Presentation made by the South African Reserve Bank to the Portfolio and Select Committees on Finance

22 September 2006

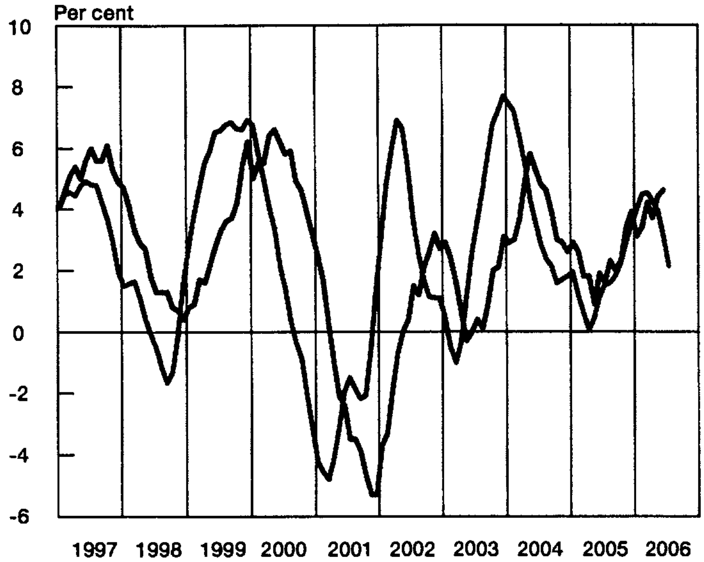
South African Reserve Bank

Contents

Recent international economic developments

Growth in global economic activity was sustained in the first half of 2006...

OECD leading indicator and industrial production



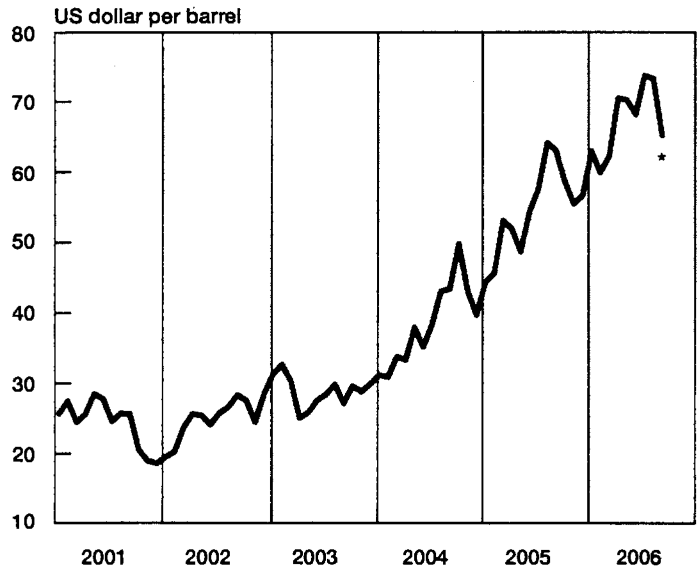
— OECD trend-restored composite leading indicator: Annualised six-month rate of change
— OECD industrial production index: Percentage change over 12 months

Source: Bloomberg

Following exceptional strength in 2004, global economic growth moderated to a still robust rate of increase in 2005 and the first half of 2006. The composite leading indicator lost momentum for four consecutive months, decelerating from a recent high in March 2006 to an annualised six-month rate of 2,1 per cent in July 2006. This suggests weaker growth in the OECD area towards year-end. However, the year-on-year rate of increase in industrial production accelerated from 4,4 per cent in May 2006 to 4,6 per cent in June.

...notwithstanding the exceptionally high and volatile price of crude oil...

International oil price



— Brent crude: Monthly average
* First half of September 2006

Source: IMF *International Financial Statistics* and SA Reserve Bank

The monthly average spot price of Brent crude oil decreased marginally from US$74 per barrel in July 2006 to US$73 per barrel in August. The daily spot price of Brent crude oil reached new record-high levels approaching US$80 per barrel in early August 2006, before receding to levels below US$63 per barrel in mid-September following the easing of geopolitical tensions and the end of the US summer season.

...and the further tightening of monetary policy in major economies...

Key central bank interest rates

Per cent

Countries	1 January 2006	14 September 2006	Latest change (Percentage points)
United States	4,25	5,25	29 Jun 2006 (+0,25)
Japan	0,00	0,25	14 Jul 2006 (+0,25)
Euro area	2,25	3,00	9 Aug 2006 (+0,25)
United Kingdom	4,50	4,75	3 Aug 2006 (+0,25)
Canada	3,25	4,25	24 May 2006 (+0,25)
Denmark	2,25	3,00	4 Aug 2006 (+0,25)
Sweden	1,50	2,50	6 Sep 2006 (+0,25)
Switzerland	0,50 – 1,50	1,25 – 2,25	14 Sep 2006 (+0,25)
Australia	5,50	6,00	2 Aug 2006 (+0,25)
New Zealand	7,25	7,25	8 Dec 2005 (+0,25)
Israel	4,50	5,50	1 Aug 2006 (+0,25)
China	5,58	6,12	19 Aug 2006 (+0,27)
Hong Kong	5,75	6,75	30 Jun 2006 (+0,25)
India	5,25	6,00	25 Jul 2006 (+0,25)
Malaysia	3,00	3,50	26 Apr 2006 (+0,25)
South Korea	3,75	4,50	10 Aug 2006 (+0,25)
Taiwan	2,25	2,50	29 Jun 2006 (+0,125)
Thailand	4,00	5,00	7 Jun 2006 (+0,25)
Brazil	18,00	14,25	30 Aug 2006 (-0,50)
Chile	4,50	5,25	13 Jul 2006 (+0,25)
Mexico*	8,25	7,00	21 Apr 2006 (-0,25)
Czech Republic	2,00	2,25	27 Jul 2006 (+0,25)
Hungary	6,00	7,25	29 Aug 2006 (+0,50)
Poland	4,50	4,00	28 Feb 2006 (-0,25)
Russia	12,00	11,50	26 Jun 2006 (-0,50)
South Africa	**7,00**	**8,00**	**3 Aug 2006 (+0,50)**

*The Bank of Mexico has decided on a gradual transition toward a policy target regime, but will retain the "el corto" until the transition is complete.
Source: National central banks

Central banks continued to tighten monetary policy in recent months. Japan ended its quantitative easing in March 2006 and increased rates in July followed by the United Kingdom and the euro area in August. In 2006 monetary policy was also tightened in Australia, Canada, Chile, China, the Czech Republic, Denmark, Hong Kong, Hungary, India, Israel, Malaysia, South Korea, Sweden, Switzerland, Taiwan and Thailand. However, the central banks of Brazil, Mexico and Russia recently lowered interest rates. By contrast, the target for the US federal funds rate remained unchanged in August after increases at seventeen consecutive meetings of the Federal Open Market Committee.

...to contain heightened global inflationary pressures which partly reflected rising energy prices.

World economic outlook: Consumer prices

Annual percentage change in consumer prices

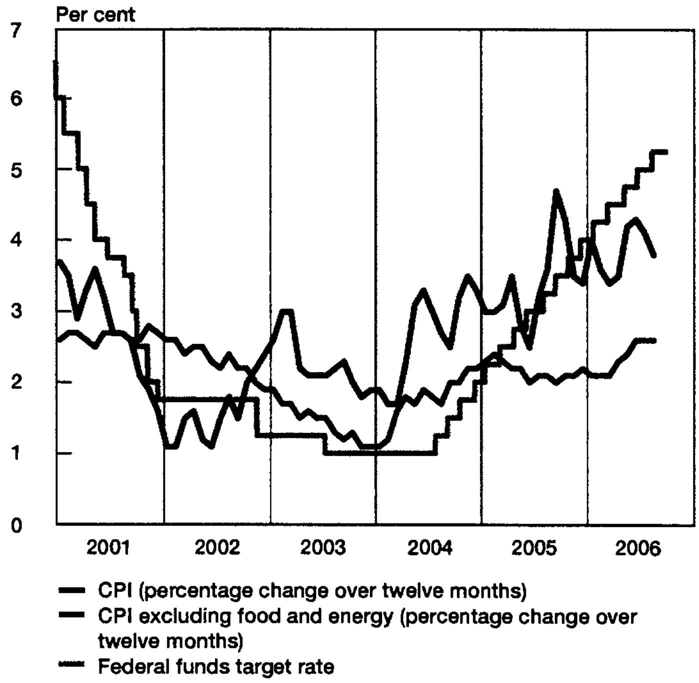
	Actual	Projections	
	2005	**2006**	**2007**
World	**3,7**	**3,8**	**3,7**
Advanced economies	2,3	2,6	2,3
United States	3,4	3,6	2,9
Japan	-0,6	0,3	0,7
Euro area	2,2	2,3	2,4
United Kingdom	2,0	2,3	2,4
Newly industrialised Asian economies*	2,2	2,2	2,2
Emerging-market and developing countries	5,3	5,2	5,0
Africa	8,5	9,9	10,6
South Africa	3,4	4,6	5,7
Central and eastern Europe	4,8	5,3	4,6
Developing Asia	3,5	3,8	3,6
China	1,8	1,5	2,2
India	4,0	5,6	5,3
Western hemisphere	6,3	5,6	5,2

* Include Hong Kong SAR, Korea, Singapore and Taiwan Province of China
Source: IMF *World Economic Outlook*, September 2006

Recently global inflation and inflationary pressures increased somewhat in several countries. The latest IMF *World Economic Outlook* indicates that global headline inflation is projected to increase slightly from 3,7 per cent in 2005 to 3,8 per cent in 2006, before moderating again to 3,7 per cent in 2007.

In the United States core inflation levelled off while interest rates most recently remained on hold.

USA: Consumer prices and central bank interest rate

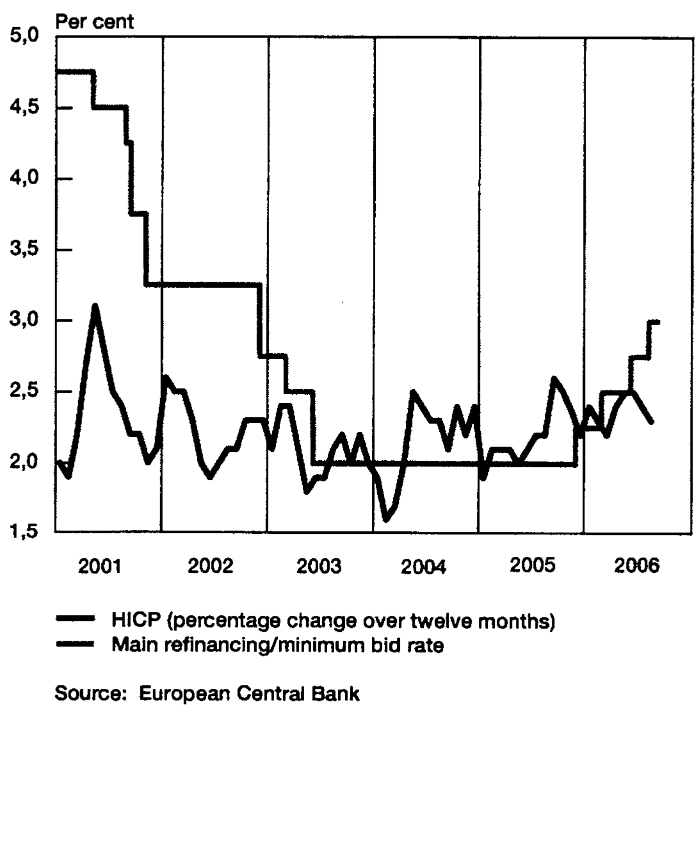


Source: Federal Reserve Bank of St. Louis

In the United States the year-on-year rate of change in the consumer price index (CPI) decreased further from 4,1 per cent in July 2006 to 3,8 per cent in August, while core CPI (overall CPI excluding food and energy) remained unchanged at 2,6 per cent. The Federal Open Market Committee left the target for the federal funds rate unchanged in August 2006 after an increase to 5,25 per cent in June 2006, the seventeenth consecutive 25-basis-point increase since the record low level of 1,0 per cent in June 2003.

In the euro area inflation moderated while interest rates increased.

Euro area: Consumer prices and central bank interest rate

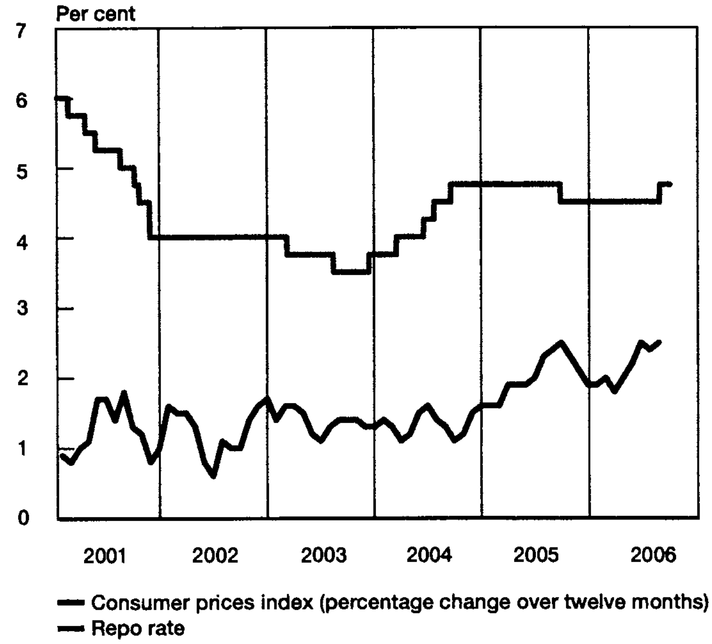


Source: European Central Bank

In the euro area the annual rate of increase in the overall Harmonised Index of Consumer Prices (HICP) decreased further to 2,3 per cent in August 2006 and the European Central Bank raised the official interest rate from 2,75 per cent to 3,00 per cent in August 2006.

In the United Kingdom inflation and interest rates increased.

UK: Consumer prices and central bank interest rate

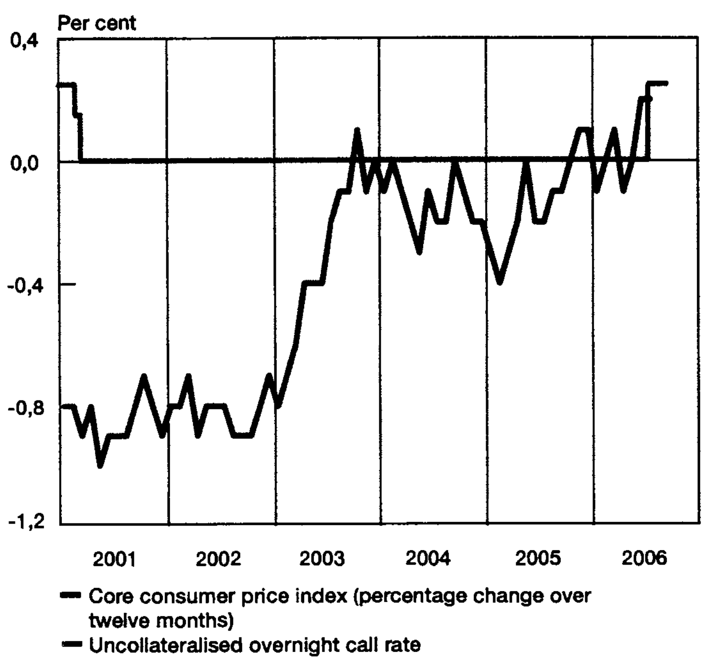


Source: UK Office for National Statistics and the Bank of England

In the United Kingdom the year-on-year rate of change in the consumer price index increased to 2,5 per cent in August 2006 from 2,4 per cent in July and the Bank of England increased the repo rate by 25 basis points to 4,75 per cent on 3 August 2006.

With inflation edging into positive territory, interest rates increased in Japan.

Japan: Core consumer prices and central bank interest rate



Source: Bloomberg

Japan's year-on-year rate of change in the core consumer price index (consumer prices excluding fresh food) remained unchanged at 0,2 per cent in July 2006. The Bank of Japan raised interest rates for the first time in almost six years on 14 July 2006, stating that it will encourage the uncollateralised overnight call rate to remain at around 0,25 per cent. Previously the central bank's key interest rate was maintained at zero per cent.

The outlook for global growth remains strong...

World economic outlook: Real gross domestic product

Annual percentage change in real GDP

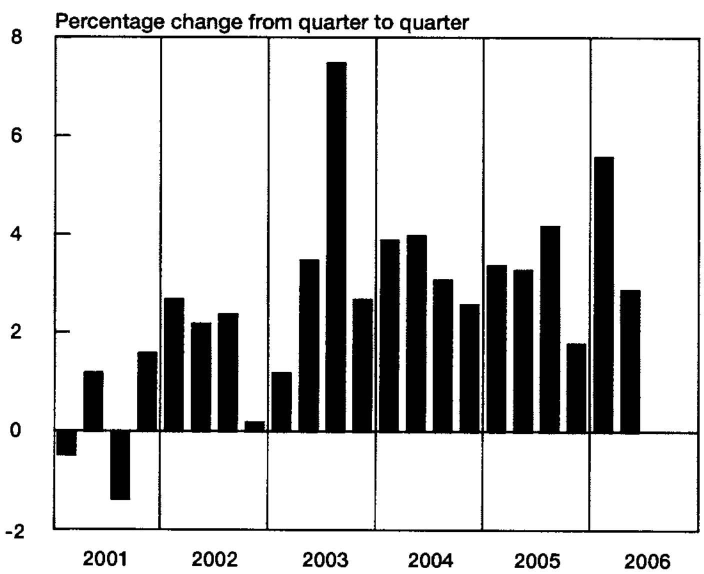
	Actual	Projections	
	2005	**2006**	**2007**
World	**4,9**	**5,1**	**4,9**
Advanced economies	2,6	3,1	2,7
United States	3,2	3,4	2,9
Japan	2,6	2,7	2,1
Euro area	1,3	2,4	2,0
United Kingdom	1,9	2,7	2,7
Newly industrialised Asian economies*	4,5	4,9	4,4
Emerging-market and developing countries	7,4	7,3	7,2
Africa	5,4	5,4	5,9
South Africa	4,9	4,2	4,0
Central and eastern Europe	5,4	5,3	5,0
Developing Asia	9,0	8,7	8,6
China	10,2	10,0	10,0
India	8,5	8,3	7,3
Western hemisphere	4,3	4,8	4,2

* Include Hong Kong SAR, Korea, Singapore and Taiwan Province of China
Source: IMF *World Economic Outlook*, September 2006

In its September 2006 *World Economic Outlook*, the IMF raised both its 2006 and 2007 forecasts for global growth by 0,2 percentage points to 5,1 per cent and 4,9 per cent, respectively. Inflationary concerns, tighter conditions in financial markets, record oil prices and other sources of uncertainty, however, highlighted downside risks to the global expansion. US growth is expected to strengthen somewhat in 2006, before moderating in 2007. Underlying this forecast is the expectation that consumption and residential investment growth will slow further as the housing market weakens, but that business investment will rebound against the background of strong profits and limited spare capacity. Euro area growth is projected to reach its highest rate in six years in 2006, while growth in emerging markets and developing countries are also expected to remain very strong.

...despite the moderation in growth in the United States...

USA: Real gross domestic product



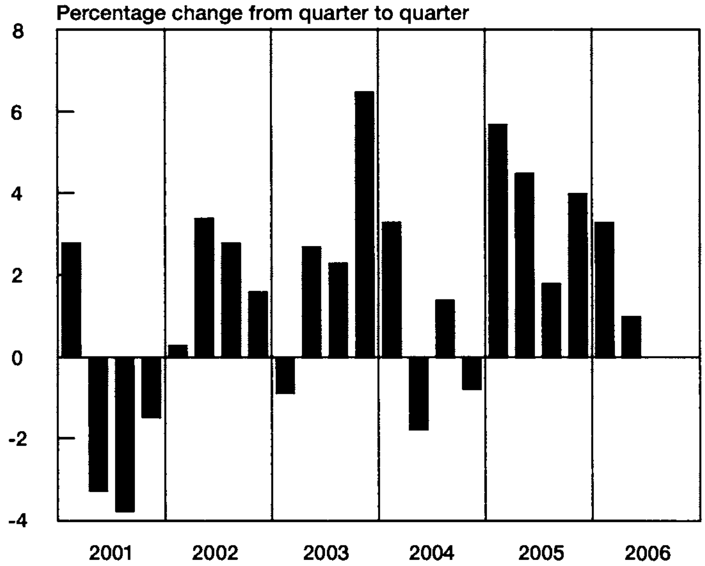
Seasonally adjusted annualised rates

Source: United States Bureau of Economic Analysis

Economic growth in the United States, after rebounding strongly to 5,6 per cent in the first quarter of 2006, moderated substantially to 2,9 per cent in the second quarter in response to the slowdown in the housing market, high crude oil prices and the effects of monetary policy tightening.

...and Japan...

Japan: Real gross domestic product



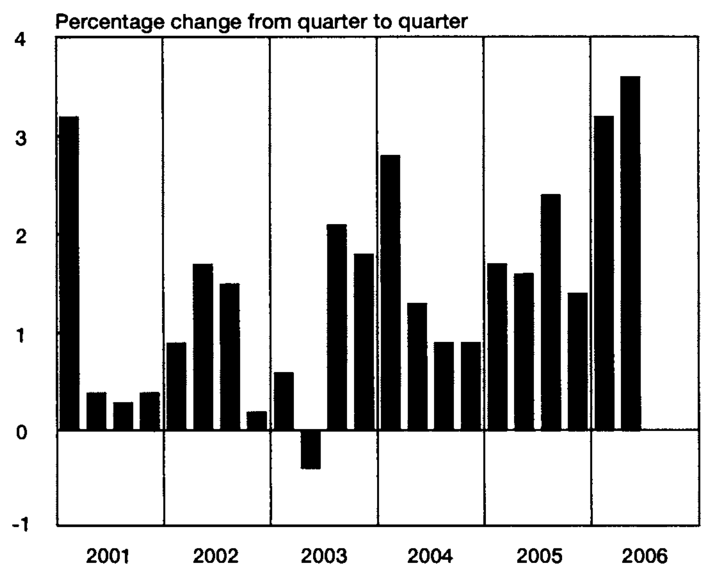
Seasonally adjusted annualised rates

Source: ESRI, Cabinet Office of Japan

Real economic growth in Japan decelerated during the first two quarters of 2006, from 3,3 per cent in the first quarter to 1,0 per cent in the second quarter, but the economy continues to expand moderately, driven by domestic final demand.

...as growth in the euro area continued to rebound...

Euro area: Real gross domestic product



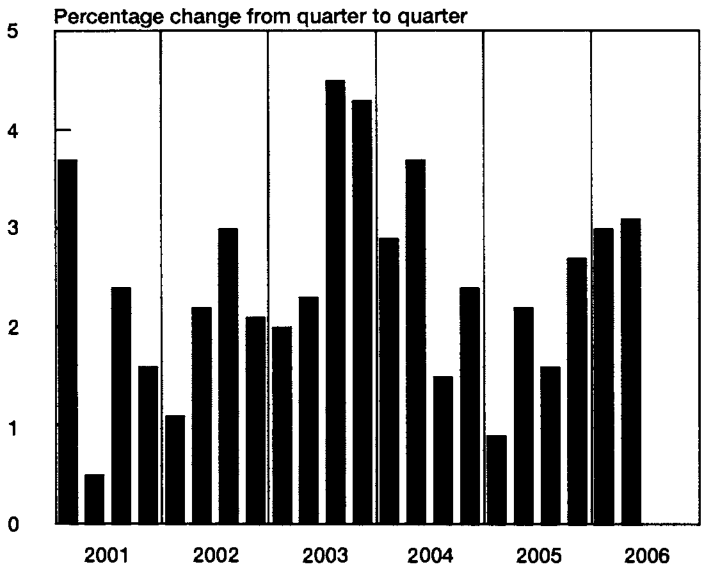
Seasonally adjusted annualised rates

Source: European Central Bank, Eurostat and Bloomberg

Real economic growth in the euro area accelerated from 3,2 per cent in the first quarter of 2006 to 3,6 per cent in the second quarter and became more broadly based as world trade continued to expand.

...and growth in the United Kingdom continued to gain momentum.

UK: Real gross domestic product



Seasonally adjusted annualised rates

Source: UK Office for National Statistics

Real gross domestic product in the United Kingdom increased by 3,1 per cent in the second quarter of 2006, following a growth rate of 3,0 per cent in the previous quarter, supported by continued strength in domestic demand.

Closer to home, inflation trends in the various SADC countries are diverging.

SADC inflation

Annual percentage change in consumer prices

	2004	2005	Jun 2006	Jul 2006	Aug 2006
Africa	8,0	8,5	*	*	*
Angola	43,6	23,0	12,9	*	*
Botswana	6,9	8,6	12,5	11,9	*
Lesotho	4,4	4,0	6,6	*	*
Madagascar	14,0	18,4	13,6	11,6	*
Malawi	11,4	15,5	15,3	14,9	*
Mauritius	3,9	5,6	7,6	10,1	*
Mozambique	6,4	10,1	14,7	11,1	10,6
Namibia	4,1	2,4	5,3	5,1	*
South Africa	**1,4**	**3,4**	**4,9**	**5,0**	*
Swaziland	3,4	4,8	5,3	*	*
Tanzania	4,1	4,4	6,8	5,4	*
Zambia	18,0	18,3	8,5	8,7	8,0
Zimbabwe	350,0	237,8	1 184,6	993,6	*

* Not available

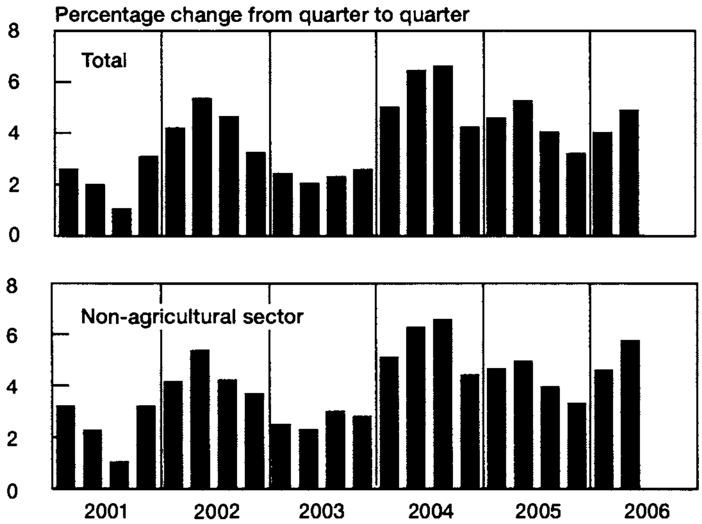
Source: National central banks and IMF *World Economic Outlook*, September 2006

Out of the thirteen SADC countries the year-on-year rate of increase of the latest measurement compared to the previous is lower for nine countries and higher for four countries. The twelve-month rate of change in consumer price indices in July 2006 ranged from 5,0 per cent for South Africa to 14,9 per cent for Malawi, with Zimbabwe as an outlier at 993,6 per cent.

Recent domestic economic developments

The growth rate of the South African economy accelerated in the second quarter of 2006 ...

Real gross domestic product

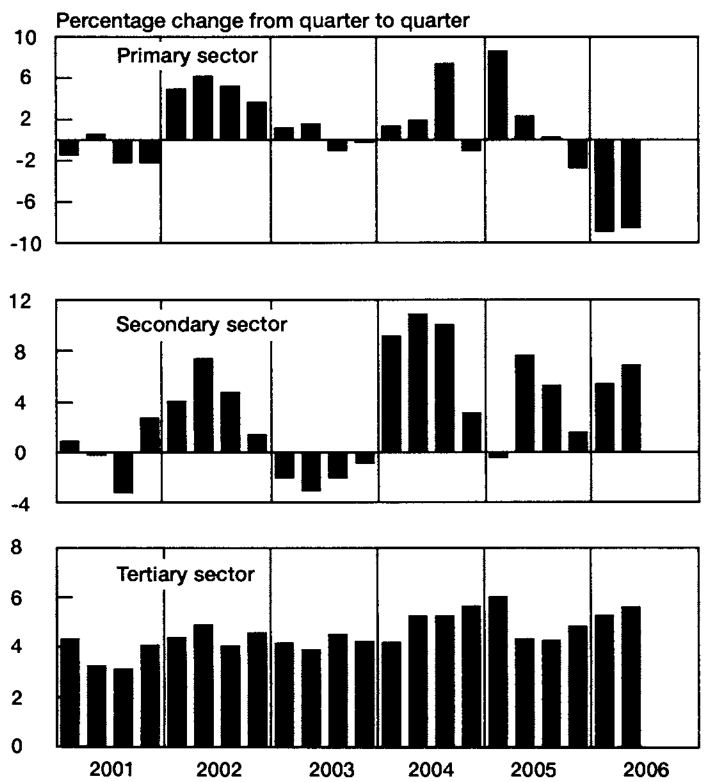


Seasonally adjusted annualised rates

The annualised growth in real gross domestic product increased from 4,0 per cent in the first quarter of 2006 to 4,9 per cent in the second quarter, bolstered by substantially stronger growth in the secondary sector and a vigorous increase in real value added by the tertiary sector. A decline in the real value added by the primary sector was comfortably offset by the increase in real value added by the other sectors. In manufacturing, for instance, the real value added expanded at a stronger pace than before as real domestic final demand continued to surge, alongside a more competitive external value of the rand in the latter half of the second quarter.

... as strong momentum in the secondary and tertiary sectors countered a decline in the primary sector.

Real gross domestic product by sector



Seasonally adjusted annualised rates

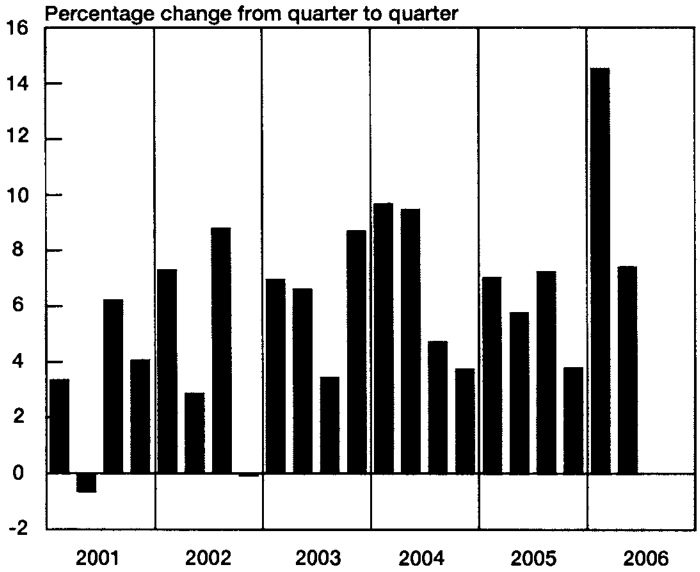
The real value added by the primary sector declined at an annualised rate of 8½ per cent during the second quarter of 2006. A sharp decline was recorded in the real output of the agricultural sector on account of a smaller maize crop, more than offsetting the positive growth rate recorded in the mining sector.

Growth in real value added by the secondary sector accelerated to annualised rates of 5½ per cent in the first quarter of 2006 and 7 per cent in the second quarter. Construction and manufacturing activity expanded briskly in the second quarter.

Real growth in the tertiary sector increased marginally from 5¼ per cent in the first quarter of 2006 to 5½ per cent in the second quarter. This firm growth was underpinned by increased activity in the trade and the transport, storage and communication sectors.

Domestic expenditure continued to expand, across all the components of domestic final demand ...

Real gross domestic expenditure

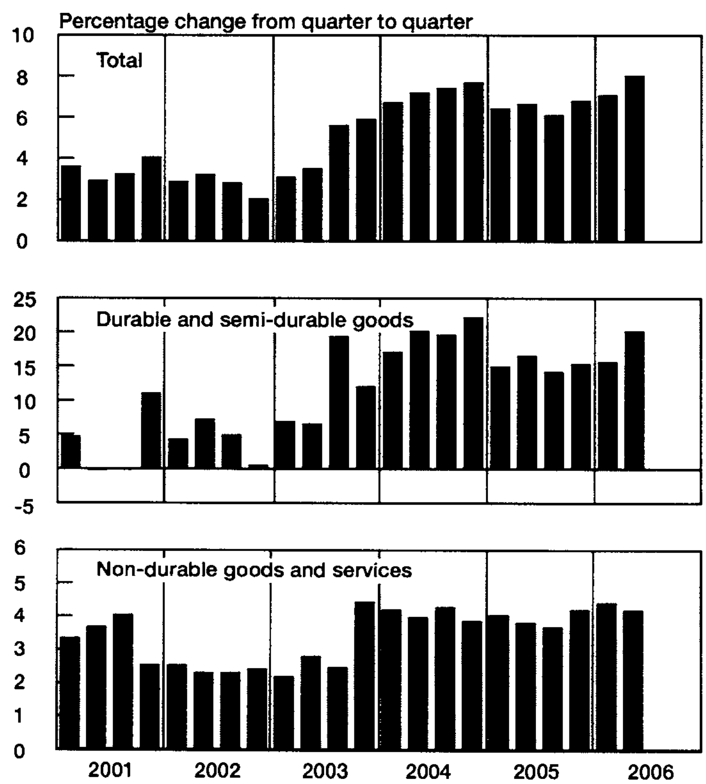


Seasonally adjusted annualised rates

Growth in aggregate real gross domestic expenditure slowed from an annualised rate of 14½ per cent in the first quarter of 2006 to 7½ per cent in the second quarter. The slower rate of expenditure mainly resulted from a considerably smaller increment to the pace of inventory accumulation during the second quarter. Nevertheless, real growth in all the final demand components – final consumption expenditure by households and general government, and gross fixed capital formation – accelerated in the second quarter of 2006.

... as reflected by the strong increase in household consumption expenditure...

Real final consumption expenditure by households

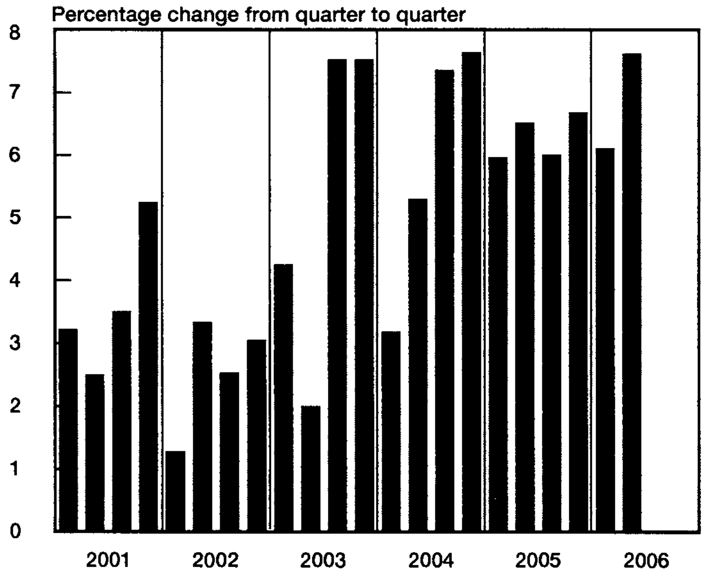


Seasonally adjusted annualised rates

Real final consumption expenditure by households expanded robustly in the second quarter of 2006. Having increased at an annualised rate of 7 per cent in the first quarter of 2006, growth accelerated to 8 per cent in the second quarter – the highest quarter-to-quarter growth rate to be recorded since the first quarter of 1995. The buoyant household expenditure reflected exceptionally high consumer confidence levels, the relatively low level of interest rates, a decline in the price of some semi-durable goods such as clothing and footwear, and a further improvement in the real disposable income of households.

… supported by the improvement in the real disposable income of households.

Real disposable income of households

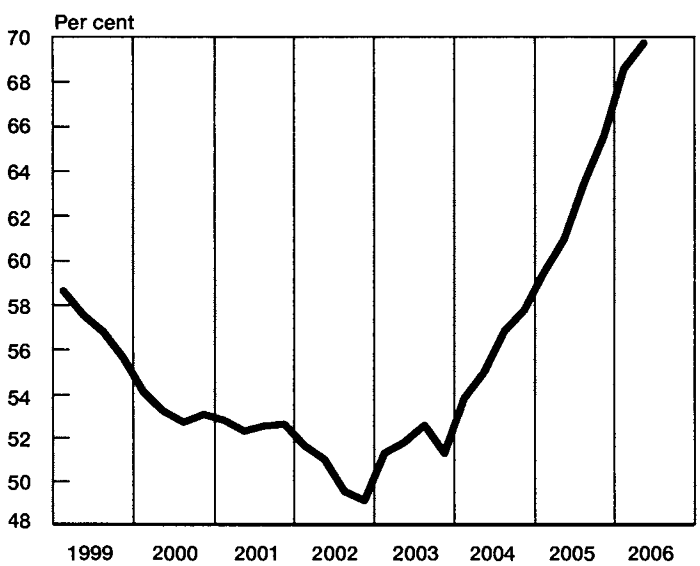


Seasonally adjusted annualised rates

The annualised pace of growth in real disposable income of households increased from 6 per cent in the first quarter of 2006 to 7½ per cent in the second quarter. Household income benefited from an increase in salaries and wages and from tax reductions announced in the 2006/07 Budget. Government transfers to the household sector also increased in the second quarter.

However, household debt levels increased to a new record high.

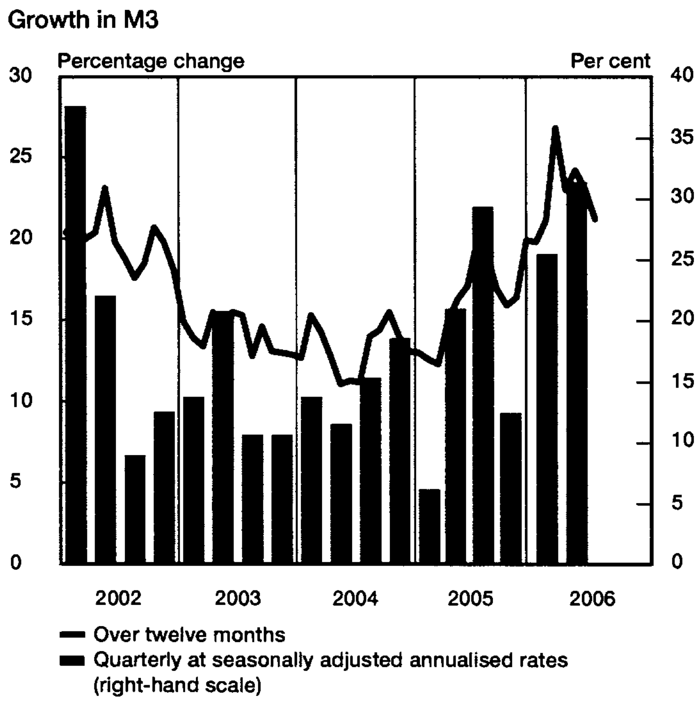
Household debt as percentage of disposable income



Seasonally adjusted

With growth in real household consumption expenditure exceeding growth in real disposable income, household saving inched lower in the second quarter and household debt continued to rise. Household debt as a percentage of disposable income amounted to 69¾ per cent in the second quarter of 2006, an increase of 1 percentage point compared with revised data for the first quarter.

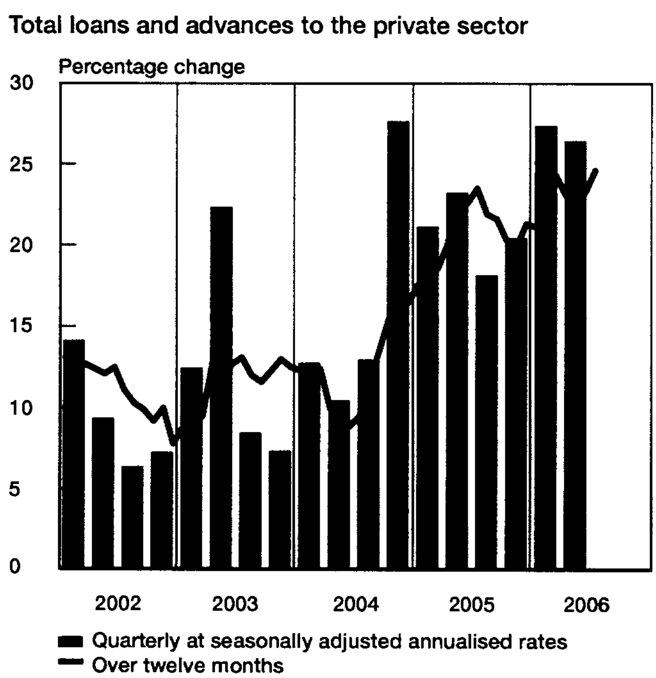
Growth in money supply was exceptionally strong in the second quarter of 2006 ...



The relatively low interest rate levels, buoyant income and expenditure, lively conditions in the financial markets and the generally rising trend in asset prices created conditions conducive to sustained brisk increases in money supply and in banks' credit extension.

The annualised quarter-to-quarter growth in the broad M3 aggregate accelerated from 25,5 per cent in the first quarter of 2006 to 31,4 per cent in the second quarter. The acceleration in M3 was also evident in its twelve-month growth as it rose at rates above 20 per cent from February 2006, registering a growth rate of 21,2 per cent in July. Both the corporate and household sectors increased their M3 deposit holdings during the month of July.

... and banks' total loans and advances also recorded vigorous increases.

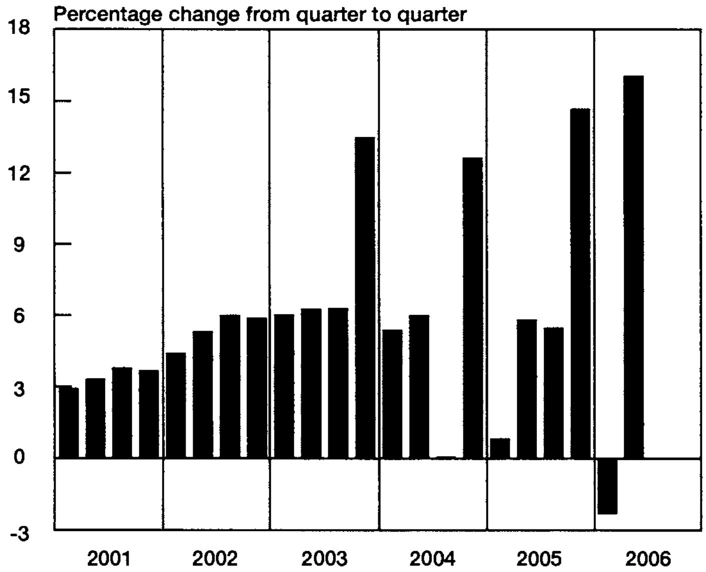


Robust growth in total loans and advances extended to the private sector continued during the second quarter of 2006, underpinned by strong domestic expenditure and income, and generally positive wealth effects.

The quarter-to-quarter annualised growth in total loans and advances decelerated from 27,3 per cent in the first quarter of 2006 to a still brisk rate of 26,4 per cent in the second quarter. Growth over twelve months remained around 23,0 per cent during the second quarter of 2006 and amounted to 24,6 per cent in July. Month-on-month, total loans and advances increased by an all-time high amount of R32,9 billion in July 2006, compared to R21,1 billion in June. Mortgage advances dominated the overall increase in total loans and advances extended to the private sector during the second quarter of 2006.

Real final consumption expenditure by general government rose strongly ...

Real final consumption expenditure by general government

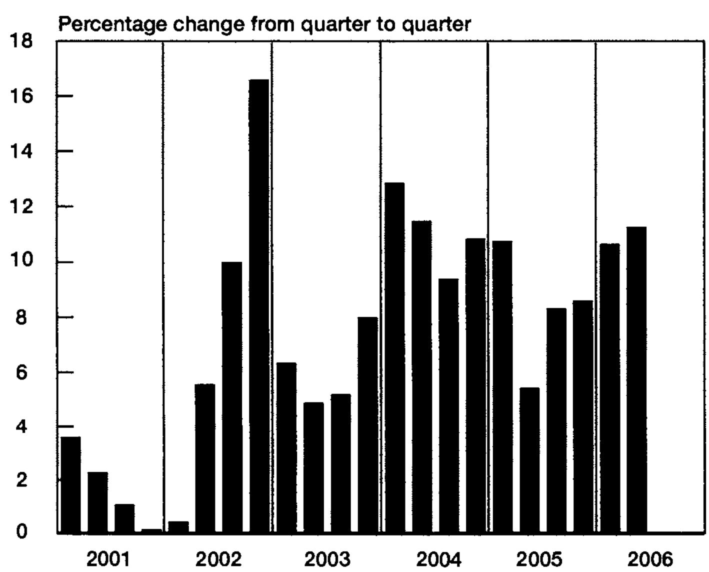


Seasonally adjusted annualised rates

Real final consumption expenditure by general government increased at an annualised rate of 16 per cent in the second quarter of 2006 following a decline of 2¼ per cent in the first quarter, mainly reflecting expenditure on non-wage goods and services, including the acquisition of aircraft as part of the defence procurement programme.

... as did real gross fixed capital formation by all institutional sectors.

Real gross fixed capital formation

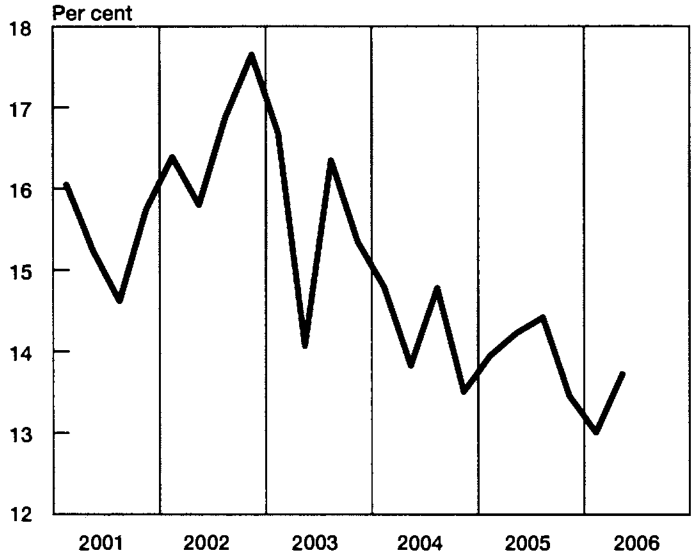


Seasonally adjusted annualised rates

Growth in real gross fixed capital formation increased further from 10¾ per cent in the first quarter of 2006 to about 11¼ per cent in the second quarter. This lifted the ratio of gross fixed capital formation to gross domestic product from 18 per cent to 18½ per cent over the same period. Solid increases in real outlays on capital goods were recorded by all three institutional sectors, i.e. private business enterprises, public corporations and general government.

On balance, the national savings ratio increased moderately.

Gross saving as percentage of gross domestic product

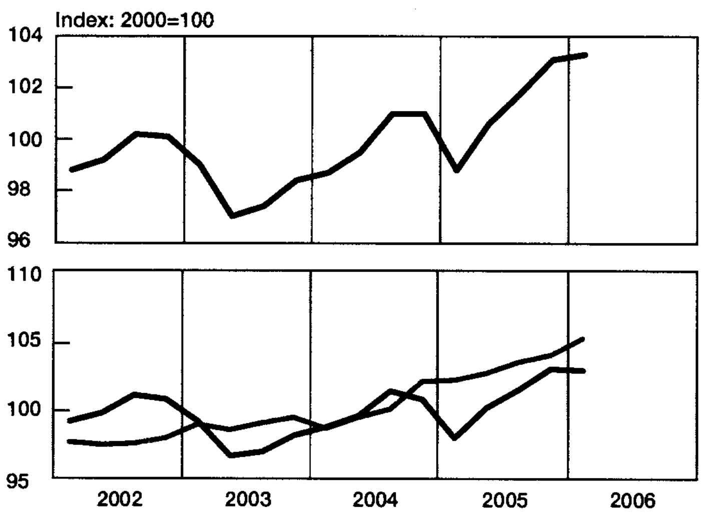


Seasonally adjusted

The national saving ratio, i.e. the ratio of total gross saving to gross domestic product, increased moderately from 13 per cent in the first quarter of 2006 to 13¾ per cent in the second quarter. The improvement in the savings ratio can mainly be attributed to an improvement in the savings performance of the corporate sector which more than offset the weaker savings originating from the household sector and general government.

Employment increased in both the private and public sectors ...

Non-agricultural employment

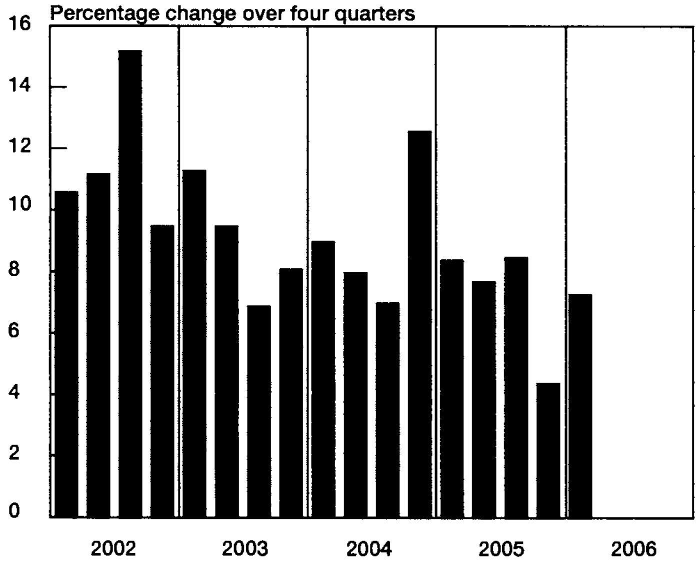


— Total
— Public sector
— Private sector
Statistically linked in the 3rd quarter of 2002 and the 4th quarter of 2004
Seasonally adjusted

Employment levels increased consistently from the second quarter of 2005 to the first quarter of 2006 according to Statistics South Africa's *Quarterly Employment Statistics* (QES) survey. Measured at a seasonally adjusted and annualised rate, employment levels increased by 0,7 per cent in the first quarter of 2006. When measured over a period of four quarters, employment increased by 4,5 per cent in the first quarter of 2006, or by around 316 000 employees. Private sector employment increased by 5,0 per cent over this four-quarter period while public-sector employment rose by 2,9 per cent.

... while the rate of increase in nominal wages per worker in the private sector outpaced that in the public sector.

Non-agricultural nominal remuneration per worker



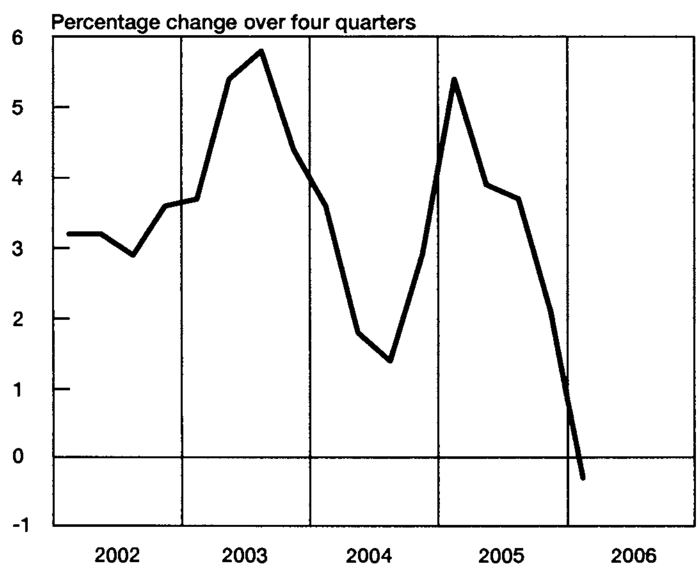
The year-on-year rate of increase in average nominal remuneration per worker amounted to 7,2 per cent in 2005 and to 7,3 per cent in the first quarter of 2006.

Growth in nominal wages per worker in the private sector amounted to 8,1 per cent in the year to the first quarter of 2006 with the non-governmental transport, storage and communication sector as well as the non-gold mining, construction and the finance, insurance, real-estate and business services sectors recording increases substantially in excess of the upper limit of the inflation target range.

The year-on-year rate of increase in nominal remuneration per worker in the public sector amounted to 6,0 per cent in the first quarter of 2006. The highest remuneration increases were recorded in national departments and in the transport, storage and communication sector.

Consistent with the increase in overall employment, labour productivity declined marginally.

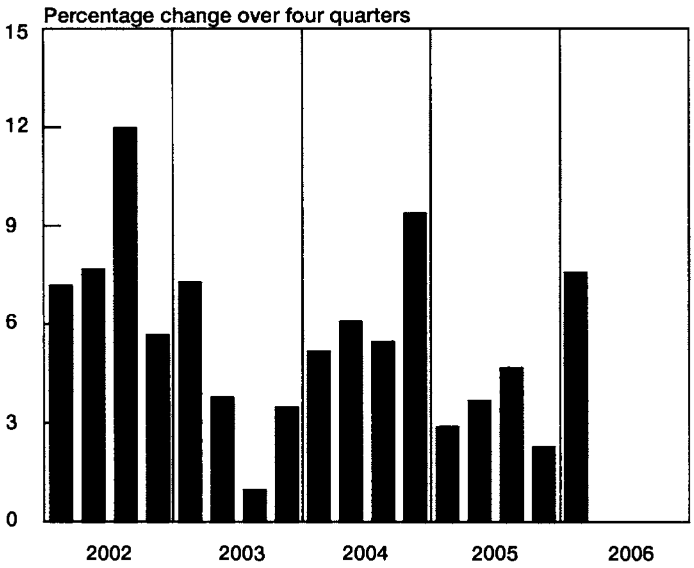
Non-agricultural labour productivity



Following increases in the overall level of employment in recent quarters, economy-wide labour productivity growth slowed down consistently from a year-on-year rate of 5,4 per cent in the first quarter of 2005 to 2,1 per cent in the fourth quarter. Real production per worker in the first quarter of 2006 was marginally lower when compared with the same period in the previous year.

The combination of an acceleration in remuneration and deceleration in productivity led to a significant increase in nominal unit labour cost in the formal non-agricultural sector.

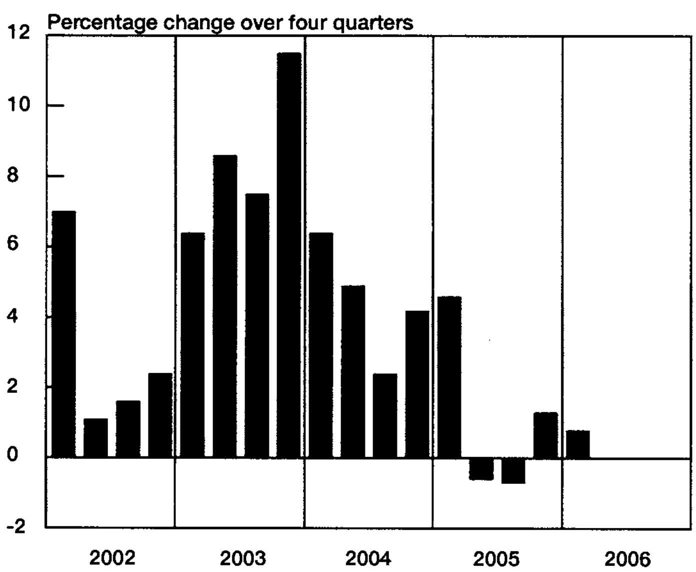
Non-agricultural nominal unit labour cost



The acceleration in the rate of increase in average nominal remuneration per worker, combined with the deceleration in labour productivity growth, caused the rate of increase in nominal unit labour cost in the formal non-agricultural sector to increase markedly. The rate of increase in nominal unit labour cost in the formal non-agricultural sector accelerated markedly from 3,4 per cent in 2005 to 7,6 per cent in the first quarter of 2006. This increase was the highest since the fourth quarter of 2004.

In the manufacturing sector unit labour cost remained well contained.

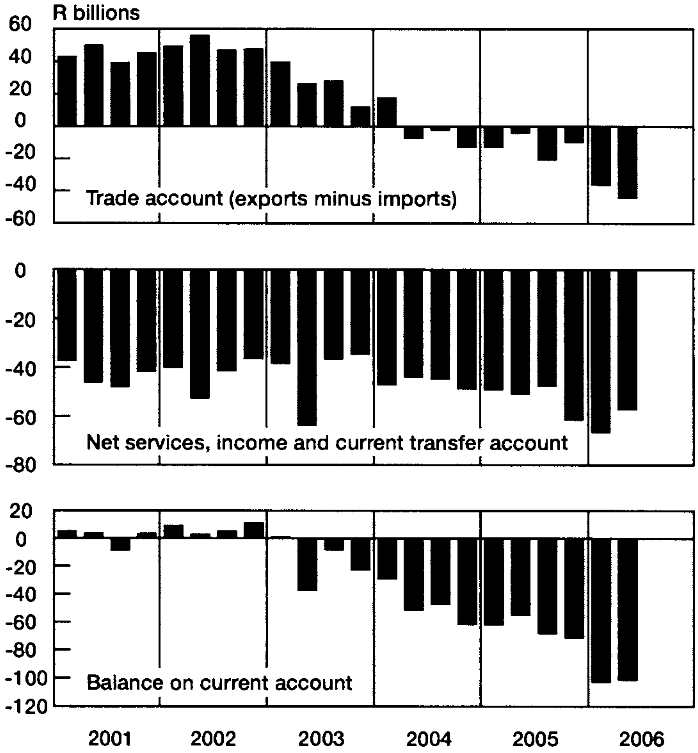
Nominal unit labour cost in manufacturing



Despite the acceleration in the year-on-year rate of increase in average nominal remuneration per worker in the manufacturing sector from 2,5 per cent in the fourth quarter of 2005 to 3,8 per cent in the first quarter of 2006, the proportionally higher level of manufacturing production resulted in year-on-year nominal unit labour cost growth in the manufacturing sector receding from 1,3 per cent in the fourth quarter of 2005 to 0,8 per cent in the first quarter of 2006.

South Africa's trade deficit widened as the brisk increase in gross domestic expenditure contributed to vibrant merchandise imports.

Balance of payments: Current account

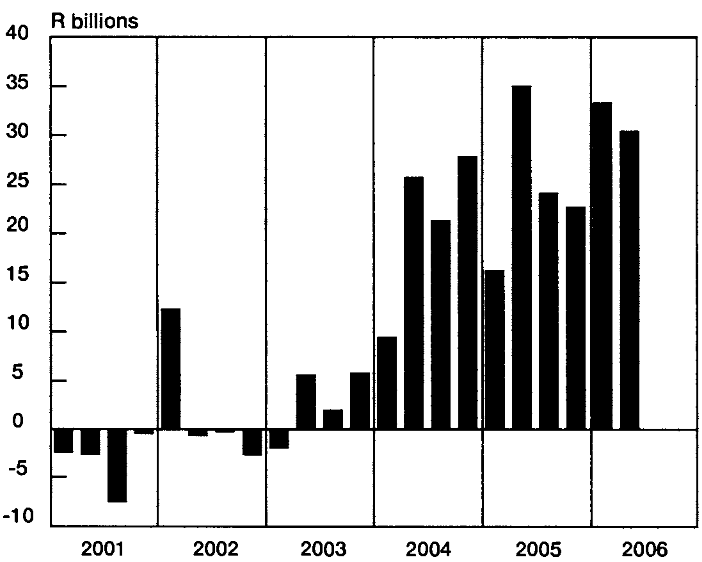


Seasonally adjusted and annualised

A substantial increase in the value of total merchandise exports in the second quarter of 2006 was more than offset by an even stronger increase in the value of merchandise imports. South Africa's trade deficit accordingly widened to R44,4 billion in the second quarter of 2006. However, owing to lower net service, income and current transfer payments to non-residents, the deficit on the current account of the balance of payments narrowed marginally to R101,7 billion in the second quarter of 2006. As percentage of gross domestic product, the current-account deficit narrowed from 6,4 per cent in the first quarter of 2006 to 6,1 per cent in the second quarter.

Notwithstanding a slightly smaller surplus on the financial account, capital inflows continued to finance the deficit on the current account.

Balance of payments: Financial account

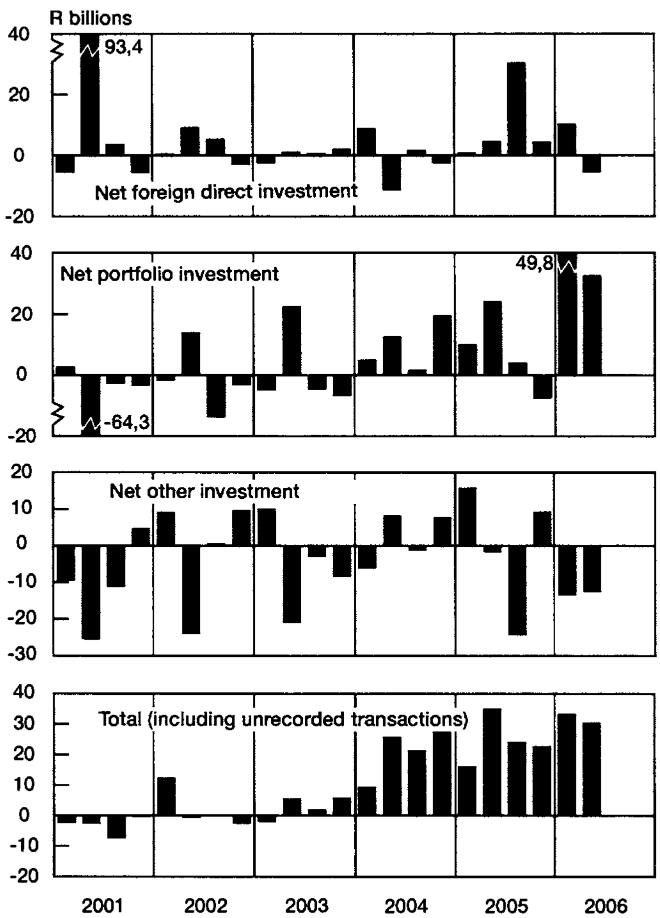


Including unrecorded transactions

Risk aversion towards emerging-market economies in general in the latter part of the second quarter of 2006 contributed to the narrowing of the surplus on South Africa's financial account with the rest of the world from R33,4 billion in the first quarter of 2006 to R30,5 billion in the second quarter.

Sizeable portfolio inflows more than offset direct and other investment outflows.

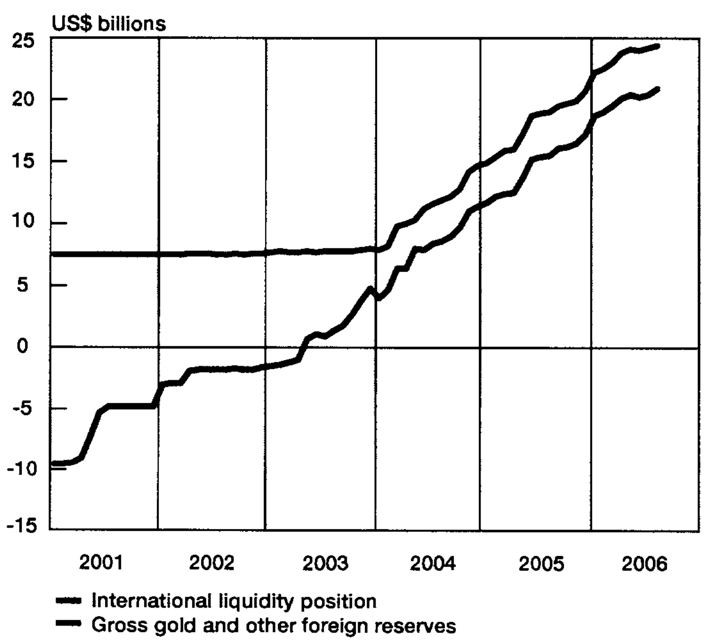
Financial account



The surplus on the financial account of the balance of payments narrowed slightly in the second quarter of 2006. Inward portfolio investment, which was exceptionally strong in the first quarter of 2006, moderated somewhat in the second quarter but remained high. At the same time direct and other investments recorded an outflow on a net basis. The surplus on the financial account (including unrecorded transactions) as a percentage of gross domestic product accordingly declined to 7,4 per cent in the second quarter of 2006.

The Bank's gross gold and foreign reserves continued to improve as did the international liquidity position ...

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



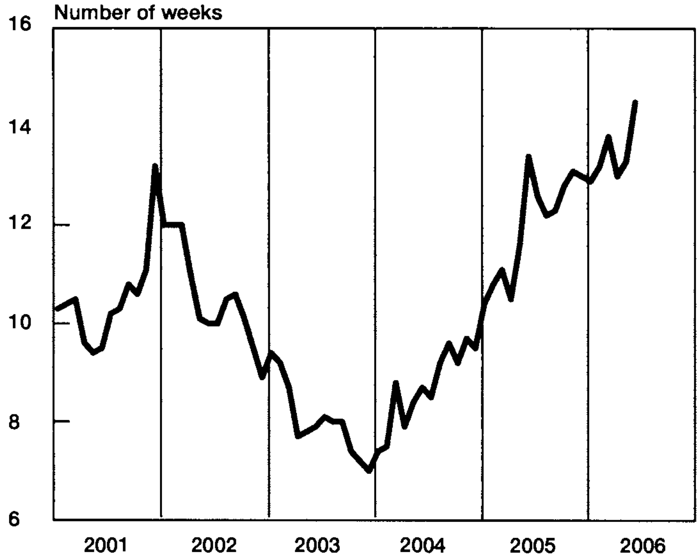
The overall balance of payments recorded a smaller surplus in the second quarter of 2006 than in the first as the Bank moderated its net purchases of foreign currency in the market. In July and August the Bank, sensitive to market conditions, continued to exercise caution in acquiring foreign exchange from the market.

The value of the gross gold and foreign exchange reserves of the South African Reserve Bank increased from US$23,0 billion at the end of March 2006 to US$24,0 billion at the end of June. Up to the end of August, the Bank's gross international reserves increased further to US$24,4 billion.

The Bank's international liquidity position also improved from US$19,5 billion at the end of March 2006 to US$20,2 billion at the end of June, rising further to US$20,9 billion at the end of August.

... which contributed to a further increase in the level of import cover.

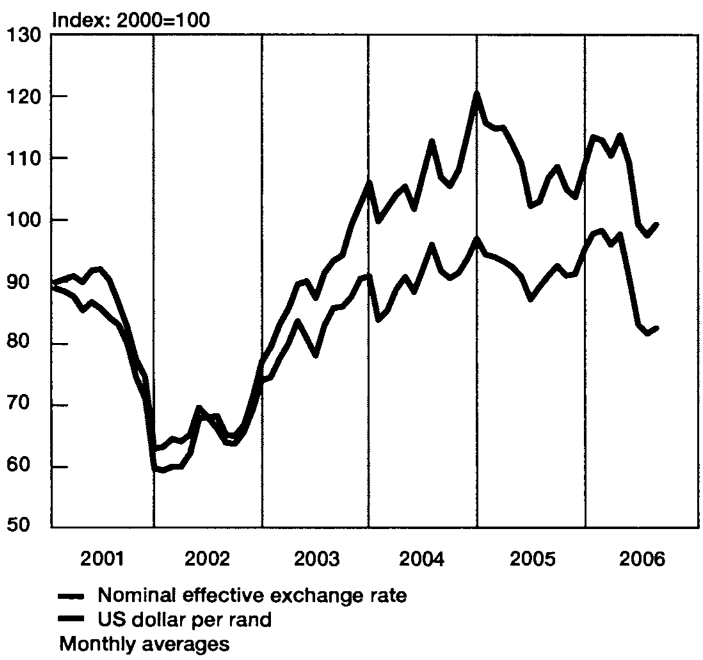
Imports covered by reserves



The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services) increased from 14 weeks at the end of March 2006 to 15 weeks at the end of June. This ratio has more than doubled since the end of 2003.

The depreciation in the exchange rate of the rand mainly took place in May and June 2006.

Exchange rates of the rand

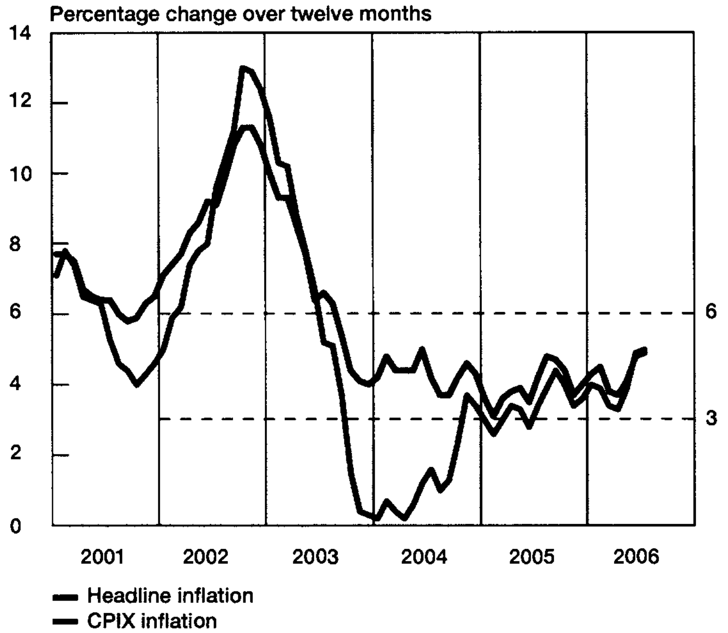


During the second quarter of 2006, increasingly attractive interest rates in some of the mature markets kindled negative sentiment and risk aversion among international investors towards the emerging-market economies. From early May 2006, this also affected South Africa as the exchange value of the rand depreciated significantly alongside the currencies of several other emerging-market economies, with the nominal effective exchange rate of the rand at the end of August some 15 per cent lower than at the beginning of May. The decline of no less than 16 per cent from the end of March to the end of June 2006, was the largest quarterly decline that has been recorded since the decline of 24 per cent in the fourth quarter of 2001.

On a trade-weighted basis the weighted-average exchange rate of the rand, on balance, decreased by 2,0 per cent in 2005 and by a further 15,3 per cent from 31 December 2005 to 31 August 2006. Over the same period the rand depreciated by 10,6 per cent against the US dollar.

Reflecting mounting price pressures, CPIX inflation increased significantly in recent months while remaining within the inflation target range.

Headline inflation and CPIX

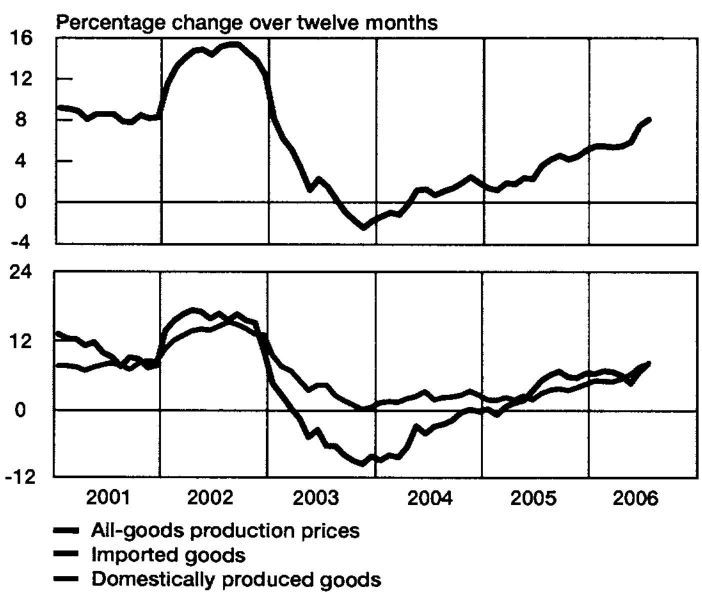


Price pressures in the domestic economy have mounted in recent months primarily due to increases in the international price of crude oil, accelerating food price inflation and sustained strong consumer demand in general. The depreciation of the exchange rate of the rand from the middle of May 2006 has also adversely affected the inflation outlook. The more subdued behaviour of services prices moderated the sensitivity of CPIX inflation to movements in the prices of goods at the production level.

Year-on-year CPIX inflation accelerated from 3,7 per cent in April 2006 to 4,8 per cent in June and further to 4,9 per cent in July, mainly due to a rise in the prices of food and petrol. Year-on-year headline inflation amounted to 5,0 per cent in July 2006.

Production price inflation accelerated strongly from the second quarter of 2006.

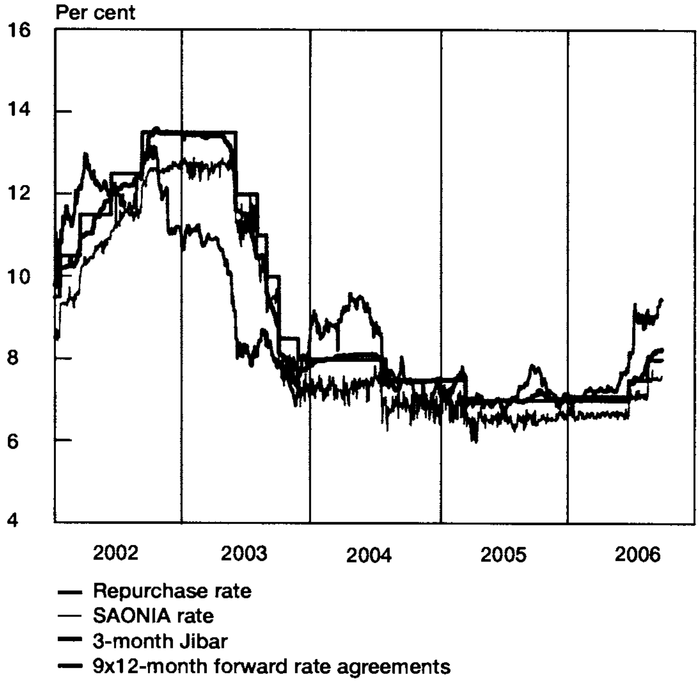
All-goods production prices



With both domestically produced goods and imported goods price inflation accelerating, the year-on-year rate of increase in the all-goods production price index more than doubled to 8,1 per cent over the twelve months to July 2006. Year-on-year inflation in the prices of imported goods amounted to 8,2 per cent in July 2006 while domestically produced goods price inflation was slightly lower at 8,1 per cent. When all-goods production price inflation is stripped of the effect of the current main inflation drivers, i.e. energy and food prices, an increase of 5,3 per cent was recorded in the year to July 2006. However, this latter rate of increase was double the rate of increase registered in the closing months of 2005, indicating that underlying production price pressures were also picking up.

Money-market interest rates trended higher in anticipation of and partly in response to monetary policy tightening.

Money-market interest rates

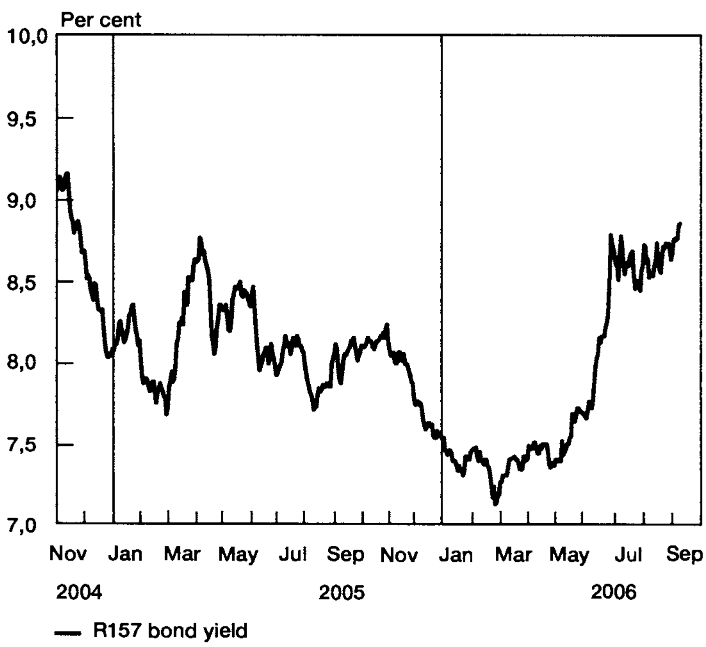


Following a 50-basis-point increase in the repurchase rate at its June 2006 meeting, the Monetary Policy Committee (MPC) raised the repurchase rate by a further 50 basis points to 8,00 per cent in August 2006. This was in response to a deterioration in the risks to the inflation outlook brought about by the weaker exchange rate of the rand, uncertainties regarding oil prices, exceptionally strong growth in household consumption and continued widening of the current-account deficit.

Movements displayed by other money-market instruments such as the three-month Johannesburg Interbank Agreed Rate (Jibar) also largely reflected the trend in the repurchase rate. The Jibar rate increased from 7,13 per cent on 3 August 2006 to 8,26 per cent on 13 September 2006.

From early May to mid-June 2006, yields on long-term bonds increased significantly alongside the depreciation in the exchange value of the rand...

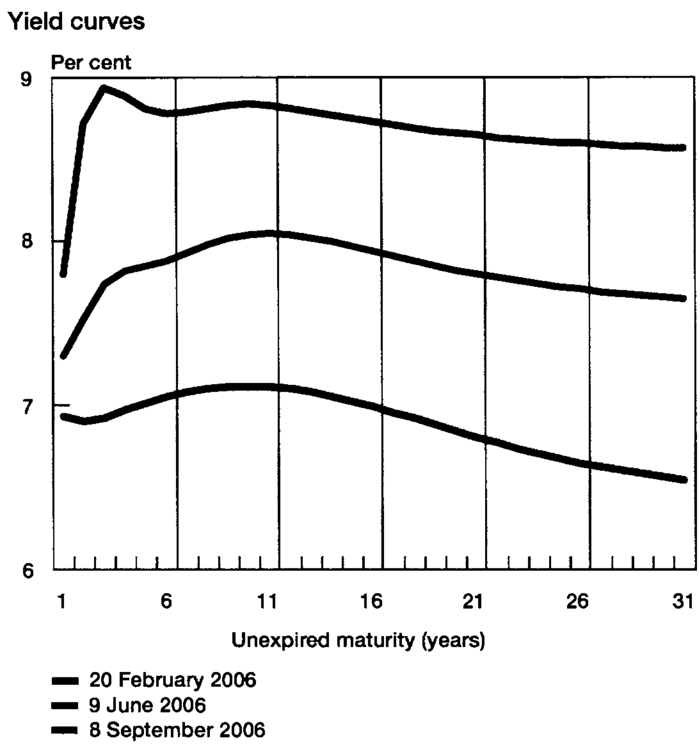
Yield on long-term government bonds



Long-term bond yields displayed an upward bias from the end of February 2006 as persistently high oil prices revived inflation concerns. The upward movement accelerated from mid-May, alongside the depreciation of the exchange value of the rand and global risk aversion towards emerging markets.

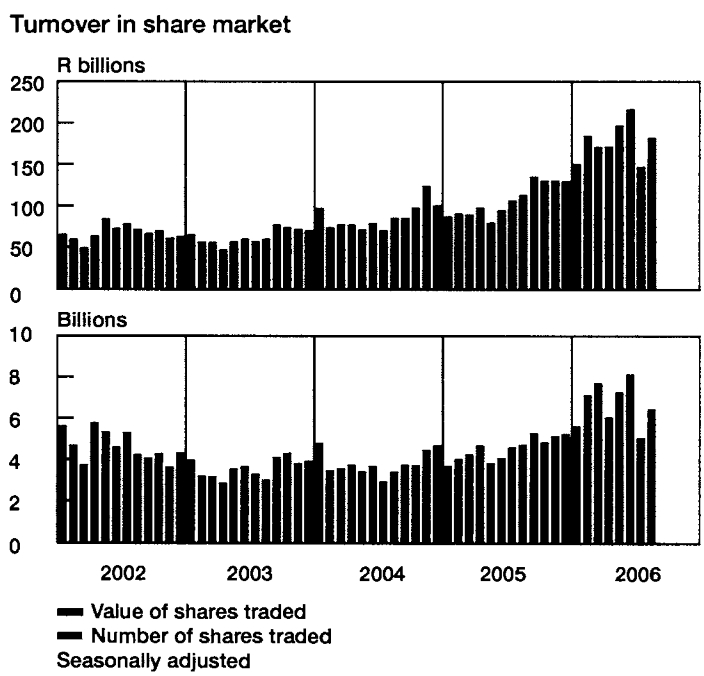
The daily average yield on the long-term R157 government bond (maturing in 2015) initially increased at a moderate pace from a 36-year low of 7,13 per cent on 20 February 2006 to 7,40 per cent at the end of April, before gathering momentum and increasing to a high of 8,79 per cent on 26 June. The upward momentum in domestic long-term bond yields started to even out towards the end of June and continued to fluctuate in a narrow range alongside a somewhat more stable exchange value of the rand, the tighter monetary policy stance and renewed investor interest in emerging markets. Bond yields declined to 8,45 per cent on 27 July, before fluctuating higher to 8,86 per cent on 8 September.

... and the yield curve moved upwards and steepened at the short end.



From a low and slightly inverted level on 20 February 2006, the level of the yield curve moved upward and steepened at the short end in the months that followed as bond yields with longer outstanding maturities rose in response to inflation concerns and fluctuations in the exchange value of the rand. Some flattening of the yield curve occurred when yields at the short end of the curve increased in accordance with the tightening of the monetary policy stance in June and early August 2006.

Trading activity in the secondary share market reached new highs ....



The value of turnover in the first eight months of 2006 was 89 per cent higher than in the corresponding period of 2005. The seasonally adjusted value of shares traded on the JSE Limited reached an all-time high of R217 billion in June 2006. Subsequently, after declining to R147 billion in July, turnover increased to R182 billion in August.

Market liquidity, measured by the annualised turnover as a percentage of market capitalisation, increased from 38 per cent in December 2005 to a record high of 65 per cent in June 2006, before declining to 45 per cent in August.

... as the all-share price index increased to a new record level in September.

Share prices - all classes

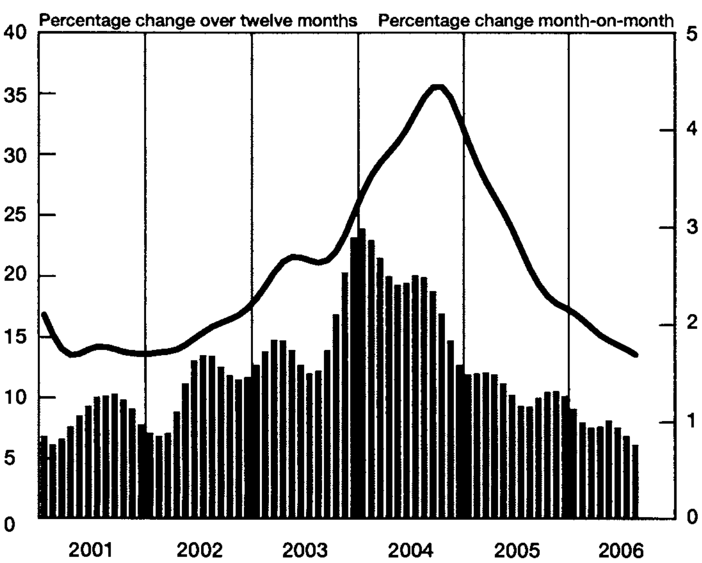
Source: JSE Limited (FTSE/JSE Africa Index Series)

South Africa counted among the countries whose financial-asset prices and exchange rates declined on account of the reassessment of risk and reward in emerging-market economies, reinforced by a retraction in international commodity prices from their previous highs. From early May to mid-June 2006, the South African all-share price index declined significantly. However, over the subsequent three months share market sentiment improved and share prices eventually rose to new record highs by early September, buoyed by the robust economy, appealing prospects for some commodities and vigorous growth in company profits.

The daily closing level of the all-share price index declined by 17 per cent from a then record high on 11 May 2006 to 13 June. Subsequently, the all-share price index increased by 22 per cent to a new all-time high on 4 September, before declining by 3½ per cent to 8 September.

In the real-estate market the pace of increase in house prices decelerated.

House prices *



Percentage change in nominal house prices
- Over twelve months
- Month-on-month (right-hand scale)

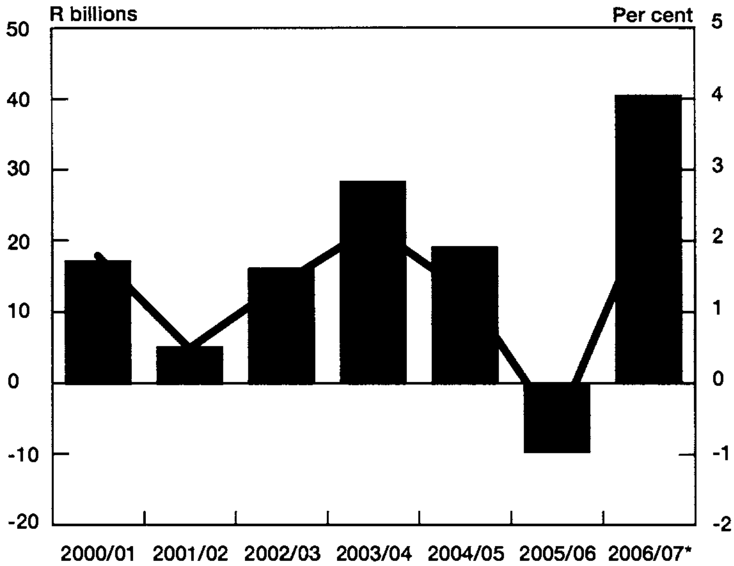
* Source: Absa

The real-estate market remained buoyant but the year-on-year rate of increase in residential property prices, as measured by Absa, decelerated from 35,5 per cent in September 2004 to 13,6 per cent in August 2006. Progressively higher monthly repayments on new mortgage bonds, due to rising house prices and an increase in mortgage rates from June 2006, together with the prolonged period during which growth in property prices has exceeded growth in remuneration, may partly explain the slowdown in growth in property prices.

The deceleration in the growth of property prices is also evident from the decline in the month-on-month rate of increase in house prices from a most recent high of 3,0 per cent in January 2004 to below one per cent in March 2006 and further to only 0,8 per cent in August 2006, the lowest growth rate in just over five years.

Government finances continued to be supportive of a disciplined monetary policy environment.

Non-financial public-sector borrowing requirement



Fiscal years
* *Budget Review 2006* estimates
■ R billions
▬ Per cent of gross domestic product (right-hand scale)

The robust increases in the tax revenue of the national government which had been recorded in fiscal 2005/06 were broadly maintained in the first four months of fiscal 2006/07, consistent with the buoyant performance of the economy.

With government expenditure rising more strongly than revenue during the period April to July 2006, the deficit widened somewhat in comparison with the same period of the previous fiscal year, but nevertheless remained well contained. The deficit was readily financed, mainly by issuing bonds and Treasury bills in the domestic financial market but also to a limited extent through recourse to the international capital market

The non-financial public sector recorded a cash surplus of R9,8 billion in fiscal 2005/06. As a ratio of gross domestic product, the non-financial public-sector cash surplus amounted to 0,6 per cent of gross domestic product in fiscal 2005/06, compared with a deficit of 1,3 per cent in the previous fiscal year. In the 2005/06 fiscal year the first public-sector surplus ever was recorded. The *Budget Review 2006* indicates a public-sector deficit of R40,5 billion – or 2,4 per cent of the estimated gross domestic product – for fiscal 2006/07.

Statement of the Monetary Policy Committee

3 August 2006

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

Introduction

Domestic inflation is on an upward trend, with food price inflation adding to the pressures emanating from persistent petrol price increases. Household consumption spending has continued to grow at a strong pace and consumer confidence remains high. This has been reflected in strong credit extension and preliminary indications are that the deficit on the current account of the balance of payments might have remained high in the second quarter. These factors, combined with a general depreciation of the rand, have resulted in a further deterioration in the inflation outlook.

In the recent past there has been considerable volatility in international financial markets in general, and in emerging markets in particular. These developments have centered around the uncertainty about the future path of interest rates globally. However, the latest developments appear to suggest that some calm may be returning to the financial markets, as evidenced by the narrowing spreads on emerging-market debt.

Recent inflation developments

Inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) increased at a year-on-year rate of 4,8 per cent in June, compared to 3,7 per cent in April and 4,2 per cent in May. This upward trend is not only attributable to petrol price increases. If petrol prices were excluded, CPIX would have measured 3,5 per cent and 3,8 per cent in May and June, respectively. This latter figure is the highest rate of increase of this measure since June 2004. Food price inflation has also made a significant contribution to this upward trend.

Prices of petrol and diesel increased at year-on-year rates of 13,2 per cent and 22,7 per cent in May and June, respectively. Food price inflation has been increasing steadily since late 2005. In November last year, year-on-year food price increases measured 2,0 per cent. In each subsequent month food price inflation increased, and measured 7,2 per cent in June. Significant increases in the prices of meat, fish and vegetables have been the major contributors to this trend. Grain product prices have not fully responded to the sizeable increase in maize prices since the latter part of last year although some upward pressure is evident. In June, the grain products inflation component of CPIX measured 3,8 per cent compared to 0,2 per cent in January 2006.

Most of the other CPIX categories continue to exhibit low rates of price increases, while the categories of clothing and footwear, and furniture and equipment have shown persistent price declines. Services price inflation has declined continuously in the past few months and measured 3,3 per cent year on year in June 2006. Administered prices excluding petrol are predominantly services and therefore have exhibited a similar trend but at marginally lower rates of increase.

Indications of possible consumer price pressures come from production price inflation which increased at a year-on-year rate of 7,6 per cent in June, compared to 5,5 per cent and 6,3 per cent in April and May, respectively. Although food and energy were important drivers of these increases, the pressure was more broad based. If food and energy were excluded, production price inflation would have measured 4,5 per cent in June, compared to 2,9 per cent in April, and 3,6 per cent in May of this year. Some of the upward pressure in June can be attributed to the change to winter electricity tariffs.

The outlook for inflation

Since the previous meeting of the Monetary Policy Committee (the MPC), the inflation forecast of the Bank has deteriorated moderately. The most recent central forecast of the Bank projects inflation to peak above the 6-per-cent level and to remain outside the target range for the first two quarters of 2007. Thereafter, based on the current assumptions, CPIX inflation is projected to decline slowly to reach a level marginally above 5 per cent by the end of 2008.

It seems to us that the use of the forecast in monetary policy decisions needs to be further explained. The MPC does not use the forecast in a mechanical way as the basis for policy making. The forecast provides a broad guide to possible inflation outcomes, but the MPC relies on its judgement about possible future developments. No model can adequately capture all the relevant dynamic processes in any economy. It is worth emphasising that the model outcomes are also dependent on the assumptions that are fed into it. Furthermore, the MPC takes a view of the risks to the forecast.

The exchange rate has exhibited considerable volatility, and has been fluctuating between levels of around R6,70 and R7,50 to the US dollar since the June MPC meeting. The behaviour of the rand was initially related to increased global risk aversion, combined with concerns relating to domestic balance-of-payments imbalances. More recently, expectations that the monetary policy tightening cycle globally may be at or near its peak have prompted an appreciation of the rand to current levels of around R6,90. On a trade-weighted basis, the rand has depreciated by about 14 per cent since the beginning of the year, and by 2,5 per cent since the previous MPC meeting. Some pass-through from the exchange rate to prices can be expected, particularly to domestic petrol prices, which have increased by a cumulative R0,56 in July and August. Exchange rate movements accounted for about R0,44 of this adjustment. The prospects for the rand going forward, and the associated risks to inflation, depend to some extent on the global interest rate trend.

In previous statements the MPC expressed concerns about the expanding deficit on the current account of the balance of payments. Current-account deficits are a reflection of higher domestic expenditure and are not in themselves inflationary. There is, however, a possible risk to the exchange rate if the deficits are perceived to be unsustainable, particularly if the deficits are reflecting higher consumption expenditure. The recent exchange rate reaction to the higher deficit is indicative of this, but it is also part of the macroeconomic adjustment process. In order for the exchange rate to play its part in this process, it is important that the exchange rate changes are not simply offset by higher inflation.

The current-account deficit is expected to be adequately financed through capital inflows, although the focus of non-residents has shifted from the equity market towards the domestic bond market. In July, non-residents became net sellers of shares to the value of R2 billion, while non-resident net bond purchases totalled R11,8 billion in the same month, compared to net sales of R1,3 billion in June.

Household consumption expenditure, which grew at an annualised rate of 7 per cent in the first quarter of this year, shows few signs of abating. The FNB/BER Consumer Confidence Index declined marginally in the second quarter of 2006, but nevertheless remains close to historically high levels. Motor vehicle sales continue to exhibit strong growth. New vehicle sales grew by 20,8 per cent in the year to July.

This higher consumer demand has been underpinned by low nominal interest rates, rising real incomes, and wealth effects arising from strong asset price growth. The residential property market remains buoyant, although the rate of increase in house prices has declined somewhat during 2006. According to the Absa House Price Index, house prices recorded year-on-year increases of 13,6 per cent in June. Prices on the JSE Securities Exchange have been somewhat volatile with the Alsi fluctuating between 18 380 and a high of 21 592.

Growth in credit extension to the private sector reflects the growth in consumer expenditure and higher property prices. Growth over twelve months in total loans and advances accelerated from 22,5 per cent in

May 2006 to 23,2 per cent in June. Asset- backed credit growth, which accounts for a significant part of the increase in total loans and advances, has remained around 27 per cent since February 2006.

Until recently, wage developments presented a benign picture. During 2005, unit labour cost in the formal non-agricultural sector increased by 3,4 per cent, providing further evidence that wage pressures were well contained. However, in the first quarter of 2006, nominal unit labour cost increased by 7,6 per cent compared to the same quarter of the previous year, and up from an increase of 2,6 per cent in the fourth quarter of 2005. This development is attributed in part to a decline in labour productivity in the first quarter of 2006 compared to the first quarter last year, as employment outpaced output growth. It is too early to tell if this represents a reversal of the previous trend, but as a significant number of wage negotiations are concluded in the third quarter, these developments will be closely monitored. Wage settlement surveys conducted by Andrew Levy Employment Publications show that settlements have averaged 6,2 per cent in the first half of 2006, compared to 6,3 per cent in 2005 as a whole.

Preliminary indications are that economic growth, although still robust, continues to show some moderation compared to the 4,9 per cent achieved in 2005, and consequently poses little threat to the inflation outlook. The RMB/BER Business Confidence Index declined in the second quarter, although it remains at a high level. Manufacturing output growth has shown some signs of sustaining the first quarter recovery after the subdued levels in the second half of 2005. The physical volume of manufacturing production increased by 4,4 per cent on a year-on-year basis in May, while the Investec/BER Purchasing Managers Index has increased for six consecutive months, with the measure for July indicating a strongly positive outlook for the sector. Mining production, however, remains under pressure. Total mining production decreased by 6,8 per cent year on year in May although in the past three months mining production increased by 5,4 per cent compared to the previous three months, mainly as a result of increased platinum group metals production.

International factors also pose a risk to the inflation and interest rate outlook. International oil price developments remain a significant source of concern. In mid-June the price of Brent crude oil had declined to levels of around US$66 per barrel as a result of higher reported inventories. However, by the end of June, oil prices had risen to levels of around US$75 per barrel as a result of strong demand pressures, supply constraints and rising geopolitical tensions. In July the price of Brent crude oil averaged almost US$74 per barrel, compared to US$68 per barrel in June.

Despite the relatively subdued global inflation environment, inflationary pressures have begun to emerge in a number of countries. This has prompted further tightening of monetary policy by several central banks in the past few months.

Monetary policy stance

The MPC remains concerned about the longer-term threats to the inflation outlook and has therefore decided that a further adjustment to the repo rate would be prudent. Accordingly, the repo rate is increased by 50 basis points to 8,0 per cent per annum with immediate effect. The MPC will, as is always the case, remain vigilant in order to ensure that CPIX inflation stays within the inflation target range.