 9 per cent and 10 per cent, respectively.

Contrary to the movements in share prices, the *dividend yield* on all classes of shares increased from 2,1 per cent in June 2007 to 2,5 per cent in February 2008. Similarly, the *earnings yield* on all classes of shares increased from 6,1 per cent in June 2007 to a high of 7,2 per cent in January 2008, before declining to 6,6 per cent in February. Conversely, the *price-earnings ratio* of all classes of shares fell from 16,4 in June 2007 to 13,9 in January 2008 – its lowest level since May 2005 – before increasing to 15,1 in February.

Alt^x continued to grow strongly during 2007 and at the beginning of 2008. The number of companies listed on Alt^x increased by 39 from January 2007 to reach 75 at the end of February 2008, with only 1 transfer to the main board. The combined market capitalisation of all the companies listed on Alt^x also increased from R9,1 billion in December 2006 to a record high of R31,2 billion in December 2007, before declining to R28,0 billion in February 2008. Turnover on Alt^x amounted to R6,0 billion in 2007, 416 per cent more than the R1,2 billion traded in 2006. In the first two months of 2008, turnover on this exchange amounted to R978 million.

Market for exchange-traded derivatives

Trading activity in the *financial derivatives market* remained robust in 2007, supported by strong growth recorded in the underlying share market. During 2007 single-stock futures (including dividend futures) remained the dominant instrument category and accounted for 89 per cent of the total *number* of contracts traded. However, in *value* terms, equity index products accounted for 93 per cent of trade over the same period. Buoyant conditions also prevailed in the financial derivatives market during the first two months of 2008.

Turnover in *commodities futures and options* recorded steady growth in 2007 as prices of all agricultural commodities traded increased on account of concerns that strong global demand could result in shortages. Increased demand and production of bio-fuels drove maize and soya-bean prices higher. Global wheat supplies dwindled in 2007 due to crop damage as a result of poor weather. Unprecedented demand for agricultural products from countries with fast-growing economies such as China and India increased price pressures further. This high global demand for grain has also pushed up prices in South Africa.

Turnover in *warrants* continued to weaken in 2007 and decreased considerably compared with the same period in 2006. Trading activity in the warrants market, however, picked up in the first two months of 2008. Turnover in derivatives on the JSE for the first two months of 2008 is indicated in the accompanying table.

Derivatives turnover on the JSE, January to February 2008

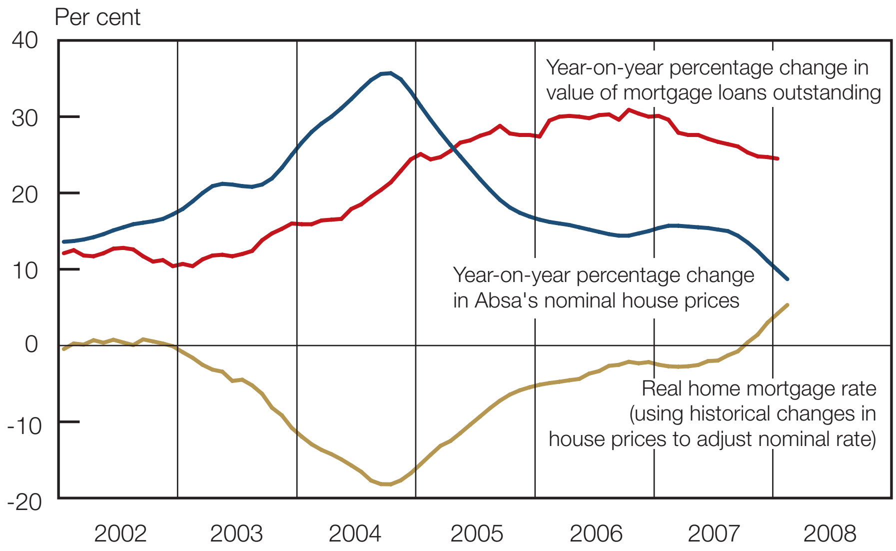
	Turnover	Change over one year
	R billions	Per cent
Financial futures and options on futures	777	105
Warrants	1	6
Agricultural commodity futures and options	59	59
Interest rate derivatives	16	121

Trading activity on *Yield-X* reached record high levels in 2007. The total *value* of turnover increased by 26 per cent from R32,1 billion in 2006 to R40,5 billion in 2007, while the total *number* of contracts traded increased by 1 125 per cent from 21 400 to 262 000 over the same period. Contracts traded were largely boosted by the introduction of currency futures in June 2007, which accounted for 76 per cent of total trades. Among the currency future contracts, dollar/rand futures contracts dominated trade. Trading activity on Yield-X remained strong in the first two months of 2008.

Real-estate market

Following a slight pause towards the end of 2006 and the first quarter of 2007, the rate of increase in real-estate prices resumed its downward trend from the second quarter of 2007. The year-on-year rate of increase of average residential property prices in the middle segment of the market, as measured by Absa, decelerated from 15,7 per cent in March 2007 to an eight-year low of 8,7 per cent in February 2008 in response to reduced affordability on account of the increasing cost of capital. This is reflected in the historical twelve-month tempo of increase in house prices which has fallen below nominal mortgage interest rates since October 2007. The month-on-month growth in house prices declined from 1,5 per cent in December 2006 to only 0,3 per cent in February 2008.

House prices, mortgage borrowing and real interest rates



Non-bank financial intermediaries

During the first three quarters of 2007 non-bank financial intermediaries[7] delivered a robust investment performance and positive balance-sheet growth despite increased volatility and uncertainty in global financial markets. The total assets of non-bank financial institutions increased by 12 per cent from the fourth quarter of 2006 to R4,2 trillion in the third quarter of 2007. Backed by large amounts of capital and reserves as well as compulsory investment mandates, non-bank financial institutions remained a strong force in all sectors of local markets, and more recently increased their exposure to the property market.

7 Defined as unit trusts, private pension and provident funds, official pension and provident funds, insurers and the Public Investment Corporation.

The accompanying table illustrates the quarter-to-quarter rate of growth in the portfolio holdings of non-bank financial intermediaries during 2007.

Growth in the portfolio holdings of non-bank financial intermediaries
Per cent

	2007		
Effective from	Cash	Bonds	Shares
1st qr...	14	-5	9
2nd qr	8	4	2
3rd qr	6	4	2

Public finance

Non-financial public-sector borrowing requirement[8]

8 *Calculated as the cash deficit/surplus of the consolidated central, provincial and local governments and non-financial public enterprises and corporations.*

As the major public corporations continued to step up their infrastructural spending, the financial activities of general government continued to be well disciplined in the first nine months of fiscal 2007/08, with national government recording a sizeable budget surplus.

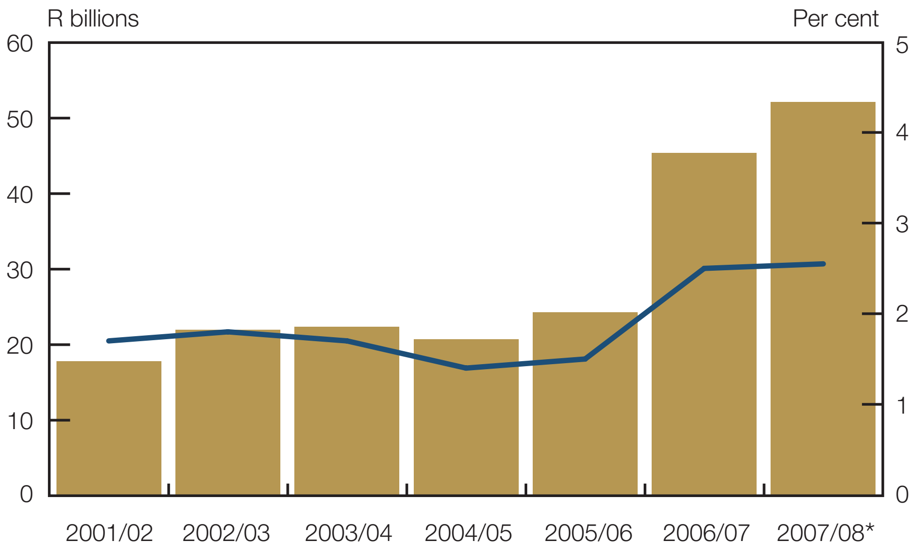
Non-financial public-sector borrowing requirement
R billions

Level of government	Apr – Dec 2006*	Apr – Dec 2007*
National government	-3,5	-9,9
Extra-budgetary institutions	-2,8	-3,9
Social security funds	-4,2	-4,8
Provincial governments	-8,5	-6,8
Local governments	5,8	2,6
Non-financial public enterprises and corporations	5,2	11,0
Total**	-7,8	-11,9

* Deficit +, surplus -
** Individual components may not add up to totals due to rounding

The *non-financial public sector* as a whole recorded a cash surplus in the October-December quarter of 2007, bringing the cash surplus for the first nine months of fiscal 2007/08 to R11,9 billion. As a ratio of gross domestic product, the surplus amounted to 0,8 per cent in the first nine months of fiscal 2007/08, slightly higher than the 0,6 per cent recorded in the corresponding period of the previous fiscal year. National

Net investment in non-financial assets by the non-financial public-sector enterprises and corporations



Fiscal years
* *Budget Review 2008*
R billions
Per cent of gross domestic product (right-hand scale)

government made the largest contribution to the accumulated cash surplus in the nine months to December 2007.

The *non-financial public enterprises and corporations* recorded a cash deficit of R11,0 billion for the first nine months of fiscal 2007/08, compared with a cash deficit amounting to R5,2 billion recorded over the same period in the previous fiscal year. As expected, net investment in non-financial assets by the major non-financial public enterprises picked up considerably and increased by 25,1 per cent in the period April – December 2007 compared with the same period of the previous year.

An analysis of *national government* statistics shows that cash receipts from operating activities increased by 16,7 per cent in the first nine months of fiscal 2007/08, compared with the corresponding period of the previous fiscal year. On a similar basis, cash payments for operating activities increased by 14,9 per cent. The net cash flow from operating activities exceeded the net investment in non-financial assets by national government, resulting in a cash *surplus* to the amount of R9,9 billion in April – December 2007, well above the surplus of R3,5 billion recorded in the corresponding period of the previous fiscal year.

The *provincial governments* recorded a cash deficit of R4,3 billion in the October-December quarter of 2007, bringing their cash surplus for the first nine months of fiscal 2007/08 to R6,8 billion – less than the surplus recorded in the same period of the previous fiscal year. The *Provincial Budget and Expenditure Review 2003/04 – 2009/10* provided for a virtually balanced budget for fiscal 2007/08 as a whole. Grants received from national government continued to represent the bulk of the provinces' income.

The financial activities of provincial governments resulted in an increase in their deposits with private banks from R7,0 billion at the end of March 2007 to R7,7 billion at the end of December 2007. More significantly, the deposits of provincial governments with the Corporation for Public Deposits (CPD) increased considerably from R2,7 billion to R6,1 billion between these dates. Provinces' overall indebtedness decreased from R1,2 billion to a negligible R0,2 billion over the same period.

The estimated cash deficit of *local governments* amounted to R2,6 billion in the first nine months of fiscal 2007/08, compared to R5,8 billion recorded in the corresponding period of the previous fiscal year. Included in the cash receipts were conditional grants earmarked for infrastructure spending which has not yet been fully utilised.

Preliminary estimates show that *extra-budgetary institutions* recorded a cash surplus of R3,9 billion in the first nine months of 2007/08, larger than the surplus of R2,8 billion recorded in the same period of the preceding fiscal year. *Social security funds* recorded a cash surplus amounting to R4,8 billion in the period under review, slightly higher than a year earlier.

Budget comparable analysis of national government finance

National government expenditure in the first nine months of fiscal 2007/08 was moderately higher than the initial budgetary expectations, while the strong growth in revenue collections exceeded the original budget projections, thereby resulting in a sizeable surplus.

Expenditure by national government in the first nine months of fiscal 2007/08 amounted to R393 billion, or 15,3 per cent more than in the corresponding period of the previous fiscal year. This increase was higher than the original budgetary provision of 13,6 per cent for the full fiscal year, and was boosted by strong increases in transfers and subsidies geared towards supporting infrastructural development essential for economic growth. Transfers and subsidies were paid to public corporations and private enterprises to assist with capital programmes. Although transfers were also made to municipalities to supplement capital budgets and eradicate the backlog in municipal infrastructure necessary for the provision of basic services, to date proportionally less than the budgetary expectations has been spent for the period under review. As a ratio of gross domestic product, national government expenditure amounted to 25,8 per cent, compared with 25,5 per cent recorded in the same nine months a year earlier.

National government revenue in the first nine months of fiscal 2007/08 amounted to R403 billion, representing a growth rate of 15,9 per cent compared with the same period of the previous fiscal year. The *Budget Review 2007* estimated an increase in national government revenue of 13,2 per cent for fiscal 2007/08 as a whole. National government revenue as a ratio of gross domestic product amounted to 26,5 per cent, compared with 26,1 per cent recorded in the same period a year earlier.

National government revenue in fiscal 2007/08

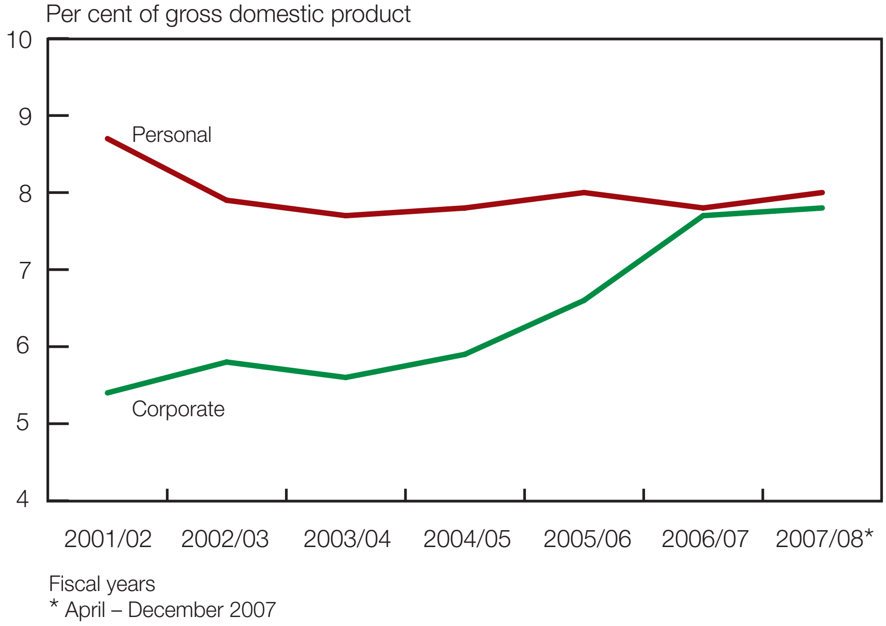
Revenue source	Originally budgeted Full year		Actual Apr – Dec 2007	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains	312,2	11,5	240,2	19,8
Payroll taxes	6,5	16,1	4,7	14,2
Taxes on property	11,0	6,4	9,2	20,7
Domestic taxes on goods and services	199,0	14,0	139,1	12,0
Taxes on international trade and transactions	27,5	14,5	20,0	12,0
Other revenue	11,5	-3,7	9,1	8,6
Less: SACU** payments	23,1	-8,5	18,9	27,8
Total revenue	544,6	13,2	403,3	15,9

* April – December 2006 to April – December 2007
** Southern African Customs Union

Both personal and corporate tax collections recorded increases of more than 19 per cent in the first nine months of fiscal 2007/08 when compared with the same period a year earlier, thereby exceeding the originally budgeted increase. Corporate income taxes signalled the continued profitability of companies as well as improvements in the efficiency of tax collection. The brisk collections from individuals were reflective of increasing employment levels, wage settlements that were above inflation, as well as the lower refunds stemming from an administrative change in the tax filing period.

Taxes on property increased at a sturdy pace in the first nine months of fiscal 2007/08. The main component of domestic taxes on goods and services – value-added tax collections – fell short of budget projections, reflective of a slowdown in domestic demand. Collections from taxes on international trade and transactions also showed signs of reduced buoyancy as imports of consumer goods lost momentum on account of a slowdown in household consumption spending.

Corporate and personal income tax collections



The net result of national government revenue and expenditure was a cash book surplus before borrowing and debt repayment of R10,6 billion in April – December 2007. This can be compared with a surplus of R7,1 billion recorded in the same period a year earlier. The national government surplus was originally budgeted to amount to R10,7 billion in fiscal 2007/08, and was kept unchanged in the *Medium Term Budget Policy Statement 2007.*

Consistent with government's borrowing and debt sustainability strategy, the debt of national government as a ratio of gross domestic product receded substantially, contributing to lower interest costs. As a result, the *primary balance* (i.e. the deficit/surplus recalculated by excluding interest payments from total expenditure) reached a surplus of 3,0 per cent of gross domestic product in the first nine months of fiscal 2007/08, broadly unchanged from the ratio recorded in the same period of the previous fiscal year. This made additional resources available for infrastructure and other essential spending, while providing the fiscal space to deal with cyclical volatility.

The net result of national government cash-flow revenue and cash-flow expenditure in the first nine months of fiscal 2007/08 was a cash-flow surplus before borrowing and debt repayment of R9,5 billion – R0,5 billion more than the cash-flow surplus recorded a year earlier. After taking into account extraordinary transactions and the cost on revaluation of foreign debt at redemption, the surplus amounted to R9,3 billion in the first nine months of fiscal 2007/08, compared with a surplus of R6,8 billion recorded in April – December 2006.

As indicated in the table on the following page, the surplus as well as the issuance of debt instruments in the domestic capital market were used to increase government's cash balances by R28,1 billion in April – December 2007. Government recorded net redemptions of foreign bonds and loans during the period under review.

National government financing in fiscal 2007/08

R billions

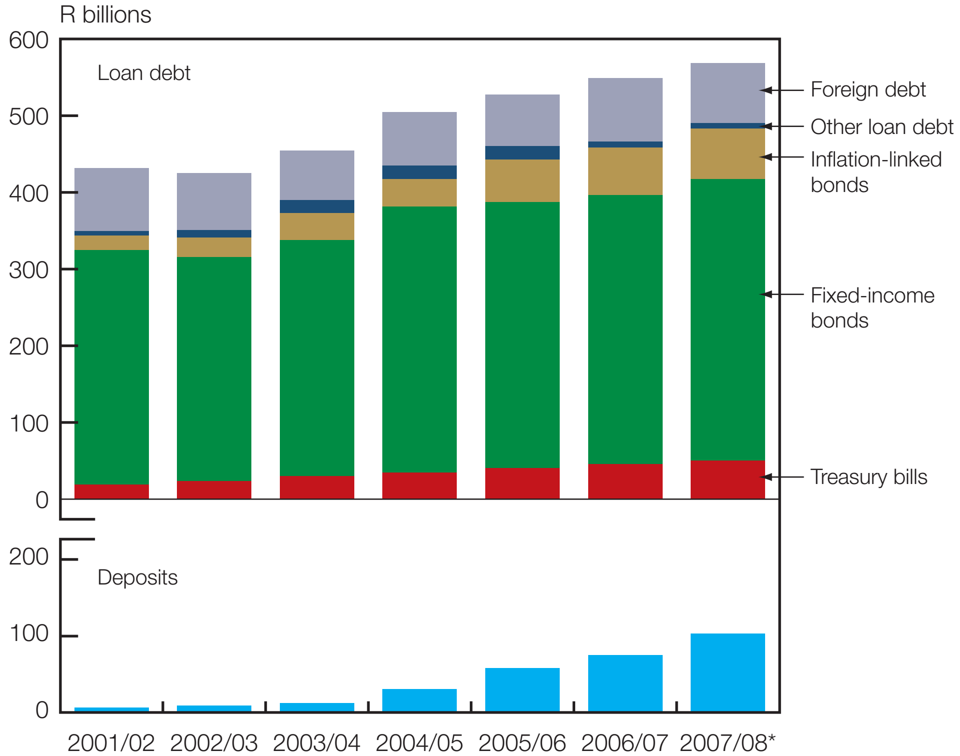
Item or instrument	Originally budgeted Full year	Actual Apr – Dec 2007	Actual Apr – Dec 2006
Budget balance*	-10,7	-9,5**	-9,0**
Plus: Extraordinary payments	0,4	0,7	3,8
Cost on revaluation of foreign debt at redemption	0,5	1,1	1,0
Less: Extraordinary receipts	0,3	1,6	2,5
Net borrowing requirement*	-10,1	-9,3	-6,8
Treasury bills	5,7	4,0	5,1
Domestic government bonds	-8,0	17,9	27,0
Foreign bonds and loans	-2,1	-3,1	2,8
Change in available cash balances***	-5,7	-28,1	-41,6
Total net financing	-10,1	-9,3	-6,8

* Deficit +, surplus -
** Cash-flow surplus
*** Increase -, decrease +

In the first nine months of fiscal 2007/08 domestic short-term funding was obtained at an average rate of 9,3 per cent per annum, while domestic long-term instruments were sold at an average rate of 8,0 per cent per annum.

Domestic debt of national government rose from R469 billion at the end of March 2007 to R493 billion at the end of December. This increased the share of domestic debt in total loan debt from 85,0 per cent at the end of March 2007 to 86,4 per cent at the end of December. However, the foreign debt of government decreased from R83 billion to R78 billion during this period, mainly on account of net redemptions of foreign bonds

National government loan debt and deposits



As at 31 March of each fiscal year
* As at 31 December 2007

and loans. As a proportion of total loan debt, this category of debt decreased from 15,0 per cent at the end of March 2007 to 13,6 per cent at the end of December.

Inflation-linked bonds as a proportion of total loan debt amounted to 11,5 per cent at the end of December 2007, broadly the same as the ratio at the end of March 2007. The National Treasury introduced a new R210 inflation-linked bond in October 2007, carrying a coupon rate of 2,6 per cent and maturing on 31 March 2028.

The average outstanding maturity of domestic marketable bonds receded from 102 months at the end of March 2007 to 97 months at the end of December. Conversely, the average maturity of the foreign marketable bonds of national government increased from 67 months at the end of March 2007 to 83 months at the end of December 2007.

Total loan debt of national government increased from R552 billion at the end of March 2007 to R571 billion at the end of December, lowering the loan-debt-to-gross-domestic-product ratio from 30,5 per cent at the end of March 2007 to 28,6 per cent at the end of December.

The Budget for the fiscal years 2008/09 to 2010/11

The Minister of Finance tabled the 2008 Budget before Parliament on 20 February. The Budget provided for a modest financial surplus which would be sustained over the medium term, i.e. the three fiscal years to 2010/11. Fiscal prudence would continue to underpin sustainable growth, benefiting all South Africans through higher employment and further increases in public spending on economic and social infrastructure, the extension of social security and investment in productive capacity. Mindful of both global and domestic storms that were building up, government was of the opinion that the cyclical benefits and robust tax revenues that South Africa enjoyed partly as a result of high commodity prices would stand the country in good stead. Policy anchors such as the prudent fiscal stance, inflation-targeting regime, more robust levels of international reserves and a floating exchange rate would continue to cushion the domestic economy against shocks and undue pressure on interest rates.

In the face of the unstable global environment, rising inflation and supply constraints alongside a substantial current-account deficit, the core priorities of public policy would be investment in sustainable long-term growth and the progressive raising of living standards. As critical infrastructure spending continued, the fiscal surplus and higher interest rates would boost domestic savings and safeguard competitiveness.

Government expected that the global economic slowdown, in combination with domestic constraints – particularly limits to domestic electricity supply – would result in slower growth in gross domestic product over the medium term, with growth projected to slow to 4 per cent in 2008. Gross fixed capital formation reached 21 per cent of gross domestic product in 2007 and the pace of investment was expected to remain robust, raising the competitiveness of the economy while reducing constraints in key areas such as electricity. The fiscal space created over the past years enabled government to step up public spending in key areas such as infrastructure, job creation, boosting export capacity, fighting crime and poverty, and improving public services. In recent years, investment in modernising public transport made in partnership with cities was already beginning to reshape the urban landscape, spurred on by the FIFA World Cup commitments. At the same time, South Africa would continue to contribute to peacekeeping efforts, investment promotion and economic co-operation in Africa.

In the Budget, the Minister announced that the limits on institutional investors' offshore asset holdings would be raised as the exchange control system made way for prudential regulation.

Expenditure by national government was estimated to amount to R611 billion in fiscal 2008/09, representing a year-on-year rate of increase of 12,7 per cent. It was estimated that national government expenditure would increase at an average rate of 11,2 per cent per annum over the three-year budget period. As a ratio of gross domestic product, national government expenditure was projected to increase slightly from 26,7 per cent in fiscal 2008/09 to 27,0 per cent in fiscal 2010/11.

Fiscal projections: National government

	2007/08		2008/09		2009/10		2010/11	
	Revised estimate		Medium-term estimates					
	R billions	Annual change Per cent	R billions	Annual change Per cent	R billions	Annual change Per cent	R billions	Annual change Per cent
State debt cost	52,8	1,2	51,2	-3,0	51,1	-0,2	51,2	0,1
Current payments	96,8	16,2	109,0	12,6	120,7	10,7	131,5	8,9
Transfers and subsidies	385,5	17,4	437,4	13,5	488,7	11,7	532,3	8,9
Payments for capital assets.................................	7,0	10,8	7,5	6,1	9,2	22,5	9,8	6,8
Contingency reserve and unallocated funds................	-		6,0		12,0		20,0	
Total expenditure	**542,1**	**15,3**	**611,1**	**12,7**	**681,6**	**11,5**	**744,7**	**9,3**
Expenditure as percentage of GDP...............................*	*26,5*		*26,7*		*27,2*		*27,0*	
Revenue	**558,0**	**16,0**	**625,4**	**12,1**	**692,9**	**10,8**	**759,0**	**9,5**
Revenue as percentage of GDP...............................*	*27,3*		*27,3*		*27,6*		*27,5*	
Budget balance before borrowing and debt repayment ....**	**15,8**		**14,3**		**11,3**		**14,3**	
Deficit (-)/surplus (+) as percentage of GDP............*	*0,8*		*0,6*		*0,5*		*0,5*	
Deficit (-)/surplus (+) as percentage of GDP: October 2007 MTBPS***.....*	*0,5*		*0,7*		*0,6*		*0,5*	

* Gross domestic product
** Deficit -, surplus +
*** *Medium Term Budget Policy Statement 2007*

Investment in social and economic infrastructure remained a core government priority. This was substantiated by the projected average real growth of about 11 per cent per annum in gross fixed capital formation over the three-year budget horizon, covering additional allocations to water and sanitation, public transport, education, health, social development, as well as justice and protection services. Public-sector infrastructure expenditure was projected to amount to R568,1 billion, representing an average annual growth rate of 19,2 per cent over the next three years. This amount was R85,7 billion higher than the estimate in the *Medium Term Budget Policy Statement 2007*, largely as a result of Eskom's revised capital expenditure plan.

A number of measures were announced to extend social security. The qualifying age for men for old-age pension would be reduced from 65 to 63 in 2008, to 61 in 2009 and to 60 – where it already is for women – in 2010. From January 2009 the child-support grant would be extended by one year to include children up to their 15th birthday. Furthermore, an increase in the old-age and disability grant by R70 a month to R940 from April 2008 was also announced, while the child-support grant would be raised by R10 in April and by a further R10 in October 2008, to R220 a month.

In light of projected budget surpluses, state debt cost was budgeted to remain well contained.

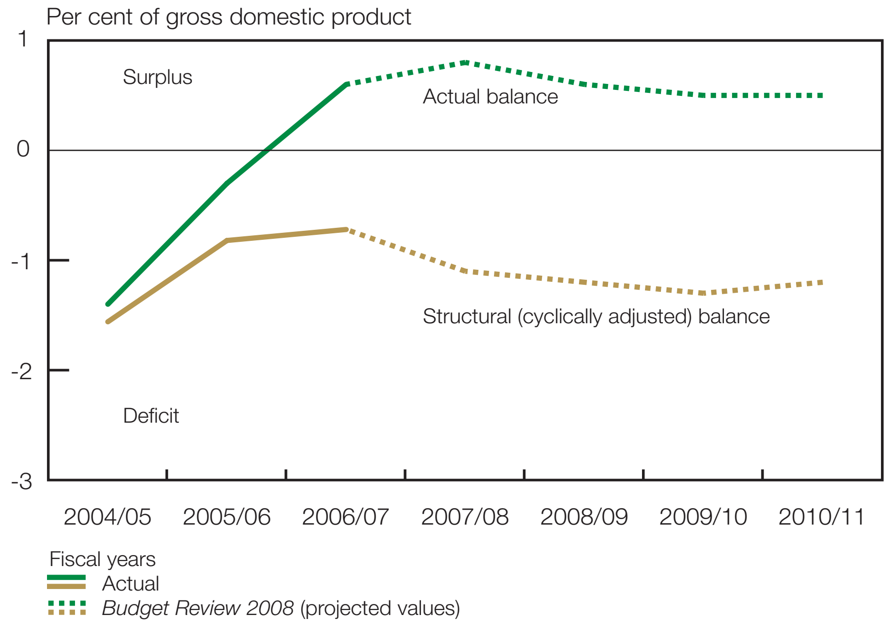
Total *national government revenue* was projected to increase by 12,1 per cent in fiscal 2008/09, decelerating to an average increase of 10,8 per cent per annum over the three-year budget period. As a ratio of gross domestic product, national government revenue was estimated to average 27,5 per cent over the medium term as the South African Revenue Service would continue to build and refine its administrative capacity. In recent years, tax revenue was also bolstered by high product prices and profits in the mining and related industries.

National government *gross* tax revenue including Southern African Customs Union (SACU) payments was estimated to amount to R642 billion in fiscal 2008/09, representing a year-on-year rate of increase of 12,5 per cent. South Africa's continued commitment to its trading partners in SACU in terms of the revenue-sharing formula would result in a revised revenue charge of R24,7 billion – R1,7 billion higher than the original budget estimate in fiscal 2007/08.

Important tax adjustments which were announced in the 2008 Budget included the further lowering of the corporate income tax rate from 29 per cent to 28 per cent; tax relief for individuals, which would fully compensate for inflation; increases in the tax-free thresholds for interest and dividend income, and in the annual exclusion threshold for capital gains or losses; higher alcohol, tobacco and fuel taxes; and the introduction of an electricity tax of 2 cents per kilowatt-hour. Furthermore, a broadening of the internship allowance to include longer-term apprenticeships targeted at technical skills, as well as tax incentives to support industrial investment and employment creation was announced. Overall tax relief would amount to R10,5 billion in fiscal 2008/09.

The budgeted estimates of the revenue and expenditure of national government resulted in an estimated surplus before borrowing and debt repayment of R15,8 billion for the fiscal year 2007/08, equal to 0,8 per cent of gross domestic product. It was projected that the surplus would recede to an average of 0,5 per cent of gross domestic product over the medium term. Budgeting for a fiscal surplus took into account the risks posed by an uncertain global and domestic economic environment. Government recognised that its tax revenue was boosted by cyclical forces, such as high prices of export commodities, which could prove to be temporary. By estimating the cyclical component of its tax revenue and saving a part thereof under favourable circumstances, the fiscus creates fiscal space to absorb cyclical headwinds. Government estimated that the structural budget balance (i.e. the budget balance after adjustment for cyclical revenue and spending) would be a deficit averaging 1,2 per cent of the estimated gross domestic product over the medium term.

National government structural budget balance



The primary balance (i.e. the deficit/surplus recalculated by excluding state debt cost from total expenditure) was estimated to reach a surplus of 3,4 per cent of gross domestic product in fiscal 2007/08 and decrease slightly to 2,9 per cent of gross domestic product in fiscal 2008/09. Primary surpluses averaging 2,6 per cent of gross domestic product were projected over the medium-term period.

As indicated in the accompanying table, the borrowing requirement of national government was determined after providing for certain extraordinary payments and receipts, as well as the cost on revaluation of foreign debt at redemption. Extraordinary payments in fiscal 2007/08 would amount to R0,8 billion. This amount included premiums of R0,7 billion paid on foreign-debt liability management transactions and losses of R74 *million* on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) during fiscal 2006/07. The R0,4 billion provided for the settlement of the remaining liability relating to Saambou Bank would be paid out of the higher-than-anticipated positive balance in the curator's operational account.

National government financing

R billions

Item or instrument	Revised estimate	Medium-term estimates		
	2007/08	2008/09	2009/10	2010/11
Budget balance*	**-15,8**	**-14,3**	**-11,3**	**-14,3**
Plus: Extraordinary payments	0,8	-	-	-
Cost on revaluation of foreign debt at redemption	1,9	1,8	0,7	1,0
Less: Extraordinary receipts	1,6	0,3	0,3	-
Net borrowing requirement*	**-14,7**	**-12,7**	**-10,9**	**-13,3**
Treasury bills	5,8	5,8	5,8	6,0
Domestic government bonds issued	-3,8	5,9	-3,4	-3,3
Foreign bonds and loans	-1,5	-1,7	-7,0	-1,7
Changes in available cash balances	-15,2	-22,7	-6,3	-14,3
Total net financing	**-14,7**	**-12,7**	**-10,9**	**-13,3**

* Deficit +, surplus -

It was projected that a cost of R1,9 billion with respect to the revaluation of foreign loans would be realised in fiscal 2007/08. An amount of R1,6 billion was provided for extraordinary receipts in fiscal 2007/08, which comprised R0,3 billion paid to the National Revenue Fund from the agricultural debt account held at the Corporation for Public Deposits, a special dividend of R1 billion from Telkom and profits of R0,3 billion on the GFECRA for fiscal 2005/06.

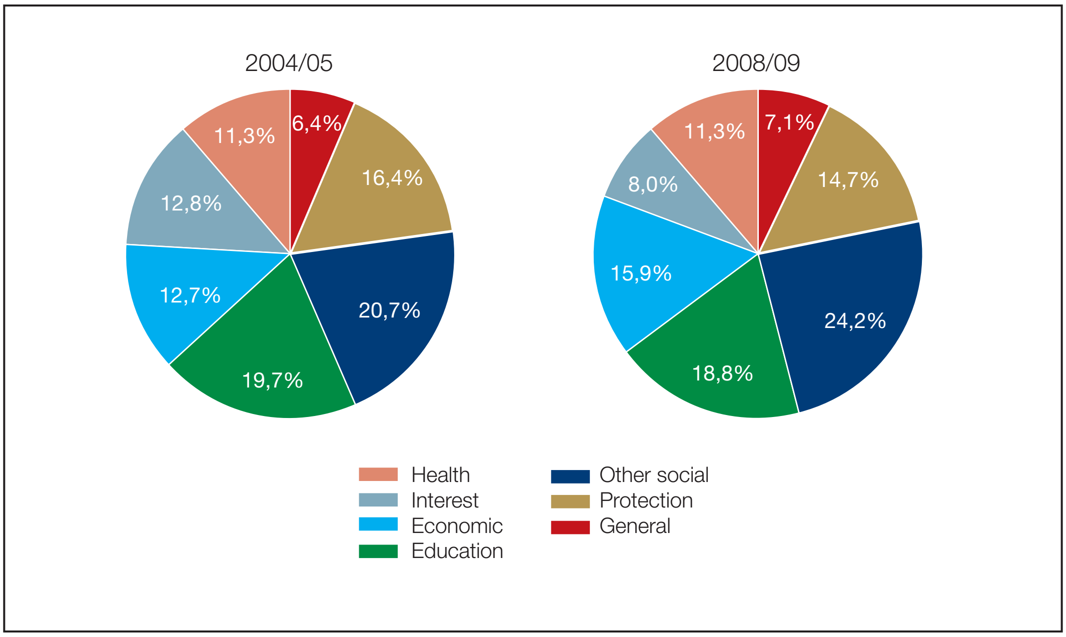
It was envisaged that the issuance of Treasury bills and occasionally domestic fixed-income bonds would continue over the medium term. Given the negative main budget borrowing requirement and government's ability to raise funding in the domestic market, no new foreign capital market loans were planned for over the medium term. Government would, however, maintain a presence in the international capital markets. Government's cash balances were projected to increase over the medium term and would be used to meet government's future cash requirements.

It was estimated that government's gross loan debt would increase from R551 billion at the end of fiscal 2007/08 to R567 billion at the end of fiscal 2008/09. As a ratio of gross domestic product, it was expected that gross loan debt would decrease from 26,9 per cent to 24,8 per cent over the same period. Further decreases to 22,7 and 20,9 per cent of estimated gross domestic product were envisaged for fiscal 2009/10 and 2010/11, respectively.

Profits on the GFECRA were estimated to amount to R47,4 billion at the end of March 2008, arising mainly from a revaluation of the Bank's gold and foreign-exchange holdings.

The accompanying graph illustrates the continuing shift in the functional classification of expenditure towards expenditure on social and economic services as well as general government services. As a ratio of total expenditure, spending on social services (including health, education and other social services) was estimated to increase from 51,7 per cent in fiscal 2004/05 to 54,3 per cent in fiscal 2008/09, indicating that

Functional classification of budgeted government expenditure*

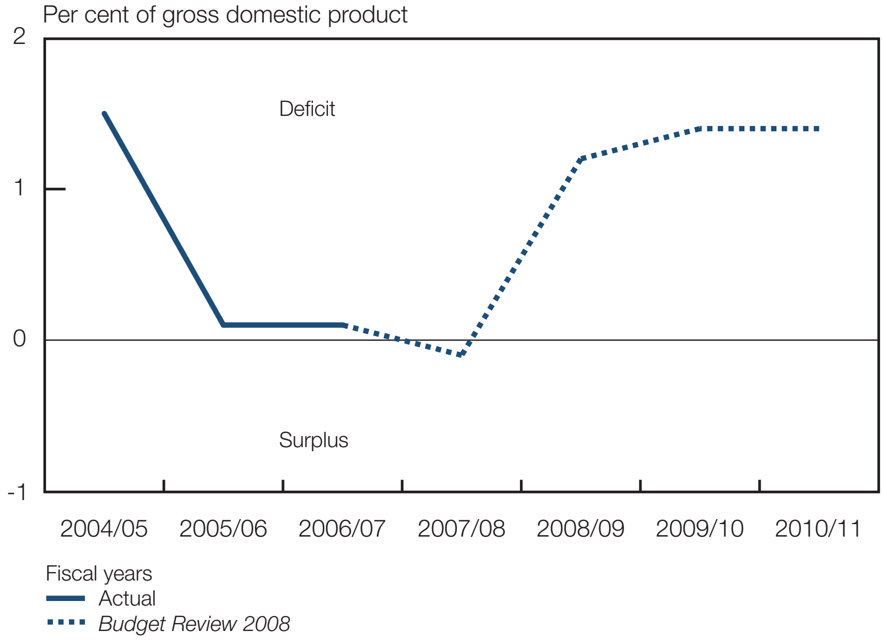


* Consolidated national and provincial government and social security funds

government continues to incur most of its expenditure on social services. Spending on social services was expected to increase at an average rate of 11,6 per cent over the three-year budget period. Government's commitment to combating crime is reflected in spending on protection services, set to increase from R62,9 billion in fiscal 2004/05 to an estimated amount of R113,5 billion in fiscal 2010/11.

Over the medium-term period, social grants expenditure would average 3,3 per cent of the estimated gross domestic product. During March 2008 an official poverty line index would be introduced by Statistics South Africa. Government's broader anti-poverty strategy and comprehensive social security programme were underscored by the reform of the retirement funding environment, with the basic social security arrangements also under consideration.

Non-financial public-sector borrowing requirement



The contingency reserve account is estimated to amount to R6,0 billion in fiscal 2008/09 and increase to R12,0 billion in fiscal 2009/10 and R20,0 billion in fiscal 2010/11. For the latter years the increase reflects the provision made for financial support for Eskom's capital investment programme. Funding of up to R60 billion was anticipated, with only one-third of this amount expected to be drawn over the medium-term period.

The public-sector borrowing requirement as a ratio of gross domestic product was projected to record a turnaround from a surplus of 0,1 per cent in fiscal 2007/08 to a borrowing requirement of 1,2 per cent in fiscal 2008/09, after which it was further projected to increase to 1,4 per cent in fiscal 2010/11. Borrowing would primarily be used to fund higher capital spending, especially by non-financial public enterprises as well as local authorities and local enterprises.

Public-sector borrowing requirement*

R billions

Level of government	Revised estimate	Medium-term estimates		
	2007/08	2008/09	2009/10	2010/11
National government	-16,9	-15,1	-12,1	-14,9
Extra-budgetary institutions	-3,8	-2,7	-2,0	-2,0
Social security funds	-4,5	-4,2	-4,7	-6,2
Provincial governments	0,5	0,9	-2,8	-5,3
Local authorities and local enterprises	8,6	10,6	12,8	14,1
General government**	**-16,0**	**-10,6**	**-8,9**	**-14,4**
Per cent of gross domestic product	*-0,8*	*-0,5*	*-0,4*	*-0,5*
Non-financial public enterprises	14,3	37,7	43,8	51,7
Public-sector borrowing requirement**	**-1,8**	**27,0**	**34,9**	**37,3**
Per cent of gross domestic product	*-0,1*	*1,2*	*1,4*	*1,4*

* Deficit +, surplus -

** Individual components may not add up to totals due to rounding

Statement of the Monetary Policy Committee
6 December 2007

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

Introduction

The short-term inflation outlook has deteriorated since the previous meeting of the Monetary Policy Committee (MPC). Food and energy prices have maintained pressure on inflation and these pressures are expected to persist in the coming months. At the same time, previous monetary policy actions are probably beginning to have an impact on household consumption expenditure and this is expected to help moderate inflation pressures over time. The MPC, however, has to ensure that the short-term impact of higher inflation does not allow inflation expectations to become entrenched at higher levels.

Recent developments in inflation

CPIX inflation remained outside the target range for the seventh consecutive month, reaching a 4-and-a-half-year high of 7,3 per cent in October 2007. Food price inflation has continued to accelerate, measuring 12,4 per cent in October. Most of the food categories in CPIX recorded double-digit rates of increase, with the main contributions emanating from grain products, milk, cheese and eggs, and vegetables. Meat price inflation, however, declined to 6,6 per cent. Petrol prices increased at a year-on-year rate of 12,0 per cent in October following moderate increases in the previous three months. Administered prices excluding petrol continued their upward trend and measured 8,5 per cent in October.

There is, however, some evidence that upward pressure on other components of inflation may be moderating. If food and petrol were excluded, CPIX inflation would have measured 4,8 per cent in October, compared to 5,0 per cent in July and August 2007. Low or negative rates of inflation are still being recorded in the following categories: Clothing and footwear, furniture, recreation and communication.

Production price inflation in October 2007 remained high at 9,5 per cent, which was marginally above that in the previous two months. Imported goods inflation declined to 7,5 per cent while the prices of domestically produced goods increased by 10,2 per cent. Prices of agricultural and manufactured foods increased by 26,1 per cent and 17,5 per cent, respectively, which suggests that further pressures on retail food prices can be expected in the coming months.

The outlook for inflation

The most recent central forecast of the Bank indicates a further deterioration in the inflation outlook, particularly in the short term, when compared to the previous forecast. CPIX inflation is now expected to peak at around 7,8 per cent in the first quarter of next year. Thereafter CPIX inflation is expected to decline to below the upper end of the target range by the final quarter of 2008. A gradual downward trend is expected to persist and to measure 5,2 per cent in the final quarter of 2009. The higher trend is a result of higher administered price assumptions, particularly for petrol and electricity, over the forecast period.

Despite the higher short-term trend in inflation, expectations remain contained within the inflation target range. According to the inflation expectations survey that is conducted on behalf of the Bank by the Bureau for Economic Research (BER) at the University of Stellenbosch, there was only a slight deterioration in expectations in the fourth quarter compared to those in the third quarter when a significant increase in expectations was recorded. CPIX inflation in 2008 is now expected to average 5,9 per cent, compared to the 5,8 per cent expected in the previous survey. Significantly, CPIX inflation expectations for 2009 remained unchanged at 5,6 per cent.

Expectations as reflected in the break-even inflation rates, which is the yield differential between conventional and inflation-linked bonds, reflect some deterioration. Break-even inflation rates over different maturities decreased between the August and October meetings of the MPC. Since the October meeting, break-even inflation has increased somewhat over all maturities, but still remains below the 6 per cent level.

The main risks to the inflation outlook emanate from food, petrol and electricity price prospects. International oil prices have continued to remain an upside risk factor. At the time of the October meeting of the MPC, North Sea Brent crude oil prices were trading at around US$78 per barrel. Since then prices increased to peak at almost US$100 per barrel, although in recent days prices have declined to around US$90 per barrel. Domestic petrol prices have been adversely affected by these international trends, and the local price of 93 octane petrol increased by 3 cents per litre in November 2007 and by 43 cents per litre in December.

The degree of upside risk from food price increases may have subsided over time, but food prices nevertheless remain the main contributors to inflation. As noted, production prices indicate that further pressures can be expected on CPIX in the short term. However there are expectations of some moderation during the course of next year as a result of base effects, more favourable weather conditions and higher crop estimates. Futures prices generally reflect an expectation of lower prices, particularly for maize, during 2008. Global food price pressures are nevertheless expected to persist for some time.

Electricity prices in particular pose a significant risk to the inflation outlook. The National Electricity Regulator is due to make a decision on the application by Eskom to raise electricity tariffs by 18 per cent in 2008 and 17 per cent in 2009 in order to help finance its capital expenditure programme.

Despite these risks and pressures, not all the recent developments have been negative from an inflation perspective. In particular, there is evidence of a lagged response by the economy to the previous monetary policy tightening. Household consumption expenditure continues to show some signs of moderation in response to the changed monetary policy stance and lower household disposable income growth. Final consumption expenditure by households grew by 4,5 per cent in the third quarter of 2007, compared to a revised 4,9 per cent growth in the second quarter. This third quarter moderation was a result of a marked deceleration in real expenditure on semi-durable goods in particular. The real value of retail sales remained broadly unchanged from the second quarter to the third quarter. Sales of new vehicles also remained subdued. Despite these developments, the FNB/BER Consumer Confidence Index reflected an increase in consumer confidence during the fourth quarter.

Reflecting the slowdown in household consumption expenditure, credit extension to the private sector has shown some signs of moderation, but nevertheless remains at high levels. Twelve-month growth in total loans and advances had declined gradually over the past few months. Growth over twelve months in loans and advances extended to the household sector declined to 20,1 per cent in October 2007, having peaked at 28,2 per cent in February 2006. The growth rate of loans and advances to the corporate sector declined to 29,7 per cent in October. Household debt as a percentage of household disposable income increased to 77,4 per cent in the third quarter.

Asset price growth, which in the past has helped to underpin domestic demand, appears to be somewhat restrained. Having recovered from the initial impact of the sub-prime developments in the United States (US) and euro area, the JSE Limited has been fairly volatile, in line with the uncertainties that prevailed in the global equity markets. In addition, according to Absa Bank, the year-on-year rate of increase in house prices in the middle segment has declined further to 13,6 per cent in October.

Fiscal policy continues to be supportive of monetary policy. In the October *Medium Term Budget Policy Statement*, the commitment to fiscal prudence was confirmed with the projection of fiscal surpluses for the coming three years.

Output growth remained strong, with GDP growth measuring 4,7 per cent in the third quarter of 2007 compared to a revised 4,4 per cent in the second quarter. Economic growth therefore continues to be at around rates consistent with the potential growth rate of the economy. Growth in gross fixed capital formation remained strong in the third quarter, and this is expected to underpin growth going forward.

The exchange rate of the rand has displayed a higher degree of volatility in recent weeks, but nevertheless has remained relatively unchanged since the previous meeting of the MPC. The relative strength of the rand has been underpinned by sustained capital inflows which financed an expanding current-account deficit in the third quarter of 2007. The deficit, which measured approximately 8,1 per cent of GDP, was driven mainly by increased imports of manufactured goods, as well as by a marked acceleration in service payments to non-residents. Despite this, capital inflows were sufficient to allow for a further accumulation of foreign-exchange reserves by the Bank. At the end of November, the official gross gold and other foreign-exchange reserves had increased to US$32,3 billion, and the international liquidity position to US$30,7 billion.

The outlook for the international economy remains uncertain, with continued turbulence in international financial markets. The reported losses of institutions with exposure to the US sub-prime mortgage market have exceeded expectations, and there are concerns that the downturn in some of the advanced economies may be more severe than originally anticipated. Global inflation appears to be contained although oil and food prices continue to pose a risk to the outlook.

Monetary policy stance

The assessment of the MPC is that the balance of risks to the inflation outlook continues to be on the upside. Therefore the MPC has decided to adjust the repurchase rate by 50 basis points to 11,0 per cent per annum with effect from Friday, 7 December 2007. The MPC will continue to monitor relevant developments and take the necessary steps to ensure that inflation returns to within the target range.

Statement of the Monetary Policy Committee

31 January 2008

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

Introduction

Since the previous meeting of the Monetary Policy Committee (MPC) in December 2007, the international environment has become increasingly uncertain and volatile. It appears that the continued fall-out from the United States (US) sub-prime crisis has not been confined to financial markets only and there has been a general downward revision to forecasts of global growth.

The slowdown in global growth could have spill-over effects on the South African economy which is also being affected adversely by electricity supply constraints. The economy has continued to respond to the tighter monetary policy stance and inflation is expected to peak in the first quarter of 2008. Nevertheless, there are still significant risks to the inflation outlook.

Recent developments in inflation

CPIX inflation has continued its upward trend, measuring 8,6 per cent in December 2007. The main drivers were again petrol and food. Petrol prices increased at a year-on-year rate of 23,8 per cent in December, while food prices increased at a rate of 13,9 per cent. Excluding food and petrol, CPIX inflation would have measured 5,0 per cent. Prices of clothing and footwear declined significantly, while modest declines were measured in recreation and entertainment, and textiles.

Production price inflation measured 10,3 per cent in December compared to 9,1 per cent in November. Prices of imported goods increased at a year-on-year rate of 11,3 per cent compared to 7,3 per cent the previous month. Manufactured food inflation increased to 18,7 per cent from 18,3 per cent in November while agricultural products inflation declined to 24,0 per cent from 26,8 per cent.

The outlook for inflation

The most recent central forecast of the Bank indicates a further deterioration in the inflation outlook in the short term when compared to the previous forecast. CPIX inflation is still expected to peak in the first quarter of 2008 but at an average of around 8,5 per cent. In line with the previous forecast, CPIX inflation is then expected to decline to below the upper end of the target range by the final quarter of 2008 and to remain at around the 5,6-per-cent level for most of 2009. The higher near-term projections are a result of slightly higher inflation outcomes and further revisions to assumptions about administered prices.

This central forecast of the Bank is broadly consistent with market expectations. The Reuters consensus forecast also expects inflation to peak during the first quarter of 2008 and to fall below the upper level of the target range in the fourth quarter. CPIX inflation is expected to average 6,8 per cent and 5,3 per cent in 2008 and 2009, respectively. The longer-term inflation expectations, as reflected in the break-even inflation rates, have remained relatively unchanged at below the 6-per-cent level since the previous MPC meeting.

The main upside risks to the inflation outlook remain food and energy price prospects, although the extent of the upside risk may have moderated somewhat. The price of North Sea Brent crude oil, which peaked at around US$100 per barrel in December, is currently trading at around US$92 per barrel. Domestic petrol prices remained unchanged in January and the current average under-recovery for January is approximately 15 cents per litre. Oil prices remain vulnerable to supply disruptions, although the adverse global growth outlook may restrain the degree of upside price risk.

Food prices remain one of the main short-term risks to inflation. Production prices continue to indicate that sustained food price pressure can be expected in the coming months. However, the more favourable weather conditions and lower futures prices for maize have reinforced a general expectation of some moderation of food price inflation during the course of this year. However, future trends will be dominated by global supply and demand conditions.

The threat posed to the inflation outlook by higher electricity prices remains. Eskom has been granted an average tariff increase of 14,2 per cent from July. The precise increase that will be faced by households may be higher, and will only be known during the coming months. Furthermore, there is a risk that the increases granted to Eskom over the forecast period could be higher than currently anticipated.

The rand exchange rate has depreciated in recent weeks following a period of relative stability. The currency has been affected by movements in the dollar and, more recently, by increased risk aversion towards emerging markets. The currency has been given some support from commodity prices which have remained firm, and in the case of gold and platinum, have reached new highs. On a trade-weighted basis, the rand has depreciated by around 7 per cent since the beginning of 2008.

Despite these pressures and risks to the outlook, there have been a number of developments which are likely to have a restraining impact on the inflation trend. The moderation of household consumption expenditure highlighted at the previous meeting appears to have continued. Real retail sales have trended downwards since the middle of 2007 and in November sales decreased by 0,7 per cent compared to October. Sales of household furniture, appliances and equipment have contracted the most. Motor vehicle sales also continued their downward trend. Sales of passenger vehicles declined by almost 10 per cent in 2007 compared to 2006 although commercial vehicle sales remained relatively strong.

Growth in household consumption expenditure is also expected to be dampened by negative wealth effects. The global financial market turbulence has been reflected in the volatility on the JSE Limited. Since its peak in October 2007, the all-share index has fallen by approximately 16 per cent. House price increases have also moderated somewhat. According to the Absa house price index, house price increases declined to 11,2 per cent in December 2007, while the month-on-month increase in December was 0,3 per cent. The Standard Bank median house price index was unchanged on a year-on-year basis in December.

Credit extension to the private sector has moderated further. Growth over twelve months in loans and advances extended to the private sector declined from 25,2 per cent in September 2007 to 22,2 per cent in December. The quarterly growth declined from

23,5 per cent in the third quarter to 18,1 per cent in the fourth quarter. Growth in all the subcategories, namely mortgage advances, instalment sales and leasing, and other loans and advances, has displayed a persistent downward trend. The growth in loans and advances to households declined to 18,9 per cent in December, down from 20,1 per cent in November 2007.

According to the *Wage Settlement Survey* by Andrew Levy Employment Publications, the average wage settlement for 2007 was 7,3 per cent compared to 6,5 per cent in 2006. This appears to be consistent with the 7,7 per cent year-on-year increase in average nominal remuneration per worker measured in the third quarter of 2007. Once productivity increases are adjusted for, year-on-year growth in nominal unit labour costs in the formal non-agricultural sector measured 4,8 per cent in the third quarter of 2007 compared to 5,0 per cent the previous quarter. These unit labour cost developments are consistent with the inflation target range.

The risks to output growth appear to be on the downside and this is likely to be reinforced by the electricity supply disruptions. Growth in the construction sector also appears to be moderating with a decline in residential and non-residential plans approved. In November the real value of building plans passed decreased by 16,5 per cent on a year-on-year basis. The volume of cement sales has also shown a significant decline in recent months.

The turbulence in international financial markets has not subsided, and losses suffered by financial institutions with exposure to the US sub-prime market continue to be reported. Fears of a slowdown in some of the advanced economies, and in the US in particular, have also been weighing on the markets. Although the emerging-market economies are expected to sustain relatively strong growth, there are indications of some moderation in growth in China, albeit still at high levels. Global inflation appears to be under control.

Monetary policy stance

There are still considerable risks to the inflation outlook. In light of, *inter alia*, heightened economic uncertainties, both domestically and globally, and some evidence of moderation in domestic consumption expenditure, the MPC has decided that it is appropriate at this time to leave the repo rate unchanged at 11 per cent per annum. The MPC remains committed to bringing inflation back to within the inflation target range.

Notes to tables

Total expenditure – consolidated general government: Functional classification – S–74

The functional classification table of consolidated general government has been expanded to comply with the *Government Finance Statistics (GFS) Manual 2001*. Future data will now be published in more detail. Data before fiscal year 2004/05 were based on the *GFS Manual 1986*.

Exchange rates, trade financing rates and commodity prices – Table S–103

Additional columns were added on page S–103 to indicate series for the prices of platinum and crude oil as well as a three-month euro trade financing rate. In order to accommodate these additional series, the columns relating to the forward cover exchange rates were moved from page S–103 to S–102. The publication of the exchange rate of the rand against the Zimbabwean dollar on page S–102 has been discontinued on account of difficulties in establishing a representative exchange rate.