



The benefits of a prudent budget

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In February the Finance Minister will stand in front of the nation and tell us how the national government finances are faring. Fortunately for South Africa, government finances are in a relatively good shape compared to some countries in developed economies like Europe.

Many European countries are finding it quite expensive to raise funding in the open market with bond yields (interest rates demanded for government debt) at historic highs. By contrast the South African government has found it comparatively easier to raise funding; net bond flows into South Africa for 2010 had an impressive average of over R40 billion. Part of the reason is that, despite weak growth in South Africa, other fundamentals were in place - like a prudent monetary and fiscal policy. The government was seen as being able to repay the capital and interest on those bonds without the risk of defaulting. All this was a result of past budgeting processes when government conducted its affairs with utmost prudence.

Balancing the books

Governments are not different from people in the way they conduct their financial affairs. There is an income stream, which in the case of government is from tax revenue and there is expenditure for example on services, infrastructure, salaries and wages. To manage government finances properly, there has to be a budget process which makes sure that the books are balanced. If government cannot meet its expenditure obligations (usually if tax revenue is poor like when we have a recession or economic growth is weak), they have to borrow. However government has to be able to service the debt and not default on payments because this affects future borrowing opportunities. Households also need to do the same, not borrow beyond their ability to repay debt.

Paying back debt

The South African overall budget has partly mirrored developments in the economy. During periods of economic expansion government revenue increased so government could reduce their debt levels. Also,

there was a very efficient tax collection campaign launched by the South African Revenue Services (SARS) which increased the tax base and tax revenue. Government was able to work down total national government debt as percentage of GDP from 49.9% in 1999 to 22.2% at the end of the 2009 tax year. This subsequently increased to 30.7% in 2010 partly due to a decline in tax revenue on the back of the recession and the economic crisis. Household debt as percentage of gross domestic product (GDP) is uncomfortably close to 80%. It would be wise for consumers to take advantage of the low interest rate and low debt service cost and continue working down these debt levels. In a year's time we might be talking about interest rate hikes which will be painful if debt levels are still so high.

Saving in good times

Government is currently running a budget deficit due to weak tax revenues as a result of the recession. However there were a few years when the economy was doing well and the country had a budget surplus as well as increased government saving as percentage of GDP. So although we're currently running a deficit it's at a manageable level, hence the continued ability of government to raise funding at favourable rates. Consumers would also benefit from saving any surplus income they have from their bonuses (after paying off debt) because it puts them in a better position to manage their finances should things take a turn for the worst.

Tax increases

In last year's budget the Finance Minister hinted at a possible increase in taxes should the economic situation not improve. GDP growth is expected to amount to 2.8% for 2010, an improvement from the decline of -1.8% for 2009. It will be interesting to see whether the Minister's warning will materialise. One thing we know is that he's not going to be as generous with tax rebates as he was before the 2009/10 fiscal year as economic growth remains fragile.

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