
SOUTH AFRICAN RESERVE BANK
SUID-AFRIKAANSE RESERWEBANK
EEN HONDERD RAND
100
Anglo American fell 2.3 percent
Anglo American Platinum de-
Food maker AVI climbed
2.96 percent to R21.61. AVI will


NEXT WEEK IS Nº 04

10 Finance

The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996), lays down 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, and the annual budget process.

The aim of National Treasury is to promote economic development, good governance, social progress and rising living standards through accountable, economic, efficient, equitable and sustainable public finances.

Fiscal policy framework

The Minister of Finance, Mr Trevor Manuel, presented the Budget for 2005/06 on 23 February 2005.

Highlights included:

- R6,8 billion in tax relief for individuals and households, directed mostly at those earning below R200 000 a year
- no personal income tax for people earning below R35 000 a year (R60 000 for people over the age of 65 years)
- a change in the tax treatment of medical scheme contributions to reduce costs of membership for lower-income families
- scrapping transaction tax on debit entries to credit card and bank accounts, to keep banking services affordable
- increases in the price of beer (11c a bottle and 5c a can) and the price of cigarettes (52c for a packet of 20)
- an increase of 10c a litre in levies on petrol and diesel
- tax relief of R1,4 billion for small business to free up growth resources
- measures to reduce tax compliance costs and red tape for small business
- a drop in the company tax rate from 30% to 29%
- changes to the tax on travel allowances to remove unwarranted benefits for higher-income earners
- a R40 increase in the maximum monthly old-age, disability and care dependency grants to R780, and a R10 increase in the monthly Child Support Grant to R180
- a R6-billion allocation to allow the land restitution programme to complete its work over the next three years

- Regional Services Council (RSC) levies will be eliminated in 2006
- R2 billion for the new comprehensive housing strategy and R3 billion for related community infrastructure
- R1,7 billion for water, sanitation and other municipal infrastructure investment
- R6,9 billion for improving teachers' salaries
- R5 billion to allow for pay progression in police salaries and increased police numbers
- R3 billion for public transport investments and roads
- R3,7 billion for the delivery of municipal services
- R776 million for the National Student Financial Aid Scheme
- R1 billion to revitalise Further Education and Training colleges
- R1,4 billion for South Africa's African development agenda, including peacekeeping operations, the African Union (AU) and the Pan-African Parliament
- R1 billion for the new micro agricultural finance scheme.

Consolidated national, provincial and social security fund expenditure: functional classification[1)]

	2003/04		2004/05		2005/06	
	Estimated outcome	**% of total**	**Budget estimate**	**% of total**	**Budget estimate**	**% of total**
General government services and unallocatable expenditure[2)]	23 158,6	7,7	26 301,1	7,7	28 337,2	7,5
Protection services:	58 982,8	19,5	63 532,0	18,6	71 974,3	18,9
Defence and intelligence	22 291,5	7,4	22 470,7	6,6	25 362,9	6,7
Police	23 688,6	7,8	26 437,5	7,7	30 496,3	8,0
Prisons	7 822,3	2,6	8813,6	2,6	9 715,1	2,6
Justice	5 180,4	1,7	5 810,1	1,7	6 399,9	1,7
Social services:	177 159,7	58,6	202 585,7	59,2	224 306,6	59,0
Education	70 204,7	23,2	76 571,3	22,4	81 995,6	21,6
Health	38 641,6	12,8	42 828,4	12,5	48067,3	12,6
Social security and welfare	51 915,8	17,2	63 532,2	18,6	72 728,4	19,1
Housing	5 636,1	1,9	7 059,1	2,1	7 261,2	1,9
Community development[3)]	10 761,4	3,6	12 594,7	3,7	14 254,1	3,7
Economic services:	43 064,3	14,2	49 534,1	14,5	55 571,1	14,6
Water schemes and related services	5 540,7	1,8	5 738,5	1,7	6 336,1	1,7
Fuel and energy	2 285,8	0,8	2 330,3	0,7	2 723,1	0,7
Agriculture, forestry and fishing	6 561,2	2,2	7 541,5	2,2	9 757,3	2,6
Mining, manufacturing and construction	1 497,6	0,5	1 729,1	0,5	2 195,5	0,6
Transport and communications	15 084,7	5,0	18 009,1	5,3	19 533,1	5,1
Other economic services[4)]	12 094,2	4,0	14 185,7	4,1	15 026,1	4,0
Subtotal: Votes and statutory amounts	302 365,4	100,00	341 952,9	100,00	380 189,0	100,00
Plus contingency reserves	-	-	-	-	2 000,00	0,5
Total non-interest expenditure	302 365,4	100,00	341 952,9	100,00	382 189,0	100,5
Interest	46 312,9	15,3	48 901,0	14,3	53 125,0	14,0
Total consolidated expenditure	348 678,4	115,3	390 853,9	114,3	435 314,0	114,5

1) These figures were estimated by National Treasury and may differ from data published by Statistics South Africa. The numbers in these tables are not strictly comparable to those published in previous years, due to the allocation of some of the unallocatable expenditure for previous years. Data for the history years has been adjusted accordingly.
2) Mainly general administration, cost of raising loans and allocatable capital expenditure.
3) Including cultural, recreational and sport services.
4) Including tourism, labour and multi-purpose projects.

Source: National Treasury

Debt management

South Africa's debt, both domestic rand-denominated bonds and foreign-debt issues, enjoys increasing recognition on international capital markets, and continues to attract a diverse range of investors.

This reflects the country's success in adopting sustainable fiscal and macro-economic policies, the evolution of a sound and transparent approach to debt management, the healthy Balance of Payments position and the maturity of South Africa's financial markets. In recent years, both Standard and Poor's and Moody's Investors' Service upgraded their ratings of South African debt, affirming their confidence in the country's macro-economic and fiscal management. These assessments contribute to broadening South Africa's international investor base and reinforce the favourable outlook for interest rates and the cost of capital.

South African foreign debt continues to trade at tighter spreads than the Emerging Market Bond Index, indicating that investors share the confidence expressed by international rating agencies and regard South Africa positively in comparison with its competitors.

The primary objective of domestic debt management has shifted to the reduction of the cost of debt to within acceptable risk limits, with diversification of funding instruments, and ensuring flexible government access to markets as secondary goals. Recourse to foreign borrowing has been stepped up, allowing the fiscus to contribute to reducing the foreign currency exposure of the South African Reserve Bank in its forward market portfolio.

Domestic-debt-management reforms have addressed several policy and instrument gaps:

- Lower coupon bonds have been introduced, in line with government's approach to reducing inflation in the years ahead.
- The Public-Sector Borrowers' Forum was established in 2001.
- Co-ordination between monetary policy and liability management has been strengthened through more effective liaison between National Treasury and the Reserve Bank.
- Regular meetings with the primary dealers, the Reserve Bank, and the futures and bond exchanges provide a forum for ensuring a transparent and efficient bond market.
- Debt consolidation has reduced fragmentation on the yield curve and improved liquidity of the benchmark issues. Illiquid bonds were consolidated into five liquid benchmark bonds, thereby smoothing the maturity profile and reducing refinancing risks.
- The integrity and efficiency of the Government securities market has been strengthened by buying back illiquid bonds, including diverse 'ex-homeland' bonds of limited issue size.
- Inflation-linked bonds were introduced to diversify government's investor base and signal confidence in government's macro-economic policy, while also providing an objective measure of inflationary expectations and benchmarks for other issuers.
- The Strips (Separate Trading of Registered Interest and Principal Securities) Programme was introduced to increase demand for the underlying instruments and encourage active portfolio management.

The liquidity in the domestic government-bond market, measured by the increase in nominal trades, has improved substantially during recent years,

In 2004, National Treasury launched the RSA Government Retail Bond, a no-cost, secure, risk-free investment, which offers bond market returns directly to the public.

The main objectives of the RSA Retail Bond are to:

- diversify the financial instruments on offer to the market by government
- target a different source of funding for government
- create awareness among the public of the importance of saving.

By February 2005, sales of the RSA Government Retail Bond had reached R1,248 billion. Some 15 733 people had invested in the bond with a total of 22 523 investments.

National Treasury, through the Asset and Liability Management Division, determines the prevailing interest rates for the two-year, three-year and five-year RSA government retail bonds at the end of each month.

especially since the appointment of primary dealers in government bonds in April 1998.

In actively managing its debt portfolio, National Treasury is responsible for identifying, controlling and managing the risks to which government is exposed. A comprehensive risk-management framework of National Treasury calls for quantitative analyses to model, monitor and manage risk exposure. The framework provides for a set of benchmarks or reference criteria against which the structure and evolution of the debt portfolio can be tested and understood.

Legislation

National Treasury tables a significant amount of legislation in Parliament annually. Legislation passed in 2004/05 included the:

- Appropriation Act, 2004 (Act 15 of 2004)
- Taxation Laws Amendment Act, 2004 (Act 16 of 2004)
- Government Employees Pension Law Amendment Act, 2004 (Act 21 of 2004)
- National Payment System Amendment Act, 2004 (Act 22 of 2004)
- Public Investment Corporation Act, 2004 (Act 23 of 2004)
- Finance Act, 2004 (Act 26 of 2004)
- Adjustments Appropriation Act, 2004 (Act 27 of 2004)
- Securities Services Act, 2004 (Act 36 of 2004)
- Financial Services Ombud Schemes Act, 2004 (Act 37 of 2004)
- Revenue Laws Amendment Act, 2004 (Act 32 of 2004)
- Second Revenue Laws Amendment Act, 2004 (Act 34 of 2004)
- Division of Revenue Act, 2005 (Act 1 of 2005).

Legislation expected to be tabled in 2005/06 included the:

- Appropriation Bill
- Taxation Laws Amendment Bill
- Adjustments Appropriation Bill
- Revenue Laws Amendment Bill
- Second Revenue Laws Amendment Bill.

Draft legislation under consideration and expected to be tabled in 2005/06, pending the outcome of the policy process, internal vetting requirements and the duration of consultation processes, included the:

- Co-operative Banks Bill that proposes a regulatory framework for deposit-taking entities other than banks and mutual banks.
- Dedicated Banks Bill, which will create a new tier of banks. The new tier will introduce financial depth in the banking system by providing basic banking services (savings accounts, transmission services, loans, etc.) to the largely low-income and historically disadvantaged communities. This will improve this market's access to financial services.
- Public Finance Management Amendment Bill, which will amend the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), to address:
  - practical difficulties encountered in the implementation of the PFMA, 1999
  - the incorporation of recent and intended budget-reform initiatives
  - improved financial regulation of public entities.

Exchange rate of the Rand – percentage changes

	31 Mar 2004 to 30 June 2004	30 June 2004 to 30 Sep 2004	30 Sep 2004 to 31 Dec 2004	31 Dec 2004 to 31 Mar 2005	31 Mar 2004 to 31 May 2005
Weighted average*	2,4	-3,2	6,6	-6,8	-4,4
Euro	2,0	-4,3	3,3	-4,9	-2,7
US dollar	1,0	-2,6	14,3	-9,7	-7,0
British pound	2,6	-2,2	6,6	-7,5	-3,8
Japanese yen	6,1	-0,8	5,7	-5,9	-6,0

*Against a basket of 13 currencies

Source: *Quarterly Bulletin*, June 2005

- Direct Charges Bill, which will authorise certain withdrawals and payments from the National Revenue Fund as direct charges.
- Financial Intelligence Centre (FIC) Amendment Bill, which will provide for various technical and policy amendments to the principal Act.
- The Auditing Professions Bill, which will establish the Independent Regulatory Board for Auditors, to accredit educational institutions and professional bodies, register auditors, and regulate the conduct of registered auditors.

The Public Finance Management Act, 1999

The PFMA, 1999 came into effect on 1 April 2000 for all departments, constitutional institutions and public entities.

The PFMA, 1999 represents a fundamental change in government's approach to the handling of public finances, as it shifts the emphasis away from a highly centralised system of expenditure control by the treasuries. It holds the heads of departments accountable for the use of resources to deliver services to communities. It will also, in time, change the accounting base from cash to accrual.

The Act emphasises:

- regular financial reporting
- independent auditing and supervision of internal control systems
- improved accounting standards
- greater focus on output and performance
- increased accountability at all levels.

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 2000. It began implementing the Municipal Finance Management Act (MFMA), 2003 (Act 56 of 2003), in 2004.

The Act aims to modernise budget and financial management, and ensure greater transparency and accountability in the finances of municipalities.

Together with the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000), the MFMA, 2003 empowers mayors and councillors to lead municipalities by approving policy and setting performance targets.

Accounting Standards Board

The Accounting Standards Board was appointed in 2002 and is responsible mainly for the implementation of Generally Recognised Accounting Practice in government.

Financial Services Sector Charter

The Financial Services Sector Charter was signed in November 2003, signalling a key milestone in the transformation of the financial sector.

The charter seeks to ensure the broad-based transformation of the sector, based on the following elements: human resource development (HRD), procurement and enterprise development, access to financial services, empowerment financing, ownership, control and corporate social investment.

South Africa's economic growth is expected to improve further in the next three years. Moderation of inflation and the sound and consistent management of monetary policy by the Reserve Bank have brought interest rates down to their lowest levels in 24 years.

Following several years of decline, South African mining production expanded by over 4% a year in 2003 and 2004. Output of gold mines continued to decline, but platinum, coal, diamonds and other minerals benefited from growth in demand and prices on international commodity markets.

Value added in the construction sector grew by over 6% in 2004. There is strong growth in the residential property market. Further impetus will be given to building and construction growth by inner city refurbishment encouraged by the urban renewal tax incentive, accelerated investment in low-income housing and municipal infrastructure, and several large economic infrastructure projects in the next few years.

Official foreign exchange reserves have increased to over US$15 billion, which is more than four times the current short-term debt level. Reserves held by the private banking sector have also increased strongly, contributing to a marked improvement in the nation's overall balance sheet, and reduced vulnerability to the inherent volatility of international financial flows.

National Treasury

Financial expenditure

National Treasury plays a pivotal role in the management of government expenditure.

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

National Treasury, furthermore, 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.

Exchange-control reforms

National Treasury continues to follow a policy of gradual relaxation of exchange controls. The following major reforms were announced by the Minister of Finance and implemented in 2004 in relation to resident and non-resident corporates and South African individuals:

- Foreign-owned South African companies were allowed to borrow locally up to 300% of the total shareholder's investment. This debt capital would be used for financing investment in South Africa or as domestic working capital.
- Foreign entities (including foreign governments and multilateral institutions) were allowed to list their securities, both bonds and equities, on South African exchanges (i.e. inward listings). South African institutional investors are allowed to invest an additional 5% of their total retail assets in 'African'-classified inward-listed securities, while South African individuals can invest freely in such African and non-African inward-listed securities.
- Exchange-control limits on outward foreign direct investment (FDI) by South African corporates have been abolished, yet South African corporates are still required to lodge an application with the Reserve Bank.
- In addition, South African companies are no longer compelled to repatriate foreign-earned dividends to South Africa.

Government is working towards the transition from exchange controls to a system of prudential regulation for institutional investors.

Currently, South African long-term insurers, investment managers and pension funds can invest up to 15% of their total retail assets offshore, while collective investment schemes can invest 20% of their total retail assets offshore.

Amnesty Unit

On 26 February 2003, the Minister of Finance announced an amnesty window to enable South Africans to voluntarily declare their foreign assets and to regularise such assets and tax affairs without fear of prosecution. By April 2005, of approximately 43 000 applications received, 35 198 had been adjudicated.

It was estimated that the exchange-control levies could raise about R2,3 billion from the adjudicated applications. The total Rand value of assets disclosed under the processed 35 198 applications was R50,7 billion, of which R26,1 billion was leviable.

Amnesty applicants were subject to a levy of 10% of the leviable amount if assets remained offshore, and 5% of the leviable amount if the assets were repatriated to South Africa. The Amnesty Unit was expected to complete its adjudication process by the end of May 2005.

Deposit insurance

National Treasury intends to introduce legislation that seeks to establish a deposit insurance scheme in South Africa. This legislation was expected to be introduced in the second quarter of 2006.

A deposit insurance scheme is a system in which the Government guarantees a payment to depositors in the event of a bank failure. Under an explicit deposit insurance scheme, the terms and conditions of the scheme are explicitly and publicly stated in statute. The development and implementation of an explicit deposit insurance scheme will bear the following benefits for the South African population:

- provide more certainty about the cost of bank failures to the fiscus
- enhance confidence in the banking system
- improve equitable treatment of depositors through transparency over the nature and extent of reimbursement
- clarify the role and extent of government involvement in the resolution of bank failures.

By assuring timely access to their deposits, a deposit insurance scheme can contain the risk of contagion by reducing the incentive for depositors to make a run on banks. An explicit deposit insurance scheme would also limit the scope for discretionary decisions that may result in arbitrary and possibly inconsistent decisions.

The Securities Services Act, 2004 seeks to facilitate an efficient, fair and secure means of securities trading in the South African capital market by regulating a multiplicity of activities and institutions.

The Act also enhances the power of the Registrar of Securities Services to regulate the interdependence between the various participants in South African markets.

The Financial Services Ombud Schemes Act, 2004 attempts to improve the ability of consumers to enforce their rights and resolve any disputes they may have against the financial services industry. Consumers will have a cost-effective and expeditious way to resolve their complaints, without having their right to take the matter to court impeded.

At the end of 2004, National Treasury issued a retirement fund reform discussion document, inviting stakeholders to provide comment by the end of March 2005. Ultimately, a revised document, which will be the product of wide consultation, will form the basis on which the new Pension Funds Act is drafted.

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 treasury norms and standards aim at deregulating financial controls, by granting accounting officers of spending agencies more autonomy in financial decision-making within the ambits 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 macro limit 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 annually requested to submit budget proposals for the following financial year to National Treasury.

Early Warning System

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

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

Financial policies, systems and skills development

National Treasury is responsible for financial management systems and the financial training of government officials.

It delivers services that support the following areas:

- financial systems, which consist of the Personnel and Salary System, Logistical Information System, Financial Management System, Basic Accounting System and Management Information System
- banking services and financial reporting for government
- financial-management capacity-development in national and provincial governments.

Procurement

The preferential procurement regulations, 2000 give substance to the content of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). This Act and its regulations apply to all three spheres of government.

Bids are evaluated according to a preference point system. A bidder can score a maximum of 80 or 90 points for price, while 20 or 10 points can be scored for contracting or subcontracting historically disadvantaged individuals (HDIs) and promoting/ achieving specified Reconstruction and Development Programme (RDP) goals. A contract is awarded to the bidder who scores the highest total number of points. The way in which the bid is evaluated, including the RDP goals to be promoted or achieved and the allocated points in this regard, forms part of the bid documents.

The implementation of the regulations enhances the involvement of HDIs in the public bidding system and contributes to achieving RDP goals, including the promotion of small and medium enterprises (SMEs).

The Supply-Chain Management Framework replaces outdated procurement and provisioning systems in government with an integrated supply-chain management system, as well as an international best-practice process for appointing consultants.

Financial Intelligence Centre (FIC)

Government has adopted a strong stance on the eradication of money laundering and financing of terrorism in keeping with United Nations (UN) conventions and international standards. In 2001, it passed the FIC Act, 2001 (Act 38 of 2001), and in February 2005, it passed the Protection of Constitutional Democracy Against Terrorist and Related Activities Act, 2004 (Act 33 of 2004). The FIC started functioning in February 2003 as an autonomous government agency reporting to the Minister of Finance.

The Protection of Constitutional Democracy against Terrorism and Related Activities Act, 2004 came into operation on 20 May 2005. The Act makes the Republic of South Africa fully compliant with the UN Counter Terrorism Conventions and Protocols, as well as the AU Convention on the Prevention and Combating of Terrorism. The Act creates a general offence of terrorism and offences relating to terrorist activities, such as recruiting, assistance to commit terrorist activities and facilitating such activities.

The mandate of the FIC is to:

- develop policy that gives effect to government's objectives of combating money laundering and financing terrorism
- identify the proceeds of crime and the financing of terrorism
- exchange relevant information with competent authorities and international equivalent organisations
- prevent and reduce the laundering of the proceeds of crime
- monitor compliance in terms of the Act
- advise the Minister of Finance on all of these matters.

The Act identifies a range of 19 different business sectors, which it defines as being accountable institutions, and which are most vulnerable to abuse by criminals. These include banks, *bureaux de change*, life-insurance companies, stockbrokers, money remitters, as well as casinos, lawyers, accountants, investment advisers, estate agents and motor dealers. These accountable institutions have a range of obligations, including implementing 'know your client' measures and reporting to the FIC when they identify suspicious transactions.

The centre analyses and stores reports from the accountable institutions. It then makes disclosures or information packages available to law-enforcement agencies for investigation. It may also make this information available to similar bodies in other countries. In 2004/05, the FIC received in excess of 22 000 suspicious transaction reports from a range of accountable institutions, mainly banks and money remitters, and referred more than 300 to law-enforcement agencies for investigation.

In 2002, South Africa joined the 14-member-strong Eastern and Southern Africa Anti-Money Laundering Group. South Africa also became a member of the Financial Action Task Force, which is the international standards-setting body. The FIC is a member of the Egmont Group of financial intelligence units, which facilitates the exchange of information, skills and technical assistance between financial intelligence units worldwide.

Financial and Fiscal Commission (FFC)

The commission, which came into operation in April 1994, is a statutory institution and permanent expert commission dealing with intergovernmental fiscal relations.

The FFC is responsible for making recommendations to Parliament and the Cabinet on the equitable division of revenue between national, provincial and local governments yearly, giving advice on fiscal policies and taxes that provinces intend to impose, borrowing by local and provincial governments, and criteria to be considered in determining fiscal allocations. Additional responsibilities can be designated by means of appropriate legislation.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial executive committee members responsible for finance. The mission of the council is to ensure that the country uses available resources productively, efficiently and equitably, to the best advantage of its people.

It recommends to the Cabinet the share each province should receive, after taking into account national priorities and FFC proposals.

Public Investment Corporation (PIC)

The PIC, a state-owned institution that manages public servants' pension funds, was corporatised under a new law that came into effect in April 2005.

The PIC Act, 2004 (Act 23 of 2004), which replaces the Public Investment Commissioners Act, 1984 (Act 45 of 1984), protects the PIC as a legal entity and enables it to operate as a modern, professional and world-class investment manager.

The State remains the sole shareholder of the PIC, which reports to Parliament's SCOPA, and whose controlling board is appointed by the Minister of Finance.

The PIC continues to use its current asset managers – RMB Asset Management, Stanlib, Futuregrowth, Sanlam Investment Management and Old Mutual Asset Management.

The biggest contributors to the PIC's assets are public servants through the Government Employees Pension Fund (91,29%). Other contributions come from the Compensation Commission (3,20%), Associated Institution Pension Fund (2,61%), Unemployment Insurance Fund (1,65%), Guardian Fund (0,65%) and Political Office Bearers Pension Funds (0,13%).

The Isibaya Fund – a division of the PIC tasked with the funding of socially responsible investments – funded Black Economic Empowerment (BEE) transactions worth R7,5 billion in 2004/05. These were in the financial, mining, infrastructure, telecommunications and industrial sectors. Combined, these transactions benefited over 221 000 people as owners of the businesses, while a further 10 255 benefited through employment.

PIC funding of BEE has resulted in better vesting for BEE ventures, while also netting good profits for the corporation.

Macro-economic strategy

The positive performance of the South African economy in the wake of a global slowdown is indicative

In July 2005, South Africa took up the presidency of the Financial Action Task Force, which is the international standard-setting body for the prevention of money laundering and terror financing. Cabinet appointed Prof. Kader Asmal to this position.

of a highly resilient economy. The long-term outlook points towards further acceleration of growth over the next few years and reflects a strong improvement in economic fundamentals that include:

- Benefits associated with stricter fiscal discipline, which have resulted in lower budget deficits, and which will eliminate government dissaving and pave the way for higher fixed investment spending.
- Improved domestic competitiveness in foreign markets. This has led to significant improvements in trade and current account balances.

Government's Micro-Economic Reform Strategy (MERS) identifies six key performance areas or objectives:

- economic growth
- employment
- small business development
- BEE
- competitiveness
- geographic spread of growth and development.

The strategy rests on three pillars:

- The first pillar consists of cross-cutting issues: HRD, infrastructure, access to finance, technology, and research and development (R&D).
- The second pillar comprises a set of actions to improve efficiency and lower costs in three input sectors: transport, telecommunications and energy. In addition, access to these sectors needs to be widened to include all South Africans.
- The third pillar consists of growth sectors that demonstrate a high potential for growth and employment, namely tourism, exports, agriculture, Information and Communications Technology and cultural industries.

Government has adopted an integrated way forward that comprises the following:

- fine-tuning the MERS
- continued managed liberalisation and infrastructure investment in key input sectors
- increased attention to the cross-cutting issues that underpin the strategy, including:
  - clarifying the role of individual departments in sectoral HRD strategies
  - adopting a research strategy and allocating the necessary resources to implement it effectively.
- establishing an integrated financing institution that is focused on BEE and small business
- an integrated approach to the planning and implementation of infrastructure investment by government
- developing and implementing an employment-creation framework
- strengthening and co-ordinating government products and services to promote key growth sectors
- an integrated strategy for small business development, emphasising co-ordination and refinement of existing initiatives, addressing access to finance and placing a greater focus on micro enterprises
- implementing three components of the BEE Strategy, namely an enhanced environment for BEE partnership programmes with the private sector, the establishment of the BEE Advisory Council and a review of government procurement
- incorporating a specific geographical dimension into the MERS, to tap the economic and human potential of all nine provinces by co-ordinating current strategies such as the Integrated Sustainable Rural Development Programme, Urban Renewal Programme, spatial development initiatives, industrial development zones and integrated development plans, as well as regional economic integration and the New Partnership for Africa's Development (NEPAD). (See chapter 7: *Economy*.)

South African Revenue Service (SARS)

In accordance with the SARS Act, 1997 (Act 34 of 1997), the service is an administratively autonomous (outside the Public Service, but within the public administration) organ of state.

It aims to provide an enhanced, transparent and client-orientated service to ensure optimum and equitable collection of revenue. Its main functions are to:

- collect and administer all national taxes, duties and levies

- collect 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
- provide protection against the illegal importation and exportation of goods
- facilitate trade
- advise the Minister of Trade and Industry on matters concerning control over the import, export, manufacture, movement, and storage or use of certain goods.

Tax system

National Treasury is also responsible for advising the Minister of Finance on tax-policy issues that arise at local, provincial and national government level. In its policy-advice function to government, National Treasury must design tax instruments that can optimally fulfil their revenue-raising function, achieve economic and allocative functions, and strengthen redistributive and social-policy functions. This must be done in a manner that creates a basis for general political acceptability of the selected tax instruments. In designing tax policies, co-operation between National Treasury and SARS is of the utmost importance.

As of 2001, South Africa's source-based income tax system was replaced with a residence-based system. With effect from the years of assessment commencing on or after 1 January 2001, residents are (subject to certain exclusions) taxed 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.

Capital gains tax was introduced on 1 October 2001. It forms part of the income tax system and includes capital gains made upon the disposal of assets in taxable income.

Value-added tax (VAT) is levied at a standard rate of 14% on all goods and services, subject to certain exemptions, exceptions, deductions and adjustments provided for in the VAT Act, 1991 (Act 89 of 1991), as amended.

Transfer duty, estate duty, stamp duty, marketable securities tax (MST), customs duty and excise duty are also levied by national government.

RSCs levy turnover and payroll taxes. However, these taxes are at fairly low rates and are scheduled for repeal with effect from 1 July 2006. Local governments levy rates on the value of fixed property, to finance the cost of municipal services.

International tax agreements for the avoidance of double taxation

International tax agreements are important for encouraging investment and trade flows between nations. 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, by providing a certain tax framework.

Agreements for mutual administrative assistance between customs administrations

These agreements cover all aspects of assistance, including the exchange of information, technical assistance, surveillance, investigations and visits by officials.

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 gross income less allowable deductions as per the Act. The income tax threshold for individuals – the entry level for tax on salaried earnings – was raised by 8,6% to R35 000 in 2005/06.

Companies are taxed at a rate of 29% after a 1% reduction for 2005/06 to stimulate investment and job creation. In addition, secondary tax on companies is levied on companies at a rate of 12,5% on dividend distributions. A formula tax applies to gold-mining companies.

A number of administrative interventions as well as tax-relief measures were announced in the 2005 budget to regularise and stimulate growth for small businesses. Small business corporations (annual turnover limit was increased to R6 million) benefit from a revised graduated tax rate of 0% on the first R35 000 of taxable income and 10% up to R250 000 of taxable income; are eligible for accelerated depreciation allowances; and can write off investments in manufacturing plant and equipment in the year in which it is incurred.

Additional measures to reduce the administrative and compliance burden on small business were announced in the budget.

Income tax returns are issued annually to registered taxpayers after the end of each year of assessment. The year of assessment for individuals covers a period of 12 months, which generally commences on 1 March of a specific year and ends on the last day of February the following year. Companies are permitted to have a tax year ending on a date that coincides with their financial years.

Tax returns must be submitted to SARS within the specified period. A taxpayer may apply for extension for the rendition of a tax return.

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. Persons who derive income from sources other than remuneration, e.g. trade, profession or investments and companies, are 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.

Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle. It is government's second-biggest source of income.

Effectively, VAT is levied on the value added by an enterprise. As vendors levy and pay over the tax included in their prices, VAT is borne by the final consumer. VAT is also levied on the importation of goods and services into South Africa by any person. It is levied at the standard rate of 14%, but certain supplies are subject to the zero-rate or are exempt from VAT.

The prices of goods and services must be quoted/displayed on an inclusive basis, which means that VAT has to be included in all prices on 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 (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 harmonisation of procedures simplify trade within the SACU common customs area.

Import duties, including anti-dumping and countervailing duties, are used as mechanisms to protect the local industry.

The renegotiated SACU Treaty is now in force and provides a new dispensation for calculating and affecting transfers based on customs, excise and a development component.

South Africa has entered into agreements on mutual assistance between 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 controls and trade facilitation.

Excise duty

Excise duty is levied on certain locally manufactured goods as well as 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 in respect of specific farming, 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%.

Transfer duty on property acquired by a person other than an individual, e.g. a company or trust, is payable at a rate of 10%.

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

Estate duty

For the purposes of estate duty, an estate consists of all property, including deemed property (e.g. life insurance policies, payments from pension funds, etc.) of the deceased, wherever situated. The estates of deceased non-residents consist of only their South African assets.

The duty, at a rate of 20%, is calculated on the dutiable amount of the estate. Certain admissible deductions from the total value of the estate are allowed.

Stamp duty

Stamp duty is levied on certain financial transactions.

Uncertified securities tax (UST)

UST is payable in respect of the issue and change in beneficial ownership of any securities that are transferable without a written instrument and are not evidenced by a certificate. It is levied at a rate of 0,25% and will eventually replace MST.

Skills-development levy

A skills-development levy was introduced on 1 April 2000. This is a compulsory levy scheme for the funding of education and training. SARS administers the collection thereof. The rate has been set at 1% of payroll as from 1 April 2001, and is payable by employers who are registered with SARS for employees' tax purposes, or employers who have an annual payroll in excess of R500 000.

Air passenger departure tax

A tax of R120 per fee-paying passenger departing on international flights, and R60 per passenger departing to the BLNS countries is payable.

Organisational performance

SARS collected R354,9 billion in taxes during the 2004/05 financial year, exceeding its revised target of R333,7 billion by almost R10 billion and its original target of R345,3 billion by R21 billion. The revenue haul will help trim South Africa's budget deficit for 2004/05 from 2,3% to 1,6% of gross domestic product (GDP).

Of the total, personal income tax yielded R1 110,7 billion; company tax yielded R70,6 billion; and VAT yielded R97,8 billion. SARS also collected R7,7 billion in transfer duties; R14 billion in excise duties; R13,1 billion in customs duties; and R18,8 billion in fuel levies.

e-Filing

e-Filing (*www.efiling.gov.za*) is a secure tax return and submission service offered by SARS that 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.

The service offers web-based capture of individual returns as well as facilities for the submission of multiple returns through back-end interfaces.

There is also a facility to apply for tax directives, which can be obtained within 24 hours.

e-Filing in South Africa has been growing significantly since its inception and has been delivering real business benefits to both the taxpayer and SARS.

By 31 March 2005, the number of registrations grew to 290 000, while more than R2,5 billion was paid in electronic transfers between January and March 2005 alone.

The increased use of Information Technology is part of SARS' longer-term objective to move towards a paperless environment where the electronic transmission of information will lead to better service delivery and accuracy.

Filing Season

Filing Season is an extensive marketing and publicity venture to remind taxpayers of their responsibilities to submit their tax returns on time with the correct details, and to ensure that their returns are assessed and processed timeously.

Filing Season also seeks to reduce the number of requests from taxpayers for extensions, and aims to help customers complete their tax returns correctly. Thirty percent of tax returns received by SARS in the past were either incorrectly completed, partially completed, or lacked the necessary substantiating documentation. This caused unnecessary delays for both taxpayers and SARS.

Each year, SARS attempts to simplify complex tax returns for salaried individuals.

The 2005 *Filing Season* was a big success, with SARS receiving about 2,4 million returns before the July deadline, compared with 2,1 million in 2004.

Gambling and lotteries

The National Gambling Board regulates the gambling industry in South Africa by ensuring that the viability, sustainability and integrity of the industry are attained and maintained.

In June 2005, a new court facility, dedicated to resolving tax disputes in Gauteng, was officially opened.

The mandate of the tax court is to strive for the fair and just interpretation and application of tax law as stated in the Income Tax Act, 1962 (Act 58 of 1962).

The court will hear all cases where the tax involved exceeds R200 000 and where the matter could not be resolved in terms of the alternative dispute-resolution process between the South African Revenue Service and taxpayers.

The tax court's pivotal role is strengthened through an appeal procedure that could go to the High Court, the Supreme Court of Appeal and potentially, the Constitutional Court.

The board fulfils its mandate by:

- promoting uniform norms and standards that apply generally throughout South Africa, bringing about uniformity in legislation relating to gambling in the various provinces
- establishing and maintaining a national inspectorate
- monitoring the existence of any dominant or overconcentrated market share in the South African gambling industry
- advising the Minister of Finance and the provinces on gambling matters
- facilitating the resolution of disputes that may arise between the respective provinces regarding the regulation and control of gambling activities
- liaising with similar foreign international bodies.

The South African Advisory Council of Responsible Gambling was created to promote the culture of responsible gambling. It comprises regulators, civil society and the industry.

The National Gambling Act, 1996 (Act 33 of 1996), defines the regulatory framework of the industry. For instance, it limits the number of casinos that can be licensed to 40. There are provincial gambling boards in each of the nine provinces, which are responsible for issuing casino licences.

The National Gambling Act, 2004 (Act 7 of 2004), provides for the co-ordination of concurrent national and provincial legislative competence matters relating to casinos, racing, gambling and wagering, and for the continued regulation of those matters; certain uniform norms and standards applicable to national and provincial regulation; and licensing of certain gambling activities. It also provides for the retention of the National Gambling Board; establishment of the National Gambling Policy Council; and the repeal of the National Gambling Act, 1996.

In September 1999, the Minister of Trade and Industry signed the National Lottery Licence Agreement with Uthingo Management (Pty) Ltd, the official lottery operator. The National Lottery celebrated its fifth anniversary in March 2005.

During this period, the Lotto paid R3 billion to more than 6 100 beneficiary groups. Some 3 920 charities received R1,4 billion. Sport and recreation institutions and arts, culture and national heritage organisations received about R800 million. Disability Sport South Africa received R4 million of that amount. Miscellaneous donations amounted to R27 million.

Auditor-General

The Office of the Auditor-General (OAG) exists as a state institution to support democracy.

The auditor-general is mandated by Section 188 of the Constitution to audit and report on the accounts, financial statements and financial management of:

- all national and provincial state departments and administrations
- all municipalities
- any other institution or accounting entity required by national or provincial legislation to be audited by the auditor-general.

In addition to these duties, and subject to any legislation, the auditor-general may audit and report on the accounts, financial statements and financial management of:

- any institution funded from the national or a provincial revenue fund or by a municipality
- any institution that is authorised in terms of any law to receive money for a public purpose.

The OAG has a budget of R712,3 million and 1 598 employees. These are divided into various centres of excellence that provide auditing services; corporate services; and specialised audit work, namely performance, forensic auditing, computer auditing and technical support. The OAG also boasts an impressive international auditing complement.

The auditor-general must submit audit reports to any legislature that has a direct interest in the audit, and to any other authority prescribed by national legislation. All reports must be made public.

Public-sector auditing involves the investigation and evaluation of government and related institutions regarding financial-management practices, performance and compliance with legal requirements.

Financial sector

South African Reserve Bank

The Reserve Bank and the Ministry of Finance form the monetary authority in South Africa. The Reserve Bank has been given a significant degree of autonomy in terms of the Constitution and must perform its functions independently. However, the Reserve Bank must hold regular consultations with the Minister of Finance. Its management, powers and functions are governed by the South African Reserve Bank Act, 1989 (Act 90 of 1989).

The Reserve Bank formulates and implements monetary policy and regulates the supply of money by influencing its cost. Monetary policy is guided by the objectives of the Reserve Bank, which are formulated to ensure financial stability. Consistent combating of inflation is the cornerstone of the bank's policy. A formal inflation-targeting monetary-policy framework has been adopted since 2000.

Monetary policy is set by the bank's Monetary Policy Committee (MPC). The committee, consisting of the Reserve Bank's governors and other senior officials, usually meets once a quarter, after which the bank issues a statement indicating its assessment of the economy and policy changes, if any.

The Reserve Bank is responsible for:

- assisting government in formulating and implementing macro-economic policy
- formulating and implementing monetary policy to achieve its primary goal in the interest of the community it serves
- ensuring that the South African money and banking system as a whole is sound, meets the

In January 2005, the Minister of Finance, Mr Trevor Manuel, announced that 12 20-foot containers of clothing and footwear would be donated by the South African Government to victims of the tsunami in south-east Asia.

The donated goods were proceeds of smuggling seizures undertaken by the South African Revenue Service.

requirements of the community and keeps abreast of international finance developments
- informing the South African community and all interested parties abroad about monetary policy, and the South African economic situation in general.

The Reserve Bank is managed by a board of 14 directors, seven of whom are elected by the shareholders of the bank and represent commerce, finance, industry and agriculture. The President of South Africa appoints the governor, three deputy governors and three directors.

The Reserve Bank acts as the central bank of South Africa and as a banker to other banking institutions. It provides accommodation to banks and is the custodian of the statutory cash reserves that all registered banks are required to maintain. It also provides facilities for the clearing and settlement of interbank obligations.

The main instrument in managing liquidity in the money market is the repurchase transactions (repo) rate, the price at which the central bank lends cash to the banking system. The repo rate has become the most important indicator for short-term interest rates.

The repurchase agreements entered into between the Reserve Bank and other banks are conducted on the basis of an outright buy-and-sell transaction, with a full transfer of ownership of the underlying assets. The system also provides for a marginal lending facility, which replaces the previous discount window. This facility is available to banks at their initiative to bridge overnight liquidity needs.

In December 2004, the Communication Division of the South African Revenue Service won the Government Communicator of the Year Award.

It conceptualised and implemented an effective strategy for the *2004 Filing Season*, which focused on improved operational efficiency in reducing the tax gap, and improved service delivery.

The annual awards are co-ordinated by the Government Communication and Information System.

The marginal lending facility forms an integrated part of the South African Multiple Option Settlement (SAMOS) System, which came into operation in March 1998.

This enables banks to electronically make payments to, and receive payments from, the Reserve Bank, through their settlement accounts held in the books of the Reserve Bank. Daily settlements of interbank exposures are effected through the SAMOS System.

Payments through the system can only be made if a bank has sufficient funds in its settlement account. Such funds can be obtained through interbank transfers, repurchase transactions, other types of liquidity-creating instruments of the Reserve Bank, or the marginal lending facility. The SAMOS System, however, allows banks to receive funds obtained in the interbank market directly in their settlement accounts in the Reserve Bank's books.

The Reserve Bank uses various instruments to achieve its objectives. These include changes in the repo-rate marginal-lending facility; open-market transactions, including selling its own debentures; changes in requirements with regard to cash reserves of banking institutions; and controlling liquidity in the money market through repurchase transactions.

The bank undertakes national and international transactions on behalf of the State, and acts for government in transactions with the International Monetary Fund (IMF).

The Reserve Bank is the custodian of the greater part of South Africa's gold and other foreign-exchange reserves.

The Reserve Bank issues banknotes (printed by the South African Bank Note Company, a wholly owned subsidiary of the Reserve Bank) and controls the South African Mint Company.

Monetary policy

Growth in broad money supply (M3) exceeded 11% throughout 2004, registering the highest value for the year at 14,9% in October. The accumulation of government deposits late in 2004 and early in 2005, in preparation for sizeable coupon interest and capital redemption payments on government bonds at the end of February 2005, contributed to the slowdown in M3 growth, as government deposists are not included in M3.

Banks' loans and advances to the domestic private sector accelerated from 9,9% at the beginning of 2004 to 17,6% in February 2005. Throughout 2004 and early in 2005, the growth in total loans and advances was driven mainly by brisk demand for asset-backed credit and a rebound in the corporate sector's use of bank-intermediated funding.

Growth in M3 and banks' total loan and advances were consistent with firm increases in nominal income, expenditure and wealth.

On 12 August 2004, the Reserve Bank's MPC announced a reduction in the repo rate of 50 basis points to 7,50%. However, based on a more neutral assessment of inflationary pressures and risks, the MPC left the repurchase rate unchanged at 7,5% at the October and December 2004, and February 2005, meetings. On 14 April 2005, the repo rate dropped to 7%.

Financial Services Board (FSB)

The FSB is an independent statutory body financed by the financial services industry itself.

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

Estimates of revenue before tax proposals, 2004/05

R million	**2004/05 Revised estimate**	**2005/06 Before tax proposals**	**% change**
Taxes on income and profits	189 900	211 350	11,3
Personal income tax	110 950	124 000	11,8
Company tax	65 450	72 100	10,2
Secondary tax on companies	7 600	8 700	14,5
Tax on retirement funds	4 500	4 900	8,9
Other	1 400	1 650	17,9
Taxes on payroll and workforce	4 600	5 000	8,7
Taxes on property	8 928	10 270	15,0
Domestic taxes on goods and services	129 033	141 085	9,3
Value-added tax	95 500	106 250	11,3
Excise duties	14 075	14 400	2.3
Levies on fuel	18 800	19 700	4,8
Other	658	735	11,7
Taxes on international trade and transactions	11 650	13 200	13,3
Stamp duties and fees	1 150	1 250	8,7
Total tax revenue	**345 261**	**382 155**	**10,7**
Department revenue	5 493	8 502	54,8
Transactions in assets and liabilities	533	646	21,1
Less: SACU payments	-13,328	-12 053	-9,6
Main budget revenue	**337 960**	**379 250**	**12,2%**

Source: *Budget Review 2005*

functions converge in the office of the executive officer, acting with the other members of the executive and heads of the various departments of the FSB's administrative infrastructure.

The FSB promotes programmes and initiatives by financial institutions and bodies representing the financial-services industry to inform and educate users of financial products and services. It also acts in an advisory capacity to the Minister of Finance.

Included in such functions is regulatory control over central securities depositories and depository institutions responsible for the safe custody of securities.

The FSB is also responsible for the financial supervision of the Road Accident Fund.

Excluded from the FSB's responsibilities are some areas involving listing requirements or public issues, take-overs and mergers.

The Securities Services Act, 2004 introduces stricter penalties of up to R50 million and/or 10 years' imprisonment for various forms of market abuse.

The executive officer is provided with an armoury of regulatory sanctions, including the cancellation of authorisation to supply financial services.

The executive officer has formal powers of investigation to which criminal sanctions attach in the event of obstruction. The executive officer can, in certain circumstances, also petition for the winding up of, or placing under judicial management or curatorship, certain financial institutions such as insurers and pension funds.

These powers of intervention do not, however, take the risk out of an investment made at a financial institution. All investments carry some degree of risk, whether relating to business or general economic conditions.

In July 2005, Barclays, the third-biggest British bank, concluded a multimillion rand deal for 56,1% control of the Amalgamated Banks of South Africa.

It was the biggest investment yet made in post-apartheid South Africa.

The Inspection of Financial Institutions Act, 1998 (Act 80 of 1998), allows the FSB to obtain warrants for searching and questioning third parties who might have information about unregistered financial institutions, such as those providing insurance or investment services.

The FSB is assisted by an advisory board on financial markets, and advisory committees on financial services providers, long- and short-term insurance, pension funds and collective investment schemes. The Financial Services Consumer Advisory Panel was established to advise the FSB and Registrar of Banks on consumer-protection issues falling within the regulators' jurisdiction.

The FSB maintains a close relationship with all existing industry associations. It liaises with overseas regulatory organisations, and is a member of the International Organisation of Security Commissions, the International Association of Insurance Supervisors, the African Association of Insurance Supervisors and the International Network of Pension Regulators and Supervisors.

On the domestic scene, it liaises with bodies such as the Public Accountants and Auditors, Consumer Affairs Committee and various government departments, as well as with prosecuting authorities such as the South African Police Service, the Directorate of Special Operations, and the National Director of Public Prosecutions.

The banking industry

At the end of December 2004, 35 banks, including 15 branches of foreign banks and two mutual banks, were registered with the Office of the Registrar of Banks. Furthermore, 45 foreign banks had authorised representative offices in South Africa. By the end of December 2004, the banking institutions collectively employed 116 940 workers.

Four major banks dominate the South African banking sector, namely Amalgamated Banks of South Africa (Absa) Bank Limited, the Standard Bank of South Africa Limited, FirstRand Bank Limited and Nedbank Limited. These banks maintain extensive branch networks across all nine provinces and by the end of December 2004 constituted 83,7% of the total assets (R1 498,1 billion) of the banking sector.

The major banks offer a wide range of services to both individual and corporate customers. One-stop relationship banking, instead of isolated services, has gained importance. Nevertheless, several banks specialise in providing services in merchant banking, securities underwriting or other niche areas.

Online banking accounts reached the one-million mark in South Africa for the first time at the end of 2003. According to the World Wide Worx research report, *Online Banking in South Africa 2004,* the number of online bank accounts in South Africa grew by 28% in 2003. The number of online bank accounts reached 1,04 million and was expected to increase by more than 30% in 2004.

Industry-wide net income after tax increased to 1,2% of total assets in 2003. As a percentage of equity, industry-wide net income after tax increased from 11,2% in 2003 to 14,7% in 2004. By the end of 2004, industry-wide net income before taxation had begun to increase to R22,5 billion, compared with R16,4 billion in 2003.

The change in focus of the regulatory authorities, from direct control to deregulation, has been accompanied by an emphasis on proper capitalisation, sound risk-management procedures and greater disclosure. South Africa adheres to the capital-adequacy guidelines for banks issued by the Basel Committee on Banking Supervision, under the auspices of the Bank of International Settlements.

In South Africa, the requirement to maintain capital equal to the full ratio of 10% of risk-weighted assets became effective in October 2001. By the end of 2004, the banking sector as a whole had a ratio of capital-to-risk weighted assets of 13,5%.

Many demands are now being made on South African banking institutions to extend their activities to accommodate the banking needs of the underprivileged, and to provide more funds for housing, export financing, agriculture and small-business development. Several initiatives are underway to develop appropriate structures to provide all sectors of South Africa's populations with access to finance.

The regulations relating to banks, which form part of South Africa's banking legislation, were revised during 2002, ensuring South Africa's continued adherence to best practice. The Bank Supervision Department envisages amending the regulatory framework to allow for the establishment of different classes of banking institutions, such as second-tier and third-tier banks.

A project to consider the establishment of narrow and core banks was initiated during 2002/03. The objective is to increase competition in the banking sector, while also creating greater access to basic banking services, such as savings accounts and housing and educational loans to the under- and unbanked.

The department proposes that such banks be subject to lower-entry criteria, but that their business scope be limited.

To safeguard the stability of the banking system, it is envisaged that narrow and core banks be subject to strict conditions, such as being permitted to take retail deposits, but not to trade or invest in, for example, derivatives. Draft legislation on this was expected in 2005.

The microlending industry

The Micro Finance Regulatory Council (MFRC) was established in 1999. Over the years, the MFRC has made good progress with formalising and regulating the microlending industry. More than 1 400 entities,

The 2005 Protea coin series depicts Chief Albert Luthuli, the first South African to be awarded the Nobel Peace Prize.

The Albert Luthuli coins were launched shortly after the 50th anniversary of the Freedom Charter in June 2005.

On 22 May 2005, the South African Mint minted gold coins on an old fly press on the ancient site of a royal fortress on the Mapungubwe Hill, in the Mapungubwe National Park situated in Limpopo.

The South African Mint's 2005 R2 gold coin series depicted South Africa's world heritage sites.

representing more than 7 000 branches, are registered with the MFRC.

A major problem for the MFRC has been the large number of unregistered lenders and the problems associated therewith. In brief, registered lenders have to comply with the rules of the MFRC, whereas unregistered lenders fall outside the ambit of the MFRC's rules.

The situation, however, improved when the Department of Trade and Industry implemented an amendment to the Usury Act, 1968 (Act 73 of 1968), whereby direct inspection powers were created for the MFRC. The amendment extended the MFRC's mandate to include unregistered microlenders in its regulation process. A number of inspections have been undertaken under this mandate, and there has been a fair level of success in obtaining successful prosecutions, although there appears to be a considerable delay between the completion of investigations and the conclusion of legal prosecutions.

Microlenders are placing an increasing number of credit records onto the National Loan Register (NLR). The MFRC is emphasising measures to combat reckless lending and has formulated a rule compelling all registered lenders to perform affordability assessments. It is believed that these measures will play an important role in curbing overindebtedness, while assisting credit grantors with improving their credit quality and decreasing their credit risk.

As a result of ongoing attention to consumer education and awareness, implementation of measures, such as the NLR, to improve lending practices and consistent disciplinary action against lenders found not to comply with rules and regulations, market conduct and corporate governance in the microlending sector, appear to have improved substantially.

On 30 November 2004, the Microlenders Association was reintroduced as Micro Finance South Africa, the industry's newly branded member association.

Insurance companies

Short-term (non-life) insurance is concerned primarily with risk assessment. The contracts usually run from year to year and can be cancelled by either party. These contracts apply to engineering, guarantee, liability, motor business, accident and health, property, transportation, and miscellaneous insurance. As at 31 March 2004, 97 short-term insurers were registered. The total gross premiums written for 2003 (unaudited figures) amounted to R35,3 billion, while total assets amounted to R39,3 billion (excluding the South African Special Risks Insurance Association Limited).

In essence, long-term insurance consists of life, assistance, sinking fund, health, and disability insurance. Long-term insurance and pension and provident funds are concerned with maximising investment results. Life insurance is dominant. As at 31 March 2004, 78 long-term insurers were registered. The total net premiums received and outstanding for 2003 (unaudited figures) amounted to R156,8 billion, while total assets amounted to R822,1 billion.

The Financial Advisory and Intermediary Services Act, 2002 (Act 37 of 2002), contains many of the provisions incorporated in the policyholder protection rules. In 2004, the FSB was redrafting these rules to ensure that there was no duplication of provisions.

Other financial institutions

Development Bank of Southern Africa (DBSA)

The primary role of the DBSA in terms of the DBSA Act, 1997 (Act 13 of 1997), is to promote economic development and growth, HRD and institutional capacity-building. This is achieved by mobilising financial and other resources from the national and international, private and public sectors for sustainable development projects and programmes. The bank operates in South Africa, in the other Southern African Development Community (SADC) countries, and increasingly as a development agent and knowledge partner in the wider region of Africa south of the Sahara.

Its mandate focuses on infrastructure (economic, social and institutional) both through loans of its own funds and by acting as a catalyst for investments in partnership with the private sector and other development finance institutions.

The bank plays the diversified roles of adviser and partner; acting as a knowledge bank, facilitator and catalyst; and often serving as a development agent to bridge institutional and execution gaps. It is actively involved in project appraisal, evaluation and management, provides development statistics and information, and undertakes policy and sector analysis.

Funding

The DBSA's capital and reserves at 31 March 2004 stood at R11,1 billion. The bank's financial resources are made up of the share capital contribution of National Treasury, borrowings in the financial markets, repayments on loans granted by it, and internally generated funds. In addition to these resources, the bank mobilises loan capital from other international sources. It has established lines of credit with reputable and highly rated international institutions such as the African Development Bank and the European Investment Bank (EIB). It also raises funds from bilateral sources such as the *German Kreditanstalt für Wiederaufbau*, the Japanese Overseas Economic Co-operation Fund and *Agence Française de Développement*.

Strategic direction

The DBSA has adopted a set of stretch targets over a 10-year period to give practical effect to its commitment to the strategic development agenda of South Africa, SADC, NEPAD and the wider international community (the millennium development goals).

The DBSA's institutional vision and strategic plan, Vision 2014, which is also guided by the bank's mandate, focuses on the following key goals:

- reducing poverty by half through economic development, comprehensive social security, land reform and improved household and community assets
- reducing unemployment by half through new jobs, skills development, assistance to small businesses, opportunities for self-employment and sustainable community livelihoods
- massively reducing the incidence of tuberculosis, diabetes, malnutrition and maternal deaths; turning the tide against HIV and AIDS; striving to eliminate malaria throughout the region; improving services to achieve a better national health profile; and reducing preventable causes of death
- positioning South Africa strategically as an effective force in global relations, with vibrant and balanced trade with countries of both the South and the North
- providing the skills required by the economy, building capacity and providing resources across society to encourage self-employment, with an education system that is geared for productive work, good citizenship and a caring society.

The DBSA estimates the impact of its funding operations using economic modelling techniques. According to these, the level of DBSA loan approvals in South Africa and the SADC is projected to grow to R6 billion a year by 2013/14. Between 2004/05 and 2013/14, this in turn should have the effect of creating a total of 127 000 jobs in South Africa, connecting 2,4 million households to one or more basic service, and contributing R22,2 billion to the local economy. To this end, it plans to invest R45,6 billion (loans and equity finance) in infrastructure development and well over R1 billion in technical assistance, capacity-building grants and knowledge development/networking.

Strategic initiatives

In line with its goal of accelerating delivery and growing the economy, especially in historically neglected and poor localities, the DBSA has introduced the Targeted Infrastructure Programme – a multi-year facility of special concessional finance dedicated to poverty-reducing infrastructure services in resource-poor areas. Priority will be given to eradicating backlogs in access to basic water and electricity.

The bank has strengthened and replenished the DBSA Development Fund, a dedicated capacity-building fund recently established as a section 21 company, to enhance and focus the bank's grant and technical support of local capacity-building in several areas, especially feasibility studies, project and programme development, systems design/ development and training.

It is also providing concerted financial and institutional support to Project Consolidate, a major local public-sector capacity-building initiative established by government and spearheaded by the Department of Provincial and Local Government. (See chapter 12: *Government system*.)

The bank is in the final stages of launching the Vulindlela Academy, a specialised institutional training facility dedicated to the creation and upgrading of skills required for the economy, in particular infrastructural delivery and improved productivity and sustainability.

The DBSA has also positioned itself to provide strategic and financial support to the South Africa Football Association in its planning and co-ordination of infrastructure development around South Africa's hosting of the 2010 Soccer World Cup.

The bank will continue to serve as a development agent and conduit for a range of national, regional and global partners to bridge institutional and execution gaps. It supports partners such as NEPAD, the World Bank, UN agencies, and the Global Alliance for Improved Nutrition, in addition to government departments.

Land and Agricultural Development Bank (Land Bank)

The Land Bank operates as a development-finance institution 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, co-operatives 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 4: *Agriculture*.)

Despite operating in a difficult business environment influenced by drought, delayed rains, a strong rand and a lower repo rate, the bank achieved a net profit of R247 million in the 2003/04 financial year, compared with a R1,429-billion loss in the previous reporting year.

The number of loans granted by the bank rose by 14% from 89 967 to 102 527. The development loan book grew by 5,3% to R1 096 billion. Arrears as a percentage of the loan book dropped by 35,4% from 9,6% to 6,2%. For the same period, the total provisions as a percentage of the loan book also declined by 27% from 9,4% to 7,4%. Non-interest income rose 330% from R39 million to R168 million.

Collective investment schemes

The Unit Trusts Control Act, 1981 (Act 54 of 1981), and the Participation Bond Act, 1981 (Act 55 of 1981), which regulated unit trust schemes and participation bond schemes, were replaced on 3 March 2003 by the Collective Investment Schemes Control Act, 2003 (Act 45 of 2003), which regulates all these schemes under the title of collective investment schemes. The structures of these schemes remained basically the same as before, although there is scope for other types of structures.

Collective investment schemes in securities

These open-ended schemes provide for a number of different types of portfolios in the equity, interest-bearing and money markets for those investors who may not have the time, money or expertise to invest successfully in these markets on their own.

The prices of participatory interests (previously known as units) are calculated at net asset value and published daily. Managers create participatory interests for sale to the public as and when the demand arises. Managers may also cancel participatory interests when investors sell their holdings of participatory interests to the manager. The manager is obliged by law to buy back any participatory interests offered to it, at a price determined within 24 hours of receiving a valid notice of a buy-back from an investor.

Various collective investment schemes in South Africa offer similar ranges of investment plans, varying mainly as to the mimimum amounts accepted for investment and certain charges. There are two types of investment plans, namely the open-account or lump-sum plan, and the regular savings plan, which caters for regular monthly investments.

Collective investment schemes in property

Previously known as property unit trusts, these schemes invest mainly in the shares of property-owning companies, direct property and certain other and foreign assets. Their issued participatory interests are listed on the JSE Limited (JSE). As at December 2003, there were seven schemes with an equal number of portfolios, with 2 443 billion participatory interests in issue, of which the market value amounted to R6,756 billion.

Collective investment schemes in participation bonds

Formerly called participation bond schemes, several of these schemes are being wound down. According to the Reserve Bank, the amount invested with these schemes was R3,820 billion as at 31 December 2003. However, by June 2003, only seven of these schemes had invested funds from the general public.

Foreign collective investment schemes

Since 1998, foreign collective investment schemes have been allowed to market their products in South Africa, provided they obtain approval from the FSB.

Individual investors utilising their foreign exposure are the primary investors. At the end of 2003, 78 foreign schemes administering 433 different portfolios had obtained approval to market their products in South Africa. The amount accepted from South African investors amounted to R45,8 billion at the end of 2003.

Stokvels

Stokvels are co-operative rotating saving schemes that mobilise funds among mostly black communities for a variety of purposes. Rotating saving schemes similar to stokvels are also found in countries such as South Korea, Jamaica, Egypt and Japan. An estimated one million stokvels operate in South Africa.

Financial intermediaries and advisers

In accordance with the Financial Advisory and Intermediary Services Act, 2002, the Advisory Committee on Financial Services Providers, established by the Act, has focused its attention on finalising numerous pieces of necessary subordinate legislation (including the codes of conduct for different categories of financial services advisers).

As of 30 September 2004, financial advisory and intermediary entities are no longer able to conduct their business activities without being in possession of a licence issued by the FSB. The FSB was assisted by 12 representative-recognised bodies for the purpose of processing licence applications.

The Office of the Ombudsman for Financial Services Providers was empowered to adjudicate complaints by consumers relating to financial advice and intermediary services from 1 October 2004, when the Act came into full operation.

By the end of February 2005, the FSB had recorded the submission of about 14 500 licence applications in terms of the Financial Advisory and Intermediary Services Act, 2002. Of these, 7 500 applications had been processed fully, considered, and, where successful, licences issued and dispatched to applicants.

Retirement funds and friendly societies

As at 31 December 2003, the FSB supervised 13 752 registered retirement funds and 180 registered friendly societies. These funds exclude the official State funds, Transnet, Telkom and some bargaining-council funds, none of which are registered in terms of the Pension Funds Act, 1956 (Act 24 of 1956).

The total membership of all pension funds at the end of 2002 was 9 779 884, of which 8 567 479 were active members, and 1 212 405 were pensioners, deferred pensioners and dependants. These figures do not reflect the total number of individuals who were members of funds, as some were members of more than one fund.

The total contributions received decreased by 0,9% from R61,097 billion in 2001 to R60,552 billion in 2002. Total contributions to the State, Transnet, Telkom and Post Office funds decreased by 1,4%, while total contributions to self-administered, underwritten and industrial funds in the private sector decreased by 0,7%.

Benefits paid decreased from R111,206 billion in 2001 to R72,492 billion in 2002. Amounts paid in respect of pensions, lump sums on retirement or death and resignations were included.

Total assets of the retirement-fund industry in South Africa increased by 3,7%, from R836 billion in 2001 to R867 billion in 2002.

The net assets of self-administered funds decreased by 4,9% from R370 billion in 2001 to R352 billion in 2002.

Financial markets

Primary capital-market activity

Government bonds

For the 2004/05 fiscal year, total government bond issuance in the primary market amounted to R53,1 billion. Over the same period, a total of R26,3 billion worth of bonds matured, bringing the net financing requirement in the domestic bond market to R26,8 billion.

This is a slight increase from the 2003/04 fiscal year, when total issuance amounted to R51,4 billion, while R26,6 billion was redeemed and net issuance amounted to R24,8 billion. Of the total amount of bonds issued, almost 80% comprised vanilla bonds, with inflation-linked bonds adding about 17% and the remainder being floating rate notes.

The Reserve Bank conducts weekly nominal bond auctions on behalf of National Treasury. For the 2004/05 fiscal year, an average of R850 million was issued weekly, compared with an average weekly issuance of R600 million in 2003/04.

The conditions for issuances in the fixed income market were conducive not only locally, but also globally and the South African Government successfully issued a 10-year US$1,0 billion (R6,5 billion) denominated bond in May 2004 at a spread of 195 basis points over the benchmark United States (US) Treasury Bond.

In addition, R3,2 billion was drawn on the foreign export credit facilities. Foreign bonds redeemed amounted to an equivalent of R5,3 billion, bringing net foreign bond issuance to R4,5 billion. This compares with gross foreign bond issuance of R14 billion in 2003/04, with redemptions totalling about R13 billion. For the 2005/06 fiscal year, no foreign bonds were expected to be issued.

Two new fixed income bonds were launched in 2004/05, namely the R203 and R204 bonds. The R203 bond was launched in May 2004 and carries a coupon of 8,25%, maturing in 2017. By February 2005, R12,3 billion had been issued. The R204 bond was launched in August 2004, carrying a coupon of 8% and maturing in 2018. Over R6 billion was raised via the R204 bond during the 2004/05 fiscal year.

In May 2004, government also launched the RSA government retail bonds, with maturities of two, three and five years. By February 2005, government had raised a total of R1,25 billion through these bonds.

Government's total loan debt increased from R389,3 billion in 2003/04 to R428,1 billion in 2004/05. However, total gross loan debt as a percentage of GDP remained steady at 35,7%.

Non-government bond issuance

In 2004, new bond issuance in the corporate sector amounted to R14,23 billion, compared with R15,34 billion issued in 2003. This figure, however, excludes the total amount of funds raised through other vehicles such as securitisation and private placements. Total issuance related to securitisation amounted to R7,5 billion, bringing total issuance to R29,5 billion by the end of January 2005. Although there was a relatively high volume of issuance in the securitisation market in 2004, it was 25% less than the R9,9 billion recorded in 2003. Nonetheless, issuance in the non-government sector, whether through corporate bonds, securitisations or private placements, has grown significantly in the past few years. This can be attributed to a diversification of instruments utilised, declining interest rates, narrowing credit spreads indicating investor risk tolerance amid the search for yield, as well as credit upgrades for a number of corporate institutions. The South African corporate market is expected to grow as new asset classes emerge and new issuers continue to enter the market.

Eurorand bonds

Following four years of negative net issuance, the Eurorand bond market expanded in 2004. Improved liquidity conditions in the global financial markets led to improvements in eurorand bond market activities. Gross issuance increased to R6,8 billion in 2004 – a 265% increase compared with the R1,9 billion issued in 2003 and higher than the average of about R4 billion over the past four years. In 2004, R3,6 billion worth of eurorand bonds matured, resulting in a net issuance of R3,1 billion.

The renewed interest in this market can also be attributed to the positive sentiment towards the Rand and an overall positive performance in global fixed income markets in 2004. In the first quarter of 2005, gross issuance amounted to R2,2 billion, while R1,3 billion matured, bringing net issuance to R875 million.

The EIB continued to dominate issuance in the Eurorand bond market, comprising almost 65% of total issuance during 2004. Other issuers were *Rabobank Nederland* (13%) and *Landsman Baden-Wuertemburg* (13%), while *Kredit Wiederauf* and the Republic of Austria issued about 5% and 4%, respectively. The type of credit issued remained predominantly AAA-rated, and the maturity structure changed to longer-dated issues. The 2010 and 2013 bonds account for 56% of total eurorand bond issuance, while the rest is concentrated in bonds maturing in five years or less.

The spreads and yields at which these bonds were issued declined during 2004, with some bonds even issued at spreads below comparable South African benchmark government bonds. The 2013 bond, for example, was tapped by the EIB at a yield of 8,95% in January 2004, and was tapped again in November 2004 at a yield of 8,22%. While coupon rates were as high as 11% in 2003, they declined to between 10% and 8% during 2004.

Secondary capital-market activity

Domestic bonds

South African bond yields declined considerably between May 2004 and February 2005. The yields on government bonds declined to historically low levels, with the yields on two-year R194, five-year R153 and 20-year R186 government bonds declining to 7,22%, 7,40% and 6,98%, respectively, by 28 February 2005.

Factors that contributed to this decline in local yields include the firmer Rand-Dollar exchange rate, reductions in the repo rate, low yields in the developed countries, and a ratings upgrade by Moody's in January 2005. In addition, the inflation outlook has remained promising, with the Consumer Price Index excluding mortgage costs (CPIX) moving to historically low levels, and not expected to breach the upper band of the Reserve Bank's 3% to 6% guideline range over the forecast period.

Improved investor sentiment towards the country's political and economic policies also contributed to the decline in bond yields, as reflected by non-resident interest in the local bond market. After being net sellers of South African bonds to the value of R8,1 billion in 2003, foreigners were net purchasers of bonds to the value of R450 million in 2004.

During March 2005, bond yields increased by an average of 80 basis points, in reaction to external factors, such as increasing US Treasury yields as well as the potential for more rapid US interest rate rises, which affected emerging market debt in general. At the time, investors also did not expect further decreases in the Reserve Bank's repo rate. However, in April 2005, the Reserve Bank cut the repo rate by a further 50 basis points to 7%, and bond yields declined further. For the first quarter of the year, non-residents were net sellers of South African bonds to the value of R1,4 billion. However, during the first half of April 2005, R5,6 billion was bought on a net basis.

Turnover in the domestic bond market declined from about R12 trillion in 2002 to R11 trillion in 2003 and R8 trillion in 2004. This can probably be attributed to declining interest rates, which motivated a buy-and-hold strategy among many investors.

Money-market activity

The South African money market is an over-the-counter market in which a fairly large number of banks and other institutions actively participate. The Reserve Bank implements its monetary policy in terms of a system based on creating a shortage in the money market.

The bank refinances this shortage through weekly repurchase transactions with seven-day maturities at its policy rate, the repo rate. Thus, the bank influences other market interest rates. The daily liquidity requirement in the money market was maintained close to R13 billion throughout the 2004/05 financial year.

The Reserve Bank used mainly four types of open-market operations to drain surplus liquidity from the money market, namely issuing Reserve Bank debentures, conducting longer-term reverse repo transactions, foreign exchange swaps and outright sales/switches of government bonds. Furthermore, with the redemption of the R151 bond and coupon payments made to the Reserve Bank on various bonds during February 2005, the bank was able to permanently drain R10,1 billion worth of liquidity from the market.

The Reserve Bank changed its repo rate once during the 2004 financial year, cutting the repo rate by 50 basis points to a level of 7,5% in August 2004, and money-market rates decreased accordingly. In April 2005, the repo rate was cut again by 50 basis points, justified by a favourable inflation outlook, as the bank expected CPIX to remain within target range over the forecast period.

Equity market

The total value of equity capital raised by companies listed on the JSE during 2003 was R22,7 billion. It subsequently increased to R41,8 billion in 2004 and R8,3 billion was raised during the first quarter of 2005. The number of new listings doubled in 2004, from eight to 16, while the number of delistings declined from 54 in 2003 to 39 in 2004. Two new listings were recorded in the first quarter of 2005. Some 873 securities were listed on the JSE at the end of 2004 compared with 745 at the end of 2003, increasing to 921 in the first quarter of 2005.

Domestic share prices, as measured by the all-share index (Alsi), increased to new highs during 2004 and the first quarter of 2005. Although the Alsi declined by about 13% from March 2004 to mid-May 2004, the decline was reversed as the Alsi rose by 40,6% to a new high of 13 761 on 17 March 2005. The Alsi rose by almost 32% from the beginning of 2004 until the end of March 2005.

The best performing index during 2004 was the banking index, followed by the financial index and the industrial index, which improved by 62,3%, 45,9% and 42,6%, respectively. The improvement in the domestic equity market occurred despite an appreciation in the exchange rate of the Rand.

Factors that influenced the market during this period were the low interest rate environment, positive economic fundamentals, prudent fiscal and monetary policies, high commodity prices, expectations of continued higher corporate earnings and strong demand from foreign and local investors.

The country's improved ratings outlook and upgrade also added to the positive sentiment within the market, combined with Fitch's upgrading of three local banks. The acquisition of a majority stake in Absa by the United Kingdom's Barclays Bank Plc also added to the improvement in the banking index. Various BEE transactions were also reported during 2004, which were well received by the market.

In contrast with the overall market, the gold index declined by 38,7% and the resources index by 7,2% during 2004. The main reason for the decline in the gold index was the strong Rand, which outweighed the impact of higher commodity prices. Other factors that played a role in the decline of both these indices were the unresolved Harmony/Gold Fields take-over bid, uncertainty about the growth in demand from China, and, to a lesser extent, the downgrading of resource stocks by some equity analysts.

Turnover on the JSE, as measured in terms of the value of shares traded, reached a level of R752 billion in 2003, and increased to a record R1 031 billion in 2004. Liquidity, as measured by turnover as a percentage of market capitalisation, increased from 35% in 2003 to 37% in 2004, with market capitalisation increasing from R1 787,2 billion to R2 566,4 billion over the same period. Market capitalisation in US dollar terms increased almost 70% from US$260,7 billion in 2003 to US$442,5 billion in 2004.

According to the World Federation of Exchanges, South Africa was in 16th position of the world league at the end of February 2005. Foreigners bought a net amount of R31,8 billion worth of equities during 2004 and increased their holdings of domestic equities by a net amount of R9,2 billion during the first quarter of 2005.

The JSE's new interest-rate exchange, Yield-X, commenced trading on 28 February 2005. This interest-rate exchange is the JSE's fourth electronic clearing and settlement platform, alongside equities, financial futures and agricultural products. Yield-X aims to open up the interest-rate market to new players and new products, encouraging liquidity and market diversification.

In addition, Yield-X seeks to ensure proper price discovery for interest-rate products in South Africa. At the heart of the new exchange is an anonymous central order book, allowing for trading via a single platform with automated trade matching and guaranteed settlement. The JSE expects Yield-X to emulate the success of the JSE equities and futures trading systems over time, establishing a sophisticated interest rate derivatives market for the country.

A major benefit of Yield-X will be the elimination of bilateral counter-party risk. The JSE, through clearing-house Safcom, will guarantee all trades and offers a cradle-to-grave audit trail. Yield-X will operate in a fully regulated environment overseen by both the JSE and the FSB. Yield-X is targeting a range of investors, from large institutional investors, banks, corporate treasuries and intermediaries, to smaller financial institutions and retail investors who may have been previously excluded from the interest rate market.

Domestic currency market

The South African Rand appreciated by almost 20% against the US Dollar during 2004. Although part of this appreciation was due to general US dollar weakness over this period, which caused most emerging-market currencies to appreciate, the Rand was also supported by domestic economic conditions such as the decline in the inflation rate, positive economic growth, improved sentiment and an increase in official foreign exchange reserves.

South Africa's official gross reserves increased from US$8,1 billion at the end of January 2004 to US$15,9 billion at the end of March 2005. Demand for the Rand was also fuelled by foreign portfolio investment, particularly during the last quarter of 2004.

According to Bloomberg's annual ranking report, the Rand was the second-best performing currency against the US Dollar during 2004. The analysis comprises 60 currencies from developed as well as emerging-market countries. The only currency to

The Mzansi bank account for low-income, previously unbanked people saw 557 439 accounts opened by the first week in February 2005.

Launched on 25 October 2004, the Mzansi account was conceived out of the requirements set out in the Financial Services Charter. Mzansi is supported by Absa, First National Bank, Nedbank, Standard Bank and the PostBank.

It was part of an attempt by the banks to draw in about 13 million people who cannot afford the high fees levied by most banks.

Data collected from participating banks showed that more than 6 000 accounts were opened throughout South Africa each day. The target market of the initiative has largely been reached with 56% of new accounts belonging to women and 27,1% to people between the ages of 16 and 25. Most account-holders are from black communities.

Mzansi brought R160 million into the formal banking sector, with an average of R290 held in each Mzansi account.

marginally outperform the Rand was the Polish Zloty. The Rand also appreciated against other major currencies. Against both the Euro and the Pound, the Rand appreciated by almost 10% and compared with the Yen, the Rand appreciated by 13%.

Volatility conditions, as reflected by the implied and historical volatility indicators, rose to as high as 25,6% and 28,4%, respectively, in January 2004, but declined significantly during the rest of the year. At the end of December 2004, the implied and historical volatility indicators were at 14,9% and 13,4% respectively, indicating that volatility in the Rand exchange rate had subsided.

The average turnover in the domestic currency market increased from US$92,9 billion for the 2003 year as a whole, to US$98,0 billion for 2004. The average net daily turnover increased from US$7,7 billion to US$8,2 billion over the same period. These increases occurred mainly in the foreign exchange swap market, and were not out of line with global trends observed in the 2004 Bank for International Settlements survey of global foreign exchange activity. Domestic rand turnover comprises 0,42% of the global foreign exchange market.

During the first quarter of 2005, the Rand depreciated by almost 10% against the US Dollar, mainly as a result of developments in international currency markets. The main reason was the appreciation in the exchange rate of the US Dollar, which began early in January, caused by expectations that the Fed could increase interest rates at a faster pace than previously expected. This affected most emerging market currencies. In addition, commodity prices declined to lower levels during 2005 with a subsequent effect on the Rand, given that it is a commodity currency.

Exchange control

Exchange control is administered by the Reserve Bank on behalf of the Minister of Finance. The Reserve Bank is assisted in this task by a number of banking institutions, which have been appointed by the Minister of Finance as authorised dealers in foreign exchange. These institutions undertake foreign-exchange transactions for their own account with their clients, within limits, and subject to conditions laid down by the Reserve Bank.

The Government is committed to an open capital market and the gradual relaxation of exchange controls. The private individual investment allowance was increased from R400 000 to R500 000 and then to R750 000 in February 2000.

The following dispensations with regard to exchange control are allowed:

Institutional investors

Part of the process of gradual exchange-control liberalisation and financial-sector strengthening is the shift to a system of prudential regulation governing the foreign portfolio investment of institutional investors, such as long-term insurers and pension funds.

Prudential regulations are applied internationally to protect policyholders and pensioners from excessive risk, and typically include restrictions on foreign asset holdings, set at a certain percentage of an institution's total assets or liabilities. As an interim step towards a prudential framework, institutional investors will be:

- Allowed to invest, on approval, up to existing foreign asset limits. These foreign asset limits are 15% of total retail assets for retirement funds, long-term insurers and investment managers registered as institutional investors for exchange-control purposes, and 20% for collective investment scheme management companies.
- Required to submit additional information when making an application for a foreign-investment allowance. The shift to prudential regulation requires improved data reporting on individual institutions' foreign investments and the foreign-diversification levels of the industry as a whole. The new regulation became operational on 1 May 2003, after National Treasury and the Exchange Control Department of the Reserve Bank, in consultation with the FSB, reached agreement with the respective industries on the appropriate revised reporting standards.

South African corporates

The global expansion of South African firms hold significant benefits for the economy – expanded access to markets, increased exports, and improved competitiveness.

With effect from 26 October 2004, limits on FDI by South African corporates were abolished. Exchange control approval is, however, required. Requests by corporations are considered in light of national interest, such as the benefit to South Africa's international reserves by, for example, generating exports of goods and services. The Exchange Control Department of the Reserve Bank reserves the right to stagger capital outflows relating to very large foreign investments, to manage any potential impact on the foreign exchange market.

Regarding foreign investments authorised before 26 October 2004, corporates will, on application, be permitted to utilise their domestic resources to repay offshore loans raised after 18 February 2004, to finance or partly finance new approved investments. Such transfers will, however, be limited to the greater of R1 million (or R2 million in the case of investments outside Africa) or 20% of the total outstanding loan capital per investment in any given year, provided that, during the first two years of the loan's term, total funds transferred from South Africa do not exceed R2 billion for each new investment, or R1 billion for investments outside Africa.

Interest payments on loans raised abroad to finance or partly finance new approved foreign investments must be repaid from offshore resources.

As a further alternate mechanism of financing offshore investments, applications by corporates to engage in corporate asset/share swap transactions will be considered.

Emigrants' funds

A system of exchange-control allowances for the export of funds when persons emigrate has been in place in South Africa for a number of decades. Emigrants' funds in excess of the emigration allowance were placed in emigrants' blocked accounts to preserve foreign reserves. Reflecting the improved strength and resilience of the South African economy, these blocked assets are now being unwound. The imminent elimination of the net open forward position, and an increasingly diversified and growing export sector, create an environment conducive to dealing with the foreign reserve problems of the past. As such, the following applies:

- The distinction between the settling-in allowance for emigrants and the private individual foreign-investment allowance for residents has fallen away, and there is now a common foreign allowance for both residents and emigrants of R750 000 per individual (or R1,5 million in respect of family units).
- Emigrant-blocked assets are being unwound. Amounts of up to R750 000 (inclusive of amounts already exited) are eligible for exiting without charge. Holders of blocked assets wishing to exit more than R750 000 (inclusive of amounts already exited) must apply to the Exchange Control Department of the Reserve Bank to do so. Approval is subject to an exiting schedule and an exit charge of 10% of the amount.
- New emigrants wishing to exit more than R750 000 (inclusive of amounts already exited) can similarly apply to the Exchange Control Department to do so, with approval subject to an exiting schedule and an exit charge of 10% of the amount.

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, foreign companies or foreign-owned South African companies are permitted to make greater use of local finance. With effect from 18 February 2004, foreign companies or foreign wholly owned subsidiaries can borrow locally up to 300% of the total shareholders' investment.

This ratio does not apply to emigrants, the acquisition of residential properties by non-residents or affected persons, and other financial transactions, such as portfolio investments by non-residents, securities lending, hedging, repurchase agreements, etc. In these cases, the 100% ratio still applies.

JSE Limited

Founded on 8 November 1887, the JSE is the sole licensed securities exchange in South Africa. In July 2005, after 188 years as a mutual association, the JSE celebrated its demutualisation and is now known as JSE Limited, a public unlisted company.

The management and control of the JSE vests in the board, which has powers conferred upon it by the Acts, the rules and the Constitution.

On 6 August 2001, the JSE acquired the business and assets of the South African Futures Exchange (SAFEX). SAFEX is now incorporated into the JSE in two divisions, namely the Financial Derivatives Division, which covers the equity and interest-rate futures and options markets; and the Agricultural Products Division, which covers commodities futures and options on maize, sunflowers, soya beans and wheat.

Regulation

As the front-line regulator of its primary and secondary markets, an independent regulatory authority, the FSB, supervises the JSE. The listings division of the JSE together with two independent bodies (the Generally Accepted Accounting Practice [GAAP] Monitoring Panel and the Securities Panel Regulation) enforce compliance with GAAP and the protection of minority shareholders respectively.

The Insider Trading Directorate of the FSB operates a stringent enforcement programme, with the support of the JSE, in respect of the secondary market. The JSE, in turn, regulates its listed companies and broking members by extensive rules and directives in line with the Securities Services Act, 2004.

In November 1995, the JSE permitted ownership by foreign and corporate members for the first time. The move, part of a broader deregulation package designed to entice local and international investors, parallels the London stock market's 'Big Bang' of 1986, although changes were phased in over time. These included closing the open-outcry market floor in favour of automated electronic trading, the introduction of fully negotiable commission, and dual-trading capacity.

International involvement

The JSE is the largest securities exchange in Africa and has a market capitalisation of several times that of all the other African markets combined. It has the third-largest market for single stock market in the world; the ninth-largest market for options and futures in the world; accounts for over 75% of market capital in Africa; and its reserves grew from US$ 31 million in 1999 to US$73 million in 2004.

The JSE is committed to promoting South Africa both regionally and internationally. In this regard, it has led the process of harmonising the listing requirements of the members of the Committee of SADC Stock Exchanges (COSSE). The COSSE envisages an integrated real-time national network of securities markets in the region by 2006. The JSE has offered its trading platform to these members, and the Namibian Stock Exchange has been trading on the JSE's trading platform for the past seven years.

In addition, the JSE has played an instrumental role in the creation of the globally prominent Code of Corporate Practices and Conduct (referred to as King II), a follow-up to the King I Code. The listings requirements of the JSE now require that all companies provide a report in their annual financial statement on their level of compliance with King II, including progress on the novel stakeholder aspects of the code.

Consistent with the objectives of NEPAD and by virtue of the JSE's position in the southern African region, the JSE remains totally committed to the concept of a pan-African board, and is involved in trying to raise money to assist neighbouring countries to participate in this initiative.

Foreign investors

Since 1994, South Africa has restructured its economic policies to attract foreign investment. The transition has led to a significant improvement in the quality and inclusiveness of institutions. Prudent social reform has been coupled with accountable political institutions and sound macro-economic management.

The economic rating agencies' reports confirm the presence of high levels of political stability. The JSE plays a vital role in the South African economy by putting capital providers together with capital seekers. Thus, cash resources are channelled into productive economic activity, building the economy while enhancing job opportunities and wealth creation.

Listing on the JSE enables capital to be raised for expanding the financing of new business and creating new employment opportunities. In addition, it provides a secondary market for dealing in securities by bringing together buyers and sellers in a manner that ensures transparent price discovery. In this way, new investment opportunities in the country are created.

During the February 2004 budget speech, the Minister of Finance continued to further relax exchange controls by approving foreign companies seeking to issue securities on the JSE and Bond Exchange of South Africa (BESA). In line with the approval, international investors have unfettered access to securities listed on the JSE:

- There are no exchange controls of any kind on foreign investors or any non-resident parties.
- There are no limits on the repatriation of capital or income on foreign shareholders.
- There are no withholding taxes or other penalties applied to the repatriation of capital, interest or dividends by foreign investors.
- There are no foreign ownership limits on South African securities.
- There is no separate registration process for foreign investors. Like all other shareholders, such shareholders are reflected in the dematerialised register. Purchases or sales of shares by foreign shareholders are reflected in its electronic share registry by insertion of a flag.
- South Africa has a free-floating exchange rate traded in all global financial centres. The currency is one of the most liquid among upper-middle income countries, with currency equivalent to 24% of South Africa's annual GDP traded every day. The currency is backed by an extremely liquid and deep sovereign bond exchange (not affiliated to the JSE) to which foreign investors similarly have unfettered access.
- JSE member firms and central securities depository participants offer custodian services to foreign investors.

Product developments

The JSE launched the Social Responsibility Index (SRI) in May 2004 to focus on corporate social responsibility and sustainable business practices, and to enable socially responsible investment in South Africa. The SRI is founded on environmental, economic and social sustainability and measures the triple bottom line performance of companies listed in the FTSE/JSE All Share Index.

The SRI criteria are customised to the South African and African context, and could be an aspirational benchmark for all organisations, regarding best practice in the triple bottom line. The background and criteria document are available on the JSE website (*www.jse.co.za*).

Driven by the quest to demystify the market and the desire to broaden the national retail investor base, by encouraging a wider spread of knowledge of the financial market and the growth of investment culture in South Africa, the JSE introduced the University Investment Challenge at the beginning of 2005.

This concept is rooted in the JSE/Liberty Schools Challenge, a simulated trading experience designed to encourage secondary school learners to learn about the market by trading phantom portfolios.

New listings requirements became effective in September 2003. These stipulate that when listed entities wish to de-list, they must make an offer to minorities and obtain a fair and reasonable statement. Listed companies are required to comply with international financial reporting standards for all financial years, starting in 2005.

The Alternative Exchange, better known as ALTX, was launched in October 2003 as a parallel market or alternative exchange for small-to-medium and growing companies. The first listings on ALTX took place in the first quarter of 2004 with a total of 10 listings during the year. ALTX provides an attractive investment area for investors interested in the growth potential of smaller stocks. It is the sum of a partnership between the JSE and government through the Department of Trade and Industry. The ALTX is Africa's first alternative market and a growth exchange for young, innovative companies and investors.

The JSE continually strives to run a low-cost, highly efficient market that offers a wide range of financial products to an ever-broadening investor community. It has served South Africa well for over 100 years and is now moving into the future, determined to take its place among the world's top exchanges.

Bond Exchange of South Africa

BESA is an independent financial exchange operating under a licence granted annually by the country's securities-market regulator, the FSB. BESA is responsible for regulating the debt securities market in South Africa.

Primary debt markets

Although primarily a government-bond market, BESA also lists rand-denominated debt securities issued by local government, public enterprises and major corporates. At 31 December 2004, BESA had 378 fixed-income securities outstanding, issued by 65 borrowers, with a total nominal value of R572 billion. Just over 70% of this debt had been issued by central and municipal government, with a further 11% issued by parastatal and utility organisations. The remaining listed debt had been issued by companies in a wide range of sectors: banking, goldmining, chemical, food, household goods and textiles, telecommunications and transport. Securitisation issues include vehicle, credit card, loan receivables, equipment receivables and mortgage products.

Vanilla bonds constitute the majority of BESA's listed instruments, but there are variations, including:

- fixed interest-bearing bonds with single and multiple redemption dates
- zero-coupon bonds
- consumer price index-linked bonds
- credit-linked notes
- variable interest-rate bonds/floating rate notes
- strip bonds
- commercial paper.

BESA has appointed the Listings Advisory Technical Committee to provide ongoing advice on its listings disclosure requirements and rules. The aim is to ensure that these contribute to the strengthening of investor protection and market confidence.

Market performance

The South African bond market is one of the most liquid emerging bond markets in the world. Turnover in listed debt declined in 2004, with volumes decreasing from R10,7 trillion nominal in 2003 to R8,4 trillion nominal, which is a drop of 21%. The decrease in nominal turnover was also reflected in the lower number of matched trades for the year, which decreased from 356 000 in 2003 to 328 000 in 2004. Turnover in the spot market increased from 33,6% of total turnover in 2003 to 34,1% in 2004.

Although turnover figures for 2004 dropped significantly, the turnover velocity of listed debt instruments remained healthy at 14 times the market capitalisation for 2004.

While 94% of market turnover in 2004 was in government and utilities stock, there was an ever-increasing amount of listings and turnover in corporate issuances and securitisations which, together in 2004, accounted for 6% of total turnover.

Offshore turnover in listed debt that was settled locally amounted to R2 trillion, or 23,6% of total turnover, indicating that South Africa's local debt has significant attraction for international investors.

Main indices

BESA, in collaboration with the Actuarial Society of South Africa, has introduced a trio of bond indices that provide a simple yet accurate measure of total returns of representative bond portfolios and serve as benchmarks for evaluating performance.

These indices (introduced in August 2000) replaced the previous bond indices used in South Africa. They are published daily by the exchange on its website (*www.besa.za.com*) and are widely disseminated to all members, the asset-management community and the media.

Regulation

BESA is a licensed exchange and, together with its member firms, must adhere to the Securities Services Act, 2004 and a set of approved rules. As a self-regulatory organisation, BESA undertakes ongoing surveillance over all aspects of bond-market activity in South Africa.

Guarantee Fund

BESA maintains the Guarantee Fund to ensure, as far as possible, the performance of transactions entered on the exchange. The fund provides members and clients with price-risk cover against a member default, to a maximum aggregate of R150 million. Since inception, no settlement defaults or claims on the fund have been recorded.

STRATE Limited

The FSB registered STRATE Limited, the central securities depository for equities, in terms of the Custody and Administration of Securities Act, 1992 (Act 85 of 1992), on 20 September 1999. The depository is responsible for equities and fixed-income securities.

According to a report by GSCS Benchmarks Limited, which is represented by 10 global participating custodians, STRATE is rated sixth in the world in terms of settlement risk, and third in terms of custody risk. These benchmarks measure settlement, safekeeping and operational risk among central securities depositories in a range of major and emerging markets.

Acknowledgements

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Business Day
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South African Reserve Bank
South African Revenue Service
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