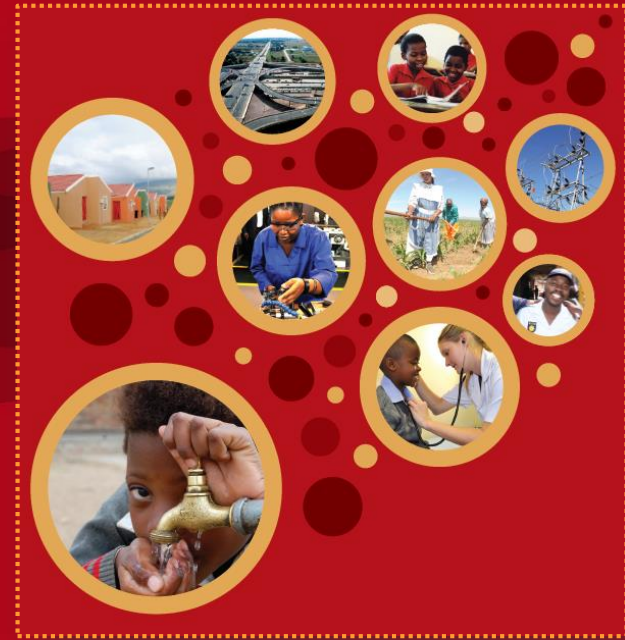


Sustaining progress in a low-growth world



2015

MEDIUM TERM

BUDGET POLICY STATEMENT

NEDLAC SPECIAL EXCO SESSION



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Sustaining progress in a low-growth world

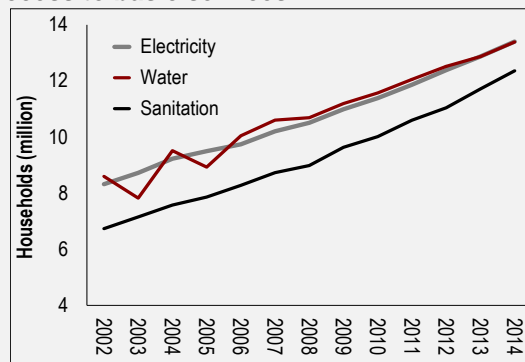
- The world economy is experiencing a sustained period of low growth. All countries – particularly developing nations – are grappling with the changes required to manage this new reality
- At home, electricity constraints, low business confidence and declining household demand have compounded the weak 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



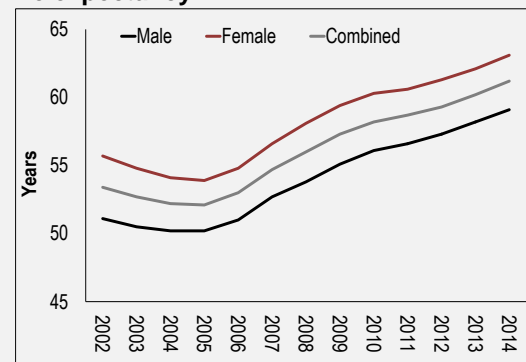
Despite challenges, social progress has been sustained ...

- The NDP is about creating work, eliminating poverty and building a more equitable society. Significant progress has been made over the past 15 years.
- These achievements are made possible by a sustainable allocation of public funds. Over the last decade, public spending has doubled in real terms.
- Good fiscal planning supports the constitutional mandate to realise social and economic rights in a progressive and affordable manner.
- The medium-term fiscal framework sustains social gains in a weak economic environment.
- **But the resources available to the fiscus are expanding too slowly to meet the country's development requirements.**

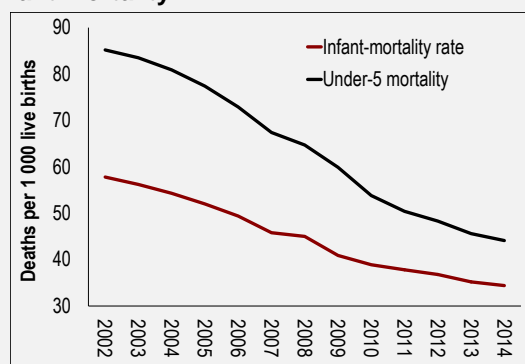
Access to basic services



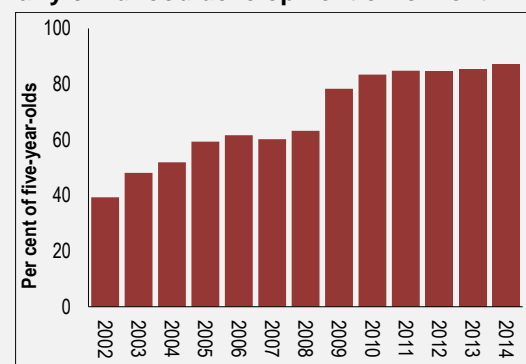
Life expectancy



Infant mortality



Early childhood development enrolment



Source: Development Indicators, 2014; Department of Planning, Monitoring and Evaluation

... but economic growth has slowed

- Economic growth is expected to be only 1.5 per cent in 2015 – the same as in 2014 – rising marginally to 1.7 per cent in 2016.
- Consumer and business confidence is muted. Supply and demand for household credit is shrinking.
- Employment growth remains weak.
- Inflation currently within target range, but with upside risks from the exchange rate.
- Without a speed up the pace of growth, South Africa will not be able to substantially reduce unemployment, poverty and inequality.

Macroeconomic projections, 2014 - 2018

Calendar year	2014 Actual	2015 Estimate	2016	2017 Forecast	2018
<i>Percentage change unless otherwise indicated</i>					
Final household consumption	1.4	1.5	1.7	2.5	2.8
Gross fixed capital formation	-0.4	1.2	1.5	3.2	3.8
Real GDP growth	1.5	1.5	1.7	2.6	2.8
GDP at current prices (R billion)	3 796	4 031	4 349	4 726	5 143
CPI inflation	6.1	4.8	6.2	5.9	5.8
Current account balance (% of GDP)	-5.4	-4.1	-4.4	-4.6	-4.8

Source: Reserve Bank and National Treasury



This partly reflects global conditions ...

- Slower, more volatile growth has become an enduring feature of the world economy, raising concerns of a protracted period of weakness in global trade, investment and commodity prices.
- Improved performance by some developed economies has offset the slowdown in developing economies.
- Slower growth in China and higher interest rates in the United States create a difficult environment for developing countries that rely on foreign capital to fund investment.
- Growth in Sub-Saharan Africa slows from 5 per cent last year to 3.8 per cent this year.

Region / country	Average Percentage 2010-2014	2014	2015	2016
World	4.0	3.4	3.1	3.6
Advanced economies	1.8	1.8	2.0	2.2
US	2.1	2.4	2.6	2.8
Euro area	0.7	0.9	1.5	1.6
UK	1.8	3.0	2.5	2.2
Japan	1.5	-0.1	0.6	1.0
Emerging markets and developing countries	5.7	4.6	4.0	4.5
Brazil	3.2	0.1	-3.0	-1.0
Russia	2.8	0.6	-3.8	-0.6
India	7.2	7.3	7.3	7.5
China	8.6	7.3	6.8	6.3
Sub-Saharan Africa	5.2	5.0	3.8	4.3
South Africa	2.4	1.5	1.5	1.7

Source: IMF, October 2015, except South Africa (National Treasury forecast)

... but domestic constraints are also significant

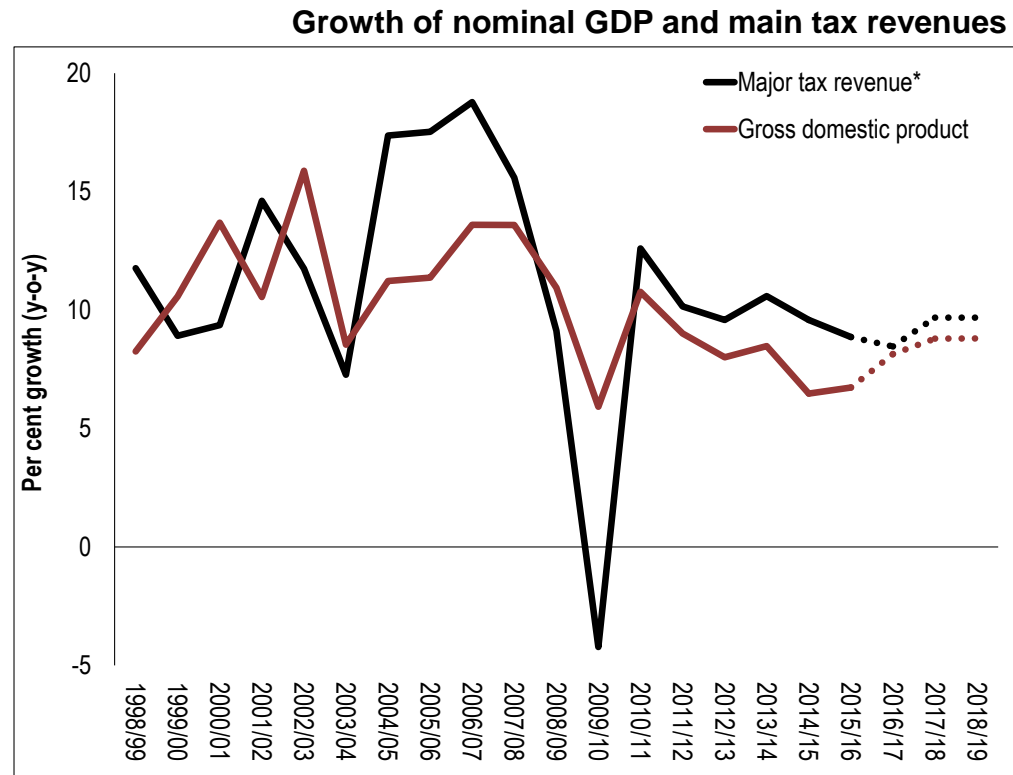
- Constrained electricity supply the largest drag on economic activities, costing close to one percentage point of annual GDP growth.
- Manufacturing and mining weighed down by electricity constraints; Drought has reduced agricultural output. Services sector has also slowed.
- Private sector investment 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.

Action is underway to chart a path for higher growth

- Government's priorities to restore economic momentum:
 - Acting to alleviate the electricity constraint
 - Continued investment in infrastructure, especially in transport, logistics and energy
 - Reforming the governance of state-owned entities, rationalizing state holdings and encouraging private sector participation
 - Labour market reforms that help avoid protracted strikes
 - Expanding the independent power producer programme to include gas and coal generation
 - Encouraging affordable, reliable and accessible broadband access
 - Promoting black ownership of productive industrial assets
 - Finalizing MPRDA amendments and continuing dialogue with the mining industry
 - Reviewing business incentives to ensure support for labour-intensive outcomes.
- Government recognizes that national development requires expanded partnerships with the private sector.
- Socio-economic impact assessments will mitigate unintended consequences of future policy initiatives

But growth trends point to weaker revenue outlook

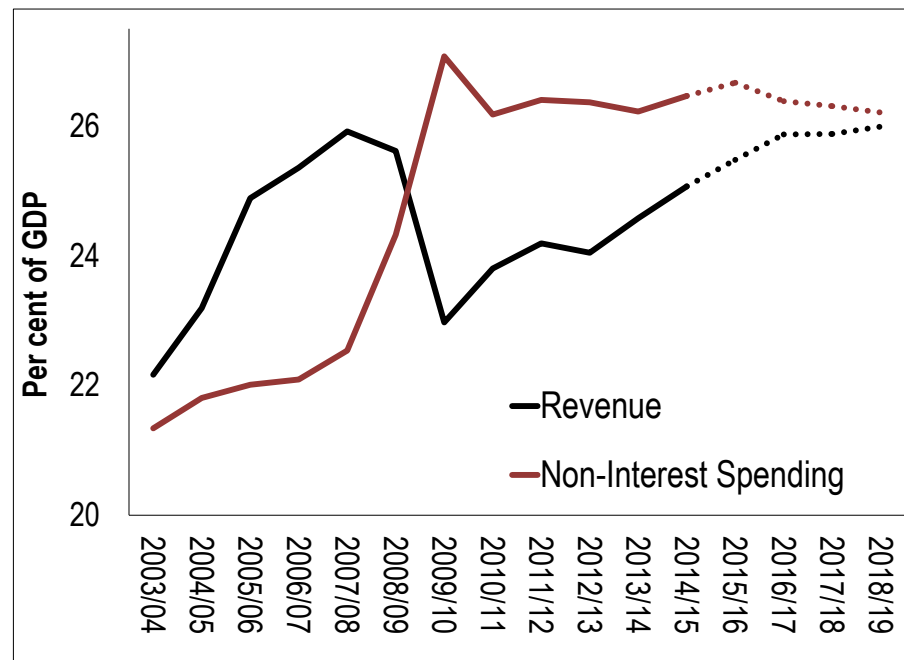
- Projected gross tax revenue down by R35 billion between 2015/16 and 2017/18, compared to the 2015 Budget. Gross tax revenue projected to continue growing faster than nominal GDP, but the margin will narrow.
- Over the medium term, government will explore reforms to promote an efficient and progressive 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.



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

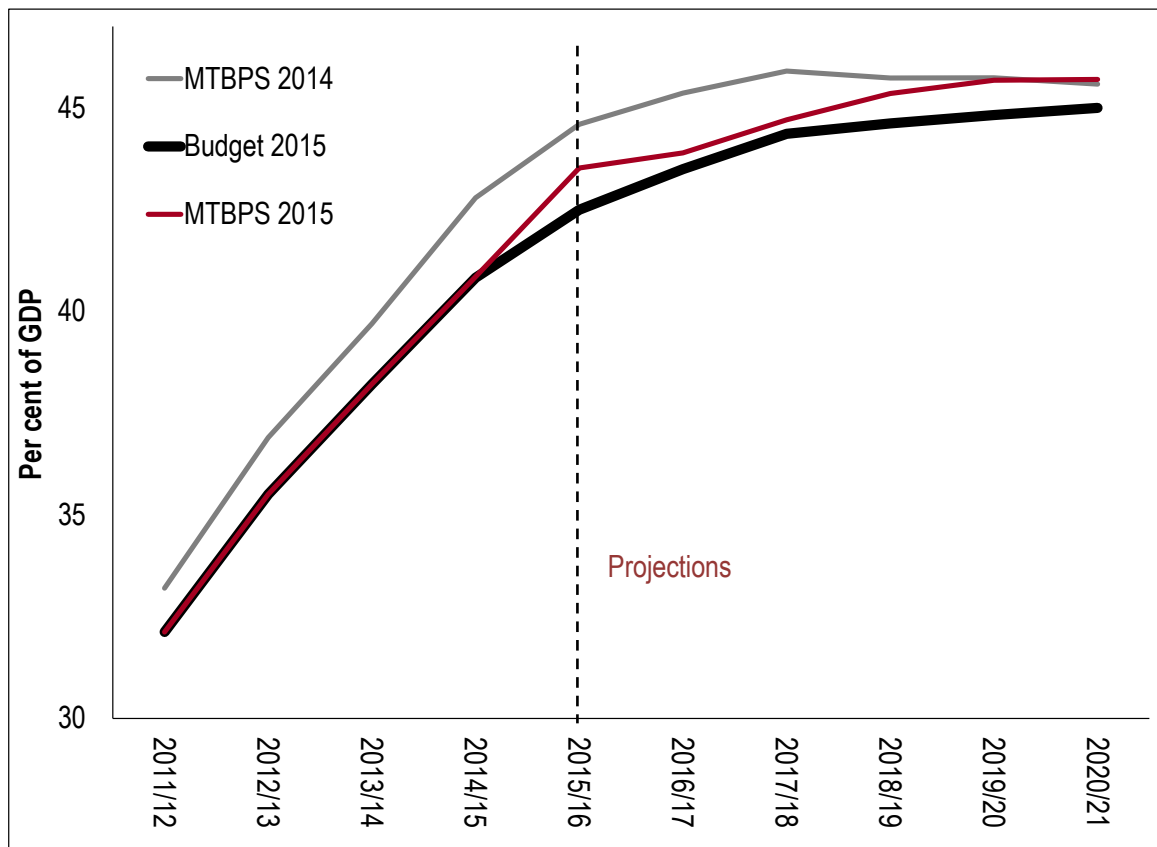
	2014/15	2015/16	2016/17	2017/18	2018/19
R billion/Percentage of GDP	Outcome	Revised	Medium-term estimates		
Revenue	1 091.9 28.4%	1 220.8 29.8%	1 306.4 29.4%	1 416.0 29.3%	1 540.9 29.3%
Expenditure	1 228.8 32.0%	1 378.7 33.6%	1 451.7 32.7%	1 568.8 32.5%	1 699.1 32.4%
Budget balance	-136.9 -3.6%	-157.9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

Source: National Treasury

... and stabilises national debt as a share of GDP

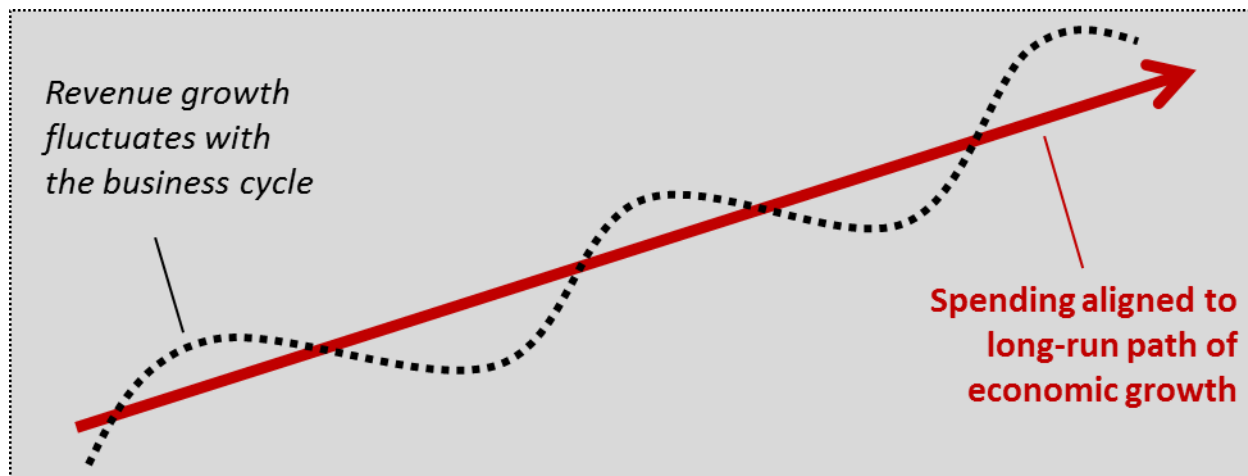
- Downward revision to GDP, shortfalls in revenue and the weaker exchange rate have led to an upward revision of the debt-to-GDP ratio.
- Continued restraint in expenditure growth results in net debt stabilising at 45.7 per cent of GDP in 2019/20.

Government debt-to-GDP ratio (net of cash balances)



New guideline cements good fiscal management

- Fiscal policy based on principles of counter cyclicity, 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

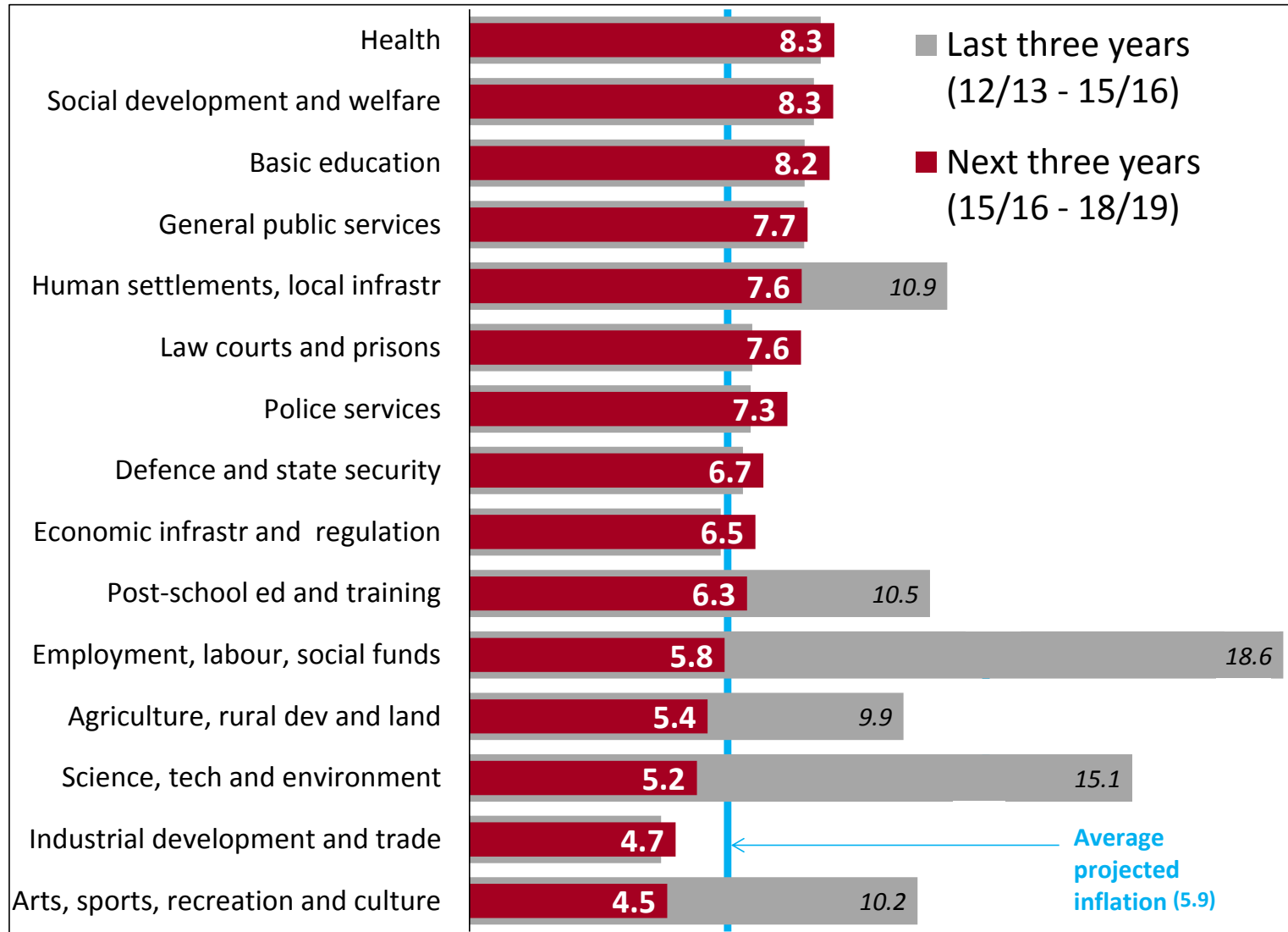


But risks to the fiscal outlook remain

- **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.

Spending growth outpaces inflation in most policy areas

Annual growth of spending by function, annual average (2012/13-2018/19)



Strong spending on public infrastructure and housing is sustained

- General government has made a large contribution to investment growth over the last two years, while private-sector investment has remained muted.
- Government continues to invest in public infrastructure and housing. Proposed medium-term budget allocations of R542 billion include:
 - R130 billion in roads and public transport
 - R60 billion in public housing
 - R55 billion in water infrastructure
 - R50 billion in other municipal infrastructure
 - R43 billion in school buildings
 - R11 billion in tertiary education capital projects
 - R30 billion in health facilities and equipment
 - R20 billion to extend the electricity grid to poor households.
- In addition, infrastructure plans by large state-owned companies exceed R400 billion over the next three years.

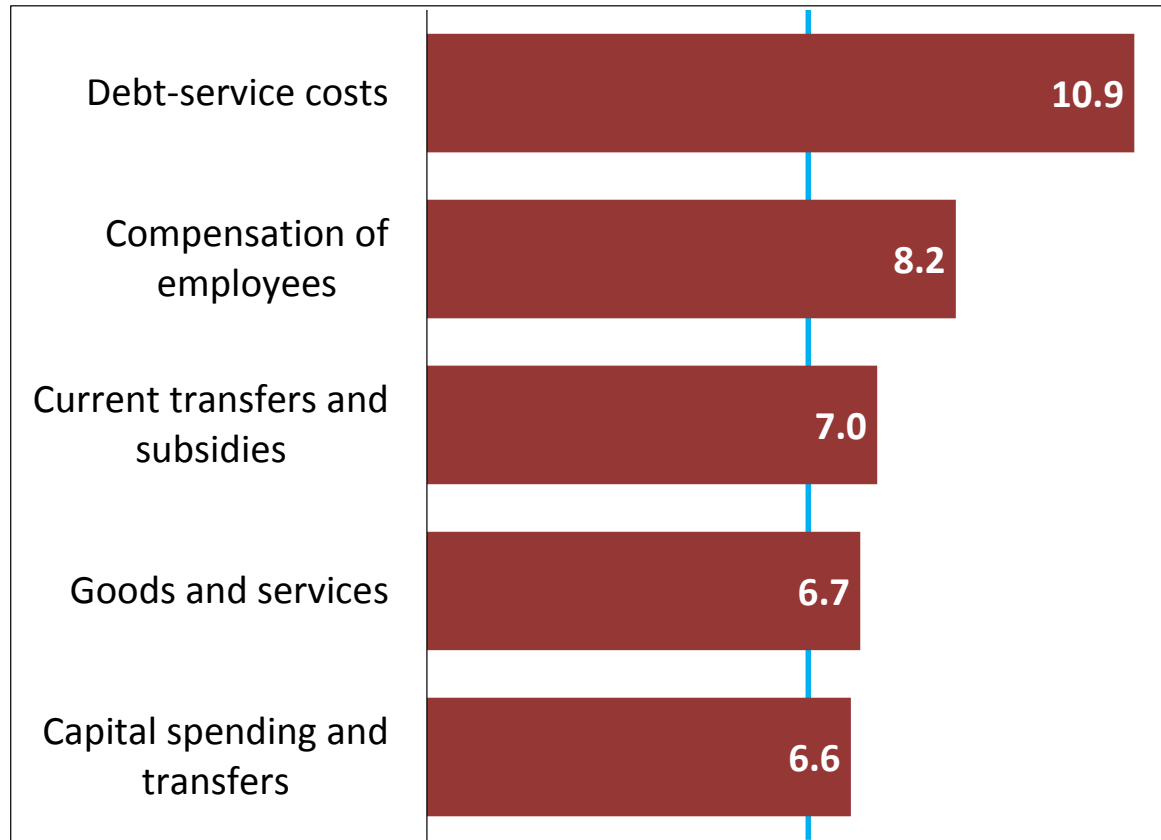
Limited resources directed to core areas of need

- The public-sector wage agreement has been accommodated, but will have consequences for the composition of spending, as salary requirements put pressure on capital and other critical inputs.
- There is little room for new spending priorities over the next three years, but government proposes additional resources (within spending limits) to core areas of need:
 - Accommodating higher-than-expected growth in grant beneficiary numbers (R13 billion over three years)
 - The local equitable share bolstered to support the rising cost of free basic services (R6 billion over three years)
 - Resources added to social development budgets for substance-abuse centres and early childhood development
 - Funds are set aside to improve the quality of public-order policing
 - Financial support for health information systems will alleviate problems in the management of medicine stocks, and help lay a foundation for national health insurance
 - Additional resources have been provided to support treatment of HIV/AIDS and tuberculosis
 - Agencies that support science and innovation have received additional resources to bolster research and development
- Revised MTEF shifts about R9 billion from within existing baselines to priority programmes: R4.8 billion is towards road networks, R1.4 billion for provincial public transport, and about R1 billion for the rollout of broadband infrastructure and broadcast digital migration.

Interest on debt grows fastest, 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)



Procurement reforms reduce red-tape and corrupt practices

- **Central supplier database:** In operation since 1 September 2015. More than 20 000 suppliers registered, 9 500 verified. Will become mandatory on 1 April 2016 for national and provincial departments and 1 July 2016 for municipalities.
- **eTender portal:** Single point of entry for business opportunities with government. More than 2 000 tenders worth about R28 billion already posted onto the portal.
- **gCommerce portal:** Government departments can purchase routine supplies through transversal contracts, reducing administrative processes.
- **Procurement bill** being developed to replace the more than 80 different legal instruments, guidelines and instruction notes
- **Tender documents** will be made more user-friendly. The number of documents needed for a tender will be reduced, and the language used will be clear and unambiguous.
- **Standard operating procedures** for procurement being developed, with changes set to take effect from 1 April 2016.
- **Compulsory standard for infrastructure** procurement and delivery management to be issued in April.

Reforms to conditional grants

- Government has completed the second phase of its local government infrastructure grant review.
- Enabling the use of funds for the renewal, refurbishment and rehabilitation of existing infrastructure, alongside asset management systems to plan and prioritise maintenance.
- Reforming the public transport network grant to support financially sustainable transit networks in large cities.
- Consolidating urban grants over the MTEF period to tackle challenges in the built environment.
- Rationalising grants to reduce complexity and administrative burdens. Several water and sanitation grants are being merged, for example.
- Introducing grants that differentiate between metros, secondary cities and rural areas. Secondary cities will see changes to their planning requirements.

Thank you



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA