momentum
investments

SA national budget 2018 (FLASH NOTE)

Tackling the fiscal wounds

Initial impressions

- Improvement relative to Treasury's October 2017 projections
- Contractionary budget ➔ (real) revenue growth expected to outstrip expenditure growth
- Budget focused on growth-enhancing mechanisms to restore confidence and propel SA's growth trajectory to a higher platform over time
- Structural revenue proposals positive for revenue base going forward
- Meaningful cuts to expenditure (outside of tertiary education allocation) suggest a prudent approach to fiscal policy

Immediate market effect

Contractionary budget ➔ lower risk of a sovereign rating downgrade is positive for bonds, the currency and domestically-orientated shares

FTSE/JSE ALSI rose 1%, supported by a rise in industrial and financial shares	FTSE/ALSI Financials gained 0.6%, as downgrade fears lifted, while a firmer rand saw an initial weakening in resources	R186 government bond rallied 9 basis points	The rand strengthened 0.8% against the dollar

Fiscal slippage arrested _

- The main budget deficit is expected to narrow from 4.6% of gross domestic product (GDP) (previously 4.7%) in FY2017/18 to 3.7% (previously 3.9%) in FY2020/21
- Faster deficit reduction relative to Treasury's October 2017 projection is largely related to higher revenue forecasts and cuts to expenditure
- Improvement in government's (gross) debt ratio projection ➔ debt expected to increase to 56% of GDP in FY2020/21 (previously 59.7%)

Tax burden still rising

- SA's tax burden still rising ➔ new revenue proposals worth R36 billion
- Tax-to-GDP ratio set to climb from 25.9% in FY2017/18 to 27.2% in FY2020/21

Tax proposals

- VAT increases from 14% to 15%, effective from 1 April 2018
- R6.8 billion from only partial relief for bracket creep ➔ relief aimed at poorer households
- A 52c/l increase in the general fuel levy (22c/l), a 30c/l hike in the Road Accident Fund levy and a 6% to 10% increase in alcohol and tobacco excise duties expected to raise R2.6 billion
- Wealth taxes in the form of a higher estate duty tax rate of 25% (from 20%) for estates greater than R30 million, an increase in the donations tax rate (from 20% to 25%) and an increase in excise duties on luxury goods (7% to 9%)
- R1.9 billion sugar tax has a proposed implementation date of 1 April 2018
- Carbon tax to be implemented from 1 January 2019
- Medical tax credits adjusted below inflation for the next three years ➔ expected to raise R4.2 billion for national health insurance

Risks to revenue collection

- Slightly higher tax buoyancy estimates in response to tax increases ➔ likely contingent on improvement in tax morality
- Revenue shortfall for FY2017/18 revised from R50 billion to R48 billion
- Structural tax adjustments positive for revenue base in the Medium-term Expenditure Framework (MTEF)

Overall negative consumer effect

- Consumer spending hurt by VAT increase ➔ vulnerable households compensated through positive real increase in social grants
- Number of grant recipients to grow from the current 17.3 million to 18.1 million by FY2020/21
- Some relief for lower-income individuals (increase in bottom three tax brackets and rebates)
- Wealthy targeted through rise in excise duties on luxury goods and increase in estate duties
- Government hinted that headcount reductions and strict adherence to inflation-linked salary increases are needed to keep compensation within expenditure limits ➔ less support for consumption spend

Wage and interest bill still sizeable

- Treasury's provision unchanged from October 2017 ➔ average 7.3% nominal increase (1.8% real) expected in the civil servant wage bill over the MTEF
- A public-sector wage agreement, which fails to take account of fiscal constraints would undercut progress in containing wage costs and remains a risk
- Interest bill shifts to being the second-fastest-growing expenditure item at an average of 9.4% in the MTEF

Government addressing ailing state-owned enterprises

- Treasury's guarantees to public institutions amount to R466 billion in FY2017/18 (R300.4 billion already used) ➔ Eskom, independent power producers and the Road Accident Fund account for the majority
- Government is developing a framework to reduce new guarantees to state-owned enterprises (SoEs)
- Further financial support required ➔ combination of disposing of non-core assets and underutilised government properties, introducing strategic equity partners or direct capital injections

Free higher education to be phased in

- Additional funding of R57 billion in the medium term
- Higher education and training growing at 13.7% y/y on average in the medium term ➔ fastest growing expenditure item
- All new first-year students with a family income below R350 000 per year at universities and TVET (Technical and Vocational Educational and Training) colleges will be funded for the full cost of study

Rating agencies more likely than not to leave SA's sovereign ratings unchanged

- Fiscal slippage arrested and government debt ratio stabilised
- Less cloudy political outlook ➔ single centre of power (same leader of the ruling party and president of the state)
- Improved growth outlook
- Favourable structural reform momentum ➔ improved governance at SoEs, investor-friendly mining sector policies, support to labour-intensive sectors, product market reform (reducing barriers to entry and encouraging competition), improving management of public infrastructure projects, curbing corruption through inquiry into state capture, assistance to troubled municipalities, amendments to the Public Audit Act to reduce wasteful expenditure, increasing number of special economic zones and greater collaboration between government, business and labour

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