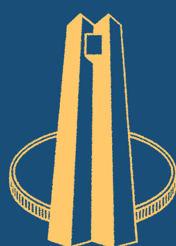
Annual Report

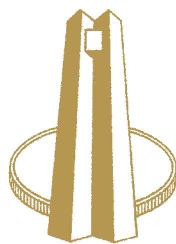
2008/09



South African Reserve Bank

Annual Report

2008/09



South African Reserve Bank

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Bloemfontein 1 Hamelberg Street Hoffman Square Bloemfontein 9301 Telephone: 051 403-7500	P O Box 790 Bloemfontein 9300
Cape Town 25 Burg Street Cape Town 8001 Telephone: 021 4816-700	P O Box 2533 Cape Town 8001
Durban 8 Dr A B Xuma Street Durban 4001 Telephone: 031 310-9300	P O Box 980 Durban 4000
East London 69 Union Street East London 5201 Telephone: 043 707-3400	P O Box 435 East London 5200
Johannesburg 57 Ntemi Piliso Street Johannesburg 2001 Telephone: 011 240-0700	P O Box 1096 Johannesburg 2000
Port Elizabeth Market Square North Union Street Port Elizabeth 6001 Telephone: 041 501-6600	P O Box 712 Port Elizabeth 6000
Pretoria North 460 Jan van Riebeeck Street Pretoria North 0182 Telephone: 012 521-7700	P O Box 17376 Pretoria North 0116

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Mr T T Mboweni
Governor

Governor's foreword

It gives me great pleasure to present the *Annual Report* of the South African Reserve Bank (the Bank) for the financial year ended 31 March 2009 to the shareholders and other stakeholders of the Bank. This *Annual Report* provides an overview of the main operational activities of the Bank, including an analysis of monetary policy. The report also includes a comprehensive review of international and domestic economic developments in the past year.

The Bank has diverse responsibilities and roles in both the domestic and international arenas. These activities are highlighted in this report. The overriding objective of the Bank remains the achievement and maintenance of price stability, which it implements within an inflation-targeting framework. Apart from monetary policy, the Bank is also responsible for the production of notes and coin; oversight of the national payment system; bank supervision; management of gold and foreign-exchange reserves; and administration of exchange control measures.

During the past year, the global financial crisis meant that the Bank became more closely involved in international forums, particularly the Group of Twenty (G-20), as part of a co-ordinated global policy response to the crisis. The Bank has also maintained a greater focus on financial stability in general. Fortunately, the domestic financial sector has been relatively insulated from the direct impacts of the global financial-sector crisis through appropriate monitoring and supervision of the domestic banking sector.

The heightened uncertainty in international financial markets also resulted in a highly synchronised global economic downturn in the final quarter of 2008. South Africa was not immune to these developments, and negative growth was experienced in the fourth quarter of 2008 and the first two quarters of 2009. International commodity prices, particularly oil prices, declined substantially and, along with weak household consumption expenditure and moderating growth in credit extension, this meant that some of the main pressures on inflation had dissipated somewhat. Nevertheless, consumer price index (CPI) inflation remained subject to a degree of stickiness as a result of stubbornly high food prices and significant increases in some administered prices. Targeted inflation has, therefore, remained outside the target range for the whole of the review period.

Despite the disappointing inflation outcomes, a more accommodative monetary policy was adopted by the Monetary Policy Committee (MPC). As a result, between December 2008 and August 2009 the repurchase rate was reduced by a cumulative 500 basis points. The MPC was of the view that, despite some inflation inertia, targeted inflation was expected to moderate to within the target range by the second quarter of 2010. By adopting a forward-looking flexible approach, the MPC was able to provide some stimulus to the slowing economy, while maintaining the focus on its primary objective of price stability.

The primary objective of the Bank remains the achievement and maintenance of price stability in the interest of sustainable economic growth in South Africa. The Bank will continue to pursue this objective within a flexible inflation-targeting framework. Recent global developments have also underlined the need for the Bank to maintain its focus on the financial sector and to contribute, where possible, to overall financial stability.

T T Mboweni — September 2009

Board of Directors as at 31 March 2009

Governor and Chairperson of the Board
Mr T T Mboweni

Deputy Governor
Dr X P Guma

Deputy Governor
Dr R D Mokate

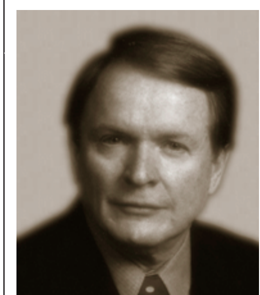
Representing
Commerce or Finance
Dr D Konar

Representing
Commerce or Finance
Ms F Jakoet

Representing
Commerce or Finance
Ms Z P Manase

Representing Industry
Ms N D Orleyn

Representing
Commerce or Finance
Mr S M Goodson


Representing Government
Prof R W K Parsons

Representing Government
Mr F E Groepe

Representing Industry
Ms T N Mgoduso

Representing Agriculture
Mr J F van der Merwe

Representing Government
Mr E Masilela

As at 31 March 2009 a vacancy existed for a deputy governor.

Composition of the Board of Directors as at 31 March 2009

Governor

Tito Titus Mboweni *

Deputy governors

Xolile Pallo Guma °

Renosi Denise Mokate °

Representing: Government

Raymond Whitmore Knighton Parsons ◆°
(Appointed on 18 March 2008)

Francois Engelbrecht Groepe ◆
(Appointed on 18 March 2008)

Elias Masilela ◆
(Appointed on 18 March 2008)

Representing: Commerce or Finance

Deenadayalen Konar ◆
(Re-elected on 18 September 2008)

Fatima Jakoet ◆†
(Re-elected on 20 September 2007)

Zodwa Penelope Manase °▲
(Re-elected on 18 September 2008)

Stephen Mitford Goodson ◆*
(Term of office expires on 18 September 2009)

Representing: Agriculture

Johannes Francois van der Merwe ◆*°
(Elected on 20 September 2007)

Representing: Industry

Noluthando Dorian Orleyn ◆x
(Re-elected on 18 September 2008)

Thandeka Nozipho Mgoduso ◆*
(Re-elected on 20 September 2007)

▲ Chairperson of the Non-executive Directors' Committee
† Chairperson of the Audit Committee
x Chairperson of the Remuneration Committee
◆ Member of the Non-executive Directors' Committee
° Member of the Audit Committee
* Member of the Remuneration Committee

Mission statement

Primary goal

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

Functions

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

1. formulating and implementing monetary policy in such a way that the primary goal of the Bank will be achieved in the interest of the whole community that it serves;
2. 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;
3. assisting the South African government, as well as other members of the economic community of southern Africa, with data relevant to the formulation and implementation of macroeconomic policy; and
4. informing the South African community and all stakeholders abroad about monetary policy and the South African economic situation.

Business philosophy

The 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.

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

Personnel philosophy

The Bank believes that its employees should find working for the Bank a stimulating and personally enriching experience, and consequently accepts co-responsibility for the development of employees to their full potential. Career progress is based primarily on the contribution made by the individual towards the fulfilment of the responsibilities of the Bank.

The Bank recognises that equal opportunities for all, irrespective of ethnicity, race, gender, disability or religion, should be pursued.

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

Executive management and Secretary as at 31 March 2009

Governor: Financial Stability and Research	T T Mboweni
Executive General Manager and Registrar of Banks Bank Supervision Department	E M Kruger
Executive General Manager and Chief Economist Currency and Protection Services, Financial Stability and Research departments	M Mnyande
Deputy Governor: Markets	X P Guma
Executive General Manager Exchange Control, Financial Markets, Financial Services and National Payment System departments	A D Mminele
Deputy Governor: Central Services	R D Mokate
Executive General Manager Business Systems and Technology, Corporate Services, Executive Management, Human Resources, Internal Audit and Legal Services departments, and SARB College	L van Zyl
Secretary of the Bank	T P Mongwe

Senior management as at 31 March 2009

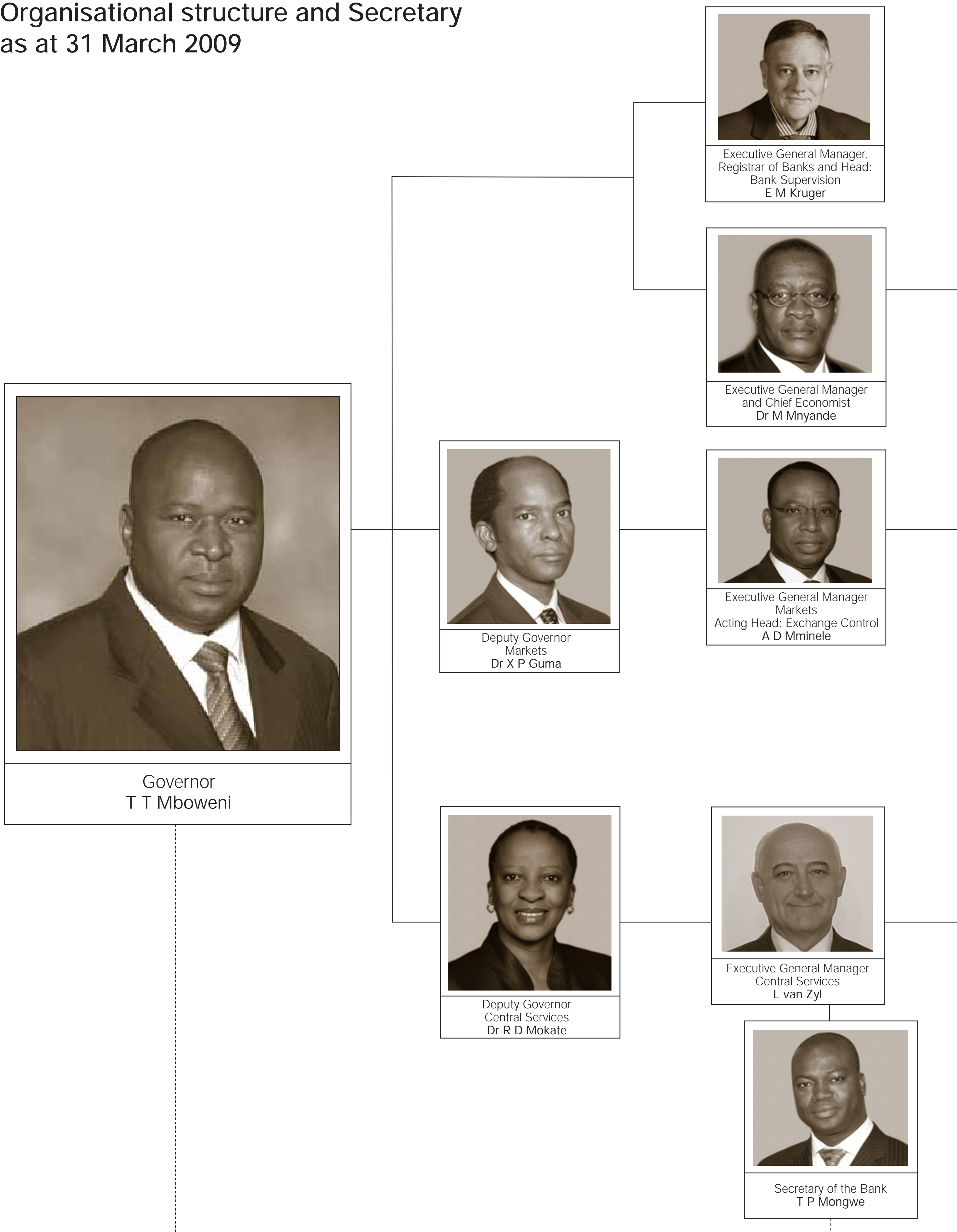
Head: Bank Supervision	E M Kruger
Head: Exchange Control (Acting)	A D Mminele*
Head: Currency and Protection Services	A Ismail
Head: Research	J P van den Heever
Head: Financial Markets	R M du Plooy
Head: Financial Stability	A Bezuidenhout
Head: National Payment System	D C Mitchell
Head: Financial Services	G J Terblanche
Head: Legal Services	J J de Jager
Head: Business Systems and Technology	M S Ismail
Head: Corporate Services	R Z Nkwali
Head: Internal Audit	M D Nkhabu
Head: Human Resources	J D Jeftha
Principal: SARB College	G R Wesso
Executive Assistant: Executive Management	J N L Fourie
Secretary of the Bank	T P Mongwe

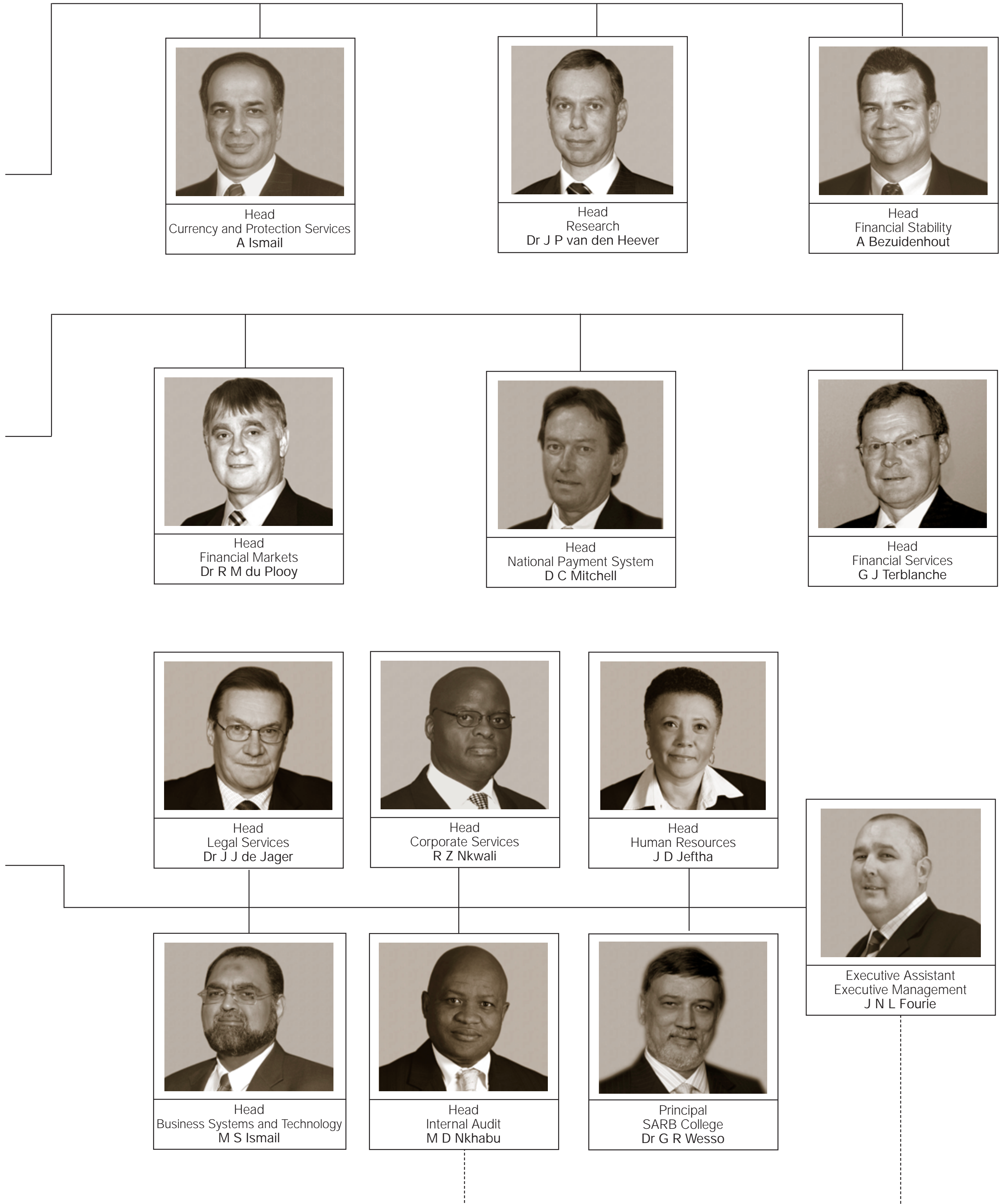
* The Executive General Manager: Markets, Mr A D Mminele, acted in this capacity from 29 October 2008, following the retirement of Mr A M Bruce-Brand.

Branch managers as at 31 March 2009

Bloemfontein	M Hellerle
Cape Town	A R Chamberlain
Durban	L W Ehrke
East London	E H Jacob
Johannesburg	B P Loving
Port Elizabeth	R Maharaj
Pretoria North (Acting)	V B M Dhlamini

Organisational structure and Secretary as at 31 March 2009




Head
Currency and Protection Services
A Ismail
Head
Research
Dr J P van den Heever
Head
Financial Stability
A Bezuidenhout
Head
Financial Markets
Dr R M du Plooy
Head
National Payment System
D C Mitchell
Head
Financial Services
G J Terblanche
Head
Legal Services
Dr J J de Jager
Head
Corporate Services
R Z Nkwali
Head
Human Resources
J D Jeftha
Executive Assistant
Executive Management
J N L Fourie
Head
Business Systems and Technology
M S Ismail
Head
Internal Audit
M D Nkhabu
Principal
SARB College
Dr G R Wesso

Corporate governance

The Bank is committed to the principles of good corporate governance and complies, to a significant degree, with the requirements of the *King Report on Corporate Governance for South Africa*. The compliance of the Bank with these requirements is reflected below.

Board of Directors

In accordance with the South African Reserve Bank Act, 1989 (Act No. 90 of 1989) (the Act) the Board of Directors (the Board) comprises fourteen members.

Executive directors

The Governor and three deputy governors are appointed by the President of the Republic of South Africa for five-year terms. The Governor serves as Chairperson of the Board, as stipulated in the Act, and as Chief Executive Officer of the Bank. As at 31 March 2009 there was a vacancy for a deputy governor.

Non-executive directors

Three directors are appointed by the President of the Republic of South Africa and seven directors are elected by the private shareholders of the Bank for three-year terms. Each director is eligible for reappointment or re-election at the end of their term.

The 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 exercising of the functions that it has delegated to executive management through a structured framework. This structured framework includes receiving reports from the Governor's Executive Committee (GEC), which is responsible for the day-to-day activities of the Bank, and various Board committees and subcommittees, chaired by non-executive directors and management. Non-executive directors have no service contracts with the Bank. There is a balance of both executive and non-executive directors to ensure independence and objectivity. The Board comprises people with integrity, and a diversity of skills and knowledge to ensure effective governance.

Audit Committee

The composition of the Audit Committee, which is a subcommittee of the Board, appears on page 3. 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 is chaired by a non-executive director, and 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 operations of the Bank, and recommends areas that internal and external auditors should review.

Remuneration Committee

The composition of the Remuneration Committee, a subcommittee of the Board, appears on page 3. The committee meets regularly to review human resources matters,

remuneration practices and policies, and the appointment of directors. This committee also determines the remuneration packages of the Governor, deputy governors, executive general managers, non-executive directors, and the remuneration of, and incentives for, staff. The Remuneration Committee is chaired by a non-executive director.

Non-executive Directors' Committee

The Non-executive Directors' Committee comprises all the non-executive directors of the Bank. The primary function of this committee is to assist the Board in fulfiling its legal and fiduciary obligations and responsibilities, and to enhance corporate governance matters and practices. The committee meets at least three times a year and is presided over by one of the non-executive directors.

Governor's Executive 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 GEC meets fortnightly to consider policy issues and other executive management matters. These meetings are attended by the Governor as Chairperson, the deputy governors and executive general managers, and the general counsel by invitation.

Monetary Policy Committee

The Monetary Policy Committee (MPC) is responsible for deciding on the monetary policy stance in line with current international best practice. As at 31 March 2009 the committee comprised the Governor, deputy governors and four 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

In discharging its duties, the Budget Committee is assisted by the Budget Subcommittee and the Procurement Committee.

The Budget Committee consists of the Governor, who presides over the meetings, the deputy governors and the Head: Financial Services Department. The committee meets at least four times a year. The Budget Subcommittee assists the Budget Committee by considering the budget process, monitoring financial and other risks, and making recommendations to the Budget Committee. The Budget Subcommittee is chaired by an executive general manager and comprises the executive general managers and the Head: Financial Services Department.

The Procurement Committee fulfils an important oversight role regarding the governance of the procurement process. The committee is chaired by an executive general manager and comprises three senior officials of the Bank.

Reserves Management Committee

The primary responsibilities of the Reserves Management Committee are to set investment guidelines for portfolio managers; review and select benchmarks for the foreign-exchange reserves of the Bank; allocate the risk budget; and set active parameters for individual portfolios. The committee meets approximately every second month and is chaired by the Deputy Governor: Markets. Two representatives of the National Treasury are *ex officio* members of this committee.

Retirement Fund

The Board of Trustees of the Bank's Retirement Fund comprises four trustees (two executive directors, one non-executive director and the Head: Financial Services Department of the Bank) appointed by the Board of the Bank and four trustees elected by members of the Retirement Fund. The Governor acts as Chairperson of the Board of Trustees of the Retirement Fund. The Retirement Fund is incorporated in terms of the Pension Funds Act, 1956 (Act No. 24 of 1956) and is a separate entity from the Bank.

Pension Fund

The Board of Trustees of the Bank's Pension Fund comprises four trustees (two executive directors and two non-executive directors) appointed by the Board of the Bank and four trustees elected by members of the Pension Fund. The Governor acts as Chairperson of the Board of Trustees of the Pension Fund. The fund is incorporated in terms of the Pension Funds Act, 1956 (Act No. 24 of 1956) and, as such, is a separate entity from the Bank.

Internal audit

The primary purpose of the IAD is to evaluate and contribute independently to the improvement of the governance, risk management and control processes of the Bank and its subsidiaries. The IAD achieves its purpose by providing independent and objective assurance and consulting services regarding the adequacy and effectiveness of these processes. The full mandate and authority of the IAD are contained in the Internal Audit Charter that is approved by the Board of the Bank. The charter is revised and updated regularly to ensure that the internal audit function remains relevant and keeps abreast of changes in the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors, codes of governance and legislation.

Acting on a direct mandate from the Governor and the Board, the IAD is functionally accountable to the Audit Committee of the Board, with direct access to the Chairperson of the Audit Committee. The department reports functionally to the Governor and administratively to a deputy governor via an executive general manager.

The IAD subscribes to the Code of Ethics issued by the Institute of Internal Auditors that promotes the principles of integrity, objectivity, confidentiality and competency.

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 assessment of the various components of the system of control, focusing on the reliability and integrity of financial and operational information, and effectiveness and efficiency of operations; safeguarding of assets; accomplishment of established objectives; and compliance with laws, regulations, contracts and procedures. In evaluating the adequacy and effectiveness of controls, the IAD adopted the principles embodied in the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's framework.

The IAD implemented a quality assurance and improvement programme for the purpose of enhancing compliance with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors, and improving its efficiency and

effectiveness. Strategic alliances are formed, where necessary, with other members of the profession in various industries in order to share matters of common interest.

Internal control

Internal control is an integral part of the management and accountability function of the Bank. The Board and management of the Bank share the ultimate responsibility for establishing and maintaining a sound system of internal control. The Audit Committee, acting on behalf of the Board, considers the adequacy and effectiveness of the Bank's internal control system and provides oversight over the internal audit function. The system of internal control adopted by the Bank is broad and includes strategic, financial, regulatory and operational controls designed to assist the Bank in achieving its goals and objectives.

To fulfil its responsibilities, the 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.

The management of the Bank, through the established governance process, provides oversight over the design and implementation of sound policies, procedures and plans, which promote the achievement of the broader objectives of the Bank.

Policies and procedures are reviewed and approved regularly to ensure that they continue to address identified business risks, and are implemented by trained and skilled staff, and that responsibilities are segregated appropriately. 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 that is beyond 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 structure

The Bank has been actively involved in employment equity consultation since its first *Employment Equity Plan* was submitted to the Department of Labour in 2000. Since then the consultative structure and processes have evolved to include SASBO – the Finance Union – and consultation relating to skills development. The success of the consultative process has yielded a steady decline in the number of barriers to employment equity and has increased staff participation in consultations on skills development issues. Special interventions, such as a task team to investigate the Bank's performance management system and a programme to educate and sensitise employees about disability issues, have emerged from the culture and climate survey. Relevant recommendations emanating from these initiatives are being implemented. In October 2008 the Bank submitted its *Eighth Annual Report on the Employment Equity Plan* to the Department of Labour.

Code of Ethics and Business Conduct

The Code of Ethics and Business Conduct, which was developed in 2006 and 2007, was finalised and is in the process of being implemented.

Human resources

Relations with staff and unions are maintained through processes of consultation, and the Wellness Management Division continues to provide the necessary support for disability and HIV/AIDS management. In addition, preventative measures are taken, such as the provision of a medical clinic and psychological well-being services, to maintain the wellness of staff.

The Bank concluded two critical agreements with SASBO during this reporting period, namely the Recognition Agreement and the Essential Service Level Agreement. The former seeks to regulate the relationship between the employer and employees, including all bargaining agreements, while the latter seeks to provide guidance should industrial action take place.

Safety, health and environmental issues

The Bank and its subsidiaries continue to comply with health, safety and environmental legislation, and are committed to the well-being 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, wellness, avoidance of discrimination, and their impact on the work environment.

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

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

As part of its obligations towards the safety of its staff and in terms of its business continuity management requirements, the Bank further ensures that evacuation exercises are held on a regular basis. The Bank acknowledges the importance of its responsibilities and is committed to ensuring that a healthy and safe working environment is maintained at all times.

Risk management

In common with most central banks, the Bank is a risk-averse institution. This stance reflects the view that the satisfactory fulfilment of its role and responsibilities could be seriously jeopardised if it were to incur significant financial losses, disruption of its operations and/or damage to its reputation. The executive management of the Bank is intensely aware of the high performance standards that all role-players outside the Bank expect of the central bank. The Bank views risk management as an integral part and an essential element of good corporate governance.

Risk Management Policy

The Bank has a Risk Management Policy to ensure that risk management is performed in a co-ordinated, comprehensive and systematic manner that is consistent with internationally accepted standards and guidelines.

The Risk Management Policy regulates all risk management initiatives and activities, and facilitates their alignment with the Bank's strategic and operational objectives. This is done to ensure that the risks threatening the achievement of these objectives are adequately and effectively managed at acceptable levels. The policy governs the full spectrum of strategic, financial (credit, market and liquidity) and operational risk management in the Bank. The policy, furthermore, specifies the risk management governance structures, general risk management principles, the Bank's risk appetite and tolerance, impact and likelihood requirements, risk management framework and processes, and the roles and responsibilities of all stakeholders.

Risk management governance structure

The Board is responsible for the entire process of risk management, and for forming its own opinion on the adequacy and effectiveness of the process. The Audit Committee assists the Board in this regard.

The GEC has overall executive responsibility for risk management in the Bank and is accountable to the Board for designing, implementing and monitoring the process of risk management, and for integrating it into the day-to-day activities of the Bank.

The GEC established the Risk Management Committee (RMC) to discharge its responsibilities in this regard. The RMC oversees the risk management process and reports to the GEC in terms of its mandate.

Risk categories

Three broad risk categories are distinguished in terms of the Bank's Risk Management Policy, namely (1) strategic risk, (2) financial risk and (3) operational risk.

Strategic risk includes all types of risk (also financial risk and operational risk), but is limited to risks at a strategic level, that is, those risks that could potentially have an impact on the effectiveness of the Bank as a whole.

Financial risk consists of interest rate risk, market price risk, credit risk and liquidity risk (which are discussed in Note 30 to the financial statements on page 129).

'Operational risk' is defined as any factor (excluding strategic risk and financial risk), internal or external to the Bank, that could have a negative impact on, or prevent the

achievement of, valid/relevant organisational objectives, as well as the risk of pursuing irrelevant or invalid organisational objectives. Operational risk, therefore, includes the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Risk management framework and processes

The risk management framework of the Bank is largely based on the principles contained in the COSO Enterprise Risk Management (ERM) Framework and is consistent with widely accepted standards, guidelines and best practice. Although the principles contained in the COSO ERM Framework largely apply to all risk management processes in the Bank, three distinct risk management processes are used by the Bank to manage strategic risk, financial risk and operational risk.

The strategic risk management process is integrated with the strategic planning process of the Bank, during which risks at a strategic level are identified and considered. A strategic risk matrix is compiled and strategic risks are analysed and assessed with the input of all heads of department, executive general managers, deputy governors and the Governor.

The Financial Markets Department is responsible for the financial risk management process. Specialised financial risk management systems and procedures, based on best practice standards, are in place to manage financial risks pertaining to domestic and foreign-exchange market operations.

Operational risk emanating from all the operational activities of the Bank is managed by the heads of department and their management teams, whereas specialised types of operational risk or those with a Bank-wide impact are managed by the structures or committees established for that purpose. These types of operational risk include business continuity risk, information security risk, and occupational health, safety and environmental risk.

A "hub-and-spoke" model is used to facilitate decentralised risk management by departments and centralised co-ordination. The centralised co-ordination function is performed by a unit that has specifically been established for this purpose, namely the Risk Management Co-ordinating Unit. The role of this unit is to facilitate risk management ownership by management, validate that the risk management processes are adequate and effective and comply with internationally accepted risk management standards, provide a standardised operational risk management methodology and process, and to ensure standardised and integrated reporting on risk management activities and exposures to the RMC.

Operational review

Primary function

As the central bank of the Republic of South Africa, the primary goal of the Bank in the South African economy is the achievement and maintenance of price stability. This is done through the application of the country's inflation-targeting monetary policy framework. Achieving the inflation target contributes to the protection of the interests of all South Africans, particularly the poor.

In the execution of its duties, the Bank recognises the need to pursue its primary goal of price stability in the interest of balanced economic development and growth. The ultimate objective is, therefore, not the pursuit of price stability in isolation. Instead, containing inflation is the contribution that the Bank can make to sustained and balanced economic growth and development in the long run, in the interest and for the benefit of all South Africans.

Overall financial stability in South Africa is important for the maintenance of price stability. The Bank contributes to the stability of the domestic financial system through its banking regulation and supervision duties.

Operational functions

Monetary policy

The Bank recognises that credibility is a prerequisite for the attainment of its primary goal, which it pursues independently and with firm intent. Furthermore, sound measurement and understanding of the inflation target variable are crucial.

Since the announcement of the inflation target by the Minister of Finance in February 2000, its specification has been reviewed on a number of occasions. The Bank endeavours to maintain the year-on-year rate of increase in targeted inflation within the set target range of between 3 and 6 per cent on a continuous basis. In January 2009 Statistics South Africa's newly reweighted, rebased and reconstituted headline consumer price index for all urban areas was adopted as the new inflation target measure.

Within the inflation-targeting framework, the Bank does not have goal independence, but it has full operational autonomy. The Bank, therefore, has instrument-independence as regards the choice and setting of monetary policy instruments. In practice, the setting of the level of the repurchase rate is the most important instrument in this regard. The MPC, which consists of the Governor, deputy governors and four senior officials of the Bank, is responsible for monetary policy decisions, which are taken on a consensus basis.

In March 2009 the frequency of MPC meetings was increased from bimonthly to monthly (apart from July) for the remainder of 2009. The timetable is published in advance on the website of the Bank, but unscheduled meetings can be called if the need arises.

Accumulation of reserves

In the 2008/09 financial year the Bank purchased approximately US$1,6 billion from Authorised Dealers to accumulate foreign-exchange reserves. Despite these purchases, the level of gross gold and foreign-exchange reserves declined marginally from

approximately US$34,4 billion at the end of March 2008 to around US$34,1 billion at the end of March 2009. This decrease reflects a decline in foreign loans and valuation losses due to the marginal decline in the US dollar price of gold, as well as the appreciation of the US dollar against other major currencies. The level of borrowed reserves declined from US$1,4 billion on 31 March 2008 to US$0,7 billion on 31 March 2009. The international liquidity position improved marginally from US$33,1 billion to US$33,5 billion over the same period.

Market operations

The purchase of foreign exchange was the main source of liquidity injected into the money market. The additional liquidity had to be drained in order to align liquidity levels with the monetary policy stance. The main instruments utilised to drain the liquidity were government deposits with the Bank, issuing of debentures and longer-term reverse repurchase transactions. Furthermore, notes and coin in circulation increased by R5,6 billion, and the cash reserve balances of the commercial banks with the Bank increased by R3,3 billion, also draining liquidity from the market. This resulted in the liquidity shortage fluctuating between R6,55 billion and R15,63 billion during the period under review.

Reserves management

In the implementation of the strategic asset allocation approved during the previous financial year, a substantial portion of the foreign-exchange reserves was invested in single-currency buffer tranche portfolios with benchmarks comprising mainly bonds issued by developed economies. Given the adverse effects of the financial crisis on global financial markets, prudent risk management became the main focus of reserves management.

The mandates of external fund managers were reviewed, resulting in the termination of the mandates of three of them. A comprehensive review of the external fund management programme is under way and will be completed during the 2009/10 financial year.

Risk management

In the wake of the global financial crisis that began in the second half of 2007 and continued through 2008, the Bank implemented measures that included the tightening of investment guidelines for reserves managers in order to minimise market risk. The maximum maturity of cash deposits was limited to one month and the placing of deposits was allowed only with central banks, official institutions and commercial banks that had a minimum rating of AA. Overnight deposits were also placed with single A-rated banks.

Administration of exchange controls

The Bank administers the exchange control function in terms of authority delegated by the Minister of Finance. The two main aims of exchange control are (1) the implementation of exchange control policy and administration of the Exchange Control Regulations; and (2) the gathering, analysis and dissemination of information. Both functions are underpinned by an inspection and compliance function.

No further exchange control reforms were announced by the Minister of Finance in the 2009 Budget Speech. Continuous effect is being given to the operationalisation of the extensive exchange control reforms announced in the 2008 Budget Speech. These reforms change the focus of exchange control from pre-approval of applications to monitoring of cross-border flows. In addition to reducing the number of pre-approval applications, a comprehensive review of remaining administrative controls was

completed. This will further enhance surveillance and prudential regulation. Financial surveillance is expected to remain an important pillar of the financial stability framework of South Africa, more so in view of the current turmoil in international financial markets.

Through the Cross-border Foreign Exchange Transaction Reporting System, all reportable data received from external sources are validated, stored securely and analysed. This enables the monitoring of foreign-currency flows, involving both capital and current-account transactions. Data are analysed and interpreted for management reports to assist with strategic decision-making by the Bank and the National Treasury. In this regard, the Cross-border Foreign Exchange Transaction Reporting System was enhanced by creating new balance-of-payments categories and reporting procedures in an endeavour to enhance the refinement of cross-border transaction data analysis.

In compliance with corporate governance and risk management principles, a formalised approach to risk assessment is followed in the implementation of control measures. This mitigates risks that are regarded as a threat to the achievement of the key objectives of exchange controls.

Maintaining a sound regulatory framework and stable banking system

The Bank has responsibility for promoting the soundness of the domestic banking system through the effective and efficient application of international regulatory and supervisory standards. Although it is accepted that there may be circumstances where banks experience distress, the key focus area is to minimise systemic risk.

The *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), effective from 1 January 2008, and the continued application of the Core Principles for Effective Banking Supervision (the Core Principles) issued by the Basel Committee on Banking Supervision (the Basel Committee) remained the cornerstones of the Bank's regulatory and supervisory framework. As part of an ongoing project, the Bank is continuously researching the regulatory and legislative environment, both domestically and internationally, to ensure that the legal framework pertaining to domestic banking legislation reflects local and international market developments, and complies with applicable international regulatory standards and best practice.

The Bank participated in the International Monetary Fund's (IMF) pilot project to review compliance with Basel II. The IMF's final report was issued in June 2008. The recommendations in the report were converted into action plans.

During the period under review the Bank was the subject of an IMF Article IV Consultation and was visited by a joint IMF/World Bank Financial Sector Assessment Program (FSAP) mission to conduct an FSAP update. The FSAP update included a stress-testing exercise performed by selected banks in the industry (bottom-up stress testing) and by the Bank (top-down stress testing). The recommendations contained in the reports issued by the IMF and World Bank have been converted into action plans and their implementation is being monitored on a project basis.

Continued monitoring of, and interaction with, banks ensured that the application of Basel II became further entrenched in the "business-as-usual" processes of the domestic banking industry. Interaction with banks included focused on-site reviews to assess the adequacy and prudence of internal models being applied by banks to calculate the minimum required regulatory capital and reserves related to credit risk, market risk and operational risk.

In terms of the revised Basel II regulatory framework, focused reviews were also undertaken to assess the internal capital-adequacy assessment processes (ICAAP) and the economic capital frameworks implemented by banks. Furthermore, thematic fact-finding reviews were conducted at various banks. These covered equity risk in the banking book, as well as the asset and liability management processes applied by banks.

The Bank also interacted with the boards of directors of banks to discuss the incentive and bonus schemes implemented by the industry, and the involvement of boards in the oversight of operational risk frameworks.

Banks were formally required to implement stress-testing elements, as prescribed in the Regulations relating to Banks, with effect from January 2008. In this regard, the Bank continued discussions with the industry regarding stress-testing frameworks. In addition, the Bank, in consultation with international organisations and a visiting international research fellow, continued to develop its own stress-testing expertise and an internal stress-testing methodology.

In response to the international financial market turmoil emanating from the sub-prime mortgage crisis, various international standard-setting bodies issued papers dealing with, *inter alia*, the causes, effects and regulatory response to the crisis. The Bank has taken cognisance of these documents, and of developments in the domestic banking industry and international markets that could have an effect on banks and/or the banking legislative and regulatory framework.

Furthermore, the Bank commissioned an independent review of all securitisation schemes in which banks participated. The aim of the review was to determine whether such schemes were being managed prudently. The final report issued contained no issues of a material nature. The recommendations in the report are being studied, and will lead to further consultation with the banking industry and possible legislative and/or regulatory framework amendments.

The Bank continued to focus on compliance of the banking industry with anti-money laundering (AML) and the combating of the financing of terrorism (CFT) legislation. The Financial Action Task Force (FATF) and Southern Africa Anti-Money Laundering Group benchmarked South Africa's AML/CFT regime against the international standards of the Forty Recommendations of 2003 and the Nine Special Recommendations of 2001 of FATF. The final report is under consideration and will be used as a framework to determine areas where the Bank can improve adherence to the FATF recommendations.

Maintaining the integrity and supply of currency

The average value of banknotes in circulation for the financial year 2008/09 was R64,0 billion. A maximum value of banknotes in circulation of R77,5 billion was achieved during December 2008. Currency counterfeiting remains a risk to the Bank and the economy in general. Continuous efforts are being made to combat counterfeiting and to ensure the integrity of currency in circulation.

The Bank continues to ensure that an adequate number of acceptable quality banknotes in circulation is maintained by

- improving management and co-ordination with commercial banks and the cash-in-transit industry;
- applying minimum standards for the recycling of banknotes;
- increasing interaction with central banks in neighbouring states; and
- engaging with various stakeholders to ensure the security and efficiency of currency

distribution. The Bank consults with the 2010 South African Local Organising Committee and the banking industry in preparation for the 2010 FIFA World Cup.

Security of currency distribution

The implementation of the first phase of the Integrated Cash Management System in collaboration with the commercial banks and SBV Services (Pty) Ltd is progressing well. This system provides a fully automated information solution to manage currency activities within the currency sector. It aims to improve the security, efficiency and effectiveness of the National Cash Management System (NCMS) and resulted in a reduction in the cost of cash provision to the public. Phase II of the project is expected to be completed by the first quarter of 2010. It will address the information needs of the Bank and all stakeholders, such as commercial banks, currency distribution centres, the South African Bank Note Company and the South African Mint Company.

The Bank continuously assesses risks to the effective functioning of the NCMS. The Bank remains particularly concerned about the high incidences of violent crime and aggravated robberies involving cash, which not only lead to the loss of human life, but also impact on the safety and efficiency of cash management in South Africa.

An interactive Cash Risk Identification and Mitigation (CRIM) programme was developed by the Bank and the South African Banking Risk Information Centre with the participation of commercial banks, cash-in-transit industry and the South African Police Service. The CRIM programme aims to mitigate risks associated with the operations of the NCMS by defining the minimum security standards required by the cash management industry to reduce incidents of cash-in-transit heists and banking crimes. Minimum security and operating standards related to the operations, information management, staffing, service provider security and training have been completed, and a governance framework is being developed. The minimum standards will be enacted into regulations by the Minister of Police.

Business continuity management

The disciplines of business continuity management (BCM), and occupational health and safety compliance management have both matured to the level of continued process improvement and enhancement in the Bank. Implementation of these disciplines is supported by continuous awareness initiatives. Bank-wide testing of business continuity plans is conducted through a combination of scheduled and unannounced tests, which further contributes towards the robustness of the BCM programme.

Developing and maintaining the payment system

The Bank, in conjunction with other stakeholders in the clearing and settlement community, continually embarks on initiatives to improve the effectiveness and integrity of the national payment system. In the retail payment environment, participating banks in the card payment stream successfully implemented a clearing and settlement conversion from a propriety system to a process that was Euro pay-, MasterCard- and Visa-compliant. The project commenced four years ago and was completed during the fourth quarter of 2008. The implementation of this initiative enhances the security of card payment transactions.

A high standard is maintained in the provision of interbank settlement services in the South African Multiple Option Settlement (SAMOS) system. Although volume and value of payment transactions increased substantially during the period of market volatility in September and October 2008, the domestic and associated foreign-exchange settlement

systems performed well without disruptions in terms of operation and liquidity provision. A peak value of R8,5 trillion was settled during October 2008.

During the year under review, the Bank reviewed the real-time gross settlement (RTGS) network infrastructure and associated applications. The RTGS network infrastructure was benchmarked against other RTGS systems operated in other parts of the world. Although the benchmarking has revealed that the SAMOS system is of a world-class standard, decisions on possible enhancements to the infrastructure and applications that would ensure that SAMOS develops in line with market needs and adheres to best practice will be made in consultation with stakeholders in the near future.

In discharging its payment system oversight role, the Bank conducted several on-site visits to the major settlement banks and payment clearing house operators during the period under review. These visits were expanded for the first time to include on-site visits to larger non-bank system operators registered in terms of a directive issued by the Bank in 2007. Other than surveillance of general behaviour within the payment system, these visits also focused on the operational efficiency and business continuity capabilities of the participants.

The Bank continues to be part of the Continuous Linked Settlement (CLS) system oversight group chaired by the Federal Reserve Bank of New York. The Bank and the other issuing central banks of currencies in the CLS system signed a CLS oversight protocol during the review period. This effectively separates the oversight role of the CLS system from the activities of the Committee on Payment and Settlement systems of the Bank for International Settlements (BIS), where it was located initially.

With the emergence of new payment technologies, such as mobile telephones for access to banking accounts and unbanked person-to-person transfers, the Bank is in the process of reconsidering its position paper on electronic money. The revised position paper will provide more specific reference to emerging instruments and will be reissued during the 2009/10 financial year.

The National Payment System Advisory Body (NPSAB), established in 2007, held two meetings during the period under review. The purpose of the body is to consult mainly with non-bank stakeholders from across the payment spectrum to understand their concerns and to enable the Bank to manage the payment system more effectively.

The Bank took note of the release of, and recommendations contained in, the full *Technical Report* of the Banking Inquiry released by the Competition Commission. The Bank is studying the recommendations.

The Bank continues to lead the Southern African Development Community (SADC) payment system project. During the past year the focus has been on assistance with efficiency of electronic settlement systems and the collection of payment system statistics on various issues. A workshop to address these issues was held in July 2008. Further work focuses on the inter-linking of payment systems on a regional basis and the efficiency of remittance systems in the region.

International and regional contribution

The SADC region remains the focal point of programmes to maintain the momentum of regional economic integration. Accordingly, the Committee of Central Bank Governors of SADC approved the establishment of a Financial Markets Subcommittee to deal with relevant issues in this important area. The Common Monetary Area governors meet regularly to discuss economic developments, monetary policy co-ordination and other matters of common concern in the region.

South Africa participated in the activities of the Group of Twenty (G-20) chaired by Brazil during 2008, the theme of which was "Fostering Growth, Innovation and Social Inclusion". The international financial turmoil dominated G-20 proceedings, which included the expansion of the brief of the Financial Stability Board as a successor to the Financial Stability Forum. Other significant issues on the agenda included the reform of the Bretton Woods Institutions, particularly with respect to the representation of developing countries, and the responsiveness of these institutions to current and future crises.

The Bank played a key role in a number of events aimed at promoting financial stability. Jointly with the Financial Stability Institute of the BIS, the Bank hosted a high-level meeting of African bank supervisors to consider the impact of the current developments on global banking supervisory issues. In co-operation with the Toronto Centre and the World Bank, it initiated and co-sponsored a seminar on improving the degree of financial crisis preparedness in SADC. The seminar was conducted by international experts. The workshop was attended by senior representatives of SADC central banks, and provided an opportunity to enhance regional co-operation in contingency planning and crisis management. The Bank also availed a resource person for the joint workshop between the IMF and the East Africa Regional Technical Assistance Centre on financial soundness indicators and participated in a seminar on financial stability reporting offered by the BIS for the SADC region.

Developments in the research environment

The Bank enhanced its monitoring of global and domestic economic conditions, the database underlying its analyses, and its suite of forecasting models. In the year under review specific emphasis was placed on the enhancement of data quality through the processes of data collection, compilation and analysis. The new consumer price index adopted for inflation-targeting purposes in January 2009 was incorporated into the forecasting models, and a quarterly projection model and a dynamic stochastic general equilibrium model were added to the Bank's suite of models. These models are especially well suited for the analysis of aspects of monetary policy.

Various other statistical projects were undertaken to enhance the provision of national data to international agencies, and to expand the availability of internationally comparable data in areas such as debt securities and cross-border banking. Research on various aspects of the domestic and international economy was also conducted.

In October 2008 the Bank hosted its biennial macroeconomic conference with the theme "Challenges for Monetary Policy-makers in Emerging Markets". The conference attracted renowned local and international participants.

Contribution to domestic financial stability

The global financial crisis put renewed emphasis on central banks' role in financial stability. It clearly demonstrated that a stable financial system is a prerequisite for the effective implementation of monetary policy, through which price stability is achieved. Financial stability is also an inherent requirement for the efficient functioning of the banking sector and financial markets to support real economic activity. In pursuit of its objective of promoting a stable and resilient financial system, the Bank publishes a semi-annual *Financial Stability Review* to identify and analyse potential risks to financial system stability, communicate such assessments and to stimulate debate.

The Bank remains active in various international forums that focus on ways of restoring confidence in, and improving the resilience of, the global financial system. Lessons

learnt so far have generated a range of proposals and recommendations from national and international organisations. The Bank will respond to any relevant regulatory reform and financial stability policy challenges.

Supervision of co-operative banks

The Bank has been mandated by the Co-operative Banks Act, 2007 (Act No. 40 of 2007) to supervise large primary co-operative banks, and all secondary and tertiary co-operative banks. A Co-operative Banks Supervision Unit is to be established in the Bank to assume this responsibility.

Infrastructural support

In pursuance of its mission of creating an enabling environment for the discharge of its responsibilities, the Bank dedicates ample resources and funding to the infrastructural upgrading and maintenance of its property portfolio. During the period under review, particular emphasis was placed on the requirements of the Bank's seven branches.

Many of the buildings housing the branch operations of the Bank have been assigned heritage status. The facilities of some of these buildings have become inadequate to meet currency distribution requirements and it is always a challenge to upgrade a building that has a heritage status.

The Bank is currently engaged in projects to upgrade some of the buildings and in building a new branch in Bloemfontein. The upgrades entail the following:

- Ensuring energy efficiency, uninterruptible power supply, environmental friendliness and access for people with disabilities.
- Bloemfontein: The transfer to the Bank of a portion of the Old Presidency property has been completed. Concept design drawings for the construction of a new branch, aligned with the heritage status of the site, are under consideration.
- East London: Tenders for the upgrade and additions to the building were received and the process to procure a contractor was completed. The project is scheduled to be completed by the end of 2010.
- Cape Town: A feasibility study for upgrading the Bank's property was conducted and tenders for the construction phase were invited. The project is scheduled for completion in April 2010.
- Johannesburg: Structural repair work on the roof of the branch building is in progress. The original architectural features of the building will not be changed.

In order to improve information and communications technology (ICT) services and ICT investment management, the Bank introduced a new planning and execution discipline called 'enterprise architecture'. Major results and benefits of the function are expected in 2010 as the new planning techniques are applied in the major projects that are implemented.

Strategic and operational reviews

Over time, the Bank has developed extensive capacity to develop strategic and operational plans. These plans are reviewed periodically to ensure continued alignment of the Bank's objectives. A well-established strategic management process is in place to drive this process. This process helps the Bank in its quest to understand the changing environment in which it operates, to determine priorities, formulate strategic objectives, analyse strengths and weaknesses, and determine the institution's ability to implement the chosen strategy.

The Bank is developing an integrated workforce plan linked to institutional strategic objectives to ensure suitable provision of talented staff. This will help ensure future organisational sustainability through the availability of appropriate skills for the continued achievement of institutional objectives.

South African Reserve Bank Enterprise Resource Planning solution

The Bank is in the process of implementing an Enterprise Resource Planning (ERP) solution. ERP refers to an ICT system that integrates data and improves business processes within the financial services and centralised support operations of the organisation. The new solution differs considerably from the previous system, and enables effective and efficient streamlining of financial and administrative processes. Departments can share common information in a standardised manner, thereby eliminating multiple systems and duplication of information, reducing time and cost, and improving productivity. Ongoing communication will be maintained in order to educate employees at all levels on the configured solution.

The human resources module of the Bank's ERP solution was configured and tested successfully before activation on 2 March 2009. Support for the pension fund, retirement fund, insurance management, learning management and payroll became operational on 1 April 2009. The remaining financial, core banking, budgeting, procurement, asset and inventory management, and many other logistical modules will become operational during 2009.

Learning and development

During the period under review the Bank received R2,4 million in the form of mandatory grants for complying with the reporting provisions of the Skills Development Act, 1998 (Act No. 97 of 1998), as amended.

In 2008 the Bank attracted cadets of a high calibre for its Cadet Graduate Programme. This can, in part, be attributed to the fact that deans of related faculties at South African universities were invited to nominate some of their best students for this programme. In 2008, for the first time, the Bank also invited departments of the Bank to nominate staff members to undergo cadet training.

The Bank has approved a new policy for external bursaries at tertiary level. A group of 25 second-year students at universities in all provinces will be granted study aid by the Bank.

During the year under review the South African Reserve Bank College (the SARB College) introduced a new Internal Quality Control Committee in order to ensure consistency and relevance of learning interventions. This structure operates in conjunction with the existing curriculum design committees that comprise internal and external experts. The ultimate aim is to ensure a high standard of learning at the College.

A number of high-level specialised workshops, seminars and a conference for specific niche markets were hosted by the College. These included the annual exchange control seminar for authorised foreign-exchange dealers, a flow-of-funds seminar presented by experts from Statistics Canada and Banco de Portugal, an advanced econometric and computational methods seminar presented by Universitat Pompeu, a financial stability seminar presented by Loughborough University, and a currency management seminar.

Wellness

As part of the Bank's HIV/AIDS programme, almost 70 employees were trained to serve as peer educators/counsellors at Head Office and in the branches. The HIV/AIDS programme is an ongoing initiative, with voluntary counselling and testing as the next phase. The Bank's contribution to the 16 Days of Activism for No Violence Against Women and Children campaign included public addresses on women's rights, HIV/AIDS, human rights and disability issues. The Bank completed its disability verification process. Employees were given an opportunity to declare their disability status voluntarily. As added benefits to staff, the Bank engaged the services of an occupational medical practitioner and fitness instructors for its gymnasium at Head Office. As part of the Bank's employee assistance programme, Bank employees are referred to its external service provider, ICAS, when the need for specialised counselling arises.

Shareholding

The Bank facilitates an over-the-counter market for the trading of its shares. During the financial year under review 40 transactions were concluded successfully in respect of 57 980 shares. A final dividend of 5 cents per share was paid on 9 May 2008 in respect of the 2007/08 financial year, while an interim dividend of 5 cents per share for the 2008/09 financial year was paid to shareholders on 31 October 2008. A final dividend of 5 cents per share for the 2008/09 financial year was declared on 1 April 2009 and paid on 15 May 2009.

Personnel report

At the beginning of the 2008/09 financial year the Bank had a total permanent staff complement of 1 896, which was increased to 1 930 by the end of the year. The increase of 34 in staff numbers resulted from 118 terminations and 152 new appointments.

The overall staff turnover for the period was 6,2 per cent.

The Bank's racial equity representation at management level increased by 2 percentage points at the general management and senior professional and vocational management levels. At the professional and vocational management level the increase was 5 percentage points. This is indicated in Table 1.

Table 1: Breakdown per broad band: Racial equity representation

Per cent

Broad band	Actual 31-03-08	Actual 31-03-09	2009 Bank target
General management	50	52	50
Senior professional and management	40	42	50
Professional and vocational management	44	49	50
Junior professional and supervisory	50	51	50
Trainee professional and clerical	68	70	50
General worker	90	93	50
Total	58	60	50

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 31-03-08	Actual 31-03-09	2009 Bank target
General management	19	21	42
Senior professional and management	30	34	42
Professional and vocational management	46	49	42
Junior professional and supervisory	62	59	42
Trainee professional and clerical	48	50	42
General worker	37	37	42
Total	47	47	42

Table 3: Workforce profile by gender and race as at 31 March 2009

Number

Broad band	Male				Female				
	African	Coloured	Indian	White	African	Coloured	Indian	White	Total
General management	24	4	7	39	10	3	1	6	94
Senior professional and management	31	9	10	85	27	4	5	33	204
Professional and vocational management	61	10	9	100	68	10	14	82	354
Junior professional and supervisory	95	18	10	72	80	24	15	159	473
Trainee professional and clerical	184	39	14	72	131	43	17	114	614
General worker	104	5	1	11	59	7	1	3	191
Total permanent	499	85	51	379	375	91	53	397	1 930
Non-permanent	42	11	2	18	13	2	2	6	96
Total	541	96	53	397	388	93	55	403	2 026

Table 4: Staff complement as at 31 March 2009

Number

Department	Permanent staff	Contract workers	Total
Executive Management	39	2	41
Bank Supervision	97	1	98
Business Systems and Technology	163	16	179
Corporate Services	202	6	208
Currency and Protection Services (including branches)	750	45	795
Exchange Control	151	1	152
Financial Markets	99	0	99
Financial Services	76	0	76
Financial Stability	21	0	21
Human Resources	56	5	61
Internal Audit	48	0	48
Legal Services	26	1	27
National Payment System	24	0	24
Research	148	1	149
SARB College (including cadets)	10	18	28
Total staff complement	1 910	96	2 006
Staff members receiving disability benefits	20	0	20
Total	1 930	96	2 026

Report on monetary policy

For much of 2008, the Monetary Policy Committee (MPC) was concerned about the more generalised dynamics of the inflation process in the South African economy, following a succession of supply-side shocks emanating from the international food and oil markets. However, the global economic landscape changed dramatically late in the year. The severe downturn in the global economy in the final months of 2008 and the speed with which it spread to virtually all parts of the world created new challenges for monetary policy-makers. These global developments have had a significant impact on the South African economy, which experienced a marked slowdown and a consequent widening of the output gap, and reduced pressures on inflation as a result of declining demand and lower commodity prices. Inflation has, nevertheless, remained above the upper limit of the inflation target range of 3 to 6 per cent and moderated relatively slowly in subsequent months.

At the time of the June 2008 MPC meeting, the outlook for inflation remained bleak, although there were some signs that the economy was beginning to slow down. There had been no respite from the acceleration in international oil prices, with the North Sea Brent crude oil price having reached levels of almost US$140 per barrel at the time of the meeting, and domestic food prices had increased at a year-on-year rate of 15,9 per cent in April 2008. The inflation rate of the targeted measure, the consumer price index excluding mortgage interest cost for metropolitan and other urban areas (CPIX), was 10,4 per cent in April, driven mainly by these food and petrol price increases. However, inflation measured in terms of the CPIX excluding food and energy prices had risen to 6,1 per cent, suggesting that price increases in South Africa had become more broad-based. Inflation expectations had deteriorated further and there was also uncertainty regarding the impending announcement of the electricity price increase to be granted to Eskom. The most recent central forecast of the staff of the South African Reserve Bank (the Bank) indicated a further deterioration in the inflation outlook, with CPIX inflation expected to peak at around 12 per cent in the third quarter of 2008 and to return to within the inflation target range by the third quarter of 2010.

While noting that the economy was responding to the less-accommodative monetary policy stance, the MPC decided that further tightening of monetary policy was warranted in the light of the deterioration in the inflation outlook. The repurchase rate was, therefore, increased by 50 basis points to 12 per cent per annum with effect from 13 June 2008, bringing the cumulative increase in the interest rate since June 2006 to 500 basis points.

The repurchase rate remained unchanged at the subsequent MPC meetings in August and October 2008. During these meetings, there was a clear change in the balance of risks. In particular, the exogenous shocks that had had a significant influence on the inflation outlook appeared to have dissipated somewhat, and even reversed in the case of oil. However, the volatility exhibited by the exchange rate of the rand was a concern. At the time of the June 2008 MPC meeting, it was trading at around R8,00 per US dollar. In late July the rand began to appreciate, and reached a level of around R7,20 against the US dollar, before depreciating to levels of around R7,85 per US dollar by the August MPC meeting. By the October meeting the rand was trading at around R9,12 against the US dollar, following significant volatility in foreign-exchange markets after the initial rejection by the US Congress of the Troubled Asset Relief Program. On a trade-weighted basis, the rand had depreciated by around 20 per cent since the beginning of the year.

By October 2008, the turmoil on global financial markets had intensified, impacting negatively on the outlook for the international economy. As the crisis deepened,

governments and central banks implemented policy responses, both individually and in concert. Although the South African banking and financial system remained stable, domestic financial markets experienced the impact of these developments.

An important development for the inflation-targeting framework was the announcement by the Minister of Finance on 21 October 2008 that the targeted inflation measure would be changed from 25 February 2009, the release date of the January 2009 consumer price index (CPI) data. On this date the year-on-year increase in the CPIX was replaced as the targeted measure with the headline CPI (CPI for all urban areas). This change coincided with the rebasing and reweighting of the CPI basket and, together with these developments, complicated the forecasting of inflation considerably. Inflation was expected to decline significantly in the first quarter of 2009, partly as a result of the reweighting and rebasing effects, but the assumptions that had to be made in this regard meant that the central forecast of the Bank was subject to additional uncertainty.

After October 2008, developments allowed for a more accommodative monetary policy stance. The repurchase rate was reduced by 50 basis points in December and by a further 100 basis points at each of the subsequent four meetings. These interest rate reductions were effected despite the fact that inflation was still above the upper end of the inflation target range. It should be noted in this regard that, given the lag in the reaction of inflation to interest rate changes, the focus of monetary policy is on the medium- to longer-term expected trajectory of inflation, rather than on the current outcomes. It is also the case that an inflation-targeting framework allows for some flexibility in the time horizon for achieving the inflation target.

By the December 2008 MPC meeting, domestic inflation had begun to moderate and was expected to decline further over the coming months. At the same time, the effects of the intensifying global slowdown on the South African economy were becoming evident. The domestic economy experienced negligible growth in the third quarter of 2008 when a number of sectors contracted. International crude oil prices had declined further, with North Sea Brent crude oil trading at around US$40 per barrel compared with US$83 per barrel at the time of the previous meeting in October.

CPIX inflation, which had peaked at a year-on-year rate of 13,6 per cent in August 2008, had subsequently declined to 13,0 per cent in September and to 12,4 per cent in October. Food, petrol and electricity prices remained the main contributors to the inflation outcomes, despite the petrol price reductions in September and October following lower international oil prices.

South Africa's economic growth rate had declined significantly in the third quarter of 2008 when real gross domestic product increased at an annualised rate of 0,2 per cent. This represented a significant widening of the output gap, measured as the difference between actual and potential output growth. The slowdown was a result of contractions in mining, manufacturing, and the retail and wholesale trade sectors. Household consumption expenditure contracted in the third quarter for the first time since 1998. Consumption of durable goods in particular declined by almost 10 per cent and non-durable goods consumption also contracted. The Bank's leading indicator of economic activity had been trending downwards for some time and, more recently, the coincident indicator had followed this trend. The Investec/Bureau for Economic Research Purchasing Managers' Index had declined to its lowest level since its inception and the Rand Merchant Bank/ Bureau for Economic Research Business Confidence Index reflected a negative outlook. The First National Bank/Bureau for Economic Research Consumer Confidence Index also deteriorated further in the fourth quarter of 2008.

The exchange rate remained the most significant upside risk to the inflation outlook at this time. The currency had depreciated to a level of R11,80 to the US dollar after the October MPC meeting, but recovered soon after to trade in a relatively narrow range of between R10,00 and R10,50 before the December meeting.

After considering these developments in the South African economy, and the risks to the inflation outlook resulting from conditions in the global economy and international financial markets, the MPC decided to reduce the repurchase rate by 50 basis points to 11,5 per cent per annum in December 2008.

At the February 2009 MPC meeting, the repurchase rate was reduced by a further 100 basis points to 10,5 per cent per annum. Domestic inflation had continued to trend downwards and a further decline was expected when the reweighted and rebased CPI was released. Economic growth continued to be adversely affected by turbulence in the global economy and the widening domestic output gap was expected to exert further downward pressure on inflation. However, the price of Brent crude oil, which reached a low of US$34 per barrel during December 2008, recovered somewhat to average almost US$45 per barrel in January 2009. As a consequence, the domestic price of petrol was increased by 61 cents per litre in February.

On 18 March 2009 it was decided that, in the light of the severe synchronised downturn in the global economy since late in 2008, it would be appropriate for the MPC to meet more frequently in order to assess the rapidly changing circumstances in a timeous manner and to be able to act appropriately when necessary. The MPC was, therefore, scheduled to meet every month, apart from July, for the remainder of 2009.

With the global and domestic economies continuing to slow and an improved medium-term outlook for inflation, the MPC decided to reduce the repurchase rate by 100 basis points to 9,5 per cent per annum at the March 2009 meeting. Inflation measured in terms of the new target measure, the CPI for all urban areas, measured 8,1 per cent in January 2009. Gross domestic product contracted at an annualised rate of 1,8 per cent in the final quarter of 2008, the first quarter of negative growth since 1998, mainly due to a 22 per cent decline in manufacturing sector output. Domestic demand conditions also deteriorated further. Gross domestic expenditure contracted by 3,9 per cent and domestic final demand by 0,4 per cent. Final consumption expenditure by households declined by 2,7 per cent, mainly as a result of a 20 per cent contraction in consumption of durable goods. The high-frequency data available at this time indicated that these adverse conditions had persisted in the first quarter of 2009.

On a trade-weighted basis, the rand exchange rate had been relatively stable since the beginning of 2009, with movements prior to the March meeting mainly reflecting volatile international currency developments. After the February MPC meeting, the rand first depreciated to around R10,60 against the US dollar, as the dollar appreciated against most currencies, before strengthening to around R9,45 per US dollar by the March meeting. The upside risks to the inflation outlook at this stage were seen to be primarily from cost-push pressures, particularly from administered prices. These included possible higher-than-expected electricity tariff increases. It was also noted at this time that the decline in inflation might be delayed by continued high rates of increases in food prices, despite marked declines in producer price food inflation.

By April 2009, a number of countries were already experiencing a recession. The Group of Twenty (G-20) countries, including South Africa, committed themselves to a programme of action in order to contribute toward the earliest possible global economic

recovery. Despite a generally positive response to the G-20 summit, it had become increasingly accepted that the slowdown was likely to be severe and protracted, and that the global recovery was likely to be gradual.

At the meeting of the MPC in late April, the severe synchronised downturns in international and domestic economic conditions were again considered, and their potential future downward impact on inflation noted. Despite the widening domestic output gap, inflation remained sticky, but was expected to continue on its downward path. The year-on-year CPI inflation rate had increased to 8,6 per cent in February 2009 and then moderated to 8,5 per cent in March. Food price inflation continued its gradual downward trend, increasing at a year-on-year rate of 14,7 per cent in March, compared with 15,8 per cent in the previous month. The adverse economic conditions continued to tilt the balance of risks to the inflation outlook to the downside over the medium term and the decision was, therefore, made to reduce the repurchase rate by 100 basis points to 8,5 per cent per annum with effect from 4 May 2009.

At the May MPC meeting, the repurchase rate was reduced by 100 basis points to 7,5 per cent per annum. The global downturn had continued to have a negative impact on the domestic economy, which had experienced two consecutive quarters of contraction. There were tentative signs that the downturn in the global economy might be bottoming out, although there were few convincing indications that the recovery would be quick. The downward trend in domestic inflation was expected to continue, despite inflation being subject to some inertia in the near term, and the significant widening of the domestic output gap had added further downside risk to the inflation outlook.

In the first quarter of 2009 gross domestic product contracted at a quarter-on-quarter annualised rate of 6,4 per cent. Manufacturing, which contracted at an annualised rate of 22,1 per cent, was the largest contributor to this outcome, although the contraction was broad-based. Food price inflation remained well above average inflation, and continued to lag behind the favourable developments at the producer price level and in the spot prices of agricultural commodities.

The main upside risk to the inflation outlook continued to come from cost-push pressures, in particular from electricity price increases. Eskom had applied to the National Energy Regulator of South Africa (NERSA) for a 34 per cent interim increase in electricity tariffs. Although there was still uncertainty about the final adjustment at this stage, a number of municipalities had already budgeted for significant electricity price increases in anticipation of higher Eskom tariffs.

After reducing the repurchase rate at each of the previous five meetings, resulting in a cumulative reduction of 450 basis points, the MPC opted to keep the rate unchanged at 7,5 per cent per annum at its meeting in June 2009. Although the domestic economy continued to show signs of stress in the wake of the global economic downturn, the MPC was also fully cognisant of the fact that there had been significant monetary accommodation since December 2008. Signs that the downturn, both globally and domestically, might be nearing the lower turning point were evident, but the recovery was expected to be slow and protracted. The exchange rate of the rand had appreciated by approximately 15 per cent on a trade-weighted basis since the beginning of the year and the domestic inflation rate continued its downward trend, although constrained by relatively sticky services price inflation.

While the widening output gap and weak domestic demand continued to pose a downside risk to the inflation outlook, these risks were partially offset by the various cost-push and exogenous factors impacting on the economy, as well as by deteriorating

inflation expectations. The international oil price had re-emerged as a potential upside risk to the inflation outlook. The price of North Sea Brent crude oil reached levels in excess of US$70 per barrel in the week preceding the meeting and a further petrol price increase was viewed as likely in July.

By the time of the August 2009 meeting of the MPC, the targeted inflation rate had declined materially from 8 per cent in May to 6,9 per cent in June. At the same time, the economy was still showing signs of slowing down with contractions in the manufacturing sector in particular. The continued decline in retail trade sales growth also indicated that household consumption expenditure growth had remained negative. Food prices at the consumer level appeared to be responding to the favourable food price developments at the producer price level. Despite continued upside cost-push pressures, the MPC decided that the risks to the inflation outlook had tilted to the downside and lowered the repurchase rate by a further 50 basis point to 7 per cent per annum.

The change in the monetary policy stance since December 2008 has occurred against a backdrop of contracting global and domestic economies. Although inflation has remained outside the inflation target range, the weak domestic demand conditions have considerably reduced the pressures on inflation and have allowed for significant monetary accommodation. The expectation of the MPC is for inflation to continue to moderate and to return to within the target range on a sustained basis by the second quarter of 2010. The MPC will continue to focus on the inflation objective within a flexible inflation-targeting framework.

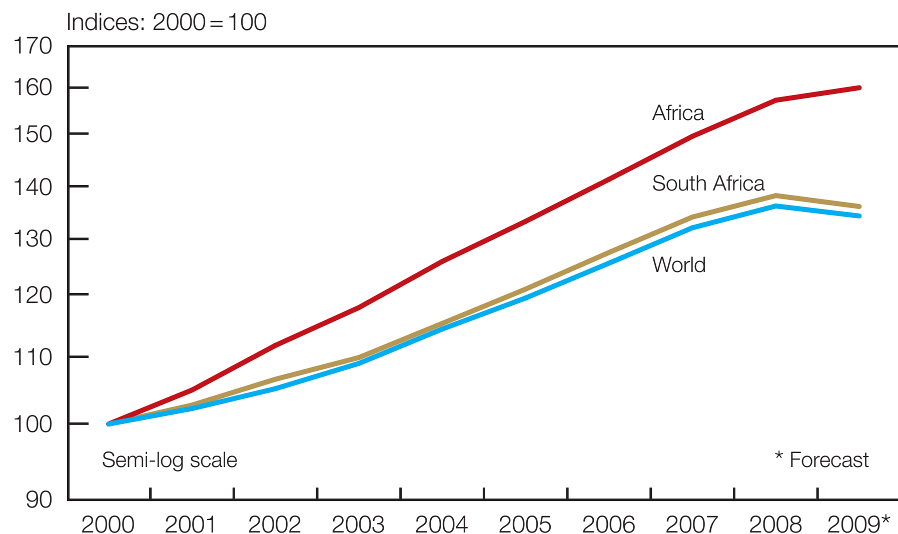
Annual economic report

Introduction

In 2007 and 2008 an unfortunate confluence of developments, the most prominent of which was the disorderly unwinding of excesses in the property market in the United States (US) and the complex derivative instruments related thereto, disrupted the financial system in the mature economies. A blow to confidence was dealt by the failure in September 2008 of a prominent investment bank in the US which, through its activities and transactions, was directly and indirectly interconnected with numerous banks and other financial institutions in many parts of the world. Shock and extreme risk aversion paralysed financial markets and liquidity disappeared as a standard assumption underlying transactions – that the counterparty is a going concern – was negated. Economic growth in the advanced economies, which had already been slowing for more than a year, was stunted, and real production and imports contracted markedly towards the end of 2008 and in the first half of 2009. This contraction immediately spread to developing countries as demand for their exports fell, resulting in declining production volumes and prices, and a highly synchronised global recession.

In the wake of the deterioration in global economic activity, commodity prices – many of which had reached record-high levels in the first half of 2008 – declined abruptly in the second half of the year. This, together with the widening of output gaps, contributed to a moderation of inflation pressures in most parts of the world. With the spectre of inflation being far less prominent, the focus of economic policy shifted towards measures to stabilise the financial system, and to support growth and employment. International organisations and forums such as the Group of Twenty (G-20) played a key role in harmonising such policies. Accordingly, monetary and fiscal policies were eased considerably – in many instances to settings that were previously unheard of. Fiscal deficits widened exponentially as recessionary conditions not only weakened fiscal revenues and activated various automatic fiscal stabilisers, but also led to deliberate actions and programmes to revive economies. In an attempt to counter the lack of

Real gross domestic product



Source: IMF *World Economic Outlook Database* (April 2009) and IMF *World Economic Outlook Update* (July 2009)

liquidity and confidence in the financial markets, central banks not only reduced policy interest rates to very low levels, but also injected liquidity through so-called quantitative easing steps, such as large-scale purchases of securities from other institutions.

Given trade and financial linkages, virtually no country has been left unscathed by the global recession, which upset the earlier protracted upward momentum in activity that the world had previously enjoyed. Nevertheless, the contraction in real global production expected for 2009 – some 1,4 per cent – would still leave the volume of world production 34 per cent higher than in 2000. Broadly similar numbers hold for South Africa, as shown in the graph on page 34. For Africa as a whole, real growth since 2000 has, on balance, been even better: allowing for a projected increase of 1,8 per cent in real production in 2009, the continent's real output would be 61 per cent higher than in 2000. A low base level of income, significantly improved economic policies, relatively high prices of exported commodities and generally favourable climatic conditions in recent years contributed to the robust progress made by the African continent over the past nine years.

In South Africa the longest business cycle upswing on record, with its starting point in September 1999, formally came to an end 99 months later in November 2007. In 2008 the economy lost momentum, first held back by interruptions in electricity supply and later by a general cooling off of final consumption expenditure by households, partly related to high debt levels, tighter interest rate policies and reduced consumer confidence. This loss of momentum was exacerbated by export volumes, which fell sharply towards the end of 2008 and in the first half of 2009, resulting in the first contractions in real gross domestic product in a decade. Facing declining sales, firms also reduced their real inventory levels considerably during the past year.

By contrast, real final consumption expenditure by government continued to rise throughout the period under review as the number of civil servants increased and real non-wage expenditure, such as procurement of military equipment, and hospital and education supplies, expanded. Importantly, real fixed capital formation rose apace as infrastructure expenditure by public corporations and general government gained further momentum, more than fully compensating for lower expenditure on residential buildings by households and other private-sector institutions. Overall fixed capital formation accordingly increased to almost 25 per cent of gross domestic product in the first half of 2009; the highest ratio in more than 25 years. The bulk of the infrastructure expenditure had been planned over many years with a view to removing bottlenecks and raising productivity, while the actual flow of spending was, in hindsight, well timed from a countercyclical perspective.

Viewed from the production side, over the past year the strongest contractions in real value added were recorded by the manufacturing and mining sectors, as both domestic and export demand weakened abruptly. Favourable weather conditions in key parts of South Africa resulted in fairly high production levels in agriculture, while the infrastructure projects supported output in the construction sector. In the trade, transport, real-estate and financial services sectors, weak demand conditions were reflected in a decline in real value added.

As capital formation was stepped up over the past years it bolstered imports, resulting in comparatively large trade and current-account deficits on the balance of payments. Declining real consumption and large-scale inventory reductions led to a sharper contraction in imports than in exports, particularly in the first half of 2009. As a consequence, the current-account deficit narrowed markedly.

At the same time, financial capital continued to flow into the country in a variety of forms and in amounts that more than fully neutralised the deficit on the current account. In the second half of 2008 the intensification of turmoil in global financial markets was accompanied by large net outflows of portfolio capital in the wake of increased risk aversion among international investors, but direct and other investment inflows strengthened simultaneously. On a net basis, South Africa again attracted an inflow of portfolio capital in the first half of 2009 as global risk aversion eased, while foreign direct investment inflows continued, particularly into mining and telecommunications enterprises. Overall, the balance of payments continued to record modest surpluses, which were reflected in further accumulation of foreign-currency reserves by the South African Reserve Bank (the Bank).

The exchange rate of the rand depreciated considerably in 2008, reflecting large trade and current-account deficits, and later in the year the net disposal of domestic securities by non-resident investors. From early in 2009 to date the rand, on balance, has recovered part of its earlier losses, supported by factors such as renewed interest in South African investments by non-residents and a narrowing deficit on the current account.

Steeply rising prices of oil and other international commodities, a depreciating exchange value of the rand, and rapidly increasing food prices bolstered inflation in the first eight months of 2008. Both producer price and consumer price inflation peaked in August 2008, and subsequently trended lower as their earlier drivers reversed and as the relatively tight monetary policies maintained in 2007 and 2008 began to bear fruit.

Up to the middle of 2008 inflation expectations were fuelled by a range of factors, such as energy prices, which rose to extraordinarily high levels and ever-higher actual inflation data. To stem, and eventually reverse, this worsening of inflation and inflation expectations, monetary policy was tightened further in the first half of 2008, continuing a process that had started as early as mid-2006. By December 2008, however, lower inflation and clear signs of a marked widening of the output gap prompted the Monetary Policy Committee (MPC) of the Bank to reduce the repurchase rate for the first time since 2005. Further reductions followed in the first eight months of 2009, bringing the cumulative decrease in the repurchase rate to 5 percentage points.

Growth in the money supply, and in bank loans and advances to the domestic private sector decelerated further in 2008 and the first half of 2009 as the recessionary conditions intensified. While impaired advances rose significantly under these circumstances, the banks remained well capitalised. The money market also continued to function normally and without any disruption in liquidity flows.

The fixed property market remained subdued during the period under review, with nominal house prices, for instance, recording year-on-year decreases in recent months. Share prices declined steeply from peak values reached in May 2008 as economic activity slowed and commodity prices worsened. However, share prices – usually a leading indicator – recovered part of their earlier losses from early 2009 onwards. Interest rates on bonds declined in the second half of 2008, but trended higher in 2009 to date, partly on account of the increase in bond issues by the public sector.

During the year under review fiscal policy became expansionary, partly due to automatic stabilisers and partly due to deliberate policy actions. Fiscal prudence in earlier years, leading to a well-contained level of government debt and debt-service cost, created the scope for government to move from a national government surplus in 2007/08 to a modest deficit in 2008/09 and a fairly large projected deficit in 2009/10. The fiscal steps taken were set to support economic growth, combat economic hardship, unemployment

and poverty, and build infrastructure with a view to enhancing the future strength and robustness of the economy. The impact of the movement to a more stimulatory fiscal stance was, of course, reinforced by the significant easing of monetary policy, referred to above, which commenced in December 2008.

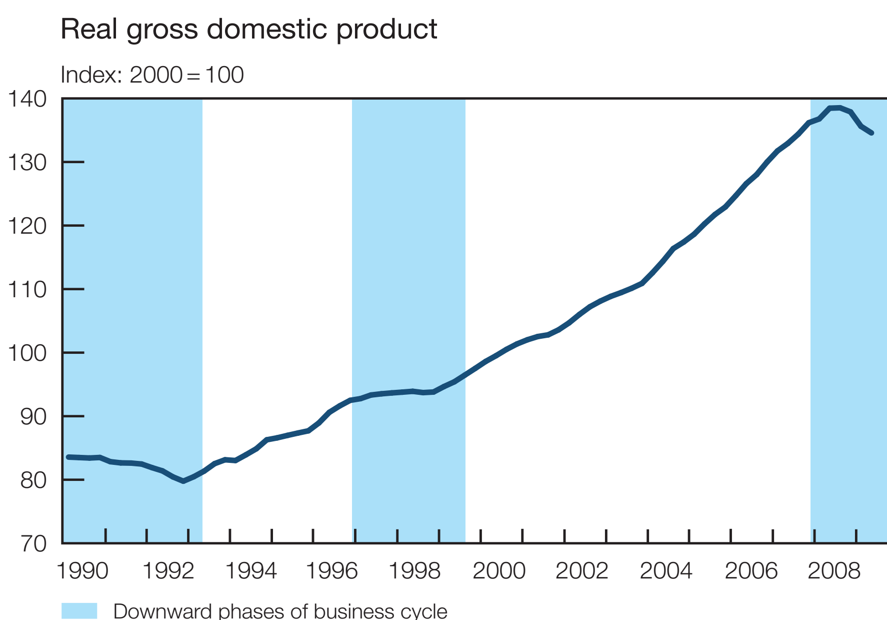
It is clear that, as is the case in numerous other countries, the South African monetary and fiscal policy settings are currently very expansionary. If sustained in more normal times, this policy mix could easily sow the seeds of the next economic dislocation. Accordingly, the same international forums that promoted co-ordinated action to counter the global economic crisis are now discussing so-called exit strategies, with a view to returning to normal policy settings in an orderly way without jeopardising the economic recovery.

Domestic economic developments

Domestic output

After 40 quarters of uninterrupted economic growth, South Africa's real gross domestic product declined at a seasonally adjusted and annualised rate of 1,8 per cent in the fourth quarter of 2008. In the first half of 2009 real gross domestic product contracted further at an annualised rate of 4,5 per cent. This could be attributed to the sharp and synchronised decline in global economic activity during the second half of 2008, which continued into the first half of 2009.

Real gross domestic product increased at an average annualised rate of about 4 per cent from the final quarter of 1999 to the final quarter of 2007 – that is, during the longest upward phase of the business cycle identified since the dating of cycles was started in 1945. This was notably higher than the growth rate of 3,1 per cent registered in the upward phases of 1986–1989 and 3,7 per cent registered in 1993–1996, but less than the growth rate of 5,3 per cent attained in the upward phases of 1978–1981 and 6,4 per cent in 1983–1984. Real growth ran out of steam in the first three quarters of 2008, falling below trend and signalling the onset of a downswing, which intensified as growth subsequently turned negative: On balance, the level of real gross domestic product in the second quarter of 2009 shrank by 3 per cent compared with its recent peak in the third quarter of 2008, reflecting the negative impact of the deep recession in the world economy.



A sectoral analysis shows that during the prolonged 1999–2007 upward phase of the business cycle, the growth in real gross domestic product was widely spread among the main sectors, with the exception of the mining industry where production, on balance, rose very little. By contrast, real value added by the secondary and tertiary sectors increased briskly at average annualised rates of 4,5 per cent and 4,7 per cent, respectively. The onset of the current downward phase of the business cycle mainly manifested itself in declines in real value added by the manufacturing and commerce sectors, and in the further deterioration in mining production in the course of 2008. By the early months of 2009, the adverse impact of the recession was clearly evident as the declines in real value added became broad-based. Consequently, with the exception of construction, and community, social and personal services, all other sectors of the economy contracted in the first half of 2009 when compared with their counterparts in the second half of 2008.

In the agricultural sector, real value added declined at an annualised rate of 2,3 per cent in the first half of 2009, compared with an increase of 23,9 per cent recorded in the second half of 2008. Farmers not only experienced a decline in the production of maize, but also a more general moderation in the growth of their gross income from livestock, field crops and horticultural production as they were adversely affected by the deterioration in the terms of trade in the agricultural sector.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Sectors	2007	2008			2009
	Year	1st half	2nd half	Year	1st half
Primary sector	0,8	-2,1	7,5	0,9	-11,8
Agriculture	2,9	20,4	23,9	18,8	-2,3
Mining	0,0	-11,0	-0,2	-6,5	-16,8
Secondary sector	6,1	5,8	-3,5	2,9	-12,7
Manufacturing	4,5	5,4	-7,4	1,2	-19,4
Electricity, gas and water	3,0	-3,6	0,3	-1,2	-5,0
Construction	17,1	13,6	12,4	13,9	13,1
Tertiary sector	5,4	3,4	1,9	3,5	-0,1
Commerce	5,2	1,5	-4,5	0,5	-2,4
Transport and communication	5,6	3,7	3,8	4,0	-0,7
Financial and other services	6,8	4,1	3,2	5,0	-1,0
Non-agricultural sector	*5,2*	*3,1*	*0,4*	*2,8*	*-4,2*
Total	5,1	3,5	0,9	3,1	-4,5

The contraction in real value added by the mining sector proceeded at an annual rate of 6,5 per cent in 2008, but became more pronounced as it shrank at an annualised rate of 16,8 per cent in the first half of 2009, mainly on account of a decline in output volumes of the non-gold segment of the industry. The buoyant foreign demand for basic metal and mineral products, still evident in the early part of 2008, reversed rather quickly from the middle of 2008 when the global financial crisis led to a recession in many countries. These demand constraints, coupled with the sharp decline in commodity prices, subsequently prompted the South African mining industry to scale down output.

In the case of the platinum group metals (PGM) industry, where South Africa is the dominant world supplier of platinum and rhodium, and a significant supplier of palladium, real value added also contracted markedly in the first half of 2009. Consequently, the average level of real value added by platinum mining for the first half of 2009 was about 11 per cent lower than the peak reached in the first half of 2007. This decline was the net result of production disruptions brought about by a combination of industrial action, safety-related shaft closures, processing bottlenecks, geological difficulties, shortages of electricity supply, falling efficiency and skilled employee shortages. Despite the raising of emission standards and an increase in the use of catalytic converters, the sharp downturn in the global economy led to a worldwide decline in vehicle sales, which restricted the demand for PGM products used in autocatalytic converters and industrial applications.

Real value added by the coal and diamond mines was also adversely affected by the worldwide slump in economic growth. In case of the gold-mining industry, real output continued along its longer-term downward trend, with occasional short-lived increases. The persistent decline in the tonnage of gold-bearing ore mined and a reduction in the average grade of ore milled, accounted mainly for the sustained decline in real output of gold.

The poor performance by the mining sector in the 1999–2007 upward phase of the business cycle, with an average annual growth rate of 0,7 per cent, indicated that the South African mining industry had been unable to capitalise on the protracted buoyancy in commodity prices that characterised much of the past decade. This weak response could be attributed to, among other things, the closure of various mines and shafts owing to safety incidents, the curtailment of electricity supplies, infrastructure constraints, regulatory constraints, shortages of appropriately skilled staff, and bottlenecks with the procurement of goods and services.

Manufacturing production contracted markedly during the past year, its quarter-to-quarter rate of decline accelerating from 9,4 per cent in the third quarter of 2008 to annualised rates of no less than 22 per cent in the subsequent two quarters before moderating somewhat to about 10,9 per cent in the second quarter of 2009. The decline in manufacturing output essentially reflected weaker demand, both domestically and from abroad. Manufacturers responded to the weaker demand by cutting output even more than the fall in demand and, consequently, reducing inventories, thereby accentuating the near-term downturn.

The decline in manufacturing production brought about a substantial reduction in the pressures on the stock of capital and labour resources employed in the sector. As a result, the utilisation of production capacity fell sharply from an average of 82,7 per cent in the second half of 2008 to 78 per cent in the first half of 2009. Estimates indicate that labour productivity has also declined recently, confirming that businesses are using their inputs substantially less intensively. Nevertheless, nominal wage increases remained fairly high.

Real value added by the sector supplying electricity, gas and water declined at an annual rate of 1,2 per cent in 2008, compared with an increase of 3 per cent registered in 2007. This decline in output was mainly the result of the curtailment of electricity supply and periodic load shedding, following the capacity constrains experienced by Eskom since the beginning of 2008, amplified by weakening demand towards the end of the year. In the first half of 2009 output declined further at an annualised rate of 5 per cent – broadly in line with the progressive deterioration in real economic output and the subsequent slowdown in domestic demand. In addition, real output in the subsector responsible for water supply was negatively affected by the abundant rain and relatively cooler weather conditions experienced in the first half of 2009.

Growth in real value added by contractors in the construction industry remained positive, accelerating from 12,4 per cent in the second half of 2008 to 13,1 per cent in the first half of 2009. Although contractors benefited from the work generated by the capital expansion programmes of general government and public corporations, the decline in residential building activity impacted adversely on the value added by the sector. In addition, activity of construction companies was also hampered by the reduced availability of debt finance for new and existing construction projects.

In contrast to the marked declines in real value added by the primary and secondary sectors in the first half of 2009, the real value added by the tertiary sector declined marginally. As the largest component – contributing around 63 per cent of aggregate gross domestic product – the performance of the services sector helped to cushion the severe decline in real economic activity in the first half of 2009.

The relative stability of the tertiary sector stemmed from robust growth in real value added by the subsector community, social and personal services, which increased at an annualised rate of 3 per cent in the first half of 2009. However, real value added by the sectors supplying transport, storage and communication as well as financial services contracted moderately in the first half of 2009. This was broadly in keeping with the decline in domestic and foreign merchandise trade volumes, the subdued performance of the equity and fixed property markets, and the fact that the declining trend in interest rates and the slowdown in credit extension put a squeeze on the profit margins of financial institutions. Likewise, the rate of decline in real value added by the commerce sector continued at a steady pace of 2,4 per cent in the first two quarters of 2009 as depressed economic conditions affected all three major subsectors, namely wholesale, retail and motor trade.

After increases of 5 per cent in 2007 and 3,7 per cent in 2008, the real gross national income, a more suitable aggregate for measuring changes in national well-being, declined at an annualised rate of 1,3 per cent in the first half of 2009. The decrease in real gross national income was due to the decline in real gross domestic production, which more than neutralised the benefit of lower net primary income payments to the rest of the world and an improvement in the terms of trade. Likewise, real gross national income per head of the population decreased at an annualised rate of 2,3 per cent over the period. Despite this weakness, the average level of real gross national income per capita for the first six months of 2009 was still about 27 per cent higher than the average level attained during the 1990s. This is clear evidence of the improvement in economic well-being that South Africans experience, having benefited from sustained high growth during the longest upward phase of the business cycle measured to date.

Gross domestic expenditure

Following a relatively high average annualised growth rate of 5,4 per cent during the recent upward phase of the business cycle, growth in aggregate real gross domestic expenditure became erratic in 2008 and the first half of 2009. In 2008 a change in any one half-year was followed by a change in the opposite direction in the subsequent half-year. In the first half of 2009 real gross domestic expenditure declined by 3,7 per cent.

Measured over one year, real gross domestic expenditure declined by 2,8 per cent in the first half of 2009. Over the same period real gross domestic product declined at a broadly similar rate of 2 per cent. This sluggishness implied little reason to expect any upward pressure from domestic demand on the average level of prices.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

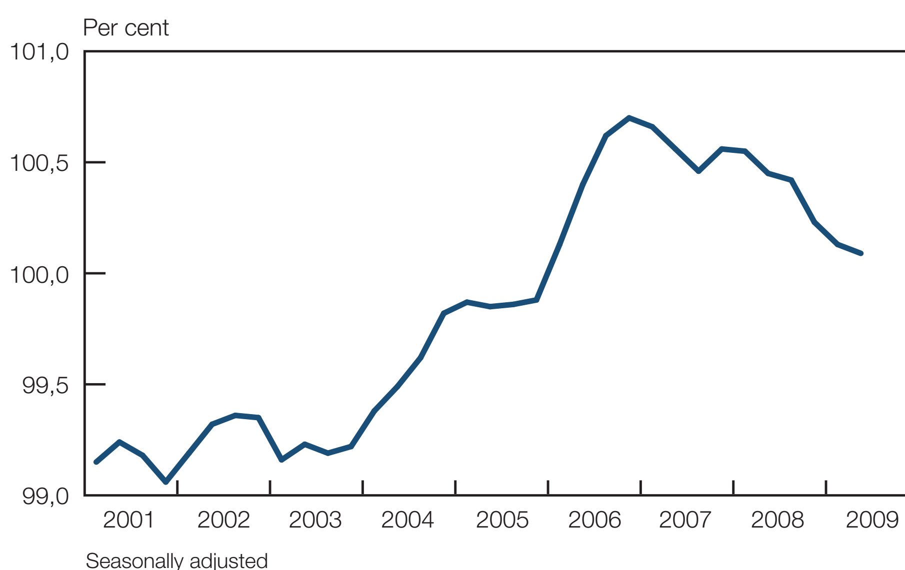
Components	2007	2008			2009
	Year	1st half	2nd half	Year	1st half
Final consumption expenditure:					
Households	6,6	2,8	-0,8	2,3	-4,5
General government	4,8	5,7	5,3	5,0	3,8
Gross fixed capital formation	16,3	10,3	5,7	10,2	7,0
Change in inventories (R billions)*	4,2	3,2	-16,1	-6,5	-34,8
Gross domestic expenditure..........	**6,0**	**5,2**	**-1,1**	**3,1**	**-3,7**

* At constant 2000 prices

An analysis of the current recession from the expenditure side of the economy shows that the contraction mainly came from final consumption expenditure by households and investment in inventories. In addition, exports of goods and services declined more than did imports of goods and services, thereby reducing the growth of gross domestic product. By contrast, and in a countercyclical manner, real consumption expenditure by general government and real fixed capital formation remained relatively strong.

Real final consumption expenditure by households

Real final consumption expenditure by households increased at an exceptionally brisk average annualised rate of 5,3 per cent from late 1999 to late 2007. This can be attributed to sustained increases in real disposable income of households and a surge in the real value of households' wealth, reflecting the buoyancy of the residential property and equity markets during this period. Households' real wealth rose at an average annualised rate of more than 10 per cent between 2000 and 2007, before it declined, at an annualised rate of 11 per cent from its high in the second quarter of 2007 to the second quarter of 2009. The sustained increase in real consumption expenditure by households during the upward phase also manifested itself in an increase in households' average propensity to consume. The average propensity of households to consume rose from 97,4 per cent during the 1990s to more than 100 per

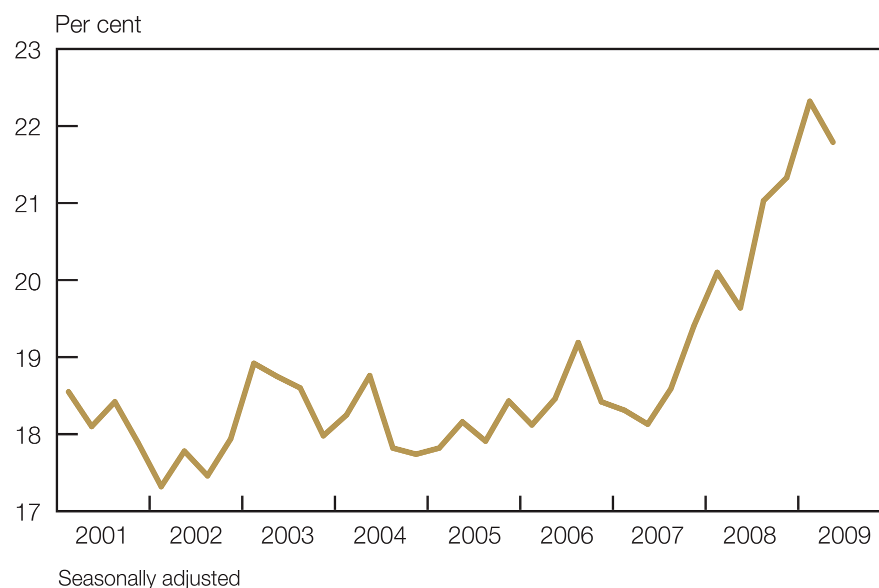


cent from the first quarter of 2006, resulting in the household sector becoming a net dissaver. The borrowing requirement of the household sector increased substantially in 2006 and 2007, before it moderated somewhat in 2008 and the first half of 2009.

An analysis of the more recent quarter-to-quarter changes in real consumption expenditure by households showed noticeable declines varying between annualised rates of 0,9 and 5,8 per cent over the four quarters up to the second quarter of 2009.

The more pronounced contraction in real consumption expenditure by households in the first half of 2009 can mainly be attributed to substantial cutbacks in real outlays on durable, semi-durable and non-durable goods, which more than outweighed a steady increase in real expenditure on services. However, the intensification of the recession during the first half of 2009 was clear in that real outlays on both discretionary and non-discretionary items came under pressure. The decline in household expenditure could, among other things, be ascribed to, firstly, the contraction in real disposable income of households, driven by higher food and energy prices, lower earnings growth and falling employment; secondly, falling house and equity prices, which reduced the value of housing equity and financial wealth, and might have led some homeowners to seek to rebuild their balances of precautionary saving at the expense of consumption expenditure; thirdly, tight credit conditions – for some households difficulties in accessing equity and obtaining loans might have made it difficult to smooth any weakness in their income; fourthly, low confidence levels among consumers, exacerbated by the growing number of insolvencies among individuals and unincorporated business enterprises; and, finally, the prevailing high level of household debt, accompanied by the lagged effect of the tight monetary policy stance effective until late in 2008.

The strain on household finances was reflected in the slowdown in the rate of increase in the value of household debt from an average annual rate of 23,8 per cent between 2004 and 2007 to 12,6 per cent in 2008 and 4,6 per cent in the first half of 2009. Despite this slowdown, households' debt-to-income ratio remained sticky and was only marginally lower at 76,3 per cent in the second quarter of 2009, compared with its most recent high of 78,2 per cent in the first quarter of 2008. The easing in the monetary policy stance since December 2008 and the concomitant decline in the lending rates of commercial banks benefited indebted households as their debt-service cost was



reduced from an average of 11,7 per cent of their disposable income in the second half of 2008 to an average of 10,2 per cent in the first half of 2009. On balance, this was still substantially higher than the average cost of 6,4 per cent registered in 2004. In addition, households' ratio of debt to total assets (or capital gearing) has increased substantially from a recent low of 18,1 per cent in the second quarter of 2007 to about 22 per cent in the first half of 2009. This suggests that the greater indebtedness of households put them in a more vulnerable position, were further adverse economic shocks to occur in the near future.

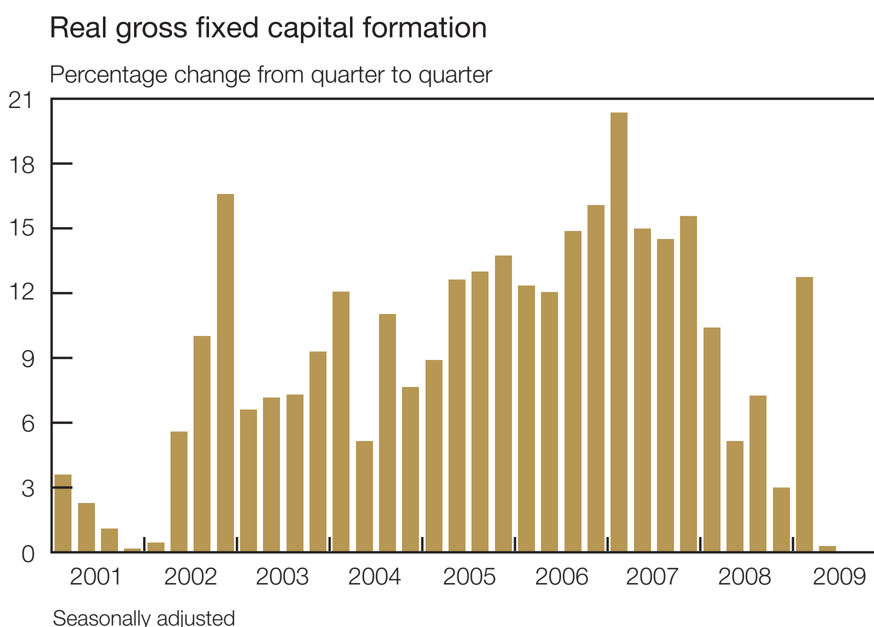
Real final consumption expenditure by general government

Over the past decade real consumption expenditure by general government increased at an average annualised rate of 4,3 per cent. This was slightly more than the average rate of growth in real gross domestic product, which resulted in an increase in the ratio of consumption expenditure by general government to gross domestic product, from an average of 18,1 per cent in 2000 to more than 20 per cent in 2008 and the first half of 2009. Relative to gross national disposable income, reflecting governments' claim on scarce and productive resources, this ratio rose from 18,7 per cent in 2000 to around 21 per cent in 2008 and the first half of 2009.

The increasing share of government's claim on gross national disposable income could mainly be ascribed to the higher growth in real outlays on intermediate goods and services relative to the growth in remuneration of employees, which was partly due to improved socio-economic development and service delivery, and to the defence procurement programme. However, in the first half of 2009, the growth in government's real outlays on the compensation of employees still increased steadily, while that on non-wage goods and services contracted, probably reflecting government's commitment to job creation during the cyclical downturn in the economy.

Real gross fixed capital formation

After real gross fixed capital formation had increased at an average annualised rate of 9 per cent in the upward phase of the business cycle, the rate of increase receded in tandem with the current downturn in economic activity from a recent high of 16,3 per cent



in 2007 to 10,2 per cent in 2008 and 7 per cent in the first half of 2009. The increase in real fixed capital formation during the economic upturn was due to equally strong growth in real capital expenditure by the private and public sectors. Consequently, the ratio of gross fixed capital formation to gross domestic product increased from an average of 15 per cent between 2000 and 2002 to 23,2 per cent in 2008 and 24,8 per cent in the first half of 2009. This reversal of the decline of aggregate gross domestic fixed investment relative to gross domestic product was also evident in an appreciable increase in the net addition to South Africa's fixed capital stock since 2004 – strengthening the structural capacity of the South African economy to support sustainable higher economic growth. Output growth nevertheless outpaced the growth in the capital stock up to the end of 2007; accordingly, the capital-output ratio of the economy declined by about 8 per cent between 2005 and 2007 when compared with the preceding four years. The improvement in capital productivity was discernible in all the major sectors of the economy, with the exception of the mining industry and the sector supplying electricity, gas and water. In 2008 and the first half of 2009 the capital–output ratio started rising.

The slowdown in real fixed capital formation in the first half of 2009 occurred in the private and general government sectors, with the most pronounced deceleration being recorded in the private sector. The rate of growth in private fixed capital formation, which comprises about 70 per cent of total fixed investment, receded from 12,6 per cent in 2007 to 6,5 per cent in 2008. However, in the first half of 2009 a negative rate of 7,6 per cent was registered. This slowdown was spread across the major sectors of the economy, reflecting the adverse impact of the global economic downturn through the marked decline in the volume of merchandise exports, alongside plummeting domestic demand, and plunging business confidence, coupled with the fact that the under-utilisation of production capacity increased markedly.

Real fixed capital formation by the public sector increased at an average annualised rate of 43 per cent in the first half of 2009, substantially higher than the growth rates of 26,9 per cent registered in 2007 and 19,4 per cent registered in 2008. In keeping with the budgeted goals to address infrastructure backlogs, capital investment by the transport sector and the sector supplying electricity, gas and water continued to increase at an exceptionally rapid pace. By contrast, real gross fixed capital formation by general government slowed in the first half of 2009, mainly on account of subdued capital expenditure by local authorities.

Classified by type of asset, the slower growth in real fixed investment spending stemmed from declines in private investment in residential buildings and in machinery and other equipment. The former was primarily in response to oversupply in some areas of the housing market alongside the weakening of the balance sheets of households, the rising trend in liquidations and sequestrations evident since the middle of 2008, and stringent credit management by banks, while the latter reflected the subdued demand for transport services associated with recessionary conditions.

Change in inventories

Aggregate inventory investment at constant prices amounted to R16,5 billion in 2006 and R4,2 billion in 2007, but inventories then declined by R6,5 billion in 2008 and by an annualised R34,8 billion in the first half of 2009. Because these net changes in inventory levels became progressively smaller and later turned negative, the contribution to growth in aggregate real gross domestic expenditure made by inventory investment declined from 0,6 of a percentage point in 2006 to negative contributions of 1 percentage point in 2007 and 0,8 of a percentage point in 2008. Rapid declines in inventories were registered in both the second half of 2008 and the first half of 2009.

The more pronounced decline in net inventory investment from the middle of 2008 was the result of a sharp reduction of inventory levels in the mining, industrial and commercial sectors, overshadowing an increase in agricultural stocks-in-trade resulting from bumper crops. Consequently, the ratio of industrial and commercial inventories to the non-agricultural gross domestic product declined from nearly 13 per cent in 2008 to an average level of 11,1 per cent in the first half of 2009.

The inventory reductions can be attributed to a number of factors. The relatively high level of interest rates undoubtedly raised the cost of carrying inventories, and thereby provided an incentive for manufacturers and distributors to economise on inventory holdings. The decline in the real effective exchange value of the rand and the concurrent increase in the prices of imported goods emphasised the need to manage inventory levels closely in accordance with changing orders. In addition, expectations of a recession and the slowdown in final demand deterred inventory accumulation.

Factor income

Aggregate nominal factor income rose by 14,8 per cent in 2007 and 15,7 per cent in 2008, but then decelerated meaningfully to a year-on-year rate of increase of 5,8 per cent in the first half of 2009. This slower increase in factor income during the first half of 2009 was essentially the result of lower growth in the aggregate remuneration of employees and the gross operating surpluses of business enterprises.

The year-on-year rate of increase in the total remuneration of employees receded from 11,8 per cent in 2008 to 8,3 per cent in the first half of 2009. This decline was evident in all the main sectors of the economy, but more prominent in the mining, manufacturing and construction sectors where employment continued to decrease on account of job shedding and a reduction in average working hours in order to cut costs. However, owing to fierce campaigns by labour unions and the acute shortage of skilled labour, average salaries and wages continued to rise despite recessionary conditions.

The growth in aggregate operating surpluses fell from 19,5 per cent in 2008 to 3,7 per cent in the first half of 2009. The generally weaker growth in total gross operating surpluses from the middle of 2008 was particularly pronounced in the primary and secondary sectors. Profitability in the mining and manufacturing sectors was negatively affected by the strengthening in the exchange value of the rand, the decline in production levels, except gold production, and the subdued performance of commodity prices. The growth in the operating surpluses of the services sectors also slowed in the first half of 2009. Although discernible in all the major subsectors, the slowdown was particularly prominent in the commercial and financial services sectors, reflecting the contraction in the volume of retail and motor car sales. In addition, commercial banks' profit margins were squeezed during a period of rising bad debts, curtailment of credit extension and progressive decline in real domestic final demand.

Domestic saving

The national saving rate as measured by the ratio of gross domestic saving to gross domestic product deteriorated substantially between 2002 and 2007 from 16,9 per cent to an average ratio of 14,6 per cent, before it rose to 15,4 per cent in 2008 and to an average ratio of 16,7 per cent in the first half of 2009. However, the quantum of saving in the first two quarters of 2009 still fell well short of total gross investment in the economy; 22,7 per cent of total gross domestic investment accordingly had to be financed through an inflow of foreign capital into the economy.

The marginal improvement in the saving rate from the middle of 2008 was primarily due to an increase in saving by the private sector, which outweighed the deterioration in saving by general government. General government saving deteriorated significantly from the second quarter of 2008, as recurrent expenditure accelerated rapidly, rising much faster than current revenue. Social security and other transfers by general government to households have increased at an average annual rate of more than 18 per cent since the third quarter of 2008.

Gross saving by the private sector as a percentage of gross domestic product increased moderately from an average of 12,1 per cent in the first half of 2008 to an average of about 15 per cent in the first half of 2009. This improvement can be ascribed to an improvement in saving by the corporate sector and a slight increase in saving by households. Incorporated business enterprises increased thrift stemmed essentially from cost-cutting measures to reduce current expenditure and the curtailment of dividend payments, given the tight financial conditions and bleak prospects for an early recovery in economic activity.

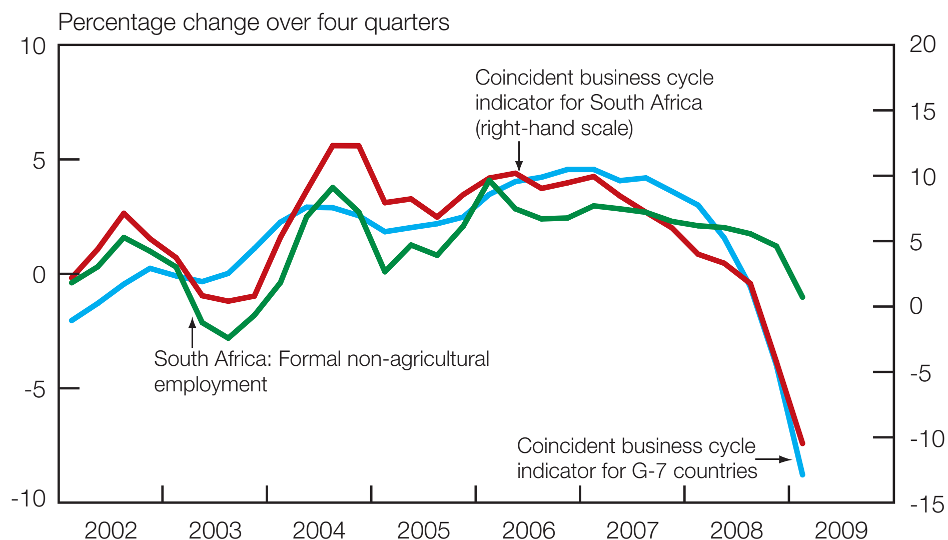
Rising household saving reflected the decline in real household consumption expenditure and an accompanying increase in the proportion of income that households save. Households increased their savings in an environment of tight economic conditions, stricter lending criteria and increased uncertainty about job prospects. Furthermore, some households may have saved more in response to significant declines in their financial wealth as asset prices receded, reinforcing the point that saving from current income was necessary to accumulate net wealth on a sustainable basis.

Employment

The South African labour market did not escape the dire consequences of the financial market turmoil that intensified and rapidly spread across the globe in the closing months of 2008. The subsequent growth-inhibiting effects and concomitant decline in world commodity prices reduced export earnings, severely affecting employment levels in especially the export-oriented sectors of the domestic economy. Employment losses, particularly in the manufacturing and gold-mining sectors, suppressed growth in overall employment in the formal non-agricultural sector in 2008.

Sturdy increases in public-sector employment during 2008 counteracted employment losses in the private sector and contributed to a continued expansion in overall

Economic activity and formal non-agricultural employment



employment numbers in the formal non-agricultural sector, albeit at a rate of only 1,8 per cent – the lowest in three years. Around 920 000 new jobs were created over the full duration of the upward phase of the employment cycle that started in the third quarter of 2003 and ended in the third quarter of 2008. The first quarterly decline in enterprise-surveyed formal non-agricultural employment in almost four years, however, occurred in the fourth quarter of 2008, solely as a result of job shedding in the private sector.

According to the quarterly *Labour Force Survey* conducted among households by Statistics South Africa, overall employment in the South African economy further decreased by 2,0 per cent between the first quarter of 2009 and the second quarter of 2009, representing a loss of 267 000 jobs. Accordingly, the official unemployment rate rose to 23,6 per cent in the second quarter of 2009, compared with a rate of 23,5 per cent in the preceding quarter. Corroborating employment losses in recent months, Unemployment Insurance Fund (UIF) payouts increased by as much as 30 per cent over the year to the first quarter of 2009.

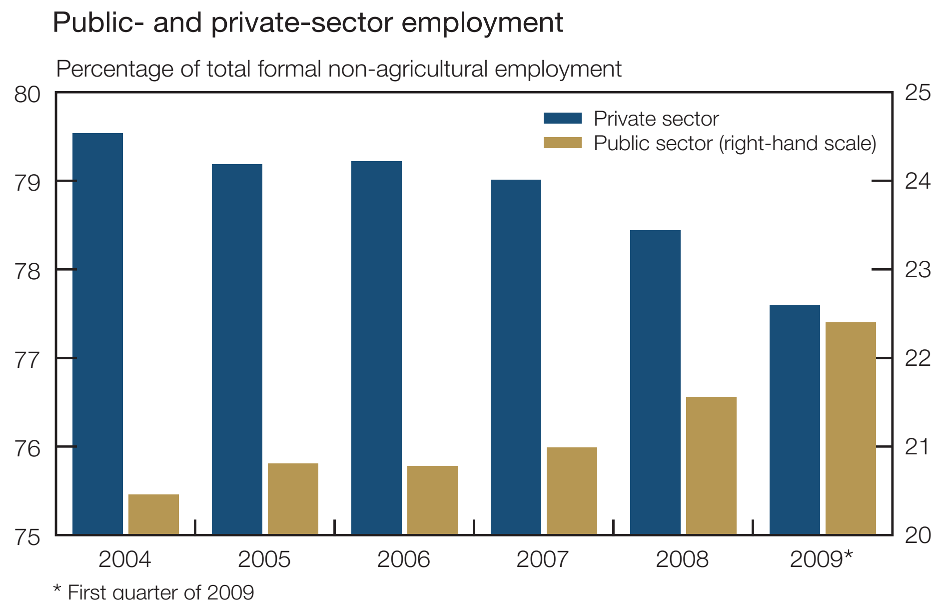
When employment growth in the *formal non-agricultural sector* of the economy is measured from quarter to quarter and expressed at an annualised rate, as an indication of the short-term pace of change, the level of employment contracted by as much as 6,4 per cent in the first quarter of 2009, or by around 139 000 jobs. Employment losses in the opening months of 2009 were not confined to a few sectors only, but were widely dispersed among all but one of the subsectors in the *private non-agricultural sector* of the economy, namely the community, social and personal services sector.

By the end of 2008, the manufacturing sector had already consistently shed jobs for a year-and-a-half and the trade, catering and accommodation services sector had done so for three-quarters-of-a-year in an environment of tighter monetary policy aimed at containing inflationary pressures. Subsequently, employment losses in these sectors continued apace, with the non-gold mining and construction sectors experiencing the largest decline in employment of all sectors in the first quarter of 2009.

Despite job shedding in the *construction sector* during the second and third quarters of 2008, due in part to electricity-related backlogs, the level of employment rose again in the closing months of the year as non-residential building activity countered the depressed state in residential building activity. Continued infrastructural development related to the hosting of the 2010 FIFA World Cup tournament and various other infrastructural developments, such as the Gautrain Rapid Rail link, contributed meaningfully to counter the labour paring which took place at construction companies involved in the residential sector. Employment in the construction sector for 2008 as a whole remained roughly at the same level compared with the previous year. As already mentioned, a large number of jobs were, however, shed in the construction sector in the first quarter of 2009 as activity levels related to site preparations and building installations declined.

The mining sector, being directly influenced by the substantial decline in international commodity prices during the closing months of 2008 and the opening months of 2009, also experienced a reversal of earlier employment growth during that period. Employment in the gold-mining sector contracted by around 7 500 in the six-month period to the first quarter of 2009, while in the non-gold mining sector the contraction amounted to 20 500 jobs. In 2008 South African gold-mining production fell to its lowest level in the past 50 years, resulting in South Africa sliding back into third place after China and the US in the ranking of the world's largest gold-mining countries.

Acting in a counter-cyclical manner, the staff complement of the *public sector* expanded by around 300 000 in the five years to the end of 2008 and by around 100 000 in 2008 alone. The main thrust in the expansion of the public sector was at local and provincial government levels. Measured as a percentage of formal non-agricultural employment, employment in the public sector rose from 20,5 per cent in 2004 to 22,4 per cent in the first quarter of 2009. The quarter-to-quarter pace of increase in public-sector employment numbers, however, slowed on all tiers in the fourth quarter of 2008 and a slight decrease was recorded in the first quarter of 2009.



In an effort to stem the contraction of the labour market, phase two of an extended public works programme was announced by government in consultation with trade unions and other social partners, with the aim of creating an additional 500 000 jobs by the end of 2009. Although these jobs will not be of a full-time, permanent nature, their creation has the potential to alleviate hardship among those being afforded these employment opportunities. Furthermore, government has embarked on a process to re-examine the various incentives that apply in all sectors of the economy completely with a view to enhancing job creation.

Labour cost and productivity

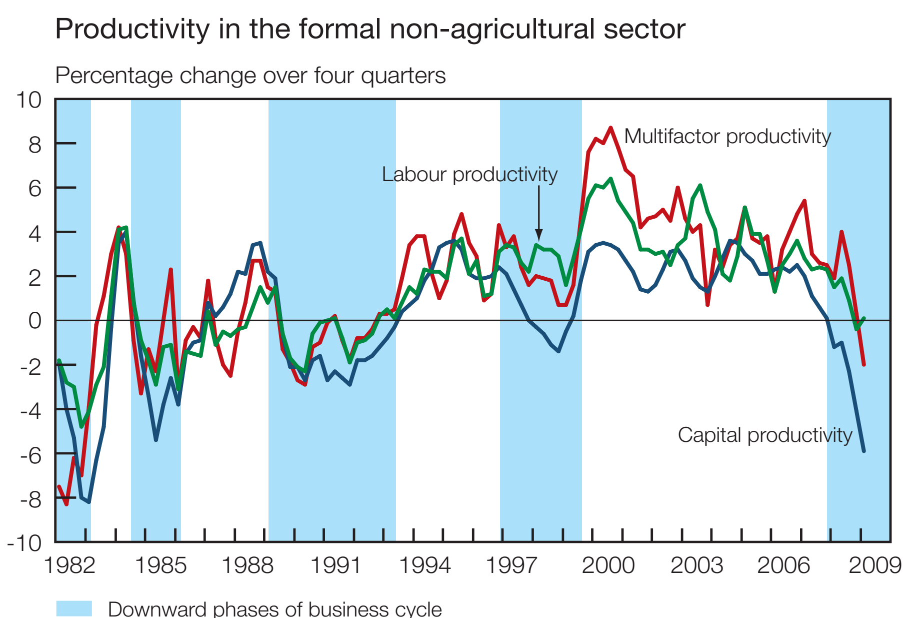
The pace of increase in *nominal remuneration per worker* in the formal non-agricultural sector, after having decelerated to a rate slightly in excess of the upper limit of the inflation target range in 2007, accelerated markedly to 12,8 per cent in 2008. This acceleration in nominal wage growth per worker was equally evident in the private and public sectors; both these sectors recorded increases in 2008 that were double that in the preceding year, within an environment of rising consumer price inflation. In the year to the first quarter of 2009, nominal remuneration growth per worker slowed somewhat in both the private and public sectors, albeit still remaining at double-digit rates of increase. After having contracted in 2007, workers' real take-home pay – that is after adjustment for inflation – rose slightly in 2008.

Increases in nominal remuneration per worker in the *private sector* in 2008 ranged between 7,1 per cent in the transport, storage and communication sector to a high of 32,6 per cent in the non-gold mining sector. With the exception of the finance, insurance, real-estate and business-services sector, and the transport, storage and

communication sector, all other subsectors in the private sector recorded double-digit rates of increase in nominal remuneration per worker in 2008. Remuneration per worker in the *public sector* in 2008 increased at a rate of 12,9 per cent, primarily as a result of steep increases – in excess of 15 per cent – in the transport, storage and communication sector and among provincial government employees.

Corroborating findings by Statistics South Africa concerning the acceleration in nominal wage growth during 2008, results from the *Wage Settlement Survey* compiled by Andrew Levy Employment Publications (a private-sector labour consultancy) indicate that the average rate of wage settlements in collective bargaining agreements amounted to 7,3 per cent in 2007, 9,8 per cent in 2008 and 9,7 per cent in the first half of 2009.

As a consequence of slowing growth in non-agricultural output in the course of 2008 and eventually a contraction in real output in the fourth quarter of 2008 and the first quarter of 2009, *economy-wide labour, capital and multifactor productivity* growth slowed materially. In particular, capital productivity decreased at an average annual rate of 2,1 per cent in 2008, while labour productivity and multifactor productivity increased at rates of 1,0 per cent and 2,2 per cent respectively; the lowest in more than a decade.



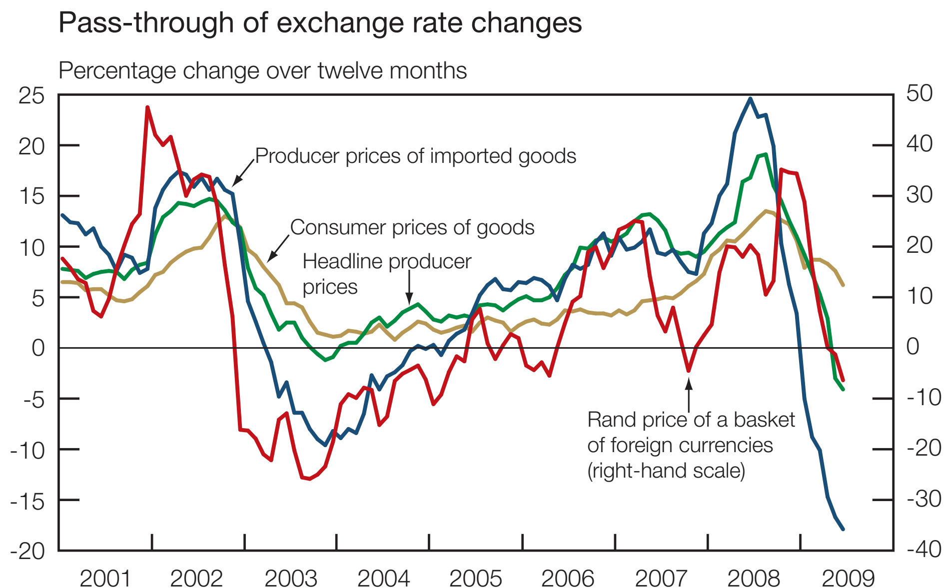
Despite accelerating at a slightly faster pace than labour productivity growth in the formal non-agricultural sector as a whole, *manufacturing labour productivity growth* slowed to a five-year low of 2,6 per cent in 2008. Of note is the reduction in manufacturing labour productivity at a rate of 9,2 per cent in the year to the first quarter of 2009 as manufacturing production fell back substantially within a recessionary environment. Despite a deterioration in labour market conditions, and reduced job security, the number of working days lost to strikes and work stoppages doubled from 265 000 in the first half of 2008 to 526 000 in the first half of 2009, with wage disputes accounting for 92 per cent of all strikes.

As a result of the acceleration in nominal wage growth and slower advances in labour productivity, the rate of increase in *nominal unit labour cost* in the formal non-agricultural sector almost tripled to 11,7 per cent in 2008 from the previous year. In the *manufacturing sector* the pace of increase in nominal unit labour cost accelerated almost sixfold to 8,9 per cent in 2008 compared with the preceding year, as manufacturing production shrank and labour costs rose amid declining international and

domestic demand. When measured over periods of four quarters, the pace of increase in nominal unit labour cost in the manufacturing sector, in particular, accelerated apace in the first quarter of 2009, amounting to 21 per cent. In the formal non-agricultural sector as a whole, nominal unit labour cost increased at a rate of 11,2 per cent in the year to the first quarter of 2009, substantially in excess of the inflation target range, thereby contributing to domestically generated inflationary pressures.

Prices

Global inflationary pressures eased rapidly in the aftermath of the financial market turmoil that engulfed world economies towards the end of 2008. The ensuing contraction in global output and trade led to a substantial decline in world commodity prices, which eased price pressures, especially at the producer level. Accordingly, year-on-year headline producer price inflation in South Africa decelerated meaningfully from just short of 20 per cent in August 2008 to 2,9 per cent in April 2009. With price pressures subsiding even further, overall producer prices decreased by 4,1 per cent over the twelve months to June 2009. The most pronounced decreases occurred in the prices of products of petroleum and coal, basic metals and mining products.



The targeted measure of consumer price inflation peaked at a year-on-year rate of 13,6 per cent in August 2008. The definitional, methodological, reweighting and rebasing changes to the targeted inflation measure, moderation in producer price inflation and a deceleration in consumer food price inflation were important contributors to the moderation in targeted inflation to 6,9 per cent in the year to June 2009.

The restrictive monetary policy stance applied since the middle of 2006 made way for a series of interest rate reductions from December 2008, totalling 500 basis points to August 2009. This change in the policy stance, following a deceleration in targeted inflation from its recent peak in August 2008, occurred despite the fact that inflation remained above the upper end of the inflation target range. These interest rate reductions were made possible in an inflation-targeting framework due to the fact that inflation outcomes react with a lag to interest rate changes. Furthermore, the conduct of monetary policy in an inflation-targeting framework is forward-looking and allows for flexibility, in the sense that current inflation outcomes do not dictate policy, but rather the medium- to longer-term trajectory of expected inflation.

The substantial decrease in international crude oil prices from a high of around US$145 per barrel in July 2008 to below US$35 per barrel at the end of that year, a general appreciation in the exchange rate of the rand since October 2008 and a deceleration in food price inflation assisted meaningfully in containing inflationary pressures in the domestic economy during that period. What was disconcerting was the renewed increase in crude oil prices from the opening months of 2009 to a high of US$75 per barrel in early August 2009.

Consumer food price inflation – comprising 14,27 per cent of the consumer price index basket – slowed from a year-on-year rate of 19,2 per cent in August 2008 to a still-high 9,9 per cent in June 2009. This remained far higher than the rate of increase in the producer prices of food and food products. Explanations for the divergence included lags and stockholding in the distribution chain, a shift in consumer spending patterns from durable to non-durable goods, alleged price collusion in certain instances, higher refrigeration costs of meat and soft produce due to higher electricity prices, higher transportation costs, and salary and wage increases pushing up costs in the retail sector more than in the manufacturing and agricultural sectors.

Despite still advancing at rates in excess of the rate of increase in the producer prices of food, moderating consumer food price inflation was, nevertheless, encouraging in terms of the outlook for inflation.

The appreciation in the exchange rate of the rand on international financial markets during the first half of 2009, in an environment of somewhat higher commodity prices and a return of risk appetite towards emerging markets, has reduced inflationary pressures in the domestic economy through price declines of imported goods. The deceleration in inflation in the producer prices of imported commodities in the final months of 2008 and outright declines in the first half of 2009 were due to sizeable decreases in the prices of agricultural and mining products, products of petroleum and coal, basic metals and furniture. In the aggregate, imported goods prices declined by as much as 17,9 per cent in the twelve months to June 2009, with imported mining product prices (including oil) declining by as much as 47,4 per cent over this period.

Producer price changes for *domestic output*, inclusive of those that are consumed in the domestic market and exported, decelerated from an average annual rate of increase of 14,3 per cent in 2008 – the highest rate in the past nineteen years – to a decrease of 4,1 per cent in the year to June 2009. The main reason for this abrupt deceleration in domestically produced goods price inflation was the significant decline in the prices of mining products and products of petroleum and coal, coupled with lower rates of increase in the prices of agricultural and manufactured food products, and chemical and chemical products.

After having fluctuated at rates within the inflation target range of between 3 and 6 per cent during the sixteen months to September 2007, *consumer goods price inflation* accelerated progressively in the course of 2008 as especially petrol and food prices rose. The subsequent deceleration in year-on-year goods price inflation from a high of 13,5 per cent in August 2008 to within single-digit territory in recent months resulted from moderating inflation in the prices of food and non-alcoholic beverages, as well as transport and communication goods. Inflation in the prices of the remainder of the goods categories was still accelerating apace in June 2009.

Year-on-year *services price inflation* picked up earlier than goods price inflation, accelerating from comfortably below the inflation target range at the beginning of 2006 to above the target range by the end of that year. It subsequently remained at around the 7 to 8 per cent

level. Higher rates of increase in the prices of health, transport, recreational, cultural, educational, restaurant and hotel services, as well as miscellaneous services were all adding to increased service price pressures during the first half of 2009.

During 2008, *administered price inflation* accelerated rapidly to year-on-year rates that were just short of 20 per cent as especially petrol and electricity price increases pushed the index higher. With a weight of almost 27 per cent in the administered price index basket, petrol prices play a prominent role in aggregate administered price changes. Following the noteworthy decrease in petrol prices at a rate of 25,0 per cent in the year to June 2009, administered price inflation slowed abruptly. Barring the inflation-containing effect of petrol price disinflation, administered price inflation approximated a double-digit rate in the year to June 2009, pushed higher especially by increases in university boarding fees, school fees, postage costs, motor registration costs as well as the electricity price – set to continue rising substantially in coming years.

The inflation-containing effect of waning demand pressures in the economy in recent months was offset by higher wage inflation and slowing productivity growth. This contributed to an increase in cost-push pressures in the economy. Consistently remaining at double-digit rates of increase during the whole of 2008 and the first quarter of 2009, year-on-year changes in nominal unit labour cost contributed materially to the elevated rates of increase in consumer price inflation in the past eighteen months. Despite stubbornly remaining at rates in excess of the inflation target range as cost-push pressures persisted, inflation outcomes are expected to moderate further during 2010 and 2011, as indicated by the *Inflation Expectations Survey* of Stellenbosch University's Bureau for Economic Research in the second quarter of 2009.

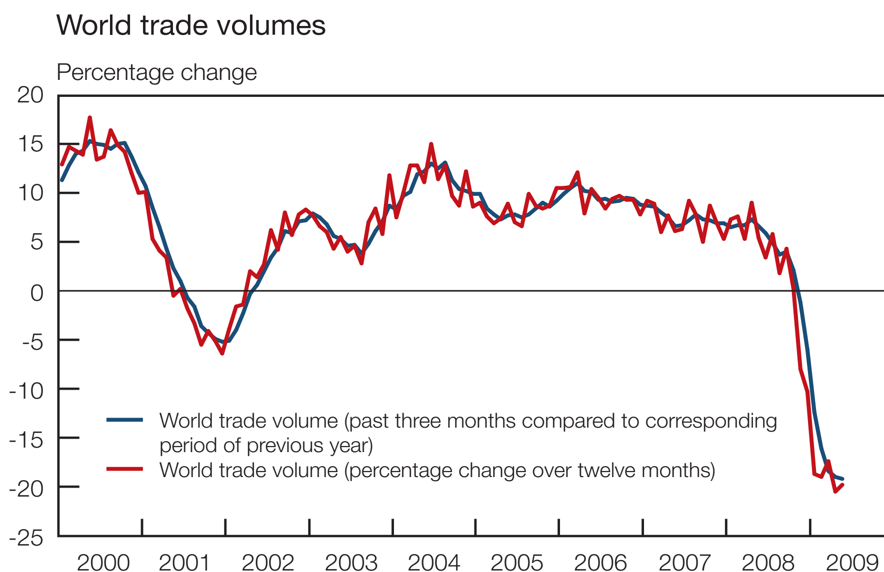
Non-agricultural nominal unit labour cost and consumer goods prices

Foreign trade and payments

International economic developments

Turmoil in global financial markets that originated in the US sub-prime mortgage market made itself felt in 2007, but intensified considerably in the closing months of 2008 following the bankruptcy of Lehman Brothers, an investment bank in the US, in

September. The curtailment of financial intermediation due to a lack of confidence and liquidity concerns contributed to a sharp contraction in economic activity and international trade volumes in most advanced economies during the second half of 2008. Although most emerging-market economies were initially unaffected by the turmoil in global financial markets, weaker demand from advanced economies impacted negatively on the exports from emerging-market economies. The global recession eventually became more synchronised with economic growth in most emerging-market economies either moderating or turning negative in the fourth quarter of 2008.

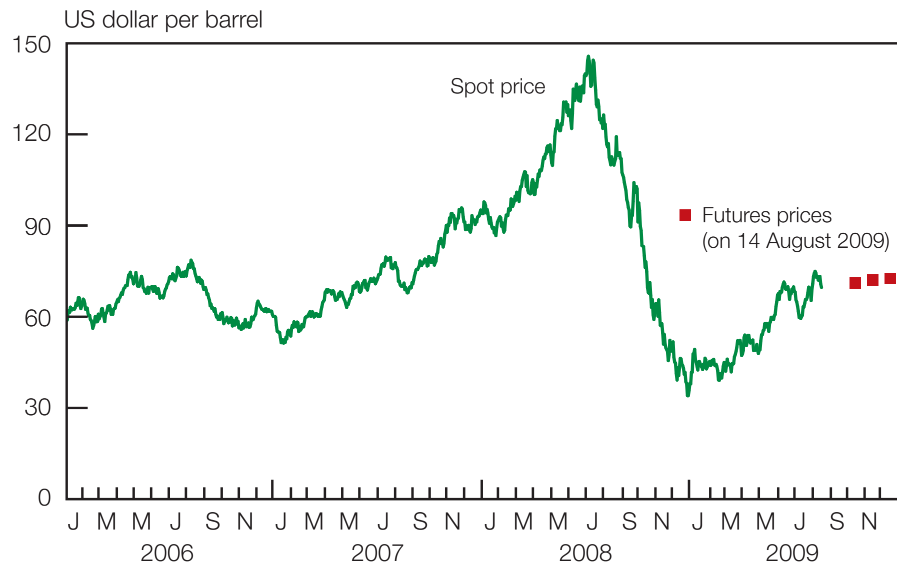


Source: CPB Netherlands Bureau for Economic Policy Analysis

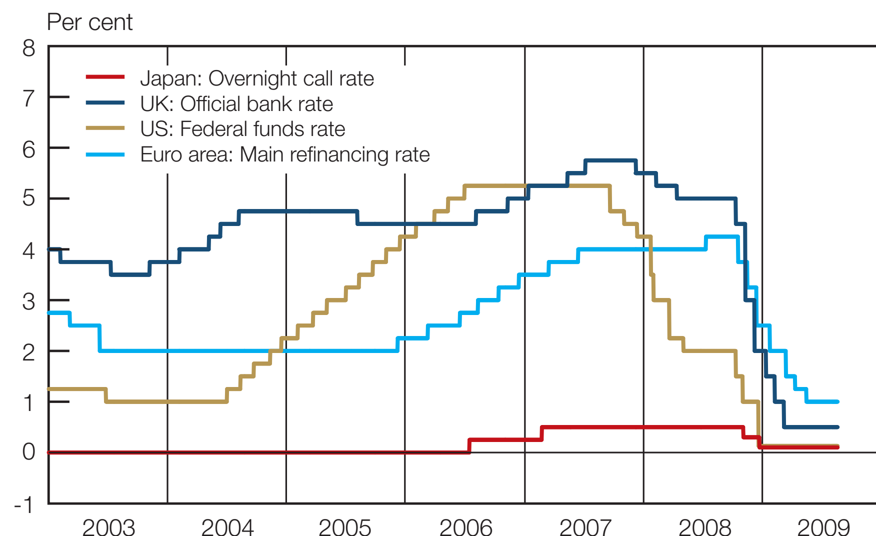
The recession in the US and the euro area is bottoming out, with the pace of contraction decelerating sharply in the second quarter of 2009. In Japan, following a contraction of almost 12 per cent on an annualised basis in the first quarter of 2009, economic growth rebounded in the second quarter by 3,7 per cent. While the rate of decline in real output decelerated somewhat in Latin American emerging-market countries as a group in the first quarter of 2009, output growth rebounded in Asian emerging markets, including China, Singapore and South Korea, in the second quarter of 2009. Economic conditions, however, deteriorated further in European emerging-market countries in the first quarter. Although several macroeconomic indicators have recently suggested that the rate of decline in global economic activity may be bottoming out in the second quarter of 2009, it is still too early to confirm conclusively that a recovery in global economic activity is under way. According to the latest International Monetary Fund (IMF) *World Economic Outlook Update* (July 2009), global output is expected to contract by 1,4 per cent in 2009, before increasing by 2,5 per cent in 2010. Real output in advanced countries is projected to contract by 3,8 per cent in 2009, while economic growth in emerging-market and developing countries is expected to moderate substantially to 1,5 per cent over the same period. Economic growth in Africa is projected to moderate to 1,8 per cent in 2009, before recovering to 4,1 per cent in 2010.

The commodity price boom experienced during the past few years peaked in mid-2008; thereafter commodity prices declined rapidly due to the substantial slowdown in the global economy. The price of Brent crude oil displayed extreme volatility during 2008 and surged from levels of around US$100 per barrel in January 2008 to a new record-high level of more than US$145 per barrel in mid-2008. Oil prices were affected by tight supply conditions, robust demand from developing countries, geopolitical tensions and speculative activities. The steep deceleration in global economic activity, however,

caused crude oil prices to decline by almost 80 per cent in the second half of 2008. The Organization of the Petroleum Exporting Countries (OPEC) responded to this considerable decline in oil prices by reducing its production target by 4,2 million barrels per day with effect from 1 January 2009. Crude oil prices, however, have rebounded sharply since early 2009 on optimism that the unprecedented fiscal and monetary stimulus was starting to bear positive results, and reached levels of around US$75 per barrel in early August 2009. Brent crude oil futures contracts for delivery in the fourth quarter of 2009 traded at around US$72 on 14 August 2009.



Consistent with the collapse in commodity prices and widening output gaps, inflationary pressures in advanced countries have declined substantially since mid-2008. Headline inflation in advanced economies decelerated steeply during the second half of 2008 and deflationary pressures have recently emerged in the US, Japan and the euro area. Inflationary pressures in emerging-market economies have also moderated since the middle of 2008. While a few major emerging-market countries such as Russia and



Venezuela still experienced double-digit inflation rates, other countries such as China, Hong Kong, Singapore, Taiwan and Thailand have experienced deflation in recent months.

Authorities in most advanced and emerging-market economies responded to the global financial crisis by introducing large monetary and fiscal stimulus packages. By mid-August 2009, central banks in countries such as Canada, Chile, Hong Kong, Israel, Japan, Sweden, Switzerland, the United Kingdom and the US had reduced official policy rates to close to zero per cent. A number of central banks also implemented a variety of unconventional measures, such as purchasing an expanded range of debt and equity instruments, to provide liquidity to financial institutions and underpin conditions in financial markets.

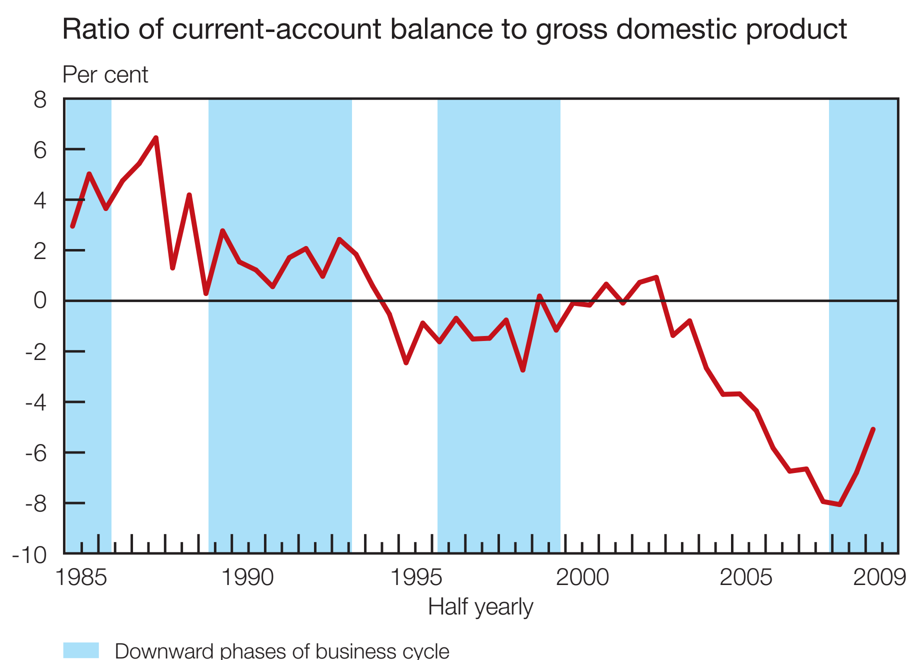
Policy issues and trade reforms

As part of an ongoing process to expand South Africa's trade relations with the rest of the world, the Southern African Customs Union (SACU) and the US concluded a Trade, Investment and Development Cooperative Agreement (TIDCA) in July 2008. The aim of the agreement is to establish a forum for consultative discussions, co-operation and possible agreements on a wide range of trade issues. Some SACU member countries also entered into a trade agreement with the European Union during the year under review. As regards trade and industry, the Automotive Production and Development Programme (APDP) was endorsed in 2009 to replace the Motor Industry Development Plan (MIDP) from 2013 to 2020. The APDP has been formulated with the objective of also promoting the vehicle component-manufacturing industry in addition to the manufacturing and assembly of vehicles. In order to support and encourage vehicle assemblers and component manufacturers to upgrade equipment to meet the APDP's production target by 2013, an automotive investment allowance equal to 20 per cent of qualifying investments will be paid to participants over a three-year period from July 2009.

Current account[1]

1 Unless stated to the contrary, the current-account data referred to in this section are seasonally adjusted and annualised.

The ongoing financial crisis, alongside a notable slowdown in global demand, adversely affected real output growth in many emerging-market economies in a process that gained considerable momentum during the second half of 2008. The deceleration in growth in South Africa's real gross domestic product in 2008 coincided with the early



stages of the latest downward phase in the country's business cycle, which had commenced in the closing months of 2007. Apart from the contraction in real domestic output and accompanying lower international trade volumes, the downward phase of the business cycle has also been associated with an improvement in the country's balance on current account. The deficit on the current account of South Africa's balance of payments, which had widened in the first half of 2008, narrowed considerably in the second half and even more impressively in the first half of 2009. Relative to the country's gross domestic product, the current-account deficit narrowed from 6,8 per cent in the second half of 2008 to 5,1 per cent in the first half of 2009.

The significant improvement in the deficit on the current account in the year to June 2009 could be attributed to a progressively smaller trade deficit, mainly reflecting the country's reduced domestic demand for consumer goods and slower growth in capital expenditure, together with lower net service, income and current transfer payments to the rest of the world. Net dividend payments to foreign investors declined notably over the period, largely due to the decline in domestic economic activity and the concomitant decrease in the profits of some domestic companies being fully or partly foreign owned.

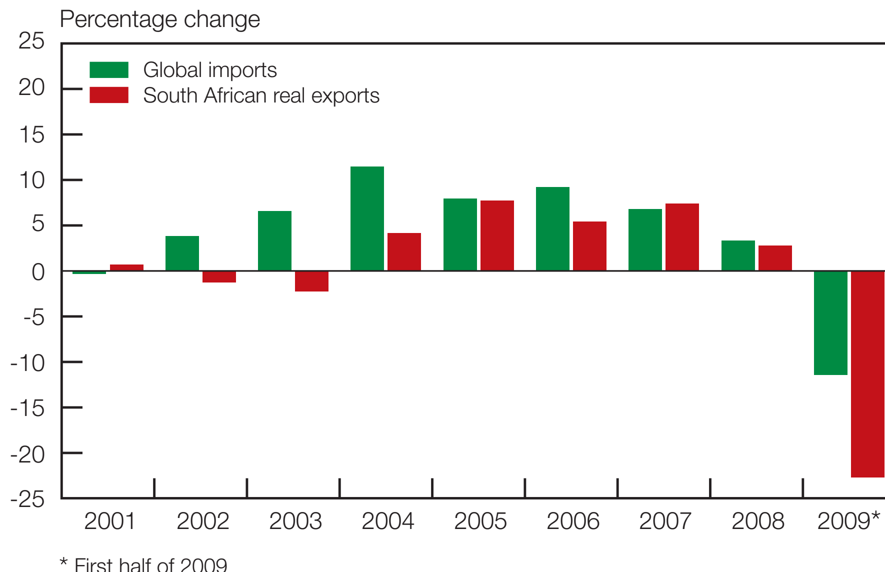
Current account

Seasonally adjusted and annualised
R billions

	2007	2008			2009
	Year	1st half	2nd half	Year	1st half
Merchandise exports	493,9	624,2	687,3	655,8	511,3
Net gold exports	39,9	46,8	50,3	48,5	49,2
Merchandise imports	-574,3	-714,0	-765,7	-739,9	-573,9
Trade balance	**-40,5**	**-43,0**	**-28,1**	**-35,6**	**-13,4**
Net services, income and current transfer payments	-105,6	-136,3	-130,9	-133,6	-105,0
Balance on current account	**-146,1**	**-179,3**	**-159,0**	**-169,2**	**-118,4**
As a percentage of gross domestic product	*-7,3*	*-8,1*	*-6,8*	*-7,4*	*-5,1*

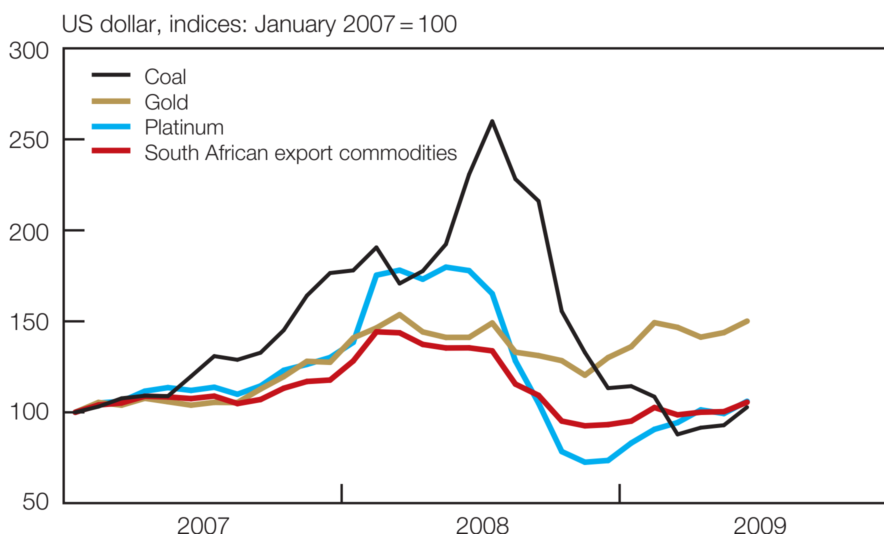
2 Real variables calculated at constant 2000 prices.

The deceleration in international demand, which ultimately culminated in a recession in many advanced economies, gradually suppressed the volume of merchandise exports in the course of 2008. The effect of the weaker global trade became more pronounced in the first half of 2009 when the volume of South African exports shrank by roughly 24 per cent. Lower investment spending in Europe contributed to a sharp contraction in the volume of manufactured exports in the first half of 2009, whereas the volume of mining exports contracted on account of weaker demand. Over and above the decline in global demand for raw mining materials, the fall in the volume of merchandise exports was further exacerbated by relatively tight credit conditions, and a scarcity of export credit finance available to domestic producers. Owing to the lack of appetite of the international economy for South African-produced goods, the ratio of real merchandise exports relative to real gross domestic product decreased from 21,5 per cent in the second half of 2008 to 16,5 per cent in the first half of 2009.[2] In the process South African exporters also lost considerable market share.



The subdued growth in the volume of merchandise exports in the second half of 2008 was more than neutralised by a moderate increase in the rand price of merchandise goods, resulting in higher export revenues during the period. The higher rand price of exported goods was underpinned by the depreciation of the exchange value of the rand as international commodity prices receded over the period. In the first half of 2009, however, export revenues contracted, consistent with the deceleration in real economic activity in South Africa's major export partner-countries.

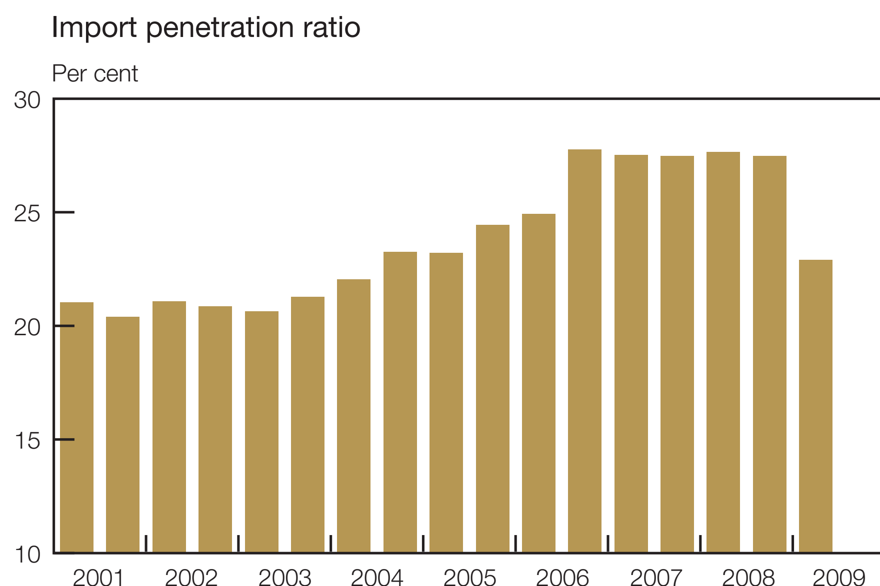
South African export commodity prices displayed tentative signs of a recovery in the first quarter of 2009, following a decline of roughly 24,5 per cent from the first half of 2008 to the second half of the year on account of the slowdown in global demand for industrial products. The price of export commodities was weighed down in the latter part of 2008 by, among other factors, uncertainty about the magnitude of credit losses following the ongoing turbulence in the world financial markets,



heightened concerns about the contraction in demand for industrial products and the strengthening of the US dollar over the period. The price of platinum, for example, decreased by 39 per cent from the first half of 2008 to the second half, before moderating by 7,5 per cent to US$1 098 per fine ounce in the first half of 2009. Disruptions in the country's platinum production mainly supported the international price of platinum in the first half of 2009. Over the same period, the dollar price of coal decreased by about 46 per cent. In addition, the upward trend in the prices of oil and gas in the opening months of 2009 continued to support the demand for coal for electricity-generating purposes in the domestic, European and Asian markets during the second quarter of 2009. The upswing in international commodity prices during this period contributed to an improvement in South Africa's terms of trade, following the deterioration in the second half of 2008.

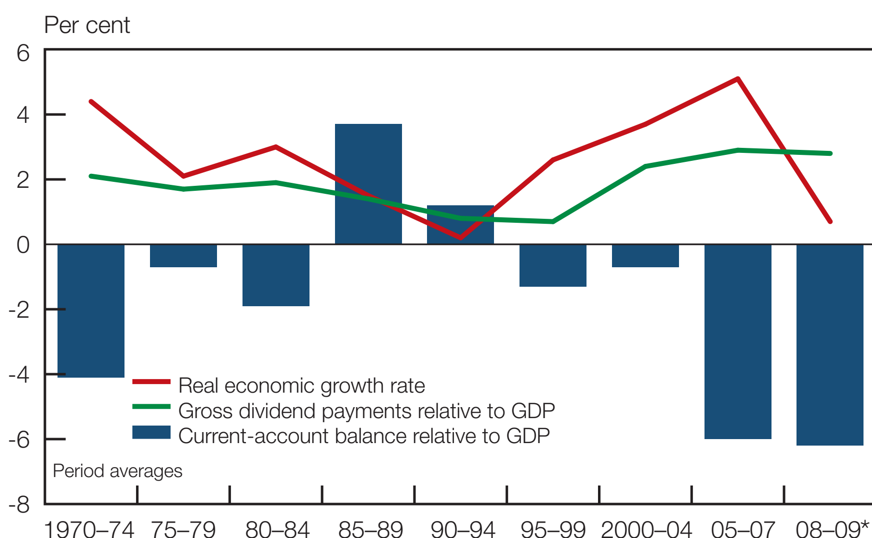
Unlike other international export commodity prices, the London price of gold expressed in US dollar declined marginally in the second half of 2008, before increasing by 9,5 per cent in the first half of 2009. Fears of a deepening global recession, the collapse of major financial institutions and concerns about the systemic risk faced by investors exacerbated uncertainty, and caused investors to switch from assets perceived to be more risky to commodities such as gold. Although these factors, together with an increase in the holding of bullion by central banks, kept the US dollar price of gold at a relatively high level compared to other metals, the rise in the price of gold was partially dampened by a sharp decline in jewellery demand and higher sales of scrap gold metal in the first half of 2009. The lower exchange value of the rand further raised the realised rand price of gold which, alongside a muted increase in the volume of net gold exports, increased the export revenue of gold producers in the second half of 2008. In the first half of 2009 a decline in the volume of net gold exports more than offset an increase in the realised price. Notwithstanding some new mines coming on stream to replace declining production elsewhere, gold production declined to about 100 tons in the first half of 2009 from 109,2 tons in the corresponding period of 2008.

The value of merchandise imports, which had advanced in the second half of 2008, contracted considerably in the first half of 2009 due to lower rand prices and import volumes. The rand price of merchandise imports benefited from fairly subdued global



inflation and lower international crude oil prices over the period. Domestic demand for imported goods as a ratio of gross domestic expenditure accordingly declined from 27,5 per cent in the second half of 2008 to 22,9 per cent in the first half of 2009, mainly on account of a noticeable decline in the volume of non-oil merchandise imports. The propensity of domestic producers to acquire imported intermediate and capital goods decreased significantly in the first half of 2009, largely due to the sharp contraction in domestic demand and uncertainty regarding the medium-term global economic outlook. Furthermore, the decline in the volume of merchandise imports, especially in the first half of 2009, was consistent with the weak levels of business confidence.

The large deficit on the services, income and current transfer account in 2008 shrank in the first half of 2009 as net income payments and, more specifically, net dividend payments decreased on account of lower profit margins of domestic companies. Tighter credit conditions probably also encouraged some companies to postpone the declaration of dividends in exchange for the use of cash. The absolute level of gross dividend payments remained broadly unchanged in 2008, following robust economic growth between 2005 and 2007. The accompanying graph illustrates the relationship between real economic growth and dividend payments. Periods characterised by high economic growth are normally associated with larger income distributions to investors and larger negative imbalances on the current account, whereas slower economic growth rates bring about the opposite. Net income payments were also contained by the general decline in global interest rates since the second half of 2008.



* Average for 2008 and the first half of 2009

Net payments for services as a percentage of gross domestic product increased in 2008, but declined during the first half of 2009 due to lower payments for transport and freight-related services as well as restrained growth in tourism spending by South African residents temporarily travelling abroad.

Components of services, income and current transfer account

Percentage of gross domestic product

	Average 1970–2006	2007	2008	2009*
Net services payments	-0,8	-1,1	-1,5	-1,0
Net income payments	-3,2	-3,2	-3,2	-2,4
Of which: Net dividend payments	-1,0	-2,9	-2,5	-1,7
Net current transfer payments	-0,3	-1,0	-1,1	-1,1
Total deficit	-4,3	-5,3	-5,8	-4,5

Deficit – surplus +
* First half of 2009

Financial account

The ongoing turmoil in world financial markets has had a profound effect on global cross-border capital flows. Although the IMF expects capital flows to emerging and developing economies to regain some momentum over the next five years, capital flows are expected to remain well below the peak recorded in the period 2007–2008. South Africa, nevertheless, continued to record capital inflows on the financial account of the balance of payments during this turbulent period.

Net financial transactions not related to reserves

R billions

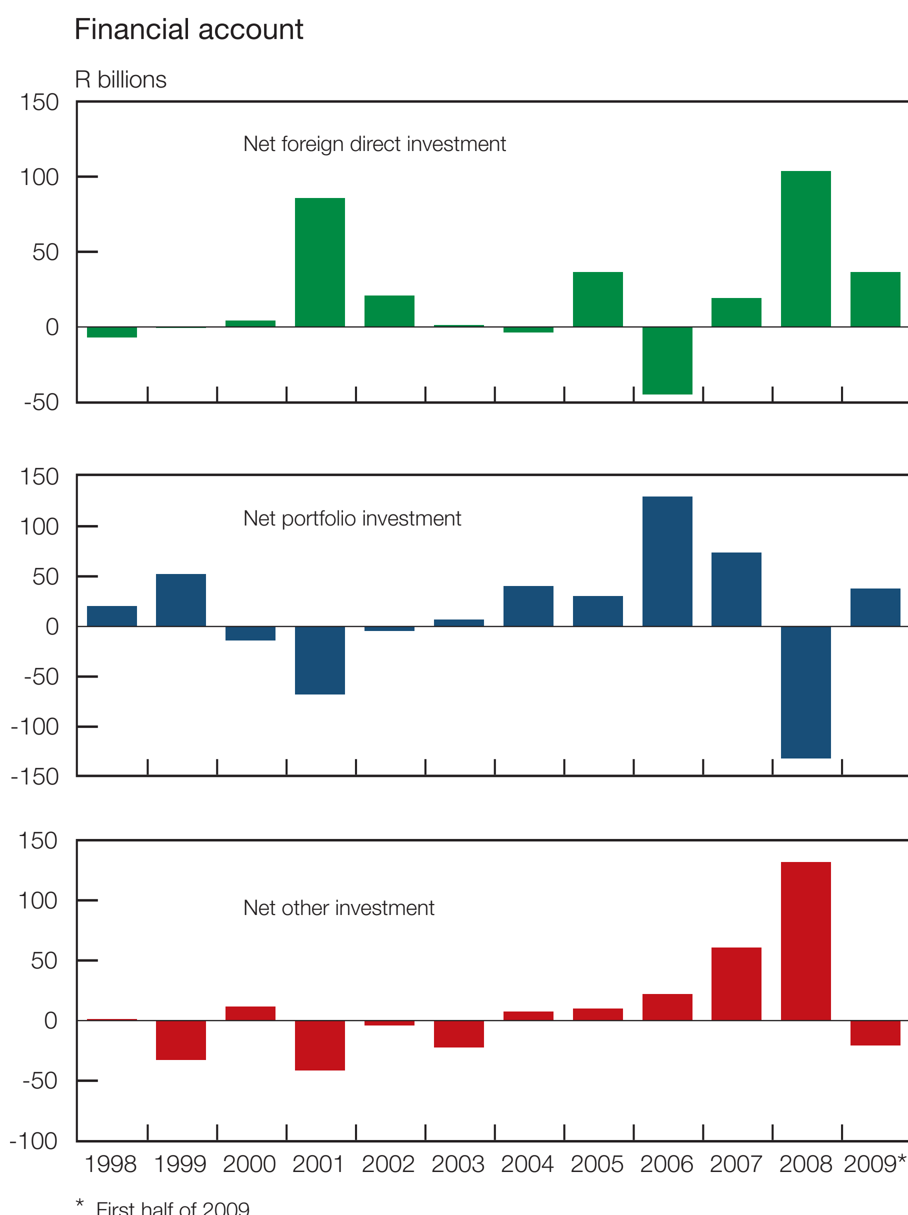
	2007	2008			2009
	Year	1st half	2nd half	Year	1st half
Liabilities					
Direct investment	40,1	48,7	25,7	74,4	35,6
Portfolio investment	97,5	-3,2	-64,9	-68,1	39,1
Other investment	58,7	29,6	24,2	53,8	-35,4
Assets					
Direct investment	-20,9	-9,9	39,0	29,2	0,7
Portfolio investment	-24,0	-8,0	-55,4	-63,4	-1,2
Other investment	2,1	19,5	58,3	77,8	14,9
Financial transactions*	193,7	95,4	99,6	195,0	62,0

* Including unrecorded transactions

Since the start of 2008 significant inflows of *direct investment* into South Africa have been recorded, of which the acquisition of a 20 per cent stake in the shareholding of a domestic bank by a non-resident bank represented the largest inflow of direct investment capital since the second quarter of 2001. Furthermore, inward direct investment during 2008 took the form of long- and short-term loan and trade finance extended to domestic subsidiaries by non-resident holding companies.

During the first half of 2009, inward direct investment continued as a result of non-resident investment in South African mining and telecommunications companies. In the outward direct investment category a substantial net inflow of capital was also recorded during 2008, following the disposal by a South African investment holding company of its interest in a foreign tobacco company. As mentioned later, this transaction also had repercussions in the portfolio investment category.

During 2008 in the category *portfolio investment liabilities*, a capital outflow was registered for the first time since 2001. The abrupt reversal of inward portfolio investment coincided with a deterioration in global credit market conditions due to sizeable credit losses, growing uncertainty and accompanying global liquidity shortages. The outflow of portfolio capital accelerated during the second half of 2008 as investors limited their exposure to emerging-market assets, following extreme risk aversion in the wake of the bankruptcy of Lehman Brothers in the US. At the same time, outward portfolio investment recorded a substantial capital outflow as the South African investment holding company mentioned above distributed its shares in a foreign tobacco investment enterprise. Global efforts to stabilise and boost confidence in financial markets seemed to have had a positive effect since global risk aversion eased and South Africa, on a net basis, again attracted an inflow of portfolio capital in the first half of 2009. The inward movement of capital was further supplemented by the successful issuance of a US$1,5 billion international bond by the government, utilised in part to redeem a US$0,6 billion international bond that matured during the same period.



* First half of 2009

On a net basis, *other investment liabilities* continued to record significant inflows throughout 2008. These inflows could largely be attributed to an increase in foreign currency-denominated short-term loans obtained by the South African banking sector and, to a lesser extent, an increase in non-resident rand and foreign currency-denominated deposits with South African banks. Other investment assets also recorded large capital inflows, mainly due to partial repatriation of the South African banking sector's foreign currency deposits abroad. During the first half of 2009 the other investment liabilities of the domestic banking sector, however, decreased as non-resident investors withdrew deposits from South African banks. The outflow of capital more than offset a long-term loan facility obtained and utilised by a South African parastatal during the period.

Foreign debt

South Africa's total outstanding external debt decreased from the end of 2007 to the end of 2008 as both the foreign currency and rand-denominated debt components declined over the period. *Foreign currency-denominated debt* decreased mainly due to the redemption of a number of international bonds by South African institutions, while the country's *rand-denominated debt* declined largely due to the depreciation of the exchange rate of the rand, which resulted in a decline in the dollar value of the country's external debt.

From the end of 2008 to the end of March 2009 the country's foreign debt declined further, mainly as a result of a decline in the foreign currency-denominated liabilities of the banking sector and the non-resident investors' net sales of domestic rand-denominated bonds. As a ratio of gross domestic product, South Africa's outstanding foreign debt decreased from 26,6 per cent at the end of 2007 to 25,9 per cent at the end of 2008 and 25,8 per cent at the end of March 2009.

Foreign debt of South Africa

US$ billions at end of period

	2004	2005	2006	2007	2008	2009*
Foreign currency-denominated debt	**27,9**	**28,1**	**35,8**	**43,6**	**42,0**	**39,4**
Bearer bonds	9,7	9,1	10,5	15,2	14,0	13,3
Public sector	4,9	4,6	5,2	5,6	5,3	5,3
Monetary sector	7,0	7,9	10,3	12,7	12,1	10,5
Non-monetary private sector	6,3	6,5	9,8	10,1	10,6	10,3
Rand-denominated debt	**17,1**	**20,5**	**23,6**	**31,7**	**29,8**	**28,0**
Bonds	5,8	6,3	7,5	7,9	8,0	6,6
Other	11,3	14,2	16,1	23,8	21,8	21,4
Total foreign debt	**45,0**	**48,6**	**59,4**	**75,3**	**71,8**	**67,4**
As a percentage of gross domestic product	*20,8*	*20,0*	*23,0*	*26,6*	*25,9*	*25,8*

* First quarter of 2009

The intensity of the global credit crisis during the latter part of 2008 necessitated a global review of the sovereign ratings and outlook of advanced and emerging-market economies. Although the financial crisis originated in advanced economies, the rating agencies were, nonetheless, concerned about the spill-over effects of global financial risk to emerging markets. In reviewing the ratings of emerging-market economies, the rating agencies also focused on the capacity of the emerging-market and commodity-producing economies to absorb the shock of a recession in the world's largest

economies, reduced capital flows and further deterioration in international commodity prices. While the sovereign ratings of most advanced economies were downgraded, the sovereign ratings of the majority of the emerging-market economies were affirmed. Fitch and Standard & Poor's (S&P) rating agencies changed South Africa's outlook on long-term foreign currency-denominated debt from stable to negative, while Moody's rating agency affirmed the country's positive outlook.

International reserves and liquidity position

South Africa's net international reserves rose by R26,1 billion in 2008 due to balance-of-payments transactions, and increased by a further R8,9 billion during the first half of 2009 as the financial account of the balance of payments continued to finance the deficit on the current account more than fully.

Having risen rapidly from 2004 to 2007, the gross international reserve position of the Bank increased at a more pedestrian pace from US$33,0 billion at the end of 2007 to US$34,1 billion at the end of 2008, and further to US$36,0 billion at the end of July 2009. Similarly, the international liquidity position of the Bank increased from US$31,3 billion at the end of December 2007 to US$34,7 billion at the end of July 2009. The import cover of gross reserves rose from around 13 weeks' imports at the end of 2007 to almost 20 weeks in the first half of 2009.

Exchange rates

The intensification of the financial crisis during the final four months of 2008 culminated in higher risk aversion towards emerging-market economies and, ultimately, a reduction in capital flows to developing economies. Non-resident investors' disposal of domestic securities during the second half of 2008 triggered a marked further depreciation in the exchange rate of the rand, following an earlier depreciation in the wake of exceptionally large trade deficits in the opening months of 2008. On balance, the nominal effective exchange rate declined by about 23,5 per cent in 2008, reversing much of the appreciation of the preceding two years. Concerns about the financing of the current-account deficit, as well as a significant decline in commodity prices, also exerted downward pressure on the exchange value of the rand over the period.

Exchange rates of the rand

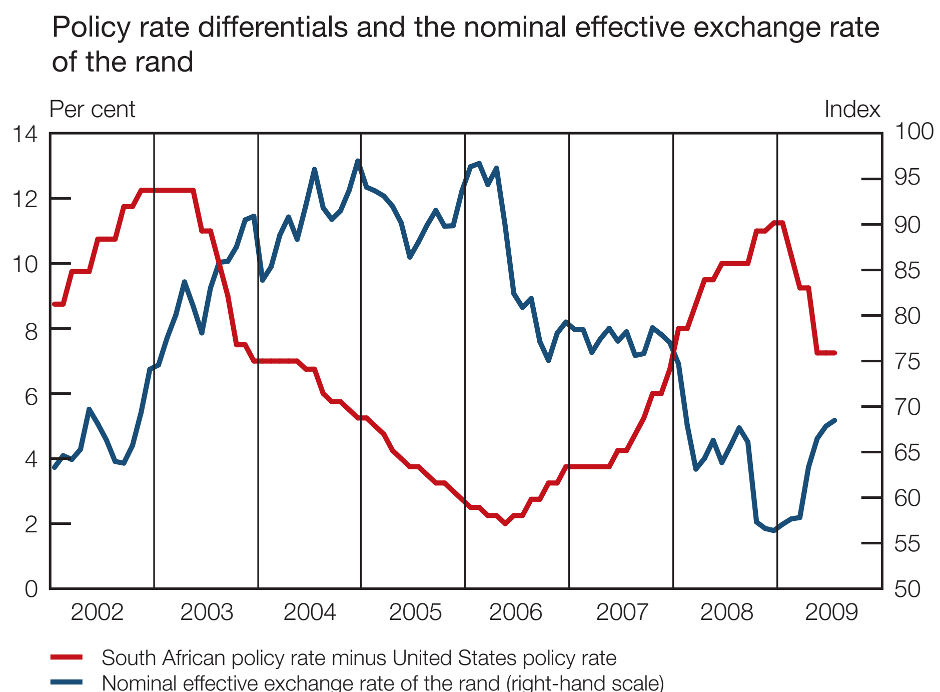
Percentage change

	31 Dec 2007 to 30 Jun 2008	30 Jun 2008 to 31 Dec 2008	31 Dec 2008 to 30 Jun 2009	30 Jun 2009 to 18 Aug 2009
Weighted average*	**-17,7**	**-7,0**	**18,5**	**-3,7**
Euro	-19,9	-5,0	19,6	-3,6
US dollar	-13,9	-15,3	19,7	-3,5
Chinese yuan	-19,2	-15,7	19,8	-3,4
British pound	-13,7	16,8	4,0	-2,3
Japanese yen	-19,2	-27,3	26,6	-3,8

* Against a basket of 15 currencies

Despite volatility reflecting foreign investors' uncertainty about comparative economic prospects, the decrease in the risk premium demanded by non-resident

investors to hold the domestic currency, as well as an increase in international commodity prices, contributed to an increase in the nominal effective exchange rate of the rand during the first half of 2009. The domestic currency also benefited from responsible monetary and fiscal policies, and a fairly wide interest rate differential in favour of South Africa as central banks in advanced economies maintained low interest rates in an effort to ward off economic collapse. A graphic comparison of the interest rate differential and the nominal effective exchange rate is made in the accompanying graph, and at first glance suggests a counterintuitive relationship – that the smaller the interest rate differential in favour of South Africa, the stronger the external value of the rand. In actual fact the relationship may be more complex, with some causation running from the exchange rate to the interest rate differential: if the exchange value of the rand depreciates, it may trigger a worsening of expected inflation, rising import prices and an increase in domestic interest rates to stem the acceleration in inflation.



The real effective exchange rate of the rand decreased by 16,5 per cent during 2008, but subsequently increased by 17,6 per cent from December 2008 to June 2009.

Owing in part to a reduction in buoyancy and activity in financial markets generally, and to the net sales of domestic equity and debt securities by non-resident investors during 2008, the average net daily turnover in the domestic market for foreign exchange declined from US$17,2 billion in the first half of 2008 to US$15,7 billion in the second half. In the first half of 2009 the daily net turnover decreased further to US$13,8 billion despite non-resident investors' net purchases of securities on the domestic bond and stock exchange markets over this period. The non-resident share in the activity on the domestic market for foreign exchange decreased from US$13,3 billion in the first half of 2008 to US$11,6 billion in the second half and further to US$10,1 billion in the first half of 2009.

Monetary developments, interest rates and financial markets

Structural and regulatory issues

Notwithstanding the crisis in the global financial markets and the concomitant slowdown in the domestic economic activity, the South African banking system remained relatively stable in the year to June 2009. The banking sector was adequately capitalised with levels of capital well in excess of minimum prudential requirements. However, the banks' operating environment deteriorated somewhat as financial distress among banks' clients generated noticeable increases in impaired advances. This negatively affected banks' earnings, although the sector remained profitable overall.

There were 35 registered banks in South Africa at the end of June 2009, unchanged since July 2007. The number of foreign banks with approved local representative offices in South Africa receded from 46 at the end of June 2008 to 43 at the end of June 2009, as difficulty at parent headquarters caused some banks to scale back their operations and close offices. The domination of the sector by four major banking groups, with combined holdings of about 84 per cent of the sector's total assets, remained intact.

Size of the South African private banking sector

	June 2008		June 2009	
	Number of institutions	Total assets R billions	Number of institutions	Total assets R billions
Locally controlled banks	13	2 035	13	2 128
Foreign controlled banks	6	683	6	706
Mutual banks	2	1	2	1
South African branches of foreign banks	14	227	14	185
Total registered banks	**35**	**2 946**	**35**	**3 020**

The decline in economic activity and the prevailing tight financial conditions remained a major constraint on the issuance of new debt securities by the banking sector. The securitisation of assets also remained severely constrained with only R0,1 billion in assets securitised during the year to June 2009, compared with R15,8 billion during the year to June 2008. Nevertheless, the sector continued to expand its retail deposit base, although the growth in such deposits slowed during the period under review.

The banking sector exceeded its Financial Services Charter requirements in terms of the objectives set out in 2003. Noticeable progress made included the addition of banking access points, such as the opening of new branches and the roll-out of automated teller machines. At the end of December 2008, the number of Mzansi banking account users surpassed the 6 million mark as improved awareness about this low-cost bank product and its growing level of sophistication continued to attract new customers.

Following the promulgation of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) by Parliament of the Republic of South Africa in September 2007, the National Treasury published, for public comment, the Draft Co-operative Banks Act Combined Rules (*Government Gazette*, No. 32356 Vol. 529) on 1 July 2009. The rules describe the forms needed to register co-operative banks and report on their activities, the submission process and the period within which these forms should be submitted.

In December 2008 the Competition Commission released its full *Technical Report* of the Banking Inquiry, following the executive overview report in June. The report supported the initial concerns about access to the payment system and high charges levied by banks for certain types of payment transactions. It also made recommendations that were aimed at addressing these concerns.

In the realm of bourses the developments in the South African financial environment include increased access to investment opportunities on the African continent, modernisation of market infrastructure, new product offerings and a major institutional change.

Access to investment opportunities on the African continent was increased, firstly, when the JSE Limited (JSE) together with the FTSE Group introduced the FTSE/JSE All-Africa 40, and the FTSE/JSE All-Africa ex South Africa 30 indices in 2008; and, secondly, when the JSE launched the Africa Board in February 2009, offering listings to companies domiciled or with the largest part of their activities in Africa.

Financial market infrastructure was modernised through the replacement by the JSE of its 15-year-old derivatives system with a multiple instrument online trading system in 2008. The Bond Exchange of South Africa Limited (BESA), in partnership with NASDAQ OMX, also established a new central counterparty clearing house 'BondClear' in 2008, with licensing pending.

Exchanges extended their various product offerings. BESA launched a joint venture online binary options exchange in 2008 for options on interest rates, economic releases, South African shares, foreign-exchange contracts, commodities, foreign indices, and foreign indicators. The equity product offerings of the JSE's Equity Derivatives Division (Safex) was broadened with the introduction not only of futures and options on the Mini Alsi (ALMI) in June 2008, encouraging retail investor participation, but also of international derivatives (IDX) in November 2008, affording South African participants exposure to international shares not listed on the JSE. The derivative product range of the JSE's Agricultural Products Division was expanded in January 2009 to include cash-settled maize futures on the Chicago Board of Trade.

A major institutional change – the acquisition of BESA by the JSE – was initiated in 2008. The shareholders of BESA approved the deal in February 2009 and the competition authorities approved the merger in June 2009, followed by the official merger on 22 June.[3] The consolidation will enhance international competitiveness and the South African market for interest rate-related products.

3 Notwithstanding the merger under the name of the JSE, discussions of the bond market still refer to BESA and that of the equity market to the JSE.

In the realm of non-bank financial institutions a new overarching association was established, long-term insurer regulation was enacted and is in progress, while a regulatory framework for the micro-insurance industry and enhanced retirement fund mobility are under consideration.

The Association of Savings and Investment South Africa (ASISA) was established in October 2008, incorporating the Association of Collective Investment (ACI), Investment Management Association of South Africa (IMASA), Linked Investment Service Providers Association (LISPA), and the Life Office Association (LOA). In the case of long-term insurers, new regulations on commission and early termination values were gazetted in 2008, and as from 31 December 2008, their capital-adequacy requirement should reflect provisions for operational and credit risk in line with a guidance note of the Actuarial Society of South Africa.

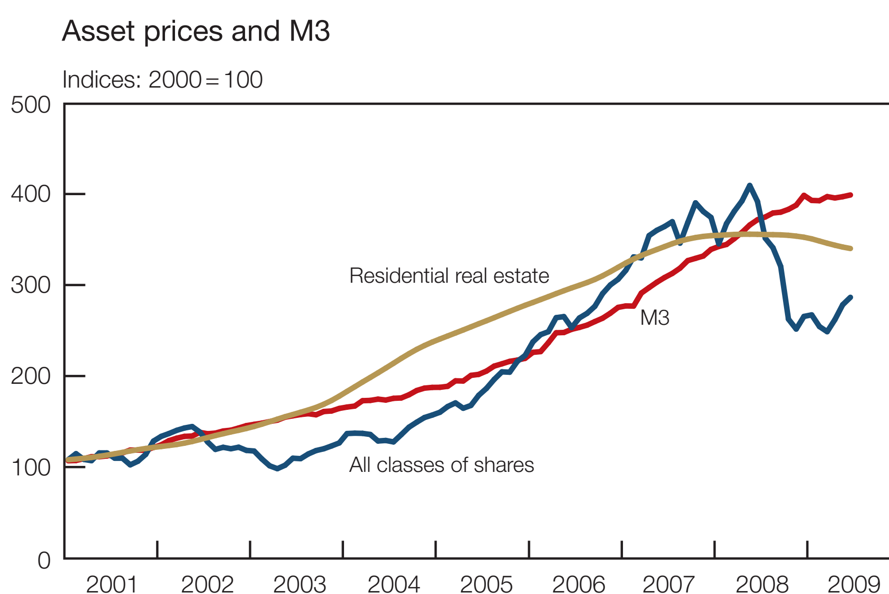
The National Treasury tabled the Insurance Laws Amendment Bill to address regulatory loopholes, among other things, drawing a clear distinction between health insurance and medical schemes, and regulating the appointment and duties of auditors. In April

2008, the National Treasury released a discussion paper on the regulatory framework of the micro-insurance industry. It is intended to encourage low-cost products for low-income consumers. The Taxation Amendment Bill 2008 proposed a distinction between pension and provident preservation funds to provide for transferability and choice when preserving retirement savings.

Money supply

The deceleration in the growth in the broadly defined money supply (M3) continued in the twelve months to June 2009. The persistent deceleration in monetary expansion was partly a reflection of the declining income growth, shrinking household wealth stemming from a decrease in residential estate prices and sharp losses in the value of financial assets, and the prevailing tight credit conditions.

Asset prices and M3



Both the household and corporate sectors restrained their holdings of monetary assets during the period under review. The marked decline in domestic interest rates from December 2008 and tentative signs of an improvement in global risk appetite in early 2009 reduced the attractiveness of monetary deposits relative to other financial assets.

As reflected in the accompanying table, the main counterpart of change in the broad money supply in 2008 was banks' claims on the private sector, despite the slowdown in the demand for credit. In the first half of 2009 the main counterpart to the much smaller increase in M3 was net foreign assets.

Counterparts of change in M3

R billions

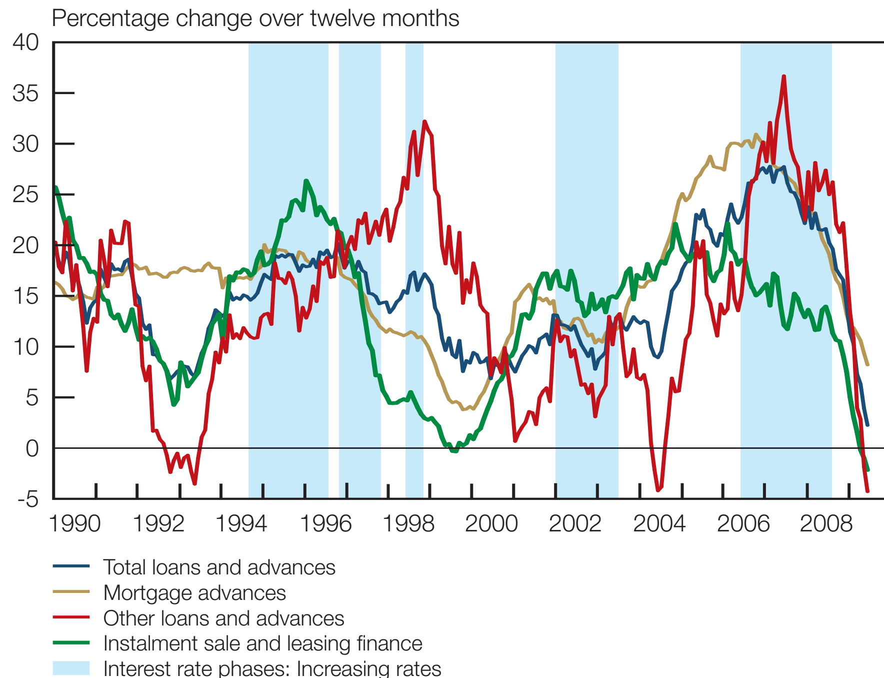
	2007	2008	Six months to June 2009
Net foreign assets	12	-15	28
Net claims on the government sector	-3	77	1
Claims on the private sector	309	237	6
Net other assets and liabilities	0	-53	-14
Total change in M3	**318**	**246**	**21**

Credit extension

Growth in total loans and advances extended to the private sector slowed noticeably throughout 2008 and slipped to near-record lows in early 2009. In the main, the combined effect of high borrowing costs emanating from the lagged effect of the tighter monetary policy stance phased in from June 2006, and strict credit conditions introduced by the banks during 2008 forced both the household and corporate sectors to scale down and postpone their borrowing requirements.

All categories of total loans and advances decelerated in the twelve months to June 2009, as shown in the accompanying graph.

Growth in the main categories of loans and advances



A breakdown of total loans and advances by category and sector is presented in the accompanying table.

Credit aggregates

Component	June 2008 R billions	June 2009 R billions	Change Per cent
Mortgage advances	909	983	8,2
Instalment sale credit and leasing	248	243	-2,2
Of which: New passenger cars	73	67	-8,2
Other passenger cars	59	63	5,9
Other assets financed	116	113	-2,6
Other loans and advances	662	633	-4,3
Overdrafts	158	137	-13,4
Credit card advances	57	56	-1,8
General advances	447	440	-1,4
Total loans and advances	**1 819**	**1 860**	**2,2**
Of which: To household sector	968	1 012	4,6
To corporate sector	851	848	-0,4

Mortgage advances, which comprise about 52 per cent of total loans and advances, contributed R74,5 billion to the overall increase in total loans and advances over the twelve months to June 2009. Growth over twelve months in this credit category trended lower as stricter lending criteria and higher deposit requirements by the banking sector continued to dampen mortgage business, especially residential mortgages.

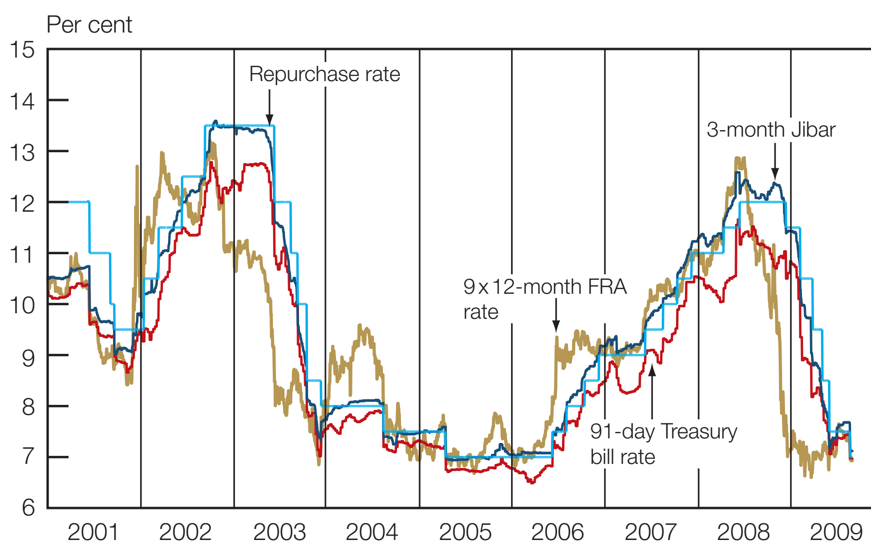
Instalment sale credit and leasing finance contributed negatively to overall growth in total loans and advances in the twelve months to June 2009 as the demand for motor vehicles and other durable goods remained under severe pressure.

Other loans and advances contracted by R28,4 billion in the twelve months to June 2009. The downturn in the business cycle, combined with the higher cost of finance, exerted downward pressure on corporate demand for bank credit. Consequently, the twelve-month growth rate in credit extension to the corporate sector approached levels close to zero in the first half of 2009.

Interest rates and yields

A cycle of easing in monetary policy started in December 2008 when the MPC reduced the repurchase rate by 50 basis points. At each of its four subsequent meetings the MPC decided on a further 100 basis point reduction. Several factors, including the widening output gap and weaker domestic demand emanating from deterioration in the global and domestic economy, pointed to improvement in the medium-term outlook for inflation and were cited as reasons for the rapid policy rate reductions. Frequent policy review was facilitated by the decision in March 2009 to change the frequency of the meetings in 2009 from bimonthly to monthly, excluding July 2009, in order to monitor and respond appropriately to the rapidly changing economic environment. The repurchase rate was left unchanged at 7,50 per cent at the conclusion of the June 2009 MPC meeting, as the risks posed by various cost-push and exogenous factors were perceived to be too high to justify further easing of monetary policy. At its August meeting the MPC reduced the repurchase rate by a further 50 basis points as more recent data suggested a softening of some of the risks to the inflation outlook. This brought the cumulative decrease from the earlier peak in interest rates to 500 basis points.

The interbank lending rates, such as the South African Benchmark Overnight Rate (Sabor) on deposits and the implied rate on one-day rand funding in the foreign-



exchange swap market (overnight FX rate), followed the movements in the repurchase rate. However, the strong demand for foreign-exchange funding as a result of the unprecedented stress in the financial markets exacerbated pressures on the overnight FX rate, resulting in occasional sharp but short-lived increases. Nevertheless, both the Sabor and overnight FX rates fluctuated within reasonable limits, reflecting a well-functioning and efficient interbank market.

In the twelve months to June 2009, growing market expectations of repurchase rate reductions and the successive lowering of the rate triggered a pronounced decline in other money-market interest rates to levels previously recorded in early 2006. Rates on forward rate agreements (FRAs) trended lower across their maturity spectrum as inflation pressures eased.

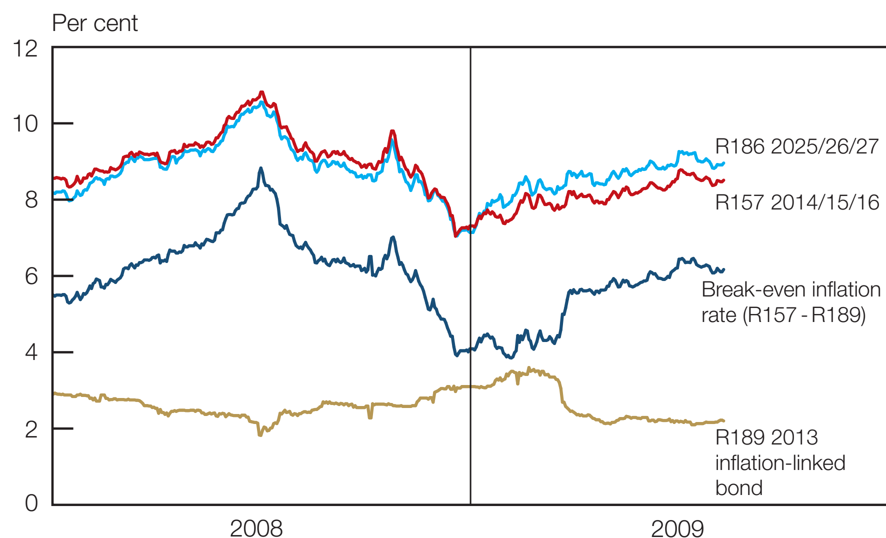
4 RSA government retail bonds are priced off the government bond yield curve on a monthly basis.

5 RSA government retail inflation-linked bonds are priced off the government bond yield curve on a semi-annual basis.

In step with the overall downward trend in bond yields, the nominal interest rates on RSA government fixed-rate retail bonds[4] of 2-, 3- and 5-year maturities declined by between 125 and 150 basis points from a recent high in August 2008 to August 2009. Real returns on inflation-linked[5] RSA government retail bonds ranged from 2,25 per cent to 2,75 per cent for the 3-year and 10-year maturities after the latest reset in June 2009.

From a most recent high of 10,82 per cent on 1 July 2008, the nominal yield on the R157 conventional RSA government bond trended lower, but this movement was temporarily stalled in October in response to the then escalating international financial crisis, before continuing to a low of 7,04 per cent on 18 December. The onset of the bullish trend in bond prices began after a period of relative stability in the exchange value of the rand and as measured inflation reached a peak and then decelerated, feeding into expectations of lower future inflation. The disinflation was discounted in the break-even inflation rate at the 4-year maturity range, which more than halved as it declined by 488 basis points to 3,95 per cent over the same period.

Government bond yields and break-even inflation



Towards year-end the downward trend changed and the yield on the R157 bond fluctuated along an upward trajectory to 8,51 per cent on 11 August 2009. The yield on the longer-dated R186 bond increased even more. The bearish trend in bond prices from mid-December 2008 was the net outcome of partly offsetting forces.

Lower bond prices were supported by the high level of actual issuance and expectations of an increased future supply of government bonds, the depreciation of the exchange value of the rand to middle-March 2009, and higher expected inflation as reflected by the increase of 222 basis points in the break-even inflation rate from December 2008 to 11 August 2009. Bond prices declined despite the widening of the output gap as South Africa's real economic growth at first decelerated and then turned negative.

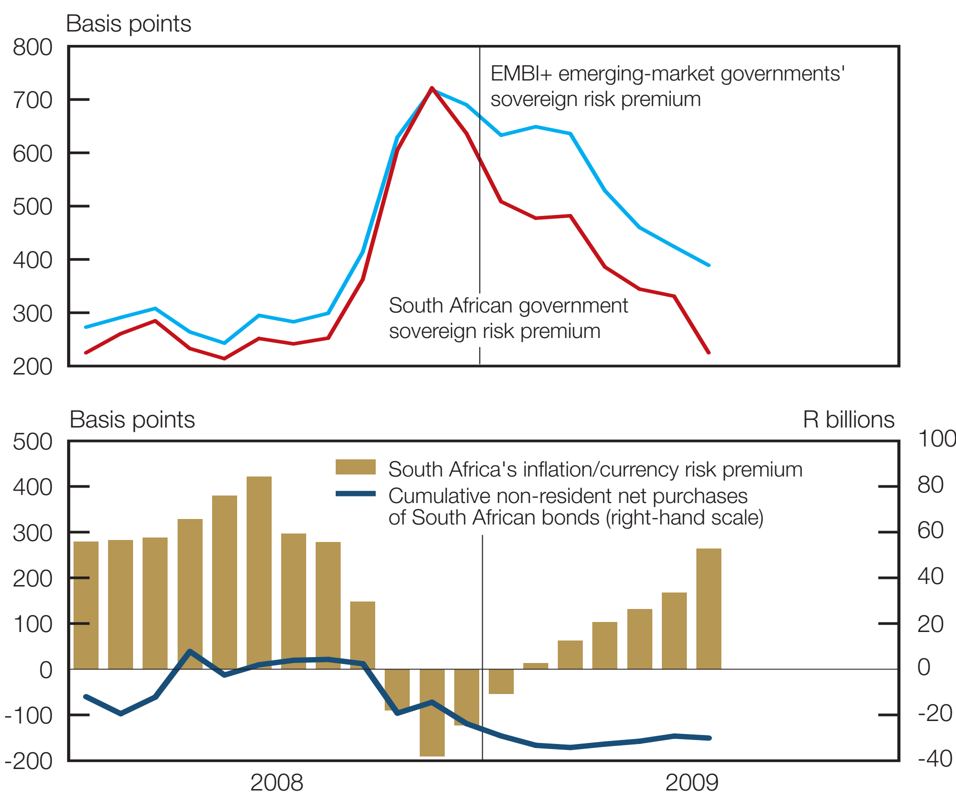
The markets' assessment of expected inflation and the monetary policy interest rate are encapsulated in the yield gap[6] and real yields. The decline in bond yields began in mid-2008 and the yield curve inverted to a negative gap of 339 basis points in January 2009. The yield gap then narrowed significantly and turned positive in May, as the Bank lowered the repurchase rate further and bond prices decreased. The real yield on the R189 inflation-linked government bond increased from a low of 1,82 per cent on 1 July 2008 to a high of 3,60 per cent on 20 February 2009, before receding sharply to 2,20 per cent on 11 August. The market-determined real yields on inflation-linked bonds were in excess of the real yield on nominal bonds adjusted for CPI headline inflation, which recorded negative real returns from February 2008 to April 2009. This divergence indicates that the market for nominal bonds priced in markedly lower future inflation relative to actual observed inflation.

6 The yield gap is calculated as the difference between the yields on the R157 bond and 91-day Treasury bills and is equivalent in both nominal and real terms.

The sovereign risk premium[7] on US dollar-denominated South African government bonds reflected the impact of the international financial crisis and the concomitant re-pricing of risk. Since August 2008, the spread increased by 480 basis points to 722 basis points in November, in tandem with that of other emerging markets as the

7 The sovereign risk premium is calculated as the difference between South African government offshore US dollar-denominated bonds with an outstanding maturity of eight years and US government dollar-denominated bonds of broadly similar maturity.

Yield spreads above US Treasuries and non-resident net purchases of bonds



yields on South African government debt increased while that of the US Treasuries fell. Since then emerging-market offshore sovereign risk spreads contracted, and South Africa gained ground relative to other emerging markets as measured by the EMBI+[8].

8 EMBI+ is a measure of the yield spread of external US dollar-denominated bonds of emerging-market governments as measured by the JPMorgan Emerging Markets Bond Index Plus over US Treasuries.

The relative changes in offshore sovereign spreads, yields on US Treasuries, and the yields on domestic rand-denominated government bonds impacted the inflation/currency risk premium[9]. This spread turned negative from October 2008 to January 2009 as South African rand-denominated bond yields did not price in the deterioration in sovereign risk and coincided with the lagged response to relative rand strength in the latter part of 2007.

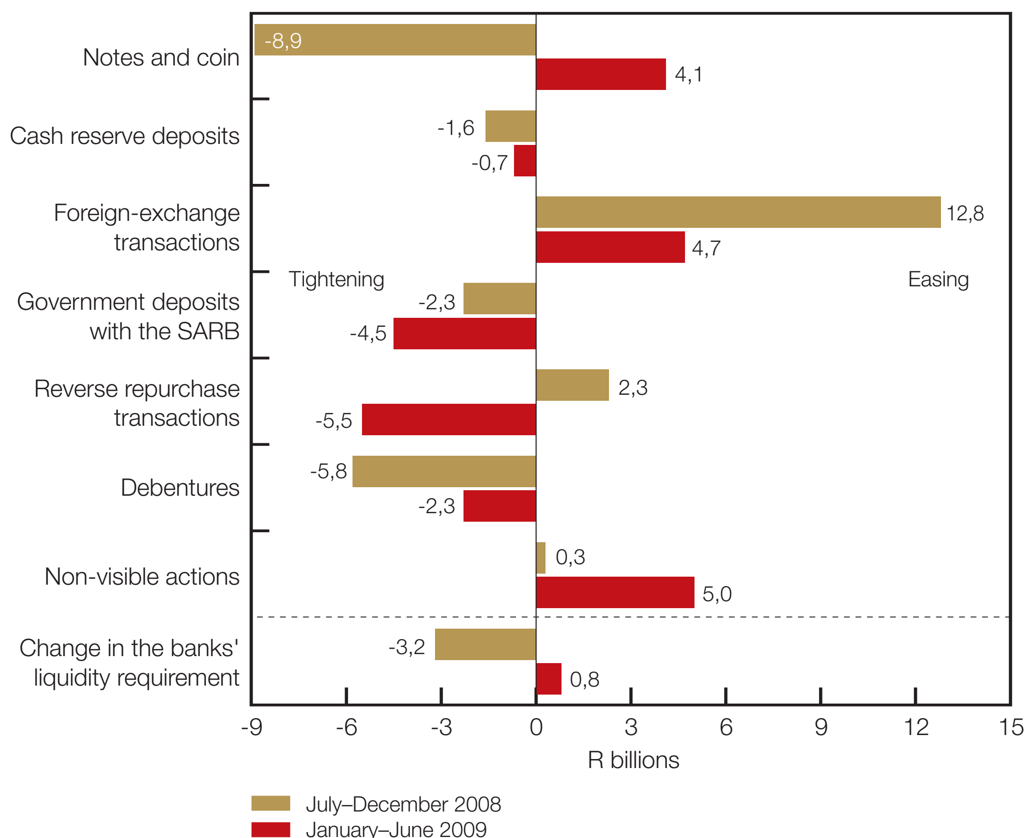
9 The inflation/currency risk premium on South African government bonds is calculated as the difference between the yields on domestic rand- and offshore US dollar-denominated debt in the 6-to-8-year maturity range.

Money market

Money-market conditions remained generally stable over the past twelve months, with no liquidity strains emerging in South Africa. The average daily liquidity requirement of the private-sector banks fluctuated within a broad range of R6,6 billion to R15,5 billion during the period under review, while the liquidity provided by the Bank at the weekly main refinancing auctions varied between R8,0 billion and R14,0 billion over the same period.

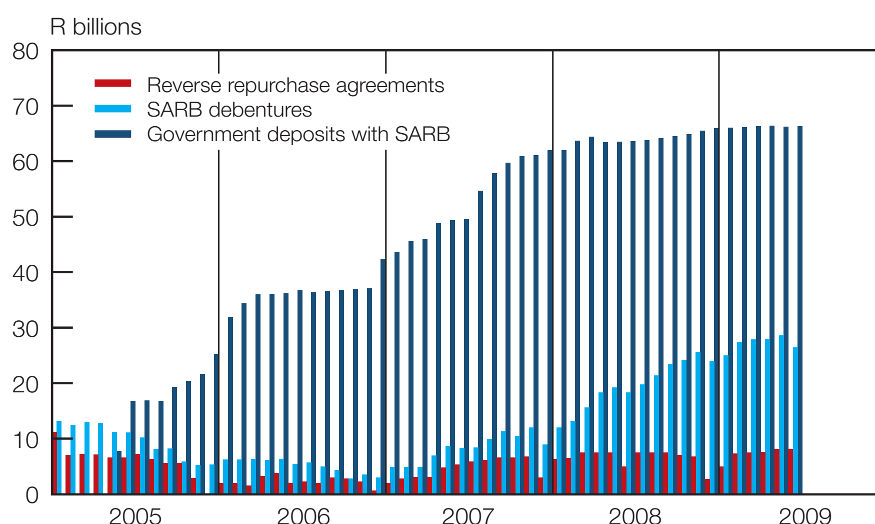
Banks utilised their cash reserve accounts and, on occasion, the standing facilities and supplementary repurchase transactions to accommodate daily liquidity fluctuations. The statistical counterparts influencing money-market liquidity over the period under review are depicted in the graph below.

In the twelve months to June 2009, an increase in notes and coin in circulation drained liquidity from the money market. This tightening in liquidity conditions was



more than fully counteracted by the substantial injection of R17,5 billion worth of liquidity resulting from the purchase by the Bank of foreign currency for reserves accumulation purposes. The proceeds from the creaming-off operations were also used to reduce bilateral foreign borrowing of the Bank by US$350 million during the period under review.

The use of liquidity-draining instruments, particularly SARB debentures and reverse repurchase transactions, was stepped up during the period under review. This increase, alongside an increase in government deposits with the Bank, largely neutralised the substantial easing in liquidity stemming from foreign-exchange transactions.

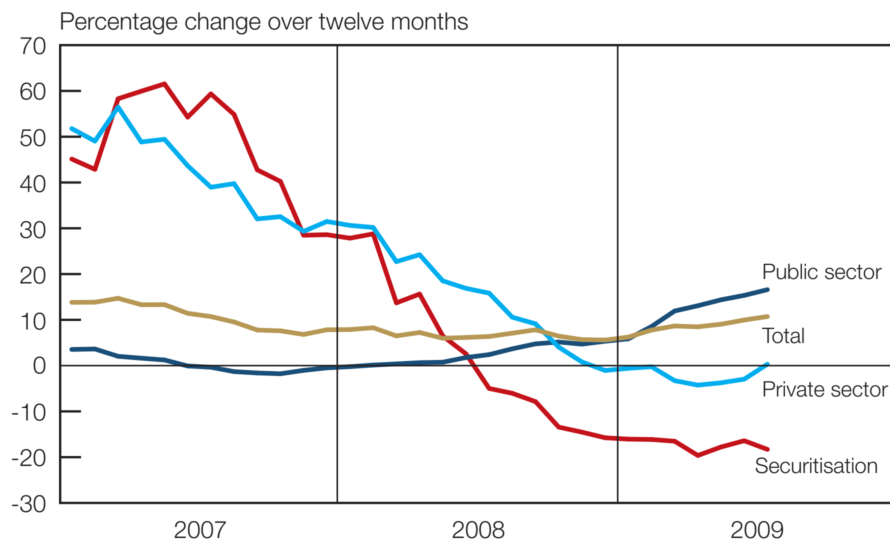


Government tax and loan accounts, representing cash balances with private banks, were increased substantially between July and December 2008, in preparation for capital redemption and coupon interest payments on various government bonds. The main redemption payment was for the final tranche of the R194 government bond – the R196 – in the amount of R18,7 billion in February 2009.

Bond market

The total outstanding nominal value of bonds listed on BESA amounted to R869,5 billion in July 2009, or 11 per cent more than a year earlier. Notable structural changes in the domestic market were evident as from July 2008 when the rate of change over twelve months in the money value of securitisations in issue turned negative and as from October 2008 when momentum underlying the increase in listed domestic debt securities began to shift from the private to the public sector. These trends were in line with global developments, as securitisation lost its appeal and as the public sector increasingly accessed capital markets for funding.

Central government securities in issue increased by R28,5 billion in the first seven months of 2009, compared with R9,6 billion in 2008 as a whole – along with the structural change in government's fiscal position from a budget surplus to a deficit. Domestic funding was supplemented when the National Treasury raised a net amount of R7,1 billion in the international bond markets in May 2009 – part of the R12,3 billion net proceeds from the issuance of a US$1,5 billion ten-year bond was offset by the redemption of a US dollar-denominated bond.



The infrastructure drive was reflected in public corporation securities in issue, which increased by R22,2 billion in the first seven months of 2009, compared with R13,5 billion in 2008 as a whole. By contrast, the slowdown in economic activity was mirrored in the decline of R2,3 billion in private-sector securities in issue in 2008 and an increase of R10,8 billion in the first seven months of 2009.

10 The liquidity ratio is calculated as the nominal value of bonds traded per annum divided by the nominal value of listed bonds.

The value of transactions in the secondary bond market on BESA amounted to a record high R21,3 trillion in 2008, or 31 per cent more than in 2007. Investor response to the drivers of bond prices in the aftermath of the turmoil in international debt markets was reflected in subdued turnover of only R8,9 trillion in the first seven months of 2009. The daily average value traded declined to R60,9 billion in the first seven months of 2009, compared with R84,6 billion in 2008. This led to a decline in the liquidity ratio[10] from 23 in 2008 to an annualised 16 in the first seven months of 2009.

11 Non-resident participation is calculated as non-residents' purchases and sales as a percentage of total purchases and sales.

Non-resident participation[11] in the secondary bond market receded from 13 per cent in 2008 to an average of 12 per cent in the first seven months of 2009. Non-resident risk aversion intensified during the period under review with net sales of bonds amounting to R23,8 billion in 2008, the bulk of it concentrated in the final four months of the year when uncertainty in global markets reached a peak. Net sales of R6,3 billion were registered in the first seven months of 2009. Offshore, the issuance of rand-denominated bonds in the European and Japanese Uridashi markets by non-resident issuers dwindled. Such net issues declined from respectively R20,5 billion and R6,6 billion in the Uridashi and European markets in 2008 to R5,0 billion and net redemptions of R8,7 billion in the first seven months of 2009.

Share market

The total value of equity capital raised in the primary share market by companies listed on the JSE amounted to a subdued R76,7 billion in 2008 – of which R49,4 billion was raised in the first half of the year. Funding slowed in the second half of 2008 in response to the weakness in economic activity and heightened volatility in share markets. Subsequently, some R76,7 billion was raised in the first seven months of 2009, as international financial markets settled down and global economic prospects improved. However, the contribution of companies with *primary* listings on the JSE amounted to only R32,6 billion in the first seven months of 2009.

The total number of listed companies on all boards of the JSE decreased from 424 in July 2008 to 415 in July 2009, with those on the main and development/venture capital boards respectively decreasing by 7 and 2, while new and delistings on Alt^{x} netted out. However, turnover on Alt^{x} as a percentage of total turnover on the JSE declined from 0,22 per cent in June 2008 to 0,06 per cent in July 2009. The value of turnover on the JSE as a whole increased by 9 per cent from 2007 to R3,3 trillion in 2008. Turnover peaked at R346,3 billion in October 2008 and, as the international financial crisis unfolded, it fell to an average of R220,9 billion per month in the first seven months of 2009. Declining share prices contributed to the sharp fall in the market capitalisation of the JSE of 16 per cent from an all-time high of R6,3 trillion in May 2008 to R5,2 trillion in July 2009. The trends in market capitalisation and turnover caused the annualised liquidity ratio[12] to recede from a peak of 94 per cent in October 2008 to 54 per cent in July 2009, close to monthly levels of the past two years.

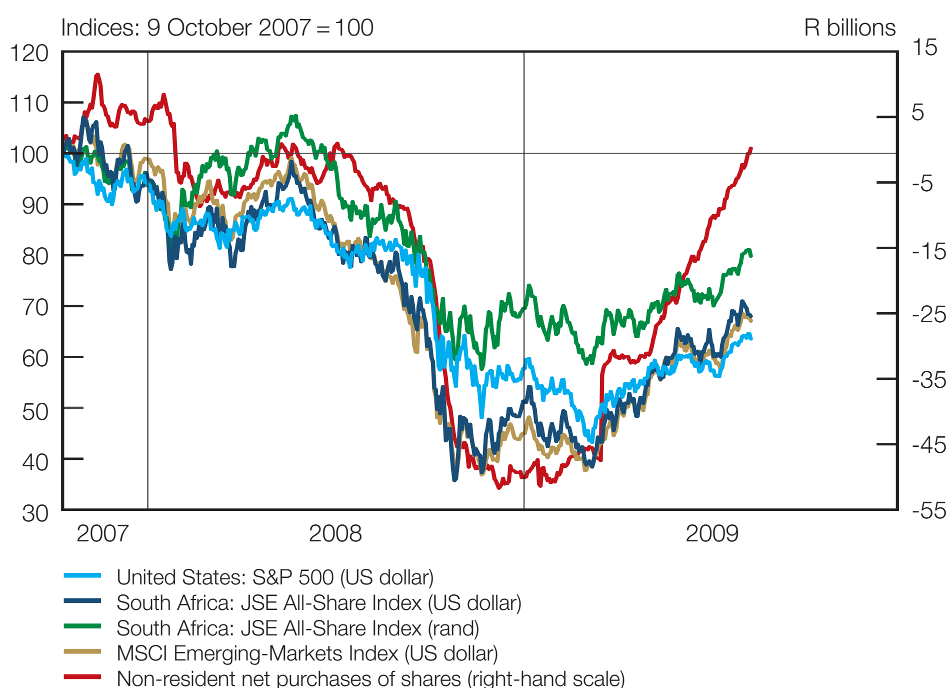
12 The liquidity ratio on the JSE is calculated as annualised monthly secondary market turnover of shares as a percentage of market capitalisation.

The financial market problems in the US developed into a global financial crisis and spilt over into a global synchronised recession, the impact of which was evident from the correlated declines, in US dollar terms, in global share prices. The S&P 500 composite index fell by 57 per cent from a high point on 9 October 2007 to a most recent low on 9 March 2009, compared with a decline of 62 per cent in the MSCI Emerging-Markets[13] and FTSE/JSE All-Share Price (Alsi) indices. Subsequently the financial market panic started to abate to some degree in response to central bank and fiscal interventions. A fair measure of confidence returned as reflected by an increase in share prices despite the unfolding adverse real economic impact. As at the end of July 2009, the S&P 500 was 37 per cent below its peak in October 2007 – an improvement of 46 per cent when compared with 9 March 2009.

13 The MSCI Emerging-Markets Index is calculated by Morgan Stanley.

The pass-through of the weaker global share market conditions to share prices on the JSE, as reflected by the Alsi, was moderated by the depreciation in the exchange value of the rand. In rand terms, the Alsi fell by 46 per cent from an all-time high on 22 May 2008

Share prices and non-resident cumulative net purchases of shares on the JSE Limited



to a recent low on 20 November, before recovering by 39 per cent to 11 August 2009. This recovery benefited from international developments and the decline in domestic interest rates due to the improvement in the medium-term outlook for inflation and the widening output gap.

Global financial and real economic developments impacted non-resident investor sentiment and led to heightened aversion to risk. Uninterrupted monthly net purchases of shares by non-residents on the JSE in 2007 were arrested in September 2007. In tandem with the decline in share prices, net sales of shares accumulated to a net amount of R51,7 billion in the period 9 October 2007 to 8 December 2008. Non-resident investors then slowly returned as net purchasers, particularly in March 2009 and again since May, as sentiment improved and risk appetite increased. Net purchases of R63,3 billion in 2007 reverted to net sales of R54,4 billion in 2008 – again followed by net purchases of R46,8 billion in the first seven months of 2009. This resulted in an average participation rate of 19 per cent.

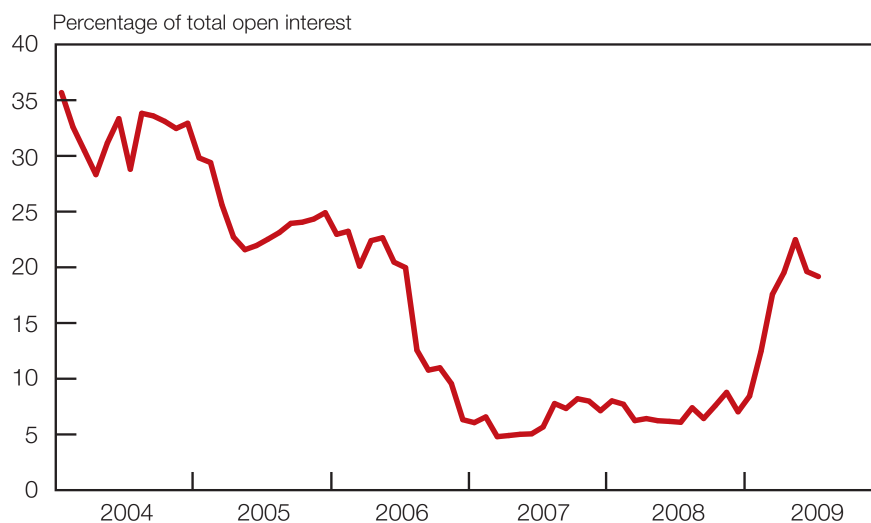
The decline in share prices contributed to an increase in the dividend yield on all classes of shares from an average level of 2,7 per cent in the first nine months of 2008 to 4,2 per cent from October 2008 to July 2009. The earnings yield was influenced by both share price movements and company earnings. This yield increased from a low of 6,1 per cent in May 2008 to a high of 11,8 per cent in February 2009, before falling back to 8,5 per cent in July. The price-earnings ratio, as the inverse of the earnings yield, consequently declined from a high of 16,3 in May 2008 to a low of 8,4 in February 2009, and subsequently increased to 11,8 in July.

Market for exchange-traded derivatives

14 Non-resident exposure in the market for exchange-traded derivatives on the JSE is calculated as the number of non-residents' open interest contacts as a percentage of the total open interest contracts at month-end.

The derivatives market tracked the changes in sentiment and price trends in the underlying securities. The total value of futures and options on futures contracts traded on the Equity Derivatives Division of the JSE declined from the second quarter of 2008, and was 50 per cent lower in the first seven months of 2009 when compared with the corresponding period of 2008. By contrast, non-resident exposure[14], in terms of open contracts, increased sharply from an average of just less than 7 per cent in 2007 and 2008 to a recent high of 22 per cent in May 2009.

Non-resident open interest in the market for exchange-traded derivatives on the JSE Limited



The number of warrants traded on the JSE increased from the third quarter of 2008 and was 8 per cent higher in the first seven months of 2009 when compared with the same period in 2008.

Currency futures dominated trade on the JSE's Yield-X and trading activity was influenced by movements in interest rates and particularly changes in relative currency values. The number of contracts traded increased 23,5 times from 2007 to 2008, and amounted to 4,5 million in the first seven months of 2009.

Maize and wheat futures contracts dominated trade in agricultural derivates on the Agricultural Products Division of the JSE, and activity levels reflected the change from a bullish to a bearish trend in commodity prices. The number of agricultural futures and options contracts traded increased by 10 per cent from 2007 to 2008, but subsequently declined by 35 per cent in the first seven months of 2009 in comparison with the same period of 2008.

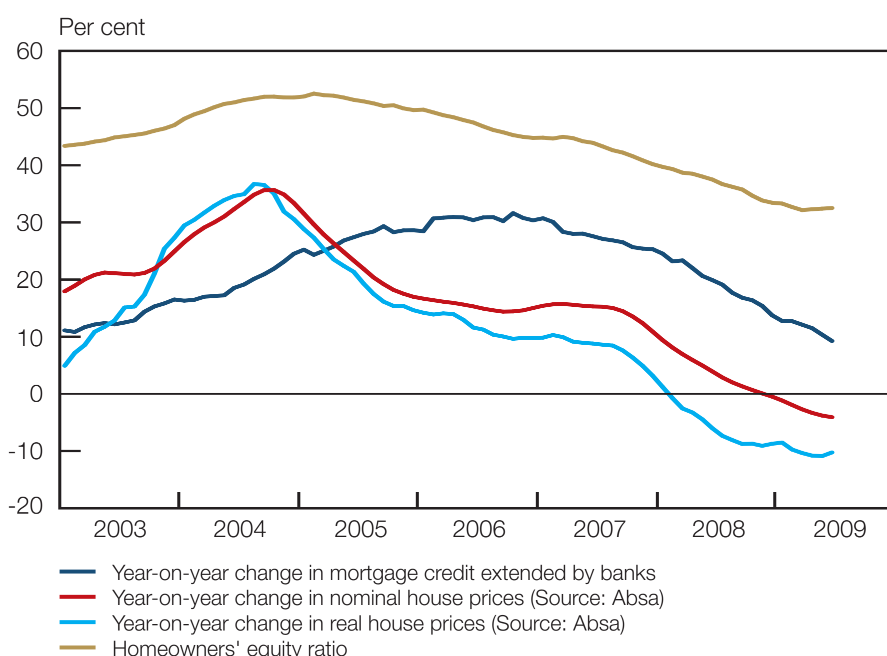
Real-estate market

In the real-estate market, the slower pace of increase in average house prices made way for declining prices during the period under review. Real[15] twelve-month declines in house prices were recorded from February 2008, followed by nominal declines from December 2008.

15 Real house prices are calculated as Absa's monthly average nominal house prices deflated by CPI headline inflation.

The bearish trend in house prices was brought about by a deterioration in affordability due to the relatively high level of house prices, interest rate developments, the level of household indebtedness, and greater reluctance on the part of banks to lend coinciding with the onset of recessionary conditions. The value of households' total assets declined as price developments dampened growth in the market value of residential property, and as financial assets were repriced consequent to the financial market crisis. Accordingly, the ratio of real-estate assets to total assets in the twelve months to June 2009 increased by only 2 percentage points to 26 per cent.

House prices and mortgages



The deceleration in the year-on-year rate of increase in mortgage credit extended by the banking sector reflected the lagged effect of turnover and price trends in the residential property market. Mortgage credit extended by banks on average accounted for 31 per cent of total bank assets and 49 per cent of total credit extended to the private sector in the twelve months to June 2009.

The deceleration and subsequent declines in house prices together with the continued slower growth in mortgage credit resulted in a ratio of outstanding mortgage debt to the market value of household residential property of 67 per cent in the second quarter of 2009, or inversely, real-estate homeowners' equity of only 33 per cent compared with high points of 52 per cent in 2004 and early 2005.

Non-bank financial institutions

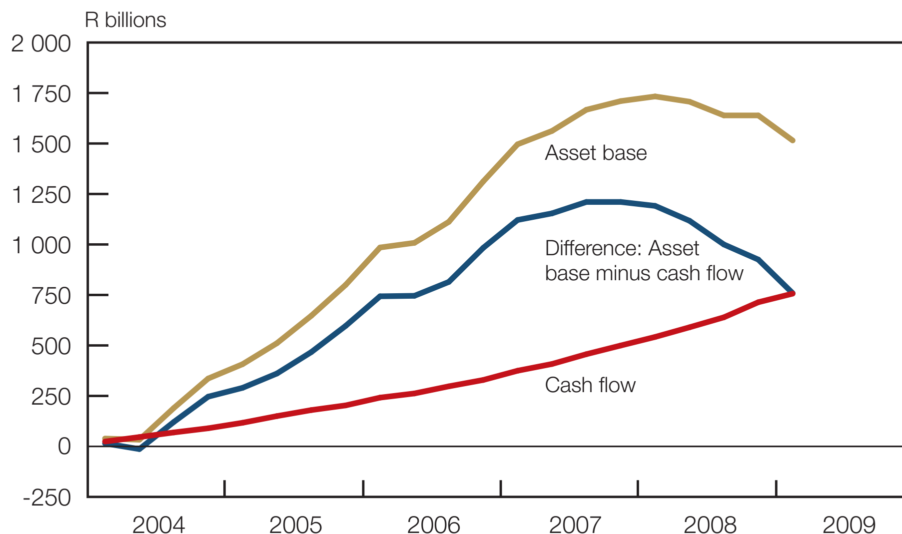
The asset base[16] of non-bank financial institutions[17] increased from R1 779 billion in the fourth quarter of 2003 to R3 294 billion in the first quarter of 2009. The cumulative change in asset holdings of R1 515 billion over the period comprises both new cash-flow injections[18] and the revaluation of asset holdings to current market prices.

The cumulative change in the asset base since the fourth quarter of 2003 peaked in the first quarter of 2008, while the inflow of cash to acquire new assets continued unabated, amounting to a cumulative total of R756,3 billion from the end of 2003 to the end of the first quarter of 2009. The gap between the cumulative change in the asset base and cumulative cash flow shows the impact of investing the cash flow and marking assets to market. This reflects the impact of the bearish trend in asset prices on asset values from the second quarter of 2008.

16 The asset base is the aggregate of the market value of all assets at quarter-ends as surveyed by the Bank.

17 Non-bank financial institutions include unit trusts, long-term insurers, short-term insurers, official pension and provident funds, and private self-administered pension and provident funds.

18 New cash-flow injections comprise net transactions in units of unit trusts and the domestic current income surplus of insurers and pension funds. The domestic current income surplus is calculated as investment income plus the net of current receipts and expenditure.



Public finance

Fiscal policy

The Minister of Finance tabled the 2009 Budget before Parliament on 11 February 2009, against the background of a deep and synchronised contraction in the world economy. In response to the adverse global environment, the Budget contained a series of policy measures to cushion the domestic economy, support living standards and activity levels, and establish a more robust platform for growth so that full advantage could be taken of any recovery in the world economy.

While considerable uncertainty remained regarding the depth and duration of the global slowdown, government's counter-cyclical fiscal policy was expected to support economic activity over the medium term through an accelerated public-sector investment programme, and increased expenditure on social and economic priorities. In order to emerge from the current recession stronger and globally more competitive, government, through its Budget, acknowledged the need for a credible medium-term framework anchored in fiscal sustainability. The central goals of economic policy remained firmly geared towards accelerating growth and job creation, broadening economic participation and reducing poverty. However, the challenge for government was to make progress in all these areas over the period ahead.

The minister anticipated that the economic slowdown would result in lower tax revenue, but, given the scope created by the relatively low ratio of government debt to gross domestic product and reduced debt-service costs on account of prudent policies in earlier years, added a significant amount to the main budget for non-interest expenditure. Higher spending and declining tax revenue in 2009/10 were expected to result in a budget deficit of 3,9 per cent of estimated gross domestic product. In time the economy was expected to recover, which would provide scope for a return to much lower deficits over the medium term.

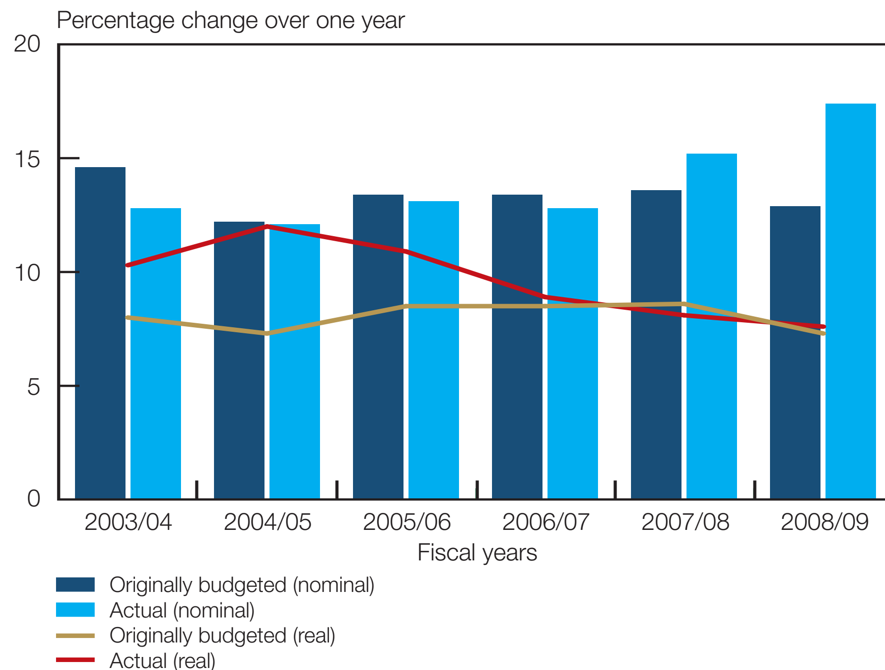
National government expenditure

Despite the economic slowdown and relatively high inflation environment, government continued to target spending areas that would contribute to long-term growth and development, such as physical infrastructure, labour-intensive employment programmes, social transfers to households and social services.

National government expenditure in fiscal 2008/09 exceeded the originally budgeted provision envisaged in the *Budget Review 2008* by R24,6 billion and amounted to R636 billion. In nominal terms this resulted in a year-on-year rate of increase of 17,4 per cent in fiscal 2008/09, which was well above the average increase of 13,7 per cent per annum over the preceding three fiscal years. During 2008/09 national government expenditure in *real terms*[19] increased by no less than 7,6 per cent – well above the country's trend rate of real economic growth.

19 Nominal value adjusted with CPI inflation for all urban areas.

National government expenditure relative to gross domestic product averaged 26,5 per cent during the three fiscal years to 2008/09 and was projected to average 29,4 per cent per annum over the three-year budget period.



Interest paid on national government debt increased by 2,8 per cent in fiscal 2008/09 when compared with the previous fiscal year, as government issued more Treasury bills and government bonds to finance the bigger deficit. As a ratio of gross domestic product, interest payments amounted to 2,3 per cent in fiscal 2008/09 and were expected to stabilise over the medium term. Growth in non-interest expenditure, mainly consisting of voted amounts to national departments and transfers to provincial governments, recorded a real growth rate of 9,2 per cent in fiscal 2008/09.

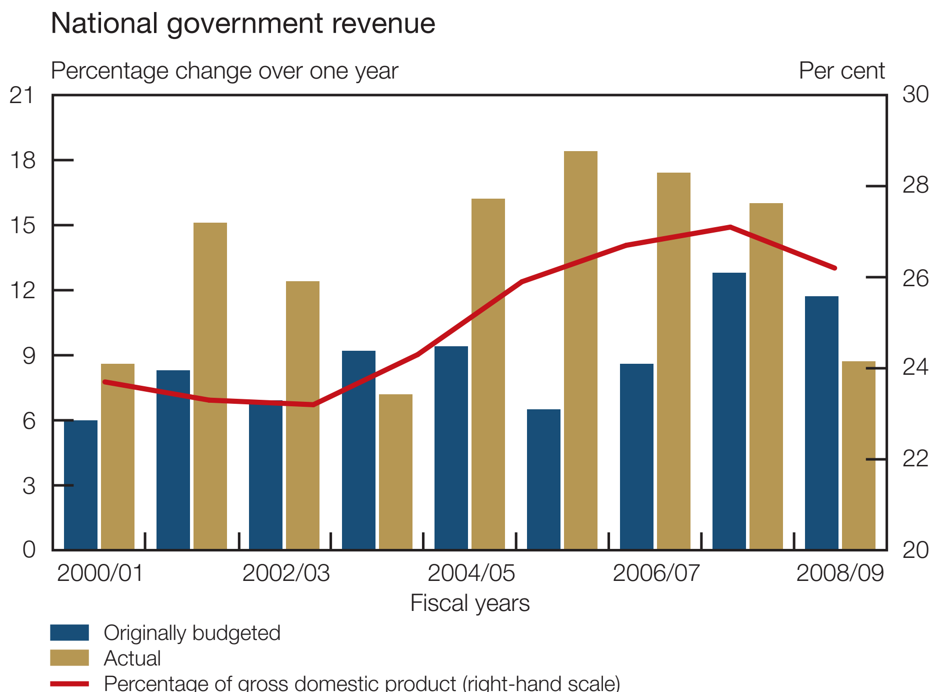
Payments for capital assets amounted to R9,0 billion in fiscal 2008/09, or 12,5 per cent higher when compared with the previous fiscal year. Strong growth in capital spending reflected government's commitment to supporting economic growth through infrastructure development. Although capital spending as a proportion of total national government spending remained relatively small, substantial infrastructure spending would be carried out by the other spheres of government and public corporations over the medium term. This would, in part, be facilitated by appropriate transfers, subsidies and debt guarantees from national government.

National government revenue

Alongside the slowdown in the global economy, South Africa experienced a contraction in domestic production on account of weak domestic demand and a significant decline in exports due to dwindling global demand. The spill-over effects of the recessionary conditions were also evident in the collection of national government revenue, especially in the latter half of fiscal 2008/09.

The *Statement of National Revenue, Expenditure and Borrowing* indicated that unaudited revenue increased at a year-on-year rate of 8,7 per cent and amounted to R608 billion in fiscal 2008/09. This rate of increase was lower than originally envisaged in both the 2008 and 2009 *Budget Reviews*, and barely half the rate of increase

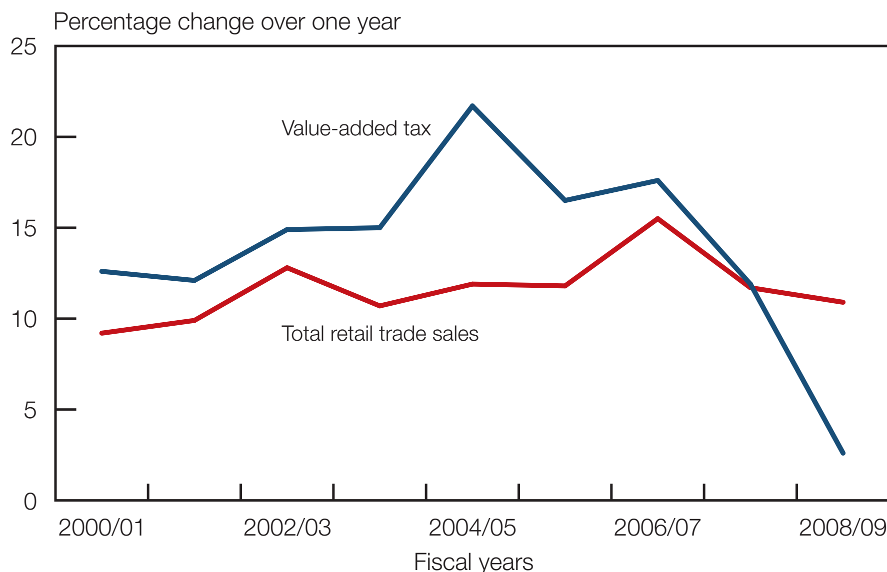
recorded in fiscal 2007/08. It was the first time since fiscal 2003/04 that the actual revenue outcome had fallen short of budgeted projections.



Notwithstanding the global financial crisis, solid collections from taxes on income, profits and capital gains underpinned growth in national government revenue in fiscal 2008/09.

Owing to time lags between realised company profits and the associated corporate income tax payments, corporate income tax remained fairly resilient despite the current weaker economic conditions and exceeded the original *Budget Review 2008* projections. Personal income tax collections responded with a shorter lag to the pressures on personal income levels, and receipts were below the budgeted estimates due to job losses and lower bonuses being paid out.

Consumer spending and value-added tax collections

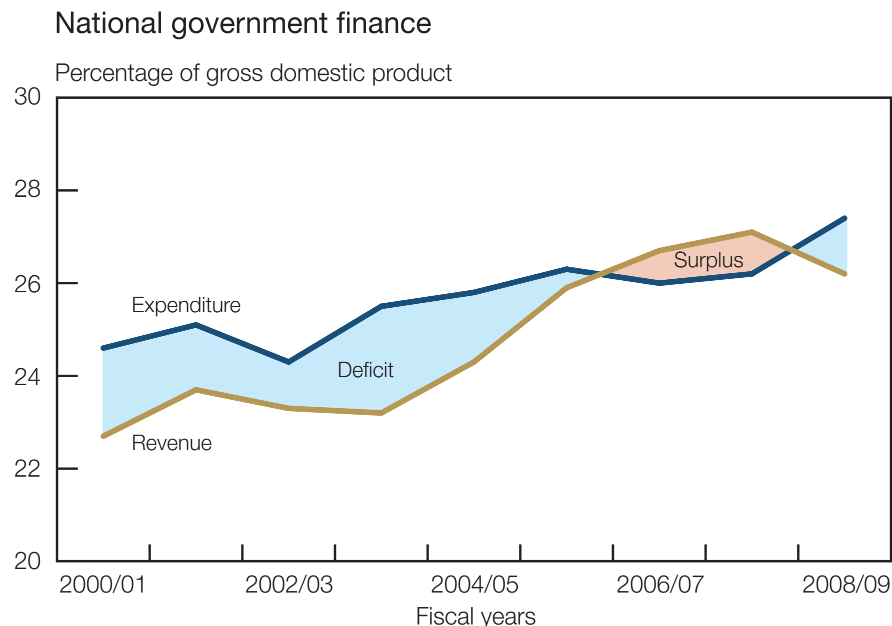


In fiscal 2008/09 taxes on property declined due to a substantial contraction in activity in the real-estate market. This was in contrast to the buoyant property market in previous years.

Domestic taxes on goods and services increased moderately with all categories recording below-budgeted growth rates. In the main sub-category, growth in value-added tax was substantially below budgeted expectations, indicative of subdued economic conditions. Taxes on international trade and transactions contracted markedly in fiscal 2008/09, with revenue from customs duties decreasing alongside declining imports due to a slowdown in domestic demand.

National government deficit

Weaker growth in national government revenue and higher-than-budgeted expenditure resulted in a cash-book *deficit* before borrowing and debt repayment of R27,3 billion in fiscal 2008/09. The current outcome was in stark contrast to the cash-book *surpluses* recorded in the previous two fiscal years. In absolute terms the 2008/09 deficit was the fifth largest ever recorded – the largest deficit of R31,5 billion was recorded in fiscal 1996/97. As a ratio of gross domestic product, the deficit for fiscal 2008/09 amounted to 1,2 per cent, in contrast to a surplus ratio of 0,9 per cent recorded a year earlier.

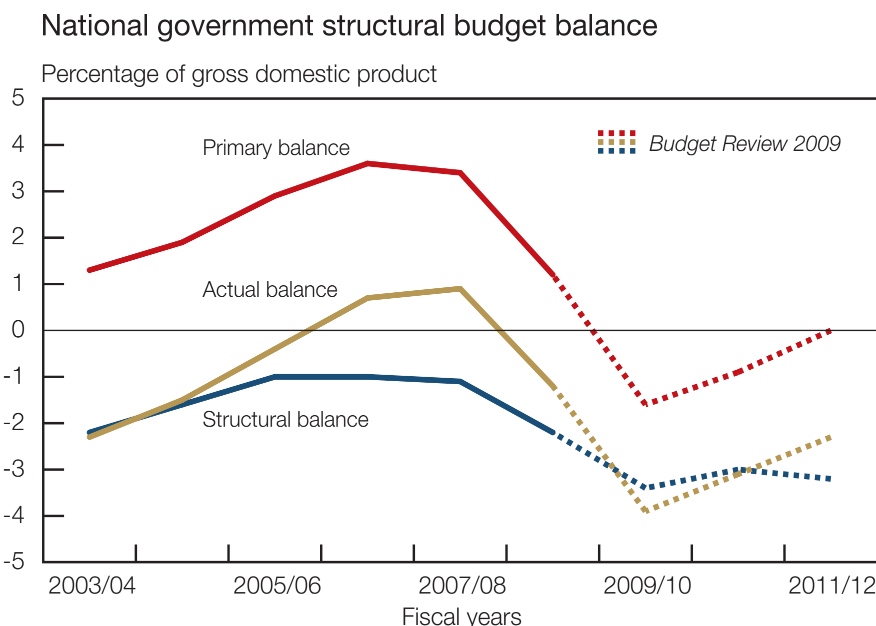


Even though government positioned itself to pursue a more expansionary fiscal policy approach with resultant rising deficits, it was envisaged that the deficit would be maintained at an average level of about 3 per cent of gross domestic product over the medium term. It is expected that, as the economy recovers, growth in revenue would recover and, together with relatively slower growth in public spending, government borrowing would retreat and savings would improve over the medium term.

The change in the underlying fiscal balance does not only reflect discretionary fiscal measures, but also the dissipation of exceptional receipts as the high and rising

commodity prices and profitability of previous years retracted. The estimated structural balance[20] points to an average deficit of 3,2 per cent of gross domestic product over the medium term.

20 Budget balance adjusted for cyclical revenue and expenditure, introduced in the October 2007 *Medium Term Budget Policy Statement*.



The primary balance[21] as a key indicator of sustainability in the public finance arena, reached a surplus of 1,2 per cent of gross domestic product in fiscal 2008/09, compared with a surplus of 3,4 per cent recorded in the previous fiscal year. The *Budget Review 2009* provided for a primary deficit of 1,6 per cent of gross domestic product in fiscal 2009/10, with the expectation that the primary balance would start rising towards more sustainable levels alongside a recovery in economic growth from 2010.

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

National government financing

Given the South African public finance landscape, government remained favourably positioned to finance its current and future deficits adequately. Owing to the depth and breadth of South Africa's capital market, it was foreseen that the issuance of domestic fixed-income bonds would remain the principal source of financing for national government, supported to some extent by the issuance of inflation-linked bonds. In addition, government retained significant scope to borrow in the foreign capital markets to finance part of its deficit or refinance some of its maturing foreign loans.

In fiscal 2008/09, after taking into account cash-flow adjustments[22], government's cash-flow *deficit* amounted to R23,0 billion, in stark contrast to a cash-flow *surplus* of R18,0 billion recorded in the previous fiscal year. The addition of extraordinary transactions and cost on revaluation of foreign debt at redemption resulted in a net borrowing requirement of R26,7 billion in fiscal 2008/09 – a significant turnaround from the surplus of R18,6 billion recorded in the previous fiscal year. Extraordinary payments included premiums on the restructuring of the domestic debt portfolio to the amount of R3,9 billion, while special restructuring proceeds from the South African Special Risk Insurance Association (Sasria) in the amount of R2,1 billion formed part of extraordinary receipts.

22 Transactions recorded as a result of timing differences between the recording of transactions and bank clearances, and late departmental requests for funds.

During fiscal 2008/09, a successful bond-switch programme was introduced switching short-term bonds with a nominal value of R70,4 billion to long-term bonds, thereby reducing funding risk. Most of the R153 bond that matures in tranches over the next three years was switched, with further switches anticipated before August 2009.

On 20 March 2009 the National Treasury released a press statement regarding the impact of the rebasing and reweighting of the CPI announced by Statistics South Africa on inflation-linked government bonds. The prices of inflation-linked bonds would be calculated in such a way that the capital value of bonds remained the same immediately before and after the indices had been rebased.

South Africa's public debt was reduced over time relative to income, and consistently remained at levels regarded as prudent and sustainable. National government total loan debt as a ratio of gross domestic product decreased from 27,6 per cent at the end of March 2008 to 26,6 per cent at the end of March 2009, although in absolute terms total loan debt of national government increased from R572 billion to R616 billion between these dates. Domestic debt as a proportion of total loan debt increased slightly from 83,2 per cent at the end of March 2008 to 84,2 per cent at the end of March 2009, while foreign debt accounted for the balance.

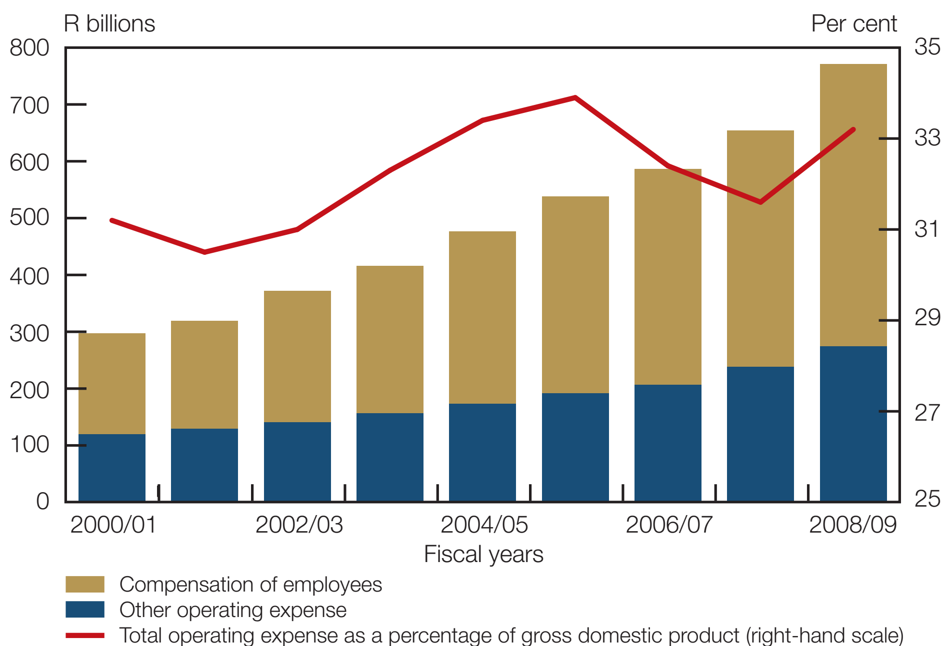
General government finance

In contrast to the surpluses of the two preceding fiscal years, the *consolidated general government* recorded a cash deficit of R34,2 billion in fiscal 2008/09, consistent with the revised deficit envisaged in *Budget Review 2009*. Cash deficits recorded in the main budget, and at provincial and local government level contributed to the deterioration of the consolidated general government deficit. As a ratio of gross domestic product, the cash deficit amounted to 1,5 per cent during the period under review. The *Budget Review 2009* estimated an average consolidated general government cash deficit of 3,1 per cent per annum relative to gross domestic product over the medium term.

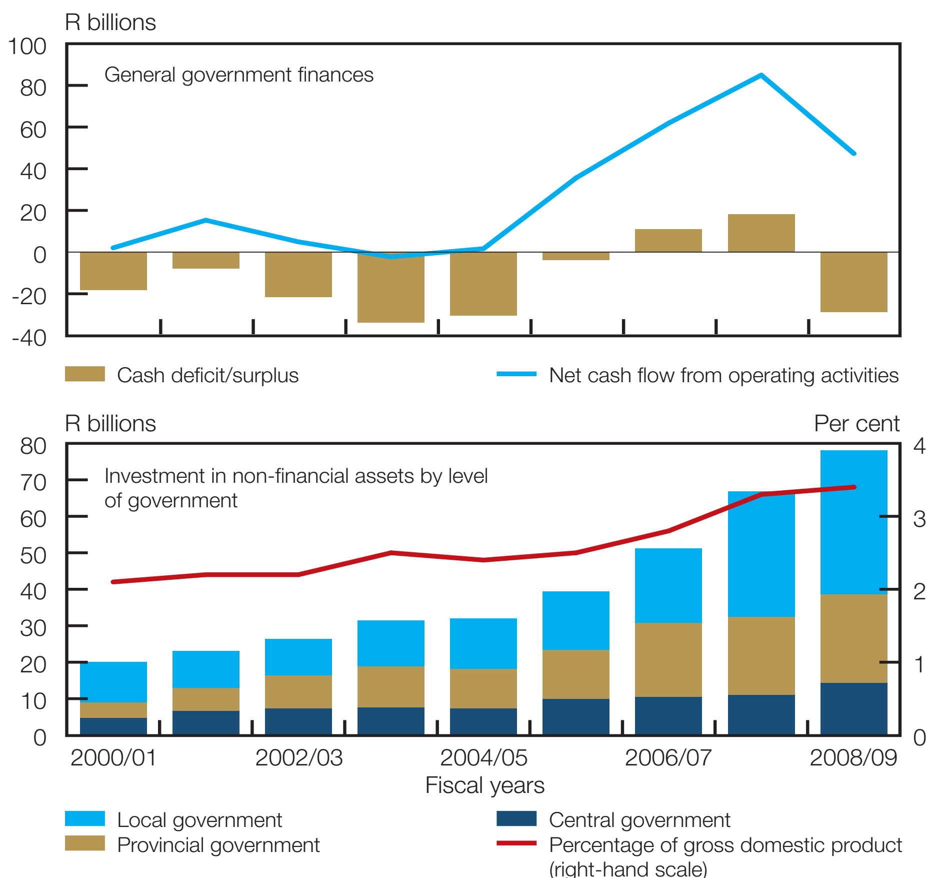
National government recorded a cash deficit due to higher expenditure as government increased transfers and subsidies for social spending and infrastructure development. The deficit recorded by provincial governments resulted from rising spending on health as the implementation of the occupation-specific dispensation for nurses took effect, combined with higher education-sector personnel costs and spending on the Gautrain Rapid Rail Link project.

The cash deficit recorded by local governments deteriorated further compared with the previous fiscal year. This can be attributed to substantial growth in total expenditure. National and provincial governments transferred a considerable amount in equitable share and conditional grants to local governments. These transfers supplemented municipal own-revenue as expenditure was increased to improve access to basic services and to step up the provision of infrastructure by municipalities.

Consolidated general government operating expense in fiscal 2008/09 amounted to R771 billion or 17,8 per cent more compared with the previous fiscal year. The substantial increase in general government expense was partly attributable to strong growth in compensation of employees, which accounted for 35,6 per cent of total operating expense. In fiscal 2008/09, the year-on-year rate of increase in aggregate compensation of employees amounted to 15,5 per cent, equivalent to the increase



recorded in fiscal 2007/08. Inflation-adjusted wage increments plus an additional 1 per cent real increase, together with a 4,2 per cent rise in employment contributed to this increase. Compensation of employees relative to gross domestic product amounted to 11,8 per cent, slightly higher than the ratio recorded a year earlier.



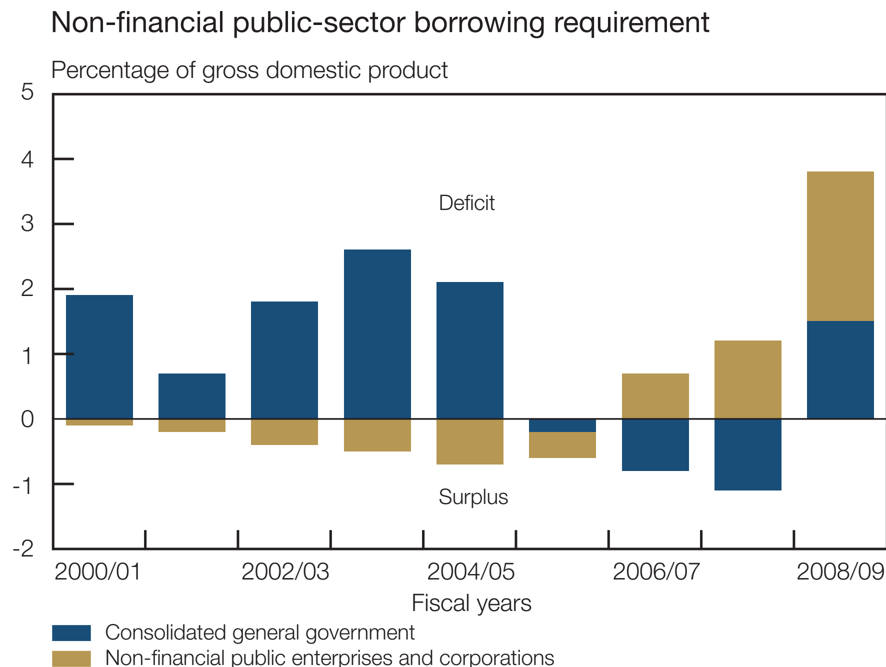
Net investment in non-financial assets by consolidated general government trended higher and amounted to R81,0 billion in fiscal 2008/09, 21,6 per cent more than a year earlier.

Local governments shouldered a significant share of general government's broader capital investment programme. These investments, predominantly in energy, transport, water-related infrastructure and 2010 FIFA World Cup tournament-related areas, remained key components of the economic and social development drive, thereby assisting in raising the economy's long-term growth potential. Medium-term estimates contained in the *Budget Review 2009* indicated that infrastructure expenditure by local governments would average R54,1 billion per annum over the three years to 2011/12, thereby supporting expansion of community infrastructure.

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

Non-financial public-sector borrowing requirement[23]

The activities of the non-financial public-sector resulted in a considerable increase in the borrowing requirement, from R0,9 billion recorded in fiscal 2007/08 to R87,4 billion in fiscal 2008/09. This was the highest borrowing requirement recorded since 1993/94 and was expected to increase further over the medium term. A vast amount of financial resources, raised through borrowing, is required to finance the public-sector infrastructure programme. Moreover, the widening of the main budget deficit in response to the deteriorating economic outlook also contributed to this increase. As a ratio of gross domestic product, the borrowing requirement amounted to 3,8 per cent in fiscal 2008/09, significantly higher than the ratio recorded a year earlier, but in line with the revised ratio of 3,9 per cent estimated in the *Budget Review 2009*. It was projected that the deficit of the non-financial public enterprises and corporations would stabilise at around R90 billion per annum over the medium term, with Eskom and Transnet accounting for the largest share.



National government finance in the April–June quarter of fiscal 2009/10

In the first quarter of fiscal 2009/10 national government expenditure and revenue resulted in a cash-book deficit of R57,7 billion, compared with a deficit of only R50 *million* in the same period of the previous fiscal year. After adjusting for cash flows, extraordinary receipts and payments, and the revaluation of foreign bonds and loans, the net borrowing requirement amounted to R53,2 billion in the period April to June 2009. The borrowing requirement was financed as shown in the accompanying table.

National government financing in fiscal 2009/10

R billions

Item or instrument	Originally budgeted	Actual Apr–Jun 2009
Deficit	**95,6**	**57,0***
Plus: Extraordinary payments	0,9	0,0
Cost on revaluation of maturing foreign debt	2,3	0,3
Less: Extraordinary receipts	4,0	4,1
Net borrowing requirement	**94,8**	**53,2**
Treasury bills	15,4	26,2
Domestic government bonds	63,7	19,2
Foreign bonds and loans	6,1	6,3
Change in available cash balances **	9,6	1,5
Total net financing	**94,8**	**53,2**

* Cash-flow deficit
** Increase – decrease +

Financial framework

Reporting framework

These consolidated financial statements have been prepared in accordance with the South African Reserve Bank Act, 1989 (Act No. 90 of 1989) (the Act) and the accounting policies set out in Note 1 to the financial statements.

The Act is not prescriptive regarding the accounting framework that the Bank should adopt, except for sections 25 and 28 which deal with the accounting treatment of gold and foreign-exchange transactions. These sections are in conflict with International Financial Reporting Standards (IFRSs). The Bank has chosen to use IFRSs as a guide in deciding on the most appropriate accounting policies to adopt, and as a model for the presentation and disclosure framework followed in its financial statements.

However, the Act takes precedence over IFRSs in the areas noted above and, as a result, the recognition and measurement criteria as set out in IFRSs have not been followed in these circumstances. In addition, the Bank considers certain disclosures inappropriate to its functions. Therefore, the Bank's financial statements disclose less detail than would be required under IFRSs.

The significant departures from IFRSs as a consequence of the above may be summarised as follows:

Recognition and measurement

According to the Act,

1. realised and unrealised valuation gains and losses on gold and foreign-denominated assets and liabilities are for the account of Government, and have, therefore, not been accounted for in the income statement of the Bank, as required by International Accounting Standards (IASs) 21: *The Effects of Changes in Foreign Exchange Rates*; and
2. gold is valued in terms of section 25 of the Act, at the statutory gold price as published in the *Government Gazette*. Gold has been recognised as a financial asset of the Bank.

Presentation

In the financial statements

1. not all information as required by IFRS 7: *Financial Instruments Disclosure* is disclosed. This relates specifically to a sensitivity analysis for each type of market risk to which the entity is exposed at reporting date, showing how profit, loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
2. the terms of certain related party transactions were not disclosed as required by *IAS 24: Related Party Disclosures*, where such disclosure was deemed inappropriate; and
3. assets and liabilities relating to securities lending activities have been disclosed, but offset in Note 7 to the financial statements because it is considered inappropriate to gross up the amount of foreign reserves of the Bank.

Budget

Certain expenditure items, such as 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.

	Budget 2009/10 R'000	Actual 2008/09 R'000	Budget 2008/09 R'000
Personnel costs	1 028 416	991 916	889 041
Operating costs	347 048	283 438	295 771
Cost of new currency	1 312 690	922 479	1 008 358

The actual performance of the 2008/09 operating costs were slightly under budget due to currency distribution costs not fully utilised, changes in the operating software licensing structure and the cancellation of some Telkom services, which resulted in the ICT infrastructure costs being underspent.

The 2008/09 personnel costs exceeded the budget. This was mainly as a result of the following:

1 Leave days accumulated by staff members being higher than the leave days budgeted, which resulted in an increased provision.

2 Post-retirement medical benefit being higher than budgeted, as a result of changes to inflation on medical aid and a change in the assumptions regarding mortality.

3 Overtime paid being higher than the budgeted overtime due to various additional projects undertaken during the year.

The under-expenditure in the cost of new currency was due to short delivery on banknotes for the 2008/09 financial year. The shortfall will be delivered in the current financial year, hence the budget for 2009/10 being higher than the 2008/09 budget.

Report of the independent auditors

To the members of the South African Reserve Bank

We have audited the group financial statements and financial statements of the South African Reserve Bank, which comprise the consolidated and separate balance sheets as at 31 March 2009, and the consolidated and separate income statements, the consolidated and separate statements of changes in equity, and consolidated and separate cash flow statements for the year then ended, and a summary of significant accounting policies and other explanatory notes, and the directors' report, as set out on pages 93 to 139.

Directors' responsibility for the financial statements

The Bank's directors are responsible for the preparation and presentation of these financial statements in accordance with the basis of accounting described in Note 1 to the financial statements and in the manner required by the South African Reserve Bank Act, 1989 (Act No. 90 of 1989). This responsibility includes determining that the basis of accounting described in Note 1 is an acceptable basis for preparing and presenting financial statements in the circumstances; designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Auditors' opinion

In our opinion, the financial statements of the South African Reserve Bank have been prepared, in all material respects, in accordance with the basis of accounting described in Note 1 to the financial statements and in the manner required by the South African Reserve Bank Act, 1989.

Emphasis of matter

Without qualifying our opinion, we emphasise that the basis of accounting and the presentation and disclosures contained in the financial statements are not intended to, and do not, comply with certain of the requirements of International Financial Reporting Standards.

PricewaterhouseCoopers Inc.
Director: J Grosskopf
Registered Auditor

SizweNtsaluba VSP
Partner: P Hiralall
Registered Auditor

Pretoria
31 July 2009

PricewaterhouseCoopers Inc. Reg. no. 1998/012/055/21 Private Bag X36 Sunninghill 2157 Tel: (011) 797 4000 Fax: (011) 797 5800
Executive: S P Kana (Chief Executive Officer), T P Blandin de Chalain, D J Fölscher, G M Khumalo, I S Sehoole, S Subramoney, F Tonelli. Resident Director in Charge: E R Mackeown.
The Company's principal place of business is at 2 Eglin Road, Sunninghill where a list of directors' names is available for inspection.

SizweNtsaluba VSP 20 Morris Street East Woodmead 2191 PO Box 2939 Saxonwold 2132 Tel: (011) 234 0933 Fax: (011) 234 0933
Partners: Aaron Mthimunye, Andrew Mashifane, Anton van den Heever, Anoosh Rooplal, Hale Qangule, Johann Strauss, Luthando Saunders, Luyanda Dudumashe, Mxolisi Mthimkhulu, Natalie Arendse, Pravesh Hiralall, Rakesh Bhika, Suleman Lockhat, Theodore Josias, Victor Sekese (CEO), Zaheeda Bashir

Report of the Audit Committee

The Audit Committee is a sub-committee of the Board. The responsibilities of the committee are detailed in its terms of reference (the Audit Committee Charter) that have been approved by the Board. The committee comprises four non-executive independent directors and two executive directors. The details of the committee members appear on page 3 of this *Annual Report*.

The permanent invitees to committee meetings include the Executive General Manager: Markets; the Heads of the Financial Services and Business Systems and Technology departments and the Risk Management Co-ordinating Unit; and representatives of the Internal Audit Department and the external auditors. The members of the committee collectively possess the necessary skills and experience to direct the committee constructively in the execution of its responsibilities.

The responsibilities of the committee, as laid down in the Audit Committee Charter, include providing oversight on financial reporting and other matters such as the monitoring of governance processes, controls and risk management in the Bank. The committee also ensures effective communication between the internal auditors, external auditors, the Board and management. The Bank's subsidiaries have their own audit committees, which subscribe to the same philosophy as the Bank. The minutes of the proceedings of these audit committee meetings are tabled at meetings of the Bank's Audit Committee.

The committee is responsible for the appointment and review of independent external auditors, and for maintaining a professional relationship with them. The external auditors have unrestricted access to the committee and the Board. The committee also annually assesses non-audit work done by external auditors to ensure that the independence of the external auditors is maintained. In assessing the independence of the external auditors, the committee reviews independence letters submitted by the external auditors. These letters include non-audit services provided by the external auditors for the period under review.

The Internal Audit Charter, which lays down the purpose, authority and responsibility of the internal audit function, is approved by the committee and the Board. The committee concurs with the appointment of the Chief Internal Auditor. It also reviews the scope and coverage of the internal audit function and approves its coverage and work plan for the period under review. The internal auditors have unrestricted access to all functions, records, property and personnel of the Bank. To enhance their independence, the internal auditors have unrestricted access to the committee and the Board of the Bank.

Management is focused on continuous improvements to the system of internal control. The internal audit function reviews the adequacy and effectiveness of internal controls. The committee reviews the internal audit reports, and assesses the role, independence and effectiveness of the internal audit function on an ongoing basis.

The committee confirms that it carried out its functions responsibly and has satisfactorily complied with its mandate for the period under review. The committee has also satisfied itself that the external auditors are independent and are able to conduct their audit functions without any undue influence from the Bank.

Directors' report for the year ended 31 March 2009

Introduction

The directors present the Bank's eighty-ninth annual report for the year ended 31 March 2009.

This report, issued in terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989) (the Act), addresses the performance of the Bank, its subsidiaries and relevant statutory information requirements.

It is the directors' responsibility to prepare annual financial statements and related financial information that present the state of affairs and the financial results of the group. These financial statements have been prepared on a going-concern basis, taking cognisance of certain unique aspects relating to the Bank's ability to create and withdraw domestic currency, its role as lender of last resort and its responsibilities in the area of financial stability, as well as its relationship with government concerning foreign-exchange and gold transactions.

Management prepared the annual financial statements set out in this report. The statements include appropriate and responsible disclosure, and are based on appropriate accounting policies that have been applied consistently, and that are supported by reasonable and prudent judgements and estimates.

In exceptional circumstances, as part of its central banking functions, the Bank may provide emergency assistance to banks experiencing difficulty in order to prevent loss of confidence spreading through the entire financial system. Confidence in the banking system can best be sustained if the Bank's support is only disclosed when conditions giving rise to potentially systemic disturbances have improved. Accordingly, the financial statements of the Bank may not explicitly identify such support the moment it is provided.

The financial statements have been audited by independent auditors, who were given unrestricted access to all financial records and related data, including minutes of all meetings of the Board, committees of the Board and management meetings.

The requirements of the *King Report on Corporate Governance for South Africa* are dealt with in the corporate governance statement which appears on pages 10 to 14.

Nature of business

The Bank is the central bank of the Republic of South Africa and is regulated in terms of the Act. The primary objective of the Bank is the achievement and maintenance of price stability. In pursuance of its primary objective, the Bank assumes responsibility for the functions as set out in its mission statement on pages 4 and 5.

The subsidiaries of the Bank are involved in the following activities:

1. Corporation for Public Deposits receives call deposits from public entities;
2. South African Bank Note Company (Proprietary) Limited produces banknotes;
3. South African Mint Company (Proprietary) Limited produces coin; and
4. South African Reserve Bank Captive Insurance Company Limited manages certain insurable risks of the Bank and its subsidiaries.

Achievement of objectives

The Bank's achievements in respect of its objectives, including its main objective, namely the maintenance of price stability, will be addressed by the Governor at the annual general meeting of shareholders to be held on 17 September 2009. The Governor's address receives extensive media coverage, and is made available to shareholders and other interested parties.

Financial results

The income statement appears on page 99.

All remaining profits of the Bank, after provisions normally provided for by bankers and payment of dividends, are paid to government in terms of the Act. Amounts paid and due in terms of the Act over the past two years were as follows:

	Group R'000	Bank R'000
31 March 2009	124 852	39 080
31 March 2008	153 152	119 005

Dividends

The final dividend of 5 cents per share for the 2008 financial year was paid on 9 May 2008 and an interim dividend of 5 cents per share for the 2009 financial year was paid to shareholders on 31 October 2008.

A final dividend of 5 cents per share for the 2009 financial year was declared on 1 April 2009 and paid on 15 May 2009.

Financial position

The balance sheet appears on page 98.

The total assets of the Bank increased by R44 billion during the year: an increase of R44 billion in gross gold and foreign assets, while domestic assets remained at the same level as the previous year. The increase in total assets was funded mainly by increases in deposit accounts (R7 billion), notes and coin in circulation (R6 billion), South African Reserve Bank (SARB) debentures (R11 billion) and an increase in the Gold and Foreign Exchange Contingency Reserve Account (R29 billion). The last-mentioned increase was mainly due to revaluation profits on the Bank's gold and foreign-exchange holdings, which are for the account of government.

Directors

The composition of the Board of Directors appears on page 3.

The term of office of Dr D Konar as shareholders' representative representing commerce or finance expired on 19 September 2008 and he was re-elected at the annual general meeting held on 18 September 2008.

The term of office of Ms N D Orleyn as shareholders' representative representing industry expired on 19 September 2008 and she was re-elected at the annual general meeting held on 18 September 2008.

The term of office of Ms Z P Manase as shareholders' representative representing commerce or finance expired on 19 September 2008 and she was re-elected at the annual general meeting held on 18 September 2008.

As at 31 March 2009 a vacancy existed for a deputy governor.

Meetings attended by directors: 1 April 2008 – 31 March 2009

	Board	Nedcom	Remco	Audit	Pension Fund	Retirement Fund
Number of meetings	5	4	4	4	4	4
T T Mboweni	5		4		0	0
X P Guma	5			3		4
R D Mokate	4			4	3	
D Konar[1]	5	2		1	3	3
F Jakoet	4	4		4		
Z P Manase	5	3		3		
N D Orleyn	5	4	4			
S M Goodson	4	3	3		3	
R W K Parsons[2]	4	4		1		
F E Groepe	3	2				
T N Mgoduso	4	3	4			
J F van der Merwe[2, 3]	5	4	2	1		
E Masilela	4	4				

Notes:

1 D Konar ceased to be a member of the Audit Committee from 18 September 2008.
2 R W K Parsons and J F van der Merwe were appointed to the Audit Committee on 24 February 2009.
3 J F van der Merwe was appointed to Remco on 25 July 2008.

Nedcom: Non-executive Directors' Committee
Remco: Remuneration Committee

Direct and indirect shareholding of directors on 31 March 2009

During the year, members of the Board held the following shares in the Bank:

Number of shares	
S M Goodson	10 000
D Konar	10 000
T T Mboweni	10 000
X P Guma	5 932
F Jakoet	500
N D Orleyn	10 000
R W K Parsons	1 000
	47 432

Subsidiaries

The following information relates to the financial interest of the Bank in its subsidiaries:

	Authorised and issued share capital					
	Number of shares	Percentage held	Shares at cost		Net indebtedness to/(by) Bank	
	'000	Per cent	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Corporation for Public Deposits	2 000	100	2 000	2 000	(1 840 368)	(6 632 380)
South African Mint Company (Proprietary) Limited	60 000	100	206 000	206 000	0	0
South African Bank Note Company (Proprietary) Limited	61 000	100	61 000	61 000	33 148	30 451
South African Reserve Bank Captive Insurance Company Limited	10 000	100	10 000	10 000	0	0
Total			279 000	279 000	(1 807 220)	(6 601 929)

The interest of the Bank in the aggregate attributable net profits of subsidiaries is as follows:

	Bank	
	2009 R million	2008 R million
Aggregate profits	130	163

Contracts

No contracts were entered into during the year in which directors or officers of the Bank had interests that significantly affected the affairs or business of the Bank or any of its subsidiaries.

Post-balance sheet events

There were no events subsequent to the balance sheet date that had a significant effect on the financial statements.

Secretary

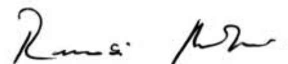
Mr T P Mongwe

Business address:
370 Church Street
Pretoria
Republic of South Africa
0002

Postal address:
PO Box 427
Pretoria
Republic of South Africa
0001

The financial statements were approved by the Board of Directors on 31 July 2009 and signed on its behalf by:

T T Mboweni
Governor



R D Mokate
Deputy Governor

J F van der Merwe
Director

E Masilela
Director

G J Terblanche
Chief Financial Officer

In my capacity as Secretary of the Bank, I certify that all the returns required to be submitted in terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), for the year ended 31 March 2009, have been correctly completed and are up to date.

T P Mongwe
Secretary

Pretoria
31 July 2009

Balance sheet at 31 March 2009

	Notes	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Assets					
Cash and cash equivalents	2	135 075	77 137	0	0
Accommodation to banks	3	10 311 399	10 935 444	10 311 399	10 935 444
South African Government bonds	4	8 437 030	8 280 044	8 437 030	8 280 044
Loans and advances	5	73 094	72 259	73 094	72 259
Current taxation prepaid		113 386	1 747	100 298	0
Amounts due by subsidiaries	6	0	0	189 178	170 030
Gold and foreign exchange	7	322 441 738	277 887 718	322 441 738	277 887 718
Inventories	8	394 354	375 333	5 955	6 340
Investments	9	8 108 758	6 835 797	0	0
Amounts due by the South African Government	10	924 973	984 019	924 973	984 019
Property, plant and equipment	11	1 369 318	1 087 668	680 742	628 727
Investment in subsidiaries	6	0	0	279 000	279 000
Equity investment in Bank for International Settlements	12	369 732	348 413	369 732	348 413
Deferred taxation assets	13	312 137	282 776	277 030	258 187
Forward exchange contract assets	14	0	16 059	0	13 563
Other assets	15	477 782	491 794	371 426	383 773
Total assets		353 468 776	307 676 208	344 461 595	300 247 517
Liabilities					
Deposit accounts	16	134 983 976	131 278 274	125 603 426	118 480 302
Amounts due to subsidiaries	6	0	0	1 996 398	6 771 959
SARB debentures	17	28 109 144	16 928 734	28 109 144	16 928 734
Foreign loans	18	6 201 166	11 311 522	6 201 166	11 311 522
Current taxation liabilities		0	214 477	0	203 919
Notes and coin in circulation	19	68 979 485	63 371 971	68 979 485	63 371 971
Provisions	20	120 272	100 196	103 043	88 025
Gold and Foreign Exchange Contingency Reserve Account	21	101 584 718	72 189 474	101 584 718	72 189 474
Deferred taxation liabilities	13	138 099	121 425	43 954	42 332
Forward exchange contract liabilities	14	11 790	9 873	0	9 873
Other financial liabilities	22	437 911	407 908	102 691	211 458
Post-retirement medical benefits	23	921 333	804 951	833 400	733 332
Total liabilities		341 487 894	296 738 805	333 557 425	290 342 901
Capital and reserves					
Share capital	24	2 000	2 000	2 000	2 000
Accumulated profit		997 196	953 097	0	0
Statutory reserve		395 164	390 822	395 164	390 822
Contingency reserve		10 233 801	9 390 975	10 154 285	9 311 285
Bond revaluation reserve		352 721	200 509	352 721	200 509
Total capital and reserves		11 980 882	10 937 403	10 904 170	9 904 616
Total liabilities, capital and reserves		353 468 776	307 676 208	344 461 595	300 247 517

SARB: South African Reserve Bank

Income statement for the year ended 31 March 2009

	Notes	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Interest income		11 330 277	12 920 307	10 244 757	12 098 728
Interest expense		8 076 497	7 495 629	7 139 102	6 767 711
Net interest income		3 253 780	5 424 678	3 105 655	5 331 017
Dividend income		28 366	23 608	28 235	23 676
Operating income		594 242	469 792	353 112	273 347
Total income	25.1	3 876 388	5 918 078	3 487 002	5 628 040
Operating costs	25.2	2 485 227	2 227 645	2 243 003	2 153 072
Profit before taxation	25	1 391 161	3 690 433	1 243 999	3 474 968
Taxation	26	374 842	1 075 475	357 377	1 022 540
Profit for the year		1 016 319	2 614 958	886 622	2 452 428
Dividend per share (cents)	27	10	10	10	10

Cash flow statement for the year ended 31 March 2009

		Group		Bank	
	Notes	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Cash flow from operating activities					
Cash generated from operating activities	28	2 530 464	5 028 246	866 150	867 056
Taxation paid		(772 838)	(698 855)	(738 008)	(661 490)
Dividends paid		(200)	(200)	(200)	(200)
Transfer to government		(153 152)	(132 693)	(119 005)	(115 800)
Net cash flow generated from operating activities		1 604 274	4 196 498	8 937	89 566
Cash flow utilised by investing activities		(1 546 336)	(4 142 970)	(8 937)	(89 566)
Purchase of property, plant and equipment		(396 062)	(175 233)	(127 914)	(80 497)
Disposal of property, plant and equipment		288	129	288	129
Acquisition of investments		(1 269 251)	(3 958 668)	0	0
Net investment from/(in) South African Government bonds		118 689	(9 198)	118 689	(9 198)
Net increase in cash and cash equivalents		57 938	53 528	0	0
Cash and cash equivalents at beginning of the year		77 137	23 609	0	0
Cash and cash equivalents at end of the year	2	135 075	77 137	0	0

Statement of changes in equity: Group*

For the year ended 31 March 2009

	Share capital R'000	Accumulated profit R'000	Statutory reserve R'000	Contingency reserve R'000	Bond revaluation reserve R'000	Total R'000
Balance at 31 March 2007	2 000	824 482	377 599	7 071 207	657 305	8 932 593
Profit for the year	0	2 614 958	0	0	0	2 614 958
Transfer to government	0	(153 152)	0	0	0	(153 152)
Transfer to reserves	0	(2 332 991)	13 223	2 319 768	0	0
Realised gains on available-for-sale financial assets	0	0	0	0	0	0
Gross realised gains					0	0
Taxation thereon					0	0
Fair value adjustments on available-for-sale financial assets	0	0	0	0	(456 796)	(456 796)
Gross adjustments					(647 296)	(647 296)
Taxation thereon					190 500	190 500
Dividends paid	0	(200)	0	0	0	(200)
Balance at 31 March 2008	2 000	953 097	390 822	9 390 975	200 509	10 937 403
Profit for the year	0	1 016 319	0	0	0	1 016 319
Transfer to government	0	(124 852)	0	0	0	(124 852)
Transfer to reserves	0	(847 168)	4 342	842 826	0	0
Realised gains on available-for-sale financial assets	0	0	0	0	(46 274)	(46 274)
Gross realised gains					(64 270)	(64 270)
Taxation thereon					17 996	17 996
Fair value adjustments on available-for-sale financial assets	0	0	0	0	198 486	198 486
Gross adjustments					275 675	275 675
Taxation thereon					(77 189)	(77 189)
Dividends paid	0	(200)	0	0	0	(200)
Balance at 31 March 2009	2 000	997 196	395 164	10 233 801	352 721	11 980 882

*Notes

Statutory reserve
The statutory reserve is maintained in terms of section 24 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), which stipulates that one-tenth of the surplus of the South African Reserve Bank, after provisions normally provided for by bankers and payment of dividends, has to be credited to the statutory reserve.

Contingency reserve
Contingency reserves are maintained to provide against risks to which the South African Reserve Bank, the Corporation for Public Deposits and the South African Reserve Bank Captive Insurance Company Limited are exposed.

Bond revaluation reserve
Gains and losses arising from a change in fair value of available-for-sale financial assets are recognised directly in equity. When these financial assets are sold, collected or otherwise disposed of, the cumulative gain or loss recognised in equity is transferred to the income statement.

Transfer to the South African Government
In terms of section 24 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), nine-tenths of the surplus of the South African Reserve Bank, after provisions normally provided for by bankers and payment of dividends, has to be paid to government. In terms of section 15 of the Corporation for Public Deposits Act, 1984 (Act No. 46 of 1984), the balance of net profits after transfers to reserves and payment of dividends has to be paid to government.

Statement of changes in equity: Bank*

For the year ended 31 March 2009

	Share capital R'000	Accumulated profit R'000	Statutory reserve R'000	Contingency reserve R'000	Bond revaluation reserve R'000	Total R'000
Balance at 31 March 2007	2 000	0	377 599	6 991 285	657 305	8 028 189
Profit for the year	0	2 452 428	0	0	0	2 452 428
Transfer to government	0	(119 005)	0	0	0	(119 005)
Transfer to reserves	0	(2 333 223)	13 223	2 320 000	0	0
Realised gains on available-for-sale financial assets	0	0	0	0	0	0
Gross realised gains					0	0
Taxation thereon					0	0
Fair value adjustments on available-for-sale financial assets	0	0	0	0	(456 796)	(456 796)
Gross adjustments					(647 296)	(647 296)
Taxation thereon					190 500	190 500
Dividends paid	0	(200)	0	0	0	(200)
Balance at 31 March 2008	2 000	0	390 822	9 311 285	200 509	9 904 616
Profit for the year	0	886 622	0	0	0	886 622
Transfer to government	0	(39 080)	0	0	0	(39 080)
Transfer to reserves	0	(847 342)	4 342	843 000	0	0
Realised gains on available-for-sale financial assets	0	0	0	0	(46 274)	(46 274)
Gross realised gains					(64 270)	(64 270)
Taxation thereon					17 996	17 996
Fair value adjustments on available-for-sale financial assets	0	0	0	0	198 486	198 486
Gross adjustments					275 675	275 675
Taxation thereon					(77 189)	(77 189)
Dividends paid	0	(200)	0	0	0	(200)
Balance at 31 March 2009	2 000	0	395 164	10 154 285	352 721	10 904 170

*Notes

Statutory reserve

The statutory reserve is maintained in terms of section 24 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), which stipulates that one-tenth of the surplus of the South African Reserve Bank, after provisions normally provided for by bankers and payment of dividends, has to be credited to the statutory reserve.

Contingency reserve

A contingency reserve is maintained to provide against risks to which the South African Reserve Bank is exposed.

Bond revaluation reserve

Gains and losses arising from a change in fair value of available-for-sale financial assets are recognised directly in equity. When these financial assets are sold, collected or otherwise disposed of, the cumulative gain or loss recognised in equity is transferred to the income statement.

Transfer to the South African Government

In terms of section 24 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), nine-tenths of the surplus of the South African Reserve Bank after provisions normally provided for by bankers and payment of dividends, have to be paid to government.

Notes to the financial statements

1. Accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. The accounting policies have been applied consistently with those adopted in the previous year.

1.1 Basis of presentation

These consolidated annual financial statements have been prepared in accordance with the South African Reserve Bank Act, 1989 (Act No. 90 of 1989) (the Act), and the accounting policies set out in this note.

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the accounting policies of the South African Reserve Bank (the Bank). The areas of a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in the relevant notes.

1.2 Consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries. The results of the subsidiaries are included from the effective dates on which control is transferred to the Bank until the effective dates of disposal. Control is achieved where the Bank has the power to govern the financial and operational policies of an investee enterprise so as to obtain benefits from its activities. All inter-company balances, transactions, and unrealised gains and losses on transactions within the group have been eliminated.

The Bank uses the purchase method of accounting for its investments in subsidiaries as the basis for recording an acquisition. Investments in subsidiaries are stated at cost less provision for losses where appropriate. No goodwill has arisen on the acquisition of subsidiaries.

1.3 Financial instruments

Classification

Financial instruments as reflected on the balance sheet include all financial assets and financial liabilities, including derivative instruments, but excluding investments in subsidiaries, employee benefit plans, provisions, property, plant and equipment, deferred taxation, inventories, and taxation payable or prepaid. Financial instruments are classified as follows:

Financial assets

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity financial assets; and available-for-sale financial assets.

The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of financial assets at initial recognition and re-evaluates this classification at every reporting date.

All financial assets are initially recognised at fair value plus transaction costs, except those carried at fair value through profit or loss. The best evidence of fair value on initial recognition is the transaction price, unless the fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on discounted cash flow models and option-pricing valuation techniques whose variables include only data from observable markets.

The purchases and sales of financial assets that require delivery are recognised on trade date, being the date on which the Bank commits to purchasing or selling the asset. Investments are initially recognised at fair value plus, in the case of all financial assets not carried at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. Financial assets are derecognised when the rights to receive cash flows from the investments have expired, or where they have been transferred and the Bank has also transferred substantially all risks and rewards of ownership.

Subsequent to initial recognition, the fair values of financial assets are based on quoted bid prices, excluding transaction costs. If the market for a financial asset is not active or an instrument is an unlisted instrument, the fair value is estimated using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses and option-pricing models.

When a discounted cash flow analysis is used to determine the value of financial assets, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate, at the balance sheet date, for a financial asset with similar terms and conditions. Where option-pricing models are used, inputs based on observable market indicators at the balance sheet date are only recognised to the extent that they relate to changes in factors that market participants will consider in setting a price.

a Financial assets at fair value through profit or loss

This category has two sub-categories: (1) financial assets held for trading and (2) those designated at fair value through profit or loss at inception.

A financial asset is classified as 'held for trading' if it is acquired principally for the purpose of selling in the short term, it forms part of a portfolio of financial assets in which there is evidence of short-term profit-taking or if it is so designated by management. Derivatives are also classified as held for trading, unless they are designated as hedges at inception.

A financial asset is designated as 'fair value through profit or loss' because either it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring the asset, or recognising the gains or losses on it on different bases; or a portfolio of financial assets is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the portfolio is provided internally on that basis to key management personnel. The main classes of financial assets designated by the Bank are debt securities.

Subsequent to initial recognition, these assets are measured at fair value. All related, realised and unrealised gains and losses arising from changes in fair value, excluding changes in fair value due to foreign exchange movements as explained in Note 1.4, are recognised as investment income in the income statement.

b Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category does not include those loans and receivables that the Bank intends to sell in the short term or that it has designated as at fair value through profit or loss or available-for-sale.

Subsequent to initial recognition, loans and receivables are carried at amortised cost using the effective interest method, less any provision for impairment.

A provision for impairment is established when there is objective evidence that the Bank will not be able to collect all amounts due according to the original terms of the receivables. Objective evidence that receivables are impaired includes observable data that come to the attention of the Bank about the following events:

- Significant financial difficulty of the debtor
- A breach of contract, such as default or delinquency in payments
- It becoming probable that the debtor will enter bankruptcy or other financial reorganisation.

The amount of a provision is the difference between the carrying amount and the recoverable amount of the assets being the present value of expected cash flows discounted at the market rate of interest for similar borrowers. The amount of the provision is recognised as a charge in the income statement.

c Held-to-maturity financial assets

No financial assets have been classified as 'held-to-maturity'.

d Available-for-sale financial assets

Available-for-sale financial assets are those intended to be held for an indefinite period and may be sold in response to liquidity needs or changes in interest rates, exchange rates or equity prices. Financial assets that are either designated in this category or not classified in any of the other categories are classified as 'available-for-sale' financial assets. The main classes of financial assets classified as available-for-sale are South African Government bonds.

Subsequent to initial recognition, available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from the change in fair value are recognised directly in equity until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest and dividend income received on available-for-sale financial assets are recognised in the income statement.

Impairment of financial assets

An asset is impaired if its carrying amount is greater than its estimated recoverable amount.

a Financial assets carried at amortised cost

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses

are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset, which can be estimated reliably.

If there is objective evidence that an impairment loss has been incurred on loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the carrying amount of the asset and the present value of estimated future cash flows discounted at the original effective interest rate of the financial asset. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement. If a held-to-maturity investment or a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment had been recognised, such as improved credit rating, the previously recognised impairment loss is reversed and is recognised in the income statement.

b Financial assets carried at fair value

The Bank assesses whether there is objective evidence that a financial asset carried at fair value is impaired at each balance sheet date. If any objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the acquisition cost and current fair value, less any impairment loss on the financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss had been recognised in profit or loss, the impairment loss is reversed through the income statement.

Financial liabilities

The Bank classifies its financial liabilities into the following categories: financial liabilities at fair value through profit or loss; and financial liabilities at amortised cost. The classification depends on the purpose for which the financial liabilities were acquired. Management determines the classification of financial liabilities at initial recognition and re-evaluates this classification at every reporting date.

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the instrument. Financial liabilities are initially recognised at fair value, generally being their issue proceeds net of transaction costs incurred.

The best evidence of fair value on initial recognition is the transaction price, unless the fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on discounted cash flow models and option-pricing valuation techniques whose variables include only data from observable markets.

a Fair value through profit and loss financial liabilities

Derivatives with negative fair values have been classified at fair value through profit and loss financial liabilities.

b Other financial liabilities

The following financial liabilities have been classified as 'other financial liabilities': notes and coin issued; foreign loans; SARB debentures; deposit accounts; amounts due to subsidiaries; and creditors. Other financial liabilities are measured at amortised cost.

Recognition and derecognition

Financial assets and financial liabilities are recognised on the date on which the group becomes party to the contractual provisions. Trade date accounting is applied for 'regular way' purchases and sales. From this date, any gains or losses arising from changes in the fair value of assets and liabilities are recognised. Loans and receivables, and other financial liabilities are recognised on the day on which they are transferred to the group or the day the funds are advanced.

Measurement

a Initial measurement

A financial asset or financial liability is initially measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs directly attributed to the acquisition of the financial asset or liability.

b Subsequent measurement

Fair value through profit or loss, financial assets and liabilities and available-for-sale financial assets are carried at fair value. Fair values are established as follows:

(i) Derivatives

A derivative is a financial instrument whose value changes in response to an underlying variable that requires little or no initial investment and is settled at a future date. Fair values are obtained from quoted market prices (excluding transaction costs), dealer price quotations, discounted cash flow models and option-pricing models, which consider current market and contractual prices for the underlying instruments as well as the time value of money.

(ii) Foreign marketable money-market investments

The fair value of foreign marketable money-market investments is based on quoted bid rates, excluding transaction costs.

(iii) Local and foreign portfolio investments including securities lending portfolio investments

The fair values of portfolio investments are valued using the quoted fair values as obtained from portfolio managers. Where these instruments are bank deposits, they are valued at nominal values plus accrued interest based on market rates. These values approximate fair values.

(iv) South African Government bonds

Listed bonds are valued using the quoted fair values at year-end as supplied by the Bond Exchange of South Africa (BESA).

Loans and receivables, and other liabilities

Loans and receivables, and other liabilities are measured at amortised cost, which approximates fair value, and are remeasured for impairment losses, except as set out below:

a Non-interest-bearing deposit accounts, the Gold and Foreign Exchange Contingency Reserve Account and loans to subsidiaries are accounted for at cost, as these accounts do not have fixed maturity dates.

b Notes and coin issued are measured at cost, as this liability does not have a fixed maturity date. The banknotes and coin in circulation represent the nominal value of all banknotes held by the public and the banks, including recalled, still exchangeable banknotes from previous series.

c Accounts payable are stated at cost, which approximates fair value due to their short-term nature.

Amortised cost is calculated on the effective interest method that discounts the estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity. When the financial assets are sold, collected or otherwise disposed of, the cumulative gain or loss recognised in equity is transferred to the income statement of the period in which it arises.

Gains and losses arising from a change in the fair value of financial assets and liabilities designated at fair value through profit and loss are recognised in the income statement of the period in which they arise, except for gold and foreign-exchange activities, as explained in Note 1.4.

Hedge accounting

Hedge accounting was not applied to any transactions for the year under review.

Set-off

Financial assets and financial liabilities are offset, and the net amount reported in the balance sheet where there is a legally enforceable right to set off the recognised amount and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In addition, as set out in Note 7 to the financial statements, financial assets and liabilities arising from securities lending activities have been offset.

Minimum reserve balances of banks

Where the balances of cash reserve accounts maintained by banks with the South African Reserve Bank, as defined by the Banks Act, 1990 (Act No. 94 of 1990), are less than the minimum reserve balances required by this Act, the shortfalls are recorded in Note 3 to the financial statements as "Application of cash reserve balances".

1.4 Foreign currency activities

Foreign currency translation

Functional and presentation currency

Items included in the financial statements of each of the Bank's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The financial statements of the Bank are presented in South African rand, which is the functional currency of the Bank.

Foreign-exchange gains and losses arising in entity accounts

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transactions.

Gains and losses of the subsidiaries arising on translation are recognised in the income statement. Foreign-exchange profits and losses of the Bank, insofar as they arise from changes in the value of the rand compared with other currencies, are for the account of government and, consequently, all these profits and losses are transferred to the Gold and Foreign Exchange Contingency Reserve Account in terms of sections 25 to 28 of the Act. Investment returns on foreign-exchange reserves and interest paid on foreign loans are for the account of the Bank and are accounted for in the income statement.

1.5 Property, plant and equipment

Freehold land is carried at cost less accumulated impairment losses. Other items of property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. Depreciation is determined separately for each significant part of an item of property, plant and equipment, and is charged so as to write off the cost or valuation of the assets (other than land and items under construction) to their residual value over their estimated useful life, using the straight line method. The estimated useful life of the assets has been disclosed in Note 11.

Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the items will flow to the Bank and the cost of the item can be measured reliably. All repairs and maintenance costs are charged to the income statement when incurred.

The residual values and useful life of assets are reviewed at each balance sheet date and adjusted if appropriate. If the carrying amount of the asset is greater than its estimated recoverable amount, the carrying amount is written down immediately to its recoverable amount.

Intangible assets

Computer software

Computer software and the direct costs associated with its customisation and installation are capitalised and amortised over two to three years.

1.6 Impairment of other assets

The carrying amounts of the group's assets other than financial assets are reviewed at each balance sheet date to determine whether there is any indication of impairment, in which case the recoverable amount is estimated.

An impairment loss is recognised in the income statement whenever the carrying amount of an asset exceeds its recoverable amount. A previously expensed impairment loss will be reversed if the recoverable amount increases as a result of a change in the estimates used previously to determine the recoverable amount, but not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognised.

1.7 Gold

Gold is held by the Bank as part of its foreign reserves. In terms of section 25 of the Act, gold is recorded at the prevailing prices at initial recognition date, including transaction costs. Subsequent to initial measurement, it is measured as follows: physical gold held by the Bank is valued at the statutory price. The statutory price is the quoted spot price at year-end. Gold loans are measured at the quoted spot price at year-end. Physical gold held by the subsidiaries is also measured at the quoted spot price at year-end.

In terms of section 25 of the Act, all gains and losses on gold achieved by the Bank are for the account of the South African Government and, consequently, all profits and losses are transferred to the Gold and Foreign Exchange Contingency Reserve Account. Profits and losses on gold of the subsidiaries are charged to the income statement in the period in which they arise.

1.8 Taxation

The charge for current taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed for taxation purposes. It is calculated using taxation rates that have been enacted or substantially enacted by the balance sheet date, and any adjustment of taxation payable for previous years.

Deferred taxation is provided using the balance sheet liability method, based on temporary differences. Temporary differences are differences between the carrying amount of assets and liabilities for financial reporting purposes and their taxation base. The amount of deferred taxation provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using taxation rates enacted at the balance sheet date. Deferred taxation is charged to the income statements, except to the extent that it relates to a transaction that is recognised directly in equity. The effect on deferred taxation of any changes in taxation rates is recognised in the income statement, except to the extent that it relates to items previously charged or credited directly to equity.

A deferred taxation asset is recognised to the extent that it is probable that future taxable profit will be available, against which the unutilised taxation losses and deductible temporary differences can be used. Deferred taxation assets are reduced to the extent that it is no longer probable that the related taxation benefits will be realised.

1.9 Employee benefits

Pension and retirement funds

The expected costs of post-retirement defined benefits are charged to income over the expected service life of the employees entitled to these benefits according to the projected unit credit method. Costs are actuarially assessed, and expense adjustments and past-service costs resulting from plan amendments are amortised over the expected average remaining service life of the employees.

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The group has both defined benefit and defined contribution plans.

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors, such as age, years of service and compensation.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past-service costs. The defined benefit obligation is calculated triennially by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the income statement when they arise. Past-service costs are recognised immediately in administrative expenses, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period (the vesting period). In this case, the past-service costs are amortised on a straight line basis over the vesting period.

A defined contribution plan is a pension plan in terms of which the group pays fixed contributions into a separate entity. The group has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

For defined contribution plans, the group pays contributions to publicly or privately administered pension plans on a mandatory, contractual or voluntary basis. The group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expenses when they are due.

Post-retirement medical benefits

In terms of certain employment contracts, the Bank provides post-retirement medical benefits to qualifying employees and retired personnel by subsidising a portion of their medical aid contributions.

The entitlement to these benefits is based on employment prior to a certain date and is conditional on employees remaining in service up to retirement age. The expected costs of these benefits are accrued over the period of employment, using an accounting methodology similar to that used for defined benefit pension plans. Past-service costs, and actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised as expenses or income in the current year to the extent that they relate to retired employees or past service.

For active employees, actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in the current year. The liability is provided for in an actuarially determined provision.

1.10 Sale and repurchase agreements

The Bank has entered into repurchase agreements as part of its monetary policy activities. Securities purchased under agreements to resell are recorded under the heading "Accommodation to banks" as loans and receivables. Securities sold under agreement to repurchase are disclosed as repurchase agreements included in deposit accounts.

The underlying securities purchased under repurchase agreements are not recorded by the Bank. Likewise, underlying securities sold under repurchase agreements are not derecognised by the Bank.

The differences between the purchase and sale prices are treated as interest and accrued using the effective interest method.

1.11 Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the cost of completion and selling expenses.

Redundant and slow-moving stocks are identified and written down to their estimated economic or realisable values. Subsidiaries value raw materials at cost according to the first-in, first-out basis. Some raw material is valued at standard cost, which closely approximates the actual cost on a first-in, first-out basis.

Consumable stores are valued at the weighted-average cost price.

Maintenance spares are valued at average cost.

Finished goods and work in progress are valued at direct costs of conversion and production overheads on a first-in, first-out basis. Production overheads are included in the cost of manufactured goods, based on normal operating capacity.

Note-printing and coin-minting expenses include ordering, printing, minting, freight, insurance and handling costs. These costs are recorded as part of work-in-progress stock for the South African Bank Note Company (Proprietary) Limited and the South African Mint Company (Proprietary) Limited, and are released to the income statement when the currency is sold to the Bank.

1.12 Cash flow

For the purpose of the cash flow statement, cash and cash equivalents include cash on hand and bank overdrafts of the subsidiaries. As far as the Bank is concerned, no cash and cash equivalents are shown because of the role of the Bank as central bank in the creation of money.

1.13 Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

Provision for leave pay and bonus

Employee entitlements to annual leave and long-service leave are recognised when they accrue to employees.

The provision for leave pay represents the present obligation to employees as a result of employees' services provided at the balance sheet date. The provision is measured as the amount that is expected to be paid as a result of the unutilised leave entitlement that has accumulated at the balance sheet date.

Provision for staff disability

A provision for staff disability was raised by the South African Bank Note Company (Proprietary) Limited to cover payments to disabled staff.

1.14 Revenue recognition

Interest income and expense are recognised on a time-proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity. Interest income and expense are recognised in the income statement for all interest-bearing instruments on an accrual basis using the effective interest method. Where financial assets have been impaired, interest income continues to be recognised on the impaired value, based on the original effective interest rate. Interest income and expense include the amortisation of any discount or premium, or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective rate of interest basis.

Dividends are recognised when the right to receive payment is established.

Other revenue arising from the provision of services to clients is recognised on the accrual basis in accordance with the substance of the relevant transaction.

1.15 Use of estimates

The preparation of financial statements requires the use of certain critical accounting estimates. These estimates are based on assumptions and judgements, which depend on available information.

Estimates have been made primarily in the following areas: residual values and the useful life of property, plant and equipment; provisions; and post-retirement benefits.

The estimates made have been disclosed in Notes 11, 20 and 23.

1.16 Changes in accounting policies and accounting estimates

Change in accounting policies

Changes in accounting policies are accounted for retrospectively by applying the new policies to transactions, other events and conditions, as if the new accounting policies had always been applied.

Changes in accounting estimates

Changes in accounting estimates are accounted for prospectively by recognising the effect of the change in accounting estimates in the current and future periods affected by the change.

2. Cash and cash equivalents

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Bank and cash balances	135 075	77 137	0	0

Owing to its role in the creation and withdrawal of money, the Bank has no cash balances in its balance sheet. All other financial instruments maturing in less than three months are shown on the face of the balance sheet under appropriate headings.

3. Accommodation to banks

	Group 2009	Group 2008	Bank 2009	Bank 2008
Repurchase agreements	10 000 000	10 900 000	10 000 000	10 900 000
Application of cash reserve balances	293 180	15 734	293 180	15 734
Accrued interest	18 219	19 710	18 219	19 710
	10 311 399	10 935 444	10 311 399	10 935 444

The repurchase agreements yield interest at the repurchase rate of the Bank.

The following table represents details of the collateral received:

	Group 2009	Group 2008	Bank 2009	Bank 2008
Fair value of collateral received	10 131 799	10 965 653	10 131 799	10 965 653
Fair value of collateral permitted to sell or repledge in absence of default	10 131 799	10 965 653	10 131 799	10 965 653
Fair value of collateral sold or repledged at reporting date	0	0	0	0
Collateral cover	101,13%	100,42%	101,13%	100,42%
Maturity date	1 April 2009	2 April 2008	1 April 2009	2 April 2008

As at balance sheet date, none of the collateralised advances was past due or impaired.

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000

4. South African Government bonds

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Listed bonds:				
Capital	8 341 404	8 168 789	8 341 404	8 168 789
Accrued interest	95 626	111 255	95 626	111 255
	8 437 030	8 280 044	8 437 030	8 280 044
Effective interest rate:	8,33%	8,91%	8,33%	8,91%
South African Government bonds that do not qualify for derecognition:				
Listed bonds pledged	7 513 335	7 578 483	7 513 335	7 578 483
Associated liability	7 546 761	7 533 613	7 546 761	7 533 613

The Bank is exposed to interest rate risk on the listed South African Government bonds pledged as security. government bonds are pledged as collateral for repurchase agreements. In terms of these transactions, legal ownership of the bonds is transferred to the counterparty. As a result, the counterparty has the ability to sell or repledge these bonds.

5. Loans and advances

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Secured foreign loans	73 094	72 259	73 094	72 259

The loan facility of R75 million expires on 31 December 2009, if not renegotiated.

The following table represents details of collateral held:

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Fair value of collateral received	81 682	81 503	81 682	81 503
Fair value of collateral permitted to sell or repledge in the absence of default	0	0	0	0
Fair value of collateral sold or repledged at reporting date	0	0	0	0
Collateral cover	111,75%	112,79%	111,75%	112,79%
Maturity date	4 June 2009	5 June 2008	4 June 2009	5 June 2008

Land Bank bills have been pledged as collateral against the foreign loans. Legal ownership of these Land Bank bills has not been transferred to the Bank. As a result, the Bank does not have the ability to sell or repledge these Land Bank bills. As the bills mature, they are replaced with new bills.

As at balance sheet date, none of the collateralised advances was past due or impaired.

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000

6. Investment in and amounts due by/(to) subsidiaries

	Bank 2009 R'000	Bank 2008 R'000
Investment in subsidiaries	279 000	279 000
Corporation for Public Deposits	2 000	2 000
South African Mint Company (Proprietary) Limited	206 000	206 000
South African Bank Note Company (Proprietary) Limited	61 000	61 000
South African Reserve Bank Captive Insurance Company Limited	10 000	10 000
Amounts due by subsidiaries	189 178	170 030
South African Bank Note Company (Proprietary) Limited: Loan	33 148	30 451
Corporation for Public Deposits: Current account	156 030	139 579
Amounts due to subsidiaries		
Corporation for Public Deposits: Call deposit	(1 996 398)	(6 771 959)
Net investment in subsidiaries	(1 528 220)	(6 322 929)

The loan to the South African Bank Note Company (Proprietary) Limited bears interest at the repurchase rate and is unsecured with no fixed repayment term. The call deposit placed with the Bank by the Corporation for Public Deposits earns interest at South African money-market rates. The subsidiaries are all wholly owned and incorporated in the Republic of South Africa.

7. Gold and foreign exchange

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Gold coin and bullion	35 175 108	30 334 353	35 175 108	30 334 353
Money- and capital-market instruments and deposits	100 872 771	93 046 597	100 872 771	93 046 597
Medium-term notes	146 032 392	120 214 250	146 032 392	120 214 250
Portfolio investments	40 259 361	34 158 946	40 259 361	34 158 946
Accrued interest	102 106	133 572	102 106	133 572
	322 441 738	277 887 718	322 441 738	277 887 718

Gold coin and bullion consists of 4 012 339 fine ounces of gold at the statutory price of R8 766,73 per ounce (2008: 3 996 992 fine ounces at R7 589,30 per ounce). The foreign-exchange balances yield the investment returns achievable in the various currencies in which they are invested. It is not practicable to calculate effective yields on the portfolios due to the volatility caused by exchange rate fluctuations.

Securities lending activities
The net effect of securities lending in which the Bank is engaged at the end of the financial year is included in the foreign exchange balances above. The gross position is as follows:

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Liability in respect of collateral received	(88 249 328)	(75 844 078)	(88 249 328)	(75 844 078)
Fair value of underlying investments	87 506 385	75 844 078	87 506 385	75 844 078
Net fair value adjustment included above	(742 943)	0	(742 943)	0

8. Inventories

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Raw materials	154 406	148 664	0	0
Work in progress	185 559	171 352	0	0
Consumable stores	21 324	17 777	5 955	6 340
Maintenance spares	9 610	6 702	0	0
Finished goods	23 455	30 838	0	0
	394 354	375 333	5 955	6 340

9. Investments

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Local registered bonds	0	5 227	0	0
Short-term South African money-market investments	8 100 260	6 818 618	0	0
Local equities	8 498	11 952	0	0
	8 108 758	6 835 797	0	0
Maturity structure				
Repayable within 30 days	8 100 260	6 818 618	0	0
Repayable in more than 12 months	8 498	17 179	0	0
	8 108 758	6 835 797	0	0
For investments that meet the definition of loans and advances received designated at fair value:				
Maximum exposure to credit risk	8 100 260	6 818 618	0	0
Amount by which credit mitigation or derivatives offset credit risk	0	0	0	0
The cumulative change in fair value arising from changes in credit risk(1)	0	0	0	0
The cumulative change in fair value arising from changes in credit risk associated with mitigating instrument(2)	0	0	0	0

(1) Credit risk policies are formulated by the Governor's Executive Committee, in terms of which counterparty limits and security arrangements are set. These policies require that no uncollateralised loans may be made and that investment funds may only be placed with institutions accredited with ratings of at least A- by Standard & Poor's. The change in fair value due to changes in credit quality or spreads is not material and has therefore not been disclosed separately.

(2) The investments have remaining maturities of less than one month. As a result, changes in fair value due to credit risk are regarded as immaterial.

10. Amounts due by the South African Government

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
International Monetary Fund accounts administered on behalf of the South African Government	794 051	794 570	794 051	794 570
government of Namibia debt taken over by the South African Government	130 922	189 449	130 922	189 449
Gross amount due	141 711	220 211	141 711	220 211
Impairment loss	(10 789)	(30 762)	(10 789)	(30 762)
Net amount due by the South African Government	924 973	984 019	924 973	984 019

No settlement terms have been agreed to in respect of the International Monetary Fund (IMF) balances administered on behalf of the South African Government. The amount is interest free. The Namibian debt taken over by the South African Government is being settled over the next two years in terms of an agreement with the South African Government. The outstanding balance yields a return of 17 per cent per annum.

11. Property, plant and equipment

11.1 Group: 2009

	Land R'000	Buildings R'000	Plant, vehicles, furniture and equipment R'000	Work in progress R'000	Total R'000
Cost					
Cost at 31 March 2008	39 895	508 993	1 540 361	13 670	2 102 919
Additions	0	14 256	281 622	100 184	396 062
Transfers (out)/in	0	8 612	7 411	(16 023)	0
Disposals	0	0	(19 762)	0	(19 762)
Cost at 31 March 2009	39 895	531 861	1 809 632	97 831	2 479 219
Accumulated depreciation					
Accumulated depreciation at 31 March 2008	0	186 223	829 028	0	1 015 251
Charge for the year	0	10 803	103 099	0	113 902
Disposals	0	0	(19 252)	0	(19 252)
Accumulated depreciation at 31 March 2009	0	197 026	912 875	0	1 109 901
Net book value at 31 March 2009	39 895	334 835	896 757	97 831	1 369 318
Estimated useful life (years)		50	5 to 15		

Insurance value of fixed assets (on a 'future replacement basis' that takes into account the expected construction times). 8 484 223

Group: 2008

	Land R'000	Buildings R'000	Plant, vehicles, furniture and equipment R'000	Work in progress R'000	Total R'000
Cost					
Cost at 31 March 2007	39 528	508 052	1 391 495	50 991	1 990 066
Additions	367	867	155 228	18 771	175 233
Transfers in/(out)	0	74	56 018	(56 092)	0
Disposals	0	0	(62 380)	0	(62 380)
Cost at 31 March 2008	39 895	508 993	1 540 361	13 670	2 102 919
Accumulated depreciation					
Accumulated depreciation at 31 March 2007	0	175 431	767 299	0	942 730
Charge for the year	0	10 792	117 346	0	128 138
Disposals	0	0	(55 617)	0	(55 617)
Accumulated depreciation at 31 March 2008	0	186 223	829 028	0	1 015 251
Net book value at 31 March 2008	39 895	322 770	711 333	13 670	1 087 668

Insurance value of fixed assets (on a 'future replacement basis' that takes into account the expected construction times). 7 453 799

Registers containing details of land and buildings are available for inspection by members at the registered offices of the Bank and its subsidiaries.

11.2 Bank: 2009

	Land R'000	Buildings R'000	Plant, vehicles, furniture and equipment R'000	Work in progress R'000	Total R'000
Cost					
Cost at 31 March 2008	30 200	375 489	871 604	6 907	1 284 200
Additions	0	14	63 517	64 383	127 914
Transfers in/(out)	0	3 823	(9 841)	6 018	0
Disposals	0	0	(18 279)	0	(18 279)
Cost at 31 March 2009	30 200	379 326	907 001	77 308	1 393 835
Accumulated depreciation					
Accumulated depreciation at 31 March 2008	0	137 475	517 998	0	655 473
Charge for the year	0	7 737	67 677	0	75 414
Disposals	0	0	(17 794)	0	(17 794)
Accumulated depreciation at 31 March 2009	0	145 212	567 881	0	713 093
Net book value at 31 March 2009	30 200	234 114	339 120	77 308	680 742
Estimated useful life (years)		50	5 to 15		

Insurance value of fixed assets (on a 'future replacement basis' that takes into account the expected construction times).	3 960 639

Bank: 2008

	Land R'000	Buildings R'000	Plant, vehicles, furniture and equipment R'000	Work in progress R'000	Total R'000
Cost					
Cost at 31 March 2007	29 833	375 244	807 648	49 662	1 262 387
Additions	367	245	66 783	13 102	80 497
Transfers in/(out)	0	0	55 857	(55 857)	0
Disposals	0	0	(58 684)	0	(58 684)
Cost at 31 March 2008	30 200	375 489	871 604	6 907	1 284 200
Accumulated depreciation					
Accumulated depreciation at 31 March 2007	0	129 710	502 025	0	631 735
Charge for the year	0	7 765	68 287	0	76 052
Disposals	0	0	(52 314)	0	(52 314)
Accumulated depreciation at 31 March 2008	0	137 475	517 998	0	655 473
Net book value at 31 March 2008	30 200	238 014	353 606	6 907	628 727

Insurance value of fixed assets (on a 'future replacement basis' that takes into account the expected construction times).	3 814 651

Registers containing details of land and buildings are available for inspection by members at the registered offices of the Bank.

12. Equity investment in Bank for International Settlements

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Unlisted shares at valuation	369 732	348 413	369 732	348 413

The equity of the Bank for International Settlements (BIS) is held by central banks and the value of each central bank's share is calculated annually by the BIS on a net asset value basis. The shares cannot be sold at the discretion of the South African Reserve Bank.

13. Deferred taxation assets and liabilities

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Balance at the beginning of the year	161 351	131 660	215 855	185 576
Income statement credit (Note 26)	12 687	29 691	17 221	30 279
Balance at the end of the year	174 038	161 351	233 076	215 855
Comprising:				
Deferred taxation asset	312 137	282 776	277 030	258 187
Deferred taxation liability	(138 099)	(121 425)	(43 954)	(42 332)
Net deferred taxation asset	174 038	161 351	233 076	215 855

Deferred taxation assets and liabilities are attributed as set out in Notes 13.1 and 13.2.

13.1 Group

	2009 R'000	Credit/(debit) to income statement R'000	2008 R'000
Property, plant and equipment	(137 581)	(19 686)	(117 895)
Post-retirement medical costs	257 973	52 640	205 333
Provisions	33 678	(11 244)	44 922
Deferred retirement fund contributions	12 894	(7 944)	20 838
Deferred software development costs	0	(3 069)	3 069
Fair value adjustment to impaired assets	6 090	797	5 293
Prepaid expenditure and other items	4	213	(209)
Tax loss	980	980	0
Total	174 038	12 687	161 351

13.2 Bank

	2009 R'000	Credit/(debit) to income statement R'000	2008 R'000
Property, plant and equipment	(43 954)	(1 831)	(42 123)
Deferred retirement fund contributions	11 522	(5 590)	17 112
Fair value adjustment to impaired assets	3 021	(5 593)	8 614
Post-retirement medical costs	233 352	28 019	205 333
Deferred software development costs	0	(2 481)	2 481
Provisions	28 852	4 205	24 647
Prepaid expenditure and other items	283	492	(209)
Total	233 076	17 221	215 855

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000

14. Forward exchange contract assets and liabilities

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Unrealised gain on forward exchange contracts	0	16 059	0	13 563
Unrealised loss on forward exchange contracts	(11 790)	(9 873)	0	(9 873)
Net gain (loss)	(11 790)	6 186	0	3 690
Net (loss debited)/gain credited to Gold and Foreign Exchange Contingency Reserve Account (Note 21)*	0	3 690	0	3 690
Net (loss debited)/gain credited to income statement	(11 790)	2 496	0	0

* These amounts represent unrealised gains and losses on forward exchange contracts, which will be for the account of government as and when they are realised.

15. Other assets

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Financial assets	357 122	324 645	250 766	224 278
Non-financial assets	120 660	167 149	120 660	159 495
	477 782	491 794	371 426	383 773
Maturity structure of financial assets				
Repayable within 30 days	357 122	324 645	250 766	224 278

16. Deposit accounts

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Non-interest bearing	51 277 570	48 763 317	51 250 214	47 811 072
Banks' reserve accounts	47 857 029	44 524 420	47 857 029	44 524 420
government accounts	3 349 409	4 173 454	3 322 053	3 221 209
Other current accounts	71 132	65 443	71 132	65 443
Interest bearing	83 706 406	82 514 957	74 353 212	70 669 230
Repurchase agreements	7 546 761	7 533 613	7 546 761	7 533 613
Government special deposit	65 813 676	63 108 965	65 813 676	63 108 965
Margin calls: Repurchase transactions	104 555	26 652	104 555	26 652
Call deposits	10 241 414	11 845 727	888 220	0
	134 983 976	131 278 274	125 603 426	118 480 302
Maturity structure of deposit accounts				
Repayable on demand	13 661 955	16 084 624	4 281 405	3 286 652
Repayment terms subject to negotiation with National Treasury	65 813 676	63 108 965	65 813 676	63 108 965
Repayable within 30 days	55 508 345	52 084 685	55 508 345	52 084 685
	134 983 976	131 278 274	125 603 426	118 480 302
The repurchase agreements are secured by South African Government bonds as follows:				
Market value	7 513 335	7 578 483	7 513 335	7 578 483
Collateral cover (per cent)	99,56%	100,60%	99,56%	100,60%

The repurchase agreements bear interest at market-related rates approximately 20 to 70 basis points below the repurchase rate of the Bank.

Government's special deposit bears interest at a rate equivalent to the return earned on foreign-exchange investments made by the Bank.

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000

17. South African Reserve Bank debentures

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Capital	27 944 000	16 807 000	27 944 000	16 807 000
Accrued interest	165 144	121 734	165 144	121 734
	28 109 144	16 928 734	28 109 144	16 928 734

South African Reserve Bank (SARB) debentures are issued to the market on tender, normally on a 28- or 56-day term. The debentures are unsecured. Details of the debentures in issue at 31 March 2009 are as follows:

Maturity date	Interest rate (Per cent)	Capital (R'000)
1 April 2009	9,62	2 773 000
1 April 2009	10,68	650 000
8 April 2009	9,56	2 355 000
8 April 2009	9,60	1 500 000
14 April 2009	9,58	2 491 000
15 April 2009	9,34	2 809 000
23 April 2009	9,02	4 805 000
23 April 2009	9,18	1 285 000
29 April 2009	9,19	2 527 000
6 May 2009	9,20	2 545 000
13 May 2009	9,13	2 509 000
20 May 2009	8,39	1 695 000
		27 944 000

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
18. Foreign loans	6 201 166	11 311 522	6 201 166	11 311 522

18. Foreign loans

Foreign loans represent unsecured credit lines utilised and bear interest at market-related rates.

Analyses of the currency composition and maturity structure of these loans are set out in Note 30.

19. Notes and coin in circulation

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Notes	65 405 039	60 078 082	65 405 039	60 078 082
Coin	3 574 446	3 293 889	3 574 446	3 293 889
	68 979 485	63 371 971	68 979 485	63 371 971

The liability for notes and coin issued is the net liability after offsetting notes and coin held by the South African Reserve Bank as cash on hand, because cash held by the central bank does not represent currency in circulation.

20. Provisions

Group	Penalties R'000	Provident fund contributions R'000	Leave pay R'000	Staff disability R'000	Total R'000
Balance at 1 April 2007	0	0	84 005	0	84 005
Transfer from post-retirement benefit liability	0	0	0	500	500
Increase in provision	0	460	26 223	1 600	28 283
Utilised during the year	0	0	(12 592)	0	(12 592)
Balance at 31 March 2008	0	460	97 636	2 100	100 196
Increase in provision	154	0	37 298	2 800	40 252
Utilised during the year	0	(460)	(19 716)	0	(20 176)
Balance at 31 March 2009	154	0	115 218	4 900	120 272
Bank					
Balance at 1 April 2007			75 813	0	75 813
Increase in provision			17 911	0	17 911
Utilised during the year			(5 699)	0	(5 699)
Balance at 31 March 2008			88 025	0	88 025
Increase in provision			23 370	0	23 370
Utilised during the year			(8 352)	0	(8 352)
Balance at 31 March 2009			103 043	0	103 043

21. Gold and Foreign Exchange Contingency Reserve Account

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Opening balance	72 189 474	28 482 310	72 189 474	28 482 310
Profit on gold price adjustment account	4 747 929	11 136 623	4 747 929	11 136 623
Loss on forward exchange contract adjustment account	(135 441)	(1 949 208)	(135 441)	(1 949 208)
Profit on foreign exchange adjustment account	24 480 718	34 700 184	24 480 718	34 700 184
Movement in unrealised gains and losses on forward exchange contracts	(3 690)	35 623	(3 690)	35 623
	101 278 990	72 405 532	101 278 990	72 405 532
Net receipts/(payments)	305 728	(216 058)	305 728	(216 058)
Amount due to government	101 584 718	72 189 474	101 584 718	72 189 474
Balance composition				
Balance currently due to government	101 584 718	72 185 784	101 584 718	72 185 784
Unrealised losses and (gains) on forward exchange contracts (Note 14)	0	3 690	0	3 690
	101 584 718	72 189 474	101 584 718	72 189 474

The Gold and Foreign Exchange Contingency Reserve Account, which is operated in terms of section 28 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), represents net revaluation profits and losses incurred on gold and foreign-exchange transactions, which are for the account of the South African Government. Settlement of this account is subject to agreement, from time to time, between the Bank and government. The current arrangement is that only transactions that have affected liquidity in the South African money market will be settled. The remainder of the transactions are in respect of the revaluation of gold and foreign exchange, and do not represent cash flow. In terms of this agreement, the balance to be settled by government in respect of the financial year amounts to R173 million.

22. Other financial liabilities

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Accounts payable and sundry balances	437 911	407 908	102 691	211 458

23. Retirement benefit information

Retirement funds

The group has made provision for pension and provident plans substantially covering all employees. With the exception of three individuals, all employees are members of defined contribution plans administered by the group or are members of funds within the various industries in which they are employed. The assets of these plans are held in administered trust funds separate from the group's assets and the funds are governed by the Pension Funds Act, 1956 (Act No. 24 of 1956).

The Bank also has a defined benefit fund, which has been closed to new members since 1 July 1995. The fund currently has three active members and 460 pensioners. Contributions to the defined benefit pension fund are charged against income based on actuarial advice. The benefits provided are based on the years of membership and salary levels. These benefits are provided from contributions made by employees and the employer, as well as income from the assets of the plan. Current contribution levels are considered to be adequate to meet future obligations. The actuarial risk in respect of current pension commitments has been fully transferred to Sanlam through an insurance policy. In view of the transfer of the pension liability to Sanlam and the insignificant number of active members, no further financial disclosures are deemed necessary in respect of the defined benefit fund, as required by International Accounting Standard (IAS) 19 (AC 116). The last actuarial valuation of the fund was done as at 31 March 2005, at which date it was determined to be fully funded. The following key assumptions were applied:

	Per cent
Discount rate	7,53
Salary inflation	5,61
Post-retirement interest rate	3,50

Post-retirement medical benefits

The Bank and a subsidiary provide post-retirement benefits to retired staff in the form of subsidised medical aid premiums. A provision for the liability has been created. The provision covers the total liability, that is, the accumulated post-retirement medical benefit liability at fair value as at 31 March 2009.

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Net liability at beginning of the year	804 951	682 254	733 332	617 862
Annual cost				
Interest cost	71 590	55 078	64 652	49 849
Service cost	25 145	13 397	22 795	14 995
Actuarial losses	51 461	79 744	42 568	77 888
Net cost	148 196	148 219	130 015	142 732
Transfer to provision for staff disability	0	(500)	0	0
Total benefit payments	(31 814)	(25 022)	(29 947)	(27 262)
Net liability at the end of the year	921 333	804 951	833 400	733 332

Key assumptions:	2009 Per cent	2008 Per cent
Discount rate	9,00	9,00
Medical inflation	6,75	7,25
Net discount rate	2,11	1,63
Valuation date	31 March 2009	31 March 2008

The effect of a 1 per cent increase and decrease in the health care cost inflation rate is as follows:

Group	1% increase	Valuation basis	1% decrease
Employer's accrued liability	1 074 382	921 333	798 539
Employer's service and interest cost	118 120	106 274	98 775
Bank			
Employer's accrued liability	977 849	833 400	718 149
Employer's service and interest cost	117 432	97 515	81 944

24. Share capital

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Authorised and issued				
2 000 000 shares (2008: 2 000 000 shares) of R1 each	2 000	2 000	2 000	2 000

These shares qualify for a maximum dividend of 10 cents per share per annum.

25. Profit before taxation

25.1 Total income is stated after crediting

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Income from investments	24 851	23 457	28 035	23 476
Dividends	28 366	23 608	28 035	23 476
Realised and unrealised (loss)/profit on investments	(3 515)	(151)	0	0
Income from subsidiaries			19 838	17 091
Dividends			200	200
Interest			18 734	16 011
Administration fees			904	880
Realised gains on available-for-sale financial assets	64 270	0	64 270	0
Fair value adjustments to financial instruments	3 943	836	0	0
Commission on banking services	273 891	243 394	273 891	243 394

25.2 Operating costs include

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Directors' remuneration (Note 31)			12 804	11 371
From the Bank for services as directors			2 487	1 962
From the Bank for other services			10 317	9 409
Depreciation	113 902	128 138	75 414	76 052
Buildings	10 803	10 792	7 737	7 765
Plant, vehicles, furniture and equipment	103 099	117 346	67 677	68 287
Net loss on disposal of:	223	6 634	197	6 241
Land	0	0	0	0
Buildings	0	0	0	0
Plant and equipment, furniture and vehicles	223	6 634	197	6 241
Auditors' remuneration	7 618	6 790	5 550	4 960
Audit fees	7 052	6 193	5 392	4 757
Underprovision for previous year	408	437	0	43
Fees for other services	0	0	0	0
Expenses	158	160	158	160
Consulting fees	55 035	50 031	50 532	46 350
Net transfers to provisions	20 076	15 691	15 018	12 212
Provision for leave pay and bonuses	17 582	13 631	15 018	12 212
Provision for staff disability and penalties	2 954	1 600	0	0
Provision for provident fund contributions	(460)	460	0	0
Retirement benefit costs	257 934	326 018	218 322	298 062
Normal contributions to funds	86 024	74 459	74 151	64 831
Additional contributions to funds	16 425	90 604	16 425	90 604
Provision for post-retirement medical costs	116 382	123 197	100 068	115 470
Medical aid premiums paid	39 103	37 758	27 678	27 157
Remuneration and recurring staff costs	908 202	782 443	728 545	630 233
Cost of new currency	113 706	107 526	922 479	869 955
Other operating costs	1 008 531	804 374	214 142	197 636

26. Taxation

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
South African normal taxation				
Current taxation	386 697	1 102 004	373 120	1 050 034
Adjustment in respect of prior year	832	377	1 478	0
Rate adjustment: Unrealised profits on available-for-sale financial assets	0	2 785	0	2 785
Deferred taxation	(12 687)	(29 691)	(17 221)	(30 279)
Current year timing differences	(12 666)	(37 379)	(17 221)	(37 988)
Rate adjustment	0	6 553	0	7 709
Adjustment in respect of prior year	(21)	1 135	0	0
	374 842	1 075 475	357 377	1 022 540
Reconciliation of taxation rate				
South African normal taxation rate	28,00%	29,00%	28,00%	29,00%
Adjusted for:				
Disallowable expenses	0,55%	0,12%	0,61%	0,13%
Exempt income and special deductions	(1,67%)	(0,27%)	0,00%	0,00%
Adjustment in respect of prior years	0,06%	0,04%	0,12%	0,00%
Tax rate change	0,00%	0,25%	0,00%	0,30%
Effective taxation rate	26,94%	29,14%	28,73%	29,43%

27. Dividends per share (cents)

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Dividends per share (cents)	10	10	10	10
Dividends were paid as follows:				
Final dividend of 5 cents per share for the 2008 financial year	100	100	100	100
Interim dividend of 5 cents per share for the 2009 financial year	100	100	100	100
	200	200	200	200

Earnings per share have not been calculated because the shares qualify for a maximum dividend of 10 cents per share per annum in terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989).

28. Cash generated from operating activities

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Reconciliation of profit before taxation to cash generated from operating activities:				
Profit before taxation for the year	1 391 161	3 690 433	1 243 999	3 474 968
Adjustments for:				
Depreciation	113 902	128 138	75 414	76 052
Net loss on disposal of fixed assets	223	6 634	197	6 241
Unrealised foreign-exchange loss/(profit)	15 070	(2 930)	0	0
Notional interest on interest-free loan	(19 973)	(28 477)	(19 973)	(28 477)
Fair value adjustments to financial instruments	3 943	836	0	0
Provisions	20 076	15 691	15 018	12 212
Post-retirement benefits liability	116 382	123 197	100 068	115 470
Realised gain on available-for-sale financial assets	(64 270)	0	(64 270)	0
Net cash generated from operating activities	1 576 514	3 933 522	1 350 453	3 656 466
Changes in working capital:				
Accommodation to banks	624 045	4 118 003	624 045	4 118 003
Loans and advances	(835)	960	(835)	960
Amounts due by subsidiaries	0	0	(19 148)	55 446
Gold and foreign exchange	(44 554 020)	(85 465 917)	(44 554 020)	(85 465 917)
Inventories	(19 021)	(83 565)	385	3 018
Amounts due by the South African Government	79 019	79 573	79 019	79 573
Gold and Foreign Exchange Contingency Reserve Account	29 398 934	43 671 541	29 398 934	43 671 541
Equity investment in Bank for International Settlements	(21 319)	(61 076)	(21 319)	(61 076)
Other assets	5 574	(81 740)	12 347	(28 917)
Deposit accounts	3 705 702	30 807 089	7 123 124	30 245 614
Amounts due to subsidiaries	0	0	(4 775 561)	(3 485 701)
SARB debentures	11 180 410	11 450 204	11 180 410	11 450 204
Foreign loans	(5 110 356)	(8 274 416)	(5 110 356)	(8 274 416)
Notes and coin in circulation	5 607 514	4 903 013	5 607 514	4 903 013
Other financial liabilities	58 303	31 055	(28 842)	(755)
Cash generated from/(utilised by) changes in working capital	953 950	1 094 724	(484 303)	(2 789 410)
Cash generated from operating activities	2 530 464	5 028 246	866 150	867 056

29. Capital commitments

	Group 2009 R'000	Group 2008 R'000	Bank 2009 R'000	Bank 2008 R'000
Contracted	153 258	99 237	47 840	51 544
Not contracted	302 456	566 602	207 634	296 810
Total	455 714	665 839	255 474	348 354

These capital commitments are in respect of property, plant and equipment and will be funded from internal resources.

30. Risk management in respect of financial instruments

The policies and procedures of the Bank regarding risk management are dealt with in the risk management statement, which appears on pages 15 and 16. Certain aspects of risk management specific to financial instruments are described in more detail below.

Interest rate risk

With the exception of South African Government bonds and amounts due by the South African Government, the rand-denominated financial assets and liabilities of the Bank earn and bear interest at rates linked to South African money-market rates. The level of these rates is managed by the Bank through its monetary policy operations. The re-pricing of these assets and liabilities therefore occurs at approximately the same time. Accordingly, the Bank is not subject to significant interest-rate risk in respect of these instruments.

The Bank is exposed to interest rate risk in respect of certain foreign investments. The risk tolerance and return expectations in respect of these financial instruments are embodied in the target duration set by the Governor's Executive Committee.

Market price risk

Market price risk is the risk of loss resulting from changes in market conditions and prices. In its monetary policy operations, the Bank is obliged to accept certain market-related risks that would not be fully compatible with pure commercial practice. The Bank, nevertheless, manages its market risks responsibly, utilising modern technology, and appropriate organisational structures and procedures. Exposures and limits are measured continuously, and strategies are routinely reviewed by management on a daily basis and, when circumstances require, throughout the day. The exposure of the Bank to market price risk is limited by the fact that gold and foreign-exchange price risks are for the account of the South African Government in terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989).

Assets used as collateral and those used in the Monetary Policy Portfolio are subject to a daily mark-to-market valuation. In order to protect the Bank against credit and market risks, participants in the repurchase transactions have to provide securities with market values in excess of the exposures ('haircut valuations'). This means that the value of the securities divided by an appropriate ratio, as set out by the Bank, must at least be equal to the total repurchase price. Treasury bills and South African Reserve Bank (SARB) debentures are valued at the most recent auction's discount rates.

The Bank is exposed to market price risk in respect of investments in dollar, pound and euro bonds.

Credit risk

Credit risk is the risk of loss due to the inability or unwillingness of a counterparty to meet its contractual obligations. Credit risk arises from activities of the Bank such as advances to, and deposits made with, other institutions and the settlement of financial-market transactions.

Credit risk with respect to monetary policy operations is sufficiently mitigated, since all repurchase transactions are fully collateralised. Furthermore, in terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), no unsecured lending is allowed. The list of eligible securities is split between Category 1 and Category 2 instruments in terms of the Operational Notice. Category 1 assets consist of rand-denominated South African Government bonds, Treasury bills, SARB debentures and Land Bank bills. Category 2 securities consist of a selection of bonds included in the All-Bond Index, as determined by the Bond Exchange of South Africa, and are published on the website of the Bank. Furthermore, operations in the foreign-exchange market can only be conducted with Authorised Dealers.

The minimum counterparty credit rating for placing foreign-exchange deposits is 'A-' by Standard & Poor's or its Moody's or Fitch's rating equivalents, while the minimum rating for investment in securities is 'A'. Certain investment securities' ratings were below 'A' at year-end. However, the Bank intends holding these to maturity.

Concentration analysis

	Group		Bank	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
Assets				
South African rand	30 807 213	29 440 077	21 800 032	22 011 386
Gold	35 175 108	30 334 353	35 175 108	30 334 353
United States dollar	198 958 309	163 014 553	198 958 309	163 014 553
Euro	58 319 097	59 780 490	58 319 097	59 780 490
Pound sterling	26 421 295	22 126 934	26 421 295	22 126 934
Other	3 787 754	2 979 801	3 787 754	2 979 801
	353 468 776	307 676 208	344 461 595	300 247 517
Liabilities				
South African rand	335 275 359	285 427 205	327 356 680	279 031 379
United States dollar	4 370 625	3 851 793	4 370 625	3 851 715
Euro	1 591 580	6 575 219	1 579 790	6 575 219
Other	250 330	884 588	250 330	884 588
	341 487 894	296 738 805	333 557 425	290 342 901
Credit quality of performing financial assets				
Investment grade	341 879 426	297 465 245	341 637 995	297 451 619
Sub-investment grade	226 779	586 353	226 779	485 986
	342 106 205	298 051 598	341 864 774	297 937 605

Liquidity risk

Liquidity risk is the risk that an entity may not be able to accommodate decreases in liabilities or fund increases in assets in full at the time that a commitment or transaction is due for settlement. In the case of the Bank, this risk is not relevant to domestic assets and liabilities because of the ability of the Bank to create rands when required. However, the Bank does face liquidity risk in respect of foreign assets and liabilities.

The Bank manages its foreign liquidity risks through the appropriate structuring of its foreign investment portfolios to ensure that the maturity profiles of foreign assets sufficiently match those of foreign commitments. This is monitored and managed on a daily basis. In addition, the foreign investment portfolio of the Bank includes sufficient short-term, highly liquid investment instruments.

The table below analyses the financial liabilities into relevant maturity groupings based on the remaining period at balance sheet date to contractual maturity date.

Liabilities (R'000)	Up to 1 month	1 to 3 months	4 to 6 months	6 to 12 months	More than 1 year	Total
Group 31 March 2009						
Foreign loans[1]	6 201 166	0	0	0	0	6 201 166
Forward exchange contract liabilities[2]	11 790	0	0	0	0	11 790
Notes and coin in circulation	68 979 485	0	0	0	0	68 979 485
Gold and Foreign Exchange Contingency Reserve Account	101 584 718	0	0	0	0	101 584 718
SARB debentures	21 195 000	6 914 144	0	0	0	28 109 144
Deposit accounts	134 983 976	0	0	0	0	134 983 976
Other financial liabilities	437 911	0	0	0	0	437 911
Total financial liabilities	333 394 046	6 914 144	0	0	0	340 308 190
Group 31 March 2008						
Foreign loans[1]	11 311 522	0	0	0	0	11 311 522
Forward exchange contract liabilities[2]	9 873	0	0	0	0	9 873
Notes and coin in circulation	63 371 971	0	0	0	0	63 371 971
Gold and Foreign Exchange Contingency Reserve Account	72 189 474	0	0	0	0	72 189 474
SARB debentures	11 861 734	5 067 000	0	0	0	16 928 734
Deposit accounts	131 278 274	0	0	0	0	131 278 274
Other financial liabilities	407 908	0	0	0	0	407 908
Total financial liabilities	290 430 756	5 067 000	0	0	0	295 497 756

[1] Amounts reflected at fair value. Undiscounted cash flows approximate fair value due to the short-term nature of instruments.
[2] Derivative instruments are reflected at fair value in the shortest maturity bucket.

Liabilities (R'000)	Up to 1 month	1 to 3 months	4 to 6 months	6 to 12 months	More than 1 year	Total
Bank						
31 March 2009						
Foreign loans[1]	6 201 166	0	0	0	0	6 201 166
Forward exchange contract liabilities[2]	0	0	0	0	0	0
Notes and coin in circulation	68 979 485	0	0	0	0	68 979 485
Gold and Foreign Exchange Contingency Reserve Account	101 584 718	0	0	0	0	101 584 718
SARB debentures	21 195 000	6 914 144	0	0	0	28 109 144
Deposit accounts	125 603 426	0	0	0	0	125 603 426
Amounts due to subsidiaries	1 996 398	0	0	0	0	1 996 398
Other financial liabilities	102 691	0	0	0	0	102 691
Total financial liabilities	325 607 949	6 914 144	0	0	0	332 522 093
Bank						
31 March 2008						
Foreign loans[1]	11 311 522	0	0	0	0	11 311 522
Forward exchange contract liabilities[2]	9 873	0	0	0	0	9 873
Notes and coin in circulation	63 371 971	0	0	0	0	63 371 971
Gold and Foreign Exchange Contingency Reserve Account	72 189 474	0	0	0	0	72 189 474
SARB debentures	11 861 734	5 067 000	0	0	0	16 928 734
Deposit accounts	118 480 302	0	0	0	0	118 480 302
Amounts due to subsidiaries	6 771 959	0	0	0	0	6 771 959
Other financial liabilities	211 458	0	0	0	0	211 458
Total financial liabilities	284 208 293	5 067 000	0	0	0	289 275 293

[1] Amounts reflected at fair value. Undiscounted cash flows approximate fair value due to the short-term nature of instruments.
[2] Derivative instruments are reflected at fair value in the shortest maturity bucket.

Foreign-exchange operations

The framework of control regarding market operations in foreign exchange, that is, in spot and forward foreign exchange, as well as gold transactions, is rigorous. Trading limits exist for these instruments, and compliance is monitored and reported daily. In terms of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), all profits or losses on the gold price, foreign-exchange adjustments on assets and liabilities, and on any current or future forward exchange contract shall be for the account of the South African Government.

Settlement risk

Settlement risk (i.e., the risk that the counterparty may not be able to complete the deal) is mitigated in a number of ways. The Bank will only transfer the funds after sufficient collateral has been secured.

For outright transactions in securities, settlement risk is eliminated through the use of systems that are based on delivery versus payment, that is, the simultaneous exchange of securities and cash. In addition to restricting foreign-exchange transactions to highly rated counterparties, a transaction limit is imposed on the total value of foreign currency transactions settling with a counterparty on a given day. Furthermore, the Bank is a participant in CLS, a clearing house that eliminates settlement risk in foreign exchange, allowing payment versus payment in a number of major currencies. It eliminates 'temporal' settlement risk, making same-day settlement both possible and final.

Risk reporting in the Financial Markets Department

A monthly risk report is compiled and distributed to senior management of the Financial Markets Department of the Bank, the Executive General Manager: Markets, the deputy governor responsible for markets and the Chief Internal Auditor. The objective of the report is to inform management of risk exposures that occurred during a month under review and their impact on the key functions of the Bank. The report, furthermore, attempts to highlight future risks that might adversely impact on the activities of the department. In line with international best practice, key risk types discussed in the report are market, credit and operational risk in relation to market and investment operations. Detailed reporting by the department is continuously being improved and formalised.

31. Related party information

Transactions between the Bank and its subsidiaries, which are related parties to the Bank, have been eliminated on consolidation. The following transactions took place between these entities:

	2009 R'000	2008 R'000
Interest received	18 734	16 011
Interest paid	860 172	1 261 510
Insurance premiums paid	10 395	11 234
Rent paid	1 900	1 700
Management fees received	904	880
Cost of currency	808 773	762 429

The Bank, as a state organisation, could be regarded as related to other state corporations. However, the only transactions that the Bank has with such related entities are on purely commercial terms.

The Bank provides banking services to the National Treasury at no cost. This is in line with central banking practice in many countries across the globe. Certain terms and conditions of transactions with the South African Government for the purpose of assisting the Bank in improving the performance of its core business have not been disclosed.

The executive directors of the Bank are regarded as being the key management personnel, because they are involved in all key management decisions. Remuneration of the directors was as follows:

	Remuneration including fringe benefits R'000	Retirement and medical benefit contributions R'000	2009 Total R'000	2008 Total R'000
Executive directors: Remuneration for other services				
T T Mboweni	3 930	404	4 334	3 796
X P Guma	2 592	350	2 942	2 774
R D Mokate	2 711	330	3 041	2 839
	9 233	1 084	10 317	9 409

No other benefits accrued to the executive directors.

	2009 Total R'000	2008 Total R'000
Non-executive directors: For services rendered as directors		
D Konar	342	318
M Padayachee	0	95
N D Orleyn	298	275
J W Raath	0	128
F Jakoet	246	229
Z P Manase	260	214
S M Goodson	271	242
R W K Parsons	207	78
F E Groepe	187	68
T N Mgoduso	238	221
J F van der Merwe	231	94
E Masilela	207	0
	2 487	1 962
Paid by subsidiaries		
Non-executive directors: For services rendered as directors		
F Jakoet	312	274
E Masilela	5	0
	317	274

32. Segment reporting

Owing to the integrated nature of the activities of the Bank and its subsidiaries, the presentation of segmental information is not considered informative.

33. Gains and losses per category of financial assets and financial liabilities

	Total	Held-for-trading R′000	Designated at fair value R′000	Available-for-sale R′000	Loans and receivables R′000	Other liabilities R′000
Group						
31 March 2009						
Interest income	11 330 277		8 041 625	743 291	2 545 361	
Interest expense	(8 076 497)					(8 076 497)
Dividend income	28 366		28 366			
Operating income	594 242	529 972		64 270		
Bond revaluation reserve	275 675			275 675		
Group						
31 March 2008						
Interest income	12 920 307		9 959 057	749 709	2 211 541	
Interest expense	(7 495 629)					(7 495 629)
Dividend income	23 608		23 608			
Operating income	469 792	469 792				
Bond revaluation reserve	(647 296)			(647 296)		
Bank						
31 March 2009						
Interest income	10 244 757		8 041 625	743 291	1 459 841	
Interest expense	(7 139 102)					(7 139 102)
Dividend income	28 235		28 235			
Operating income	353 112	288 842		64 270		
Bond revaluation reserve	275 675			275 675		
Bank						
31 March 2008						
Interest income	12 098 728		9 959 057	749 709	1 389 962	
Interest expense	(6 767 711)					(6 767 711)
Dividend income	23 676		23 676			
Operating income	273 347	273 347				
Bond revaluation reserve	(647 296)			(647 296)		

34. Classification of financial assets and liabilities

	Total	Held-for-trading R'000	Designated at fair value R'000	Loans and receivables R'000	Available-for-sale R'000	Other liabilities R'000	Fair value[1] R'000
Group 31 March 2009							
Financial assets							
Cash and cash equivalents	135 075			135 075			135 075
Accommodation to banks	10 311 399			10 311 399			10 311 399
South African Government bonds	8 437 030				8 437 030		
Loans and advances	73 094			73 094			73 094
Gold and foreign exchange	322 441 738		322 441 738				
Investments	8 108 758		8 108 758				
Amounts due by the South African Government[2]	924 973			924 973			924 973
Equity investment in Bank for International Settlements	369 732		369 732				
Other assets	357 122			357 122			357 122
Financial liabilities							
Deposit accounts[3]	134 983 976					134 983 976	134 983 976
SARB debentures	28 109 144					28 109 144	28 109 144
Foreign loans	6 201 166					6 201 166	6 201 166
Notes and coin in circulation	68 979 485					68 979 485	68 979 485
Gold and Foreign Exchange Contingency Reserve Account	101 584 718					101 584 718	101 584 718
Forward exchange contract liabilities	11 790	11 790					
Other financial liabilities	437 911					437 911	437 911

[1] Fair values have been disclosed only for instruments carried at amortised cost. Carrying value has been used where it closely approximates fair value.
[2] Included in the amount above are International Monetary Fund accounts administered on behalf of the South African Government. The amount is interest free and no settlement terms have been agreed.
[3] Included in deposit accounts are amounts that do not bear interest. These deposit accounts do not have fixed maturity dates.

34. Classification of financial assets and liabilities (continued)

	Total	Held-for-trading R'000	Designated at fair value R'000	Loans and receivables R'000	Available-for-sale R'000	Other liabilities R'000	Fair value[1] R'000
Group							
31 March 2008							
Financial assets							
Cash and cash equivalents	77 137			77 137			77 137
Accommodation to banks	10 935 444			10 935 444			10 935 444
South African Government bonds	8 280 044				8 280 044		
Loans and advances	72 259			72 259			72 259
Gold and foreign exchange	277 887 718		277 887 718				
Investments	6 835 797		6 835 797				
Amounts due by the South African Government[2]	984 019			984 019			984 019
Equity investment in Bank for International Settlements	348 413		348 413				
Forward exchange contracts asset	16 059	16 059					
Other assets	324 645			324 645			324 645
Financial liabilities							
Deposit accounts[3]	131 278 274					131 278 274	131 278 274
SARB debentures	16 928 734					16 928 734	16 928 734
Foreign loans	11 311 522					11 311 522	11 311 522
Notes and coin in circulation	63 371 971					63 371 971	63 371 971
Gold and Foreign Exchange Contingency Reserve Account	72 189 474					72 189 474	72 189 474
Forward exchange contract liabilities	9 873	9 873					
Other financial liabilities	407 908					407 908	407 908

[1] Fair values have been disclosed only for instruments carried at amortised cost. Carrying value has been used where it closely approximates fair value.
[2] Included in the amount above are International Monetary Fund accounts administered on behalf of the South African Government. The amount is interest free and no settlement terms have been agreed.
[3] Included in deposit accounts are amounts that do not bear interest. These deposit accounts do not have fixed maturity dates.

34. Classification of financial assets and liabilities (continued)

	Total	Held-for-trading R'000	Designated at fair value R'000	Loans and receivables R'000	Available-for-sale R'000	Other liabilities R'000	Fair value[1] R'000
Bank **31 March 2009**							
Financial assets							
Accommodation to banks	10 311 399			10 311 399			10 311 399
South African Government bonds	8 437 030				8 437 030		
Loans and advances	73 094			73 094			73 094
Amounts due by subsidiaries	189 178			189 178			189 178
Gold and foreign exchange	322 441 738		322 441 738				
Amounts due by the South African Government[2]	924 973			924 973			924 973
Equity investment in Bank for International Settlements	369 732		369 732				
Other financial assets	250 766			250 766			250 766
Financial liabilities							
Deposit accounts[3]	125 603 426					125 603 426	125 603 426
Amounts due to subsidiaries	1 996 398					1 996 398	1 996 398
SARB debentures	28 109 144					28 109 144	28 109 144
Foreign loans	6 201 166					6 201 166	6 201 166
Notes and coin in circulation	68 979 485					68 979 485	68 979 485
Gold and Foreign Exchange Contingency Reserve Account	101 584 718					101 584 718	101 584 718
Other financial liabilities	102 691					102 691	102 691

(1) Fair values have been disclosed only for instruments carried at amortised cost. Carrying value has been used where it closely approximates fair value.

(2) Included in the amount above are International Monetary Fund accounts administered on behalf of the South African Government. The amount is interest free and no settlement terms have been agreed.

(3) Included in deposit accounts are amounts that do not bear interest. These deposit accounts do not have fixed maturity dates.

34. Classification of financial assets and liabilities (continued)

	Total	Held-for-trading R'000	Designated at fair value R'000	Loans and receivables R'000	Available-for-sale R'000	Other liabilities R'000	Fair value[1] R'000
Bank							
31 March 2008							
Financial assets							
Accommodation to banks	10 935 444			10 935 444			10 935 444
South African Government bonds	8 280 044				8 280 044		
Loans and advances	72 259			72 259			72 259
Amounts due by subsidiaries	170 030			170 030			170 030
Gold and foreign exchange	277 887 718		277 887 718				
Amounts due by the South African Government[2]	984 019			984 019			984 019
Equity investment in Bank for International Settlements	348 413		348 413				
Forward exchange contracts asset	13 563	13 563					
Other financial assets	224 278			224 278			224 278
Financial liabilities							
Deposit accounts[3]	118 480 302					118 480 302	118 480 302
Amounts due to subsidiaries	6 771 959					6 771 959	6 771 959
SARB debentures	16 928 734					16 928 734	16 928 734
Foreign loans	11 311 522					11 311 522	11 311 522
Notes and coin in circulation	63 371 971					63 371 971	63 371 971
Gold and Foreign Exchange Contingency Reserve Account	72 189 474					72 189 474	72 189 474
Forward exchange contract liabilities	9 873	9 873					
Other financial liabilities	211 458					211 458	211 458

[1] Fair values have been disclosed only for instruments carried at amortised cost. Carrying value has been used where it closely approximates fair value.

[2] Included in the amount above are International Monetary Fund accounts administered on behalf of the South African Government. The amount is interest free and no settlement terms have been agreed.

[3] Included in deposit accounts are amounts that do not bear interest. These deposit accounts do not have fixed maturity dates.

Notice of ordinary general meeting 2009

Notice is hereby given that the eighty-ninth ordinary general meeting of shareholders will be held at the Head Office of the South African Reserve Bank, 370 Church Street, Pretoria, on Thursday, 17 September 2009 at 10:30.

Agenda

1 To approve minutes of the ordinary general meeting of shareholders held on 18 September 2008.

2 To receive the annual financial statements and reports of the Board of Directors and the auditors for the year ended 31 March 2009.

3 To elect a shareholders' representative, representing commerce or finance, to the Board of Directors. The term of office of Mr S M Goodson will expire on 18 September 2009.

4 To determine the remuneration of the auditors for the past audit.

5 To appoint auditors for the 2009/10 financial year.

6 To transact any other business to be transacted at an ordinary general meeting.

In terms of section 23(1) of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), no shareholder is entitled to vote at an ordinary general meeting unless the shareholder has been the registered holder of shares for not less than six months prior to the date of the meeting and is ordinarily resident in the Republic of South Africa.

Shareholders who are unable to attend the meeting in person may use the proxy form to be distributed to shareholders with the *Annual Report 2008/09*. All proxy forms must be deposited at the Head Office of the Bank in Pretoria at least twenty-four hours prior to the meeting.

By order of the Board

T P Mongwe
Secretary of the Bank

Pretoria
August 2009

Shareholders' calendar

Dividends

	Declared	Paid
Interim	1 October 2008	31 October 2008
Final	1 April 2009	15 May 2009

Date and time of the ordinary general meeting in Pretoria: 17 September 2009 at 10:30.