NATIONAL COUNCIL OF PROVINCES

QUESTION FOR ORAL REPLY

QUESTION NUMBER 119 [CO720E]

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Prince M MM Zulu (IFP-KZN) to ask the Minister of Finance:

(1) Whether he has put any measures in place to protect South African economy from (a) the current Eurozone crisis and (b) a possible collapse of the Euro; if not, why not; if so, what measures;

(2) whether he will make a statement on the matter?

CO720E

REPLY:

(1) To date, the impact on South Africa has been primarily through falling business and consumer confidence and financial market variables such as capital flows and the exchange rate. The RMB/BER Business Confidence Index has declined from 55 index points in the first quarter of 2011 to 39 in the third quarter, while the FNB/BER Consumer Confidence Index has fallen from +15 at the start of the year to +5 in the fourth quarter.

The euro zone crisis and associated spike in risk aversion has affected capital flows to South Africa. Foreign investors became net sellers of local bonds and equities to the value of R21.9 billion between July and mid-October. Flows are likely to remain volatile until European leaders agree to a detailed and comprehensive package of measures to address the euro area fiscal and banking crisis.

The Medium Term Budget Policy Statement (MTBPS) acknowledged the considerable risks to the world economic recovery and the outlook for our own economy, and set out the fiscal and budgetary dimensions of the government's response.

At this point we do not see a need for additional policy changes, but we will closely monitor global developments in our preparations for the 2012 Budget to assess their impact on the economy. The key elements of the macroeconomic response set out in the 2011 MTBPS can be summarised as follows:

- We have pursued an accommodative fiscal stance since 2009, in response to the global crisis and the recession. Revenue has fallen, but we have maintained real growth in expenditure, complementing the Reserve Bank's support for the economy through lower interest rates and monetary easing.
- Recognising that our tax revenue collections have not yet recovered fully from the effects of recession, our counter-cyclical fiscal stance allows for the budget deficit to be reduced at a slower pace over the MTEF than previously anticipated.
- The short-fall between expenditure and revenue will be financed through a temporary increase in borrowing. The projected doubling in the country's debt burden to about 40 per cent of GDP in 2015, signals the substantial contribution of thefiscus to the economic recovery and growth.
- The MTBPS also highlighted strongly that long-term sustainability depends also on shifting the composition of government spending from consumption to investment. Our aim is to strengthen infrastructure investment and maintenance, because this will improve the underlying growth potential of the economy. This means that we must see a moderation in the growth of the wage bill and spending on goods and services over the MTEF period ahead. We must do more with less.
- Over the MTEF, government will focus support towards infrastructure investment, job creation, social development priorities and an economic support and competiveness package.
- We will create a "policy reserve" to finance initiatives that support economic growth.

Measures that we have available for managing the impact of the Eurozone crisis – and should it occur, a collapse in the euro – are part of a broader strategy that aims to build up the resilience of the South African economy to external shocks and improve the manner in which the economy functions.

We also have a number of short-term mechanisms in place to help us manage the potential fallout from a deepening of the Euro crisis. These include:

- A flexible funding strategy thatwill help us manage our need to enter the market in the event of a sharp increase in bond yields or a sudden drying up of capital, as occurred in the financial crisis of 2008

- In the event that there is once again a dollar shortage globally as occurred following the Lehmann's crisis, we have foreign currency cash balances which can be used to help finance our foreign currency requirements

- Low levels of foreign currency debt and a flexible exchange rate work together to reduce the potential for our existing debt payments to become onerous.

- We have measures in place to maintain adequate levels of liquidity in the domestic banking system

- Continued exchange control liberalisation will encourage greater two way demand for the currency, which should mitigate rand volatility to some extent.

- We have a number of social support mechanisms in place to help manage the human side of any potential worsening of the crisis, including the Unemployment Insurance Fund (UIF), which helps to protect vulnerable South Africans from the income loss associated with unemployment and an extensive system of social grants. Initiatives such as the training layoff scheme and IDC funding for distressed firms, were aimed at mitigating job losses and firm closures during the last recession, and could offer support if economic conditions deteriorate further.

(2) We will continue to closely monitor domestic and international economic developments and rigorously implement the plans outlined above to bolster the prospects of growth and job creation.