

HIGHER BUDGET DEFICITS RAISE SOME CONCERNS

Slower deficit reduction may undermine SA's good fiscal image

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The international investment community could start to question the South African government's previous strict fiscal stance due to the higher budget deficits announced today by Finance Minister Pravin Gordhan in today's 2011-12 Budget, according to Rian le Roux, chief economist at Old Mutual Investment Group SA (OMIGSA).

The projected budget deficit for the South African government for the 2011-12 fiscal year has risen to 5.3% of GDP from 4.6% expected previously, while the 2012-13 and 2013-14 deficits have also been revised upward to 4.8% and 3.8%, respectively (3.9% and 3.2% previously). These were the most keenly watched numbers in the Budget for most foreign investors, says le Roux.

"This was a surprise move, as most economists expected lower budget deficits due to higher-than-forecast revenues this year," he pointed out. "It is, in fact, a bit of a shock, in that it raises the question whether government will not be forced to do the same next year and the years following that, or alternatively, eventually be forced to raise taxes substantially in order to regain control over the deficit.

"The good news, however, is that the three-year projections still call for a decline in the deficit, and that, compared to many other countries, the deficits and current levels of government debt are still relatively low. They have also been very transparent in announcing the expected higher deficits, rather than attempting to cover them up (like some other countries have done), which investors could interpret positively. So, the markets may forgive this slippage for now, but will not do so if it were to be repeated again next year and thereafter."

At the same time, le Roux said, government has obviously opted to support social spending and government priorities like job creation, skills development and infrastructure to help spur economic growth. While such programmes indeed have merit in the short term, growth and job creation can, over the longer term, not be raised by increasing government's claim on the country's resources. Reigning in the size of government, lowering the tax burden and creating conditions for the private sector to thrive is the only road to long term growth and employment success.

Taxes – no surprises for the man-in-the-street

Turning to taxes, le Roux noted the R8.1 billion in individual income tax cuts - focused on lower-income earners - was near what he expected. The increases announced in excise duties, the fuel levy, green taxes and others were basically in line with previous years and as expected.

Forecasts for economy in line with OMIGSA's

Le Roux added that the Budget's forecasts for growth, inflation and other key economic data for the next three years were realistic and generally in line with his own. Inflation was not likely to be a significant concern during the three-year period, and growth was not likely to reach over 4.4%.

Looking forward, markets and investors will now strongly focus on how the 2011-12 fiscal situation actually unfolds, in order to assess the likelihood of the promised deficit reduction from the next fiscal year actually being attained without putting further pressure on the tax base.