Mini-budget strikes a good balance

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Now that the dust has settled from the initial reaction to the mini-budget, it is useful to take a sober look at the essence of South Africa's fiscal disposition.

The first and, arguably most profound observation is that the mini-budget simply reflects the fiscal dilemma caused by two different factors – one of a short-term nature and the other having been caused by a decade of maladministration by the public sector at large.

The pandemic caused by the corona virus has inflicted huge pain on every country on the globe, but the global economy has recovered remarkably well, and swiftly. It took mere months for the composite purchasing managers' indices (PMIs) of virtually every economy of note to return to above the neutral level of 50, which signals the difference between economic expansion and contraction.

In South Africa's case, key indicators such as retail and wholesale trade sales, mineral sales and value added by the agriculture sector have all but shrugged off the negative effects of the disastrous second quarter, when the lockdown regulations decimated economic activity in most sectors.

Softening the blow

The South African government's response followed the commendable global trend of fiscal assistance to businesses and vulnerable households where bread winners had lost their jobs.

The flip side of this relief programme was always going to manifest itself in a dramatically larger fiscal deficit – substantially larger unemployment inevitably leads to lower taxation revenues. The fiscal situation was battered from both sides – higher government spending on temporary grants and a shrinking tax base.

Fortunately, this effect will come to an end as the economy ultimately starts to match and improve upon its pre-Covid output levels.

The long-term problem facing National Treasury is more complex, as it relates to gross mismanagement of many public sector entities, the cost of which has been borne by the country's taxpayers.

During much of the decade of Mr Jacob Zuma's administration, a toxic combination of cadre deployment, incompetence, corruption, theft and tender fraud led to a sharp downward trajectory for public sector capital formation, which inevitably lowered investor confidence – from both a domestic and international perspective.

The good news is that this effect has been decisively halted by South Africa's new president, whose ticket to winning the leadership of the ANC was precisely aimed at an anti-corruption drive. This is starting to bear fruit, albeit at a slow pace and with a measure of opposition by the Zupta faction in the ANC.

The second observation is that South Africa has every chance of turning the corner, due to the fact that the root causes of the country's fiscal constraints are slowly but surely disappearing.

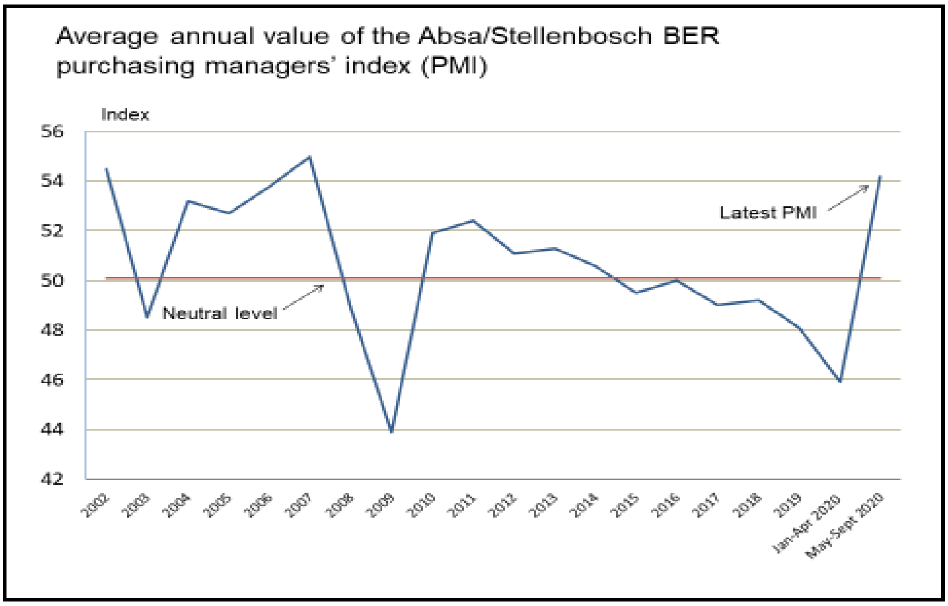
Growth is the priority

Mr Tito Mboweni has done a good job under extremely difficult circumstances and the mini-budget sends a clear signal that growth is the overriding priority. Fiscal consolidation is obviously necessary, but a hasty approach has the danger of suffocating an economy that has just started breathing more freely.

The acid test for capital market reaction to the mini-budget has provisionally been passed with flying colours, as the long-term bond yield has hardly blinked in the aftermath of the mini-budget – it remains 300 basis points lower than in March.

Nevertheless, one confounding aspect of the mini-budget is National Treasury's paltry GDP growth forecast for the next three years.

The budget team must have short memories, for the last time that the country experienced a combination of low interest rates, an undervalued exchange rate, balance of payments stability and an uptick in construction activity, the economy expanded by close to 5% per annum for five years in a row – until 2009, when the sub-prime crisis erupted.



The historical trend of the average Absa/BER PMI suggests that the economy could well sustain a growth rate of between 3% and 5% for several years to come, which would undoubtedly prevent a fiscal crisis.