Economic and fiscal context for national development

November 2015

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

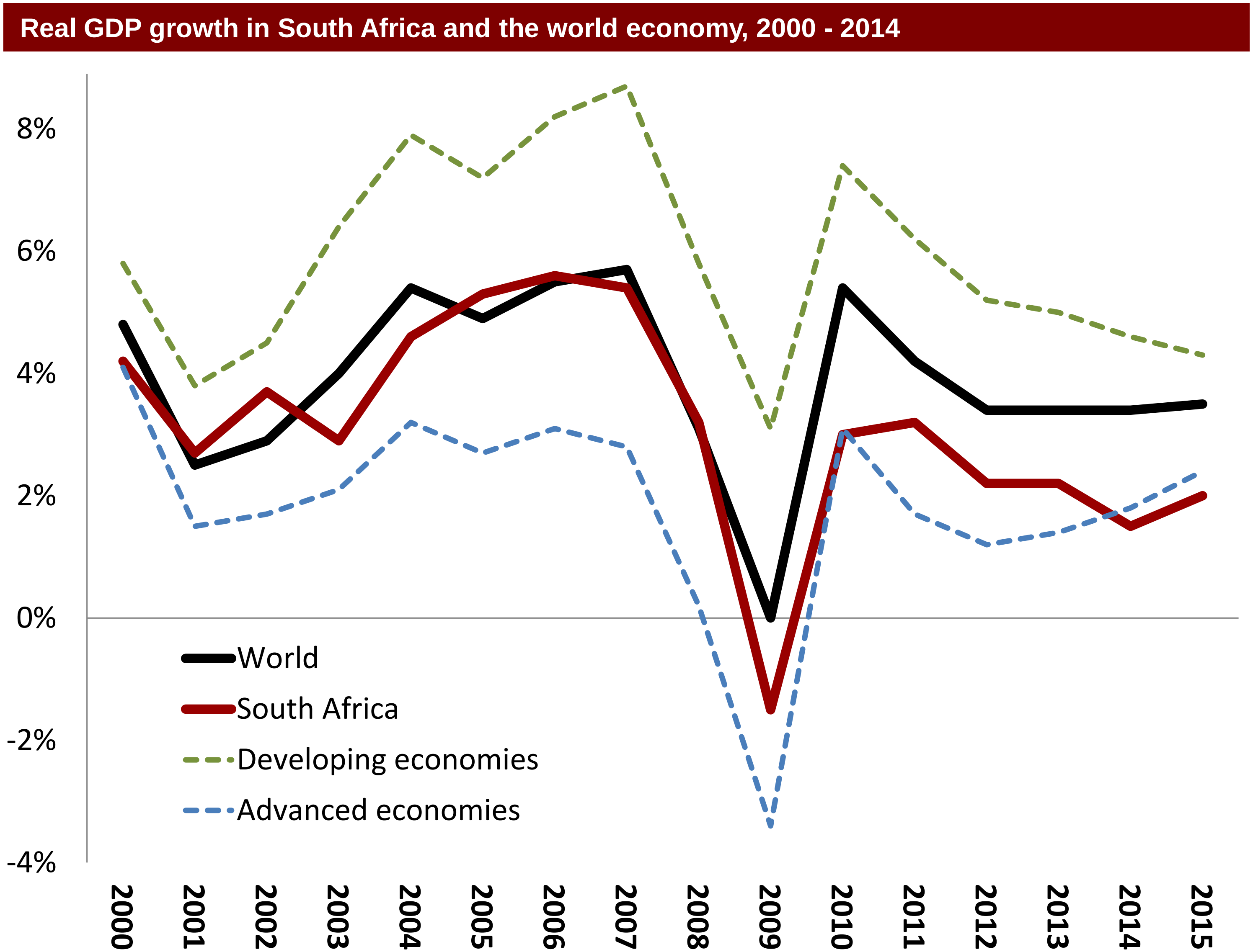
Global conditions

- A slowdown in productivity growth, ageing populations and anemic investment levels are feeding into a decline in potential growth across the world.
- Growth in developing countries has slowed, resulting in a decline in demand for commodities.
- The combination of slowing growing and rising US interest rates makes South Africa and other emerging markets vulnerable to capital market turbulence.
- Recent developments in China point to the possibility of a faster deceleration and even greater global turbulence. This could have knock on effects in advanced economies.
- Geopolitical tensions remain high and unpredictable. The political trajectory of Europe, the middle east and former Soviet bloc add to global uncertainty and turbulence.

Domestic constraints

- Constrained electricity supply the largest drag on economic activities, costing close to one percentage point of annual GDP growth.
- Manufacturing and mining weighed down by electricity constraints; drought has reduced agricultural output. Services sector has also slowed.
- Private sector investment contracted by 0.1 per cent in the first half of 2015. Public corporations continue to invest. Government is the largest contributor to investment growth in the last year.
- The current account deficit is likely to remain wide, indicating the continued need for foreign savings to fund South African investment.
- Although the rand has depreciated against the dollar, South Africa's inflation is higher than trading partners, resulting in real exchange rate appreciation in recent months.
- South Africa's capital markets have been resilient, enabling continued inflows of portfolio capital to sustain external imbalances.
- Without stronger effort to overcome domestic constraints, improve competitiveness and speed up the pace of structural change, South Africa will not be able to substantially reduce unemployment, poverty and inequality in the years ahead.

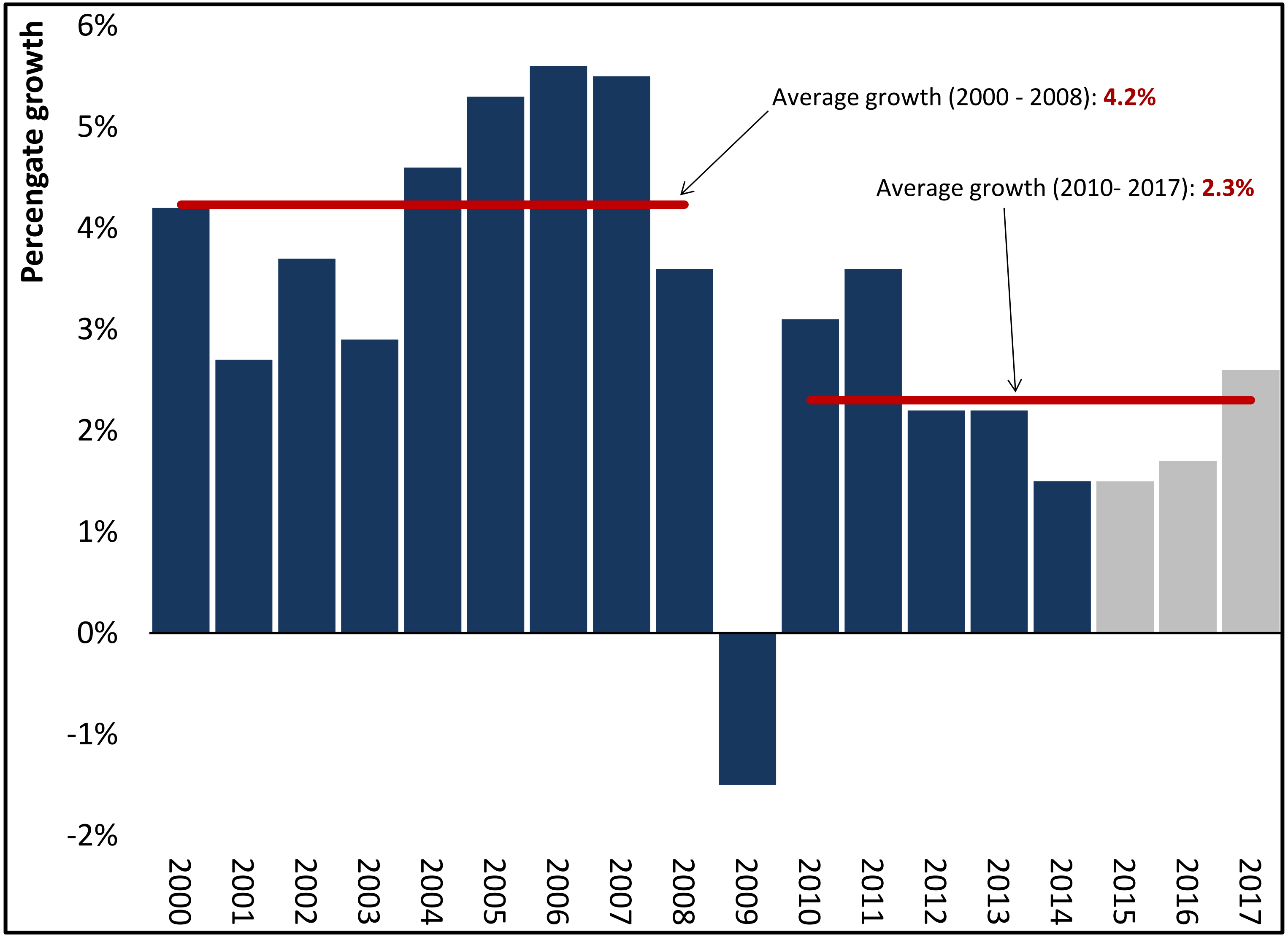
South Africa's performance is below the average



national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

South Africa's growth has been slower over the last six years and recovery will be slow in the years ahead

Real GDP growth, 2000 - 2017



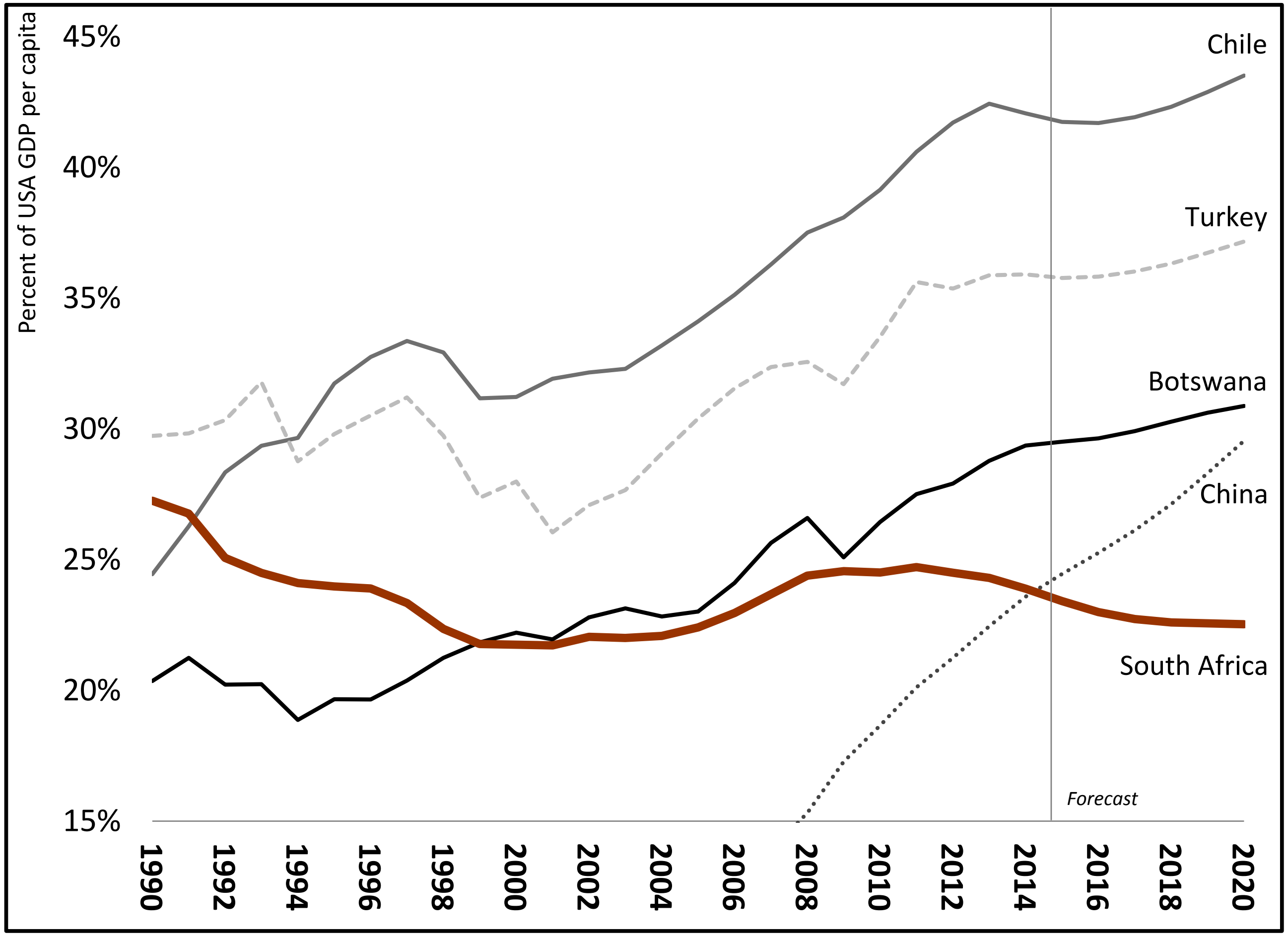
national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

South Africa's average income is now stagnating

- South Africa's GDP per capita has grown over the last twenty years, but the GDP per capita of the world leader (USA) has grown faster.
- Several other small open economies (Botswana, Turkey, Chile) have made progress in narrowing the gap in per capita income with the USA.

Average income

GDP per capita as a share of USA GDP per capita at PPP exchange rates

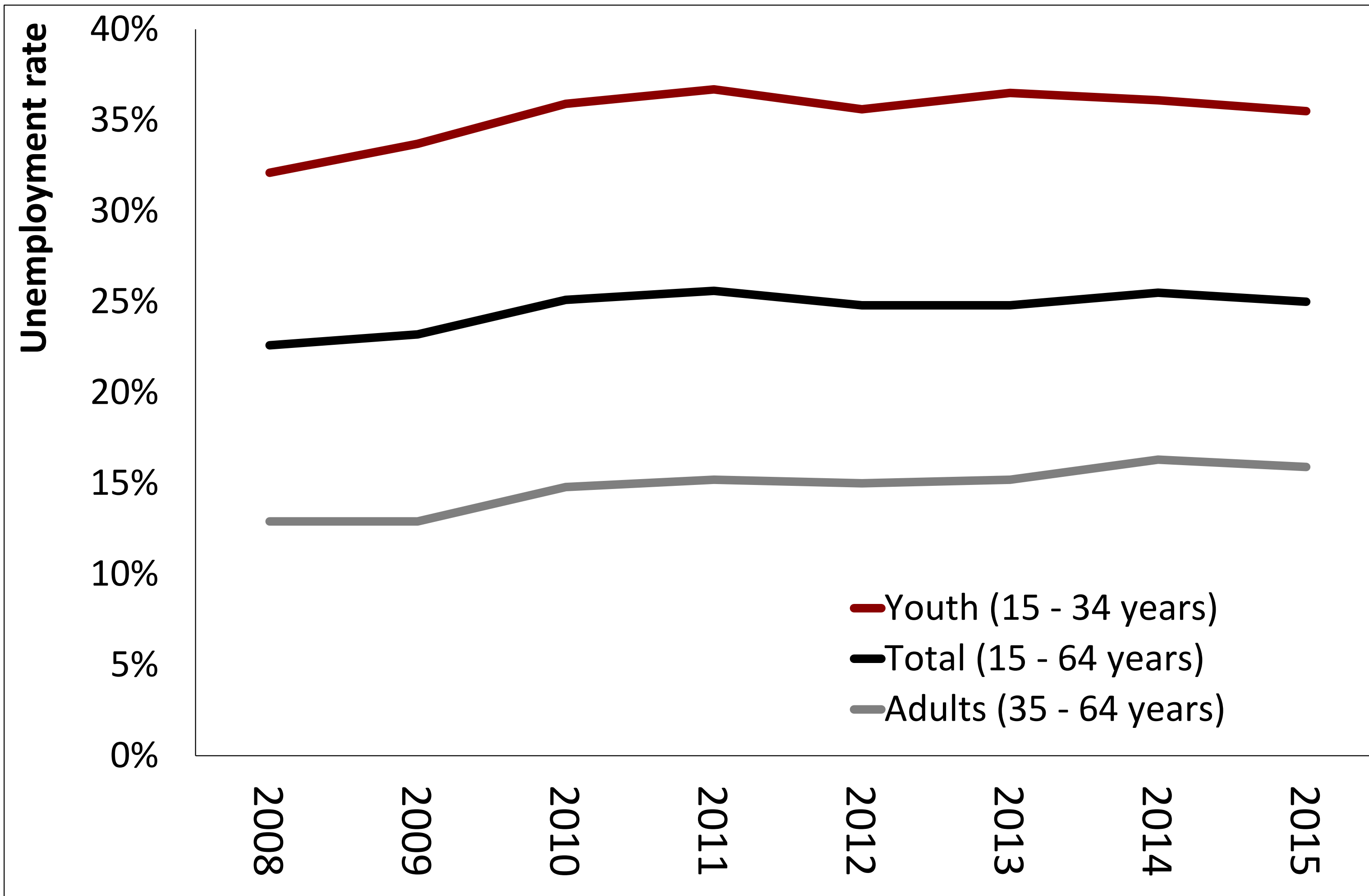


Source: IMF World Economic Outlook

national treasury
Department: National Treasury
REPUBLIC OF SOUTH AFRICA

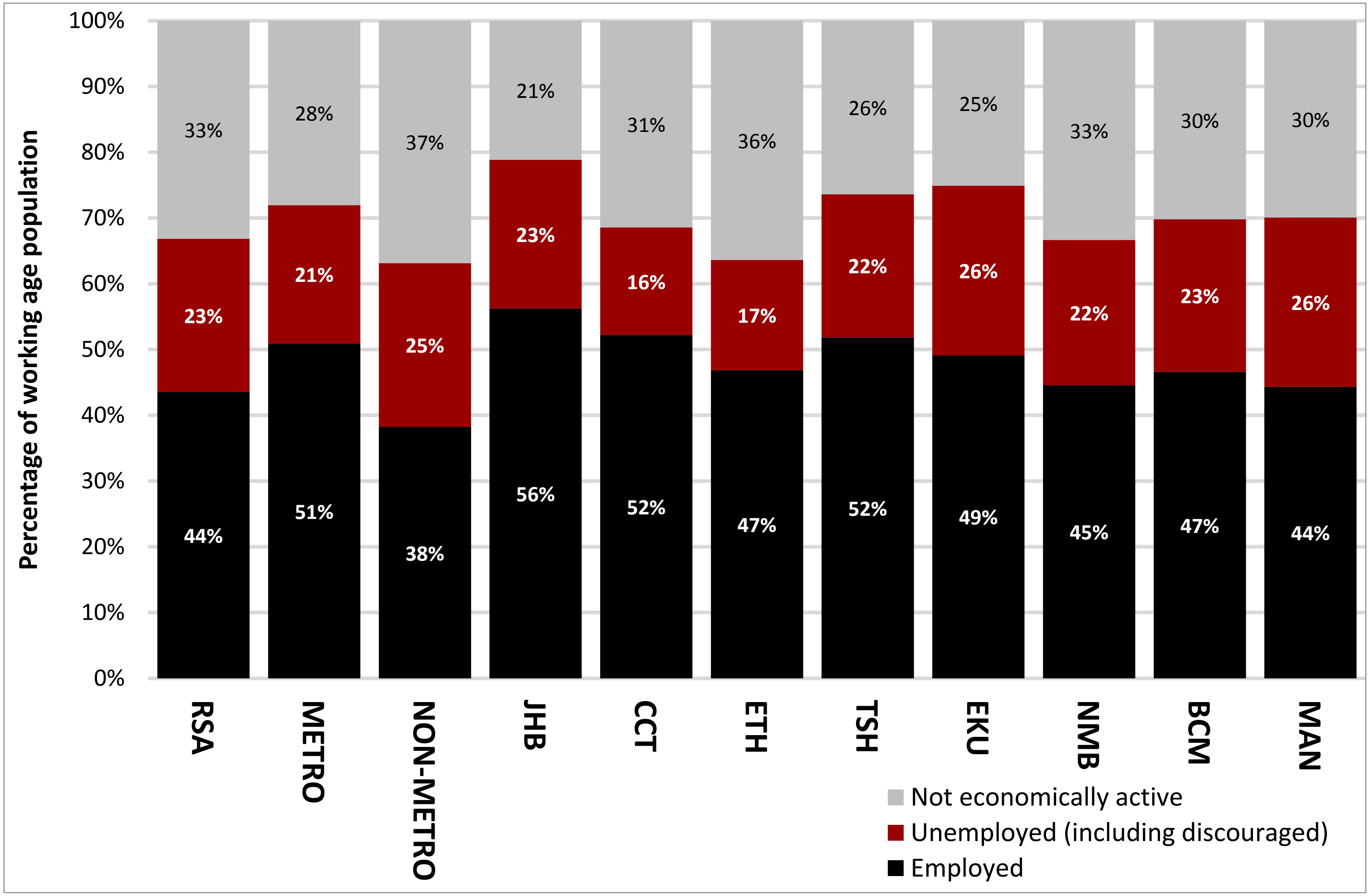
Unemployment remains stubbornly high

Unemployment rate by age group (narrow definition)



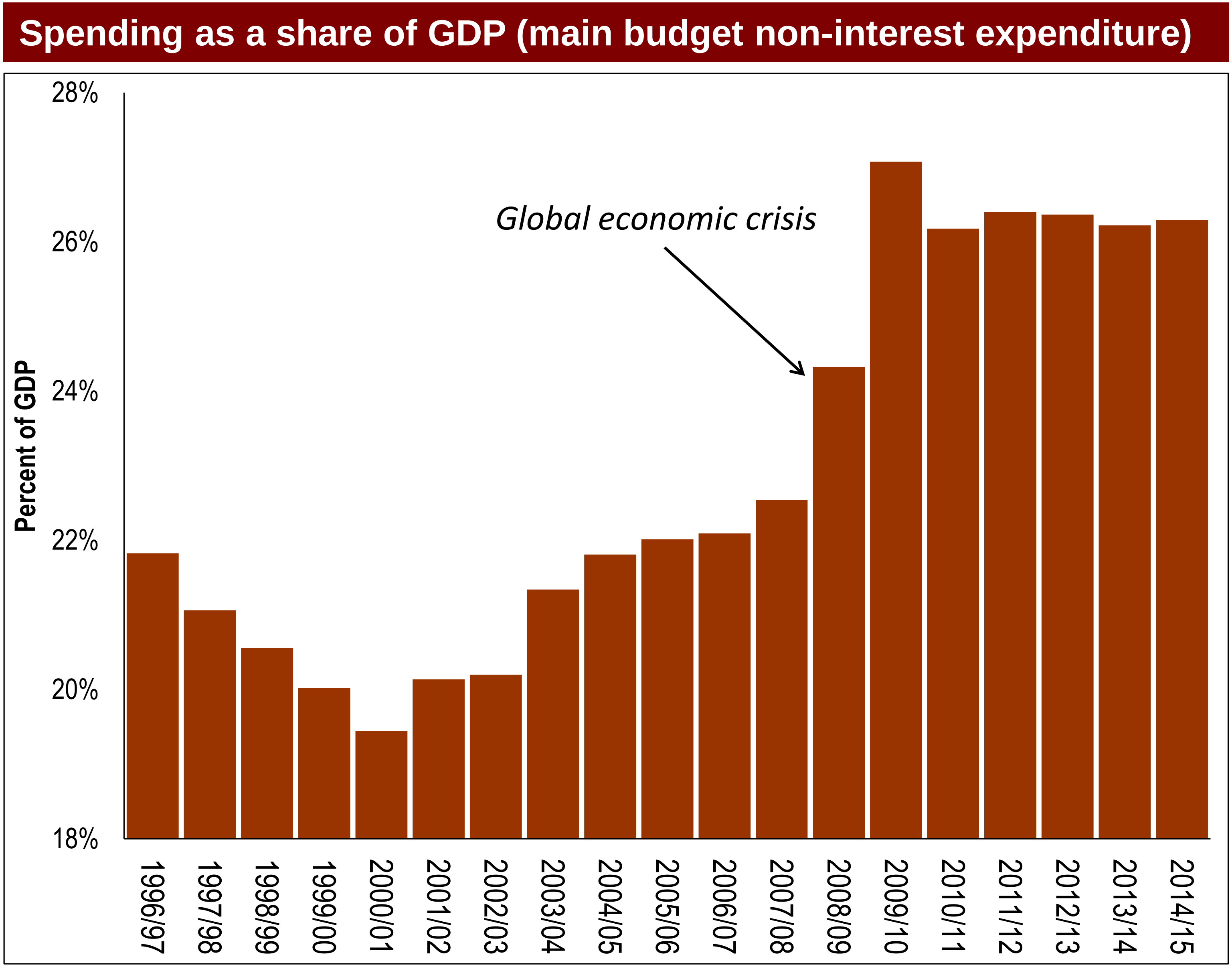
Less that half of the working age population is employed

Employment status of people age 15 - 64



national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Government kept on spending after economy weakened with much of the increase going to salaries

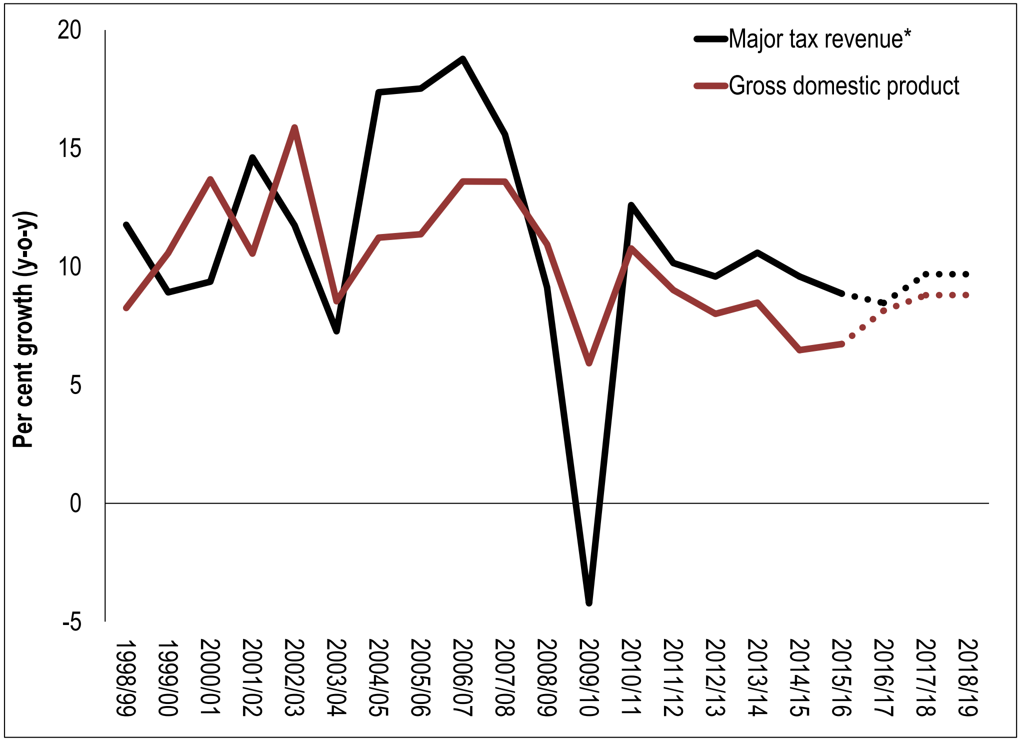


national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Lower growth trends point to weaker revenue outlook

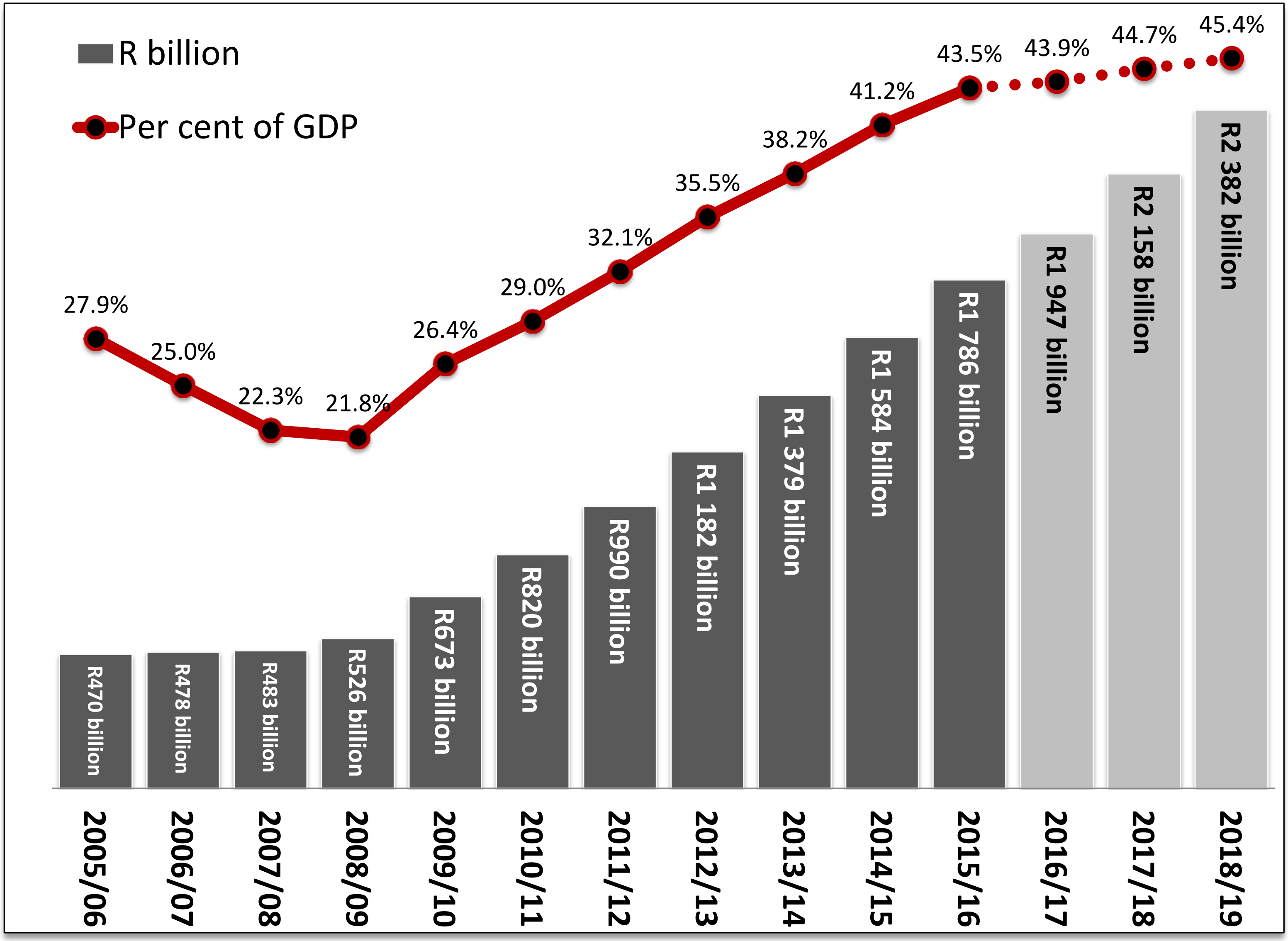
- Projected gross tax revenue down by R35 billion between 2015/16 and 2017/18, compared to the 2015 Budget. Gross tax revenue projected to continue growing faster than nominal GDP, but the margin will narrow.
- Over the medium term, government will explore reforms to promote an efficient and progressive tax system, taking into account recommendations of the Davis Tax Committee.
- Additional taxes will be needed to fund government's ambitious policy agenda, but will be approached with caution given weak economic conditions.
- Initiatives under way to combat base erosion, profit shifting and the misuse of transfer pricing.
- No decision has been made on VAT, but it remains an option as part of a progressive fiscal system.

Growth of nominal GDP and main tax revenues



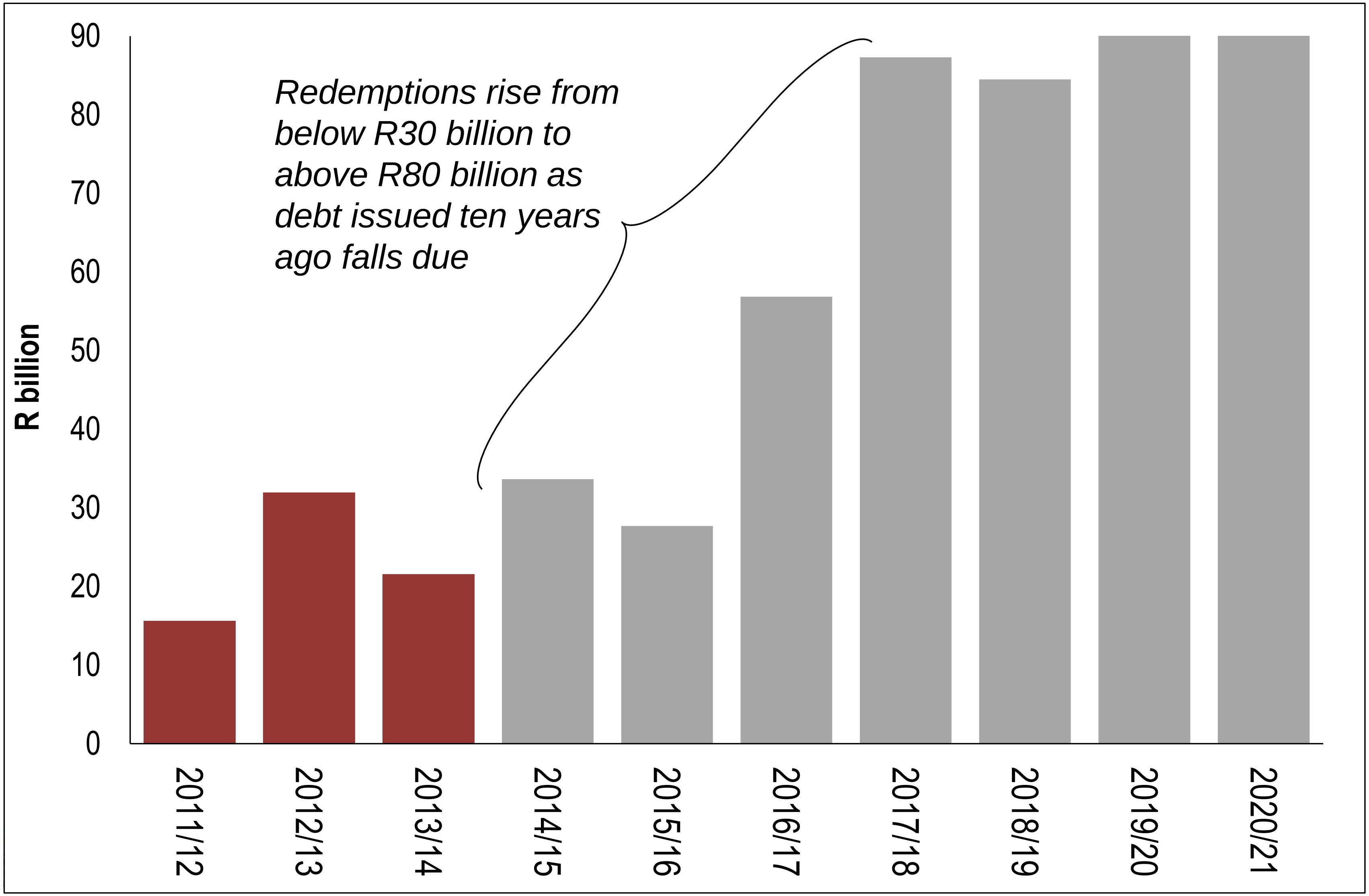
national treasury
Department: National Treasury
REPUBLIC OF SOUTH AFRICA

Government debt has not yet stabilised as a share of GDP



And large debt redemptions loom from 2017/18
This debt will need to be re-issued, adding to financing risks

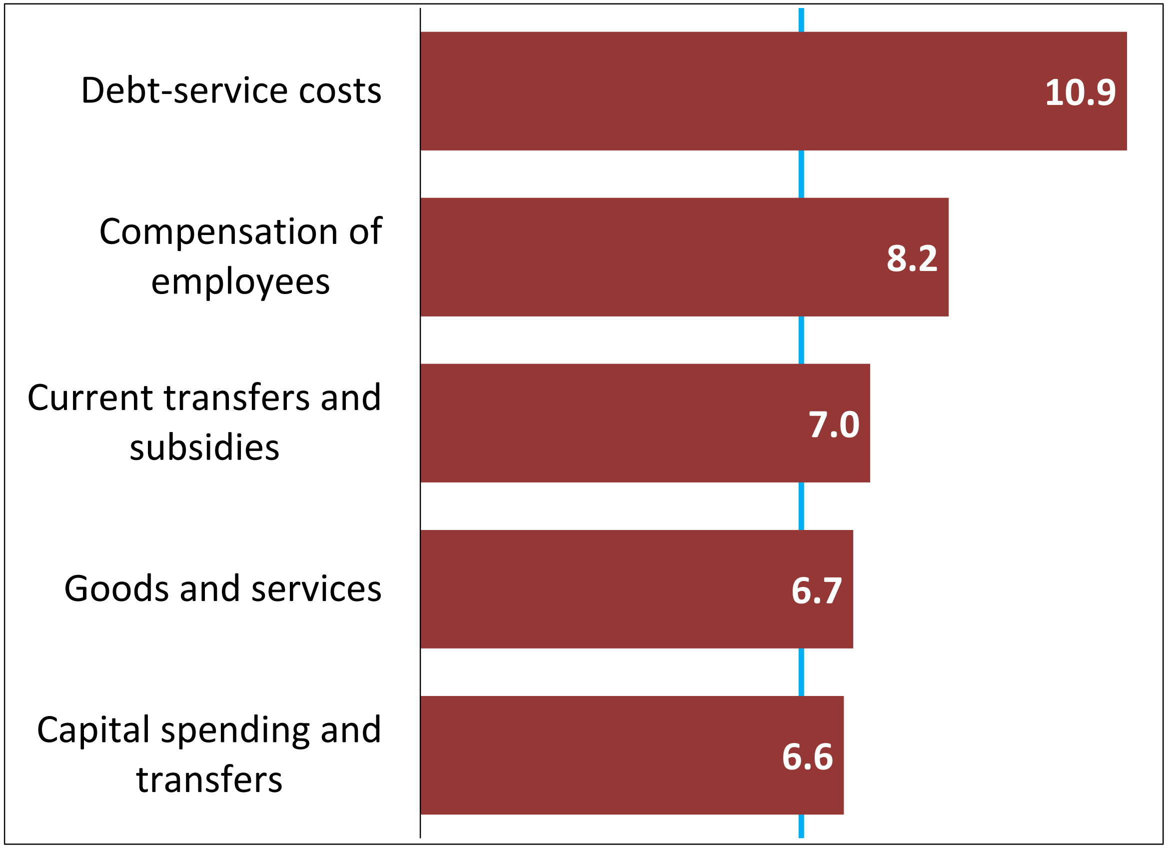
Domestic government bond maturities



Interest on debt is the fastest growing element of expenditure, followed by compensation

- Debt-service costs remains the fastest growing type of spending
- New wage agreement and higher inflation pushes compensation growth to 8.2 per cent over the medium term

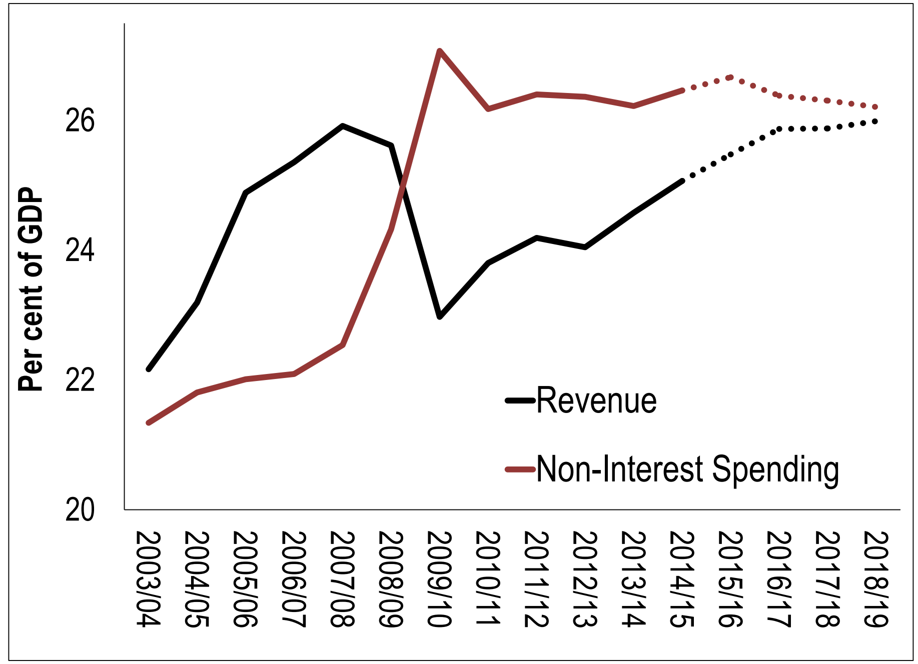
Growth of spending by economic type, annual average (2015/16-2018/19)



The fiscal framework closes the gap between revenue and spending

- Two risks identified in the 2015 budget have materialized:
  - Slower economic growth means lower revenue and some slippage on the budget deficit.
  - Public sector wage settlement higher than inflation means more pressure on the public finances
- Expenditure on track to stay within ceiling
- Government remains on course to achieve its fiscal objectives: stabilising debt and closing the primary balance

Main budget primary balance



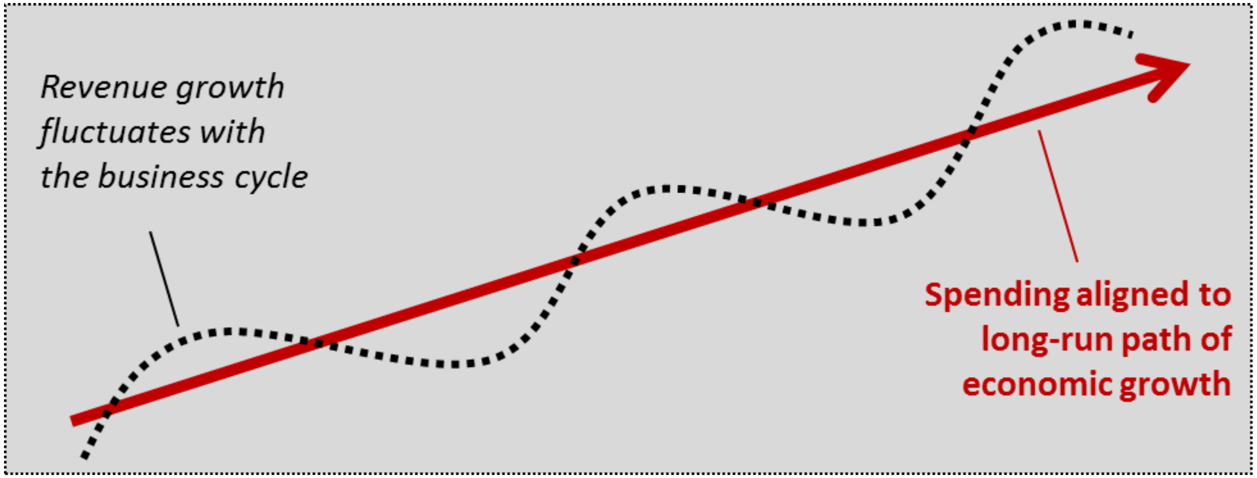
Consolidated fiscal framework

R billion/Percentage of GDP	2014/15 Outcome	2015/16 Revised	2016/17	2017/18	2018/19
			Medium-term estimates		
Revenue	**1 091.9**	**1 220.8**	**1 306.4**	**1 416.0**	**1 540.9**
	28.4%	*29.8%*	*29.4%*	*29.3%*	*29.3%*
Expenditure	**1 228.8**	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**
	32.0%	*33.6%*	*32.7%*	*32.5%*	*32.4%*
Budget balance	**-136.9**	**-157.9**	**-145.3**	**-152.8**	**-158.2**
	-3.6%	*-3.8%*	*-3.3%*	*-3.2%*	*-3.0%*
Total net loan debt	**1 584.2**	**1 785.7**	**1 947.4**	**2 158.0**	**2 382.0**
	41.2%	*43.5%*	*43.9%*	*44.7%*	*45.4%*

Source: National Treasury

New guideline cements good fiscal management

- Fiscal policy based on principles of counter cyclicality, debt sustainability and intergeneration fairness
- A fiscal *rule-of-thumb* will link the spending ceiling to long-run path of economic growth:
  - All South Africans share in the benefits of economic expansion on a sustainable basis.
  - Spending remains stable as a share of GDP, unless financed by permanent increases in revenue
  - Flexibility to respond to inflation shocks
- New approaches to medium-term capital budgeting and appraisal
- Enhanced budget transparency



But risks to the fiscal outlook remain

- **Further deterioration in economic growth**
  - Decline in growth typically results in falling revenue growth, increasing the deficit and debt as a share of GDP.
  - Global uncertainty, particularly concerning the path of US monetary policy, could put upward pressure on domestic interest rates and cost of government debt
- **Expenditure pressures linked to inflation**
  - Rising inflation would increase the likelihood of unplanned expenditure
  - The wage agreement is linked to inflation.
- **Weak financial positions of several major public entities**
  - Government has acted to stabilise several state-owned enterprises.
  - Eskom, SANRAL and SAA being closely monitored
  - Government remains committed to deficit-neutral capital financing of state-owned companies in the years ahead.
  - Work has begun to develop a uniform legislative framework to regulate state-owned companies.

Sustaining progress in a low-growth world

- The world economy is experiencing a sustained period of low growth. All countries – particularly developing nations – are grappling with the changes required to manage this new reality
- At home, electricity constraints, low business confidence and declining household demand have compounded the weak economic situation
- In order to adapt to this low-growth world, government has:
  - Identified structural reforms needed for a higher growth path
  - Reduced South Africa’s vulnerability by maintaining the health of the public finances
- Sustaining social progress and building a more competitive economy will require rapid implementation of the NDP
- The 2015 MTBPS builds on previous commitments to stabilise public debt and improve the effectiveness of government spending
- A proposed long-term fiscal guideline will align spending and GDP growth, ensuring that all South Africans can enjoy the benefits of future economic expansion

Thank you