

Economic Commentary

Preview of National Budget 2011

Expect faster deficit reduction, limited tax relief and a strong focus on infrastructure and job creation

- In 2010/11, a recovering economy and contained government spending probably helped to reduce the budget deficit to about 5,1% of gdp, below October's revised estimate of 5,3% of gdp.
- In 2011/12 through to 2013/14, better growth prospects will help to reduce the budget deficit to the psychologically-important 3% of gdp over a shorter time period than originally envisaged, creating the scope for slightly higher expenditure over the next three years.
- Personal tax relief is likely to be limited, consisting mainly of compensation for the effects of inflation.
- Company tax relief will take the form of incentives to encourage expansions and employment. More details are expected on the qualifying criteria for the R20 billion tax incentives for manufacturers announced in the State of the Nation address.
- The key themes on the expenditure side of the budget are likely to be education, health, infrastructure development and job creation initiatives. More details are expected on the operation of R9 billion jobs fund announced in the State of the Nation address as well as the infrastructure expenditure programme over the next three years.
- Further exchange control relaxation is likely to be limited following significant concessions in October 2010.

The expected outcome of the 2010/11 National Budget

Finance Minister Pravin Gordhan tables his second budget in better circumstances than those prevailing a year ago. The global economic and local climates have improved considerably and revenue projections can be made with more confidence. Government finances over the past year have improved and give the Minister more room to manoeuvre. However, the task remains difficult. While the deficit is still high and needs to be brought under control over the medium term, government has announced an ambitious job-orientated growth plan that needs more substantiation in the budget.

Table 1 : Expected outcome for the 2010/11 fiscal year

	Budget		Revised MTBPS		Outcome based on 1st 9m		Outcome expected	
	Rbn	Yoy%	Rbn	yoy%	Rbn	yoy%	Rbn	yoy%
Revenue	738.4	12.3	761.0	14.1	764.3	14.6	767.6	15.1
% gdp	27.3		28.4		28.4		28.6	
Expenditure	907.0	8.6	904.1	8.6	897.4	7.8	904.9	8.7
% gdp	33.6		33.7		33.3		33.7	
Balance	-168.6		-143.1		-133.2		-137.3	
% gdp	-6.2		-5.3		-4.9		-5.1	
Gdp	2699.9	10.2	2683.9	9.3	2694.1	10.3	2687.8	10.0

Sources: National Treasury and Nedbank

Group Economic Unit

Dennis Dykes
+27 11 295 6435
DennisD@nedbank.co.za

Nicky Weimar
+27 11 295 6840
NickyWe@nedbank.co.za

Matimba Khosa
+27 11 294 1835
JohannesKh@nedbank.co.za

Corporate Place, 135 Rivonia Road,
Sandown, 2196, South Africa

<http://nedbankgroup.co.za>

Table 1 presents the key variables for the fiscal year ending March 2011. 'Budget' refers to government's projections at the time of the last budget in February 2010; 'Revised MTBPS' to the revised estimates presented in the Medium Term Budget Policy Statement (MTBPS) in October 2010; 'Outcome based on first 9 months' applies the relevant percentage changes already experienced for revenue and expenditure in the year to December 2010 and 'outcome expected' is our estimate for what might be tabled next week. All figures are at the consolidated government level.

Revenue is likely to have overshoot the original target by a considerable 29,2%, rising by around 15,1% compared with the originally-budgeted 12,3%. The key reason for the overshoot will be a strong rise of about 18% in VAT (versus the budgeted 11,9%), following the collapse in this category in fiscal 2009/10. Other categories will have performed roughly in line with the original budget, with the exception of property taxes, which will again undershoot budget given the slower than expected pickup in the property market.

The outcome for expenditure will be significantly better than those achieved over the previous few fiscal years. Unusually, there will probably be an undershoot on the February 2010 budget levels. However, the expected 8,7% growth rate will be similar to the 8,6% set in the budget as the base has been revised down in the MTBPS. The relatively modest increase in expenditure this year is due partly to improved economic circumstances but largely to more modest public sector wage increases after several years of massive increases.

Our revenue and expenditure estimates result in a deficit of around R137 billion or 5,1% of gdp, significantly lower than the originally-budgeted deficit of R168,6 billion or 6,2% of gdp and also better than the MTBPS estimate of 5,3% of gdp.

Expectations for the 2011/12 Budget

Table 2 below sets out our expectations for fiscal 2011/12 through to 2013/14. Better growth prospects will help government reduce its deficit to the psychologically-important 3% of gdp over a shorter time period than that originally envisaged, while at the same time allowing slightly higher expenditure over the medium-term framework.

Table 2 : Budget expectations

	2011/2012		2012/2013		2013/2014			
	MTBPS		Expected					
	Rbn	yoy%	Rbn	yoy%	Rbn	yoy%		
Revenue	843.0	10.8	854.3	11.3	944.9	10.6	1052.6	11.4
% gdp	28.7		29.0		28.8		28.9	
Expenditure	977.2	8.1	982.8	8.6	1066.3	8.5	1162.3	9.0
% gdp	33.3		33.3		32.6		32.0	
Balance	-134.2		-128.4		-121.4		-109.6	
% gdp	-4.6		-4.4		-3.7		-3.0	
Gdp	2933.5	9.3	2949.6	9.7	3275.6	11.1	3637.0	11.0

Sources: National Treasury and Nedbank

Revenue

There is unlikely to much tax relief in this year's budget, given the need to reduce the budget deficit to more manageable levels.

Some of the possible measures expected in this year's budget are outlined below:

- **Personal income tax relief** will probably be very limited. The top marginal tax rate, which currently stands at 40%, will remain unchanged. However, there will be some compensation for the effects of inflation (otherwise known as bracket creep). This will take the form of adjustments to the thresholds where the various tax rates kick in. The exemptions on domestic and foreign interest and dividend payments will probably also be raised.
- **Company tax relief** will also be limited and selective, focused on encouraging capital expenditure and job creation. The company tax rate, which currently stands at 28%, is expected to remain unchanged. More details are also expected on the R20 billion of tax incentives for manufacturing announced by President Zuma in the State of the Nation address. The incentives are aimed at encouraging expansions and upgrades within the

manufacturing sector and will probably take the form of 'depreciation allowances' but with specific requirements on job creation.

- The **VAT rate** will remain unchanged at 14%.
- There will be usual inflation-related increases in **general fuel levies** and **excise duties** on alcoholic beverages and tobacco products.
- Given government's concern over the impact of a relatively strong rand on exports and job creation, there is a possibility that a tax on speculative capital inflows will be introduced, but if so, probably at low rate.

Expenditure

Government's initiatives to promote and stimulate job creation are likely to dominate the headlines on the expenditure front. The Medium-Term Expenditure Framework (MTEF) already indicated the focus of government expenditure will be on education, health, infrastructure development and job creation.

Some specifics were provided in the MTEF and the State of the Nation address, including the following:

- In **education**, efforts will focus on raising standards and improving teaching tools and equipment. In 2011, about 6,6 million pupils and 125 000 teachers in grades R to 6 will be equipped with new learning and teaching materials, informal and unsafe school buildings will be either replaced or upgraded, and university and further education enrolment will be improved.
- In **healthcare**, the focus remains on the continued rollout of HIV prevention and treatment programmes, but efforts will also be made to improve infant, maternal and child mortality rates.
- In **infrastructure development**, a key tenet of the New Growth Path, the MTEF set aside R811 billion for infrastructure over the next three years, including road, rail, power, water and digital infrastructure. Despite allocating considerable funds to infrastructure development over the past two years, the Reserve Bank's fixed investment figures show that capital expenditure by general government continued to shrink on an inflation-adjusted basis. This suggests serious management, administrative and other organisational capacity constraints in rolling out capital expenditure within government, which is placing significant pressure on profits and employment within in the broader building and construction industries.
- On the **jobs** front, more details are expected on the announced R9 billion jobs fund over 3 years and the R10 billion over 5 years allocated to the Industrial Development Corporation (IDC) to help develop and encourage small- to medium-sized businesses.

Financing

The projected deficit for 2011/12 is likely to be only slightly lower than the 5,3% of gdp estimated in October, consequently the financing requirement is not expected to vary greatly from R146,3 billion predicted in the MTEF. As usual, the bulk of the financing requirement will be raised in the domestic market, around R129 billion, but National Treasury is also planning to raise about R5 billion in foreign loans, possibly to take advantage of growing foreign interest in emerging market debt and relatively favourable financial terms.

Table 3 : MTEF – Main budget deficit, the net borrowing requirement and financing

	2009/10	2010/11	2011/12	2012/13	2012/13	
R billion	Actual	Budget	Revised	Medium-term estimates		
Main budget balance¹	-166.9	-174.9	-142.1	-146.2	-145.3	-0.131
Extraordinary payments	-0.671	-	-0.572	-0.120	-	-
Extraordinary receipts	6.4	-	2.5	0.1	-	-
Financing requirement	-161.1	-174.9	-140.2	-146.3	-145.3	-130.8
Domestic short-term loans (net)	49.8	22.0	22.0	20.0	20.0	20.0
Domestic long-term loans (net)	118.9	137.7	137.7	129.1	120.2	102.8
Foreign loans (net)	23.3	11.6	-2.4	4.8	-3.5	-8.3

Source: National Treasury MTEF October 2010

For the next two fiscal years, National Treasury is expected to continue along the path of gradual deficit reduction while broadly sticking to the funding framework set out in October 2010's MTEF.

Other issues

In October 2010, Finance Minister Gordhan announced further significant exchange control relaxation and other measures, mostly aimed at offsetting surging foreign capital inflows and weakening a relatively strong rand. These measures included:

- Aggressive purchases of foreign exchange reserves by National Treasury and the Reserve Bank funded by revenue overruns in 2010/11 and debt issuance.
- The 'sterilization' of capital inflows associated with foreign direct investment using foreign exchange swaps.
- Raising the offshore investment limits on individuals to encourage diversification and removing unnecessary limitations on offshore investments.
- Lifting the restrictions on the 'blocked' assets of emigrants.
- Allowing qualifying international headquarter companies to raise and deploy capital offshore without exchange control approval from 1 January this year.
- Lifting barriers on domestic companies to expand internationally.
- Raising the offshore limits of institutional funds.
- Reviewing the prudential framework for foreign investment by private and public pension funds to encourage offshore diversification, especially to other African countries and other emerging markets.

There may be more concessions announced on Wednesday. However, these are likely to be limited given the extent of the relaxation in October last year. Foreign exchange controls are now so limited that a move away from formal controls to prudential requirements is probably imminent.

No change on the Reserve Bank's 3% to 6% cpi inflation targets is expected.