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After the Budget of 2015 - Some reflections and opinions

Brian Kantor for GSBA Cape Town, March 11th 2015

The economic outlook- slow growth forever? Budgets for a low growth environment

Table 1.2 Macroeconomic outlook – summary

	2014	2015	2016	2017
Real percentage growth	**Estimate**		**Forecast**	
Household consumption	1.2	2.0	2.6	3.0
Gross fixed-capital formation	-0.6	2.2	3.4	3.8
Exports	0.9	3.3	4.6	5.0
Imports	-0.3	4.6	5.3	5.5
Real GDP growth	**1.4**	**2.0**	**2.4**	**3.0**
Consumer price inflation (CPI)	6.1	4.3	5.9	5.7
Current account balance (% of GDP)	-5.8	-4.5	-4.9	-5.2

Across all tables in the Budget Review, the use of "0" refers to a value of small magnitude that is rounded up or down to zero. If a value is exactly zero, it will be denoted by "–". If data is not available it is denoted by "N/A"
Source: National Treasury

The electricity constraint- is this underestimating private sector responses? -Though with high import content

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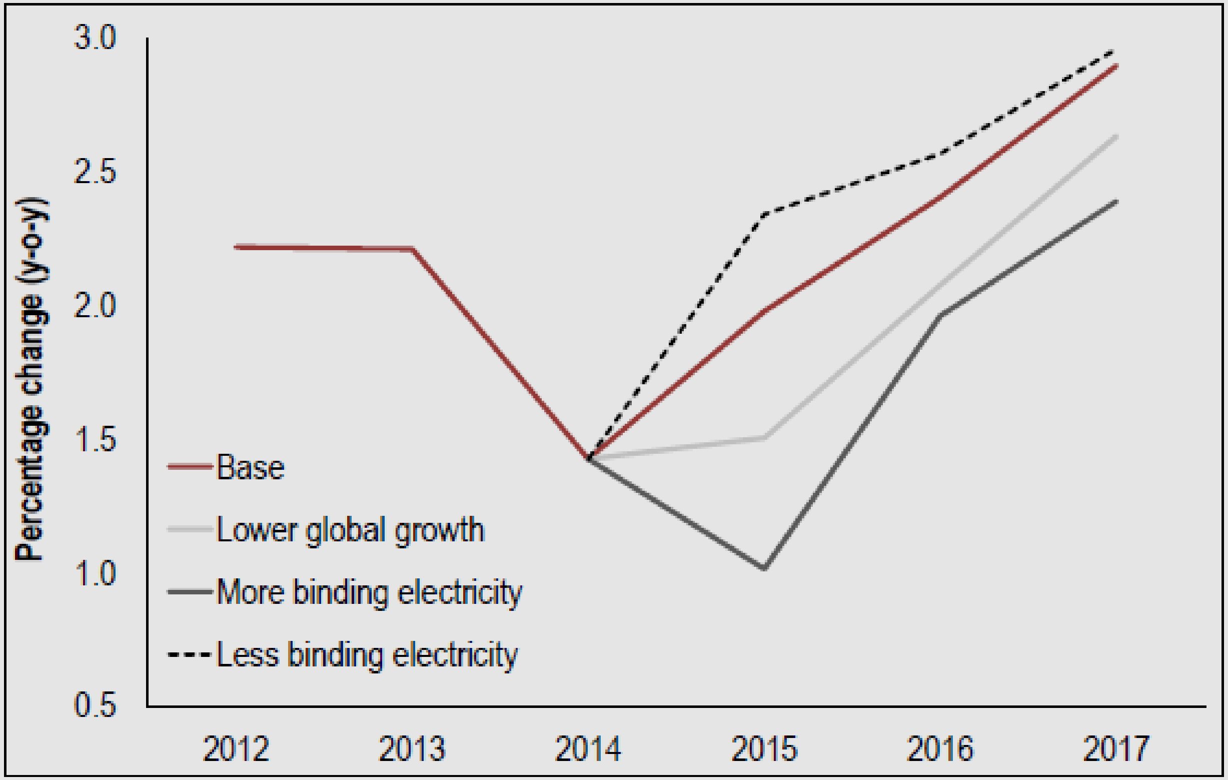
GDP growth scenarios to 2017



Source: National Treasury

The big fiscal picture

No more crowding out than before- welcome fiscal conservatism

Table 1.3 Consolidated government fiscal framework

R billion/percentage of GDP	2014/15 Revised estimate	2015/16 Medium-term estimates	2016/17	2017/18
Revenue	1 091.0	1 188.9	1 331.5	1 439.5
	28.1%	*28.4%*	*29.3%*	*29.2%*
Expenditure	1 243.4	1 351.0	1 448.8	1 561.7
	32.0%	*32.2%*	*31.9%*	*31.7%*
Budget balance	-152.4	-162.2	-117.3	-122.2
	-3.9%	*-3.9%*	*-2.6%*	*-2.5%*

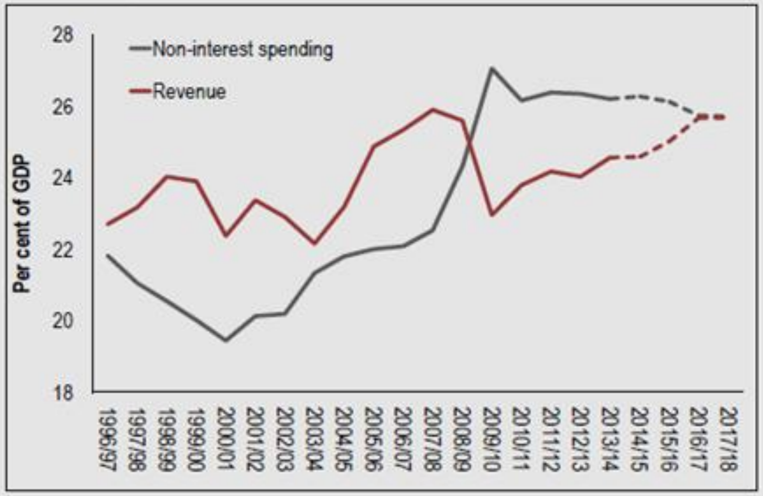
Source: National Treasury

Fiscal trends and constraints

The failure was the strong growth in expenditure in the boom years- on employment benefits

Revenue and non-interest spending

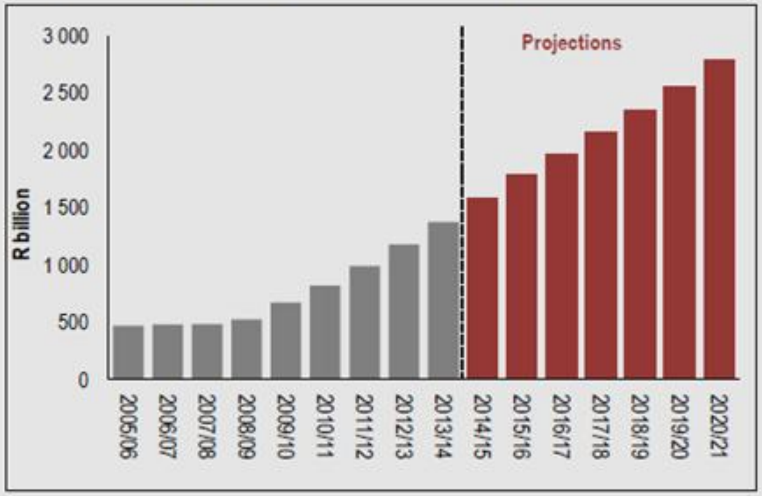
Main budget, 1996/97 – 2017/18



Source: National Treasury

Government debt

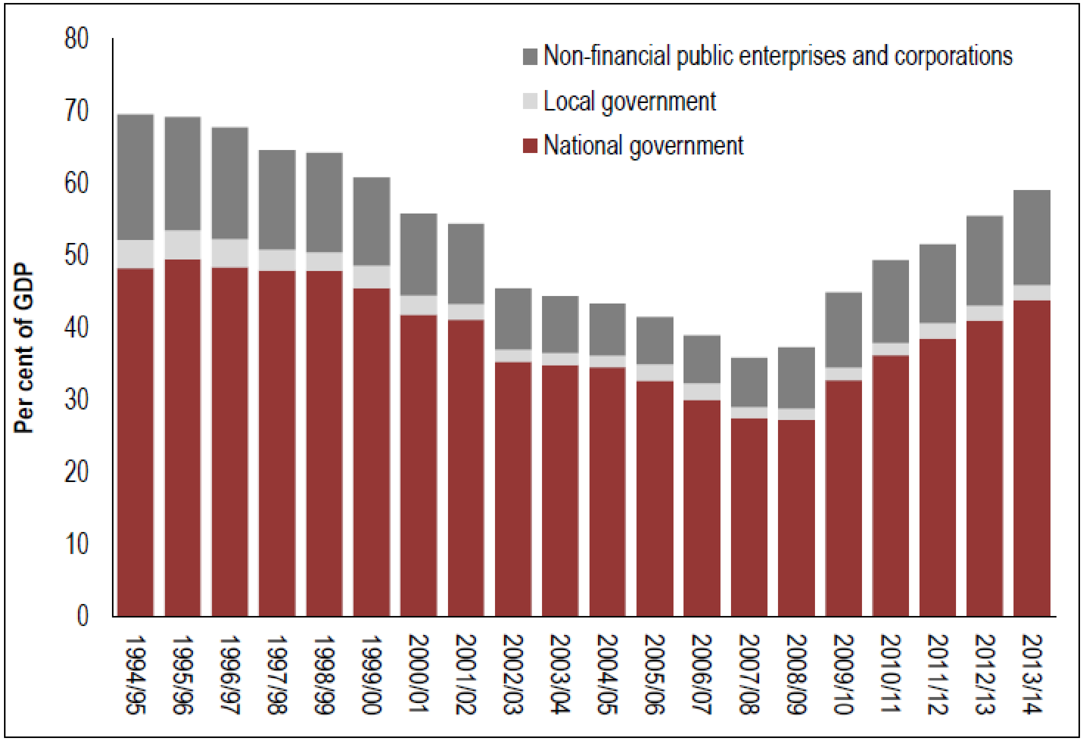
Net of cash balances, 2005/06 – 2020/21



Source: National Treasury

Adding in the public enterprise debt

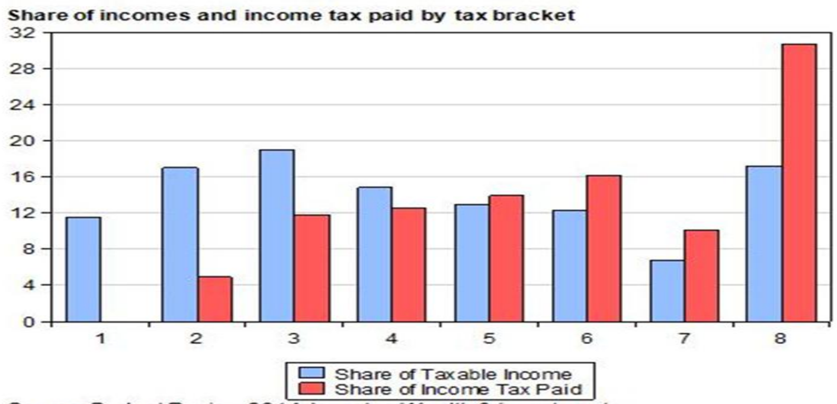
Figure 3.4 Public-sector debt as percentage of GDP, 1994/95 – 2012/13



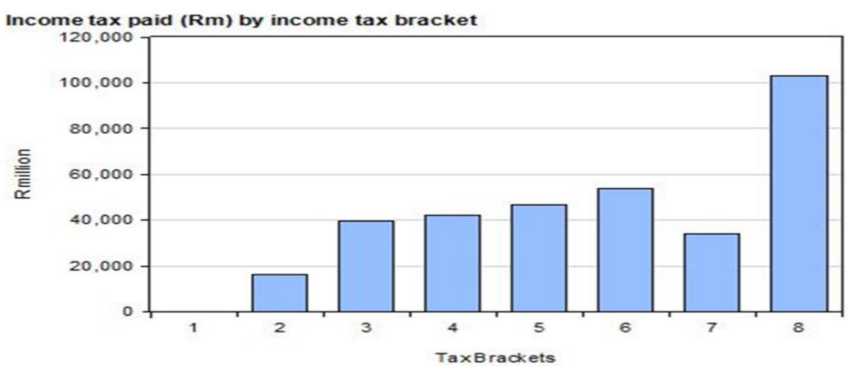
Source: Reserve Bank

The limits to income tax

The fiscal income tax pips have been squeezed. To raise more income tax the burden has to be spread



Source: Budget Review 2014, Investec Wealth & Investment



Source: Budget Review 2014, Investec Wealth & Investment

Growth in expenditure and revenue 2015-6/2014/15

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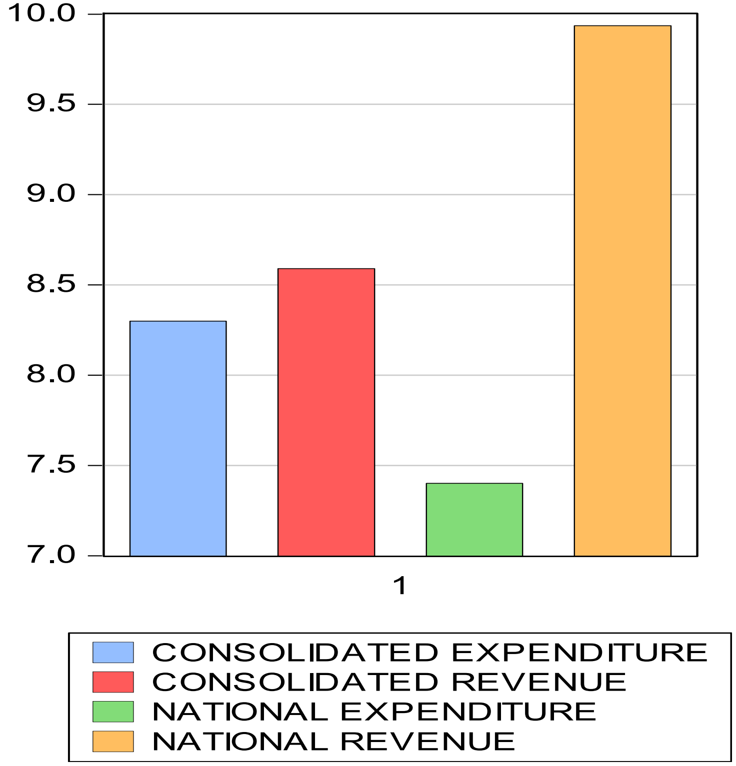
A degree of austerity- revenue rising faster than expenditure



Budget 2015-2016; Key Growth rates

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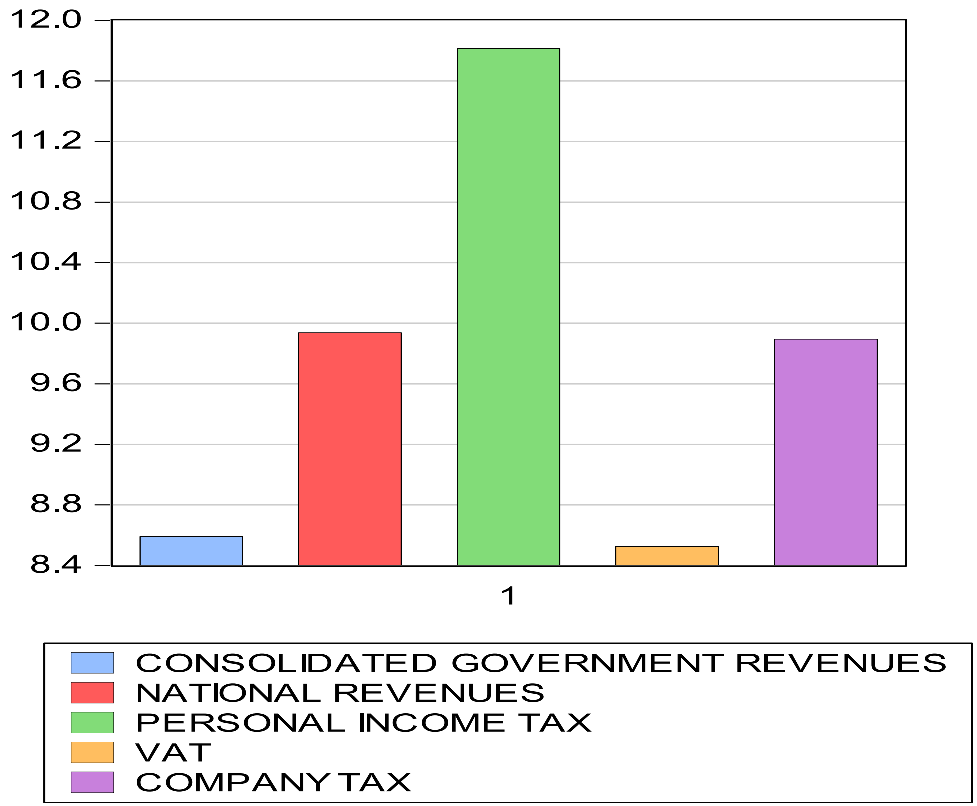
Despite slow growth in GDP- revenues have been growing across the board



Strategic Priorities

The response to government failure is more (hopefully) better government. Words are easier than deeds

•Resolving the energy challenge,

•Revitalising agriculture,

•Adding value to our mineral wealth,

•Enhancement of the Industrial Policy Action Plan,

•Encouragement of private investment,

•Reducing workplace conflict,

•Unlocking the potential of small enterprises, •Infrastructure investment, and •Support for implementation of the National Development Plan through in depth, results-driven processes, known as *phakisa* laboratories.

Phakisa laboratories a new buzz word to inspire government interventions

Phakisa is a Tswana word for hurry (up) – so I am informed. May my cynicism about "*many programmes and interventions*" prove unfair

The first of these laboratories focused on the oceans economy, including off-shore oil and gas exploration and aquaculture opportunities. Already this has led to investment of R9.6 billion in Saldanha Bay.

Strategies for improving primary health clinics have also been developed through a *phakisa* process. The mining sector will be next. These processes draw widely on the talents and expertise of South Africans, from the public and private sectors, and the scientific and research community.

In each of these areas, there are many programmes and interventions underway,

Operation Phakisa

The government can hire labour on terms denied the private sector

One element of Operation Phakisa, government's programme to speed up project implementation, is aimed at unlocking the economic potential of South Africa's oceans. This effort is allocated R296 million to fund scientific expeditions by the SA Agulhas II and the Algoa, and to conduct essential research on climate change and deep ocean environments.

Medium-term allocations of R35.9 billion support government's active labour-market interventions. At 21 per cent a year, the Community Work Programme grows fastest, allowing it to expand its presence to every municipality by 2017. The Jobs Fund is expected to spend about R4 billion over the next three years on projects that create permanent jobs and address structural constraints to growth and employment.

Some government interventions in the labour market

The Jobs Fund will spend R4 billion in partnership with the private sector on projects that create new employment, support work-seekers and address structural constraints to more inclusive growth.

The community work programme will be extended to all municipalities. Its allocations increase by 21 per cent a year.

The Department of Environmental Affairs has an allocation of R11.8 billion to fund more than 107 000 full time equivalent jobs and 224 000 work opportunities through environmental EPWP programmes.

A total of R590 million has been allocated to the Green Fund over the medium term for strategic environmental projects in partnership with the private sector

Other interventions

The Competition Commission plays an important role in ensuring greater economic efficiency and increased opportunity for new and smaller businesses. Over the medium term, it will receive additional support of R25 million to investigate private healthcare costs. To support more rapid economic growth, and the development of new sources of energy, a sum of R65 million has been set aside to ensure the optimal regulation of shale gas exploration. Over the medium term, the newly established Department of Small Business Development will spend about R3.5 billion on non-financial support to small businesses through training and mentoring. It will also seek to reduce regulatory barriers to small firms, especially informal businesses in townships.

On social grants

Grants in cash are to be preferred. Grants in kind are mostly salaries paid to well paid officials who are charged with helping the poor

The budget for social assistance has been increased by R7.1 billion since the 2014 Budget to cater for increases to beneficiary numbers (mostly in the child support grant) and the carry-through costs of increasing grant values. By 2017/18, it is expected that 17.5 million beneficiaries will be receiving social grants, the budget for which will be R148.9 billion.

Overall, social grant expenditure remains at a stable 3 per cent of GDP. Improved efficiencies at the South African Social Security Agency mean that administrative costs will fall from 5.5 per cent of expenditure on social grants in 2013/14 to 5 per cent in 2017/18. This has facilitated a reduction of R354 million in the amount budgeted for the agency's administrative fee.

Social Grants – numbers of beneficiaries and rands granted

Table 5.7 Social protection expenditure, 2014/15 – 2017/18

R million	2014/15 Revised estimate	2015/16 Medium-term estimates	2016/17	2017/18	Total 2015/16 – 2017/18	% of Total	Average annual MTEF growth
Social protection expenditure	**143 926**	**155 297**	**165 997**	**176 523**	**497 818**	**100.0%**	**7.0%**
of which:							
Social grants	120 702	130 093	139 556	148 934	418 584	84.1%	7.3%
of which:							
Child support	*43 428*	*47 842*	*51 174*	*54 117*	*153 134*	*30.8%*	*7.6%*
Old-age	*49 422*	*53 518*	*58 110*	*62 993*	*174 620*	*35.1%*	*8.4%*
Disability	*18 957*	*20 210*	*21 333*	*22 481*	*64 023*	*12.9%*	*5.8%*
Foster care	*5 851*	*5 535*	*5 671*	*5 807*	*17 012*	*3.4%*	*-0.3%*
Care dependency	*2 259*	*2 461*	*2 685*	*2 922*	*8 067*	*1.6%*	*9.0%*
South African Social Security Agency	6 705	7 088	7 425	7 619	22 132	4.4%	4.3%
Provincial social development	15 319	16 714	17 545	18 428	52 687	10.6%	6.4%
Total	**143 926**	**155 297**	**165 997**	**176 523**	**497 818**	**100.0%**	**7.0%**
Social grants as percentage of GDP	*3.1%*	*3.1%*	*3.1%*	*3.0%*			
Social grants beneficiary							
Child support	11 677	11 925	12 131	12 280		*70.4%*	1.7%
Old-age	3 070	3 190	3 311	3 431		*19.2%*	3.8%
Disability	1 133	1 144	1 153	1 161		*6.7%*	0.8%
Foster care	478	478	478	478		*2.8%*	0.0%
Care dependency	138	144	150	156		*0.9%*	4.2%

Source: National Treasury

The government agenda

Under Minister Motsoaledi's direction there has been progress over the past year in preparing for the transition to national health insurance. A discussion paper on financing options will be released shortly by the National Treasury, to accompany the NHI white paper.

Honourable Speaker, I have also agreed with Ministers Dlamini and Oliphant that we will jointly publish the long-outstanding discussion paper on social security reform.

Both health insurance and social security are vital concerns of all South Africans, and we look forward to public debate and engagement between stakeholders.

The key budget unknown - employment costs

A budget with 40% of expenditure still to be decided

Consolidated non-interest expenditure will grow at an annual real average rate of 2.1 per cent over the next three years. The share of compensation as a percentage of non-interest spending has moderated from 41.4 per cent in 2011/12 to 40.6 per cent in 2014/15, and will stabilise around this level over the medium term. Assuming that cost-of-living adjustments will be aligned with CPI projections and overall headcount numbers remain broadly constant, the consolidated wage bill is expected to grow at a nominal annual average of 6.6 per cent over the MTEF period.

The urban challenge

All politics is local- a welcome recognition of the importance of urban areas as the growth machines of the economy

Investment to transform urban spaces

South Africa's urban infrastructure must be renewed. Population growth places enormous pressure on ageing transport systems, roads, housing, water and other amenities. Moreover, apartheid spatial planning dominates the urban landscape. Over the next three years, government will expand investment in the urban built environment, using resources more effectively to transform human settlements, and drawing in private investment to support more dynamic and inclusive economic growth.

The 2015 Budget begins a fundamental realignment to achieve these goals. The National Treasury will work directly with municipal governments, development finance institutions and the private sector to expand investment in urban infrastructure and housing. A series of transformative projects valued at over R128 billion has been identified for potential investment in large cities, supported by a project preparation facility at the Development Bank of Southern Africa (DBSA). To broaden funding streams, city governments will focus on improving their systems for revenue collection, expenditure management and land-use zoning.

Some helpful realism on visas and immigrants

Government also plans to reduce regulatory obstacles that might hinder growth in these areas. For example, it is reconsidering the implications of visa regulations for tourism and a range of other businesses, aligning incentives and policy to support agriculture and agro processing, and promoting employment-intensive aquaculture projects.

More on local government

Refocusing the Neighbourhood Development Partnership Programme to support the development of economic hubs in large urban townships.

- Reforming the system of development charges to improve fairness and transparency, and reduce delays in infrastructure provision for private land developments.
- Expanding opportunities for private investment in municipal infrastructure through the Development Bank of Southern Africa increasing its origination of longer-term loans, packaging pooled finance instruments and, where appropriate, supporting the introduction of new lending instruments such as revenue bonds.
- Reviewing the sustainability of existing own-revenue sources for metropolitan municipalities, particularly in light of their expanding responsibilities in public transport and human settlements.

The infrastructure delivery management system used by national and provincial governments is also currently being expanded to cities to help them manage the implementation of these projects.

Recognising a problem

Reviving investment by the private sector

Despite strong corporate balance sheets, private-sector investment growth remains weak. Restoring confidence in the future growth of the economy is the key to unlocking the long-term investment commitment of private funds. Regulatory and other obstacles to private investment are receiving attention. Government plans to build on the success of its initiative to purchase renewable energy from independent producers. The programme illustrates the benefits of public-private cooperation, clear policy frameworks and the potential for South African firms to innovate.

Corporate welfare

Taxing and subsidising. Rather keep it simple with low effective tax rates for all business in the form of generous investment allownaces

Government has provided significant tax relief and incentives to business, including depreciation allowances that seek to support investment. Tax expenditures, or revenue foregone, to support social or industrial policy objectives is estimated at R120 billion, or 15 per cent of gross tax revenue.

A tax expenditure statement appears in Annexure C.

What the government says it gives back-details from the Budget Review

Estimates of tax expenditure

The following table summarises tax expenditure in terms of the Income Tax Act (1962), the VAT Act (1991) and the Customs and Excise Act (1964).

Table C.2 Tax expenditure estimates (R million)

Personal income tax	2009/10	2010/11	2011/12	2012/13
Pension and retirement annuity contributions[1]	17 966	20 380	22 277	24 393
Pension contributions – employees	*6 765*	*7 647*	*8 344*	*9 083*
Pension contributions – employers	*7 608*	*8 600*	*9 384*	*10 215*
Retirement annuity	*3 593*	*4 133*	*4 549*	*5 094*
Medical	12 237	14 808	16 413	19 782
Medical contributions & deductions – employees	*6 917*	*14 808*	*16 413*	*3 901*
Medical contributions – employers[2]	*5 320*	–	–	–
Medical credits[3]	–	–	–	*15 881*
Interest exemptions	1 730	2 960	1 468	2 202
Secondary rebate (65 years and older)	1 061	1 151	1 252	1 330
Tertiary rebate (75 years and older)	–	0	107	111
Donations	115	134	167	195
Capital gains tax (annual exclusion)	88	111	143	292
Total personal income tax	**33 196**	**39 545**	**41 828**	**48 305**

Corporate welfare

Corporate income tax				
Small business corporation tax savings	1 300	1 361	1 455	1 467
Reduced headline rate	*1 280*	*1 343*	*1 434*	*1 450*
Section 12E depreciation allowance	*20*	*18*	*21*	*17*
Research and development	966	1 153	964	343
Learnership allowances	740	1 144	1 004	689
Strategic industrial policy[4]	352	740	38	3
Film incentive	283	185	288	1
Urban development zones	207	285	390	208
Total corporate income tax	**3 848**	**4 868**	**4 139**	**2 710**

Corporate welfare continued

Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[7]	12 089	12 673	16 306	15 823
Textile and clothing (duty credits – DCCs)[7]	2 024	2 230	860	652
Furniture and fixtures	128	153	150	163
Other customs[8]	1 230	787	847	678
Diesel refund	1 993	2 184	2 668	4 137
Total customs and excise	**17 464**	**18 027**	**20 831**	**21 453**
Total tax expenditure	**84 853**	**97 429**	**108 627**	**119 758**
Tax expenditure as % of total gross tax revenue	**14.2%**	**14.5%**	**14.6%**	**14.7%**
Total gross tax revenue	**598 705**	**674 183**	**742 650**	**813 826**
Tax expenditure as % of GDP	**3.3%**	**3.4%**	**3.5%**	**3.6%**

1. Some of this tax expenditure is recouped when amounts are withdrawn as either a lump sum or an annuity
2. Prior to their abolishment on 1 March 2010, employer contributions were assumed to be equivalent to employee deductions
3. Medical credits were introduced in 2012/13 to replace income tax deductions for medical scheme contributions
4. Tax expenditure for all years is attributable to allowances under the s12I Strategic Industrial Policy
5. VAT relief in respect of basic food items based on National Treasury research of 2010/11 income and expenditure survey data
6. Based on fuel volumes and average retail selling prices
7. Motor Industry Development Programme (MIDP), replaced in 2013 by the Automative Production Development Programme (APDP); import rebate credit certificate (IRCC), duty credit certificates (DCC)
8. Goods manufactured exclusively for exports, television monitors and agricultural goods exempted
Source: National Treasury

Vat sacrificed

Would you trust the government to target relief for the poor should the VAT net be widened?

Value-added tax				
Zero-rated supplies				
19 basic food items[5]	14 258	15 497	17 106	18 628
Petrol[6]	9 660	10 845	13 797	15 343
Diesel[6]	903	1 107	1 532	1 759
Paraffin[6]	519	367	585	611
Municipal property rates	3 973	6 032	7 568	9 598
Reduced inclusion rate for commercial accommodation	127	142	153	175
Subtotal zero-rated supplies	**29 440**	**33 989**	**40 742**	**46 115**
Exempt supplies (public transport and education)	**905**	**999**	**1 088**	**1 175**

Whistling in the wind- reducing electricity demands

Leave it to the private sector and produce all the electricity demanded at a price that makes economic sense. Given abundant coal and possibly gas this could make relative cheap energy a competitive advantage for SA

In the present circumstances, government can encourage firms and sectors that are not reliant on high electricity usage to expand output and employment, benefiting from current trade patterns and the weaker rand exchange rate. Supporting opportunities in more labour-intensive sectors like agriculture and tourism, and in higher value-added manufacturing, for example, is consistent with the goal of structural transformation but less likely to be affected by electricity constraints. These sectors will also diversify exports and relieve current account pressures.

Incentives to increase employment without affecting competitiveness or labour productivity will complement these initiatives and increase economic participation. Similarly, immigration reform to attract critical skills and encourage tourism and trade would boost economic growth, because skilled migration and tourism create jobs.

Although more needs to be done to support structural change and raise growth potential, government has made progress in a range of areas.

Debt management in SA – a critique

Does it make sense to lengthen duration?

The strategy will focus on mitigating the risks presented by the sharp increase in loan repayments in 2017/18 and beyond. To meet these high loan repayments, cash will be generated from higher long-term borrowing in 2014/15. Over the medium term, the cash will be used to pay down short-term borrowing. In addition, government will continue to exchange short-dated bonds for longer-term bonds as market conditions permit.

In 2014/15, the net increase in short-term loans will be R10 billion, increasing to R13 billion in 2015/16. In the two subsequent years, shortterm loans increase by a net R60 billion to finance a sharp increase in loan redemptions. Borrowing from the Corporation for Public Deposit will be used to manage cash shortfalls during the year.
Loan redemptions will increase sharply from an average of R26 billion over the past four years to R56.9 billion in 2016/17, averaging R88.5 billion per year in the four years thereafter.

The bond-switch programme will be used to partly mitigate refinancing risk – the risk that government will not be able to raise money to repay debt at any scheduled point, or will have to do so at a high cost. The programme eases pressure on targeted areas of the redemption profile by exchanging short-term for longer-term debt.

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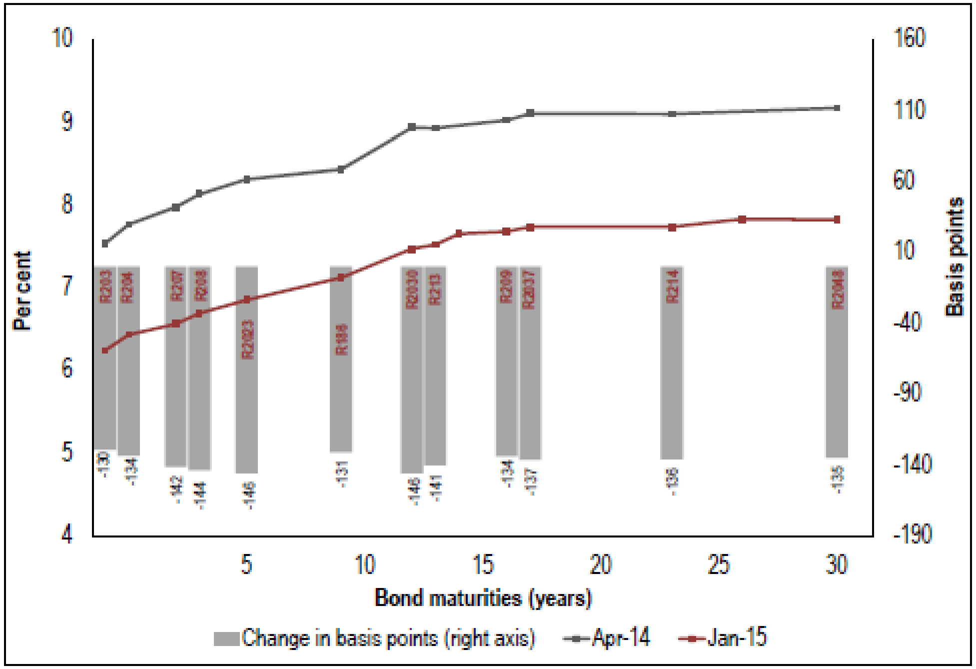
Surprising interest rate moves in 2014

Adding duration proved an expensive mistake in 2014 as interest rates came down

Figure 7.1 Fixed-rate bond yield curve movement



Source: Bloomberg

Bait and switch in the bond market

There is no shortage of rands- made in South Africa

Cash balances

Government's total cash holdings, which consist of deposits in rands and US dollars held with commercial banks and the Reserve Bank respectively, will total R182 billion by the end of 2014/15, decreasing to R178.4 billion in 2015/16. Of government's total cash balances in 2014/15, R137 billion are deposits made with the Reserve Bank to increase the level of official foreign-exchange reserves and are only available for use by government as bridging finance.

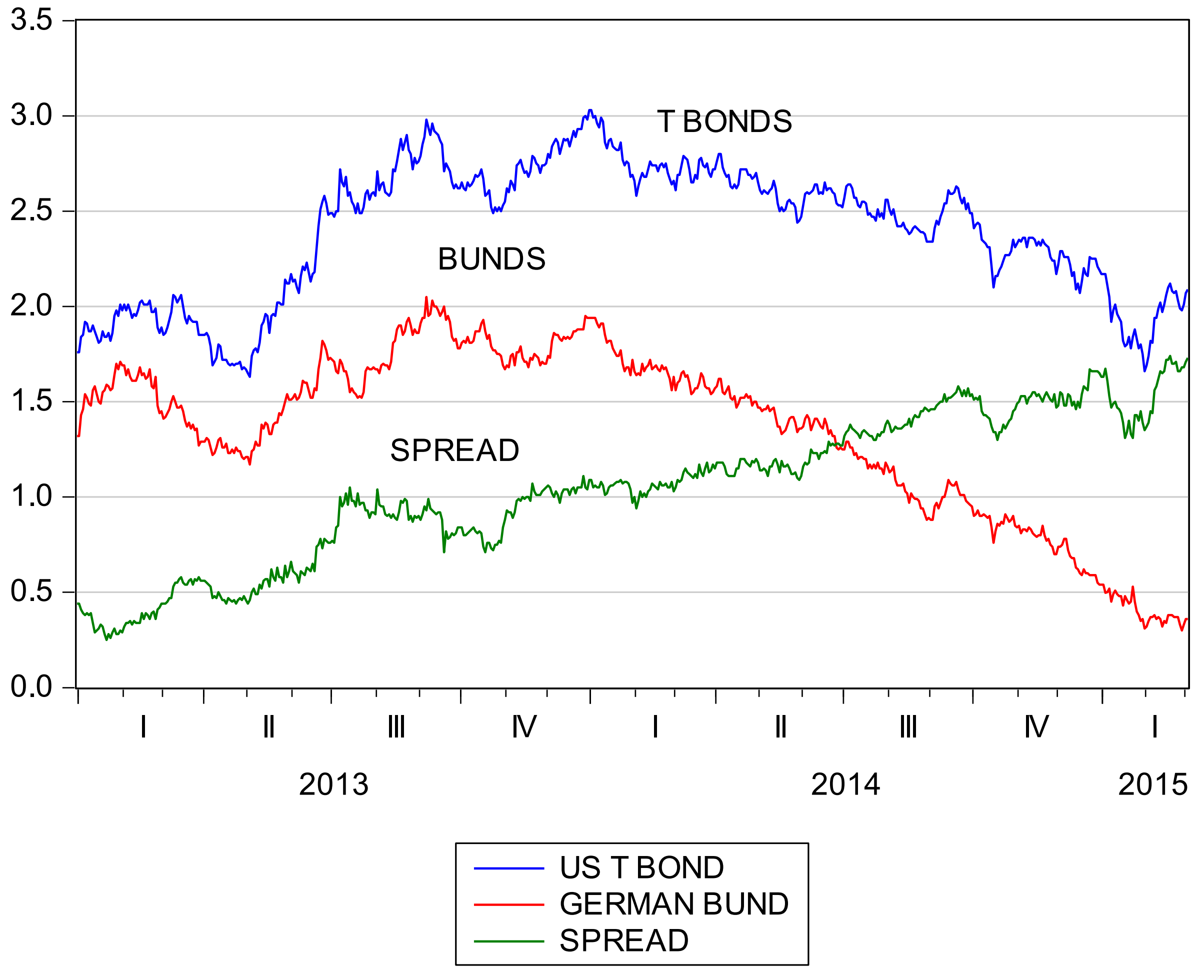
The bond-switch programme will be used to partly mitigate refinancing risk – the risk that government will not be able to raise money to repay debt at any scheduled point, or will have to do so at a high cost. The programme eases pressure on targeted areas of the redemption profile by exchanging short-term for longer-term debt.

Fiscal Risks

- Standard & Poor's (BBB-, stable outlook) rates South Africa at one notch above investment grade, while Fitch (BBB, negative outlook) and Moody's (Baa2, stable outlook) are each one notch higher. Any deterioration in economic growth, the budget balance, or government's debt metrics could trigger rating downgrades, which would make government borrowing more expensive.
- Capital flows to emerging markets are expected to decline in 2015 due to the prospects of higher US interest rates. A sudden and sharp reversal of capital inflows could lead to a depreciation of the exchange rate and the repricing of government debt.
- A higher-than-anticipated wage bill, a deterioration in economic growth or funding difficulties at state-owned companies could increase the borrowing requirement, raising yields and borrowing costs.

Government's prudent fiscal policy and debt-management strategies, in combination with deep and liquid domestic capital markets, will continue to support investment, ensure that government can finance its borrowing requirement and improve the debt trajectory.

Interest rates- surprising developments- how will we be surprised this year?



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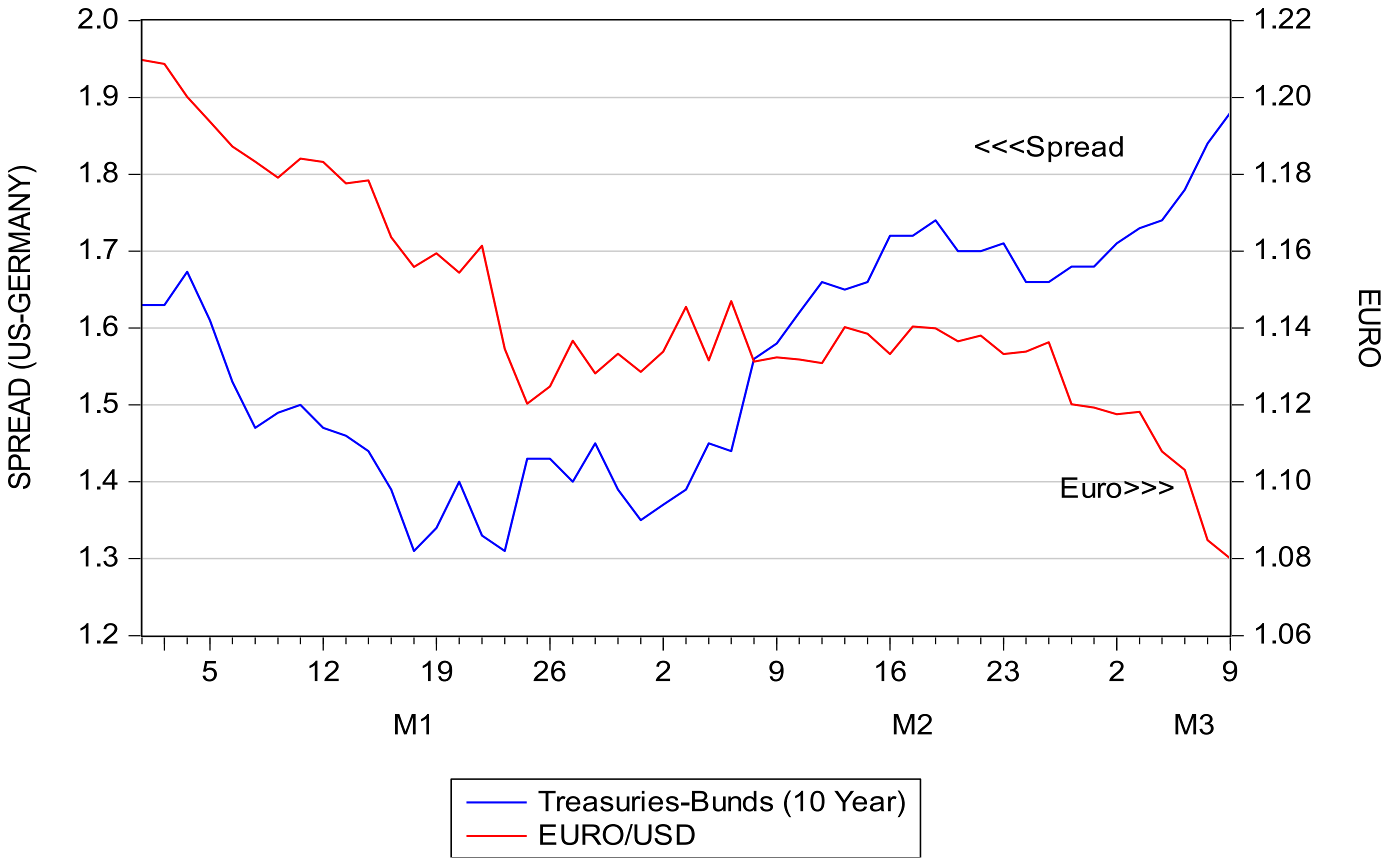
The USD and the spread over Bunds

All explained by the spread



Daily Levels of the Euro and the Interest rate Spread (US – Germany 10 year Yields (Daily Data 2014-2015

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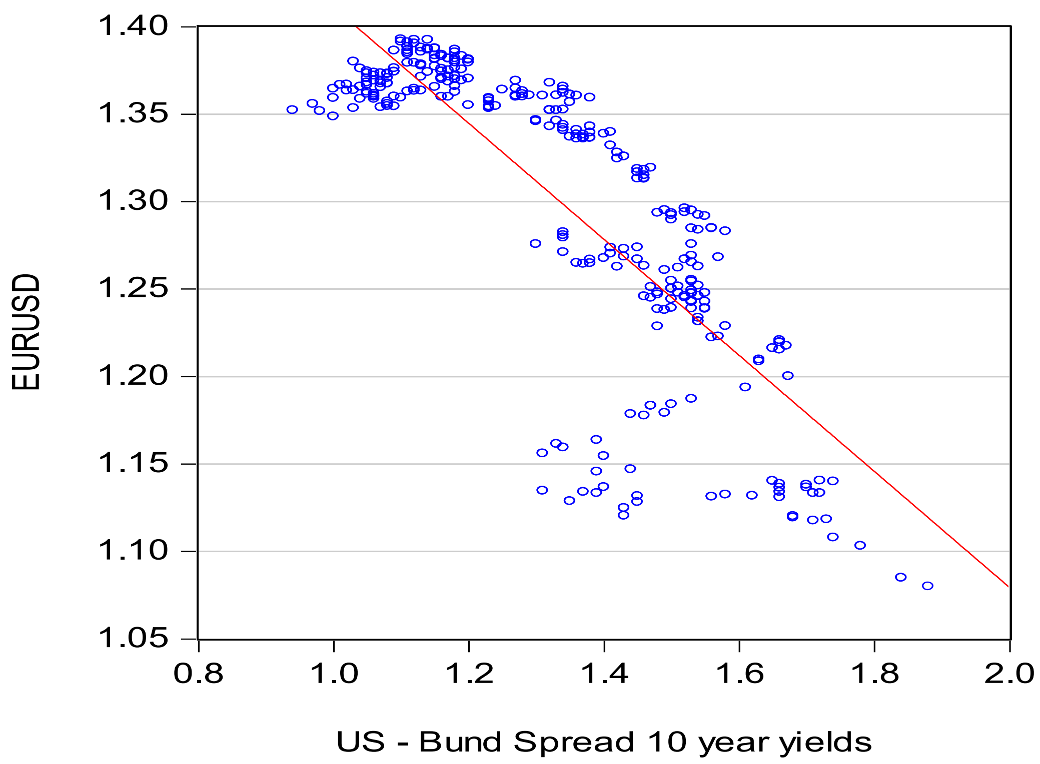
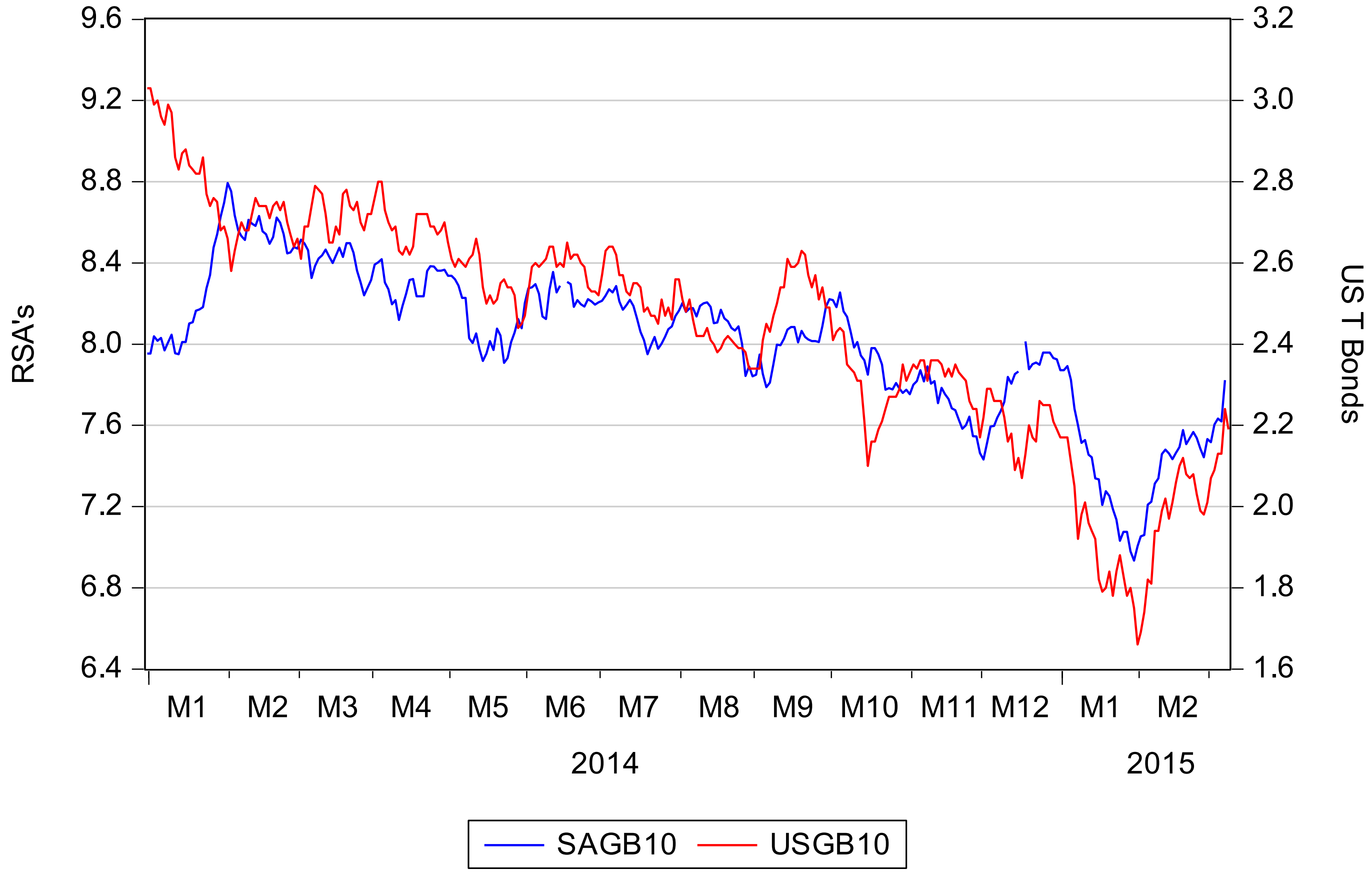


The global force in the debt markets

It is the market not the rating agencies that will set borrowing costs for SA



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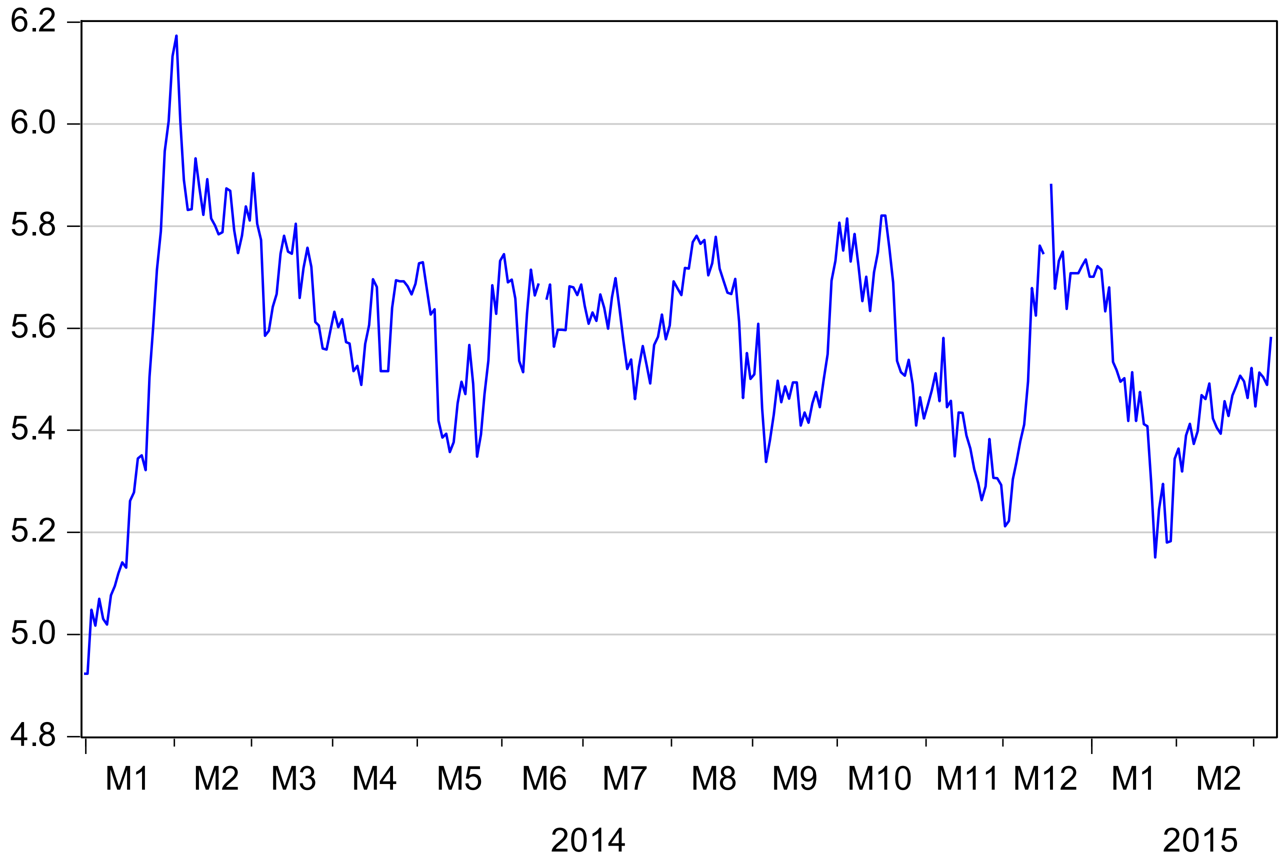
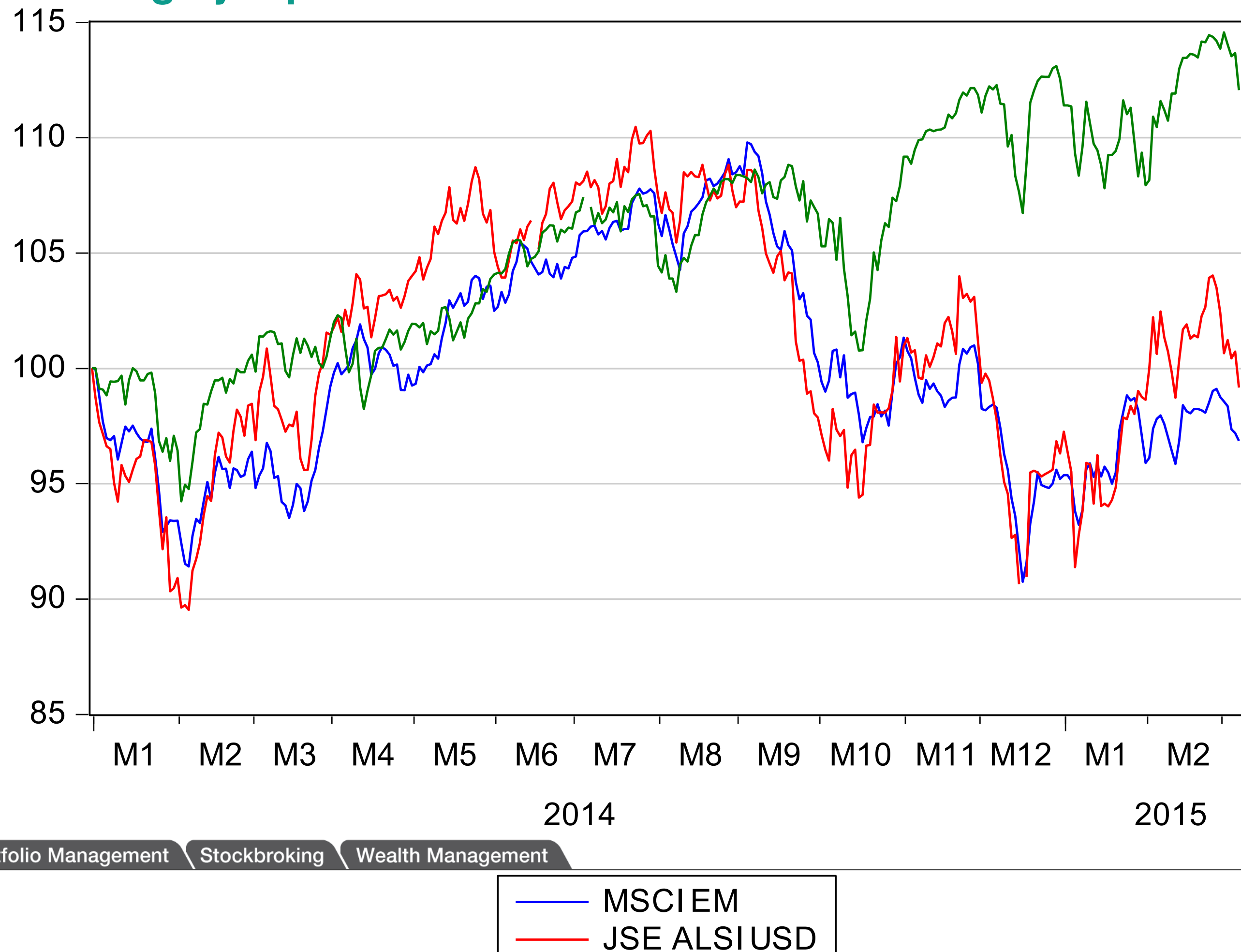
The RSA Risk premium

More risk lower rand exchange rate



Emerging Markets are underperforming

The weakness in EM helps explain rand and other EM currency weakness. When will it be the right time to up weight EM markets for which the JSE is highly representative?



Awards

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Ranked #1

Stockbroker for the Sophisticated Executive and #1 CFD Provider 2014

Ranked #1

By our peers in the Wealth Management Banking Survey 2013

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Thank you