

Economic Commentary

National Budget 2011

Key Points

- The consolidated budget deficit stays constant at 5,3% of gdp, unchanged from 2010/11. The deficit then falls gradually to 3,8% by 2011/12, slower than that projected in the Medium Term Budget Policy Statement (MTBPS) in October 2010.
- The key reason for this is a lower estimate for government revenue rather than significantly higher government spending. The revenue estimates appear conservative.
- Limited tax relief for individuals of R8,85 billion, only slightly larger than last year's modest R5,4 billion.
- The usual increases in so-called sin taxes and the fuel levy. Environmental taxes also rise.
- Tax relief for job-creating investments.
- On the expenditure side the focus is on job creation through the introduction of a R9 billion Job Fund as well as through a youth employment subsidy.
- Skills development and education are also targeted to improve greater participation in the economy.
- National Health Insurance to be phased in over a period of 14 years given the complexities and costs.
- No new measures announced to weaken the rand at this point.

Stronger economic growth and rising commodity prices have given Minister Gordhan more flexibility in this budget. Somewhat surprisingly, however, the downward trajectory in the fiscal deficit is less aggressive than that projected at the time of the MTBPS in October last year. This is partly because of higher expenditure, but mainly because of a downward revision to tax projections over the medium term. In practice, the deficit could recede more quickly than projected because the revenue estimates look conservative. However, it does highlight that government needs to use existing resources more efficiently and improve spending discipline. This applies particularly to the wage bill.

Economic background and assumptions

Economic conditions improved in 2010. Consumer spending accelerated, helped by improved household finances, stronger asset prices, very low interest rates and the spending injection from the flood of foreign visitors during the 2010 FIFA World Cup. In contrast, the production side of the economy was more subdued, mainly contained by prolonged strike action in the automotive industry around the middle of the year. However, conditions improved towards the end of the year as export sales accelerated on strong demand for commodities from Asia and the continued moderate recovery in industrialised countries. Despite the general improvement in both global and local demand conditions, business remained uncertain about the sustainability and strength of the upswing and consequently reluctant to expand capacity or accelerate employment too aggressively. Fixed investment activity remained very weak, while employment only started to increase in final quarter of 2010.

The local recovery should strengthen and broaden in 2011 as a whole. Household confidence should improve further, helped by a modest increase in employment, rising household income, increased government transfers, firmer asset prices and low interest rates.

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At the same time, firmer global demand and stronger international commodity prices should support exports, boosting production and inventory accumulation. However, capital formation will remain relatively weak, rising only moderately in 2011, mainly due to ample spare capacity in the private sector, lingering doubts about both the global and local recoveries, continued regulatory uncertainties in some industries and general infrastructure constraints, especially power supply and transport capacity. We expect real gdp to grow by around 3,2% in 2011, only slightly softer than National Treasury's expected 3,4%.

Table 1 : Budget assumptions

Annual growth rates (%)	2009	2010	2011	2012	2013
Real gdp	-1.7	2.7	3.4	4.1	4.4
Real hce	-2.0	4.6	4.2	4.3	4.5
Real gfcf	-2.2	-3.6	3.9	5.5	6.8
Current account (% of gdp)	-4.1	-3.2	-4.2	-4.9	-5.0
Consumer inflation (%)	7.1	4.3	4.9	5.2	5.5

Source: National Treasury Budget Review 2011

Budget arithmetic

The key budget figures are set out in the table below. It details the estimated outcome for the current fiscal year (2010/11), which ends in March, compared with the originally budgeted figures, as well as the budget for the year ahead (2011/12), which starts on 1 April 2011. The estimates at the time of the MTBPS are also shown. The assumptions for nominal gdp on which all the calculations are based are also shown.

Table 2 : National Budget 2011

	2010/2011			2011/2012		2012/2013		2013/2014	
	Budget Feb 2010	MTBPS Oct 2010	Outcome Feb 2011	MTBPS Rbn	Budget Feb 2011	MTBPS Oct 2010	Budget Feb 2011	MTBPS Oct 2010	Budget Feb 2011
Revenue (Rbn)	738.4	761.0	755.0	843.0	824.5	931.7	908.7	1040.2	1017.2
% gdp	27.3	28.4	28.3	28.7	28.3	28.9	28.4	29.1	28.8
Yoy%	12.3	14.1	13.6	10.8	9.2	10.5	10.2	11.6	11.9
Expenditure (Rbn)	907.0	904.1	897.4	977.2	979.3	1059.1	1061.6	1154.2	1151.8
% gdp	33.6	33.7	33.6	33.3	33.6	32.8	33.2	32.3	32.6
Yoy%	8.6	8.6	8.7	8.1	9.1	8.4	8.4	9.0	8.5
Balance (Rbn)	-168.6	-143.1	-142.4	-134.2	-154.8	-127.4	-152.9	-114.0	-134.6
% gdp	-6.2	-5.3	-5.3	-4.6	-5.3	-3.9	-4.8	-3.2	-3.8
Gdp (Rbn)	2699.9	2683.9	2666.9	2933.5	2914.9	3227.9	3201.3	3568.7	3536.0
Yoy%	10.2	9.3	9.2	9.3	9.3	10.0	9.8	10.6	10.5

Source: National Treasury Budget Review 2011, MTBPS October 2010, Budget Review 2009

Expenditure

- Main budget expenditure in 2010/11 rose by 8,7%, slightly higher than the 8,6% increase envisaged in both the 2010 National Budget and the MTBPS.
- For 2011/12 expenditure is budgeted to increase by 9,1% and to then ease marginally over the three-year period.
- **Debt service costs** are expected to rise by around 16% per annum over the next three years, increasing from 2,6% of gdp in 2010/11 to 2,9% by 2013/14.
- **Non-interest expenditure** will increase by 8,8% in 2011/12 from 7,8% in the previous fiscal year and to grow by 8,2% per annum over the next three years.
- The **wage bill**, which accounts for 33,3% of total expenditure, increased by a more modest 8,0% in 2010/11 and is budget to rise at an annual average rate of 6,6% over the next three years.
- As promised in President Jacob Zuma's state of the nation's address, the budget provides some details on its job creation initiatives, in line with the New Growth Path which targets 5 million jobs over the next 10 years. R10 billion will be allocated to the Industrial Development Corporation (IDC), which will form part of the corporation's R70 billion allocation to finance industrial and business development programmes over the next five years. The R10 billion will be channelled into the job creating projects.

- A R9 billion **Jobs Fund** to support projects with the potential to create new jobs, particularly for the youth, has also been created. The projects that will be financed are expected to help create between 50 000 to 100 000 jobs over the medium term. A **youth employment subsidy**, which will cost R5 billion over the next three years has also been initiated. The subsidy is intended to increase demand for young workers by lowering the cost of employment for businesses.
- Spending on **expanded public works programmes** will receive R73 billion over the next three years to sustain short-term job creation activities. The programme, which has created about 1 million short-term jobs since the beginning of its second phase in April 2009 targets about 800 000 more jobs in 2011/12.

Table 3 : Government expenditure at a consolidated level

	Budget	% of total	Annualised changes	
	2010/11-2011/12 % change	spending	2010/11-2013/14 % change	2007/08-2010/11 % change
Protection Services	9.6	13.9	8.0	11.1
Defence	13.3	4.1	9.0	6.7
Police	8.4	6.5	7.5	13.4
Prisons	8.6	1.8	7.3	10.9
Justice	6.5	1.5	7.9	14.8
Social Services	10.9	57.9	8.5	15.7
Education	10.0	20.6	7.9	16.0
Health	10.3	12.1	7.6	17.9
Welfare (incl. social security.)	10.7	15.9	8.9	13.0
Housing	23.2	2.9	13.0	22.8
Community development	12.2	5.7	9.7	22.0
Economic Services	-2.7	13.8	2.9	15.6
Water schemes	24.6	1.8	13.1	13.2
Fuel and energy	-76.1	0.7	-44.8	75.6
Agric, fishing, forest.	16.2	2.0	8.8	5.7
Mining, manufacturing & construction	6.6	0.5	6.0	-1.3
Transport, communications	10.6	6.2	7.7	12.2
Other economic services	21.1	2.7	12.6	7.2
Gen government services & unallocated	9.0	5.7	5.4	14.8
Total votes & statutory	8.3	91.3	7.3	14.9
Interest	15.0	8.3	16.0	8.0
Contingency	-	0.4	-	-
Consolidated expenditure	9.3	100.0	8.8	14.3
Memorandum items				
Remuneration	8.0	33.3	6.6	17.3

Source: National Treasury Budget Review 2011

- **Social services** remain the key priority in this year's budget, with spending on the category accounting for 58% of the total. Within this category, spending on **housing** will receive much of the increase, probably because such activity will help to create job opportunities. After the growth rate in spending moderated gradually over the past three years, it is budgeted to pick up to 23,2% this year and will remain high over the next three years. However, the growth in spending on other categories of social services has moderated off the higher base established over the past five years.
- **Education and skills development** is a key focus, with spending on these programmes aimed at sustaining long-term economic growth, reducing unemployment and poverty. In 2011/12 spending on education will increase by 10% to R191,2 billion and the allocation will grow to R218,5 billion in 2013/14 fiscal year. Spending at the basic education level will be dedicated to improving existing or building new school infrastructure as well as employing new teachers. Higher education and training will receive R8,1 billion over the next three years to help disadvantaged students to access tertiary education.
- Investment in **health** is also one of the government's key priorities. Spending on health increased by over 10% to R112,5 billion in 2011/12, with the funds to be allocated to general infrastructure improvement as well as to address the shortage of skills in the health profession. The focus on health programmes remains on reducing HIV/AIDS prevalence, the reduction of infant mortality and the provision of access to health facilities to the poor. A provision will be made to increase the number of trainee doctors from 2 200 to 2 500 per year

as well as to increase support services, the procurement of medicine at lower cost and improve supervision to enhance the delivery of health services.

- Spending on **welfare services** is set to increase by over 10% in 2011/12 after the growth rate moderated to single digits in the previous fiscal year. About 70% of the total amount in this category will be allocated to social grants. Over the medium term, spending on social services will increase to about R171,9 billion, with the South Africa Social Security Agency receiving R870 million which will be used to improve the grant application process and reduce fraud.
- Crime prevention receives attention in this budget. Spending on **protection services** will increase by 9,6% in 2011/12 and by 8% over the medium term. The funds will be allocated to programmes aimed at reducing crime levels and clearing backlogs in courts. The justice information and technology infrastructure will be upgraded at a value of R670 million over the next three years, while new high courts will be constructed in Polokwane and Nelspruit. R243 million will be used to upgrade selected correctional facilities in order to reduce the problem of overcrowding in prisons.
- The more modest expenditure estimates signal a return to better fiscal restraint after several years of highly expansionary fiscal policy marked by rapid growth in spending.

Revenue

- **Tax revenue** over the medium term is forecast to be slightly below that projected at the time of the MTBPS in October 2010, with revenue estimates for 2011/12, 2012/13 and 2013/14 about 2% below the MTBPS estimates.
- **Tax proposals** result in a R4,1 billion revenue loss for the fiscus in 2011/12. Tax adjustments for individuals and companies amount to R8,4 billion, adjustment to transfer duties result in a R750 million revenue loss, while increases in indirect taxes raise about R5 billion.
- **Tax relief for individuals** amounts to R8,9 billion in 2011/12, with the adjustments mainly for fiscal drag. Most of the benefit accrues to those with a taxable income below R270 000.
- The **primary rebate** rises to R10 755 from R10 260, while the **secondary rebate** increases to R6 012 from R5 675. Additionally, a **third rebate** of R2 000 is proposed for individuals 75 and older.
- The **income tax threshold** rises to R59 750 from R57 000 for taxpayers under 65 and to R93 150 from R88 528 for taxpayers over 65. A third rebate of R2 000 for taxpayers over 75 is proposed, which sets the tax threshold for this group at R104 261.
- The **top marginal tax rate** remains unchanged at 40%, while the top marginal tax rate threshold increases to R580 000 from R552 000.
- The **tax-free lump sum benefit** upon retirement rises from R300 000 to R315 000.
- Exemptions on **domestic interest** rises to R22 800 from R22 300 for individuals below 65 and to R33 000 from R32 000 for those above 65. The **foreign interest-income rebate** remains unchanged at R3 700.
- A **dividend tax**, which treats dividends at issue as ordinary revenue, will replace the Standard Tax on Companies (STC) with effect from 1 April 2012.
- Adjustments were made to the **capital gains** tax regime. The annual exclusion threshold for capital gains or losses increases to R20 000 from R17 500 for individuals and special trusts, while the capital gains tax exclusion on death increases to R200 000 from R120 000. The threshold for capital gains on disposal of a small business for individuals 55 years and older rises to R900 000 from R750 000.
- The **transfer duty exemption** rises to R500 000 to R600 000.
- A **withholding tax on gambling winnings** above R25 000, including the National Lottery, is proposed at 15% with effect from 1 April 2012.
- **General fuel levies** increase by 18c per litre. The levy on petrol and diesel rises by 10c per litre each with effect from 6 April 2011, while the **Road Accident Fund** levy goes up by 8c per litre.
- The **VAT** rate remains unchanged at 14%.
- The **headline corporate tax rate** remains at 28%.
- The **National Health Insurance** scheme will be implemented over a 14-year period and although this is being discussed, the scheme will need more revenue than the current

allocations to health; extra revenue could be raised through a payroll tax payable by employers, a higher VAT rate and/or a surcharge on individuals' taxable income.

Table 4 : Revenue Estimates

	2011/12		Proposals		2010/11
	(Rm)	% growth	% of tax	(Rm)	(% overshoot)
Consolidated revenue	824,466	9.2			2.3
Provincial and other revenue	94,608	7.0			-7.0
National revenue	729,858	9.5			3.6
Other revenue	10,001	6.9			-9.9
Less Customs UA	21,763	45.2	2.9	0	0.0
Tax revenue	741,620	10.3	100.0	-4,115	3.8
Incomes and profits	418,345	10.1	56.4	-8,350	0.6
Individuals	252,750	10.9	34.1	-8,850	1.5
Other companies	144,165	8.8	19.4	500	-0.9
STC	18,100	9.7	2.4	0	0.0
Other	3,330	8.1	0.4	0	6.6
Payroll and workforce	9,150	8.7	1.2	0	0.0
Skills dev fund	9,150	8.7	1.2	0	0.0
Property	9,590	2.4	1.3	-750	-6.0
MST	3,300	10.0	0.4	0	-26.8
Transfer duties	5,350	-2.7	0.7	-750	10.0
Other	940	8.7	0.1	0	0.6
Goods and services	274,210	10.8	37.0	4,985	7.2
VAT	200,880	10.8	27.1	0	10.6
Fuel levy	36,900	7.6	5.0	1,900	-0.9
Excise duties	25,085	9.5	3.4	1,785	-5.6
Electricity levy	6,530		0.9	1,150	0.0
Other	4,815	26.5	0.6	150	34.5
International trade	30,325	13.2	4.1	0	28.5
Customs duties	29,860	13.1	4.0	0	28.8
Other	465	19.2	0.1	0	11.4
Stamp duties & fees	0	-100.0	0.0	0	-75.0
Memorandum items:					
Direct taxes	428,435	10.0	57.8	-9,786	0.6
Indirect taxes (net)	313,185	10.7	42.2	5,671	8.4

Source: National Treasury Budget Review 2011

Financing

- The **consolidated budget deficit for 2010/11** is estimated at R142,4 billion or 5,3% of gdp. The estimated outcome is slightly below the R143,1 billion projected in MTBPS, but since the gdp estimate has been revised downwards from the value forecasted in October last year, the budget deficit relative to the size of the economy remains unchanged from the 5,3% of gdp estimated in MTBPS. The estimated outcome remains well below the original target of R168,6 billion or 6,2% of gdp set out in the National Budget in February 2010.
- Surprisingly, the **consolidated budget deficit for 2011/12** is projected to rise to R154,8 billion or 5,3% of gdp, significantly above the deficit of R134,2 billion or 4,6% of gdp envisaged in the MTBPS. Thereafter, the projected deficit for each year up to 2013/14 is higher than the plan set out in October last year as National Treasury now expects slightly milder gdp growth and lower tax revenue over the next three years than expected at the time of the MTBPS. National Treasury now plans to gradually reduce the consolidated deficit to R134,6 billion or 3,8% of gdp by 2013/14.
- The **public sector borrowing requirement (PSBR) for 2011/12** is estimated at R276,4 billion or 9,5% of gdp, which is larger than the R268,8 billion or 9,2% of gdp projected in October last year. This is largely the result of higher-than-expected borrowing by general government, while estimated borrowing by public corporations to finance capital expenditure is expected to be less than the values set out in the MTBPS. The PSBR will slowly be reduced to R222 billion or 6,3% of gdp by 2013/14.
- In 2011/12, the net financing requirement will increase to R157,9 billion. Of this, government will raise R22 billion in **short-term loans**, R135,4 billion in the **local bond market** and almost

R5 billion in **foreign loans**. Compared with last year, government's reliance on short-term loans and the local bond market will decline slightly, while more will be raised from foreign bond issues, possibly to take advantage of investor interest in emerging market debt and relatively favourable financing terms.

- **New loan issues** of about R150 billion are planned for both 2011/12 and 2012/13, with **redemptions** of about R15 billion and R26 billion respectively over the next two years.
- The deterioration in government finances during the past two years has pushed total net loan debt up to 30,8% of gdp in the last fiscal year from only 22,7% of gdp back in 2008/09. **Total net loan debt** is expected to rise further to 34,3% in 2011/12, before climbing up to 39,3% of gdp in 2013/14. The bulk of the country's debt remains domestic, with foreign debt accounting for less than 10% of gross loan debt.

Table 5 : Government financing

	2010/11		2011/12
	Budget Rbn	Outcome Rbn	Budget Rbn
National deficit	-174.9	-143.36	-159.07
Plus extraordinary transfers	0.00	3.15	1.35
Less proceeds from state assets	0.00	0.80	0.15
Net borrowing requirement	-174.90	-141.01	-157.87
Financing			
Domestic	159.74	174.25	157.37
- short-term loans	22.00	35.10	22.00
- long-term loans	137.74	139.15	135.37
Financing loans	137.74	139.15	135.37
New loans	151.34	152.61	150.40
Redemptions	13.60	13.46	15.03
Foreign loans	11.56	-2.27	5.00
Change in cash balances	3.60	-30.97	-4.50
Finance raised	174.90	141.01	157.87

Source: National Treasury Budget Review 2011

Other issues

No new measures for dealing with speculative capital inflows or weakening a strong rand were announced in this year's budget, after Minister Gordhan significantly reduced foreign exchange controls and indicated that National Treasury will support aggressive purchases of foreign exchange reserves by the Reserve Bank in October last year.

The measures announced in October last year 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.
- Continuing to monitor the effectiveness of tax and other regulatory measures adopted to deter speculative capital inflows in other emerging markets countries, and if effective the necessary steps will be taken locally. On this front, Minister Gordhan indicated that they will continue to monitor measures adopted elsewhere in the world, but no new tax or regulatory controls on speculative capital inflows were announced in this year's budget.
- 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.

The Minister announced the release of a discussion paper on regulating the foreign direct investment and on the prudential framework for institutional investors. With foreign exchange controls now so limited, a move away from formal controls to prudential requirements is probably imminent.

The Minister confirmed that fiscal and monetary policy will continue to work together, highlighting the success of inflation targeting in managing inflationary expectations, containing actual inflation and reducing interest rates to their current low levels. In this context, the Minister expressed concern over the impact of rising global food and fuel prices on inflation and suggested that the Reserve Bank will have to remain vigilant and effective in maintaining inflation within the target range. There was also no change to the Reserve Bank's 3% to 6% cpi inflation targeting range.

A discussion paper on proposed financial sector reforms was also released, with the proposals aimed at enhancing the regulatory framework and improving financial services. The proposed reforms include a new system of financial regulation, supervised by both the Financial Services Board and the Reserve Bank. National Treasury also proposes measures to regulate the setting of banking charges, the formation of a new 'inter-agency financial stability oversight committee' and a Council of Financial Regulators to ensure that the financial sector serves the country better.

Assessment

The 2011/12 budget contained few surprises and was well received by the markets. Government is now very focused on creating jobs to address poverty and inequality and to improve the inclusiveness of growth. While the various incentives, targets and energy applied to this problem are welcome, it is still not clear that individual businesses will respond in a way that government envisages. Companies are still adjusting to a changed local and global environment in the aftermath of the global financial crisis and are not likely to expand aggressively in the short term. Added to this, government policy is not consistent, with new proposed labour legislation and regulatory concerns in key industries unlikely to stimulate confidence. As part of this package a more conducive overall environment for business needs to be created and maintained if the government's targets for employment are to be achieved.

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