The mini-budget: calming the nerves

Yesterday's mini-budget addressed the concerns of the rating agencies and, more importantly, bond market investors; maintained spending on both poverty relief and development; detailed what growth and job creation can be expected over the next three years; and in general helped to alleviate the anxieties that hung over the country since Marikana.

Deficits and debt: steering a middle course

Gordhan steered a middle course between the two extremes of current economic debates: either austerity or higher deficits in support of growth.

The budget deficit is now slightly higher than envisaged in the February budget (4.8% of GDP vs 4.6%). It will also come down slower in future years: 4.5% in 2013 (in February 4%), 3.7% in 2014 (3%) and 3.1% in 2015. Essentially reaching a 3% deficit has been postponed by a year (from 2014 to 2015).

On the other hand, there is a nod to austerity by pinning government expenditure for the next two years at the base line set in February. This is not a freeze, but it is a slowdown of the growth of government expenditure. It will rise by 2.9% p.a. over the next 3 years.

Over the decade and a half since the 3 year rolling budgets were introduced, the habit has developed to set the expenditure baseline for three years hence in February and then adjust it upwards at the time of the mini-budget in October, and increase it again the next February. Cabinet has now decided to stick to this year's baseline for the next two years.

The overall result is that government debt rises to just over R1 trillion. The critical number, however, is the debt to GDP ratio and that rises from 35.7% this year to 39.2% in 2015. When Trevor Manuel became minister of Finance it was 46%, when he left the Treasury it was 23% and it is now creeping towards 40%.

This is in my opinion not a train smash: the increase is against the worst global recession since the 1930s and SA's debt levels are way below that of other countries with current account deficits. Without that increase the SA economy would have been in really serious trouble.

As recent events in Europe have indicated, and the fears for a "fiscal cliff" in the US confirm, too much austerity can make deficits and debt worse. Gordhan avoided that. The best antidote for deficits and debt is higher growth.

The markets were apparently relaxed as there was no response from the bond market.

Credibility

How credible is this no-higher-than-baseline-increases stance?

His hand is considerably strengthened by the 3 year wage agreement concluded between government as employer and the public service unions in August this year. There is now certainty on what the numbers will be on a very big expenditure item.

Will the 3 year agreement hold? With Mangaung soon out of the way and the 3 year wage agreement running till after the 2014 elections there are not too much political pressures on government and it can enforce the negotiated agreement.

Also, the recent industrial relations chaos caused by not sticking to negotiated agreements will not be forgotten soon. Government is unlikely to repeat the mistakes of some private sector employers in this regard.

Job Creation

The growth number s of 3%, 3.8% and 4% for the next three years imply that the economy by 2015 would be some 11% bigger than in 2012. The Treasury expects that 780 000 jobs would be created by 2015. This implies an employment co-efficient of about 0.5 (meaning for every 1% the economy grows jobs will grow by 0.5%).

That is a conservative assumption given that the National Planning Commission found that SA enjoyed an employment co-efficient of between 0.6 and 0.7.

780 000 more jobs imply continued growth for the retail sector and consumption and of course it means 780 000 more taxpayers. The mini-budget again confirms that 34% of taxes come from individuals; 43% from indirect taxes and the remaining 23% from companies and dividend taxes. Every extra job contributes to at least indirect and company taxes. The base gets strengthened.

Sources of Growth

Job creation is absolutely dependent on growth, so where will the growth come from? Treasury expects growth to come from mainly four sources:

- expanded infrastructure investment,
- activation of new electricity supply,
- relatively low inflation and interest rates and
- strong regional growth.

Investment spend is expected to rise by about 5% over the next few years, heavily underpinned by government spend. The mini- budget has not increased the R845 billion for infrastructure spend set aside in February. That amount is 8% of GDP, up from 6.5% in 2010. The National Development Plan sets a target of 10%.

The FNB/BER Construction surveys released earlier this week indicate an increase in confidence from the country's construction industry.

Scepticism on non-spending should be tempered. According to the City Press last Sunday underspending has been reduced from 32% of budgets to 20% over the last two years and work is on-going. A Municipal Infrastructure Support Agency has been established; it assessed 92 municipalities and deployed 67 technical experts. Incrementally this should help.

The regional story is an interesting one. SADC is currently SA's second biggest export market after the EU. The share of manufactured exports to the region has grown strongly. So much for competitiveness surveys which say SA cannot compete. In Africa SA certainly competes.

With weak growth in the EU and strong growth in SADC expected for the next five years, SADC could soon become SA's biggest market for manufactured exports. The weaker Rand will certainly help.

Less of a downgrade

In February the minister budgeted for growth of 2.7% for the year. In July he downgraded it to 2.5%. Almost everybody (myself included) was expecting a further downgrade of the expected growth rate in this mini-budget, particularly in the light of strikes.

Well, the minister did not downgrade from 2.5%. So much for the hysteria from some in the chattering classes that strikes will plunge the economy into a *recession!*

It is clear that the major damage to the platinum industry was done in the 12 months **before** Marikana and the strikes– in the year to August mining output fell by 3.3% with platinum down by 15.3%. The decline in platinum, gold and coal has been somewhat off-set by strong demand in iron ore.

The National Development Plan 2030

An interesting feature of both the minister's speech and the printed documents was the consistent references to the above plan, drafted by the National Planning Commission under the chairmanship of Trevor Manuel.

In September cabinet formally endorsed the 2030 Plan and stated that in future all government plans and actions must adhere to the Plan. This has certainly happened in this mini-budget statement. Over the next few years we must monitor to what extent the NDP gets embedded in our politics, but this budget made a good start.

So What?

- The ratings agencies mouths should be shut, at least for a while.
- There is no swing to populist or ill-discipline spending plans as generally feared/predicted.
- Growth was not downgraded as feared/predicted, certainly not to recession as feared/predicted; proving once again the resilience of the SA economy.
- 3% growth p.a. and 780 000 jobs over three years – more resources created, more people working, more tax contributors … it is progress by muddling through and 100% in line with our 3 year old "muddle through" scenario.