MEDIUM TERM BUDGET POLICY STATEMENT 2012

Presenter: Pravin Gordhan | **Minister of Finance** | **26** October 2012

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Summary

- Broad themes
  - Challenging environment of continued economic uncertainty
  - GDP growth has been revised down and global risks to the outlook are high
  - Domestic events highlight urgent need to accelerate South Africa's social transformation
  - Supportive fiscal policy with disciplined spending trajectory and debt management

- Economic growth projected to be lower than the Budget and is expected to remain moderate
  - GDP is expected to be 2.5% this year and 3.0% in 2013
  - South Africa's economy supported by sound monetary and fiscal policies grounded in a stable institutional framework.

- The budget deficit is forecast to moderate from 4.8% of GDP in 2012/13 to 3.1% in 2015/16
  - Tax revenue has been revised slightly downwards, by R5 billion in 2012/13.
  - Government debt is expected to peak at 39.2 per cent of GDP in 2015/16.

- Real growth in expenditure averages 2.9% over the MTEF
  - Total expenditure of R1.15 trillion in 2013/14 rising to R1.34 trillion in 2015/16.
  - The 2013 MTEF reprioritises approximately R40bn of funds, provides drawdowns on the contingency reserve, and allows for the revision of budget baselines

The macroeconomic forecast

- Growth expected to be 2.5% this year, 3.0% in 2013 picking up to 4.1% in 2015.
- Public-sector infrastructure investment, activation of new electricity-generating capacity, low inflation and interest rates, and improved confidence support improved medium term growth
- Inflation to remain within the target range of 3% – 6% over MTEF
- Current account deficit widens to 5.9% this year before moderating to 5.5% in 2014 and 2015.

Table 2.2 Macroeconomic performance and projections, 2009 – 2015

	2009	2010	2011	2012	2013	2014	2015
Calendar year		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	-1.6	3.7	5.0	3.4	3.5	4.0	4.2
Final government consumption	4.7	4.9	4.5	3.7	3.5	3.5	3.2
Gross fixed-capital formation	-3.2	-1.6	4.4	5.2	4.5	5.1	5.8
Gross domestic expenditure	-1.6	4.2	4.3	4.1	3.8	4.4	4.7
Exports	-19.5	4.5	5.9	0.5	3.5	5.8	6.5
Imports	-17.4	9.6	9.7	6.3	6.4	7.4	7.6
Real GDP growth	**-1.5**	**2.9**	**3.1**	**2.5**	**3.0**	**3.8**	**4.1**
GDP inflation	7.7	7.9	8.0	5.4	6.5	6.1	5.8
GDP at current prices (R billion)	**2 398.2**	**2 661.4**	**2 964.3**	**3 202.5**	**3 513.5**	**3 868.9**	**4 263.9**
Headline CPI inflation	7.1	4.3	5.0	5.7	5.5	5.1	4.9
Current account balance (% of GDP)	-4.0	-2.8	-3.3	-5.9	-5.8	-5.5	-5.5

Source: Reserve Bank and National Treasury

Global outlook has deteriorated as the European debt and banking crisis remains unresolved

IMF growth and inflation projections 2012-2014

Region / country Percentage	2012	2013	2014	2012	2013	2014
	GDP projections[1]			CPI projections[1]		
World	3.3	3.6	4.1	4.0	3.7	3.6
Advanced economies	1.3	1.5	2.3	1.9	1.6	1.8
US	2.2	2.1	2.9	2.0	1.8	1.8
Euro area	-0.4	0.2	1.2	2.3	1.6	1.4
UK	-0.4	1.1	2.2	2.7	1.9	1.7
Japan	2.2	1.2	1.1	0.0	-0.2	2.1
Emerging markets and developing countries	5.3	5.6	5.9	6.1	5.8	5.3
Brazil	1.5	4.0	4.2	5.2	4.9	4.8
Russia	3.7	3.8	3.9	5.1	6.6	6.5
India	4.9	6.0	6.4	10.3	9.6	8.3
China	7.8	8.2	8.5	3.0	3.0	3.0
Sub-Saharan Africa	5.0	5.7	5.5	9.1	7.1	6.1
South Africa[2]	2.5	3.0	3.8	5.7	5.5	5.1

1. IMF World Economic Outlook, October 2012
2. National Treasury forecasts

- Subdued growth in advanced economies in 2012 and 2013
  - High debt and borrowing costs
  - High levels of unemployment
  - Banking sector problems
- Slowdown in Brazil, China and India this year but robust in 2013 and 2014
- Unconventional monetary policy in advanced economies insufficient to offset negative effects from front loaded fiscal consolidation and private sector deleveraging.
- Euro debt crisis and US fiscal cliff are the significant global risks to forecasts

Risks to the economic outlook reflect on-going global turmoil and domestic factors

Global factors

- Uncertainty about resolution of European sovereign debt and banking crisis remains the key source of volatility in financial markets, eurozone recession affects trade flows
- Global factors have direct and indirect effects on South Africa's economy
  - Weak global demand for South African exports
  - Global investment uncertainty
  - Volatile capital flows, currencies, and commodity prices

Domestic factors

- Primary obstacles to faster, more inclusive growth are rooted in the domestic economy.
  - Strike activity in mining and other sectors
  - The balance between electricity supply and demand
  - Infrastructure bottlenecks
  - Weak business confidence
  - A widening current account deficit

Impact of mining strikes on the economy

- Total rand value of production lost in platinum and gold mining is roughly R10.1 billion so far …

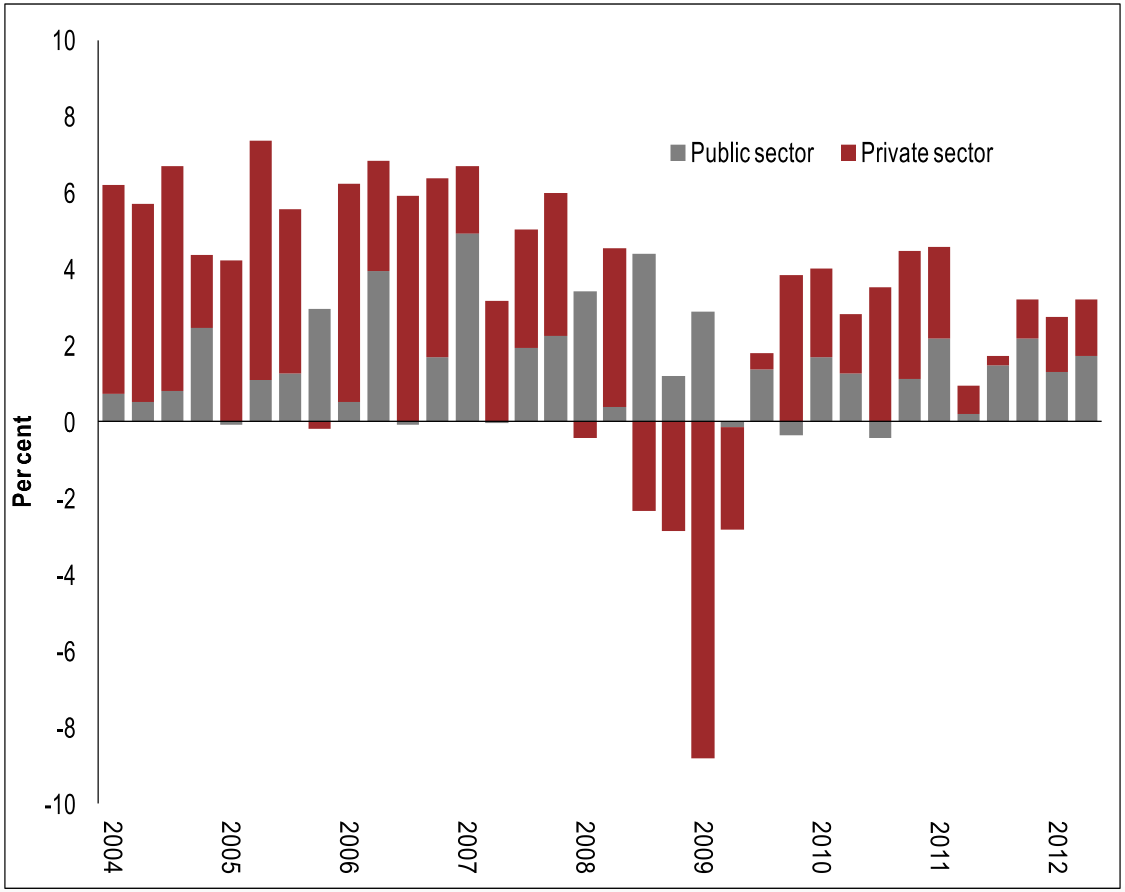
- Violent and protracted strike action has exacted a much higher cost in terms of social stability and falling confidence in South Africa

- The mining stoppages since the beginning of the year have subtracted an estimated 50 basis points from GDP growth
  - GDP growth for 2012 would have been 3% instead of the 2.5% we currently forecast
  - 38 500 fewer jobs have been created in mining, manufacturing and related services
  - The total impact on tax revenue is estimated to be about R4.1 billion
  - Export revenues projected to be R12.5 billion lower in 2012

- The negative impact on GDP growth in 2012 and 2013 will be larger if strike activity is protracted and spreads further to other mines and industries

Rising public-sector investment offsets slowdown in private domestic demand

Public and private sector contributions to GDP growth 2004-2012



- The contribution of the private sector to domestic growth has slowed over the past 15 months.
- Weaker business confidence, domestic supply constraints and low demand restrain private investment growth at weaker pace than during 2011.
- Household consumption growth has slowed from 5.0% in 2011, and is forecast to average 3.4% in 2012 due to sluggish job creation, elevated debt and limited growth in real disposable income
- Gross fixed-capital formation by the public sector expanded at an annual rate of 10.9% during the first half of 2012.

Source: Reserve Bank

National Development Plan : implementation

President's Leadership Summit commitments

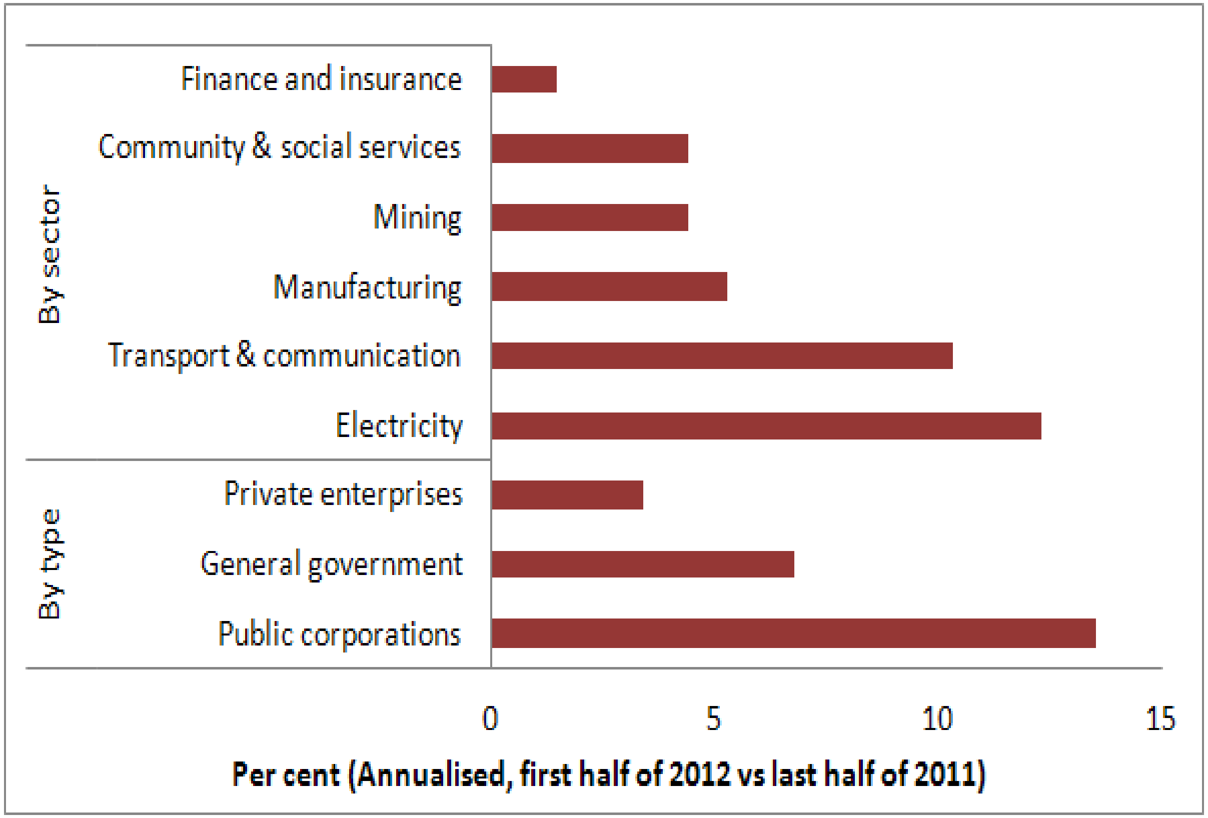
- Strategic infrastructure investment programmes under PICC coordination
- Strengthening municipal finances and investing in urban infrastructure
- Industrial policy action plan and promotion of special economic zones for industrial and export opportunities
- Accelerating the creation of youth employment opportunities
- Improving living conditions in informal settlements, including mining communities
- Expanding exports, especially to emerging markets, and realising investment opportunities in Africa
- Agricultural support, investment in rural areas and small business development.

Progress in implementing previous commitments: eg

- Investment incentives for industry
- Manufacturing competitiveness enhancement programme
- Renewable energy independent power programme
- Cities support programme ande Municipal Infrastructure Support Agency

Investment in electricity, transport and communications boosts overall investment growth

Growth in gross fixed capital formation by type and sector

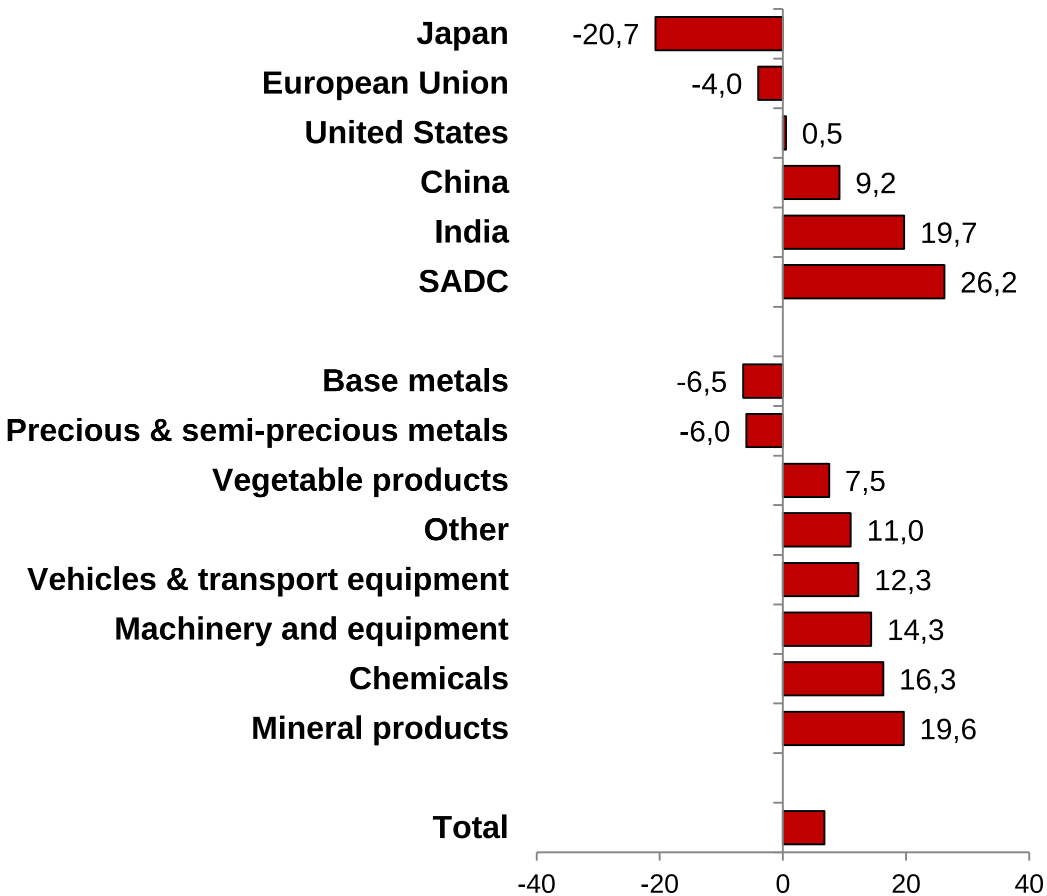


Source: Reserve Bank

- Emphasis on network infrastructure to ease bottlenecks and reduce cost of doing business
- As the economic environment strengthens, rising confidence should support a gradual improvement in private-sector gross fixed-capital formation.
- Public-sector infrastructure programme will continue to support overall investment over the medium term.

Export performance varies across destinations and products

Annual growth in export values (first 8 months of 2012)

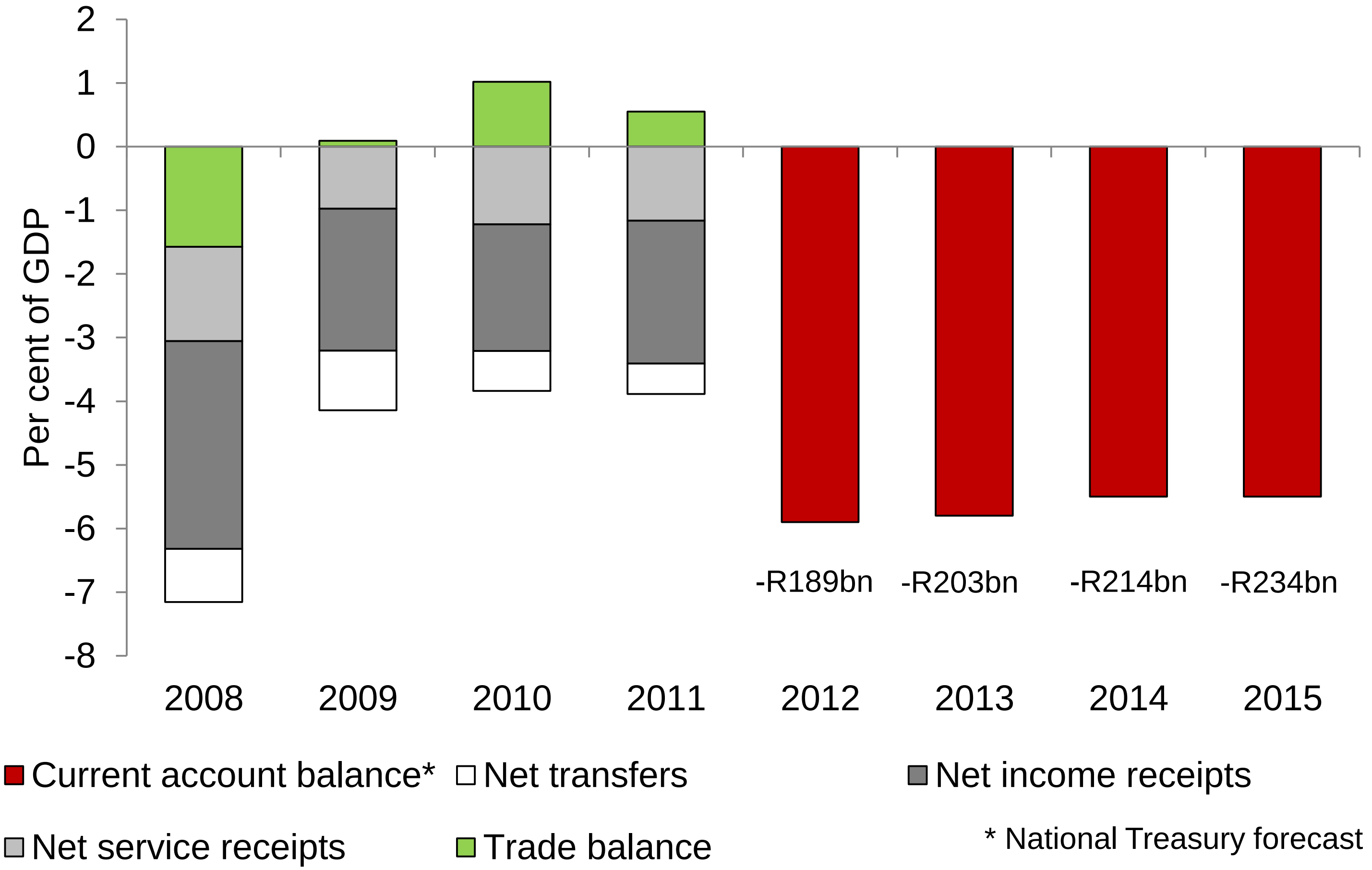


- Export volumes contracted at an annual rate of 6.3% in the 2nd quarter after falling 1.5% in the 1st quarter of 2012.
- The value of coal and chemicals exports robust, while platinum (-21.9%) and base metals (-6.7%) declined.
- Domestic supply constraints have exacerbated the pressure on exports from weaker external demand.
- Disruptions to platinum output affected trade with Germany, Japan and the US.
- SADC is our 2nd-largest export market.
- Share of manufactured exports to SADC (21.8%) has increased rapidly, led by steel, chemical products, and machinery and appliances, especially mining equipment.

Source: Quantec

Current account deficit increases reliance on foreign funding … domestic investment higher than savings

Components of the current account deficit and projections, 2008-2015



* National Treasury forecast

R189 billion to fund expected current account deficit in 2012

Source: Reserve Bank and National Treasury forecasts

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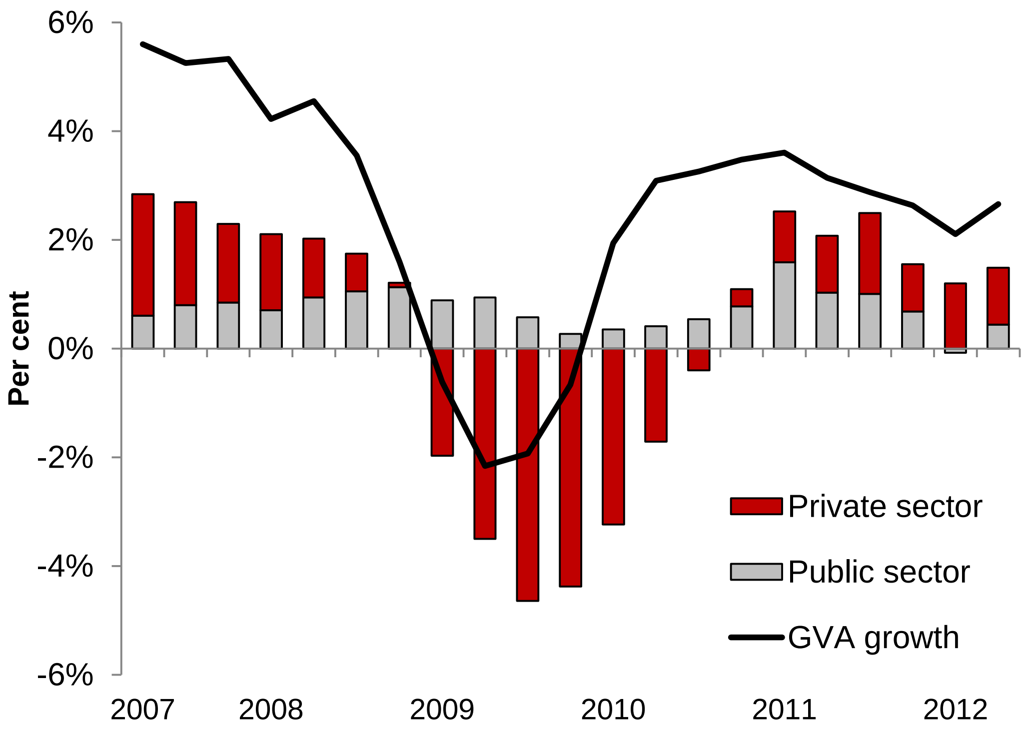
Employment gains have decelerated with slower growth over the past year

Growth in gross value added and public and private sector contributions to formal employment, 2007-2012

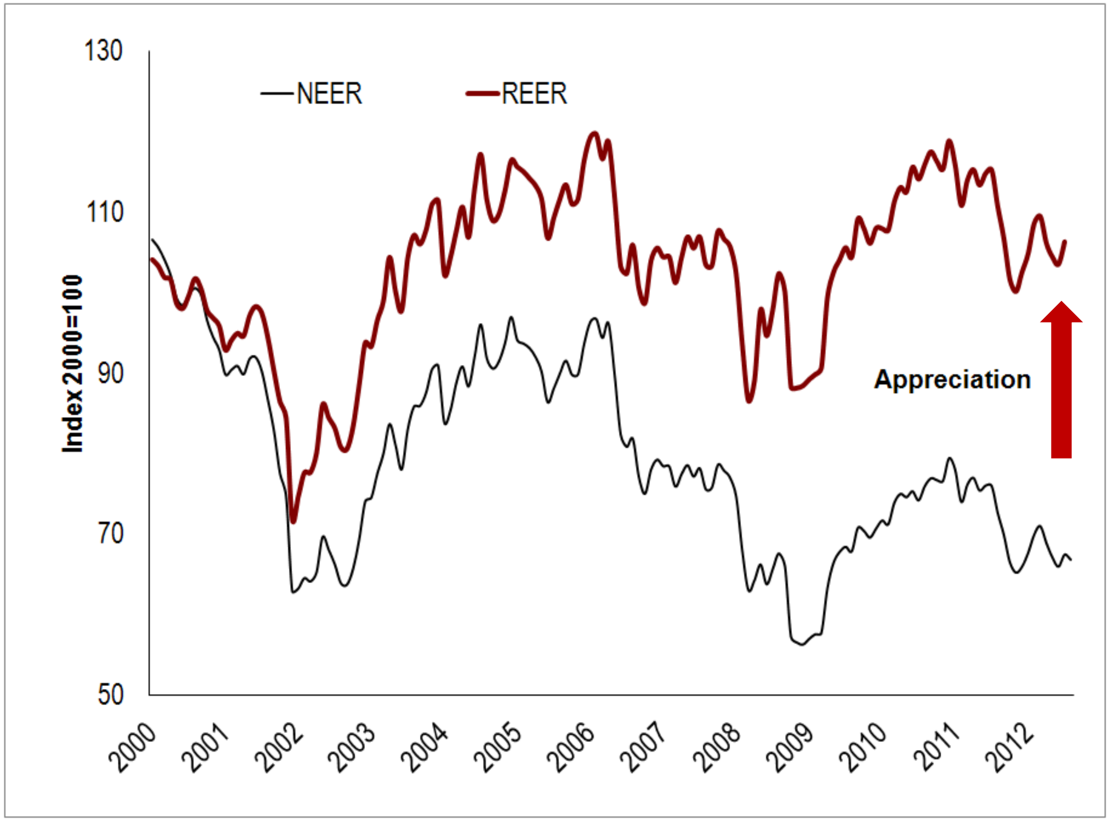


Source: Statistics South Africa

- Economic growth is integral to job creation.
- Unemployment rate is high at 25%.
- Formal non-agricultural employment rising towards pre-2009 levels, with 125 000 jobs added over the past 12 months.
- Public-sector employment has risen by 38 000 jobs compared with 87 000 additional private-sector jobs.
- Nominal wage settlements averaged 7.4% in the first nine months of 2012, from 7.7% in 2011.
- Current trends of rising wage demands could put pressure on new hiring.
- The economy is projected to create 780 000 jobs over the next three years.

The rand has depreciated in 2012 but remains volatile

Nominal and real effective exchange rate indices 2000-2012



Source: Reserve Bank

- Global financial turmoil and swings in risk appetite continue to affect the rand.
- Sentiment towards the rand has also been negatively affected by deterioration of the current account and wildcat strikes.
- The nominal trade-weighted rand was on average 10% weaker in the first three quarters of 2012 relative to the same period in 2011.
- The weaker rand has so far provided little support for manufacturing export growth, which remains subdued in the present economic environment.
- Durable gains from weaker rand requires productivity gains and contained domestic input costs

Securing South Africa's fiscal footing

- South Africa's fiscal framework remains grounded in a sustainable, countercyclical approach
- The current challenge is to navigate a path between fiscal consolidation and appropriate support for the economy
  - Fiscal stance targets medium-term consolidation, with moderate expenditure growth to support economic recovery and sustain the social wage,
  - Three policy objectives:
- **Moderating expenditure growth**
  - No increase to overall spending projections set out in the 2012 Budget for 2013/14 & 2014/15.
  - Provision for moderate growth of non-interest expenditure in the outer year of the fiscal framework, consistent with the objective of stabilising debt.
- **Stabilising government debt**
  - Slower spending growth and recovery in revenue narrows the primary deficit to 0.4% of GDP in 2015/16 and results in the stabilisation of debt.
  - Subsequent reductions in the debt to GDP ratio requires government to maintain a primary surplus.
- **Improve outcomes and shifting the composition of spending**
  - Commitment to sustaining infrastructure investment spending.
  - Government will step up efforts to combat waste, inefficiency and corruption, including through procurement reforms.

Fiscal framework

- Weaker economic conditions result in downward revision to tax revenue estimates (R5bn less in 2012/13), and a higher fiscal deficit than projected at the Budget
- Expenditure remains contained, growing by 2.9% over the MTEF
- Debt costs projected to rise to R114.8 billion by 2015/16

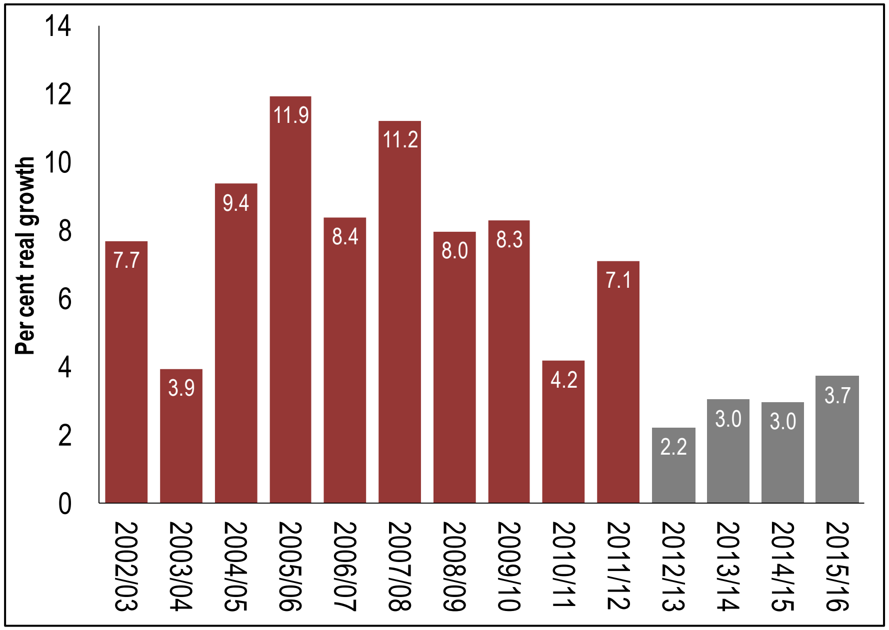
Table 3.2 Consolidated fiscal framework, 2010/11 – 2015/16

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
R billion / percentage of GDP	**Outcome**		**Estimate**	**Medium-term estimates**		
Revenue	**757.4**	**837.0**	**900.6**	**986.1**	**1 092.1**	**1 205.0**
	27.5%	*27.7%*	*27.5%*	*27.5%*	*27.6%*	*27.6%*
Expenditure	**874.4**	**964.4**	**1 057.1**	**1 147.4**	**1 238.1**	**1 339.0**
	31.8%	*32.0%*	*32.3%*	*32.0%*	*31.3%*	*30.7%*
Non-interest expenditure	808.2	887.9	968.3	1 048.8	1 131.3	1 224.2
	29.4%	*29.4%*	*29.6%*	*29.2%*	*28.6%*	*28.0%*
State debt cost	66.2	76.5	88.8	98.6	106.8	114.8
	2.4%	*2.5%*	*2.7%*	*2.7%*	*2.7%*	*2.6%*
Budget balance	**-117.0**	**-127.4**	**-156.5**	**-161.3**	**-146.0**	**-134.0**
	-4.3%	*-4.2%*	*-4.8%*	*-4.5%*	*-3.7%*	*-3.1%*
Primary balance (percentage of GDP)	*-1.8%*	*-1.7%*	*-2.1%*	*-1.7%*	*-1.0%*	*-0.4%*

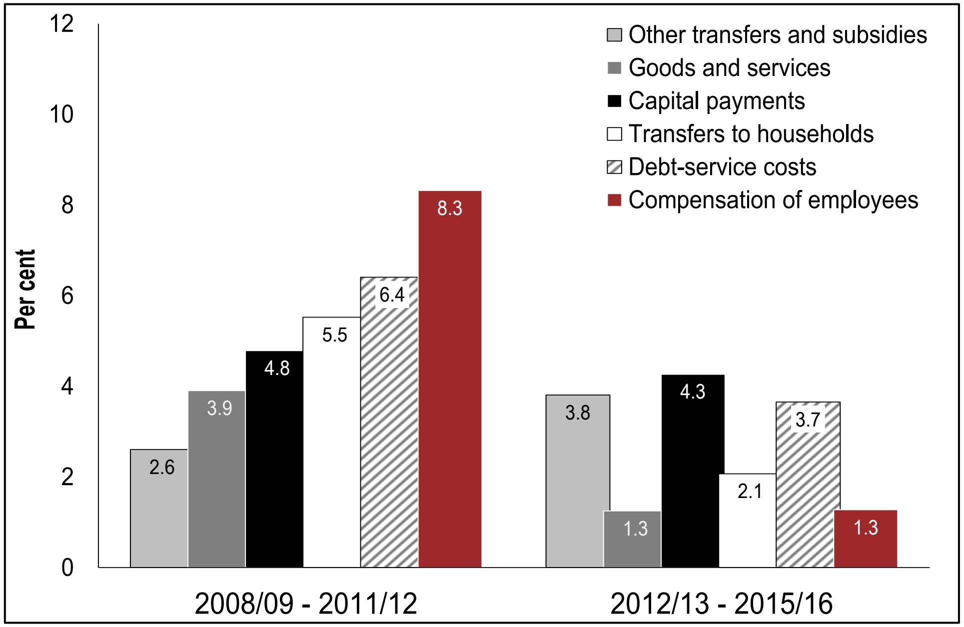
Source: National Treasury

Trends in expenditure growth

Real growth in non-interest expenditure



Real growth of expenditure components

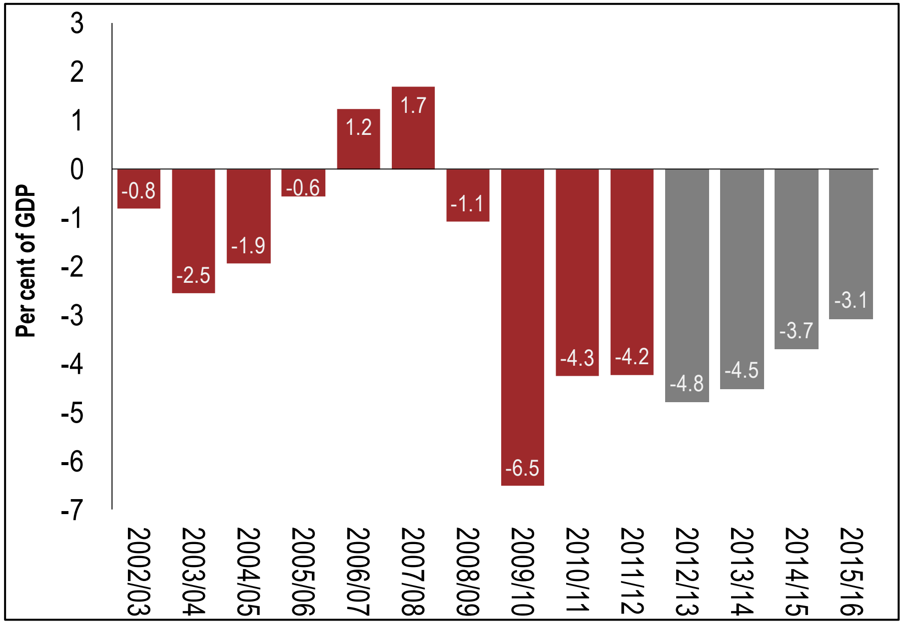


- ❑ Non-interest expenditure grew rapidly in the past decade but moderates over the MTEF
- ❑ Growth in the budget for compensation of employees will be contained
- ❑ Capital budgets grow strongly, the main challenge is to ensure that allocations are spent – and spent effectively

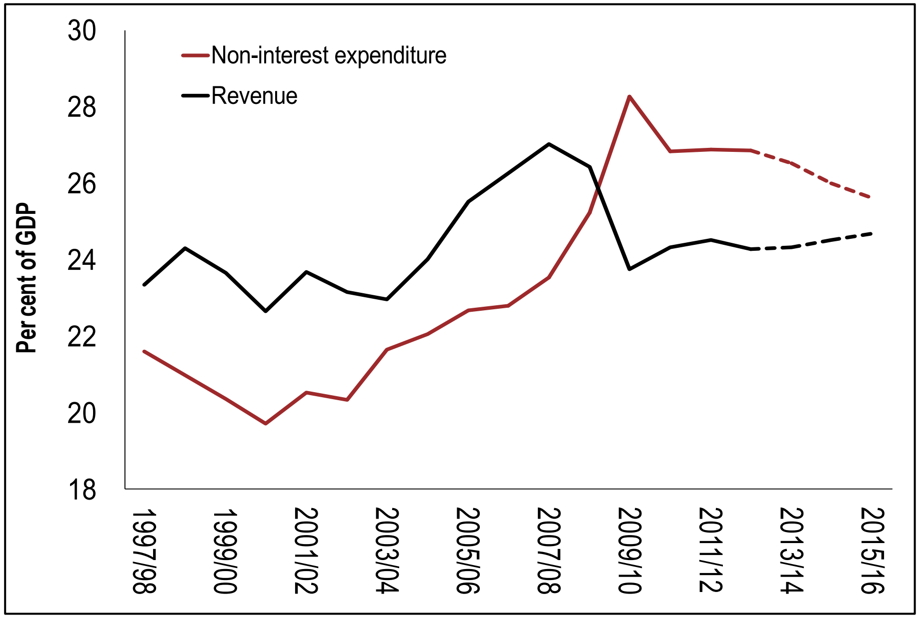
Source: National Treasury

Budget balance

Consolidated budget balance



Main budget revenue and non-interest expenditure

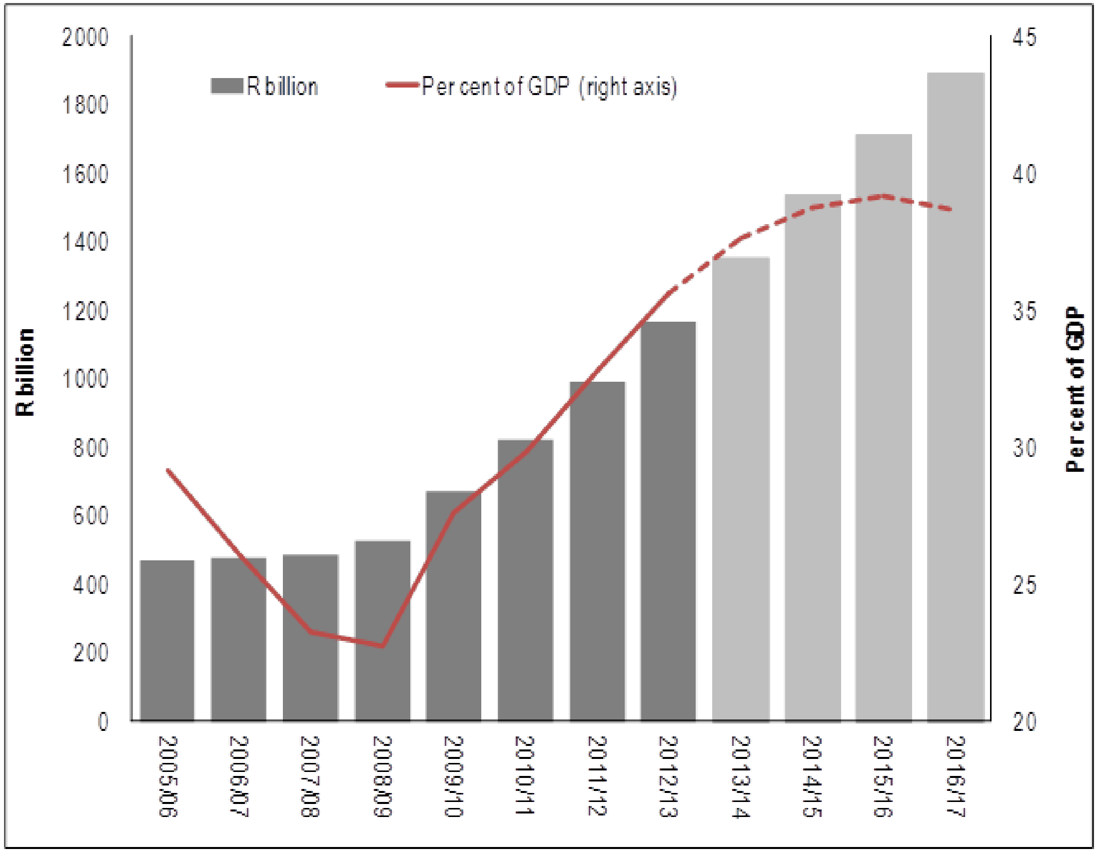


- The 2008/09 recession resulted in a dramatic widening of the deficit
- Non-interest expenditure remains above revenue, but primary deficit narrows over the MTEF
- Moderate expenditure growth to improve access to services and accelerate the pace of infrastructure investment

Source: National Treasury

Medium-term financing and debt

Stock of government debt, 2005/06 – 2016/17



Source: National Treasury

- Government debt peaks at 39.2% of GDP in 2015/16
- Domestic bond markets will remain the main funding source.
- Debt issuance will be maintained at sustainable levels through drawing on cash balances, exchanging debt maturing and borrowing in global capital markets
- Public-sector borrowing requirement remains at 7.1 per cent of GDP moderating in the medium term.

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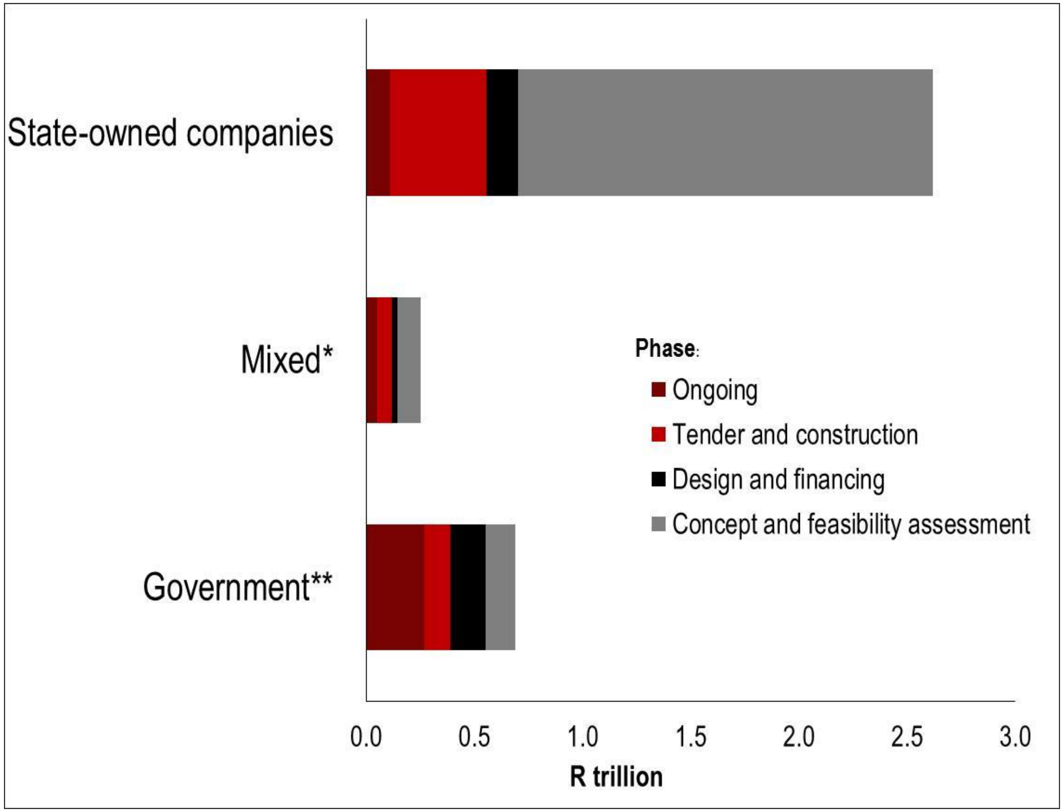
Public-sector infrastructure investment

Major infrastructure projects by phase and implementing agent



* Financed jointly by SOEs and government

** National, provincial and local government projects financed from the budget

- Bulk of infrastructure spending to be financed from the balance sheets of SOEs.
  - Costs will be recovered by charges levied on users
- The fiscus will fund social and community infrastructure projects such as schools, health facilities and secondary roads
- Over the MTEF, R250 billion will finance "shovel ready" projects
- Other cost-effective projects that provide optimal long-term benefits will be eligible for support from the fiscus.

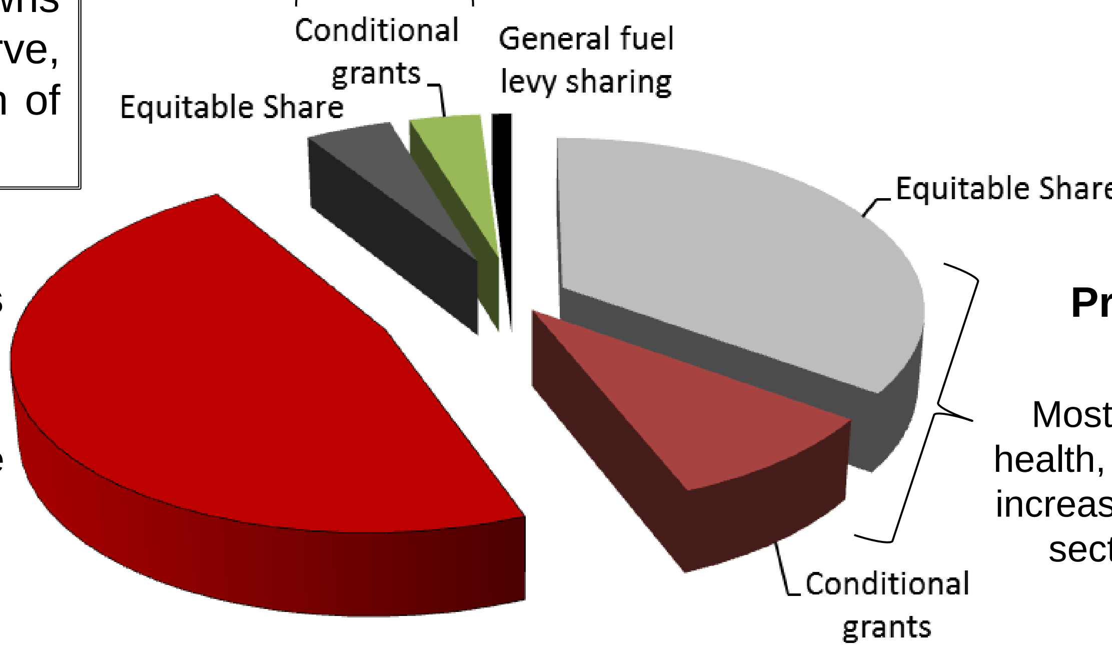
Source: National Treasury

Division of revenue

The 2013 MTEF reprioritises approximately R40bn of funds, provides drawdowns on the contingency reserve, and allows for the revision of budget baselines

Local government
9%

Mostly to accommodate infrastructure investment



National departments
47%

Main factors :

- salary costs & infrastructure

Provinces
44%

Mostly education, health, and cost of the increase in the public-sector wage bill

- The fiscus does not increase available funds beyond the 2012 budget baseline
- The aggregate non-interest spending ceiling will be retained for the 2013 Budget
- Drawdowns on the contingency reserve provide for limited increases in allocations, largely accommodating the costs of the 2012 public-sector wage agreement

Source: National Treasury

Reprioritisations over the 2013 MTEF

- Over the MTEF, R40 billion has been moved away from non-performing programmes or programmes that are not closely aligned to departments' core mandates.

- Funds were also shifted away from programmes that are not expected to disburse funds as quickly as initially scheduled

  Main recipients of these reprioritised funds include:
  - Police – Expanded detective and forensic capacity
  - Defence – Maritime Security Strategy and military veterans
  - Department of Labour – To prepare for amended labour legislation
  - Education – Education infrastructure and community libraries
  - Transport – Roads and public transport
  - Social development – Social workers and grant infrastructure
  - Expanded public works – The non-state sector (NGOs)
  - Water Affairs: Water infrastructure upgrade and maintenance

Appropriation adjustments

In-year adjustments

- R1.9bn downward adjustment in total estimated spending in 2012/13
  - R11.5bn in additional appropriations:
    - R5.5bn in higher than expected personnel remuneration increases
    - R2.3bn in unforeseeable and unavoidable expenditure
    - R1.5bn in roll-overs
    - R0.4bn in self-financing expenditure
    - R1.8bn for the skills levy and SETAs
  - Offset by the following, amounting to R13.4bn:
    - R5.8bn contingency reserve
    - R3.0bn declared savings
    - R0.5bn local government repayment into the NRF
    - R3.5bn projected underspending
    - R0.6bn decrease in projected state debt costs

Change to provincial equitable share and grants: 2013 MTEF

- R27.7bn added to provincial equitable share
  - Costs of wage agreement
  - Growth in numbers of health practitioners, improved healthcare diagnostics, and greater welfare support
  - Improvements in education for learners from poor communities

- Conditional grants
  - Proposed increases for education infrastructure, higher take-up of antiretroviral medicines and increased condom distribution
  - Proposed adjustments to conditional grants
    - Cost of wage agreement at *Further Education and Training Colleges*
    - Cater for reduced donor funding of HIV and Aids prevention and treatment programme
    - Informal settlement upgrading
    - Further investment in provincial roads
    - Increased support to community library services
    - Improved school infrastructure delivery in provinces
  - Devolution of property rates fund grant to be phased out when grant conditions are met

Change to local government equitable share and grants: 2013 MTEF

- Equitable share
  - Compensate municipalities for increased costs to provide basic services

- Conditional grants
  - Substantial investments made to assist municipalities with infrastructure rollout
    - Over R100bn between 2007/08 and 2011/12
  - Targeted reforms to conditional grants needed for 2013 MTEF to cater for ...
    - Devolution of human settlements and public transport functions to urban municipalities
      - Cities be supported to create integrated human settlements
    - Greater technical support to rural municipalities
      - A new direct grant to enable Department of Water Affairs to help municipalities to provide clean drinking water to households
      - Expansion of integrated national electrification programme and subsidisation of critical refurbishment projects in electricity and water

Implications of Census 2011 for provinces and municipalities

- Census 2011 results will affect the division of revenue
  - Released end-October 2012

- Provinces
  - Equitable share formula (introduced in 2011 MTEF) to be updated for 2013 MTEF with latest available data (including results of Census 2011)
    - Provincial populations and children of school-going age (5-17) per province
      - Provinces with above average increases in population and learners will benefit
      - Appropriate phase-in strategies will be considered to cushion impact on provinces adversely affected by data updates
- Local Government
  - Equitable share
    - Review of formula underway and will be introduced alongside data updates
      - Formula reforms include: improved targeting towards poorly resourced municipalities; catering for more regular data updates; and improved costing of municipal services
      - Appropriate phase-in strategies to be considered to cushion impact
  - Conditional grants
    - Comprehensive review to commence in 2013 for implementation in 2014/15
      - Census 2011 to help determine areas where backlogs are most prevalent and to help target grants at areas with the most urgent needs

THANK YOU