Annual Report and Financial Statements

2005

South African Reserve Bank

Contact details

Physical address	Postal address
Head Office 370 Church Street Pretoria 0002 Telephone: (012) 313 3911	PO Box 427 Pretoria 0001
SARB College Besembiesie Drive Montana Park 0157 Telephone: (012) 548 8000	PO Box 427 Pretoria 0001

Branches

Bloemfontein Hoffman Square Bloemfontein 9301 Telephone: (051) 403 7500	PO Box 790 Bloemfontein 9300
Cape Town 25 Burg Street Cape Town 8001 Telephone: (021) 481 6700	PO Box 2533 Cape Town 8001
Durban 8 Commercial Road Durban 4001 Telephone: (031) 310 9300	PO Box 980 Durban 4000
East London c/o Cambridge & Union Street East London 5201 Telephone: (043) 707 3400	PO Box 435 East London 5200
Johannesburg 57 Ntemi Piliso Street Johannesburg 2001 Telephone: (011) 240 0700	PO Box 1096 Johannesburg 2000
Port Elizabeth Market Square North Union Street Port Elizabeth 6001 Telephone: (041) 501 6600	PO Box 712 Port Elizabeth 6000
Pretoria North 460 Jan van Riebeeck Street Pretoria North 0182 Telephone: (012) 521 7700	PO Box 17376 Pretoria North 0116

Contents

Mr T T Mboweni
Governor

Governor's foreword

The South African Reserve Bank has again successfully pursued its strategic objectives in the past financial year.

The main objective of the Bank remains the pursuit of low and stable inflation. Consumer price inflation for metropolitan and urban areas, excluding mortgage interest cost (CPIX), has been inside the 3-to-6-per-cent target range since September 2003. Owing to the success achieved in the containment of inflation and with benign forecasts of future inflation, it was possible to decrease the repurchase rate by 50 basis points in August 2004. In April 2005 the repurchase rate was decreased by a further 50 basis points to 7 per cent per annum.

The Bank continued to purchase moderate amounts of foreign exchange to increase the foreign reserves. Consequently gross foreign reserves increased from US$9 964 million at the end of March 2004 to US$15 858 million at the end of March 2005 and US$18 679 million at the end of June 2005. Over the same period the net reserves increased from US$6 375 million to US$12 381 million and eventually to US$15 176 million.

A significant milestone was reached when the Bank started to settle foreign exchange transactions through the Continuous Linked Settlement (CLS) system in December 2004. The rand is now positioned as one of 15 international currencies settling through the CLS.

The Bank remains committed to providing a regulatory environment that allows South African banks to adopt international best practice. A key focus area is the preparation for the implementation of an enhanced system of risk management and capital requirements, or Basel II. As an extension of the Bank's interest in financial stability, which encompasses more than bank supervision, the Bank launched the *Financial Stability Review*, a bi-annual publication communicating the Bank's overall assessment of the soundness of the financial system.

It remains a challenge for the Bank to ensure public confidence in the South African currency. A new bi-metal R5 coin was introduced in August 2004 in response to the counterfeiting threat of the silver-coloured R5 coin. The Bank also introduced a series of upgraded banknotes in February 2005.

During the 2004/05 financial year the balance sheet of the Bank increased by a significant margin, mainly as a result of the accumulation of foreign reserves. In April 2004 the National Treasury paid the third tranche of R7 billion in the form of zero-coupon bonds as compensation for losses accumulated previously on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). In February 2005 a further R2,5 billion payment was received as an advance on the R7 billion due in April 2005. The balance was duly received in April 2005.

Mostly owing to these payments, the debit balance on the GFECRA declined by about R10 billion. Since April 2005 this balance has swung into credit. Besides the payments received from the National Treasury, the significant change from debit to credit was caused by unrealised revaluation profits on the net foreign reserves.

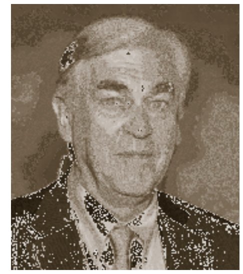
As disclosed in the financial statements, the Bank's profit after taxation improved during the year. This, however, was mostly owing to profits realised on the sale of Government bonds, as the increase in foreign reserves is impacting negatively on the Bank's profitability. With a higher level of foreign reserves and a lower interest rate environment than in the past, the Bank's profitability is likely to be under pressure. Hence increasing vigilance in the budgeting process will be required.

July 2005

Board of Directors


Governor and Chairperson of the Board
Mr T T Mboweni


Dr X P Guma


Mr I Plenderleith


Dr D Konar


Prof M Padayachee

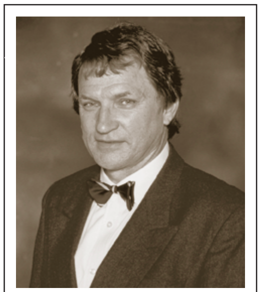

Mr J W Raath

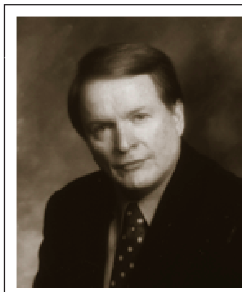

Ms F Jakoet


Ms A M Mokgabudi


Ms Z P Manase


Ms N D Orleyn


Mr S M Goodson


Prof R W K Parsons


Mr F E Groepe

Board members as at 31 March 2005

Mr T T Mboweni
Governor and Chairperson of the Board

Dr X P Guma
Deputy Governor

Mr I Plenderleith
Deputy Governor

Dr D Konar
Representing Commerce or Finance

Prof M Padayachee
Representing Government

Mr J W Raath
Representing Agriculture

Ms F Jakoet
Representing Commerce or Finance

Ms A M Mokgabudi
Representing Industry

Ms Z P Manase
Representing Commerce or Finance

Ms N D Orleyn
Representing Industry

Mr S M Goodson
Representing Commerce or Finance

Prof R W K Parsons
Representing Government

Mr F E Groepe
Representing Government

As at 31 March 2005 a vacancy existed for a deputy governor

Corporate governance

The South African Reserve Bank is committed to the principles of, and complies to a significant degree with the requirements of the King Report on Corporate Governance. The compliance of the Bank with these requirements is reflected below.

Board of Directors

In accordance with the South African Reserve Bank Act, No 90 of 1989 (Reserve Bank Act) the Board of fourteen directors must comprise:

Executive directors

- the Governor and three deputy governors appointed by the President of the Republic. The Governor serves as Chairperson of the Board, as stipulated in the Reserve Bank Act, and as Chief Executive Officer of the Bank. As at 31 March 2005, there was a vacancy for a deputy governor.

Non-executive directors

- three directors appointed by the President of the Republic; and
- seven directors elected by the shareholders.

The Reserve Bank Act requires that of the directors elected by the shareholders:

- four shall be persons with experience in commerce or finance;
- one shall be a person with experience in agriculture; and
- two shall be persons with industrial experience.

The Board meets regularly (at least four times a year) and monitors the exercise of the functions that it has delegated to executive management through a structured approach. This structured approach includes receiving reports from the Governor's Committee, which is responsible for the day-to-day activities of the Bank, and various subcommittees, chaired by non-executive directors. Non-executive directors have no service contracts with the Bank and are appointed for a specific term. Re-election is not automatic. There is a balance of both executive and non-executive directors to ensure independence and objectivity. The Board comprises people with integrity and diversity of skills and knowledge to ensure effective governance.

Governor's Committee

The Governor and deputy governors, in their capacity as executive directors of the Bank, are responsible for the day-to-day management and policy decisions of the Bank, except those reserved for the Board. The Governor's Committee meets fortnightly to consider policy issues and other executive management matters. These meetings are also attended by the Chief Economist and the General Counsel.

Audit Committee

The composition of the Audit Committee, which is a subcommittee of the Board, appears on page 23. The external and internal auditors have unrestricted access to the Chairperson of this committee. The committee meets regularly with management, the Internal Audit Department (IAD) and the external auditors. The committee reviews the financial statements and underlying accounting policies, the effectiveness of management information, other systems of internal control and the internal audit function. The Audit Committee also reviews the risk management processes applicable to the Bank's operations and examines and recommends areas that internal and external auditors must cover.

Remuneration Committee

The composition of the Remuneration Committee, a subcommittee of the Board, appears on page 23. The committee meets regularly to review human resources matters and remuneration practices and policies. This committee also determines the remuneration packages of the Governor and deputy governors.

Monetary Policy Committee

The Monetary Policy Committee is responsible for ensuring the formulation of monetary policy in line with current international best practice. As at 31 March 2005, the committee comprised the Governor and deputy governors, as well as five senior officials of the Bank. The committee meets at regular intervals and a statement on the monetary policy stance of the Bank is issued after each meeting. Decisions are taken by consensus.

Budget Committee

The Bank ensures financial discipline through a Budget Committee comprising the Governor, who presides over the meetings, the deputy governors, the head of the Financial Services Department and a representative from the Corporate Services Department. This committee meets regularly to oversee the preparation of the operational and capital budgets and the monitoring and management of actual expenditure. Quarterly reports are submitted to the Board.

Internal audit

The primary purpose of the IAD is to evaluate independently the Bank's and its subsidiaries' corporate business risks and to provide objective assurance and consulting services regarding the adequacy and effectiveness of the system of control, risk management, and governance processes.

Acting on a direct mandate from the Governor and the Board of Directors of the Bank, the IAD is functionally accountable to the Audit Committee of the Board of Directors with direct access to the Chairperson of the Audit Committee. The department reports administratively to the Governor.

The IAD performs its functions in accordance with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors. The scope of internal audit work includes assessments of the various components of the system of control, focusing on the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, accomplishment of established objectives and compliance with laws, regulations, contracts and procedures.

Internal control

To fulfil its responsibilities, management of the Bank has established and maintains an adequate and effective system of internal control and ensures compliance therewith. This internal control system, which is designed to provide reasonable assurance about the integrity and reliability of financial and management information, is based on the established written policies and procedures of the Bank.

Policies and procedures are implemented by trained and skilled staff, and duties are appropriately segregated. All staff members are required to maintain the highest level of ethics in ensuring that the practices of the Bank are conducted in a manner which, in all reasonable circumstances, is above reproach.

Systems are in place to ensure the safeguarding of and control over assets, the economical and efficient use of resources allocated, and the effective performance of all functions.

Employment Equity Consultative Body and Management Steering Committee

In compliance with the Employment Equity Act, No 55 of 1998, the Bank submitted its five-year Employment Equity Plan (EE Plan) to the Department of Labour in 2000. In the compilation as well as the implementation of the EE Plan, employees have the opportunity to participate through the Employment Equity Consultative Body (EECB), which represents employees at all occupational levels. The EECB consults regularly with the Management Steering Committee (MSC), representing management, on employment equity related matters in the Bank. The annual employment equity progress reports are compiled in consultation between the EECB and the MSC. As the Bank's current EE Plan ends in 2005, the EECB and MSC will consult on a subsequent employment equity plan that must be lodged with the Department of Labour. The EECB and the MSC also play a significant role in the review of the staff policies of the Bank to ensure that these are supportive of employment equity. To improve further the relationship and co-operation between the EECB and the MSC, the two structures have signed a Memorandum of Understanding. Plans are underway to expand the scope of the EECB and the MSC to include consultations on skills development.

Code of Ethics and Conduct

While staff members of the Bank have always been expected to conduct themselves in a manner befitting central bank employees, a formal code of ethics and conduct for staff members has never been documented. A proposed Code of Ethics and Conduct has now been circulated to staff for comment. This will lead to a formal Code of Ethics and Conduct containing the set of principles that employees of the Bank subscribe to and the behaviour expected of them.

Safety, health and environmental issues

The Bank and its subsidiaries continue to comply with health, safety and environmental legislation and are committed to the interest and wellbeing of their employees, as part of their broader social responsibilities. The strategy on life-threatening diseases, including HIV/Aids, addresses various issues such as awareness, education, support, avoidance of discrimination and the impact of the work environment.

The specific requirements of the Bank's subsidiaries in terms of effluent and other production waste disposal operations, are stringently adhered to.

The Bank proactively ensures a healthy and safe working environment through the regular commissioning of compliance assessments and environmental studies by external specialist organisations, accompanied by the implementation of corrective actions where required.

The Bank further ensures, as part of its obligations towards the safety of its staff and in terms of its Business Continuity Management requirements, that evacuation exercises are held on a regular basis.

The Bank acknowledges the importance of its responsibilities and is committed to ensure that a healthy and safe working environment is maintained at all times.

Risk management

Risk is an inherent feature of the activities of the Bank. The Bank is committed to managing risks by applying appropriate structures, systems and procedures. These structures, systems and procedures evolve continuously in response to changes in the financial and economic environment in which the Bank operates.

Management structures

The organisational structure of the Bank is designed to ensure an appropriate allocation of responsibilities. This is supported by a formal delegation of authority and a proper segregation of duties to achieve sound internal controls. The management of foreign and local financial market risks is strengthened by separate middle-office functions to monitor exposures and to report independently to management.

Risk elements

The financial risk elements in the activities of the Bank are: Interest rate, market price, credit and liquidity. These risks are discussed in Note 30 to the financial statements. Operational, human resource, legal and reputational risks are discussed below.

Operational risk

Operational risk is the risk of loss due to factors such as inadequate systems, management failure, ineffective internal controls, fraud and human error.

The Bank addresses these risks through comprehensive internal controls, back-up facilities, contingency planning and independent internal audit procedures. Assessments of operational risk are conducted on an ongoing basis by the appropriate organisational units. These risks are closely monitored by executive management and the Board through both the IAD and the Audit Committee.

Human resource risk

The particular nature of the activities of the Bank necessitates specialised knowledge in many areas.

In order to ensure an adequate knowledge base at all times, the Bank invests significantly in staff training, maintains succession plans for key personnel and is committed to remunerating its staff on a market-related basis.

Legal risk

Legal risks arise from any uncertainty or lack of enforceability, whether through legal or judicial processes, of the obligations of the Bank's clients and counterparties.

The Bank seeks to minimise such uncertainties through continuous consultation with internal and external legal advisers to better understand the nature of such risks and to improve the documentation and structure of transactions. In addition, the Bank has established legal procedures designed to ensure, as far as reasonably possible, compliance with all applicable internal, statutory and regulatory requirements.

Reputational risk

The executive management of the Bank has the necessary freedom and discretion to exercise central banking functions. However, this freedom is exercised within the context of fiduciary duties of good governance and by ensuring a proper balance between accountability and the best interests of the Bank and its various stakeholders. Consequently, the management of the Bank follows to the best of its ability the principles and guidelines contained in the Code of Conduct of the King Report on Corporate Governance in fulfilling its fiduciary duties.

The Bank's function of overseeing and ensuring the integrity of the country's banking system exposes it to severe criticism whenever there is an incident of bank failure or systemic difficulty. The responsibilities of the Bank regarding monetary policy, the national payment system and the issuing of notes and coin also expose the Bank to significant reputational risk. The Bank adheres to international best practice and, to this end, maintains close liaison with international peers. The Bank strives towards full compliance with the Basel Core Principles for effective banking supervision.

Mission statement

The South African Reserve Bank is the central bank of the Republic of South Africa. It regards its primary goal in the South African economic system as

the achievement and maintenance of price stability.

The South African Reserve Bank maintains that South Africa has a growing economy based on the principles of a market system, private and social initiative, effective competition and social fairness. It recognises, in the performance of its duties, the need to pursue balanced economic development and growth.

Functions

The Reserve Bank, in the pursuance of its goal, the realisation of its business philosophy and the fulfilment of its responsibilities, assumes responsibility for

- formulating and implementing monetary policy in such a way that the primary goal of the Reserve Bank will be achieved in the interest of the whole community that it serves;
- ensuring that the South African money, banking and financial system as a whole is sound, meets the requirements of the community and keeps abreast of international developments;
- assisting the South African government, as well as other members of the economic community of southern Africa, in the formulation and implementation of macroeconomic policy; and
- informing the South African community and all interested stakeholders abroad about monetary policy and the South African economic situation.

Business philosophy

The Reserve Bank accepts that the credibility of its policy and actions is a prerequisite for the attainment of its goals and that such credibility can only be achieved and maintained through independent action, firmness of principle, resoluteness and fixed intent. Furthermore, the Bank is convinced that fairness is integral in its judgement and actions.

The Reserve Bank ensures, through the application of modern management practices and technology, that all its activities are conducted effectively and efficiently.

Personnel philosophy

The Reserve Bank is convinced that its employees should find working for the Bank a stimulating and personally enriching experience, and consequently accepts co-responsibility for the development of each employee to his/her full potential. Career progress is based on the contribution made by the individual towards the fulfilment of the responsibilities of the Bank and therefore initiative, innovative thinking and professional expertise are systematically developed and rewarded.

The Reserve Bank is convinced that equal opportunities for all, irrespective of ethnicity, race, gender or religion, should be pursued.

The Reserve Bank accepts that only through the loyalty and dedication of its employees will the Bank be able to achieve its goal and fulfil its aims.

Monetary policy decision-making

The Monetary Policy Committee (MPC) currently comprises eight members: The Governor, the two deputy governors and five senior officials of the Reserve Bank.

Meetings are scheduled for every second month, and the timetable is finalised before the beginning of the year and published on the website of the Bank. However, provision is made for unscheduled meetings should the need arise. During the past year, there were no unscheduled meetings.

Between meetings, there is a continuous monitoring of economic developments, particularly those that impact directly on inflation and monetary policy. Members receive briefing updates, analysis and research output from various departments in the Bank, as well as input from various external domestic and international sources. These include financial institutions, academic economists, and international organisations such as the International Monetary Fund (IMF) and the Bank for International Settlements.

The MPC cycle begins approximately three to four weeks prior to the scheduled meeting, when committee members meet with the staff of the Research Department. The Macro Models Unit will have consulted various other units of the Research Department and the Financial Markets Department regarding the assumptions that have to be made in the models. Great emphasis is given to the forecast. However, it is important to stress that there is no mechanical relationship between the forecast and monetary policy decisions. Because of the uncertainties inherent in the forecast, the models and forecasts are tools to policy-making, but the final decision has to be a professional judgement based not only on the forecast but also on the analysis of the MPC.

Monetary policy decisions are made on the basis of current and expected economic developments. The MPC monitors a number of factors that influence inflation, including the components of domestic and external demand; money supply and credit extension; changes in wages and productivity and unit labour cost; the output gap; exchange rate developments; and import prices, oil prices and other administered prices. There is no target for any of these variables other than for CPIX, which is the benchmark for monetary policy decisions.

The first day of the scheduled MPC meeting starts with presentations on special items of topical interest that are prepared on an *ad hoc* basis, usually at the prior request of the MPC. In the past, such topics have included analyses of food prices, international oil prices and the role of monetary aggregates in the inflation process. This is followed by a review of financial market developments, prepared by the staff of various departments in the Bank and presented by senior members of the Research and Financial Markets Departments. The MPC members will have received a full set of documentation the previous week. The standard agenda for the economic developments is as follows:

- International economic conditions: Prepared by the Research Department.
- Financial markets, including domestic and international monetary and bond markets, and currency markets: Prepared by the Financial Markets Department.
- Financial and fiscal developments: Prepared by the Research Department.
- National economic conditions: Prepared by the Research Department.

- Economic forecasts: The forecasts of the various Bank econometric models as developed by the Research Department and also surveys of inflation expectations.

Each presentation is followed by discussion. These presentations usually continue until late afternoon, and up to that point the monetary policy stance is not discussed. In the evening there is a working dinner where some of the issues raised during the day are discussed further, with a focus on the implications for the monetary policy stance.

The following morning begins with a summary of the discussion of the previous evening. At this point, the discussion turns to the monetary policy stance. Committee members are then asked in turn to express their views on the appropriate monetary policy stance and on any interest rate changes that may be deemed appropriate. In general, decisions are made by consensus. There is no voting.

Once the MPC has reached a decision, a statement is issued to the press. The statement is also covered on national television and radio and posted on the Bank's website.

Apart from the press conference, monetary policy decisions are communicated and explained in a variety of other forums. The *Monetary Policy Review* is published twice per year, and released at the National Monetary Policy Forum in Pretoria. The forum is attended by interested persons, including financial analysts, academics, trade unionists and politicians. The MPC members also deliver presentations at nine regional Monetary Policy Forums. The aim of the forums is to explain monetary policy decisions and build up support for the low inflation objective of the Bank.

Other channels of monetary policy communication include quarterly presentations by the Governor to the Parliamentary Portfolio Committee on Finance, numerous speeches by the Governor and deputy governors of the Bank and regular presentations by senior members of the Bank to the National Economic Development and Labour Council.

Operational review

Primary function

The thrust of the the Bank's monetary policy remains the maintenance of price stability. International economic developments, real economic conditions in South Africa and the domestic monetary situation make it essential for South Africa to bring domestic inflation in line with that of its trading partners.

The primary focus in the process of executing monetary policy, therefore, is the achievement of inflation targets. This will not only contribute to the protection of the interests of the poor by protecting the purchasing power of the rand, but also to sustainable growth in the long run.

It is also essential for banking regulation and supervision to stay abreast of international developments, and for the financial system to be strengthened further to ensure stability of financial institutions and markets.

Operational functions

Inflation targeting

The monetary policy stance is decided at the bi-monthly meetings of the MPC. There exists, however, a continuous process of review that takes new information and developments into consideration.

Monetary policy is anchored to an inflation target set by the Government. Currently the target is set at 3 to 6 per cent – measured as the year-on-year increase in consumer price inflation excluding mortgage interest cost in metropolitan and other urban areas (CPIX). The target must be met continuously.

Six MPC meetings were held during the period under review. An important factor in determining the stance of monetary policy is the forecast generated by the Bank's macroeconomic models. But monetary policy is not decided mechanistically according to the forecast of economic developments. The judgement of the MPC plays an important part too. Forecasts, of course, differ from one MPC meeting to the other as assumptions about the driving forces behind economic decision-taking change and forecast errors are corrected.

At the time of the April 2005 meeting, uncertainty regarding the future course of the oil price had increased, with suggestions of high upside risk. However, the MPC had to consider a number of other factors. First, although there is no doubt that higher oil prices do impact negatively on measured inflation, it is generally accepted that monetary policy should not respond to these first-round effects.

Secondly, there is the impact of higher oil prices on the international economy. Although there has been a significant increase in prices, the impact has been far more muted than in previous rounds of price increases. Despite the higher prices, the IMF still forecasts inflation to be well contained. This continued subdued world inflation has been one of the considerations in the setting of domestic monetary policy. The higher oil prices have, however, resulted in a downward revision of world economic growth by ±0,5 per cent.

Developments in wage settlements and unit labour cost were also closely monitored. In February 2005, the committee commented on the favourable unit labour cost data, which showed that unit labour cost had increased by 4,9 per cent in the third quarter of 2004, compared to the third quarter of the previous year. At the time of the subsequent meeting, this figure had been revised up to 6,6 per cent, and the figure for the fourth quarter was 10,1 per cent. These figures appear to be a threat to the inflation outlook. However, the surveys on wage settlements continue to reflect a downward trend, with the latest figures for the first quarter of 2005 indicating settlements averaging 6 per cent.

Domestic expenditure trends continued to be carefully analysed. Domestic expenditure remained robust and was sustained by higher consumer confidence, the stronger rand, lower interest rates, higher real incomes and high asset prices. There was, however, evidence that the rate of increase in house prices was slowing. Nevertheless, the strong consumer demand continued over the period, but there was little evidence of inflationary pressure emanating from this.

The strong domestic demand pressure was also reflected in the money supply and credit extension figures. Although M3 money supply growth has remained fairly stable at around 12 per cent on a year-on-year basis, credit extension has been growing at a much faster rate. Much of this was related to mortgage loans, reflecting the buoyant conditions in the property market, and the purchases of new motor vehicles which have reached near record highs.

Although output was also relatively robust, it declined moderately in the fourth quarter of 2004 in line with the expectations of the MPC. In the April 2005 meeting, the committee was concerned about the slackening pace of growth in a number of sectors, in particular the manufacturing and gold-mining sectors. The outlook for growth in these sectors would be affected by world economic growth as well as the rand exchange rate.

The MPC also noted the fact that the current-account deficit has been increasing as a result of the higher levels of imported goods. In 2004 the current-account deficit as a percentage of gross domestic product averaged 3,2 per cent for the year, and around 4 per cent in the fourth quarter. The MPC was, however, confident that deficits around these levels would continue to be financed comfortably through capital inflows.

The rand exchange rate, which has had an important impact on the inflation outcome, has been a source of uncertainty. At the time of the December 2004 meeting, the rand had strengthened mainly as a result of dollar weakness, but subsequently the dollar recovered somewhat as US monetary policy was tightened. However, the continued imbalances in the US economy implied that the outlook for the US dollar, and therefore for the rand exchange rate, remained uncertain.

In the April 2005 meeting the MPC expressed concern about the fact that since the middle of 2004 the rand had been in a trading range significantly higher than the beginning of 2003. This was not only true against the US dollar. The average effective (trade-weighted) exchange rate index was approximately 10 per cent higher than its level between the beginning of 2003 and mid-2004. The MPC expressed concern about the impact of this development on certain sectors of the economy which were beginning to show signs of stress in the face of a stronger rand.

It should be emphasised that achieving the inflation target remains the primary and overriding objective of monetary policy. The objective is not to achieve low inflation for its own sake, but to provide a stable platform for sustained economic growth. Being concerned with the impact of developments in the rand exchange rate on the growth prospects of the economy is therefore entirely consistent with the inflation-targeting framework.

In the December 2004 meeting the committee noted that the increase in the price of consumer services had remained consistently above the upper level of the inflation target. By the April 2005 meeting, however, this measure had fallen below the 6-per-cent level for two consecutive months, measuring 5,6 per cent in February 2005. This was viewed as a positive development, as these prices are generally less affected by exchange rate developments than goods prices. In part this reflected progress made by the public authorities in containing administered price increases. Fiscal policy also continued, and is expected to continue to be supportive of monetary policy during this period, with the MPC highlighting the lower-than-expected budget deficit outturn for the 2004/05 fiscal year.

Other favourable developments over the period included the continued low levels of production price inflation, which indicate few pressures coming through on consumer prices in the short term and continued low levels of food price increases.

Finally, a further important positive development has been the evolution of inflationary expectations. All the recent surveys showed a progressive decline in inflation expectations. The results of the latest survey by the Bureau of Economic Research showed that all categories of respondents expected CPIX inflation to remain in the target range over the next three years. These improved expectations are seen as an illustration of the improved credibility of monetary policy and an important signal that low inflation is sustainable.

The MPC was cognisant of the risks to the inflation forecast. However, it was felt that, on balance, and given the favourable inflation outcome and expected outcomes, factors supporting a further rate reduction outweighed the risks. Accordingly, the MPC decided at its April 2005 meeting that a further 50-basis-point reduction in the repo rate was justified. This brought the repo rate down to 7 per cent.

Refinement of monetary policy operational procedures

The Bank moved to same-day square-off on 9 August 2004, as this was a prerequisite for the rand to be included as a (CLS) currency. Also, the Bank adapted its monetary policy operations in line with the same-day settlement cycle.

In December 2004 the Bank issued a consultative paper to market participants for comment. The paper proposed a number of modifications to streamline and simplify the Bank’s refinancing operations. The proposed changes were discussed extensively for implementation in May 2005.

Accumulation of reserves

The Bank continued to purchase moderate amounts of foreign exchange to increase its official reserves. Gross reserves increased from US$9 964 million at the end of March 2004 to US$15 858 million at the end of March 2005, while net reserves increased from US$6 375 million to US$12 381 million over the same period.

On 1 April 2004, the National Treasury paid the third tranche of R7 billion in the form of zero-coupon bonds as compensation for losses accumulated in the GFECRA. These bonds were switched into interest-bearing bonds and used in reverse repo transactions to drain liquidity from the money market.

The Bank also undertook various switches and, on occasion, sold bonds outright from its monetary policy bond portfolio. On 28 February 2005, the R151 government bond matured and the Bank received R9,5 billion for those bonds held.

Management of international reserves

The efficient and prudent management of reserves remained a strategic priority. At the end of March 2005, 88 per cent of gross reserves was managed internally and 12 per cent was managed by external fund managers. In 2005, the Governor's Committee approved a revised portfolio structure of the Bank's foreign exchange reserves as well as the continuation and expansion of the external fund management programme. Further progress was made with the roll-out of internally-managed portfolios.

Ensuring availability of credit lines

At the end of the financial year, the Bank's total foreign loan facilities amounted to US$4,4 billion, of which US$3,5 billion was utilised. The lower utilisation of facilities resulted mainly from a reduction in syndicated loans from US$3,25 billion to US$3 billion.

Administration of exchange controls

The Bank continued to administer exchange controls on behalf of government and successfully implemented the exchange control liberalisations that were announced during this financial year. In the 2004 Budget Speech, the Minister of Finance announced that foreign companies would be permitted to list on the Bond Exchange of South Africa and the JSE Securities Exchange South Africa. The Bank formally implemented this on 17 September 2004. This exchange control dispensation was further liberalised in October 2004 in the *Medium Term Budget Policy Statement* when the Minister announced the abolishment of investment restrictions on private individuals wishing to invest in inward listings.

Simultaneously, a further package of liberalisations was introduced when the Minister abolished the limits on new outward foreign direct investments by South African corporates. Corporates are now permitted to retain foreign dividends offshore, and foreign dividends repatriated to South Africa after 26 October 2004 could be transferred offshore again at any time, for any purpose.

Promoting a sound regulatory framework and stable financial system

The Bank is committed to providing a regulatory environment that allows South African banks to adopt international best practice. An important responsibility of the Bank is to ensure that the legal framework for the regulation and supervision of banks and banking groups remains relevant and current. A key focus area is the preparation for the implementation of an enhanced system of risk management and capital requirements, or Basel II. As from the Basel II implementation date of 1 January 2008, South African banks will no longer be able to use the current

Basel Capital Accord. It is envisaged, in principle, that all risk management approaches offered in terms of Basel II will be available to banks.

The Bank was integrally involved in the implementation of the Financial Intelligence Centre Act (FICA), No 38 of 2001, which is aimed at preventing banks from being used for purposes of money laundering. Frequent meetings took place between the Registrar of Banks and the banking industry to explore the impact of section 21(2) of the FICA, 2001. In terms of the Act, an accountable institution was not permitted to conduct a transaction in the course of an existing business relationship with a client after 30 June 2004 unless that institution had established and verified the identity of a client.

During the year under review, several pieces of draft legislation relating to consumer protection and the provision of broader access to finance were published for comment. The draft legislation is likely to affect not only the banking industry, but also the ongoing regulation and supervision of banks. The Bank is involved in ongoing negotiations with the National Treasury towards the development of a joint position paper on the proposed South African Deposit Insurance Scheme (SADIS). The SADIS will protect insured depositors, particularly small depositors, against the consequences associated with the failure of a bank.

The Bank monitored regulatory developments in the financial system and updated the scorecard based on the twelve key financial stability standards identified by the Financial Stability Forum. It also continued to develop and maintain key indicators of potential distress and instability in the financial system, and was engaged in an ongoing study of systemic risks for the financial sector. The Bank has advanced the development of a contingency planning and crisis management manual to be used in the event of a systemic crisis and to help market participants deal with financial sector contingencies, threat identification and systemic crisis resolution. The Bank also launched the *Financial Stability Review*, a bi-annual publication through which the Bank's overall assessment of the robustness of the financial system is communicated to policy-makers, market participants and the general public.

Developing and maintaining the national payment system

The Bank continued to improve the effectiveness and integrity of the national payment system (NPS) during the financial year by developing payment system oversight capacity and maintaining a high standard in the provision of settlement services.

A significant milestone was reached when the Bank started to settle all foreign exchange trades through the CLS system, and officially became part of CLS on 1 December 2004. As a currency in the CLS system, the rand is now positioned globally as one of the top 15 settlement currencies. This enhances foreign exchange settlement practices and reduces foreign exchange settlement risk. In order to allow for the inclusion of the rand in the CLS system, the NPS Amendment Bill was promulgated. Additional amendments to the NPS Act, No 78 of 1998 enhanced the Bank's payment system oversight function by providing for the issuance of directives.

Upgrade of banknote series

A major challenge for the Bank is to ensure public confidence in the currency and improve the efficiency as well as the effectiveness of the National Cash Management System through enhanced collaboration with all stakeholders.

The Bank, in order to enhance the integrity and security of its currency, introduced an upgraded banknote series on 1 February 2005. The Bank also launched a comprehensive communications campaign to educate the public about the new security features on the banknotes and to encourage people to check their banknotes. The campaign was aimed at key stakeholders in the financial sector and the public, and was intended to reach even the remotest parts of the country. Campaign materials were also sent to cash management staff of central banks in the Southern African Development Community (SADC).

The Bank also introduced a new bi-metal R5 coin on 2 August 2004 in response to the counterfeiting threat of the old silver-coloured R5 coin.

The number of counterfeit banknotes in circulation has decreased significantly. Attempts to counterfeit the upgraded series were thwarted by a number of arrests and by public vigilance arising from the communications campaign on the upgraded banknote series.

Maintaining international and regional relations

The Bank plays an important role in the SADC region, the African continent and the global arena and participates in a number of important regional and international initiatives. It contributes to and participates in the work of, *inter alia*, the Basel Committee via the Core Principles Liaison Group (CPLG), the CPLG Working Group on Capital, the Accord Implementation Group, the Financial Stability Institute and the biennial International Conference of Banking Supervisors.

The Bank strives to promote relations with its counterparts in Africa to gain a greater understanding of continental issues, foster policy co-ordination and provide technical assistance. During the period under review, the Bank provided expertise and infrastructure for the development and deployment of the Bank Supervision Application which was developed on behalf of SADC and some East African countries. This application was implemented in 11 participating countries and is used to supervise commercial banks and other financial institutions. The Bank has set up a support office to provide support and maintenance for this application. The Bank also concluded a Memorandum of Understanding with the Bank of Algeria, which provides for close co-operation.

The payment system was the subject of a number of conferences and workshops. Two SADC payment system conferences and an international conference were held during the financial year. In July 2004 a workshop on a cross-border settlement model was held. The annual SADC regional conference was held in September 2004 with the focus on payment system oversight. In February 2005 the Bank hosted the Bank for International Settlement's Committee on Payment and Settlement Systems conference.

During the year under review the South African Reserve Bank College (the College) placed great emphasis on co-operation with international training institutions, local universities, other central banks in the SADC region, financial institutions in South Africa as well as with departments in the Bank. In addition, the College offered a variety of training programmes to external clients, including the University of Johannesburg (formerly RAU), the University of Pretoria, the Bank of Namibia, Momentum School, Momentum Administration Services, Eskom, the Financial Services Board and the South African Revenue Services. The SARB College, in collaboration with the Bank of Tanzania Training Institute, also offered training to SADC central banks.

Human resources

The Bank embarked on a policy review process which included the review of 41 staff-related policies with the aim of addressing any form of discrimination and in an effort to comply with best practices. The Bank has made significant progress in finalising the review of the Staff Manual and the various staff policies. It is envisaged that the formal adoption and implementation of the revised policies will be completed by the last quarter of 2005.

In compliance with legislation on employment equity, the Bank facilitated interaction on employment equity issues with employees via the MSC and the EECB. In this regard, twelve consultative meetings were held. The fourth *Employment Equity Report* was compiled, consulted on with staff and lodged timeously with the Department of Labour.

Over-the-counter share market

The Bank continued to operate an over-the-counter market for transactions in its shares. With regard to the Over-the-Counter Share Transfer Facility, 20 transactions were successfully concluded representing 63 600 shares which were traded during the financial year.

Executive management, secretary and directors

Executive management as at 31 March 2005

Governor: Executive management and internal audit	T T Mboweni
Deputy Governor: Bank supervision, currency and protection services, financial stability and research	X P Guma
Deputy Governor: Exchange control, financial markets, financial services and national payment system	I Plenderleith
Chief Economist: Business systems and technology, corporate services, human resources, legal services and SARB College	E J van der Merwe

Acting Secretary of the Bank	H H van Gass

Directors

Tito Titus Mboweni *
Governor

Xolile Pallo Guma
Ian Plenderleith °
Deputy governors

Mahavishnu Padayachee °*
Raymond Whitmore Knighton Parsons *
Francois Engelbrecht Groepe °
Representing: Government

Deenadayalen Konar †
(Term of office expires on 25 August 2005 and available for re-election)
Fatima Jakoet °
Zodwa Penelope Manase °
(Term of office expires on 25 August 2005 and available for re-election)
Stephen Mitford Goodson
Representing: Commerce or Finance

Jacob Wouter Raath *
Representing: Agriculture

Audrey Matshidiso Mokgabudi x
Noluthando Dorian Orleyn *
(Term of office expires on 25 August 2005 and available for re-election)
Representing: Industry

† Chairperson of the Audit Committee
x Chairperson of the Remuneration Committee
° Member of the Audit Committee
* Member of the Remuneration Committee

Senior management at 31 March 2005

Adviser to the Governor	L van Zyl
Head: Currency and protection services	A Ismail
Head: Financial markets	A D Mminele
Head: Exchange control	A M Bruce-Brand
Head: Research	M Mnyande
Registrar and Head: Bank supervision	E M Kruger
Head: Financial stability	A Bezuidenhout
Head: National payment system	D C Mitchell
Head: Financial services	G J Terblanche
Head: Legal services	J J de Jager
Head: Internal audit	H P Badenhorst
Head: Human resources	S M Motsepe
Head: Corporate services	Z S Gumede
Head: Business systems and technology	M S Ismail
Principal: South African Reserve Bank College	G R Wesso

Branch managers as at 31 March 2005

Bloemfontein	I Oberholster *
Cape Town	A R Chamberlain
Durban	A C Botha
East London	E H Jacob
Johannesburg	H T Gape
Port Elizabeth	A G Dent *
Pretoria North	M Mogapi

* Employed on a contract basis.

Organisational structure

Governor
T T Mboweni

Deputy Governor
Dr X P Guma

Deputy Governor
I Plenderleith

Chief Economist
Dr E J van der Merwe

Adviser
L van Zyl

Head
Currency and protection services
A Ismail

Head
Research
Dr M Mnyande

Registrar and Head
Bank supervision
E M Kruger

Head
Financial stability
A Bezuidenhout

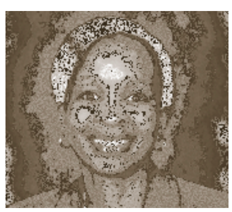
Head
Financial markets
A D Mminele

Head
Exchange control
A M Bruce-Brand

Head
National payment system
D C Mitchell

Head
Financial services
G J Terblanche

Head
Legal services
Dr J J de Jager



Head
Human resources
S M Motsepe

Head
Corporate services
Z S Gumede

Head
Business systems and technology
M S Ismail

Head
Internal audit
H P Badenhorst

Principal
SA Reserve Bank College
Dr G R Wesso

Personnel report

At the beginning of the 2004/05 financial year, the Bank had a total permanent staff complement of 2 073, which was reduced to a total of 1 988 by the end of the financial year. The reduction of 85 in staff numbers resulted from a combination of a moratorium on the appointment of new staff, a once-off voluntary enhanced early retirement programme for employees 50 years of age and older and normal attrition.

The overall staff turnover for the period was 5,6 per cent (excluding the effect of the enhanced early retirement programme) and 7,8 per cent (including the effect of the enhanced early retirement programme).

The Bank improved its equity representation, most notably at the management broad bands with the following percentage increases: General management (3 per cent), senior professional and management (5 per cent) and professional and vocational management (8 per cent). This is indicated in Table 1 below.

Table 1: Breakdown per broad band: Employment equity representation
Per cent

Broad band	Actual 31-03-04	Actual 31-03-05	2005 Bank target
General Management (GM)	45	48	50
Senior Professional and Management (SPM)	38	43	50
Professional and Vocational Management (PVM)	33	41	50
Junior Professional and Supervisory (JPS)	49	48	50
Trainee Professional and Clerical (TPC)	58	59	50
General Worker (GW)	89	89	50
Total	**54**	**55**	**50**

The higher percentage increase at the professional and vocational management broadband was a result of departments' restructuring and the subsequent appointments made especially in the Business Systems and Technology and Research Departments.

The Bank has also made improvements with regard to the gender representation in the respective broad bands. Improvement in gender representation will remain a focus area in the new financial year.

Table 2: Breakdown per broad band: Female representation
Per cent

Broad band	Actual 31-03-04	Actual 31-03-05	2005 Bank target
General Management (GM)	20	21	33
Senior Professional and Management (SPM)	24	27	33
Professional and Vocational Management (PVM)	36	40	33
Junior Professional and Supervisory (JPS)	61	62	33
Trainee Professional and Clerical (TPC)	50	50	33
General Worker (GW)	31	33	33
Total	**45**	**46**	**33**

Table 3: Workforce profile by gender and representivity at 31 March 2005
Number

Broad band	Male				Female				
	African	Coloured	Indian	White	African	Coloured	Indian	White	Total
General Management (excluding governors)	23	2	4	41	10	2	2	5	89
Senior Professional and Management	25	7	10	68	16	4	3	18	151
Professional and Vocational Management	61	12	10	132	43	9	11	78	356
Junior Professional and Supervisory	73	8	9	61	73	19	10	149	402
Trainee Professional and Clerical	196	47	18	132	124	60	23	188	788
General Worker	106	10	2	17	53	9	0	5	202
Total permanent	**484**	**86**	**53**	**451**	**319**	**103**	**49**	**443**	**1 988**
Non-permanent	2			28	2		3	12	47
Total	**486**	**86**	**53**	**479**	**321**	**103**	**52**	**455**	**2 035**

Table 4: Staff complement at 31 March 2005
Number

Department	Permanent staff	Contract workers	Total
Executive management (excluding governors)	29	2	31
Bank supervision	84	3	87
Business systems and technology	165	1	166
Corporate services	199	-	199
Currency and protection services (including branches)	837	3	840
Exchange control	158	24	182
Financial markets	95	1	96
Financial services	71	-	71
Financial stability	17	-	17
Human resources	54	-	54
Internal audit	47	-	47
Legal services	28	-	28
National payment system	22	-	22
Research	146	2	148
SARB College (including cadets)	9	11	20
Total staff complement	**1 961**	**47**	**2 008**
Staff members receiving disability benefits	27	-	27
Total	**1 988**	**47**	**2 035**

Corporate social responsibility report

The following contributions were made by the Bank during the 2004/05 financial year:

Donations during 2004/05

Rand

Fundraising	
Top Women in Business	16 872,00
Women in Action for Development	20 000,00
SA Tank Regiment – Golf Day	34 000,00
Payment Association – Golf Day	4 000,00
Economic Society of South Africa	40 000,00
Business Woman of the Year Award	10 000,00
Association of Black Securities and Investment Professionals	11 400,00
You and Your Money	5 000,00
Association for People with Disabilities	23 680,00
National Junior Business Executive Council	3 800,00
Economic History Society	10 000,00
Eastern Cape Awards	10 000,00
Hospice	15 000,00
Legal Resource Centre	10 000,00
International Accounting Standards Committee Foundation	61 400,00
SA Ballet Theatre	23 420,00
Total	298 572,00
Donation	
Eastern Cape Provincial Safety and Liaison	2 772,00
Total	2 772,00
Education	
JSE: Schools Challenge Project	40 000,00
Total	40 000,00
Universities*	
University of Cape Town	100 000,00
Rhodes University	100 000,00
University of Fort Hare	100 000,00
University of South Africa (UNISA)	250 000,00
University of the Free State	150 000,00
University of Stellenbosch	100 000,00
University of Johannesburg	250 000,00
University of Transkei	100 000,00
University of Kwa-Zulu Natal	200 000,00
University of Venda	100 000,00
University of Limpopo	200 000,00
University of the Western Cape	100 000,00
Nelson Mandela Metropolitan University	250 000,00
University of the Witwatersrand	100 000,00
North West University	250 000,00
University of Zululand	100 000,00
University of Pretoria	150 000,00
Total	2 600 000,00
Technikons	
Border Technikon	100 000,00
Eastern Cape Technikon	100 000,00
Cape Peninsula University of Technology	200 000,00
Mangosuthu Technikon	100 000,00
Central University of Technology, Free State	150 000,00
Tshwane University of Technology	300 000,00
Durban Institute of Technology	200 000,00
Vaal University of Technology	100 000,0
Total	1 250 000,00
Total spent	R4 191 344,00

* The amounts for the respective Universities and Technikons vary to make provision for the mergers that have taken place.

Financial framework for 2005/06

Introduction

The Bank strives to conduct its financial affairs in accordance with international best practice. It is governed by the Reserve Bank Act. The Bank also strives to comply with South African Statements of Generally Accepted Accounting Practice (SA GAAP), even though it is not required to do so by any of the Acts applicable to it. In the year under review SA GAAP was applied, except for the following:

- Realised and unrealised valuation gains and losses in gold and foreign-denominated assets and liabilities are for the account of the Government according to the Reserve Bank Act and have therefore not been accounted for in the income statement of the Bank.

- The concentration per foreign currency of all the significant foreign exchange traded positions are not disclosed.

- For each class of financial asset and financial liability, both recognised and unrecognised, information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows, and the interest rate re-pricing of those instruments are not disclosed due to the sensitivity of the information.

- For each class of financial asset, both recognised and unrecognised, information about the exposure to and concentration of credit risk is not disclosed, also due to the sensitivity of the information.

Budget for 2005/06

The Bank's income depends on the Bank's activities in the financial markets, which are guided by the policy options chosen by the Bank, taking into account the prevailing market conditions and, particularly, the expected inflation rate. The inherent volatility of these market conditions makes it impracticable for the Bank to budget for income, but the outlook for the Bank's income is monitored closely.

Expenditure is closely controlled through a formalised budget process.

Bank expenditure budget

Certain expenditure items, such as adjustments to the provision for post-retirement medical benefits and depreciation of fixed assets, are not included in the figures in the table below, because they are not managed as part of the operational budget process.

Expenditure budget

	Budget 2005/06	Actual 2004/05	Budget 2004/05
Personnel costs			
Normal recurring costs	631 463	594 786	623 654
Early retirement packages	0	14 353	2 000
Total personnel costs	**631 463**	**609 139**	**625 654**
Operating costs	**227 447**	**189 884**	**248 397**
Cost of new currency	**649 711**	**591 201**	**623 519**

The actual performance of the 2004/05 recurring personnel and operating costs was significantly below budget. This was mainly as a result of the following:

- The Currency and Protection Services Department was involved extensively in projects relating to the release of the new R5 and R2 coins and the communication campaign in respect of the new banknote series. This limited their normal activities to some extent in 2004/05.

- Several activities in the Exchange Control Department were also limited in 2004/05 due to its involvement in the exchange control amnesty programme.

- A change in the insurance structure, the softening in the world insurance market and the strengthening of the rand resulted in very favourable renewals, and hence substantial savings on the operational insurance budget were achieved.

- The 2005/06 budget for personnel and operational costs has increased somewhat over the 2004/05 actual outcome as provision has been made for the return to more normal activity levels in the Currency and Protection Services and Exchange Control Departments. In addition, the Bank Supervision Department will be embarking on implementing the Basel II principles and significant provision has been made in the 2005/06 budget for this initiative.

The cost of new currency for 2004/05 is below the budget as significant savings were achieved on the cost of materials due to the strengthening of the rand. In addition, there was a deliberate running down of stocks of the old banknote series due to the launch of the upgraded series. This has impacted on the growth of the 2005/06 budget, as buffer stocks for the upgraded series have to be built up.