SOUTH AFRICA: BUDGET 2015/16 REVIEW.

International background

- Forecasts indicate that the world economy will show modest growth of 3.5% in 2015.
- Forecasts indicate US growth of 3.5%, UK growth of just less than 3%, the European Union growth of just more than 1% and Japan growth of less than 1% in 2015.
- In the case of the BRIC countries growth of just less than 7% is forecast for China and India, negative growth of 0.6% for Brazil and -5% for Russia.
- Sub-Sahara Africa is forecast to grow at just less than 5% in 2015.
- At the same time inflation remains well under control in all major industrialised countries with average inflation rates of less than 2% in 2015. The fear exists that the EU could show negative inflation or deflation in 2015 as well as in 2016. This is a reflection of lower energy prices as well as indications that food prices and commodity prices in general, remain weak for most of 2015.
- Given the expected modest growth as well as low inflation rates, short-term interest rates are forecast to move sideways in most industrialised countries in the rest of 2015 with the exception of the US and perhaps the UK where a modest rise is expected in the second half of the year. In many countries, short-term interest rates have been cut in recent weeks to prevent strengthening currencies from adversely affecting exports in poor performing export markets.

- General commodity prices are forecast to weaken even further in 2015 given poor demand in countries like China while supplies are rising.

Domestic background

Five main areas in the domestic economy need the attention of government policies

- Growth. Modest growth of 2% or less is expected in 2015 following the 1.5% growth recorded in 2014. This growth is unbalanced in the sense that it is based on consumption expenditure by the private as well as public sectors of the economy rather than production, infrastructure development and exports. This creates an imbalance between demand and supply in the domestic economy.
- Balance of payments. Given the imbalance between domestic demand and supply, the foreign trade account is showing large deficits. According to Customs and Excise figures the trade balance showed a deficit of R95 billion in 2014. Added to the foreign trade deficit, the services account deficit (interest payments, dividends, tourism) brought the current account of the balance of payments deficit to an estimated more than R200 billion in 2014. It is assumed that this deficit will drop to less than R200 billion in 2015 due to the cut in energy import costs, but will remain large and has to be financed by the inflow of foreign capital. In past years, these deficits were financed by sufficient inflows of short-term foreign capital. Unfortunately, these inflows are very volatile and are often subjected to occurrences in other countries over which South Africa has no control. The volatility in these foreign capital flows are reflected in the volatility that occurs in the local financial markets from time to time.
- Unemployment. The official unemployment rate of 24.30% is unacceptably high, while youth unemployment could be even higher than 50% in many regions. This is a reflection of the poor quality of education and training, a rigid labour dispensation and salary and wage payments rising faster than either inflation or productivity levels.

- Inflation. Low inflation, or increases in general prices, assist the domestic economy to be competitive in the domestic and international trading markets. Currently inflation is well within the target band of between 3% and 6% of the authorities. Forecasts indicate an average inflation rate of 4.5% for 2015 rising to approximately 6% in 2016. The current lower inflation rate is mainly due to the substantial cut in energy costs following the almost 50% drop of international dollar oil prices in the second half of 2014. Current forecasts indicate an international oil price of between $50 and $70 in 2015 compared with recent prices of approximately $60 per barrel. Higher year-on-year energy prices could result in a rising trend of the inflation rate towards the end of 2015. Food prices also moderated in recent months, but the current drought affecting summer crops could result in generally higher food prices in the rest of the year. Tariff and tax increases are also likely to push the inflation rate higher in coming months. The performance of the rand is likely to play a very important role in determining the inflation rate in coming months – a strengthening rand assists in keeping the inflation rate low, while a weaker rand pushes the inflation rate higher.
- Government finances. The forecast central government budget deficit of 3.9% for the fiscal year 2014/15 is fairly close to the accepted international target of 3% of gross domestic product (GDP). According to forecasts included in the budget delivered by the Minister of finance on 25 February 2015, the budget deficit will decline in the next two years to 2.5% of GDP in fiscal year 2017/18. This is an indication of fiscal discipline by the central government in coming years, but is a very familiar tune sung by previous ministers of finance as well.

Impact and challenges of latest budget

- The biggest challenge of the latest budget lies within the execution of all the proposals to control growth of expenditure. Will the Minister of Finance be successful in obtaining the support from his colleagues in cutting unnecessary travelling, catering, corruption and wasteful expenditure? In the next few months, the biggest challenge will however be in limiting salary and wage increases to not more than 6% against demands of 15%.

- In the next three years, the challenge will be to keep the total salary, wage and welfare bill within target by not allowing real expenditure on these items exceed a real two percent compared with the real increase of 7% in the period 2000 to 2013. (Real increase = inflation plus a percentage.) This will demand a lot of courage from government in the light of local authority elections in 2016, ANC party elections in 2017 and the next general election in 2019.
- The latest budget addresses to a certain extent the broad imbalance between demand and supply that arose from cutting consumers' tax rates regularly in previous years, while not offering real support for the business or production sectors of the economy. This year tax rates on individuals were increased modestly for people earning more than R181, 000 per annum for the first time in ten years. Government will however have to be careful in not pushing high taxpayers into offshore countries – like Mauritius – where the tax dispensation is friendlier. High taxpayers are the people that provide the economy with savings, investments and job opportunities.
- Some relief was given to the business sector in the form that small enterprises with a turnover of less than R335, 001 will no longer pay taxes. However, in general terms benefits to the business sector remain very limited and specific. The latest budget once again does not indicate that government is really determined to support the production/business sector of the economy, which should be the sector supporting growth, employment and production of goods and services. Is government really concerned about growth, the jobless rate of the economy, the deficit on the trade and current accounts of the balance of payments?
- According to the latest budget, government is still of the opinion that the public sector can alleviate poverty levels in the country on a sustained basis by public sector works programmes, employing people in the public sector and by an increasing number of people on the welfare system with rising benefits over a period of time. According to government forecasts, 17.5 million people will be on the welfare system by 2018. The question remains whether it is sustainable that almost a third of the population will be dependent on the welfare payments of government funded by a limited number of taxpayers.

- Price pressures will emanate from the budget proposals. The sharp increases in the fuel levy and in sin taxes – alcoholic beverages, tobacco products – as well as the increased levy on electricity consumption will exert upward pressure on general prices in coming months. It necessitates that businesses watch cost increases even closer in an effort to keep costs as low as possible and maintain competitiveness in an increasing more competitive domestic and international market.
- Indications that government is serious in its efforts to limit the budget deficit to even less than 3% of GDP in coming years had a positive impact on local financial markets. The rand strengthened against most major currencies following the budget and the capital markets remained stable. However, as mentioned earlier, the execution of the Minister of Finances proposals will be the crux of the matter in coming months. It is also clear that the budget will have no impact on the movements of short-term interest rates in the rest of the year if government adheres to the budget proposals.
- If government follows the budget proposals it is clear that the growth rate will be inhibited by the tax proposals as the tax burden on consumers earning more than R181,000 per annum will increase will leave less money in consumers' pockets to be spend. At the same time, government expenditure is set to grow at a real 2.5% in the tax year 2015/16.
- The announcement that land redistribution will continue in coming years also creates further uncertainty in the farming community.

Implications for the business sector

- The latest budget tries to limit government borrowing requirements and the large and rising government debt. This was necessary to prevent the rating agencies from downgrading the country's credit rating even more and the risk of becoming a country with junk bonds and not being able to attract even short-term foreign investment. The budget however creates a more difficult environment for the business sector as it limits the consumption expenditure of the private consumer as well as of government. In essence, the budget is not supporting improved growth in the rest of the year.

- It also increases the cost of doing business in the sense that it pushes levies and tariffs higher on fuel and electricity. (Local authorities will increase local tariffs and levies in the rest of the year increasing the cost of doing business.)
- The budget assists education and training by allocating more funds to education, but it unfortunately cannot guarantee the outcome of this expenditure. The budget of course also cannot deliver a more flexible labour dispensation.
- Unemployment will remain at unacceptable levels. Although there is some relief for small and medium sized businesses, the overall environment is not business friendly. It is therefore unlikely that this budget will improve the environment to employ more people. Actually, the necessity to control costs indicates that, if possible, businesses are likely to get rid of more employees in coming months.
- The budget stabilised the financial environment. Short-term interest rates are likely to remain stable in the rest of the year, while long-term interest rates are influenced by international trends, the domestic inflation rate and demand from the public sector. The latter is likely to remain at very high levels in the rest of the financial year. The rand strengthened following the budget, but could be vulnerable to interest rate increases in the US later in the year.
- The financing of organisations like Eskom, Transnet, SANRAL and other state-owned enterprises remains vast and will exert upward pressure on the local capital markets from time to time.
- The 2015/15 budget creates a stable, but still difficult business climate to do profitable business in an economy growing at approximately 2% in calendar year 2015.

This 2015 economic and National Budget summary was prepared for BCE Consulting by Ulrich Joubert.

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