MONTHLY INVESTMENT REPORT

31 December 2008

CPSA PROVINCIAL PENSION FUND

- FINANCIAL OVERVIEW
- MARKET VALUES AND RETURNS
- LONGER TERM RETURNS
- FUND SPECIFIC ANALYSIS
- PORTFOLIO STRATEGY
- MANAGER PERFORMANCE

FUTURE STRATEGY

- The Fund is currently under weight equities, under weight bonds & property and alternatives, but overweight cash and internationals.
- The Fund remains conservatively positioned to take advantage of the current volatile market conditions.

Fund Manager: Leo Vermeulen

Fund Administrator: Nuraan Desai

Novare Actuaries & Consultants

Monthly Investment Report
31 December 2008

CPSA Provincial Pension Fund

FINANCIAL OVERVIEW

The market managed a positive return for the final month of the year, ending up 1.5%. For 2008 as a whole, the FTSE/JSE All Share Index ended deeply in the red, down 23.2%. The main contributors to this outcome were Resource and Financial stocks which were down 28.4% and 25.7% respectively for the year. Industrial counters proved to be most resilient, falling by 15.7% over the course of 2008. Interest rate sensitive asset classes fared significantly better, outperforming equities by a substantial margin. For the full year, property and cash returned -4.5% and 11.7% respectively while bonds were the top performers, yielding a staggering 17% despite the Rand weakening by 39.8%.

Equity market returns have taken their direction from deep recessionary fears that have gripped the global economy. Domestically, real gross domestic product stalled in the third quarter while prospects for the fourth quarter appear bleak. The Investec/BER Purchasing Managers' Index which reflects the health of the manufacturing sector declined to its lowest level since its inception to 39,5. The Reserve bank's leading economic indicators as well as a range of business confidence Indices all point to a negative economic outlook.

The more interest rate sensitive asset classes have benefited from the more dovish Monetary Policy Committee (MPC) that decided to reduce the repurchase rate by 50 basis points to 11,5%. The statement reflected that the inflation outlook had improved. Specifically that inflation is expected to continue its downward trajectory, and to return to within the inflation target range in the third quarter of 2009. The Reserve bank expects inflation to average 6,2% and 5,6% in 2009 and 2010 respectively. The benign view is largely shaped by the likely impact of the rebasing and reweighting of the CPI basket to be introduced by Statistics South Africa in January 2009 as well as plummeting oil and food prices. The MPC highlighted that the exchange rate remained the most significant upside risk to the inflation outlook.

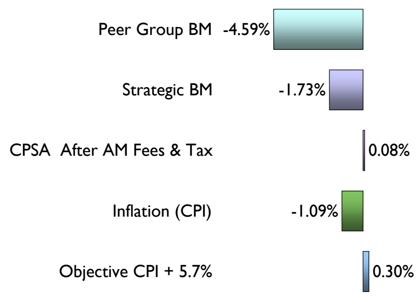
Global Equity (US$)	Level	1 Month	3 Months	6 Months	YTD	12 Months
S&P 500	903.3	0.8%	-22.6%	-29.4%	-38.5%	-38.5%
Nasdaq	1,577.0	2.7%	-24.3%	-31.2%	-40.5%	-40.5%
MSCI Global Equity	920.2	3.1%	-22.2%	-34.4%	-42.1%	-42.1%
MSCI Emerging Mkt	567.0	7.6%	-27.9%	-47.8%	-54.5%	-54.5%
Global Bond (US$)						
Global Bonds	446.5	7.1%	9.7%	6.9%	12.0%	12.0%
Commodity Prices						
Brent Oil (USD/Barrel)	37.7	-25.5%	-61.8%	-73.4%	-60.6%	-60.6%
Platinum (USD/oz)	927.0	5.2%	-8.6%	-55.2%	-39.3%	-39.3%
Gold (USD/oz)	879.9	7.5%	0.9%	-4.9%	5.5%	5.5%
South African Mkt (Rand)						
Africa All Share	2,354.3	1.5%	-9.2%	-27.8%	-23.2%	-23.2%
Africa Top 40	2,144.2	0.6%	-10.0%	-30.9%	-23.6%	-23.6%
Africa Resource 20	1,867.9	-0.2%	-12.9%	-46.3%	-28.4%	-28.4%
Africa Financial 15	2,263.8	-2.3%	-11.6%	-1.1%	-25.7%	-25.7%
Africa Industrial 25	2,611.5	3.9%	-4.4%	-10.0%	-15.7%	-15.7%
Africa Mid Cap	4,159.2	8.3%	-2.5%	1.1%	-18.7%	-18.7%
Africa Small Cap	5,537.1	1.8%	-9.6%	-11.0%	-31.2%	-31.2%
All Bond Index	302.0	6.9%	11.3%	25.3%	17.0%	17.0%
Stefi Composite	214.8	1.0%	2.9%	6.0%	11.7%	11.7%
Africa SA Listed Property - (SAPY)	588.3	4.9%	8.5%	33.5%	-4.5%	-4.5%
MSCI Global Equity (R)		-2.3%	-10.0%	-20.1%	-19.0%	-19.0%
Global Bonds (R)		1.5%	26.8%	30.1%	56.6%	56.6%
Rand Dollar Exchange Rate	9.53	-5.2%	15.6%	21.7%	39.8%	39.8%

Monthly Investment Report
31 December 2008

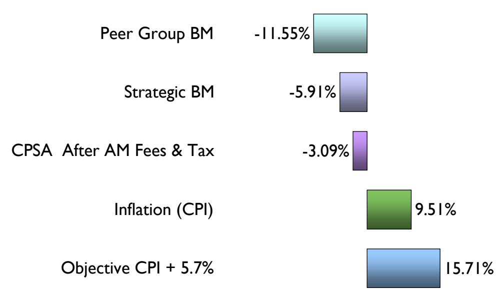
CPSA Provincial Pension Fund

MARKET VALUES AND RETURNS

Quarterly return up to December 2008



Return since 1 January 2008 up to 31 December 2008



The table below (and on the following page) is the return matrix for the CPSA. It shows the various manager returns as well as that of the total portfolio for various periods and compares it with their respective benchmarks. The benchmark used for the portfolio is in line with its investment objective, which is CPI + 5.7% p.a.

	Fraters	RMB	Allan Gray	FG IBF	Liberty Cash
Market Value	48,049,725	58,123,644	326,515,226	30,993,580	20,263,303
% of Fund	7.6%	9.2%	51.6%	4.9%	3.2%
Benchmark	JSE ALSI	JSE ALSI	AFGLMW	All Bond Index	n/a
Monthly Return	7.59%	2.63%	2.99%	6.77%	-5.26%
Benchmark	1.52%	1.52%	2.19%	6.93%	n/a
Out/ Under Perf	6.07%	1.11%	0.80%	-0.16%	n/a
Last 3 Months	-2.60%	-9.82%	1.46%	10.93%	-15.50%
Benchmark	-9.17%	-9.17%	-4.59%	11.35%	n/a
Out/ Under Perf	6.57%	-0.65%	6.05%	-0.42%	n/a
Calendar YtD	-11.92%	-19.99%	0.31%	18.30%	-8.47%
Benchmark	-23.23%	-23.23%	-11.55%	16.97%	n/a
Out/ Under Perf	11.31%	3.24%	11.86%	1.33%	n/a
Last 12 Months	-11.92%	-19.99%	0.31%	18.30%	-8.47%
Benchmark	-23.23%	-23.23%	-11.55%	16.97%	n/a
Out/ Under Perf	11.31%	3.24%	11.86%	1.33%	n/a
Since July 2005	89.69%	65.55%	94.71%	45.13%	12.87%
Benchmark	67.47%	67.47%	61.42%	36.54%	n/a
Out/ Under Perf	22.22%	-1.92%	33.29%	8.59%	n/a
	Jul-05	Jul-05	Jul-01	Dec-03	Feb-02
Ann Since Inception	20.07%	15.49%	21.38%	11.76%	5.88%
Benchmark	15.87%	15.87%	15.20%	10.27%	n/a
Out/ Under Perf	4.20%	-0.38%	6.18%	1.50%	n/a

CPSA Provincial Pension Fund

MARKET VALUES AND RETURNS (CONTINUED)

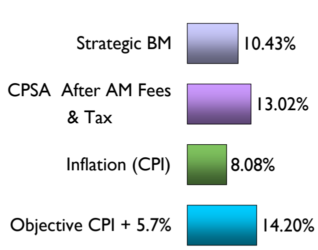
	Sortino	FG CPF	Stanlib IF	NOAF	Mayibentsha	Total
Market Value	20,133,651	8,176,210	17,449,173	49,198,518	53,608,074	632,511,105
% of Fund	3.2%	1.3%	2.8%	7.8%	8.5%	100.0%
Benchmark	JSE Listed Property	JSE Listed Property	All Bond Index	60% MSCI/40% JPMGGB	CPI + 4.5%	CPI + 5.7%
Monthly Return	4.29%	0.86%	2.80%	0.02%	0.36%	2.68%
Benchmark	4.88%	4.88%	6.93%	-0.81%	-0.78%	-0.69%
Out/ Under Perf	-0.59%	-4.02%	-4.13%	0.83%	1.14%	3.37%
Last 3 Months	6.76%	2.74%	5.63%	7.54%	-2.33%	0.08%
Benchmark	8.46%	8.46%	11.35%	3.87%	0.01%	0.30%
Out/ Under Perf	-1.70%	-5.72%	-5.71%	3.67%	-2.34%	-0.22%
Calendar YtD	-4.57%	8.69%	14.11%	6.37%	-6.42%	-3.09%
Benchmark	-4.47%	-4.47%	16.97%	6.71%	14.40%	15.71%
Out/ Under Perf	-0.11%	13.16%	-2.86%	-0.34%	-20.83%	-18.79%
Last 12 Months	-4.57%	8.69%	14.11%	6.37%	-6.42%	-3.09%
Benchmark	-4.47%	-4.47%	16.97%	6.71%	14.40%	15.71%
Out/ Under Perf	-0.11%	13.16%	-2.86%	-0.34%	-20.83%	-18.79%
Since July 2005	n/a	n/a	n/a	45.85%	42.66%	76.80%
Benchmark	n/a	n/a	n/a	40.07%	49.58%	55.64%
Out/ Under Perf	n/a	n/a	n/a	5.78%	-6.92%	21.16%
	Jul-07	May-07	Oct-06	Mar-04	May-03	Jul-02
Ann Since Inception	0.65%	19.75%	10.89%	8.39%	14.89%	17.42%
Benchmark	2.72%	-41.87%	11.85%	8.71%	9.85%	11.60%
Out/ Under Perf	-2.06%	61.61%	-0.96%	-0.32%	5.04%	5.83%

LONGER TERM RETURNS

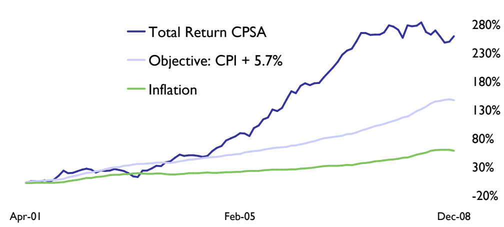
The Fund's Investment Objective is set over 3 year rolling periods. Longer term returns should be used to assess the Fund's performance when compared to its set Investment Objectives as short term market volatility may distort short term performance measurement.

The cumulative graph above shows the Fund performance since 1 Jan 2001. It is benchmarked against it's Investment Objective i.e. CPI + 5.7% as well as inflation.

Last 36 Months Annualised Return



Cumulative Returns since 1 Jan 2001



Monthly Investment Report
31 December 2008

CPSA Provincial Pension Fund

FUND SPECIFIC ANALYSIS

The **Return Table** below shows the monthly returns added to the portfolio. It is compared to the Fund's Investment Objective (i.e. to outperform CPI plus 5.7% per annum) and its strategic Benchmark.

Period	CPSA Net of Fees & Tax	Objective: CPI + 5.7%	Strategic Benchmark	Market Value History
Last 12 Months	-3.09%	15.71%	-5.91%	
Jan-08	-3.81%	1.60%	-1.80%	639,182,042
Feb-08	6.09%	0.79%	6.82%	676,975,352
Mar-08	-0.41%	2.05%	-0.89%	676,710,448
Apr-08	0.39%	2.22%	1.44%	676,807,905
May-08	1.37%	1.61%	1.81%	683,814,016
Jun-08	-4.34%	1.73%	-2.41%	654,456,488
Jul-08	-1.16%	2.58%	-3.62%	645,737,997
Aug-08	1.93%	1.20%	1.08%	653,593,711
Sep-08	-2.87%	0.64%	-6.19%	635,400,233
Oct-08	-2.97%	0.46%	-4.89%	616,112,428
Nov-08	0.45%	0.52%	1.63%	617,320,945
Dec-08	2.68%	-0.69%	1.66%	632,511,104

The **Cash Flow Table** below, gives an indication of the Rand value that has been added to the CPSA portfolio. The added value is divided between cash in/out flows and the return achieved on the Fund's investments over various periods.

	Since Jun 03	Since Jan 04	From 1 Jan 06	From 1 Jan 07	From 1 Jan 08
MV at Start	265,026,619	301,386,988	475,182,236	602,209,484	665,842,189
Cash In/Out Flow	(82,675,066)	(73,306,714)	(49,202,416)	(28,929,505)	(12,960,816)
Return	450,159,550	404,430,830	206,531,283	59,231,125	(20,370,269)
Current MV	632,511,104	632,511,104	632,511,104	632,511,104	632,511,104

Attribution Analysis measures the value added through stock and asset class selection, where the Fund's actual returns are compared to its benchmark return. The Asset Allocation out/under performance is the extra return achieved by the Fund by using tactical deviation from its long term strategic asset allocation. The Stock Selection out/under performance is the extra return achieved by the various Asset Managers of the Fund, by selecting equities/holdings which are different from the underlying benchmark indices.

	Last 12 Months	Last 3 Months	Last Month
CPSA Provincial PF Return	-3.09%	0.08%	2.68%
Total Out/(Under) Performance of Benchmark	2.82%	1.81%	1.03%
Out/(Under) Performance due to Asset Allocation	0.48%	-0.35%	-0.52%
Out/(Under) Performance due to Stock Selection	2.34%	2.16%	1.55%
Residual Term	0.00%	0.00%	0.00%

The Fund's **Value at Risk** i.e. expected maximum loss over 20 working days at a 95% probability can be seen in the table. Compared to the sum of the individual Managers Value at Risk , it shows the diversification benefit achieved by combining various investment mandates.

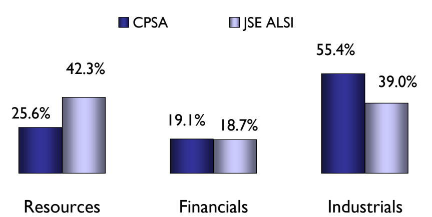
Portfolio Expected Return	-0.45%
Portfolio Standard Deviation	2.69%
Individual Portfolio VaR	6.79%
Portfolio VaR	4.43%
Total Amount VaR	27,991,306

CPSA Provincial Pension Fund

FUND SPECIFIC ANALYSIS (CONTINUED)

Most recent strategic changes

Date	Transferred From:	Transferred To:	Amount
24-Aug-07	Investec Bank	NOAF	6,000,000
03-Sep-07	Investec Bank	Liberty Cash	2,798,103
16-Oct-07	Stanlib IF	NOAF	1,393,000
20-Dec-07	Allan Gray	Liberty Cash	5,000,000
28-Jan-08	Liberty Cash	NOAF	4,680,000
08-Feb-08	Allan Gray	Liberty Cash	2,000,000
14-Apr-08	Investec Treasury	Liberty Cash	37,235
12-May-08	Fraters	Liberty Cash	10,000,000
13-May-08	RMB Equity	Liberty Cash	10,000,000
01-Dec-08	Mayibentsha	Liberty Cash	5,000,000

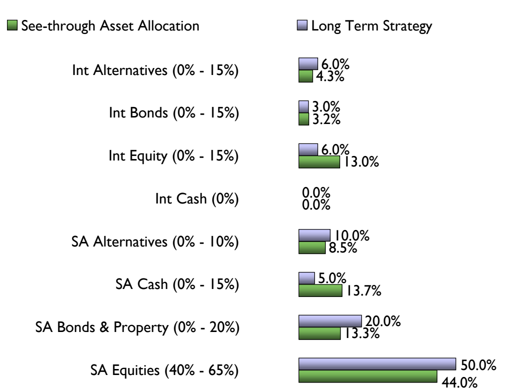


The fund is currently underweight Resources, slightly over weight Financials and overweight Industrials. For the month of December, Industrials was the best performing sector (3.9%), followed by Resources (-0.2%), and Financials (-2.3%).

CPSA Top 15 Shares	% of CPSA Equities	% JSE ALSI
SAB	7.77%	6.31%
MTN GROUP	7.59%	6.97%
ANGLOGOLD ASHANTI	7.31%	3.06%
SASOL	5.00%	6.13%
HARMONY	4.01%	1.40%
STANBANK	3.82%	4.35%
SAPPI	3.81%	0.69%
REMGRO	3.80%	1.16%
COMPAGNIE RICHEMON	3.57%	3.22%
SANLAM	3.34%	1.28%
BHPBILL	2.28%	13.63%
NAMPAK	2.18%	0.30%
ABSA	2.09%	1.27%
AFRICAN RAINBOW	2.02%	0.32%
SHOPRITE	1.83%	0.99%

PORTFOLIO STRATEGY

Strategic vs. Actual Asset Allocation



The CPSA Pension Fund is currently:
- under weight equities
- under weight bonds & property
- over weight cash
- slightly underweight alternatives, and
- over weight international

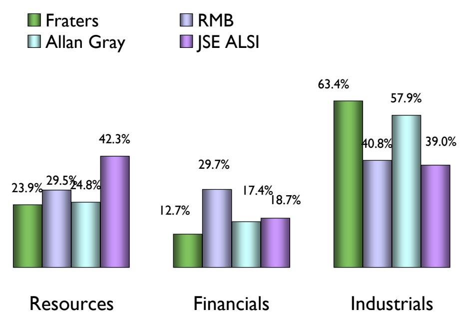
The Fund is fairly conservatively positioned to take advantage of current volatile market conditions.

Monthly Investment Report
31 December 2008

CPSA Provincial Pension Fund

MANAGER PERFORMANCE

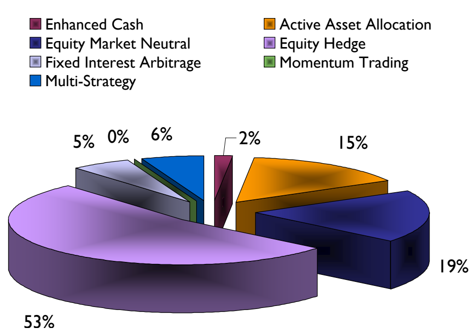
Equity Manager	Fraters	RMB
Inception Date	Jul-05	Jul-05
Classification	Concentrated	Concentrated
Benchmark	JSE ALSI	JSE ALSI
Return since Inception	89.69%	65.55%
Benchmark	67.47%	67.47%
Annualised Return	20.07%	15.49%
Benchmark	15.87%	15.87%
Information ratio	0.11	(0.03)
Sharp Ratio	0.20	0.12



All the Equity Managers were underweight Resources at the end of December 2008. Fraters and Allan Gray were significantly overweight Industrials at the end of December 2008 while RMB had a slight overweight exposure to this sector. Sector allocation and stock selection still remains critical in the current economic environment.

Manager	Mayibentsha	FG CPF	FG IBF	Sortino
Inception Date	May-03	May-07	Dec-03	Jul-07
Return since inception	119.6%	35.0%	76.0%	0.7%
Ann Return since inception	14.9%	19.7%	11.8%	0.7%
Avg Monthly return	1.18%	1.54%	0.95%	0.24%
% + months	76.5%	95.0%	73.8%	50.0%
% - months	23.5%	5.0%	26.2%	50.0%
Max Drawdown	-6.0%	-0.1%	-5.1%	21.7%
Std Deviation	6.1%	n/a	6.6%	7.2%

Mayibentsha Strategic Asset Allocation



Mayibentsha Fund of Funds ended positive for the month. Underlying strategies adding to the positive return includes: Market Neutral and Asset Allocation, both posting positive return in a difficult month. Multi-strategy and Equity Long/Short ended flat, while Fixed Interest Arbitrage detracted slightly from the overall positive performance. Underlying managers maintained low levels of Net Exposure and Leverage during December and into the New Year, helping Mayibentsha to preserve capital and brighten the outlook for a promising start to 2009.

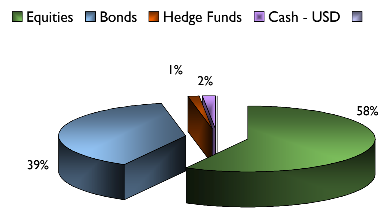
Monthly Investment Report
31 December 2008

CPSA Provincial Pension Fund

INTERNATIONAL MANAGER PERFORMANCE

Fund Name	**: Novare Offshore Advised Fund**
Manager	: Standard Bank Fund Administration Jersey Limited
Advisor	: Novare Investments (Pty) Limited
Custodian	: Standard Bank Jersey Limited
Auditors	: PricewaterhouseCoopers CI LLP
Trustee	: Capita Trust Company (Jersey) Limited
Domiciled	: Jersey, Channel Islands
Inception Date	: March 2004
Benchmark	: 60% MSCI Global Equity Index
	: 40% JP Morgan World Government Bond Index

NOAF Asset Allocation



	1 Month	3 Months	Year to Date	Since Mar 04
NOAF	0.02%	7.54%	6.37%	47.61%
Benchmark	-0.81%	3.87%	6.71%	49.75%
Out/Under perf	0.83%	3.67%	-0.34%	-2.14%
MSCI GEI	-2.33%	-10.04%	-19.01%	23.25%
JPM WGBI	1.47%	26.84%	56.62%	92.59%
Rand / $ *	-5.22%	15.60%	39.84%	43.13%

* Negative change indicates Rand strength

Underlying Managers of NOAF	Fund Allocation	3 Months	Year to Date	Last 12 Months	Since May 04
Global Equity	**58.04%**				
Morgan Stanley Global Brands (SICAV)	19.68%	1.1%	-1.0%	-1.0%	61.7%
Investec Global Strategic Equity	17.29%	-11.9%	-28.4%	-28.4%	n/a
Fortune Global Equities	4.30%	-2.1%	-23.0%	-23.0%	n/a
Templeton Global	16.78%	-11.2%	-23.3%	-23.3%	n/a
Fortune Explorer	0.00%	-9.8%	-31.9%	-31.9%	n/a
Global Bonds & Property	**39.04%**				
Franklin Templeton Global Bond	28.92%	22.0%	51.0%	51.0%	n/a
Franklin Templeton Global Total Return	10.12%	18.3%	36.7%	36.7%	n/a
Global Alternative	**1.16%**				
Quellos ILF Ltd	1.16%	-3.3%	4.7%	4.7%	n/a
Global Cash	**1.76%**				
Fidelity Institutional Cash - USD	1.09%	16.1%	43.8%	43.8%	69.7%
Cash	0.67%	n/a	n/a	n/a	n/a

NOVARE HOUSEVIEW MATRIX – NOVEMBER/DECEMBER 2008

RSA Equities

In line with developments around the globe, domestic growth is under significant pressure. This can be seen from a number of surveys and data releases that continue to reflect that business and consumers are struggling. Vehicle sales, retail sales, Purchasing Managers survey, business and consumer confidence surveys have all plunged. The Treasury has estimated GDP growth for 2009 at 3% but we believe that this view may be too optimistic which does not bode well for domestic equity performance.

Furthermore, we believe that company earnings have much further to fall in the local market and that this will further undermine domestic equity performance.

The recent bull run was largely driven by foreign portfolio inflows. As foreigners have had to deal with problems in their own markets they have continued to withdraw their funds. In October they withdrew in excess of R20bn. Losing this key support for our market keeps us under weight this asset class.

RSA Bonds

Interest rates in South Africa remain oppressively high despite rates falling dramatically in the global economy. Our growth picture has turned for the worst but the inflation outlook continues to improve. Oil prices have plunged and petrol prices will follow suit bringing about much needed relief.

Forward Rates are pricing in interest rate cuts as early as December 2008 but with the Rand trading at levels beyond R10/$, there are definite risks to this view. The Monetary Policy Committee will have to balance the risks of the Rand depreciating on the back of lower interest rates as the carry trade benefit is reduced as opposed to the risks of the domestic economy stalling. At this stage, we hold the latter view; that concerns of domestic overkill may well prevail and we may see some policy reprieve.

As such we believe that this is the opportune time to close our under weight position in this asset class. Furthermore, corporate spreads have widened giving rise to attractive pickings.

RSA Property, Alternatives & Cash

Property yields are now at attractive levels and with our benign view of inflation and interest rates, we continue to find this asset class compelling. The main detractor comes from our expectation that Property Income will come under pressure in line with falling GDP growth. This leads us to maintain our on weight position in this asset class as some headwinds remain.

We continue to advocate a neutral exposure to alternative assets as they play a key role in reducing risk via the diversification opportunities that they provide for portfolios.

Although cash has been very good to us in recent market conditions, it is now beginning to lose some of its appeal. While we remain over weight this asset class, we have pared the exposure down somewhat, favouring the other asset classes.

International

International equities have suffered immensely over the very recent three months and the bottom remains elusive. Worse yet prospects of global economic recession imply that there is unlikely to be a bounce back in financial markets. Rather, a long and hard road lies ahead were international equity returns are likely to be soggy and desperately uninspiring. As such we maintain our under weight position.

In the United States, advance third quarter GDP growth numbers reflected a modest 0.3% contraction but we believe that in the fourth quarter, the growth picture will worsen considerably. Numerous surveys and data releases bear testimony to this. The October US ISM manufacturing survey plummeted as the stronger dollar and slowing global activity undermined export performance. The unemployment rate jumped to 6.5% in October while US Retail sales plunged; both of these are at worse levels than those recorded during the 2001 recession. The October Consumer Confidence surveyed confirmed that indeed, the outlook is bleak. We look to further fiscal and monetary stimulus to help to kick start this economy.

The outlook in other developed countries is also gloomy. In the United Kingdom, the Bank of England recently slashed interest rates by 1.5% and the governor, Mervyn King, issued a sombre assessment of the economy. Specifically that the inflation scare is behind us but they forecast 2009 GDP growth for the UK at -1.3% The UK economy faces major headwinds as house prices are expected to fall further and a large proportion of national income has been derived from the now defunct financial services industry. The Euro zone as well as Japan are now in technical recession as GDP growth contracted in the second and third quarters of 2008. Export-led saver countries like Germany and Japan are likely to come out of this malaise before the US and UK due to stronger fiscal balances that can be used to stimulate domestic demand.

In essence, the global interest rate cutting cycle is to continue well into 2009 and our view remains positive on the outlook for International Bonds, while we continue to sideline the riskier equity asset class.

NOVARE HOUSE VIEW: NOV/DEC 2008

	Balanced Fund	Relative	Present Month	Previous Month
RSA	**85%**	**ON**	**85%**	**84%**
RSA Equities	50%	UNDER	42%	42%
RSA Bonds	15%	ON	15%	13%
RSA Property	5%	ON	5%	5%
RSA Alternatives	10%	ON	10%	10%
RSA Cash	5%	OVER	13%	14%
International	**15%**	**ON**	**15%**	**16%**
Int Equity	9%	UNDER	7%	7%
Int Bonds	3%	OVER	6%	6%
Int Alternatives	3%	UNDER	0%	0%
Int Cash	0%	OVER	2%	3%

BANK OF ENGLAND INFLATION REPORT PRESS CONFERENCE: Wednesday 12 November 2008

Opening Remarks by the Governor, Mervyn King

Since the August *Report,* the economic landscape has changed. As a result, the downward revision to the inflation outlook in today's *Report* is the largest in any one quarter since the Monetary Policy Committee was set up. It is very likely that the UK economy entered a recession in the second half of this year. The preliminary estimate of the fall in output in the third quarter was 0.5%, a little more than the fall in the Committee's central projection in August. But since then three factors have transformed the outlook.

First, the short-run indicators for activity declined markedly. Surveys and reports from the Bank's Agents suggest that in September and October there was a sharp fall off in demand, both at home and abroad. Growth in the fourth quarter is likely to be materially weaker than the Committee expected in August. And, as we saw this morning, unemployment in the UK has risen at the fastest rate for seventeen years.

Second, following the failure of Lehman Brothers, the most serious banking crisis since the outbreak of the First World War reduced the supply of credit to the real economy, and, in some cases, led to a cessation of lending altogether. Confidence has been badly affected. All this will restrain demand looking into next year.

Third, although CPI inflation did rise above 5% in September, its expected future path has fallen very significantly. Oil and other commodity prices have more than halved since their peak. In August, the projections were conditioned on a starting level for the oil price of around $124 a barrel, whereas today's *Report* assumes a level of $64 a barrel. In the space of a few months, we have gone from the highest rate of manufacturing input price inflation in nearly thirty years to the lowest monthly rate on record. And measures of short-run inflation expectations have fallen back sharply.

In response to those three factors, there have been significant policy actions. On 8th October, the UK authorities announced a plan to recapitalise the banks in order to repair banks' balance sheets and thereby restore confidence in the UK financial system. Other countries have taken similar measures. Central banks around the world cut interest rates in a coordinated move in early October. And the MPC cut the Bank Rate again last week. The Committee's latest projection for GDP growth is shown in Chart 1 (below). The central projection is for output to decline over the next year, so that four-quarter growth falls further in the near term. That is markedly lower than the projection in August, reflecting the impact of the banking crisis on credit supply and the sharp falls in confidence in the real economy. Further ahead, domestic demand should gradually start to recover as the impact of lower interest rates, the effects of the bank recapitalisation programme on credit availability, and some recovery in real take-home pay take hold. And that, together with a pickup in exports following the fall in sterling's effective exchange rate, should support a recovery in output growth to slightly above its long-run average. But in the central projection, inflation reaches the 2% target in the second half of 2009 and then moves materially below the target. The weakness in inflation further out in the forecast period reflects weak demand which, despite a material slowing in the growth rate of potential supply, opens up a margin of spare capacity and pulls down on price and wage increases.

For some time, the Monetary Policy Committee has faced a balancing act between the upside risk to inflation from continuing high inflation in the near term, and the downside risk that a sharper or more prolonged slowdown could pull inflation well below the target in the medium term. Over the past two months, the three factors I described earlier have turned the prospects for inflation decisively to the downside. As a result, the Committee judged at its meeting last week that, to return inflation to the target, it was necessary to cut Bank Rate by 1 ½ percentage points to 3%. The outlook for inflation has changed substantially. But the Committee's approach to setting monetary policy has not. It continues to set interest rates in a deliberate, forwardlooking manner in order to ensure that inflation is on track to hit the inflation target in the medium term. That approach has served the UK economy well over the past eleven years. And I am confident that it will continue to do so in these exceptional and difficult times.

Chart 1 GDP projection based on market interest rate expectations

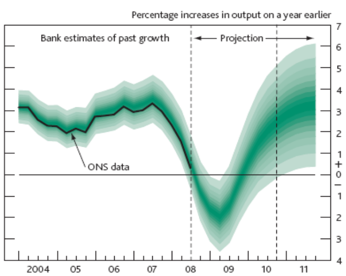
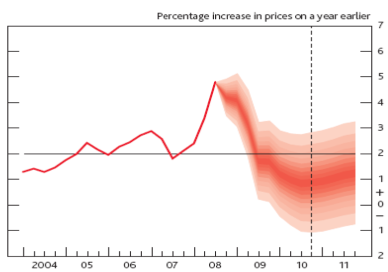


Chart 2 CPI inflation projection based on market interest rate expectations



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