Volatility provides opportunities

Money Matters

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You had to feel a little sorry for our newest finance minister when he presented the recent mini-budget.

Stuck between a rock and a hard place, with no room to manoeuvre.

South Africa has literally hit its fiscal cliff with the budget deficit now expected to be 4,3% of GDP vs a projected 3,1%. What happened?

Quite simply there is no growth; expected GDP growth has now been revised down, from 1,3% to a measly 0,7%, dragging projected tax revenue down with it. What is interesting to note is the fall in taxes collected per percentage GDP growth, which the minister referred to as tax buoyancy.

Tax buoyancy is code for a slippage in tax collection – a mini-tax revolt. Have taxes reached a level where taxpayers have decided to opt out?

There is a well documented principle, commonly known to as The Laffer Curve, which states that increasing tax rates beyond a certain point results in lower tax collection, notwithstanding the higher rate of taxation.

I somehow don't think this will prevent our finance minister from trying his luck on this front, but any details on future tax increases were conveniently left out of the budget.

There was much reference to growth in the mini-budget, although once again it was very thin on any detail of how and where this growth will come from. The way you stimulate growth is to grow employment, but without confidence and fixed investment there will be no employment growth. In fact, the opposite is more likely with further job losses on the cards. There is another way to drive growth, and that is through productivity.

Productivity can come from technology, which requires investment and/or labour productivity through education and upskilling.

Needless to say, on these two metrics our productivity is tanking and our GDP growth outlook looks poor.

If you cannot grow your income then you need to cut your expenses, right? Not a chance. Keep in mind the bulk of tax revenue is spent on government wages and social grants, so we're very unlikely to see any reduction here, but more likely an increase ahead of inflation.

The fastest growing expense item in the budget is the interest on debt, which is now consuming 15c of every rand in taxes collected. The concern is the cost of this debt, which is likely to spiral upwards if we are downgraded, thus consuming an even bigger portion of the pie, which means less for other critical services.

You can decide which is the rock and which the hard place, with income falling, expenses growing and the only way out borrowing more money, which is not really a way out. It is simply delaying the inevitable, for you cannot live beyond your means forever, and eventually your creditors will say no more and the "chickens come home to roost". The minister knows this, having just bailed SAA out to the tune of R5,2 billion when the banks refused to roll-over the airline's debt.

For now, the minister seems to be playing a political game, unsure of who will be victorious come year-end. He appears to be playing both sides by not showing his cards. As investors, we must never forget that volatility, however uncomfortable, provides opportunities for successful long-term investing. –
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