FINANCE

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, rising to 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 the 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

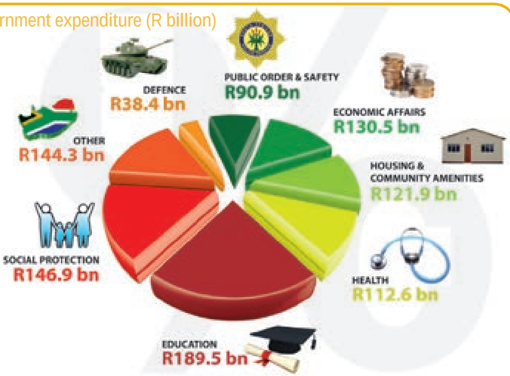
The Constitution stipulates a framework for the division of responsibilities between national, provincial and local government. It prescribes an equitable division of revenue between the spheres of government, taking into account their respective functions. It also creates an independent auditor-general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

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 balanced the short-term need for economic stimulus with the long-term imperative of fiscal sustainability.

Government expenditure (R billion)



Source: National Treasury: *People's Guide to the Budget, 2011*

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.

The economy and fiscal stance

The Minister of Finance, Mr Pravin Gordhan, presented the national Budget for 2011/12 in February 2011.

The 2011 Budget outlined several aspects of a new growth path for South Africa:

- R10 billion for job creation, small enterprise development and youth employment

- R9,5 billion to increase enrolment at Further Education and Training colleges and enhance skills development
- R8,2 billion to improve school facilities
- R7,9 billion to improve primary healthcare, revitalise hospitals and combat HIV and AIDS
- R10,4 billion for public transport, roads and rail infrastructure
- R7,2 billion to upgrade human settlements, municipal services and water infrastructure
- R2,8 billion for rural development and emerging farmer support
- R8,9 billion for social security benefits and social grants
- Old age and disability grants increase by R60 to R1 140 a month and the Child-Support Grant will increase to R260 in April and R270 in October
- R1,8 billion for municipalities and provinces to deal with immediate disaster needs.

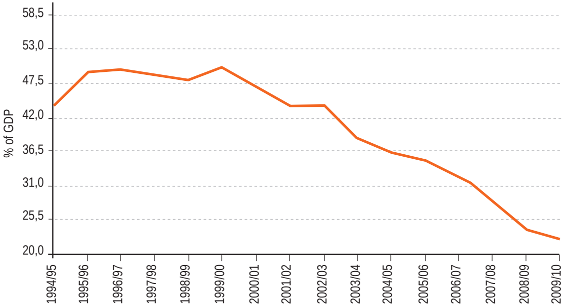
Debt management

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 macro-economic objectives.

Government continued to support state-owned enterprises during the economic downturn, through the issuing of guarantees on a case-by-case basis. Steps taken to strengthen

Government debt as percentage of gross domestic product (GDP)



Source: *Development Indicators, 2010*

the capital market enable the public sector to finance the growing borrowing requirement in the domestic market.

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

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 is refinanced in a lower interest rate environment.

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:

- an improved linkage between planning and budgeting, whereby departments are now 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
- departments submitting monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes, which are being implemented by institutions
- establishing internal-audit functions and audit committees in all departments
- 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 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), value-added tax (VAT) (R147,9 billion) and company income tax (R134,9 billion).

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 as per the Act.

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.

Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle.

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 Projects (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 was announced in the Budget in 2008.

Among some of the criteria to receive the tax relief include companies going green by saving energy and projects creating direct employment in the country.

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 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.

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 Monetary Policy Committee (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 and to 5,5% in November 2010.

The banking industry

As at the end of December 2009, there were 31 banking institutions reporting data to the Bank Supervision Department

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
2010-03-26	6,5
2010-09-10	6
2010-11-19	5,5

Source: South African Reserve Bank

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

Furthermore, 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 R10 million or 10 years in jail or both.

of the South African Reserve Bank (excluding two mutual banks, but including one institution conducting banking business in terms of an exemption from the provisions of the Banks Act, 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%.

Insurance companies

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.

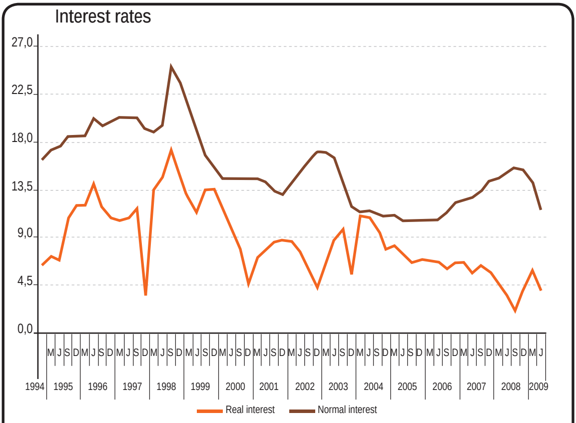
Development Bank of Southern Africa

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 (FSB)

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.



Source: *Development indicators 2010*