FINANCE

SOUTH AFRICA

YEARBOOK 2010/11

2010/11

After contracting by 1,8% in 2009 in response to the global recession, South Africa's domestic economy was expected to grow by 2,3% in 2010, increasing by 3,6% by 2012.

The recession had a far-reaching impact on South Africa, with almost a million jobs lost between the fourth quarter of 2008 and the first quarter of 2010.

Economic activity has started to revive and a gradual improvement in household consumption, employment and private investment is expected.

The improved outlook is supported by expansionary fiscal and monetary policies, public-sector investment, lower inflation, higher commodity prices and the upturn in global demand.

National Treasury aims to promote economic development, good governance, social progress and rising living standards through accountable, economic, efficient, equitable and sustainable management of South Africa's public finances.

National Treasury endeavours to advance economic growth, broad-based empowerment, progressive realisation of human rights and the elimination of poverty. It is responsible for preparing a sound and sustainable national budget and an equitable division of resources among the three spheres of government. It strives to raise fiscal resources equitably and efficiently and to manage government's financial assets and liabilities soundly, promoting transparency and effective financial management

The Constitution stipulates a framework for the division of responsibilities between national, provincial and local government. It prescribes an equitable division of revenue between the spheres of government, taking into account their respective functions. It has also created an independent Auditor-General (AG) and an independent central bank, and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

Financial expenditure

National Treasury plays a pivotal role in managing government expenditure.

It determines financial-management norms and standards, and sets reporting policy that guides the AG's performance. It also assists Parliament, through the Standing Committee on Public Accounts, with its recommendations and the formulation of corrective actions. National Treasury closely monitors the performance of state departments and is obliged to report any deviations to the AG.

The department maintains transparent and fair bidding processes, as well as accounting, logistic and personnel systems. It sets and maintains standards and norms for treasury and logistics, acts as a banker for national departments and oversees logistical control of stocks and assets.

National Treasury draws its mandate from Chapter Two of the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), based on Chapter 13 of the Constitution. It is mandated to:

- coordinate macroeconomic policy
- promote government's fiscal policy framework
- manage the budget preparation process
- coordinate intergovernmental financial relations
- facilitate the Division of Revenue Act, 2009 (Act 12 of 2009), which provides for an equitable distribution of nationally raised revenue between national, provincial and local government
- monitor the implementation of provincial budgets
- create an enabling regulatory environment for the financial sector
- defend the integrity of the financial system
- ensure efficient and effective revenue collection
- oversee the programmes of development finance institutions (DFIs).

Fiscal policy framework

Government's fiscal policy seeks to support structural reforms of the South African economy consistent with long-run growth, employment creation and an equitable distribution of income.

The 2010 budget framework balances the short-term need for economic stimulus with

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The third national census since the advent of democracy will be held in October 2011.

Statistics South Africa (Stats SA) will deploy 120 000 officials across the country to document all people, including illegal immigrants and the homeless, from 10 to 31 October 2011.

The estimated budget for the census, with results expected in March 2013, is R1,2 billion.

Census 2011 will consist of three questionnaires: one for households, the other for institutions and the third for people in transit.

the long-term imperative of fiscal sustainability.

It aims to promote investment and export expansion while enabling government to finance public services, redistribution and development in an affordable and sustainable budget framework.

Fiscal policy seeks to:

- present a fuller picture of government finances and the effects of policy decisions
- ensure a sound and sustainable balance between government's spending, tax and borrowing requirements
- improve domestic savings to support a higher level of investment and reduce the need to borrow abroad
- keep government consumption spending at an affordable level
- contribute to lower inflation and a sustainable balance of payments
- support an export-friendly trade and industrial strategy to improve South Africa's competitiveness.

Due to the changed economic outlook in 2008/09, the fiscal stance has become significantly more expansionary. This expanded stance enables government to continue financing its priorities and support aggregate demand during the cyclical decline in revenue, supporting sustainable economic growth and social development.

Lower revenue and higher expenditure have resulted in an increase in the budget deficit, which will need to be financed. To ensure that a growing debt burden will not crowd out spending on developmental priorities, government will stabilise growth in interest costs through a careful and controlled reduction of the deficit.

The deficit will therefore be reduced to a sustainable level in a countercyclical manner.

Growth in spending in the current context will stimulate economic growth and maintain spending on public services at a time when businesses and households require fiscal support the most.

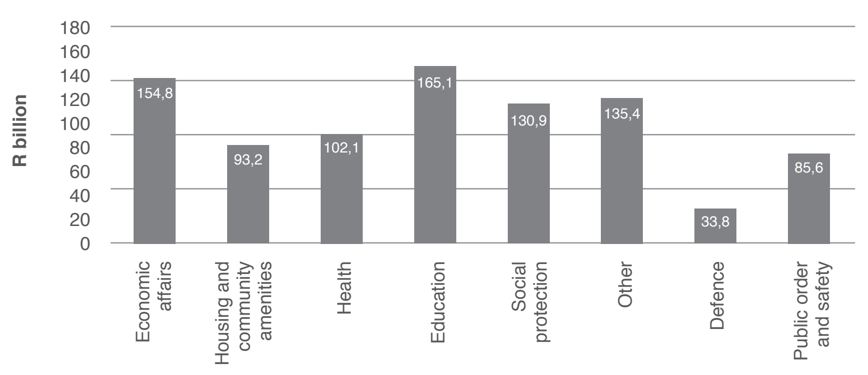
Economy and fiscal stance

The Minister of Finance, Mr Pravin Gordhan, presented the national Budget for 2010/11 in February 2010.

The Budget outlined several aspects of a new growth path for South Africa:

- a concerted effort to reduce unemployment among young people
- support for labour-intensive industries through industrial policy interventions, skills development, public employment programmes and a rural development strategy
- sustaining high levels of public and private investment and raising the savings level
- improving the performance and effectiveness of the State, especially the provision of quality education and training at all levels
- reforms to increase inclusion and participation in the labour market, alongside efforts to improve competition in product markets
- keeping inflation low, striving for a stable and competitive exchange rate and providing a buffer against global volatility
- raising productivity and competitiveness, opening up the economy to investment and trade opportunities that can boost exports.

Government expenditure



Source: National Treasury, *People's Guide to the Budget, 2010*

Macroeconomic strategy

The South African economy expanded at an average annual rate of 4,7% between 2004 and 2008. The pace of growth slowed rapidly after the intensification of the global financial crisis in October 2008, which led to a collapse in global demand and trade.

Real gross domestic product (GDP) contracted for three consecutive quarters from the final quarter of 2008, resulting in South Africa's first recession in 17 years. Overall, the economy contracted by 1,8% in 2009 as production, consumption and investment declined.

Economic conditions stabilised in the second half of 2009 as mining and manufacturing production started to recover. Real GDP recorded a positive quarterly growth rate of 0,9% annualised in the second quarter of 2009, and accelerated to 4,6% by the first quarter of 2010.

Economic activity is expected to continue improving in the period ahead. South Africa's macroeconomic policies are supportive of a recovery in private demand as interest rates have declined to historically low levels and the budget deficit has risen in a countercyclical manner to accommodate falling tax revenues during the recession.

Continuing public-sector investment, particularly in electricity and transport infrastructure, provides crucial support to the recovery and is essential to reduce bottlenecks in the economy and to draw in private investment.

To reduce South Africa's high unemployment rate, the economy needs to grow at a faster pace and there needs to be greater labour absorption, particularly of low-income workers and the youth.

Government's approach to this challenge is multifaceted, building on the policies previously implemented as part of the Accelerated and Shared Growth Initiative for South Africa. Government maintains prudent macroeconomic policies that promote a favourable environment for investment and job creation through low and stable inflation and interest rates, a competitive real exchange rate and measures to support financial stability.

Responsible management of fiscal policy will prevent an unsustainable rise in debt that will limit the ability of the economy to grow at a faster rate in the future. Social and economic spending priorities will remain in focus to support poverty reduction and investment.

The employment challenge cannot be overcome if the economy does not sustain higher levels of growth. The policies therefore seek to create a favourable environment for growth and investment by removing bottlenecks to trade, reducing red tape and business costs, increasing competition, raising productivity, and expanding exports.

While the State plays an important role in addressing inequality and infrastructure backlogs, a climate conducive to dynamic private-sector investment, entrepreneurship and growth must be supported.

Specific measures to raise employment include measures to encourage industries and services that have significant employment potential, stepped-up implementation of the Expanded Public Works Programme (EPWP), investment in further education and skills development, encouragement of small-business development and entrepreneurship, and a new focus on promoting youth employment.

Revenue estimates and tax proposals

As a result of the slow-down in the South African economy in 2009, tax revenue for the 2009/10 fiscal year was R60,5 billion below the initial estimate made in February 2009, although it was higher than the revised estimate made in February 2010.

For the first time in recent years, total nominal revenues declined year-on-year by R26,3 billion (2009/10 versus 2008/09).

Value-added tax (VAT) declined by R6,4 billion while corporate income tax was R30,5 billion or 18,4% below that of the previous year.

Customs duties were R3,1 billion below that of 2009. Government was likely to continue to face revenue challenges in 2010/11. Given the gap between spending and revenue, together with efforts to curb spending growth, it is expected that government will require more tax revenue during 2011/12.

The preferred method of achieving higher revenues is through broadening the tax base, closing loopholes and improving tax compliance. Additional environmental taxes will be explored to raise more revenue and meet environmental objectives.

Income-tax relief for individuals during 2010/11 amounted to R6,5 billion, which largely compensated for the effects of inflation. To support further broadening of access to medical-scheme membership, the monthly monetary caps for deductible medical-scheme contributions were also increased.

A flat rate tax on new vehicle carbon emissions (based on vehicles' certified carbon emissions g/km) took effect from September 2010. The more fuel-efficient the car, the less tax is paid.

Fuel taxes were increased by 25,5 cents per litre. This included a 7,5-cents per litre increase to contribute to the funding of a new multiproduct petroleum pipeline between Durban and Gauteng, and an increase of 8 cents per litre towards the Road Accident Fund (RAF) levy.

Indirect taxes on tobacco products and alcoholic beverages were also increased in terms of a set indirect tax burden, resulting in above-inflation increases in these excise duties.

Spending on public services

Government's determination to create world-class infrastructure and stadiums reaped rewards the year ahead of the 2010 World Cup. However, investment did not end when the tournament began. Government will spend some R845 billion on infrastructure projects over the next three years, in addition to the R33 billion it spent preparing for the World Cup.

Spending plans for the economy as a whole will be aided by an additional R87-billion allocation in the 2010/11 Budget and will have a particular focus on education, health, rural infrastructure and human settlements. Spending highlights included the following:

- The total national and provincial health spending was projected to be R101 billion in 2010/11.
- An additional R8,4 billion was allocated for spending on the HIV and AIDS programme to accommodate more people and to improve the effectiveness of treatment programmes.
- The total budget for education in 2010/11 was R165 billion. To improve literacy and numeracy for learners in grades R to nine, a further R2,7 billion was allocated to the Department of Basic Education to roll out workbooks in all 11 official languages.
- In an effort to reduce crime and corruption, an additional R1 billion was added to the criminal justice sector.
- The local government equitable share received a further R6,7 billion to support municipalities to cover the increase in the cost of providing free basic electricity and an additional R2,5 billion went to the Municipal Infrastructure Grant.
- Additional funding was also provided for rural development (R1 billion) and for water and sanitation infrastructure (R1,2 billion) in support of rural households.
- R1 billion was provided to speed up the provision of housing and R500 million for bulk infrastructure.
- Total allocations to municipalities rose from R55 billion in 2009/10 to R83 billion in 2012/13.

Government continues to look after the country's most vulnerable citizens. In 2010/11, R89 billion was expected to be spent on social grants. More than 14 million South Africans received social grants in 2010 following the extension of the Child Support Grant to a child's 16th birthday (children up to 18 years will be eligible in 2011/12) and the equalisation of eligibility for the State Old-Age Grant for men and woman alike at age 60.

These and other grants provided a vital safety net to South Africans during the recent economic slowdown. So did the Unemployment Insurance Fund (UIF), which provided income support for those who lost their jobs.

To make more money available for much-needed projects even when less money was coming in, government achieved savings on projects that were either not functioning effectively or were a lower priority.

Efficiency savings were identified throughout government, and there has been a new focus on achieving value-for-money for all government spending.

Key to this efficiency drive is a new outcome-based approach to measuring performance. This approach, together with enhanced planning, monitoring and evaluation capacity, will aid development projects and deliver better services.

Reforms of the procurement process and tender systems – aided by a resolution to eliminate corruption – will also improve efficiency and lower costs.

Creating work remains a key challenge. Government is committed to addressing the challenge of youth unemployment through, among other measures, targeted incentives for employment, and accelerated investment in further education and skills training.

Government also continued to create jobs through the EPWP, which will receive R52 billion over the 2011 to 2013 period. Over the 2009 to 2014 period, the second phase of the EPWP aims to create 4,5 million short-term job opportunities.

Expanding and improving capacity at the further education and training (FET) colleges is a vital part of the growth strategy.

Government has set targets to expand the number of young people studying vocational subjects. The budget for FET colleges of R10,6 billion over three years, has been shifted from provinces to the national department. A further R1,3 billion was allocated to contribute to the strengthening of colleges.

Government made allowance for the recapitalisation of the Land Bank to the value R2,5 billion. A guarantee of R15,2 billion was approved for the Development Bank of Southern Africa, enabling it to extend capital to poorer municipalities for infrastructure projects.

Task team to effect savings

In July 2009, Cabinet established a ministerial task team to look at government expenditure in the context of the economic meltdown. The task team comprises the Minister of Finance, the Minister for Performance Management and Evaluation in The Presidency and the Minister of Public Service and Administration.

The work of the task team includes government's comprehensive expenditure review, and the outcome of its work will help inform preparation of the Medium Term Expenditure Framework (MTEF).

Government is determined to work collectively to review spending plans, to reprioritise the budget, to reduce wastage and inefficiency and to get greater value for each rand spent.

In 2009, the task team announced savings of R14,5 billion at national level over the 2010 MTEF. The budget in February 2010 updated this to proposed savings of R23 billion at national level and R2,6 billion at local government level.

Debt management

The prudent management of government's financial assets and liabilities remains a priority.

Government's debt-management policies have evolved from concentrating exclusively on financing the borrowing requirement to broader support for government's macroeconomic objectives.

Government continued to support state-owned enterprises (SOEs) during the economic downturn, through the issuing of guarantees on a case-by-case basis. Steps taken over the past 17 years to strengthen the capital market enabled the public sector to finance the growing borrowing requirement in the domestic market.

Debt levels remain sustainable, despite an expected increase in government debt from R627 billion in 2008/09 to R1 419 billion in 2012/13.

Debt-service cost as a percentage of GDP will average 3% over the medium term. Debt-service cost as a ratio of revenue will be maintained as maturing debt and refinanced in a lower interest rate environment.

The cost of higher borrowing is, however, greater expenditure on interest. National government's net debt is expected to rise from 23% of GDP in 2008/09 to about 40% in 2013, and is expected to stabilise in 2015.

Exchange-control reforms

Steps have been taken to support prudent foreign diversification by institutional investors, including increasing the foreign prudential limits for pension funds and underwritten long-term insurance policies from 15% to 20%, while the limit for collective investment schemes (CIS), investment-linked business of long-term insurers and investment managers were increased from 25% to 30%.

Institutional investors are also allowed to undertake foreign investments without prior approval, but subject to quarterly reporting. The macro-prudential foreign exposure limit for banks was implemented at 25% of total liabilities for a bank, effective from March 2010.

To improve access to domestic credit in the financing of local foreign direct investment (FDI), restrictions on the granting of local financial assistance to affected persons have been further liberalised with the doing away of the 3:1 ratio, except for financial transactions and real estate. The Southern African Development Community (SADC) loop structures were also liberalised, and the restrictions on the number of days within which foreign currency could be held in domestic bank accounts were abolished.

Social-security reform

By mid-2010, the Interdepartmental Task Team on Social Security and Retirement-Fund Reform was in the process of finalising a consolidated government paper.

This paper will outline the rationale behind social-security reform and detail the Government's main proposals, including the creation of a national fund, which will allow workers to save for retirement and protect themselves and their dependents from periods of disability or unemployment during their career.

At the same time, the task team is looking at ways to improve the efficiency of existing social-insurance arrangements such as the

UIF, the RAF and the Compensation Fund (CF).

There is considerable scope for alignment between these statutory funds in terms of administration, financing and benefits. The Government is also examining ways of improving access to quality healthcare.

Treasury norms and standards

In terms of Section 216(1)(c) of the Constitution, National Treasury must prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing uniform treasury norms and standards.

These aim at deregulating financial controls, by granting accounting officers of spending agencies more autonomy in financial decision-making within the ambit of impending financial legislation.

Budget evaluation

National Treasury plays an important role in supporting the economic policy to which government has committed itself. It determines the macrolimit on expenditure, which is then matched with requests from departments, in line with the affordability and sustainability of services.

Based on this limit, all national departments are requested to submit budget proposals annually to National Treasury for the following financial year.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial members of the executive councils responsible for finance.

The Budget Forum extends the Budget Council to include representatives of organised local government. These forums ensure cohesion between national policy priorities, the division of nationally raised revenues, and planning and budgeting in provincial and local spheres of government.

The forums also allow the leadership of the three spheres of government to evaluate the performance of government on key national programmes and, where necessary, to agree on support initiatives that will ensure the attainment of national goals.

Early Warning System

The Early Warning System was established in 1997. Any likely under- or over-expenditure is brought to the attention of Cabinet, so that the relevant minister can ensure that appropriate action is taken.

The system assists in monitoring provincial departments' expenditure trends monthly, by having provincial treasuries report to National Treasury in a prescribed format. The information derived from early warning reports is used for advising the Minister of Finance, Budget Council and Cabinet.

Financial systems

National Treasury is responsible for the development, maintenance and support of financial management systems (Bas, Persal, Logis and Vulindlela) that support:

- payment of government employees' salaries and service-providers
- financial reporting and management for government departments.

In 2005, Cabinet approved the development of the Integrated Financial Management System (IFMS). The year 2010 saw the roll-out of lead modules at selected lead sites.

Supply Chain Management (SCM)

SCM forms an integral part of financial management. The SCM Framework, issued in terms of Section 76 of the PFMA, 1999, replaced outdated procurement and provisioning systems in government.

The Preferential Procurement Policy Framework Act (PPPFA), 2000 (Act 5 of 2000), and its related regulations are in the process of being aligned with the aims and strategies of the Broad-Based Black Economic Empowerment (BBBEE) Act, 2003 (Act 53 of 2003).

It is envisaged that a two-phased approach will be followed. The first approach will be alignment through the amendment of the current preferential procurement regulations as an interim measure.

The second long-term approach will be the comprehensive review of the primary framework, namely the PPPFA, 1999. The current Act prescribes that tenders must be evaluated on a preference point system where 80 or 90 points will be allocated for the price of the lowest acceptable tenderer, and a maximum of 10 or 20 points are allocated for Reconstruction and Development Programme goals.

Draft revised preferential regulations were advertised for comments. These revised regulations propose that the 10 or 20 points should be awarded based on their BBBEE level of contribution.

Legislation

Public Finance Management Act, 1999

Transforming public-sector financial management is one of National Treasury's key objectives.

To this end, National Treasury has been implementing the PFMA, 1999 since 1 April 2000.

The Act changed the approach to the way in which public funds are managed by introducing a less rigid environment for financial management, with a stronger emphasis on the prudent use of state resources, improved reporting requirements and the use of management information to enhance accountability.

Since its introduction, the PFMA, 1999 has contributed towards measurable improvements in financial management in both the national and provincial spheres of government, which include, among other things:

- an improved linkage between planning and budgeting, whereby departments are required to compile and table strategic plans that are consistent with their budget envelope
- strategic plans and budget documentation containing improved information on measurable objectives expressed in terms of quantity, quality and timeliness
- the submission by departments of monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes
- establishing internal-audit functions and audit committees in all departments
- setting accounting standards in accordance with best accounting practices
- finalising and submitting financial statements to the AG within two months of the end of the financial year
- tabling annual reports in the legislature within six months of the end of the financial year.

While it is recognised that the PFMA, 1999 has contributed positively towards the enhancement of public-sector financial management, it has been acknowledged that an increased emphasis should be placed on capacity-building to further improve the quality of financial management.

The Public Administration Leadership and Management Academy has, in association with National Treasury, developed the Financial Management Training Strategy for the roll-out of training programmes to improve the skills of public-sector finance practitioners.

Municipal Finance Management Act, 2003 (Act 56 of 2003)

The Act applies to all municipalities and municipal entities, and national and provincial organs of state, to the extent of their financial dealings with municipalities.

The objective of the Act is to secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing norms, standards and other requirements for:

- ensuring transparency, accountability and appropriate lines of responsibility in their fiscal and financial affairs
- managing their revenues, expenditures, assets and liabilities, and handling their financial dealings
- budgetary and financial-planning processes and coordinating processes of organs of state borrowing
- handling financial problems and other financial matters.

Cooperative Banks Act, 2007 (Act 40 of 2007)

The Cooperative Banks Act, 2007 came into effect on 1 August 2008.

The Act aims to:

- promote and advance the social and economic welfare of all South Africans by improving access to banking services
- promote the development of sustainable and responsible cooperative banks
- establish an appropriate regulatory framework for cooperative banks that protects members of cooperative banks.

The Act provides for the establishment of the Cooperative Banks Development Agency as a public entity under the Executive Authority of the Minister of Finance.

The agency is responsible for, among other things:

- supervising and registering deposit-taking financial services cooperatives as cooperative banks
- capacitating, promoting and informing communities and groups about cooperative banking
- registering and regulating representative bodies and support organisations
- establishing the Deposit Insurance Fund for Cooperative Banks
- liquidity/solvency management through loans and grants
- formalising approaches to developing cooperative financial institutions.

Financial institutions

Financial Intelligence Centre (FIC)

The Financial Intelligence Centre Act (Fica), 2001 (Act 38 of 2001), came into effect on 30 June 2003 as part of the South African Government's fight against money laundering and terrorism financing. The centre was established to identify the proceeds of unlawful activities and to combat money-laundering.

Certain financial institutions and businesses that might otherwise be exploited for money-laundering purposes are required to introduce compliance controls.

South Africa's system of combating money laundering and the financing of terrorism is based on the interaction of three separate laws namely:

- the Prevention of Organised Crime Act, 1998 (Act 121 of 1998), which criminalises money laundering
- the Fica, 2001, which provides for the establishment of the centre, and imposes reporting and administrative obligations on financial and other institutions
- the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004 (Act 33 of 2004), which provides for the reporting of terrorism-financing activities.

The FIC is a government agency, which reports to the Minister of Finance. Its mandate is to:

- identify the proceeds of crime
- seek to combat money laundering and the financing of terrorism
- formulate and lead the implementation of policy regarding money laundering and the financing of terrorism
- advise the Minister of Finance about issues aimed at anti-money laundering and combating the financing of terrorism (AML/CFT)
- monitor the compliance of accountable institutions and supervisory bodies regarding their AML/CFT obligations
- prevent and reduce money laundering and CFT activities
- uphold the international obligations and commitments required of the centre and South Africa as a country.

The centre analyses and stores reports made by the accountable institutions. After further analysis and due consideration, it makes disclosures to investigating authorities such as the South African Police Service, the intelligence agencies and the South African Revenue Service (Sars) for investigation. Contravention of the Act constitutes an offence for which stiff penalties are imposed.

The FIC Amendment Act, 2008 (Act 11 of 2008), provides for detailed procedures for the administrative adjudication and sanctioning of non-compliance with the Act, as well as extended powers for supervisors to address compliance failures appropriately.

The Amendment Act also provides for issues relating to customer due diligence and the updating of the schedules to the Act.

South Africa is a member of the Financial Action Task Force, which is the international standards-setting body for combating money laundering and financing terrorism and its regional body, the Eastern and Southern Africa Anti-Money Laundering Group.

Financial and Fiscal Commission (FFC)

The FFC is an independent, objective, impartial and unbiased constitutional advisory institution. It is a permanent expert commission with a constitutionally defined structure, a set of generic responsibilities and institutional processes.

The FFC submits recommendations and advice to all spheres of government, based on research and consultations on a range of intergovernmental fiscal issues.

The research includes:

- developing principles for intergovernmental fiscal relations, based on analysis of international best practice
- analysing local, provincial and national government budgets to understand revenue and expenditure trends
- identifying and measuring factors influencing provincial and local revenues and expenditures
- assessing fiscal policy instruments, such as conditional grants, equitable share transfers and taxes.

Government is required by the Constitution and other legislation to consult with the FFC on issues such as provincial and local government revenue sources, and provincial and municipal loans.

Consultation is also required on the fiscal implications of assigning functions from one sphere of government to another.

Public Investment Corporation (PIC)

As at 31 March 2010, the PIC managed assets valued at R910,9 billion, making it one of the largest investment managers on the African continent. The PIC's clients are public-sector entities, most of which are pension, provident, social security, development and guardian funds. The PIC's role is to invest funds on behalf of these clients, based on investment mandates set by each client and approved by the Financial Services Board (FSB), with which it is registered as a financial services provider (FSP).

The PIC is wholly owned by the South African Government, with the Minister of Finance as shareholder representative. The PIC was established as a corporation on 1 April 2005 in accordance with the PIC Act, 2004 (Act 23 of 2004). Corporatisation has enabled the PIC to structure its investment activities and operations in a manner comparable to that of private-sector investment managers. Apart from pursuing FSB-compliant mandates, the PIC benchmarks its investment performance against market-driven indices, enabling clients and the shareholder to compare PIC's returns with those achieved in the marketplace.

South African Revenue Service

In accordance with the Sars Act, 1997 (Act 34 of 1997), the revenue service is an administratively autonomous organ of state. It aims to provide a world-class, transparent and client-orientated service, ensuring optimum and equitable revenue collection. Its main functions are:
- collecting and administering all national taxes, duties and levies
- collecting revenue that may be imposed under any other legislation, as agreed upon between Sars and an organ of state or institution entitled to the revenue
- advising the Minister of Finance on all matters concerning revenue and the exercise of any power or the performance of any function assigned to the Minister of Finance or any other functionary in the national executive in terms of the above-mentioned legislation
- facilitating trade
- providing protection against the illegal importation and exportation of goods
- advising the Minister of Trade and Industry on matters concerning control over the import, export, manufacture, movement and storage or use of certain goods.

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> In April 2010, Japanese ratings agency Rating and Investment Information (R&I) affirmed South Africa's foreign currency issuer rating and domestic currency issuer rating at A- and A respectively, while upgrading the ratings outlook for both from negative to stable.
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> Although South Africa's real gross domestic product growth rate in 2009 was negative, due to the global economic crisis, R&I believed the country's economic growth trend would be unaltered, with capital inflows to remain steady even as the global financial environment undergoes adjustments.

Tax administration

As a result of its Modernisation Programme, Sars is able to use third-party information obtained from other institutions to verify information supplied by taxpayers. This has enabled Sars to take a much tougher stance against non-compliant taxpayers. Tough action is also being taken against firms who do not pay pay-as-you-earn (PAYE) and other taxes/levies that have been deducted from employees.

In October 2009, Sars introduced new administrative penalties to bring about greater fairness by ensuring that all taxpayers meet their tax obligations. Sars has always shown leniency and understanding to those who come forward voluntarily to disclose prior non-compliance. In line with international practice, this is formalised in the Voluntary Disclosure Programme, which came into effect in November 2010 for a period of 12 months. Non-compliant taxpayers can use this window of opportunity to disclose and pay undeclared tax liabilities. Relief with regard to interest and penalties will apply. Consideration will also be given to aligning exchange-control violation penalties with the voluntary disclosure opportunity.

Tax system

National Treasury is responsible for advising the Minister of Finance on tax-policy issues that arise in local, provincial and national government spheres. As part of this role, National Treasury must design tax instruments that can optimally fulfil their revenue-raising function, and are aligned to the goals of government's economic and social policy. National Treasury and Sars cooperate in compiling tax policies.

In 2001, South Africa's source-based income tax system was replaced with a residence-based system. Residents are now taxed (subject to certain exclusions) on their worldwide income, irrespective of where their income was earned.

Foreign taxes are credited against South African tax payable on foreign income. Foreign income and taxes are translated into the South African monetary unit, the Rand.

International tax agreements for the avoidance of double taxation

International tax agreements are important for encouraging investment and trade flows between nations, by providing certainty about the tax framework. By reaching agreement on the allocation of taxing rights between residence and source countries of international investors, double-taxation agreements provide a solid platform for growth in international trade and investment. South Africa has tax agreements with various countries.

African Tax Administration Forum (ATAF)

In November 2009, the ATAF was launched in Kampala, Uganda, to give a platform to African tax administrations to articulate African tax priorities, develop and share best practices and build capacity in African tax policy and administration.

Sars Commissioner, Mr Oupa Magashula, was unanimously elected as chairperson of the ATAF at this inaugural conference. South Africa will also host the Secretariat of the new African tax body.

Sources of revenue

Income tax

Income tax is government's main source of income and is levied in terms of the Income Tax Act, 1962 (Act 58 of 1962).

In South Africa, income tax is levied on South African residents' worldwide income, with appropriate relief to avoid double taxation. Non-residents are taxed on their income from a South African source.

Tax is levied on taxable income, which, in essence, consists of total income less exemptions and allowable deductions as per the Act. The remuneration received by or accrued to a person is subject to tax and the employer deducts employees' tax in the form of PAYE.

A person who receives income other than remuneration, such as income from trade, profession or investments, which is not subject to employees' tax, is under certain circumstances required to register as a provisional taxpayer. In these circumstances, that person must pay provisional tax.

Provisional tax is not a separate tax but simply a provision for the taxpayer's final income tax liability for a year of assessment, which will be determined upon assessment. That person is required to make two provisional tax payments during the course of the tax year and may opt for a third "topping-up" payment, six months after the end of the tax year.

The income threshold below which no tax is payable by individuals under 65 years was raised to R57 000 for the tax year beginning March 2010, and for taxpayers 65 years and older to R88 528 a year.

The 2010 Budget proposed personal income tax relief to individual taxpayers amounting to R6,5 billion to compensate partially for inflation. Most of the relief was provided to taxpayers in lower-income brackets.

Taxpayers with an annual taxable income below R150 000 received 24,6% of this relief; those with an annual taxable income between R150 001 and R250 000 received 28,8%; those with an annual taxable income between R250 001 and R500 000 received 26,2%; and those with an annual taxable income above R500 000 received 20,4%.

Alongside corporate income tax and VAT, personal income tax is one of the three main tax instruments and provides the basis for the progressive structure of South Africa's income tax system.

Registered taxpayers with taxable income below R250 000 account for about 30% of personal income tax revenue; those with taxable income of between R250 000 and R500 000, 26%; and those with taxable income above R500 000 account for 44%.

In line with government's goal of encouraging greater national savings, it is proposed to increase the tax-free interest-income ceiling from R21 000 to R22 300 for persons below the age of 65 and from R30 000 to R32 000 for persons 65 years and older.

It is also proposed to increase the tax-free income ceilings for foreign dividends and interest from R3 500 to R3 700. The annual exclusion of R17 500 for capital gains and losses is granted to individuals and special trusts. Where a person dies during the year, the annual exclusion is R120 000.

From 1 March 2010, the monthly monetary caps for tax-deductible contributions to medical schemes increased from R625 to R670 for each of the first two beneficiaries, and from R380 to R410 for each additional beneficiary.

Tax returns must be submitted to Sars within the specified period.

People who owe Sars tax are charged interest at a rate as published in the *Government Gazette* that is linked to the rate specified in accordance with the PFMA, 1999.

Capital gains tax was introduced in October 2001. It forms part of the income-tax system. Capital gains made upon the disposal of assets are included in taxable income.

Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle. Effectively, VAT is levied on the value added by an enterprise.

Vendors levy and pay over the tax included in their prices, resulting in VAT being paid by the final consumer. VAT is also levied on the importation of goods and services into South Africa. It is levied at the standard rate of 14% but certain supplies are zero-rated or exempt from VAT.

The prices of goods and services must be quoted or displayed on an inclusive basis, which means that VAT has to be included in prices on all products, price lists, advertisements and quotations.

Customs duty

South Africa is a signatory to the Southern African Customs Union (Sacu) Agreement, together with Botswana, Lesotho, Namibia and Swaziland (the BLNS countries).

The five member countries of Sacu apply the same customs and excise legislation, the same rates of customs and excise duties on imported and locally manufactured goods, and the same import duties on imported goods.

The uniform application of tariffs and the standardisation of procedures simplify trade within the Sacu common-customs area. Import duties, including anti-dumping and countervailing duties, are used as mechanisms to protect local industry.

The renegotiated Sacu Agreement is in force and provides a new dispensation for calculating and effecting transfers based on customs, excise and a development component.

South Africa has entered into agreements on mutual administrative assistance with a wide range of customs administrations.

These agreements cover all aspects of assistance, including the exchange of information, technical assistance, surveillance, investigations and visits by officials. Efforts continue to improve the effectiveness of custom control and trade facilitation.

Following the launch of the SADC Free Trade Area, a SADC customs union will be established.

Excise duty

Excise duty is levied on certain locally manufactured goods and their imported equivalents. This duty is levied as a specific duty on tobacco, liquor, and as an ad valorem duty on cosmetics, audio-visual equipment and motor cars.

Relief from excise duty is available where excisable products are exported. In addition, relief is also available for specific farming and forestry, and certain manufacturing activities.

Excise duties are imposed both as a means to generate revenue for the fiscus and to change consumer behaviour.

Transfer duty

Transfer duty is payable on the acquisition of property by individuals at progressive marginal rates between 0% and 8%. With effect from 1 March 2006, houses costing less than R500 000 attract no duty.

A 5% rate applies to properties between R500 000 and R1 million. In respect of property with a value above R1 million, the duty is R25 000 plus 8% of the value above R1 million. A rate of 8% applies on the value of the property for companies and trusts.

All transactions relating to a taxable supply of goods that are subject to VAT are exempt from transfer duty.

Estate duty

An estate consists of all the property, including deemed property (for example, life-insurance policies and payments from pension funds) of the deceased.

The duty is calculated on the dutiable amount of the estate.

Certain admissible deductions are made from the total value of the estate to determine the net value. Some important deductions are allowable against the value of the estate such as:

- the value of property in the estate that accrues to the surviving spouse of the deceased
- all debts due by the deceased
- a R3,5-million general deduction.

The estate duty rate is 20% of the dutiable amount of the estate.

Stamp duty

Stamp duty was abolished with effect from 1 April 2009 when the Stamp Duties Act, 1968 (Act 77 of 1968), was repealed. However, stamp duty is still applicable on lease agreements or other dutiable instruments if they were executed before 1 April 2009 and were not duly stamped at the time.

Securities transfer tax (STT)

STT was introduced by the STT Act, 2007

(Act 25 of 2007), with effect from 1 July 2008 at a rate of 0,25% of the taxable amount.

It replaced stamp duty and uncertificated securities tax on marketable securities.

STT is levied on any transfer of a security (whether listed or unlisted) based on the taxable amount of the security. A "security" means any:

- share in a company
- member's interest in a close corporation
- right or entitlement to receive any distribution from a company or close corporation.

Skills-development levy

This is a compulsory levy scheme for the funding of education and training. Sars administers the collection of the levy. The rate, as from 1 August 2005, is 1% for employers with an annual payroll in excess of R500 000.

Unemployment Insurance Fund

The UIF insures employees against the loss of earnings due to termination of employment, illness or maternity leave. A monthly contribution is collected from the employer, which consists of:

- a contribution made by the employee equal to 1% of the remuneration paid or payable by the employer to the employee during any month
- a contribution made by the employer equal to 1% of the remuneration paid or payable by the employer to that employee during any month.

The maximum earnings for UIF contributions are R149 736 per year, R12 478 per month or R2 879,53 per week.

Air-passenger departure tax

A tax of R120 is payable per fee-paying passenger departing on international flights, and R60 per passenger departing to Botswana, Lesotho, Namibia and Swaziland. This was increased to R150 and R80, respectively, from 1 October 2009.

Rates on property

Municipalities levy rates on the value of fixed property to finance the cost of municipal services.

Organisational performance

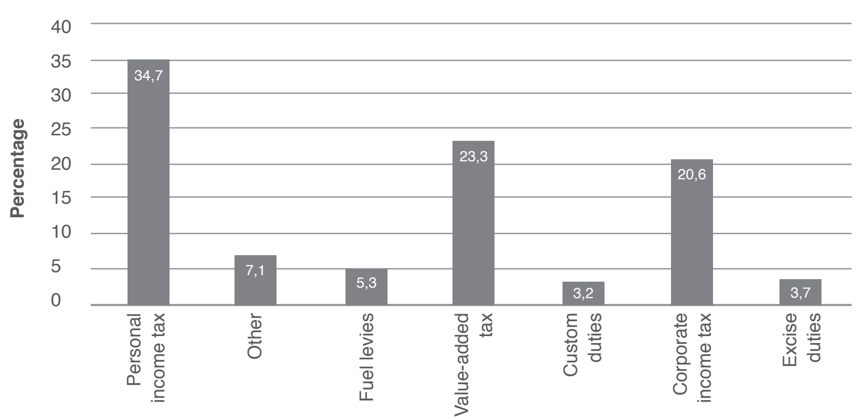
Sars collected R598,8 billion (unaudited) in revenue for 2009/10 – R8,4 billion more than its target. In line with the economic slowdown, the revenue target was adjusted downwards in October 2009 from R659,3 billion (the amount announced in the Budget of February 2009) to R589 billion, with a slight upward revision in February 2010 to R590,4 billion.

The main contributors to total tax revenue, based on the 2009/10 revised estimate of R590,4 billion, were personal income tax (R205,2 billion), VAT (R147,9 billion) and company income tax (R134,9 billion).

E-filing

E-filing (*www.efiling.gov.za*) is a secure service, enabling taxpayers to submit their

Tax revenue



Source: *National Treasury Budget Highlights 2010* tax returns online. It removes the risks and inconvenience of manual tax returns. Not only can returns be submitted via the Internet, but users can also make secure tax payments online. There is also a facility to apply for tax directives, which can be obtained within 24 hours.

The e-filing service is on par with international standards, being comparable with services offered in the United States of America (USA), Australia, Singapore, Ireland, Chile and France. Sars has seen e-filing in South Africa grow significantly since it was initiated in 2003.

For the 2009 tax year, more than 2,7 million individual tax returns were submitted through e-filing and annually over 7,5 million returns are submitted by businesses and practitioners.

Filing of tax returns season

Filing Season is an extensive marketing and publicity venture to remind taxpayers of their responsibilities to submit their tax returns on time and with the correct details.

The Taxpayer Education Campaign focuses on helping all eligible taxpayers to complete their tax returns correctly.

National Gambling Board (NGB)

The NGB was established in terms of the National Gambling Act, 1996, (Act 33 of 1996), which was repealed on 1 November 2004 by the National Gambling Act, 2004 (Act 7 of 2004).

The Act provides for the oversight of matters relating to casinos, gambling, racing and wagering, and promotes uniform norms and standards in relation to gambling throughout South Africa.

The vision of the board is to position the South African gambling regime as the pre-eminent jurisdiction with an effectively regulated industry. The NGB is committed to effective regulation and supervision of the South African gambling industry, a significant economic sector, by upholding internationally recognised standards of compliance.

Compliance

Five national registry systems: self-exclusions, probity, information sharing, gambling machines and devices, and central monitoring have been fully developed.

The Limited Payout Machine (LPM) industry continued to gain momentum. By the end of March 2009, over 10% of LPM machines had been rolled out and would remain operational until the promulgation of 50 000 machines countrywide. By mid-2010, each province had promulgated its relevant legislative policy framework and all were in the process of implementation.

The NGB provided for the introduction of a central electronic monitoring system (CEMS) for LPMs. The core functions of the CEMS are to monitor and record gambling revenue, as well as prescribe significant events associated with an LPM that is made available for play to the public. These functions ensure that the correct gaming levies and taxes are collected by the regulator while players are protected at the same time.

The NGB has spent considerable time ensuring that uniform norms and standards are applied within the racing and betting industry. The NGB participated in the review of the wagering software standard and consulted with provincial gambling boards to develop uniform regulatory systems for compliance and revenue audit.

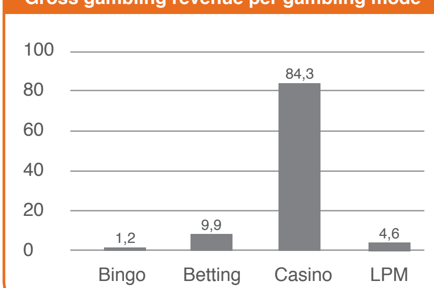
Research

The board published a research report on the socio-economic impact of legalised gambling in South Africa, as commissioned by the Bureau of Market Research.

In an effort to provide comprehensive and user-friendly information about the gambling industry, the NGB updated the National Gambling Statistics Database, which focuses mainly on primary statistics such as turnover, gross gambling revenue (GGR) and taxes/levies.

The results for 2009/10 continued to show an increase in GGR around the country as GGR increased by 2,17% from R15,921 billion (2008/09) to R16,268 billion in 2009/10. Casinos as major gambling modes contribute the most (84,3%) to GGR. This is mainly because punters tend to commit higher monetary amounts when visiting

Gross gambling revenue per gambling mode



Source: National Gambling Board

the 37 well-established casinos in South Africa.

Gauteng is the biggest generator of GGR. Apart from the highest number of casinos that generate income in Gauteng (seven) compared with other provinces, the GGR in this province is also boosted by the presence of a high number of other gambling activities, for example, racing and betting, the roll-out of LPMs in mid-2009, as well as bingo venues operating in Gauteng only.

Responsible gambling

The NGB has a legislated responsibility to educate the public on the odds of gambling and the negative socio-economic impact of the gambling industry on society.

During 2009/10, the board engaged the services of women who led small enterprises to run public awareness and education workshops over a period of 14 weeks.

The National Responsible Gambling Programme (NRGP) is a resource that integrates research and monitoring, public education and awareness, training, treatment and counselling. It was the first of its type internationally to integrate these components and is still the only programme of its kind to be jointly controlled by a public-private-sector partnership involving government regulators and the industry.

With effect from March 2009, the NRGP is being managed by the South African Responsible Gambling Foundation, which comprises a board of directors, representing regulators and industry. The main thrust of the NRGP's prevention programme is to educate gamblers and potential gamblers and society as a whole about responsible gambling.

Gambling Review Commission

After considering all relevant aspects of gambling, the Gambling Review Commission will make recommendations to the Minister of Trade and Industry, Dr Rob Davies. Based on the recommendations, the Minister will table the policy position regarding the proliferation of legal and illegal gambling activities in South Africa in Parliament.

This review process will assist government to assess whether there is a need to curtail gambling activities or consider requests to expand such activities, considering the number of casinos, LPMs and bingo outlets already licensed. The scope of the Gambling Review Commission covers, among other things:

- the social effects of gambling and mechanisms in place to address them
- commitment of the industry to social investment
- the evaluation of adequate regulatory framework to accommodate and effectively deal with the impact of technology and new trends
- the effectiveness of current regulation, control and enforcement structures.

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In August 2010, online gambling was banned in South Africa following the Gauteng Gambling Board's long-running battle with online casinos.

The effect of this decision meant that both Internet operators who offer online gambling to South African residents for gain, and a player or punter who takes part in online betting, are guilty of breaking the law.

The ruling also makes Internet service-providers accountable for the services, and targets banks and financial institutions that process the winners' payments and betting transactions.

People who are prosecuted and found guilty of breach or contravention of the gambling legislation could receive a fine of up to R10 million or 10 years in jail or both.

National Lotteries Board (NLB)

The NLB was established in October 1998 in terms of the Lotteries Act, 1997 (Act 57 of 1997).

The board's main activities are, among other things, to:

- advise the Minister of Trade and Industry on the issuing of the licence to conduct the National Lottery
- ensure that the National Lottery and sports pools are conducted with all due propriety
- ensure that the interests of every participant in the National Lottery are adequately protected
- ensure that the net proceeds of the National Lottery are as high as possible
- administer the National Lottery Distribution Trust Fund and hold it in trust
- advise the Minister on percentages of money to be allocated in terms of Section 26(3) of the Lotteries Act, 1997
- advise the Minister on establishing and implementing a social-responsibility programme in respect of lotteries
- administer and invest the money paid to the board in accordance with the Lotteries Act, 1997.

The National Lottery' operator is Gidani, a 89,2% black-majority-owned private company.

Auditor-General of South Africa (AGSA)

The AGSA has a constitutional mandate. It strengthens South Africa's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

The AGSA is one of the chapter nine institutions mandated by the Constitution to fulfil certain functions. These institutions are not part of government and do not have a duty to be part of the mechanisms of cooperative government. The independence of the AGSA is thus respected and strengthened.

As mandated by the Constitution and the Public Audit Act, 2004 (Act 25 of 2004), the AGSA is responsible for the auditing of national and provincial state departments and administrations, all municipalities and any other institution or accounting entity required by national and provincial legislation to be audited by the AGSA.

Various business units provide auditing services, corporate services and specialised audit work, such as performance audit, information systems audit and audit research and development.

The AGSA also boasts an impressive international auditing complement.

Financial sector

South African Reserve Bank (SARB)

The SARB is the central bank of South Africa. The bank was established in 1921 in terms of a special Act of Parliament, the Currency and Banking Act, 1920 (Act 10 of 1920), and was the direct result of the abnormal monetary and financial conditions, that had arisen during and in the period immediately following World War I.

Since its establishment, the bank has always been privately owned and has more than 600 shareholders. Except for the provision of the bank that no individual shareholder may hold more than 10 000 shares of the total number of two million issued shares, there is no limitation on shareholding. The bank's shares are traded on the Over-the-Counter Share-Trading Facility managed by the bank.

After allowing for certain provisions, payment of company tax on profits, transfers to reserves and dividend payments of not more than 10 cents per share per year to shareholders, the surplus of the bank's earnings is paid to government. The bank's operations are therefore not driven by a profit motive, but rather by serving the best interests of all South Africans.

The bank holds an ordinary general meeting of shareholders at its Head Office in Pretoria annually. This is the occasion where the Governor, as chairperson, delivers an annual address on the state of the economy and monetary policy, which is covered widely in the media.

The bank has a board of 14 directors. Among them are the Governor and three deputy governors, who are appointed by the President for terms of five years. Three other directors are appointed by the President for a period of three years.

The remaining seven directors, of whom one represents agriculture, two industry and four commerce or finance, are elected by shareholders for a period of three years.

The bank has a staff of around 2 000. Management comprises the Governor, deputy governors, the executive general managers and the heads of departments. The bank has branch offices in Bloemfontein, Cape Town, Durban, East London, Johannesburg, Port Elizabeth and Pretoria North.

The bank is governed by the SARB Act, 1989 (Act 90 of 1989). It has, furthermore, been given an important degree of autonomy in the execution of its duties, in terms of the Constitution.

The bank must submit a monthly statement of its assets and liabilities and an annual report to Parliament. The Governor of the bank holds regular discussions with the Minister of Finance and appears before the Parliamentary Portfolio and select committees on finance from time to time.

The SARB, like central banks in other countries, has a unique position in the economy as it performs various functions and duties not normally carried out by commercial banks. Although the functions of the bank have changed and expanded over time, the formulation and implementation of monetary policy has remained one of the cornerstones of its activities.

The bank has used different monetary-policy frameworks over time, such as credit ceilings and credit controls in the 1970s, money-supply growth targets in the 1980s, money-supply growth guidelines in the early 1990s and an eclectic monetary policy with an informal inflation target from the mid-1990s. In February 2000, an inflation target was specified for the first time, and the adoption of this target entrusted a single objective to the bank: price stability. This target was set for the first achievement in 2002.

Between 2002 and 2003, South Africa's inflation target was specified as increases in CPIX (year-on-year increase in the Consumer Price Index [CPI]), excluding mortgage interest costs for metropolitan and other urban areas) of between 3% and 6%.

Inflation targeting is a framework and not a rule. The numerical rate is made public and a definite time horizon is specified.

The framework was introduced because of certain perceived advantages, such as:

- making the objective of monetary policy clear, thereby improving planning in the private and public sectors
- forming part of a formalised coordinated effort to contain inflation and pursuit of the broader economic objective of sustainable high economic growth and employment creation
- helping to focus monetary policy and enhancing the accountability of the central bank to the public
- providing an anchor for expectations of future inflation, which should influence price and wage setting.

The inflation target is set in consultation between the Governor and the Minister of Finance. This approach implies that the bank does not have complete goal independence (that is, the setting of the objective to achieve), but has operational independence (such as the choice of instruments and the autonomy to adjust such instruments) in monetary-policy decisions aimed at achieving the target. The bank publishes monetary-policy reviews, while regular regional monetary-policy forums are held to provide a platform for discussions of monetary policy with broader stakeholders from the community.

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In April 2010, Cabinet announced the need to amend the South African Reserve Bank (SARB) Act 1989 (Act 90 of 1989), to ensure that it meets its constitutional mandate. The amendments are designed to enhance the governance of the Reserve Bank and to uphold its public-interest role. The public-interest principle forms the cornerstone of a central bank, and particularly that of the SARB.

The Bill seeks to achieve this by:

- stopping shareholders from circumventing the current Act's limitation of a maximum of 10 000 shares per shareholder
- allowing for the nomination of directors by a broader base of South Africans and to broaden representation on the board of the bank
- providing for the establishment of a panel for the election of directors
- defining clear criteria for the disqualification of persons from serving on the board
- providing for the confirmation of board nominees against "fit and proper" and fiduciary criteria
- clarifying the powers and functions of the board
- providing for the possibility of the Governor and deputy governors to be re-appointed to serve a term of less than five years.

In March 2010, the bank's Monetary Policy Committee (MPC) cut the repo rate by 50 basis points to 6,5%.

The bank took note that the domestic economy had shown signs of recovery since the previous meeting in January 2010 and that inflation expectations had moderated.

Data released by Statistics South Africa showed that the CPI for February 2010 fell within the bank's target range of between 3% and 6%. It came in at 5,7%.

The bank's inflation forecast was expected to average 5,3% and 5,4% in 2010 and 2011 respectively, while it was expected to reach a low point at an average of 4,9% during the third quarter of 2010.

Factors contributing to the improved expected inflation trajectory included favourable food price developments as well as lower-than-expected inflation outcomes.

Growth in domestic expenditure appeared to be recovering at a modest pace but did not pose an upside risk to the inflation outlook. After five consecutive quarters of negative growth, real household consumption expenditure increased at an annualised rate of 1,4% in the fourth quarter of 2009.

System of accommodation

The bank's refinancing system is the main mechanism used to implement its monetary policy. Through its refinancing system, the bank provides liquidity to banks, enabling them to meet their daily liquidity requirements.

"Liquidity" refers to the banks' balances at the central bank that are available to settle their transactions with one another, over and above the minimum statutory level of reserves that they have to hold.

The main instrument for managing liquidity in the money market is repurchase (repo) transactions. The refinancing system, based on repo transactions, was introduced in March 1998.

The repo rate is the price at which the central bank lends cash to the banking system and is the key operational variable in the monetary-policy implementation process. It represents the most important indicator for short-term interest rates.

The refinancing system also provides for supplementary and standing facilities to bridge the banking sector's overnight liquidity needs, as well as a concession to banks to use their cash-reserve balances with the bank to square-off their daily positions.

Creating a liquidity requirement

In terms of its monetary-policy implementation framework, the SARB has to compel banks to borrow a substantial amount (the liquidity requirement or the money-market shortage) from the bank.

The bank, therefore, creates a liquidity requirement (or shortage) in the money market, which it then refinances at the repo rate – a fixed interest rate determined by the MPC, comprising the bank's governors and other senior officials. After each meeting, the MPC issues a statement indicating its assessment of the economy and announces policy changes, if necessary.

The bank's repo rate influences the interest rates charged by banks, the general level of interest rates in the economy and therefore other economic aggregates such as money supply, bank-credit extension and ultimately the rate of inflation.

The repo rate influences market rates in two ways: it directly influences the bank's marginal cost of funding and it reflects the bank's stance on monetary policy.

The bank has to intervene regularly in the money market to create such a shortage, that is, to drain excess liquidity from the money market. In addition to the liquidity-management operations described above, the bank uses other open-market operations (OMOs) to achieve its monetary-policy objectives.

The OMOs refer to the selling of SARB debentures, longer-term reverse repos, money-market swaps in foreign exchange and the movement of public-sector funds, for example, Corporation for Public Deposits and central government funds, as well as changes in the cash-reserve requirements for banks, which by mid-2009 amounted to 2,5% of banks' liabilities.

Functions of the bank

The bank performs a number of functions to achieve its objectives. Its current functions can be grouped into the following major areas of responsibility:

- Formulation and implementation of monetary policy (aimed at achieving the inflation target).
  - Refinancing system and interest rates: The essence of the bank's monetary-policy implementation framework and the transmission of monetary policy is its influence on the level of interest rates through its refinancing system.
  - OMOs: OMOs are conducted for two reasons: Firstly, to neutralise or smooth the influence of exogenous factors on the liquidity position in the money market. Secondly, to maintain an adequate liquidity requirement in the market, which has to be refinanced from the bank. Through this mechanism, the bank can exert influence over interest rates in the market.
- Service to government:
  - Gold and foreign-exchange reserves: The bank is the custodian of the country's official gold and foreign-exchange reserves. Subsequent to the conversion of the negative net open foreign currency position in May 2003 into a positive position, foreign reserves have been growing ever since.
  - Banker and adviser to government: The main services provided are administering the auctions of government bonds and National Treasury bills, participating in the joint standing committees between the bank and National Treasury, and managing the flow of funds between the Exchequer Account and tax and loan accounts.
  - Administration of exchange control: The bank is responsible for the administration of government's exchange-control policy.
  - Provision of economic and statistical services: The bank collects, processes, interprets and publishes public information, economic statistics and other information, and uses this information in policy formulation.
- Bank supervision: The purpose is to achieve a sound and effective banking system in the interest of depositors of banks and the economy as a whole.
- The national payment system: The bank is responsible for overseeing the safety and soundness of the national payment system. The main aim is to reduce interbank settlement risk with the objective of reducing the potential of a systemic risk crisis emanating from settlement default by one or more of the settlement banks.
- Banker to other banks: The bank acts as custodian of the cash reserves that banks are legally required to hold or prefer to hold voluntarily with the bank.
- Banknotes and coin: The South African Mint Company, a subsidiary of the bank, mints all coin on behalf of the bank. The South African Bank Note Company, another subsidiary

of the bank, prints all banknotes on behalf of the SARB. Currency is distributed through the bank's seven branches to commercial banks. It is the responsibility of the branches to ensure that there is an adequate supply of new notes available to meet the demand, and to replace unfit notes. The branches are responsible for the quality of banknotes in circulation in their respective regions.

- Lender of last resort:
  In terms of its "lender-of-last-resort activities", the bank may, in certain circumstances, provide liquidity assistance to banks experiencing liquidity problems.
- Monitoring financial stability:
  In view of the interrelationship between price and financial-system stability, the bank monitors the macro-prudential aspects of the domestic financial system. The objective of financial stability is to prevent costly disruptions in the country's financial system.
- Provision of internal corporate support services and systems.

To ensure smooth operations and administration, the bank provides its own internal services, supported by Information Technology and Human Resources (HR).

Monetary policy

Growth over 12 months in the broad money supply (M3) slowed significantly from a high of 13,9% in January 2009 to an all-time low of 0,1% in February 2010 and 1,5% in March. Growth over 12 months in banks' total loans and advances similarly moderated from 11,4% in January 2009 to a negative growth rate of 0,3% in March 2010.

Banks' total loans and advances recorded declines across all categories during 2009.

> As part of ongoing reforms, the Minister of Finance, Mr Pravin Gordhan, announced the shift from exchange controls to a system of prudential regulation by replacing unnecessary administrative controls with improved surveillance and prudential limits on foreign exposure risks.
>
> In line with the gradual change in the functions and responsibilities of the Department of Exchange Control of the South African Reserve Bank, the Minister also announced that the name of the department would be changed to the Department of Financial Surveillance. The name change was effective from August 2010.
>
> Since financial surveillance is an important pillar of financial stability, the drafting of a document relating to a modernised policy and legislative framework had already commenced.
>
> The broad strategy remains prudential management of foreign exposure risk, along with improved management of capital flows and maintaining macro-economic and financial stability.

The most pronounced decline was in the other loans and advances category, which is used mainly by the corporate sector. Mortgage advances, used mainly by the household sector, retained a modest positive growth rate during 2009 and dominated growth in total loans and advances in early 2010.

The moderation in the growth in banks' total loans and advances was consistent with the slowdown in the general level of economic activity during 2009. Lending standards of banks must comply with the National Credit Act (NCA), 2005 (Act 35 of 2005), implemented in June 2007.

Headline inflation moved to within the inflation target range of 3% to 6% for the first time since April 2007 when a year-on-year increase of 5,9% was recorded in October 2009.

After again breaching the upper limit of the inflation target range for technical reasons in December 2009 and January 2010, inflation has moved back to within the range on a sustainable basis since February 2010. In April, CPI headline inflation measured 4,8%.

In the wake of the global financial crisis, many central banks loosened monetary policy significantly. Most of these adjustments occurred during late 2008 and the first half of 2009. South Africa generally followed this trend, and between December 2008 and August 2009 the repurchase rate was reduced by a total of 500 basis points.

The stance of monetary policy remained unchanged until March 2010. During this period, the MPC was of the view that the repurchase rate was consistent with the expected inflation trajectory and with the projected recovery in the domestic economy.

At the March meeting, the repurchase rate was reduced by a further 50 basis points to a level of 6,5% per year. This further reduction in the rate was implemented against the backdrop of a more favourable inflation outlook and continued weakness in domestic household consumption expenditure in particular.

The repo rate was lowered to 6% in September 2010.

The banking industry

As at the end of December 2009, there were 31 banking institutions reporting data to the Bank Supervision Department of the SARB (excluding two mutual banks, but including one institution conducting banking business in terms of an exemption from the provisions of the Banks Act, 1990 [Act 94 of 1990], namely Ithala Limited) and 42 international banks with authorised representative offices in South Africa.

Of the nominal value of the total South African banking sector's shares in issue at the end of December 2009, foreign shareholders held 47,5%; domestic shareholders held 30,4%; and minority shareholders held 22,1%.

Total banking-sector assets amounted to R2 967 billion at the end of December 2009, compared with R3 177 billion at the end of December 2008, representing negative year-on-year growth of 6,6%. Total assets of the four largest banks accounted for 84,6% of total banking-sector assets (December 2008: 84,4%).

Gross loans and advances declined by 2,6% from R2 316 billion at the end of December 2008 to R2 257 billion at the end of December 2009 (December 2008: 9% increase).

Home loans and term loans remained the largest component of gross loans and advances, representing about 50% thereof, followed by lease and instalment debtors at 10,5% and commercial mortgages at 9,7%.

At the end of December 2009, banking-sector total equity and liabilities amounted to R2 967 billion. Total deposits, amounting to R2 366 billion, represented 85,4% of banking-sector liabilities of R2 769 billion at the end of December 2009 (December 2008: 79,6%).

Fixed and notice deposits accounted for 27,4% of total banking-sector deposits at the end of December 2009 (December 2008: 24,9%), while call deposits represented 18%; negotiable certificates of deposit 18%; current accounts 16,8%; and other deposits 10,5% of total banking-sector deposits.

Deposits from corporate customers constituted the largest portion of total banking-sector deposits, namely 42,6% at the end of December 2009, followed by retail customers and bank deposits, which accounted for 22,3% and 13,7% respectively.

The total capital-adequacy ratio of the banking sector improved during 2009, increasing from 13% at the end of December 2008 to 14,1% at the end of December 2009. The Tier 1 capital-adequacy ratio also improved from 10,2% at the end of December 2008 to 11% at the end of December 2009.

The banking sector remained profitable throughout 2009. However, profitability levels were negatively impacted, mainly by an increase in credit losses and operating expenses. The banking sector's return on equity and return on assets ratios, calculated on a smoothed basis (that is, utilising a 12-month moving average), deteriorated during 2009 to 15,9% and 0,94% respectively at the end of December 2009 (January 2009: 20,7% and 1,2% respectively).

Liquid assets held by the banking sector increased by 20% during 2009 and the statutory liquid asset holdings of the sector exceeded the minimum prescribed requirement by 46,3% (December 2008: 15,5%). Liquid assets held by the banking sector exceeded the statutory liquid asset requirement throughout 2009.

Credit ratios continued to deteriorate during 2009, but at a slower rate than in 2008. Impaired advances (that is, advances in respect of which a specific credit impairment has been raised) increased by 47,5% between December 2008 and December 2009, and amounted to R134 billion at the end of December 2009 (December 2008: R90,8 billion).

Impaired advances to gross loans and advances deteriorated to 5,9% at the end of December 2009 compared with 3,9% at the end of December 2008. The deterioration in this ratio was exacerbated by the impact of negative annual growth of 2,6% in gross loans and advances at the end of December 2009. However, the banking sector reported a slight decline of 0,5% (month-on-month) in impaired advances in December 2009, the first decline since the commencement of the credit down-cycle.

The microlending industry

The Department of Trade and Industry introduced the NCA, 2005, to allow the credit market to function in a robust and effective manner.

The NCA, 2005 replaced the Usury Act, 1968 (Act 73 of 1968), and the Credit Agreements Act, 1980 (Act 75 of 1980). The NCA, 2005, which became effective on 1 June 2007, aims to regulate the granting of consumer credit by all credit-providers, including microlenders, banks and retailers.

It created the National Credit Regulator (NCR) and the National Consumer Tribunal, which play a vital role in ensuring enforcement, promoting access to redress and adjudicating contraventions of the Act.

The NCR is responsible for regulating the South African credit industry. It carries out education, research and policy development; registers industry participants; investigates complaints; and ensures that the Act is enforced.

In terms of the Act, the NCR has to promote the development of an accessible credit market to meet the needs of people who were previously disadvantaged, earn a low income or live in remote, isolated or low-density communities.

The National Consumer Tribunal adjudicates various applications and hears cases against those who contravene the Act.

The Act provides for the registration of debt counsellors to assist overindebted consumers. Debt counsellors are required to undergo training approved by the NCR through approved training service-providers appointed by the regulator.

Other financial institutions

Development Bank of Southern Africa (DBSA)

The DBSA Act, 1997 (Act 13 of 1997), stipulates that the main role of this DFI is to promote economic development and growth, HR development and institutional capacity-building. The bank achieves this by mobilising financial and other resources from the private and public sectors, both nationally and internationally, for sustainable development projects and programmes.

The DBSA's annual financial results for the year ended 31 March 2010, showed enhanced development impact amounting to R8,9 billion despite the economic downturn, characterised by rapid strengthening of the Rand from the previous financial year against major currencies; a sharp decline in interest rates; and increased costs of borrowing, specifically on short-term funding.

During 2009/10, the DBSA spent R550,2 million on developmental initiatives, representing 66,9% of its sustainable earnings for 2010. This was higher than the 2008/09 figure of 48,9%.

Land and Agricultural Development Bank (Land Bank)

The Land Bank operates as a DFI within the agricultural and agribusiness sectors, and is regulated by the Land and Agricultural Development Bank Act, 2002 (Act 15 of 2002). The Land Bank provides a range of financing products to a broad spectrum of clients within the agricultural industry.

Financing products include wholesale and retail financing to commercial and developing farmers, cooperatives and other agriculture-related businesses.

The Land Bank's objectives are defined within its mandate, which requires that it should achieve:

- growth in the commercial market
- growth in the development market
- business efficiency
  -service delivery
  -resource management
- sustainability.

(See Chapter 3: *Agriculture, forestry and fisheries*.)

The Land Bank is the sole shareholder in the Suid-Afrikaanse Verbandversekeringsmaatskappy Beperk, which provides insurance to people indebted to the bank through mortgage loans.

In the 2009/10 financial year, National Treasury approved R3,5 billion of guarantees in support of the Land Bank's turnaround. Of this amount, R1 billion has been converted into a cash injection in the bank's capital.

Financial Services Board

The FSB is a regulatory institution established in terms of the FSB Act, (Act 97 of 1990), to oversee the non-banking financial services industry in the public interest.

Collective investment schemes

CIS are investment structures whereby individual investor funds are pooled with those of other investors. Qualified asset managers regulated under the Financial Advisory and Intermediaries (FAIS) Act, 2002 (Act 37 of 2002), invest these funds on behalf of the investor. Each investor owns units (participatory interest) in the total fund.

The South African CIS industry has recovered well in the aftermath of the financial crisis. Total assets under management at the end of March 2010, increased to R817 billion, compared with R658 billion in March 2009, indicating a growth of 24%.

CIS in shares are generally considered a medium- to long-term investment and past performance is not necessarily a guide to the future.

Financial advisers and intermediaries

The purpose of the FAIS Act, 2002 is to regulate, in pursuance of consumer protection, the provision of advice and intermediary services to certain clients in respect of a range of financial products and services.

The FSB, through the FAIS Department, is responsible for the regulation of the rendering of financial advisory and intermediary services to clients by FSPs in respect of a wide range of financial products.

The provisions of the FAIS Act, 2002 became effective on 30 September 2004.

In terms of this Act, before conducting any transaction, consumers should ensure that the FSP they are dealing with has obtained a licence from the FSB. Information on authorised FSPs can be obtained from the FSB website.

Recognised representative bodies

Section 6(3)(iii) of the Act provides for the Registrar of FSPs to delegate any of their powers in terms of the Act to anybody recognised by the Act. Two such functions, the consideration of applications for licences under Section 8 and the consideration of applications for approval of compliance officers under Section 17(2) of the Act, were delegated to 11 recognised representative bodies.

Advisory Committee on Financial Services Providers

The Minister of Finance appoints the Advisory Committee on FSPs whose function is to investigate and report or advise on any matter covered by the FAIS Act, 2002.

The advisory committee consists of a chairperson and other members, including a representative of the Council for Medical Schemes established by Section Three of the Medical Schemes Act, 1998 (Act 131 of 1998), and persons representative of product suppliers, FSPs and clients involved in the application of this Act, appointed by the Minister after consultation with the Board.

The members of the advisory committee, except for the Registrar and Deputy Registrar, who are ex officio members, hold office for a period determined by the Minister.

Licensing of financial services providers

The Registrar of FSPs authorises and renders ongoing supervision over five categories of FSPs. Category One consists of financial advisers and intermediaries who provide financial services without discretion. Category Two FSPs (also referred to as discretionary FSPs) offer discretionary intermediary services in terms of financial product choice, but without implementing bulking. Category TwoA FSPs are hedge fund managers. Category Three FSPs are investment administrators specialising mainly in the bulking of collective investments on behalf of clients (linked investment services providers). Category Four is a new category in which assistance business administrators render intermediary services in terms of the administration of assistance business (funeral policies) on behalf of an insurer to the extent agreed to in a written mandate between the two parties.

The total number of approved FSPs at 31 March 2010 was:

- Category One, 13 280
- Category Two, 572
- Category TwoA, 116
- Category Three, 23
- Category Four, eight.

Insurance companies

Insurance is divided into long-term and short-term insurance. Insurance is an agreement between a policy-holder and the insurance company. Under a short-term insurance policy, the insured is entitled to be compensated by the insurer for the loss of or damage to assets caused by the event against which they are insured.

The aim of short-term insurance is to put the insured in the same position they occupied immediately before the loss, depending on the terms and conditions of the policy contract. Examples of short-term insurance include motor-vehicle, household, theft and fire insurance.

By 31 March 2010, there were 110 short-term insurers.

Long-term insurance includes life and assistance policies that pay a benefit to dependants on the death of the insured person/s, endowment (savings) policies payable at a predetermined date, disability policies, pensions and retirement policies, or even a combination of these policies.

By 31 March 2010, there were 88 long-term insurers.

In terms of the Long-Term Insurance Act, 1998 (Act 52 of 1998), and the Short-Term Insurance Act, 1998 (Act 53 of 1998), all insurance companies must be registered by the FSB and must comply with the provisions of these Acts.

The insurance industry has appointed an ombudsman for short-term and long-term insurance to play a mediatory role in dispute-resolution between insurers and policy-holders.

Market abuse

The Directorate: Market Abuse is a committee of the FSB and is responsible for combating market abuse in the financial markets in South Africa.

Retirement funds

At 31 March 2010, there were 10 699 registered retirement funds supervised by the FSB. The latest available statistics are for the year ended 31 December 2008 and are from the Government Employees Pension Fund, Transnet and Telkom funds, bargaining council funds not registered with the FSB and 59% of registered funds that submitted financial statements. The last-mentioned constitute about 70% of the assets of funds registered with the FSB.

Total membership of retirement funds in South Africa at 31 December 2008 was 10 496 541, 8 557 228 of whom were active members and 1 939 313 pensioners, deferred pensioners and dependants.

Total contributions received by retirement funds in South Africa increased by 8,6% from R91,1 billion in 2007 to R99 billion in 2008.

Total benefits paid by retirement funds in South Africa, which include pensions, lump sums on retirement, death and resignations, increased by 30,8%, from R108,8 billion in 2007 to R142,3 billion in 2008.

Financial markets

Primary capital-market activity

Government bond

Retail bonds can be purchased from government outlets and selected private retailers. Since the introduction of RSA fixed-rate retail savings bonds in May 2004 and inflation-linked retail bonds in April 2007, a cumulative amount of some R6,5 billion was raised up to March 2010.

Financial shortfalls of the public sector continued to be funded mostly locally, with net issues amounting to an all-time high of R113,5 billion in 2009, compared with R27,2 billion in 2008. Public-sector borrowers' demand for funds was buoyed by increased infrastructural capital expenditure programmes and borrowing requirements. Net issues of fixed-interest securities of R59,4 billion were recorded in the first four months of 2010.

After its previous foreign bond issue in May 2009, National Treasury used the international bond market in March 2010 to help finance the budgeted fiscal deficit. A total of R14,8 billion was raised through the issuance of a US$2-billion 10-year bond with a coupon rate of 5,5% at a spread of 197 basis points over equivalent US treasuries.

The daily average yield on the R157 government bond (maturing in 2014/15/16) increased from a low of 7,04% on 18 December 2008 to 8,78% on 3 July 2009. Thereafter, the bond yield fluctuated in a narrow 76-basis points range to 8,61% on 12 January 2010.

Subsequently, the bond yield declined to 8,03% on 18 May 2010, alongside the appreciation in the exchange value of the Rand, the lowering of the repurchase rate and the release of lower-than-expected inflation data.

While yields at the short end of the yield curve tracked the movements in the repurchase rate from December 2008 to March 2010, the medium-to-long end of the curve moved higher from December 2008 to January 2010, before declining to April following the appreciation in the exchange value of the Rand and the decline in measured inflation.

The yield gap, measured as the difference between the yields at the extreme long and short ends of the curve, widened marginally from 228 basis points on 12 January 2010 to 261 basis points on 18 May.

Amid bond yield volatility, the break-even inflation rate – calculated as the differential between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds within the three-year maturity range – fluctuated higher from a low of 3,88% in February 2009 to above the 6% level in June, and reached 6,82% in October 2009.

Subsequently, in line with improved inflation expectations, the break-even inflation rate fluctuated lower to 5,93% on 18 May 2010 as the nominal yield declined while the real yield increased somewhat.

The currency risk premium on South African government bonds widened from 34 basis points in January 2009 to 428 basis points in November 2009 as the yield on domestic rand-denominated bonds increased and the corresponding yield on dollar-denominated bonds declined.

Although the Dollar-denominated yield continued lower, the spread subsequently narrowed to 404 basis points in April 2010 as the Rand-denominated yield changed course and declined by more than the Dollar-denominated yield.

The bond point spread for South Africa (the rate at which South Africa has to pay its creditors compared to the USA) has been steadily falling since 2001. This shows that the risk of investing in South Africa has fallen compared with other emerging markets.

This is largely due to macroeconomic stability, industrial policies that add to domestic value and increase the country's competitiveness, and positive global assessment of the country's socio-political prospects. The rising premium from 2007 to the end of 2008 was largely a result of the global reaction to the financial crisis in the USA.

Investor participation in emerging markets' financial assets, improved as inferred from the JPMorgan Emerging Markets Bond Index Plus (EMBI+) spread, which narrowed from a high of 718 basis points in November 2008 to 265 basis points in April 2010.

Similarly, the sovereign risk premium on South African government dollar-denominated bonds in the four-year maturity range trading in international markets narrowed significantly from an average high of 720 basis points in November 2008 to a low of 102 basis points in April 2010.

Private-sector bond issuance

After recording net redemptions of R2,3 billion in 2008, private corporate funding activity in the bond market increased by R18,1 billion in 2009. Activity was largely driven by banks, capitalising on a revival of investor appetite as economic conditions improved and foreign funding opportunities remained strained.

Securitisation, however, remained out of favour. In the first four months of 2010, funding by private-sector borrowers accelerated to net issues of R11,4 billion, compared with net redemptions of R1,5 billion in the same period of 2009.

Funding in the form of commercial paper was subdued in 2009 as reflected by net redemptions of R14,9 billion, compared with net issues of R16,5 billion in 2008. This lack of demand for, and supply of, commercial paper continued in the first two months of 2010, before activity rebounded somewhat from March. Net redemptions of commercial paper to the amount of R4,3 billion were recorded in the first four months of 2010.

Eurorand and Uridashi bonds

In the middle of the recession in major global economies, non-residents' demand for rand-denominated bonds issued in the Japanese and European bond markets waned in 2009. Net redemptions of R12,9 billion were recorded in 2009 following net issues of R28,5 billion in 2008.

Subsequently, non-residents' participation in rand-denominated bond issuance in foreign markets increased alongside the improvement in global economic activity. In the four months to April 2010, foreign borrowers' interest was particularly evident in the Japanese Uridashi bond markets where the nominal value of bonds issued was higher than that traded in the European bond markets.

The increase in issuances was, however, offset by higher redemptions, which consequently resulted in net redemptions of bonds traded in these markets to the value of R4 billion, compared to similar net issues registered in the same period in 2009.

> **i**
>
> In November 2010, government introduced a new tax-incentive programme, which seeks to improve the productivity of the country's manufacturing sector, by supporting investments in assets as well as training for employees.
>
> The incentive replaces the Strategic Industrial Project (SIP), which was launched by government to attract private-sector investment. The SIP resulted in the creation of 6 600 jobs.
>
> The incentive, which will run until 31 December 2015, offers R900 million for new industrial projects that use new and unused manufacturing assets (greenfield investments) as well as R550 million for brownfield projects, which provide for expansion or upgrades of existing projects.
>
> The decline of credit extension to support investment in manufacturing was another reason for the creation of the incentive.
>
> The loss of the fiscus, as a result of the incentive, in terms of tax revenue foregone, will be R5,6 billion, as announced in the Budget in 2008.
>
> The criteria to receive the tax relief include companies going green by saving energy and projects creating direct employment in the country.

Secondary capital-market activity

Domestic bonds

After recording a record-high turnover of R21,3 trillion in 2008, the value traded declined to R14,9 trillion in 2009 along with lower trading volumes and bond prices. The total number of trades was 13% less in 2009 compared with 2008.

Amid volatile bond yields, turnover in the secondary bond market picked up from February 2010, contributing to turnover of R4,8 billion in the first four months of 2010.

This was, however, still 9% lower than the value traded in the corresponding period of 2009. Repurchase agreements accounted for the bulk of turnover, constituting 69% of total turnover, with standard transactions accounting for 27% by mid-2010.

The market recorded a liquidity ratio of 14 in 2009, down from 23 in 2008, before declining further to an annualised ratio of 13 in the four months to April 2010.

Non-residents increased their holdings of local debt securities by a quarterly record-high amount of R24,3 billion in the fourth quarter of 2009, subsequent to net sales of domestic bonds amounting to R3,4 billion in the third quarter. The cumulative net purchases of domestic debt securities by non-residents amounted to R15,5 billion in 2009 as a whole, compared with net sales of R23,8 billion in 2008. Further net purchases of R29,3 billion were recorded in the first four months of 2010, despite the decline in domestic bond yields as well as the appreciation in the exchange value of the Rand.

Non-residents' participation in the South African secondary bond market, measured by their purchases and sales as a percentage of total purchases and sales, declined to an average of 10% in the first four months of 2010, compared with 12% in 2009.

Exchange rates

The exchange value of the Rand remained resilient in the opening months of 2010 and, on balance, increased by 3,9% in the first quarter of 2010 against a basket of 15 currencies of South Africa's most important trading-partner countries.

Small declines in January and February 2010 were followed by an increase in March. The increase in the first quarter of 2010 reflected, among other factors, a sustained increase in international commodity prices and a generally more positive outlook for economic growth in emerging-market economies.

The sovereign debt problems in Greece and their potential effect on peripheral economies negatively affected the Euro, while the political uncertainty regarding the outcome of the elections in the United Kingdom (UK) put strain on the Pound. The exchange rate of the Rand appreciated by 7,8% and 7,5% against the Euro and Pound respectively in the first quarter of 2010.

Exchange control

Exchange control is administered by the SARB on behalf of the Minister of Finance.

The Minister of Finance has also appointed certain banks to act as authorised dealers in foreign exchange as well as authorised dealers with limited authority, which gives them the right to buy and sell foreign exchange, subject to conditions and within limits prescribed by the Exchange Control Department (Excon) of SARB. Authorised dealers are not agents of Excon, but act on behalf of their customers.

The Government is committed to an open capital market and the gradual relaxation of exchange controls. The following dispensations regarding exchange control are allowed:

Institutional investors

Exchange-control limits on foreign investment by institutional investors – insurers, pension funds, CIS and investment managers – have been gradually liberalised since 1996.

Foreign diversification of investment portfolios, consistent with prudential limits, has largely been achieved. This allowed the authorities to replace exchange controls on institutional investors with a system of prudential regulation.

This shift entails the removal of the pre-application process for foreign investment and its replacement with a system of quarterly reporting on and monitoring of foreign exposures.

Retirement funds, long-term insurers, CIS management companies and investment managers are allowed to transfer funds from South Africa for investment abroad:

- Retirement funds and the underwritten policy business of long-term insurers may invest up to 20% of total retail assets. Investment managers registered as institutional investors for exchange-control purposes, CIS management companies and investment-linked businesses of long-term insurers are restricted to 30% of total retail assets under management.
- Institutional investors will be allowed to invest an additional 5% of their total retail assets by acquiring foreign-currency

Exchange rates of the Rand (percentage change)

	30/06/09 – 31/04/09	30/09/09 – 30/12/09	31/12/09 – 31/03/10	31/03/10 – 31/05/10
Weighted average*	2,5	1,2	3,9	0,1
Euro	1,2	2,0	7,8	4,8
US dollar	5,0	0,5	0,6	-4,0
Chinese yuan	4,9	0,5	0,6	-4,0
British pound	8,6	0,1	7,5	0,0
Japanese yen	-1,5	3,5	1,7	-5,9

* Against a basket of 15 currencies

Source: South African Reserve Bank, *Quartely Bulletin*, June 2010.

denominated portfolio assets in Africa through foreign-currency transfers from South Africa or by acquiring approved inward-listed instruments based on foreign reference assets or issued by foreign entities listed on the JSE Limited (Ltd).

- Foreign companies, governments and institutions may list instruments, including derivative instruments, based on foreign reference assets, on South Africa's bond and securities exchanges.
- Institutional investors are required to report on a quarterly basis on the allocation of assets according to the major asset classes and provide information from institutions in excess of the foreign-asset limit on proposed portfolio adjustments to bring foreign asset levels back in line.

Effective February 2009, South African institutional investors may invest in rand-denominated instruments issued abroad as well as instruments issued by South African corporates in the offshore market, on condition that the institutional investor remains within its applicable foreign-portfolio investment allowance.

As from February 2010, private equity funds that are members of the South African Venture Capital Association, mandated to invest into Africa, may apply to the Excon of the SARB, for an annual approval to invest in Africa.

With effect from 1 March 2010, authorised dealers are able to acquire direct and indirect foreign exposure up to a macro-prudential limit of 25% of their total liabilities, excluding total shareholder's equity.

South African corporates

With effect from October 2009, the pre-approval process for FDI was removed for transactions totalling less than R500 million per company per year. Authorised dealers administer the directives and guidelines on these types of investments.

The exchange-control requirement that a shareholding of at least 25% is obtained was replaced with the requirement that at least 10% of the foreign target entity's voting rights must be acquired.

In addition, the prohibition of SADC loop structures has been abolished, while the policy regarding loop structures into the Common Monetary Area (CMA) (South Africa, Namibia, Swaziland and Lesotho) remains extant.

By October 2009, where the total cost of FDI exceeded R500 million per company per calendar year, an application had to be submitted to Excon prior to the investment being made.

As a further alternative mechanism of financing offshore investments or to repay existing offshore debt, applications by corporates to engage in corporate asset or share-swap transactions and requests for share placements offshore by locally listed companies will be considered.

The corporates that had existing approved subsidiaries abroad were allowed to expand such activities without prior approval, subject to certain conditions. Dividends declared by the offshore subsidiaries of South African corporates may be retained offshore and used for any purpose, without recourse to South Africa.

Authorised dealers may also extend foreign currency-denominated facilities to South African corporates for financing approved FDI.

To further enable South African companies, trusts, partnerships and banks to manage their foreign exposure, they were, with effect from February 2008, permitted to participate without restriction in the Rand Futures Market on the JSE Ltd. This dispensation was also extended to investment in inward listed (foreign) instruments on the JSE Ltd.

Active currency management

With effect from 15 April 2010, authorised dealers may provide active currency management facilities to their South African resident and non-resident clients (excluding transactions by private individuals trading on online platforms).

Authorised dealers may grant forward cover to their South African resident clients with an underlying foreign-exchange exposure, without the necessity to view suitable documentary evidence at the time of entering into the contract, provided that the duration of the exposure is less than six months.

Emigrants' blocked assets

A system of exchange-control allowances for the export of blocked assets when persons emigrate, has been in place in South Africa for a number of decades.

Emigrants' blocked assets in excess of the emigration allowance are placed in blocked accounts to preserve foreign reserves. Since 2003, emigrant blocked assets are being unwound, subject to payment of an exit levy. Current policy is as follows:

- Emigrants qualify for a foreign capital allowance of R4 million per individual or R8 million in respect of family units emigrating.
- Amounts of up to R4 million/R8 million, inclusive of amounts already existed, are eligible for exit without the 10% exit levy. Holders of blocked assets wishing to exit more than R4 million/R8 million, inclusive of amounts already exited, have to apply to the Excon of SARB to do so. Approval is subject to an exiting schedule and an exit levy of 10% of the amount requested.
- New emigrants wishing to exit more than R4 million/R8 million, inclusive of amounts already exited, could similarly apply to Excon to do so, with approval subject to an exiting schedule and an exit levy of 10% of such additional amount.

Private individuals residing in South Africa

Private individuals residing in South Africa qualify for a foreign-capital allowance of R4 million per private individual who is a taxpayer in good standing and over the age of 18 years, for investment purposes outside the CMA.

A single discretionary allowance of R750 000 may be availed of per calendar year, per resident over the age of 18 years, without the requirement to obtain a tax clearance certificate, which may be apportioned for the purpose of:

- maintenance transfers to the father, mother, brother or sister of the applicant against the production of documentary evidence
- gifts and loans to non-resident individuals or to resident individuals who are overseas temporarily
- donations to missionaries, against production of a letter from an official or recognised religious body confirming that the beneficiary is a missionary
- travel allowance
- study allowance (the same allowance may be accorded if accompanied by a spouse).

Local financial assistance to affected persons and non-residents

To improve access to domestic credit in financing FDI in South Africa or for domestic working capital requirements, since October 2009 foreign investors have been allowed to borrow domestically, without restriction, to finance FDIs.

Affected persons and non-residents who will use the funds for financial transactions and/or to acquire residential property in South Africa would be restricted to the 1:1 ratio that applies to these transactions. Local financial assistance made available to emigrants remains subject to the 1:1 ratio.

Customer foreign currency (CFC) accounts and foreign bank accounts

Effective October 2009, South African entities (legal persons) operating CFC accounts are permitted to retain funds in their CFC accounts without the obligation to convert the funds into rand, with the current repatriation requirement remaining extant.

South African companies are permitted to open and operate foreign bank accounts, without prior approval of Excon, for the accrual of funds in respect of transactions permissible in terms of the exchange control rulings or a specific exchange control authority.

JSE Limited

As South Africa's only full-service securities exchange, the JSE Ltd connects buyers and sellers in the following different markets: equities, which include a primary and secondary board; equity derivatives; agricultural derivatives; and interest-rate instruments. The JSE Ltd is one of the top 20 exchanges in the world in terms of market capitalisation.

The JSE Ltd is the market of choice for local and international investors looking to gain exposure to the leading capital markets in South Africa and the broader African continent. The JSE Ltd also provides companies with the opportunity to raise capital in a highly regulated environment through its markets: the Main Board and AltX, the Alternative Exchange. A respected brand associated with high market integrity, the JSE Ltd is regarded as a mature, efficient, secure market with world-class regulation, trading, clearing, settlement assurance and risk management.

The exchange has been part of that process, playing an instrumental role in creating the internationally prominent King II Code on Corporate Governance. The JSE's listing requirements require all companies to adhere to key concepts of King II and all companies are required to report on their level of compliance with the code in their annual financial statements. Furthermore, the JSE Ltd has harmonised its listing requirements, disclosure and continuing obligations with those of the London Stock Exchange and offers superb investor protection.

The JSE Ltd renders a diversified range of products and services. It provides investors with the opportunity to trade a multitude of financial instruments, and at the heart of its diversified product offerings are single stock futures (SSFs). This area has grown substantially to become one of the five largest in the world.

SSFs are ideal for conservative investors seeking to hedge their share portfolios, or for sophisticated speculators seeking geared exposure to anticipated share price movements. This market also offers investors derivatives on indices, Kruger rands, dividend futures as well as can-do options, which give investors the advantage of listed derivatives with the flexibility of over-the-counter contracts.

The JSE's Agricultural Products Market reflects the commitment to providing versatility in the product offering.

It is a transparent electronic market used vigorously in the price-risk management of commodities through futures. This market continues to grow due to a greater understanding of its function and the development of a broader base of marketing strategies based on the derivative products. It is the first market in the world for trading both the cash spot bond (secondary trading) as well as the interest-rate derivative products, on one trading platform.

The JSE Ltd provides total price transparency through its world-class information systems. The trading activity on the markets generates a wide range of data that assist market participants with make-or-break investment decisions.

The JSE Ltd has both domestic and global reach in terms of the provision of all its information, through data-providers, investment banks, other financial industry stakeholders and directly through the exchange.

In March 2010, the JSE Ltd reported a rise in revenue as it released its full year results for 2009. Operating revenue climbed 8% to R1,156 billion for the year with the equities business contributing the bulk of this revenue. However, group headline earnings per share dropped slightly from 456,9 cents to 456,1 cents.

The exchange weathered a year of tough global market conditions well. This resilient performance was a result of rising trade volumes in its cash equity markets and strong performances from several other divisions in the group.

In addition to adapting to the aftermath of the economic crisis, management focused on positioning the exchange for continued growth.

This included strategic initiatives such as the launch of the Africa Board and the acquisition of the Bond Exchange South Africa.

The economic conditions of 2009 resulted in fewer listings and more de-listings across most exchanges and the JSE Ltd was no exception. In 2009, 10 new companies listed on the JSE Ltd compared with 23 in 2008.

Nevertheless, the market remains an ongoing focus for the JSE Ltd and plays an important role in raising funds for small-cap South African companies.

Foreign investors were net buyers of R75 billion of equities during 2009; a swing of R130 billion on the previous year. Increased foreign inflows for 2009 indicate confidence in South Africa's economic prospects and well as trust in the JSE Ltd's world-class systems and regulation capabilities.

In November 2010, the JSE launched the Rand Index, a new measure of rand volatility against the currencies of South Africa's top five international trading partners. The Rand Index can be used to track the Rand's strength against the Euro, US Dollar, Chinese Yuan, UK Pound and Japanese Yen.

Strate Limited

Since its inception over 10 years ago, Strate Ltd is the licensed Central Securities Depository for the electronic settlement of financial instruments in South Africa.

Strate Ltd's core purpose is to mitigate risk, bring efficiencies to the South African financial markets and improve its profile as an investment destination. Strate Ltd is aligned to international best practices and strives to ensure operational excellence and provide enhancements for the good of the Southern African financial markets.

Strate Ltd handles the settlement of a number of securities, including equities and bonds for the JSE Ltd as well as a range of derivative products such as warrants, exchange traded funds, retail notes and tracker funds. It has added the settlement of money-market securities to its portfolio of services.

Acknowledgements

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