FINANCE

South Africa's prudent financial-sector regulations and macro-economic policy framework have partly protected it from the knock-on effects of the global financial crisis.

National Treasury's work on fiscal policy and budget reform focuses on strengthening infrastructure investment and maintenance, broadening participation in the economy and improving the quality of social services, in support of government's Accelerated and Shared Growth Initiative for South Africa (AsgiSA).

Improved budget planning, better documentation and greater transparency in public finances continue to be key priorities. National Treasury is expanding its capacity to provide technical support, particularly for infrastructure planning and project 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 also creates an independent auditor-general and an independent central bank, and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

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.

Due to the start of the changed economic outlook in 2008/09, the fiscal stance has become significantly more expansionary. Lower revenue and higher expenditure have resulted in an increase in the budget deficit. The change enables government to continue financing its priorities and support aggregate demand during the cyclical decline in revenue.

Budget 2010/11

The main changes to the Budget for the next three years are:

- R12,2 billion more to extend the Child-Support Grant up to a child's 18th birthday
- R2,7 billion more to provide literacy and numeracy workbooks and R1 billion to increase subsidies for higher education institutions
- R15,1 billion extra for occupation-specific salary dispensations for school and further education and training college educators, health workers and correctional services workers

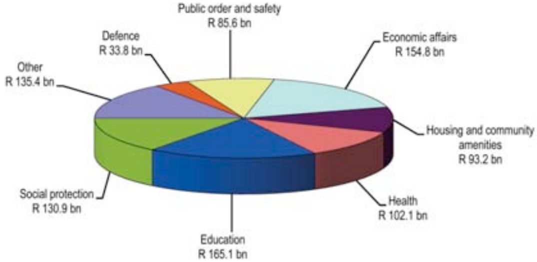
- R2,2 billion in addition for the new defence force remuneration system
- R8,4 billion extra for the HIV and AIDS programme to broaden antiretroviral treatment programmes
- R3,6 billion more for industrial policy initiatives
- R2,5 billion for public works programmes
- R1 billion more to the criminal justice sector
- R2,8 billion more for public transport, roads and rail infrastructure
- R2,5 billion extra for municipal infrastructure and R6,7 billion to municipalities to cover the increased cost of free basic services
- R1 billion more for rural development, R1,2 billion for water and sanitation infrastructure in support of rural households and R1,5 billion for the Land Bank to support rural development
- R1 billion in addition for human settlements and R0,5 billion for bulk water infrastructure.

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. The global economic downturn, together with South Africa's

Government expenditure (R billion)



Source*: National Treasury: Budget Highlights* countercyclical fiscal policy stance, meant that government became a net issuer of debt in 2008/09.

Debt levels remain sustainable, despite an expected increase in government debt from R629 billion in 2008/09 to R919 billion in 2011/12.

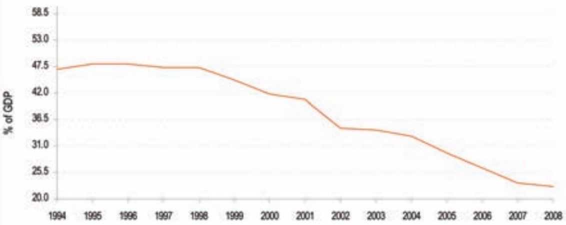
Market performance

Bond turnover

The Bond Exchange of South Africa (Besa) operated as an independent, licenced exchange until 22 June 2009, when it became a wholly-owned subsidiary of the JSE Limited (Ltd).

The South African bond market is a leader among emerging-market economies. Prior to the transaction with the JSE Ltd being concluded in June 2009, bond-market turnover reported on Besa in 2008 reached an annual record of R19,2 trillion. Given listed debt securities of R825 billion nominal, overall market velocity (the number of times an exchange "turns over" its market capitalisation) in the local market was 23%, up from 17,7% reported in 2007. However, when offshore online-trading system trades are included, turnover velocity for the year was 29%, up from 24% in 2007. At December 2008, Besa listed some 1 102 debt securities, issued by 100 sovereign and corporate borrowers, with a total market cap of R935 billion.

Government debt as a percentage of gross domestic product



Source*: Development Indicators, 2009*

Managing public finances

Transforming public-sector financial management is one of National Treasury's key objectives. To this end, National Treasury has been implementing the Public Finance Management Act (PFMA), 1999 since 1 April 2000.

Since the implementation of the PFMA, 1999, there have been measurable improvements in financial management in both the national and provincial spheres of government, which include, among other things:

- strategic plans and budget documentation containing improved information on measurable objectives expressed in terms of quantity, quality and timeliness
- departments submitting monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes
- setting accounting standards in accordance with best accounting practices, both locally and internationally
- finalising and submitting financial statements to the Auditor-General (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.

Auditor-General

The Constitution guarantees the independence of the AG. The office audits national, provincial and local government.

The AG has the power to audit the activities of public entities without the approval of the chief executive officer or directors.

Taxation

The South African Revenue Service collected R625,57 billion by 31 March 2009. The preliminary result was 0,34% below the revised February 2009 Budget estimate of R627,69 billion, representing a 9,2% growth in revenue collection over 2008.

In anticipation of the economic downturn, the revenue target was adjusted downwards in February from R642,27 billion to

R627,69 billion. The current conditions resulted in a collection of R625,57 billion or 99,66% of the target.

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.

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 gross income less allowable deductions according to the Act.

The income threshold below which no tax is payable by individuals under 65 years was raised to R54 200 for the tax year beginning March 2009, and for taxpayers over the age of 65 to R84 200 a year.

Value-added tax (VAT)

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 are exempt from VAT.

South African Reserve Bank

The bank, which is independent, formulates and implements monetary policy and regulates the supply of money by influencing its cost.

An important responsibility of the bank is to ensure that the banking system as a whole is sound and meets the requirements of the community.

The bank acts as a banker to other banking institutions. It is also the custodian of the statutory cash reserves and provides facilities for the clearing and settlement of inter-bank obligations.

Monetary policy

Growth in the broad money supply (M3) slowed noticeably from an annual high 12-month growth rate of 24,5% in January 2008 to 13,2% in February 2009. Growth over 12 months in banks' total loans and advances similarly moderated from 23,8% in January 2009 to 10,2% in February 2009 – the lowest growth rate since July 2004.

Asset-backed credit (mortgage advances, leasing finance and instalment sale credit) constituted the bulk of the increase in banks' total loans and advances throughout 2008. However, in early 2009, other loans and advances, which are mainly used by the corporate sector, dominated.

The moderation in the growth in banks' total loans and advances was consistent with the gradual tightening of monetary policy since June 2006, accompanied by tighter lending standards set by the National Credit Act, 2005.

The banking industry

The South African banking system remained stable and banks were sound during 2008. The capital-adequacy ratio for the banking sector remained above the minimum requirement of 9,5%, reaching 13% at the end of December 2008.

As at the end of December 2008, there were 33 banking institutions reporting data to the Office of the Registrar of Banks

Dates of change in the repurchase rate

Date	%
2008-04-11	11,5
2008-06-12	12
2008-12-12	11,5
2009-02-06	10,5
2009-03-25	9,5
2009-05-04	8,5
2009-05-29	7,5
2009-08-14	7

Source: South African Reserve Bank

(excluding two mutual banks). At the end of December 2008, 43 foreign banks had authorised representative offices.

At the end of 2008, banking-sector assets amounted to R3 170 billion, representing an annual growth rate of 24,5% year-on-year (January 2008: 27%). Total assets of the four large banks amounted to R2 676 billion and accounted for 84,4% of banking-sector assets at the end of December 2008. At the end of December 2008, gross loans and advances amounted to R2 316 billion (January 2008: R2 103 billion). The growth in gross loans and advances (measured year-on-year) eased to 9% at the end of December 2008, compared to 19,2% at the end of January 2008.

Insurance companies

By March 2008, 82 long-term insurers and 106 short-term insurers were registered with the Financial Services Board (FSB). According to class of policies, life-insurance business forms the bulk of premiums of primary insurers and accounts for almost 50% of net premiums.

Development Bank of Southern Africa

The primary purpose of the bank is to promote economic development and growth, human-resource development and institutional capacity-building. The bank's mandate is focused on infrastructure.

Financial Services Board

The FSB is an independent statutory body financed by levies imposed on regulated institutions and persons.

The FSB supervises institutions and services, in terms of several parliamentary Acts that entrust regulatory functions to the registrars of long-term insurance, short-term insurance, friendly societies, pension funds, collective investment schemes, financial services providers, exchanges and financial markets.