POCKET GUIDE TO SOUTH AFRICA

FINANCE

South Africa's economic growth typically follows the average global trend closely. The South African economy has averaged about 3% growth a year since 2009. Against the background of the slowdown in the global economy, real gross domestic product (GDP) growth is expected to fall to about 2,7% in 2012.

In the Budget Speech in February 2012, the Minister of Finance, Mr Pravin Gordhan, announced that government expected a recovery to 3,6% and 4,2% growth in 2013 and 2014. The deficit on the current account of the balance of payments is expected to widen from 3,3% in 2011 to 4,4% GDP in 2014.

National Treasury aims to promote economic development, good governance, social progress and rising living standards through the accountable, economic, efficient, equitable and sustainable management of South Africa's public finances.

National Treasury endeavours to advance economic growth, Broad-Based Black Empowerment, progressive realisation of human rights and the elimination of poverty. It is responsible for preparing a sound and sustainable national budget and an equitable division of resources among the three spheres of government. It strives to raise fiscal resources equitably and efficiently and manage government's financial assets and liabilities soundly, promoting transparency and effective financial management

The Constitution stipulates a framework for the division of responsibilities between national, provincial and local government. It prescribes an equitable division of revenue between the spheres of government, taking into account their respective functions. It also creates an independent auditor-general (AG) and an independent central bank, and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

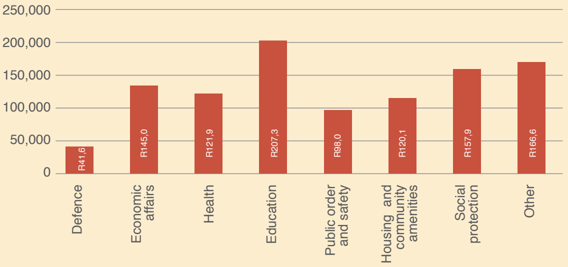
Fiscal policy framework

Government's fiscal policy seeks to support structural reforms of the South African economy consistent with long-run growth, employment creation and an equitable distribution of income.

Fiscal policy seeks to:

- present a fuller picture of government finances and the effects of policy decisions
- ensure a sound and sustainable balance between government's spending, tax and borrowing requirements

Government expenditure (R' billions)



Source: National Treasury, *People's Guide to the Budget, 2012*

- improve domestic savings to support a higher level of investment and reduce the need to borrow abroad
- keep government consumption spending at an affordable level
- contribute to lower inflation and a sustainable balance of payments
- support an export-friendly trade and industrial strategy to improve South Africa's competitiveness.

The economy and fiscal stance

The focus of the 2012/13 Budget, announced in February 2012, was on government's infrastructure-development programme. It aims to grow the economy, create jobs and improve people's lives through massive investment in infrastructure.

The State has chosen five major programmes for infrastructure development:

- Geographically strategic projects such as:
  - The development and integration of rail, road and water infrastructure around the Waterberg and Steelpoort areas in Limpopo to unlock the enormous mineral belt of coal, platinum, palladium, chrome and other minerals. Rail transport in Mpumalanga will be expanded, connecting coalfields to power stations. Parts of the North West will also benefit from the greater focus on infrastructure.
  - Improving the movement of goods and economic integration through the Durban-Free State-Gauteng

logistics and industrial corridor. Transnet has developed the Market Demand Strategy, which entails an investment over the next seven years of R300 billion in capital projects. There are various improvements to the Durban-Gauteng Rail Corridor and the phased development of a new 16-million ton a year manganese export channel through the Port of Ngqura in Nelson Mandela Bay.
  - The development of a major new South Eastern node that will improve the industrial and agricultural development and export capacity of the Eastern Cape.
  - Expansion of water, roads, rail and electricity infrastructure in the North West. Ten priority roads will be upgraded.
  - Expansion of the iron-ore rail line between Sishen in the Northern Cape and Saldanha Bay in the Western Cape, which will create large numbers of jobs and industrial activity in both provinces.
- Critical social infrastructure projects that will lay the basis for the National Health Insurance system, such as the refurbishment of hospitals and nurses' homes.
- Building new universities in Mpumalanga and the Northern Cape. Some R300 million has been allocated for the preparatory work towards these facilities.
- The Square Kilometre Array radio telescope in partnership with eight other African countries and Australia.

Exchange rates of the Rand (percentage change)

	30/09/10 – 31/12/10	31/12/10 – 31/03/11	31/03/11 – 30/06/11	30/06/11 – 31/08/11
Weighted average*	5,4	-5,0	-1,5	-4,0
Euro	7,3	-8,2	-2,0	-3,1
US dollar	5,1	-2,4	0,0	-3,5
Chinese yuan	3,6	-3,0	-1,3	-4,7
British pound	7,8	-6,2	0,8	-5,1
Japanese yen	2,8	-0,7	-2,8	-8,0

* Against a basket of 15 currencies

Source: South African Reserve Bank, *Quarterly Bulletin*, September 2011.

- The North-South Road and Rail Corridor, which South Africa champions and which is part of the African Union's New Partnership for Africa's Development Presidential Infrastructure Championing initiative.

Debt management

South Africa's countercyclical response to the economic crisis generated a significant national government borrowing requirement, which peaked at 6,8% of GDP in 2009/10. However, sound economic and fiscal policies, deep and liquid domestic capital markets, and the availability of international funding enabled government to finance the 2010/11 budget deficit for less than originally projected.

As a result, debt-service costs for 2010/11 were R4,8 billion lower than expected. Lower debt-service costs create more space to fund investment in economic infrastructure, which creates jobs, and to increase spending on social priorities such as education and health. While the gap between expenditure and revenue is projected to narrow in line with the economic recovery, national government borrowing in 2011 remained substantial at 5,4% of GDP, declining to 4,2% of GDP in 2013/14. Debt-service costs are expected to increase gradually to 2,9% of GDP in 2013/14.

Managing public finances

Transforming public-sector financial management is one of National Treasury's key objectives. To this end, National Treasury has been implementing the Public Finance Management Act (PFMA), 1999 since 1 April 2000.

South Africa has improved its ranking and remains the highest-ranked African country in sub-Saharan Africa on the World Economic Forum's global competitiveness scale, released in September 2011.

The country moved up to number 50 on the list, and is also the second-highest ranked of the BRICS countries (Brazil, Russia, India, China and South Africa). South Africa especially benefited from its economy – it ranked 25th in market size.

It also ranked fourth in financial market development, which was "particularly impressive" and showed "high confidence in South Africa's financial markets at a time when trust is returning only slowly in many other parts of the world," according to the *Global Competitiveness Report 2011 – 2012*.

In October 2011, the stock exchanges of the BRICS emerging market bloc – Brazil, Russia, India, China and South Africa – announced an initiative to cross-list benchmark equity index derivatives on each other's boards, in an effort to expose investors to opportunities in the world's leading developing markets.

The initiative brings together the BM&F BOVESPA from Brazil, Moscow Interbank Currency Exchange from Russia, Hong Kong Exchanges and Clearing Limited as the initial China representative, and South Africa's Johannesburg Stock Exchange Ltd.

The National Stock Exchange of India and the BSE Limited (formerly known as Bombay Stock Exchange) have signed letters of support and will join the alliance after finalising outstanding requirements.

These seven exchanges represent a combined listed market capitalisation of US$9,02 trillion, equity market trading value per month of $422 billion and 9 481 companies listed. They also accounted for over 18% of all exchange-listed derivative contracts traded by volume worldwide in June 2011.

Since the implementation of the PFMA, 1999, there have been measurable improvements in financial management in both the national and provincial spheres of government, which include, among other things:

- an improved linkage between planning and budgeting, whereby departments are now required to compile and table strategic plans that are consistent with their budget envelope
- strategic plans and budget documentation containing improved information on measurable objectives expressed in terms of quantity, quality and timeliness
- departments submitting monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes, which are being implemented by institutions
- establishing internal-audit functions and audit committees in all departments
- setting accounting standards in accordance with best accounting practices, both locally and internationally
- finalising and submitting financial statements to the AG within two months of the end of the financial year
- tabling annual reports in the legislature within six months of the end of the financial year.

In October 2011, government relaxed foreign-exchange control rules for individuals, making it easier for citizens to invest up to R5 million abroad a year, comprising an annual R4 million foreign investment allowance plus a R1 million single discretionary allowance.

National Treasury also allows companies to top up capital in their offshore businesses, and has relaxed rules for corporations that want to invest outside their current business lines.

Limits for individuals on alimony, wedding and travel allowances were done away with.

Auditor-General

The Constitution guarantees the independence of the AG. The office audits national, provincial and local government.

The AG has the power to audit the activities of public entities without the approval of the chief executive officer or directors.

Taxation

In 2010/11, the South African Revenue Service (Sars) collected R2 billion more than the targeted R672,2 billion, representing an increase over the previous financial year of R75,6 billion or 12,6%.

In 2010/11, government spent R891 billion of the budgeted R897 billion. The preliminary budget deficit was expected to be 5% of the GDP.

The more than one million jobs lost during the recent recession limited the growth in revenue from personal income tax. While Sars' personal income tax revenue grew, it was 0,5% below the target.

Value-added tax (VAT) collection rose to R184,2 billion from R147 billion in 2010. Of the R674,2 billion collected, R226,3 billion came from individual taxpayers, while companies paid R133,4 billion.

A 2011 report by the World Bank, the International Finance Corporation and accounting firm PricewaterhouseCoopers ranked South Africa's tax system as number one among emerging economies.

The system was ranked for its efficiency and for easing the compliance burden on taxpayers. The report found that South Africa took the lead as a result of first-world initiatives taken by the Government, such as eFiling.

The revenue collected from the fuel levy earned Sars R35 billion, which was 2,2% above target, and contributed 5,2% to the overall revenue collected. This increased from 4% in 2008/09 to 4,8% in 2009/10.

Main sources of revenue

Income tax (IT)

IT is government's main source of income and is levied in terms of the IT Act, 1962.

Tax is levied on taxable income, which, in essence, consists of total income less exemptions and allowable deductions according to the Act. The remuneration received by or accrued to a person is subject to tax and the employer deducts employees' tax in the form of pay as you earn.

A person who receives income other than remuneration, such as income from trade, profession or investments, which is not subject to employees' tax, is required, under certain circumstances, to register as a provisional taxpayer and must pay provisional tax.

Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle.

Effectively, VAT is levied on the value added by an enterprise. Vendors levy and pay over the tax included in their prices, resulting in VAT being paid by the final consumer. VAT is also levied on the importation of goods and services into South Africa. It is levied at the standard rate of 14%, but certain supplies are zero-rated or are exempt from VAT.

South African Reserve Bank

The bank, which is independent, formulates and implements monetary policy and regulates the supply of money by influencing its cost.

An important responsibility of the bank is to ensure that the banking system as a whole is sound and meets the requirements of the community.

The bank acts as a banker to other banking institutions. It is also the custodian of the statutory cash reserves and provides facilities for the clearing and settlement of inter-bank obligations.

In February 2011, the Johannesburg Stock Exchange (JSE) Ltd announced that it was getting a new trading system that would make equity-market transactions 400 times faster. The migration was planned for the first half of 2012.

The JSE would move its equity-market trading activity – the buying and selling of company shares – onto a system called Millennium Exchange. The new system will operate from Johannesburg, instead of London where it was based.

Monetary policy

The primary objective of monetary policy in South Africa is to achieve and maintain price stability in the interest of sustainable and balanced economic development and growth. Price stability reduces uncertainty in the economy and, therefore, provides a favourable environment for growth and employment creation. Furthermore, low inflation contributes to the protection of the purchasing power of all South Africans, particularly the poor who have no means of defending themselves against continually rising prices.

The Reserve Bank has full operational autonomy. Monetary policy is set by the bank's Monetary Policy Committee (MPC), which conducts monetary policy within a flexible inflation-targeting framework. This allows for inflation to be out of the target range as a result of first-round effects of a supply shock and for the bank to determine the appropriate time horizon for restoring inflation to within the target range. This flexibility does not relieve the bank of its responsibility with respect to returning inflation to within the target range but allows for interest rate smoothing over the cycle, which may mitigate any output variability from the monetary policy response to the shock.

The MPC maintained the repo rate at 5,5% at its meetings held in September and November 2011, extending the period during which the policy rate had been kept unchanged for almost a full year. The most recent period when the repo rate was kept on hold for almost such a long duration was between June 2005 and April 2006, when the MPC viewed the threats to the inflation outlook to be balanced enough not to require an adjustment to the policy stance.

The banking industry

As at the end of December 2010, 33 banking institutions – 12 locally controlled, six foreign-controlled, 13 registered branches and two mutual banks – were reporting data to the Bank Supervision Department of the Reserve Bank. There were also 41 international banks with authorised representative offices in South Africa. The banking industry is characterised by a high degree of concentration, with four banks – ABSA Bank Ltd, The Standard Bank of South Africa Ltd, FirstRand Bank Ltd and Nedbank Ltd – dominating the sector.

Total banking-sector assets amounted to R3 122 billion at the end of December 2010, compared to R2 963 billion at the end of December 2009 (and R3 167 billion at the end of December 2008), representing year-on-year growth of 5,4%. Total assets of the four largest banks accounted for 84,1% of total banking-sector assets (December 2008: 84,7%). Gross loans and advances increased by 2,5% from R2 253 billion at the end of December 2009 to R2 309 billion at the end of December 2010 (after a 2,6% decrease between December 2008 and December 2009).

Insurance companies

The aim of short-term insurance is to put the insured in the same position they occupied immediately before the loss, depending on the terms and conditions of the policy contract. Examples of short-term insurance include motor-vehicle, household, theft and fire insurance.

By 31 March 2011, there were 108 short-term insurers.

Long-term insurance includes life and assistance policies that pay a benefit to dependants on the death of the insured person/s, endowment (savings) policies payable at a predetermined date, disability policies, pensions and retirement policies, or even a combination of these policies.

By 31 March 2011, there were 87 long-term insurers.

Development Bank of Southern Africa

The primary purpose of the bank is to promote economic development and growth, human-resource development and institutional capacity-building. The bank's mandate is focused on infrastructure.

Financial Services Board (FSB)

The FSB is an independent statutory body financed by levies imposed on regulated institutions and persons.

The FSB supervises institutions and services, in terms of several parliamentary Acts that entrust regulatory functions to the registrars of long-term insurance, short-term insurance, friendly societies, pension funds, collective investment schemes, financial services providers, exchanges and financial markets.


JSE