



**Question:** *Earlier this week President Bush tabled his budget for the fiscal year that will start on 1<sup>st</sup> October 2005. Will he succeed in cutting the deficit, thereby bolstering the dollar and thus ensure the Rand's decline?*

**Answer:** The short answer is no. There is no budget cutting, just wishful thinking.

**Question:** *Why so negative?*

**Answer:** Two reasons: credibility and the cold comfort of numbers.

**Question:** *Credibility?*

**Answer:** A year ago the Bush Whitehouse suggested that the deficit this year (ending on 30<sup>th</sup> September 2005) would be \$268 billion. In this budget now, the number is expected to be \$427 billion. A whopping 45% difference! A year ago the deficit for 2006 was forecast at \$364 billion, it is now set at \$390 billion, WITHOUT provision for wars in Afghanistan and Iraq. About a 17% difference. Let Trevor Manuel put in that kind of performance and you will see how he gets slaughtered.

**Question:** *The US constitution and Congress also affect credibility?*

**Answer:** Indeed. Under US constitution Congress can change the budget as it sees fit and in fact does so: vested interests, critical voters and so on all get accommodated. Under British and SA law, for example, parliament does not have the right to change the budget: they can reject in toto or accept, but no individual tinkering. Last year Mr Bush submitted a budget that proposed to cut 65 programs for a total of \$4,8 billion in savings. However, in the end Congress eliminated only 4 programs for a total saving of \$200 million. That is 4,1% of what the president proposed. This year he is proposing to cut 150 programs and save \$150 billion. What if the actual cut by Congress is again only 4%? Be optimistic and assume the actual cut will be 50% of what the president asked for. Then half of the \$150 billion envisaged cuts, must be added back. There goes the \$390 billion projected deficit.

**Question:** *And then there is the cold comfort of numbers?*

**Answer:** Indeed. This year the deficit amounts to \$427 billion 3,6% of GDP. For next year the forecast is \$390 billion, but then expenditure for Afghanistan and Iraq must still be added on. The bill for that is \$81 billion – less than half that amount will take next year's \$390 billion deficit to over this year's \$427 deficit. As long as the US is in Iraq and Afghanistan, deficits will remain comfortably above \$400 billion.

**Question:** *These numbers exclude popular tax changes that will probably be enacted by Congress?*

**Answer:** Yes, the minimum tax charge (originally devised to ensure that rich Americans pay some tax, but now threatening to engulf middle income families) will probably be rolled back. Just fixing that will cost \$70 billion – add that to the budgeted deficit of \$390 billion and... Then, in the long run, there is the change in Social Security that will add billions to the annual deficit.

- Question:** *But economic growth will swell the tax receipts and that will help reduce the deficit?*
- Answer:** There is a lot of that in the cold comfort numbers already. Mr Bush's budget expects income to rise by 10%, way above nominal GDP growth. But there is also a structural issue: Mr Bush's tax cuts have taken the tax take down to 16,8% of GDP from the 20,8% when he was elected. You will need an explosion in growth to make up 4% of GDP. Pedestrian growth rates (by US standards) will not do it.
- Question:** *Vice-president Cheney reportedly said that Ronald Reagan taught us that deficits do not matter?*
- Answer:** Rubbish. After Reagan, Bush senior had to increase taxes and it cost him his job. He became a one-term president. Clinton then took over and harvested a huge peace dividend from the contraction in American defence spending that followed the Fall of the Wall and dissolution of the USSR. He also harvested from the IT and Internet booms, which brought in billions in capital gains taxes. Extraordinary events that are unlikely to be repeated.
- Question:** *So fiscal policy is not going to support the dollar?*
- Answer:** Nope. And the rand may therefore not weaken as much as most people hope.
- Question:** *And the smart money backs that view?*
- Answer:** Yes. This is what Warren Buffet said: "Unless we have a major change in trade policies I don't see how the dollar avoids going down: we are force-feeding dollars to the rest of the world". He was referring to trade, not fiscal policies, but in the end the one feeds into the other.

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