

An unimaginative mini-budget

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31 October 2018

October's medium-term budget policy statement (MTBPS) was a dour affair and National Treasury continues to walk a tightrope with regard to the investment grade status of South Africa's sovereign bonds.

Moody's is the only authoritative credit rating agency that has not downgraded the country's bonds to the dreaded sub-investment level. Unfortunately, however, South Africa remains dangerously close to the cut-off point between investment grade and so-called "junk" status.

The most unpleasant surprise in the MTBPS, dubbed the "mini-budget", was the confirmation of an amount of R20 billion in VAT refunds that had not been paid out within the statutory prescribed period of 21 days. For no particularly good reason, SARS has been holding on to these refunds and the backlog will now be settled in a once-off payment.

Acting SARS head Mark Kingon has alluded to the possibility that SARS may in the past deliberately have frozen VAT refunds to artificially bolster its financial position – one of a series of examples of gross incompetence and mismanagement that characterised SARS during Mr Tom Moyane's "reign of terror", as it has been referred to during the Nugent Commission's hearings.

It should be pointed out, however, that the aggregate refund of R20 billion to mainly private sector enterprises will effectively translate into fiscal stimulus at a time when the economy is in desperate need for a demand-side boost. In terms of the country's input-output table multipliers, this amount should translate into an additional R60 billion of GDP.

A thorough analysis of the mini-budget shows an alarming tendency for National Treasury to conduct the exercise in an ultra-conservative manner, without due regard of the likely macro-economic impact of factors such as the VAT refund, the likelihood of good second half GDP growth and the early success of Mr Cyril Ramaphosa's global and domestic investment drive.

The table serves as an illustration of an entirely plausible fiscal outcome in the case of a more imaginative and forward-looking approach having been followed by National Treasury.

GDP estimate fiscal year 2018/19 (R billion)	R billion
Mini-budget (0.7% growth)	5 045.6
Realistic growth (1.2%) & VAT refund impact	5 130.9
Budget deficit as % of GDP	%
Mini-budget	4.3
Expenditure growth capped at CPI & realistic GDP	3

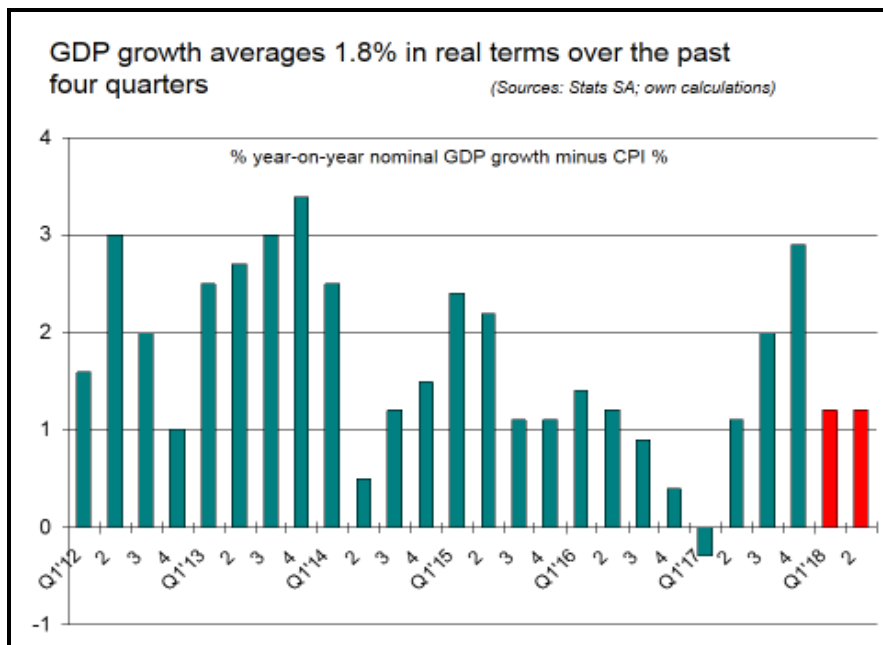
Assumptions underpinning the calculations are:

- A GDP growth forecast of 1.2%, (instead of 0.7%), which is highly likely against the background of a traditional bumper fourth quarter for the two largest sectors of the economy (finance and retail). It should be noted that total salaries & wages in the economy increased by 7% in nominal terms during the first half of 2018, compared to the first half of last year). This represents an increase of more than two percentage above the average consumer price inflation (CPI) over the past 12 months.
- A GDP impact of R60 billion induced by the VAT refund
- Limiting total government expenditure to the current rate of CPI (instead of 7.7%)

The advantage of higher economic growth cannot be over-emphasised. In the scenario described above, a fiscal backflow effect automatically occurs, due to the predictable and fairly consistent relationship between the level of economic activity and a variety of taxes.

Higher growth therefore exerts a twin positive effect on fiscal stability. The key indicator of the budget deficit as percentage of GDP is lowered by virtue of an increase in the denominator (the GDP) and a decrease in the numerator (the budget deficit, by virtue of higher tax revenues).

The most glaring error of judgement by National Treasury in estimating GDP for 2018 is related to the inadequate consideration of the exchange rate effect. One of the reasons for lacklustre economic growth (year-on-year basis) during the first half of 2018 is to be found in a relatively strong currency (in the aftermath of Mr Cyril Ramaphosa's ascension to the country's presidency).



This changed abruptly during the third quarter, for three main reasons: firstly, the dissipation of the record trade surplus of 2017; secondly the currency crisis in Argentina and Turkey,

which led to emerging market aversion by global fund managers; and thirdly, the higher interest rates in the US, which diverted portfolio investment to US bonds.

As a rule of thumb, a relatively weak currency is always good for growth, as it leads to higher export earnings (in local currency terms), whilst also incentivising retailers to purchase locally manufactured goods (due to more competitive prices).

National Treasury has missed a good opportunity to impress Moody's with a more objective growth outlook and firmer control over the enormous public sector wage bill.