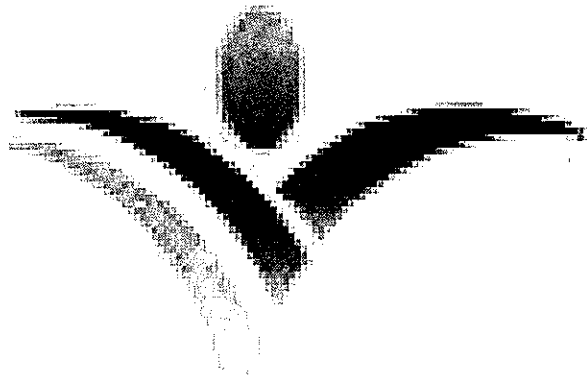


CHAPTER 9



Overview Of Budget Assumptions

CHAPTER 9

OVERVIEW OF BUDGET ASSUMPTIONS

The 2012/13 – 2014/15 Medium Term Budget has been prepared in a less volatile global and local economic market which hopefully will result in realistic and accurate budget assumptions and a credible budget.

Global Economic Trends

The global environment remains a challenge. The Eurozone is expected to experience a recession in 2012, but growth in the US and Japan is expected to be more favourable. The SA inflation outlook has deteriorated and is forecast to remain above target for all of 2012. Inflation is likely to return to target range in Q1 2013. Inflation is set to peak at 6.6% in Q2 2012. The higher inflation forecast is mainly due the weak rand. In addition, food prices remain elevated. The South African Reserve Bank has cut its GDP growth estimate to 2.8% from 3.2% for 2012. For 2013 it expects growth to be in the region of 3.8%, down from 4.2%. Business confidence remains weak. Job growth is uncertain and the possibility of wage hikes could pose some risk to inflation. Growth in consumer spending has started to moderate. Credit extension trends remain relatively subdued. Oil prices have been surprisingly stable, but could spike higher. Gill Marcus ended her speech by saying that “the Monetary and Policy Committee (MPC) remains of the view that inflation pressures are primarily of a cost-push nature, but is concerned that a persistent upward trend in inflation and prolonged breach of the inflation target could have an adverse effect on inflation expectations which could reinforce the upward inflation dynamics”. The MPC is aware of the slowing domestic economy and feels that given the lack of demand pressures, monetary tightening at this stage would not be appropriate.

In December 2011, headline CPI inflation rose by a relatively modest 0.2%*m/m*, with the annual rate remaining unchanged at 6.1%*y/y*. For 2011 as a whole, SA CPI inflation averaged a respectable 5.0%*y/y*. Looking ahead, there are still some upside risks to SA inflation. These include a range of administered prices (electricity, water, fuel etc.) as well as the recent Rand weakness. The extent to which these price pressures will impact core/underlying inflation will be heavily influenced by the strength of the domestic economy; which is currently slowing, thereby creating less opportunity for companies to pass-on cost increases.

Offshore, resolving the Euro-area financial crisis remains extremely complex. After the European Union (EU) summit on 8 and 9 December 2011, EU leaders announced the establishment of a new "fiscal compact", which aims to better enforce fiscal discipline within the region. However, the details of the new treaty are still vague. This means that there is a significant risk that the financial markets will remain relatively volatile, especially if growth rates continue to soften. There is also a real concern that the higher cost of refinancing sovereign debt will derail the ability for key governments (especially Italy) to affect the necessary fiscal discipline. Under the leadership of Mario Monti, Italy has adopted a severe austerity package aimed at eliminating its budget deficit by 2012. Italy requested that Germany assist with lowering Italian bond yields. The motivation is that without some incentive, it will be difficult to sell austerity to the Italian people. The EU will break-up without support from the populace, and the populace needs to be given a reason to remain part of the Union. The Italian 10-year bond yield is currently a little below 7%. Unfortunately, Italy has a

huge gross financing requirement of €440 billion for 2012, with about €130 billion in the first quarter. Should Italian bond yields push higher, the increased cost of borrowing could start to swamp the budget, and effectively undermine the government's ability to implement a managed and orderly path to fiscal discipline. The Greek private sector bail-out is still unresolved and Greece could still default.

The key policy concern for many emerging economics in 2012/2013 is how to control the upward bias inflation without severely dampening the economic recovery and job creation.

Socio Economic Trends in the District – Background and Basic Demographic

The South African National Census of 2001 is the most recent recognised source of South African statistical information, undertaken by Statistics South Africa (Stats SA) in October 2001.

The census determined the country's population as 44.8 million and Cacadu's population to be 369 782.

The Cacadu District covers approximately one third of the Eastern Cape's land area. However, it only houses 5.4% of the provinces' population, with an average distribution of seven people per square kilometer. Only 22% of houses are informal, and 2/3 of households have potable water and a flush toilet or pit latrine on site. Conditions are worse in the small towns of the interior where poverty can be severe, compounded by isolation from the mainstream economy.

The Cacadu area consists of a predominantly rural or agricultural base but differs from the mainstream 'rural' definition that refers primarily to the former homelands. Population concentrations are in Makana, Kouga and Ndlambe, with more than 50% of residents in the District residing in these Municipalities. The remaining Municipalities all have less than 50 000 inhabitants per Municipality.

One explanation for this distribution is the variation in land types, agricultural practices and associated income generating opportunities that are characteristic of Cacadu's inland and coastal areas.

District Economy

The average growth rate of the Cacadu District is estimated at 1.1%, which is higher than the Provincial growth rate, estimated at 0.3% and slightly lower than the National growth rate of 1.2%. There has been a significant decrease in the growth rate of the District between 1996 (2.6%) to 2007 (1.1%).

There is a correlation between the concentration of people and population growth trends, with Makana, Kouga & Ndlambe experiencing the most significant increases between 1996 and 2007. Camdeboo and Sundays River Valley have also experienced increases over this period. Locally, internal migration trends are predominantly towards the more affluent centres of Makana, Kouga and Ndlambe, presumably by people in search of improved economic opportunities.

Migration trends increase the number of people seeking employment, demand for housing and other associated services in more secure economic areas. Living in larger cities permits individuals and families to take advantage of the opportunities of proximity, diversity, and marketplace competition. Rural migrants are attracted by the possibilities that larger cities can offer, but can find themselves in informal settlements and experience extreme poverty. Migration trends need to be studied and formulated as a planned phenomenon to prevent urban sprawl and the perpetuation of impoverishment. The Medium Term Spatial Framework (MTSF) stipulates that effective and efficient urban management and development should provide employment and economic growth opportunities. Statistical trends of migration within the Cacadu area should be used to influence the Spatial Development Frameworks of affected local municipalities to ensure that correct measures are in place to accommodate an anticipated influx.

The Cacadu District Municipality's Progress Development Indicators

There has been progress on improving the standards of living in the district. The improvement in the Human Development Index between 1996 and 2007 has been significant.

The HDI in Cacadu has specific spatial and social characteristics. Those municipalities with an urban bias display a stronger Human Development Index (HDI) demonstrating that human development was higher in urban rather than rural areas. These LMs include:

- Camdeboo (0.58)
- Makana (0.58)
- Ndlambe (0.58)
- Kouga (0.64)

The reduction in poverty and improvement in living standards can be attributed to steady economic growth over the same period. The problem with unemployment especially in the rural areas is a challenge and is the main reason many people live in poverty. Although social grants have provided a safety net for some people, it is not enough to ensure people live above the poverty line.

According to STATS SA, South Africa's unemployment rate has declined from 23.1% in 2008 to 21.9% April 2009. The unemployment rate in Cacadu also declined between 2006 (32.1 %) and 2007 (31.4%). The Cacadu unemployment rate however remains substantially higher than the South African average. The rate of unemployment in Cacadu can be compared to other African Countries of Cameroon and Equatorial Guinea both of whom hold an unemployment rate of 30%. According to the GID, the unemployment rate has increased from 28.9% in 1996 to 31.4% in 2007.

Unemployment in Cacadu is coupled with slow job growth. Cacadu specific industries are limited with little expansion and or revitalization plans. This situation has resulted in the obvious increase in the number of job seekers. The increasing numbers of unemployed residents erodes the private income source of service provision and increases the demand for social services.

An economy with high unemployment is not utilising all of the labour resources available to it and is thus operating below its productive potential. Such an economy could have higher outputs if all of the available workforce were gainfully employed in industrious enterprises.

The MTSF calls specifically for efforts to be taken to identify and enhance existing economic opportunities in the interests of work creation and sustainable livelihoods.

The current situation in Cacadu requires:

- The mobilisation of existing industries to increase production or add value to existing products;
- The investigation and establishment of new or alternative production industries;
- Labour to become skilled in providing the services required by existing industries;
- A drive to establish and support gainful self-employment; and
- The establishment of a committed work ethic.

Long term unemployment has negative effects beyond impoverishment and social dependency of the jobless. These include:

- During a long period of unemployment, workers can lose their skills, causing a loss of human capital;
- Being unemployed can also reduce the life expectancy of workers by approximately 7 years; and
- High unemployment can encourage xenophobia as workers fear that foreigners could occupy available positions

CDM's Economic Base

Cacadu ranks as a third largest economy of the province. The two predominant economic sectors within the District are agriculture and tourism.

Agriculture, the Economy and Social Impact

Agriculture dominates the district's economy, contributing 28% of all value added and amounting to 41% of formal employment.

Small-stock farming predominates in the dry Karoo interior. This is the centre of wool and mohair farming in the Eastern Cape. Karoo mutton is known for its high quality and is also exported. Cattle and dairy farming are dominant in the areas around Grahamstown, Cookhouse, Alexandria and Humansdorp. Stock production has seen a decline in the past decade, primarily as a result of game farm establishment and the expansion of the Addo National Elephant Park.

Game reserves are now a major industry within the district and contribute to the other prominent economic sector of the area, namely tourism.

The Langkloof valley is home to deciduous and stone fruit production. Major citrus farming areas are irrigated from the Sundays and Fish Rivers. Fruit is exported through Port Elizabeth. Commercial forestry is established around Tsitsikamma and Grahamstown. A small fishing industry operates from St Francis, centered on rock lobster.

Manufacturing, focused on agro-processing, is a relatively small sector, providing only 10% of value added and 7% of employment.

Agro-processing is currently limited to food and dairy. Furniture production is present in the larger towns of Grahamstown and Humansdorp. Small businesses and craft co-operatives in district towns focus on specialty products ranging from hand knitted mohair items to essential oils.

Tourism, the Economy and Social Impact

Tourism is well established in Cacadu. Tourism attractions include the well-known Tsitsikamma National Park, the Baviaanskloof Mega-Reserve (a World Heritage Site), and the Addo Elephant National Park and the coastal resorts of Jeffrey's Bay and Port Alfred. Farm tourism is beginning to develop in the Karoo, and Graaff-Reinet is commonly visited for its history and architecture.

This economic sector has massive potential for growth. The Addo and Baviaans Parks and the Fish River Reserve are expanding, and will increase the attraction of game reserves in the district with economic spin-offs in terms of retail, accommodation, hospitality etc.

Government services play a significant role in the economy, providing 28% of added value and 23% of formal employment.

Summary of Budget Assumptions

The global and national economic outlook has improved and higher growth rates are expected over the medium term. This impact positively on collection rates of municipalities. The current harsh economic conditions are hard for both the businesses and households which have impacted negatively on the payment for municipal services.

The table hereafter gives a summary of the assumptions used to prepare the medium term budget.

Supporting Table: Social, Economic and Demographic Statistics and Assumptions

Description of Indicator	2009/2010 Actual	2010/2011 Estimate	2011/2012	2012/2013	2013/2014
Demographics					
Population (Stats SA 2001)	388 210	388 210	388 210		
Economic					
Inflation / inflation outlook (CPIX)	6,7	4,3	6,1	6,6	5,5
Interest rate – borrowing	N/A	N/A	N/A	N/A	N/A
Interest rate – investment	8	6	7	6	6
Remuneration increases	8	8	6	5	5
Collection Rates					
Property tax / services charges					
Rental of facilities & equipment					
Interest – external investments					
Interest – debtors					
Revenue from agency services					