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National budget preview: Navigating a treacherous path towards sustainable fiscal consolidation

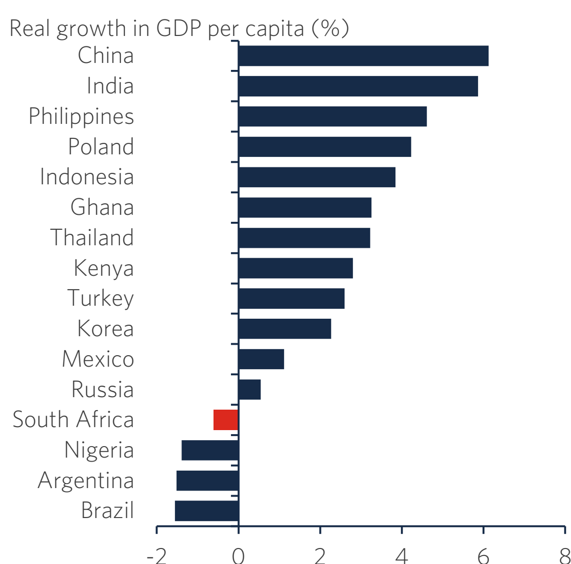
Highlights

- South Africa (SA) has experienced one of the weakest average growth rates in per capita gross domestic product (GDP) in the past five years from a range of emerging economies.
- We see a marginal downside risk of 0.2% to treasury's forecasts on nominal GDP growth between fiscal year 2019/2020 (FY2020/21) and FY2022/23 implying further savings (above the R150 billion announced by government) are needed to close the primary budget deficit, after Eskom funding is excluded.
- Advancing capacity at SA Revenue Service (Sars) to collect taxes, a diminution in tax evasion as well as fraud and restoration in tax morality provide the potential to alleviate pressure on revenue collection in the coming years.
- Poor economic activity has taken a toll on revenue growth. Extrapolating tax receipts year to date (YTD) points to a R22 billion shortfall for FY2019/20. This could be lower (R14 billion) if value-added tax (Vat) refunds normalise.
- Tough business and consumer conditions provide a tricky setting in which to raise additional taxes. We expect limited compensation for bracket creep (fiscal drag), fuel levies and sin taxes on alcohol and tobacco to contribute towards additional tax revenues in the next fiscal year.
- A bloated government wage bill and burdensome debt-service costs are crowding out other more useful government expenditure. For every R1 000 spent on consolidated expenditure, R340 is paid to civil servants. While an across-the-board wage freeze for civil servants is less likely in our view, government could potentially achieve a significant portion of its intended savings of R150 billion through earmarking higher-income categories for wage freezes and bonus cuts, while implementing strict inflation-linked increases for the remainder.
- Government's debt ratio is unlikely to stabilise in the medium-term expenditure framework (MTEF). As such, rapidly increasing debt-service costs will continue to limit the availability of money to implement policy priorities.
- Recent positive announcements around the energy sector and network industries and measures to improve the ease of doing business have been welcomed by business, but investors remain frustrated by the lack of clarity on politically contentious reforms, which have elicited a polarised response from within the ruling party's structures.
- Comments by Moody's rating agency that there was "nothing really to flag for the time being" may suggest that, in the absence of a large negative shock in the budget on 26 February 2020, the rating agency may decide to leave SA's sovereign rating unchanged on 27 March 2020 and defer ratings action to 20 November 2020. In our view, the risk of a downgrade remains high in 2020, as the consensus-building nature of the incumbent administration and the current incremental pace of structural reform do not indicate that we are firmly on the path of strong reform efforts to instil significantly higher levels of confidence and credibility to meaningfully kick-start growth.

A stagnating economy

According to data from the International Monetary Fund (IMF), SA has experienced one of the weakest growth rates in per capita GDP in the past five years from a range of emerging market peers (see chart 1).

Chart 1: Living standards moving backwards



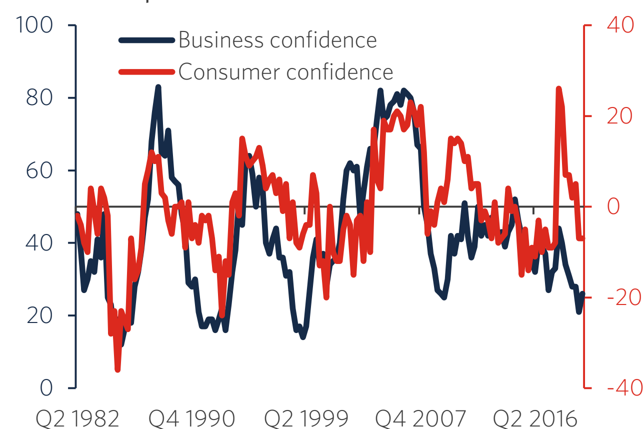
Source: IMF, Momentum Investments

Weak momentum behind growth has reflected chronic policy uncertainty, stretched government finances, infrastructure constraints and crushed confidence. Reluctance to invest in the SA economy, given concerns about insufficient levels of demand and uncertainty around the political climate, has left growth in SA private fixed investment below an average rate of 1% since 2015 relative to the 3.3% longer-term average.

In the past five years, growth in GDP averaged 0.9%, while growth in SA's labour force increased by 3%. As such, the anaemic pace of growth has been insufficient to support the growth of new entrants into the labour market, resulting in the headline rate of unemployment reaching 29.1% and the number of unemployed topping 6.7 million in the fourth quarter of 2019.

Incremental progress on the implementation of economic and regulatory reforms should see local sentiment levels edge higher from a gloomy base in the coming years (see chart 2), but no quick turnaround is expected.

Chart 2: Depressed sentiment



Source: Bureau of Economic Research, Momentum Investments, data up to Q4 2019

Given tepid growth in local demand and continued headwinds to exports due to unfavourable trade developments, we expect real growth in GDP to average 1.4% between FY2020/21 and FY2022/23 in comparison to treasury's October 2019 forecast of 1.5%. Risks to our growth view remain firmly to the downside, particularly if load shedding persists in the severity and frequency observed since late 2019.

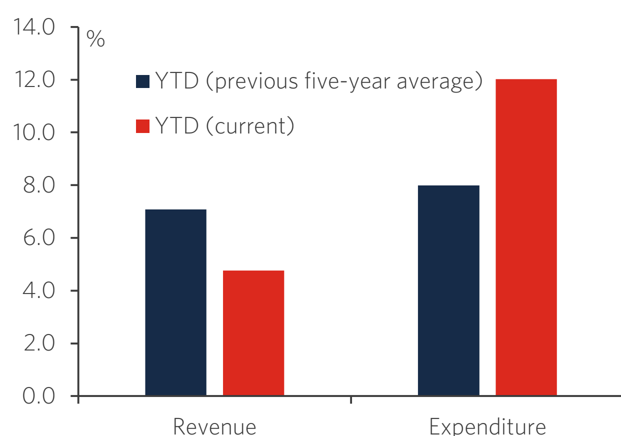
A lack of demand-pull inflation pressure and a muted pass-through from past depreciation in the local currency should see headline inflation averaging 4.7% in the next three fiscal years. This estimate is only marginally lower than treasury's October 2019 estimate of 4.8% for the corresponding period.

Using these real GDP growth and inflation forecasts to proxy the outcome of the nominal GDP deflator, we see marginal downside risks of at least 0.2% to treasury's forecasts during the MTEF. This indicates that even larger savings are needed than the initial R150 billion indicated by government to achieve a zeroed primary balance after excluding Eskom funding. While this adds a negative slant on expected revenue collection, advancing capacity at Sars to collect taxes, a recovery in tax morality as well as a diminution in tax evasion and fraud could alleviate pressure on revenue collection in the coming years.

Tax collection is lagging

Growth in government revenue has disappointed (fiscal) YTD (for the first nine months of FY19/20) relative to the average for the past five years, whereas growth in expenditure continues to outstrip past trends, partly owing to further allocations to state-owned enterprises (SoEs), including Eskom (see chart 3).

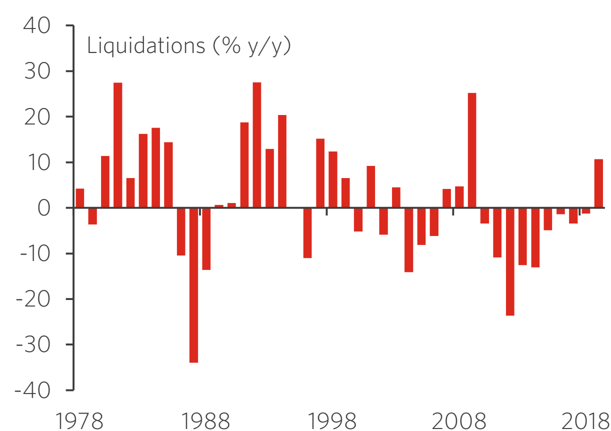
Chart 3: Growth in government revenue and expenditure compared to past averages



Source: Global Insight, treasury, Momentum Investments

At a YTD growth rate of 4.6%, total tax revenue is not only lagging the past five-year average of 7.7%, but it is also undershooting treasury's FY2019/20 target of 6.4% set out in October 2019.

Chart 4: Tough operating climate for firms

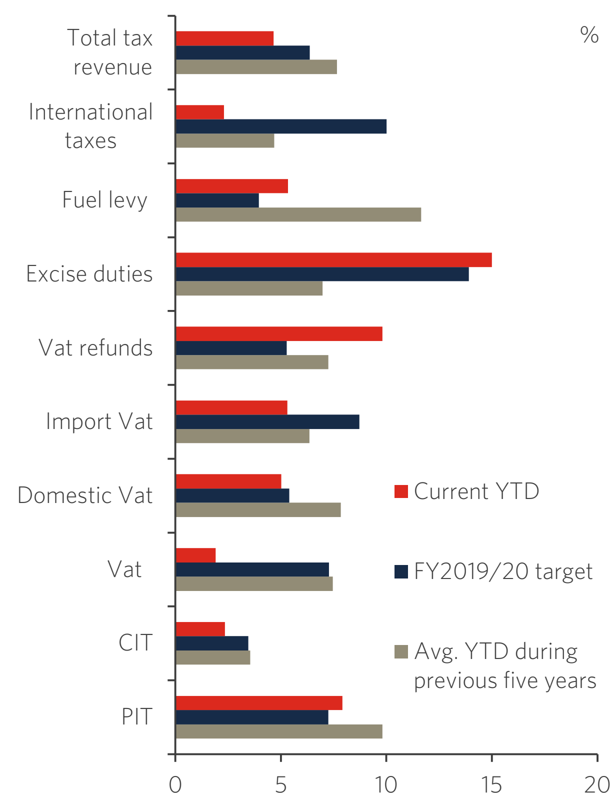


Source: Iress, Momentum Investments, annual data up to 2019

The under-collection in revenues relative to treasury's October 2019 target for FY2019/20 has primarily stemmed from company income taxes (CIT) and Vat. Growth in CIT averaged 2.4% YTD relative to treasury's estimate of 3.5% for FY2019/20. A rise in company liquidations according to data from Statistics (Stats) SA (see chart 4) reflects a tough trading environment for firms and explains the relative weakness in CIT collections.

Vat receipts averaged 1.9% YTD relative to treasury's October 2019 projection of 7.3% (see chart 5).

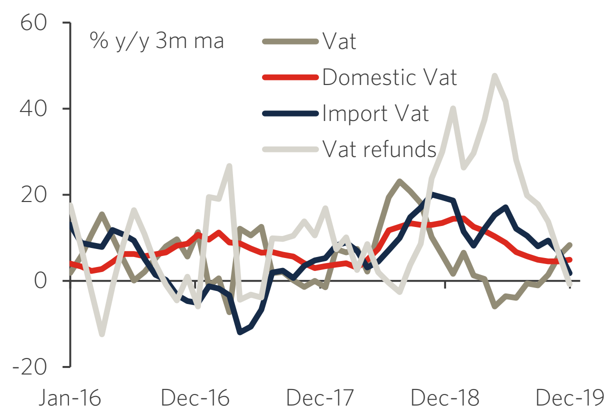
Chart 5: Growth in government revenue compared to past averages



Source: Global Insight, treasury, Momentum Investments

This discrepancy is partly clarified by the 9.8% run rate in Vat refunds YTD relative to treasury's October 2019 target of 5.3%. More recently, the run rate in Vat refunds slowed to negative 0.8% year on year (y/y), see chart 6.

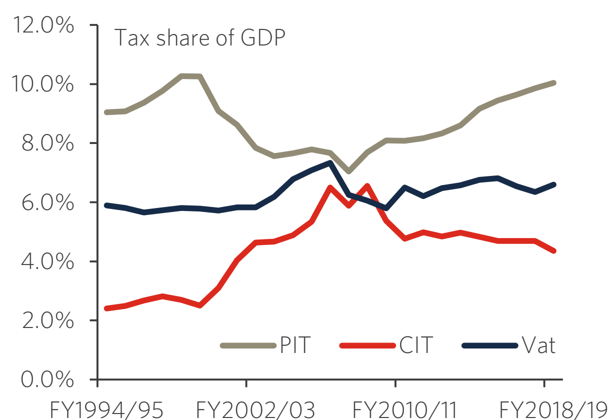
Chart 6: Pace of Vat refunds has moderated lately



Source: Global Insight, treasury, Momentum Investments

Growth of 7.9% in personal income tax (PIT) collections YTD is below the average for the same period in the past five years of 9.8%, but exceeds government's October 2019 assumption of 7.3% by a narrow margin.

Chart 7: PIT share nearly back at 1999 peak

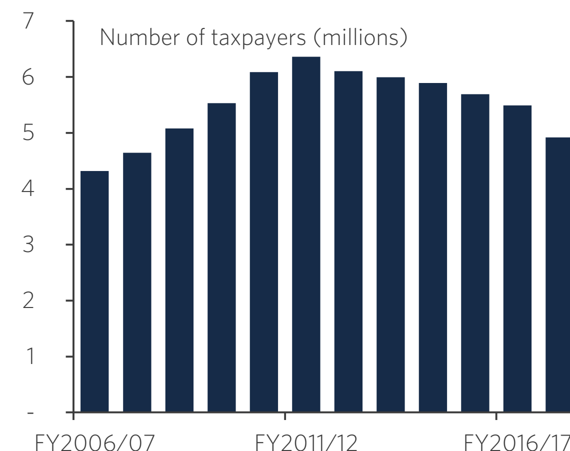


Source: Global Insight, treasury, Momentum Investments

PIT has recovered from a trough of 7% as a share of GDP in FY2007/08 during the global financial crisis, to 10% in FY2018/19 (38% of total tax receipts) likely on the back of limited compensation for bracket creep and adjustments to PIT rates. The PIT share of GDP is nearly at its previous high in FY1999/00 (see chart 7). This is in spite of the quarterly wage statistics, published by Stats SA, showing country-wide wage trends having dipped from a long-term average of 11.7% in nominal terms to an average of 5.4% in the four quarters ended September 2019, pointing to downward pressure on household disposable incomes.

Moreover, despite an increase in the number of registered taxpayers to 21.1 million in FY2017/18, the number of assessed taxpayers has dropped to 4.9 million, highlighting a narrowing in the tax base (see chart 8).

Chart 8: Narrowing tax base



Source: Sars, Momentum Investments, data up to FY2017/18

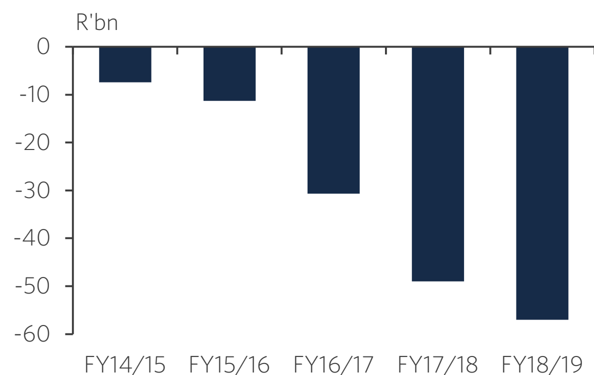
CIT peaked as a share of GDP in FY2008/09 at 6.6% but has since dropped to 4.7% (16% of total tax receipts) on policy uncertainty, a slowdown in export growth and weak local demand. Meanwhile, Vat, as a share of GDP, increased from 5.8% in FY2009/10 to 6.6% in FY2018/19 (25% of total tax revenues) despite weaker consumption spending.

Revenue shortfalls are a function of weak growth and inherited tax administration problems

Revenue shortfalls widened in the past few years. Revenue under-collections increased from R7.4 billion in FY2014/15 to R57 billion in FY2018/19 (see chart 9), using the prior year's national budget estimates. If the current run rate in total tax revenue is extrapolated for the remaining three months of FY2019/20, a shortfall of around R22 billion arises relative to October's medium-term budget projections. Rand Merchant Bank (RMB) estimates the shortfall could drop to below R14 billion if the pace of Vat refunds moderates.

RMB notes this could push the consolidated budget deficit to R6.2% of GDP, which is higher than the 5.9% forecasted by treasury in October 2019.

Chart 9: Tax shortfalls against budgeted estimates



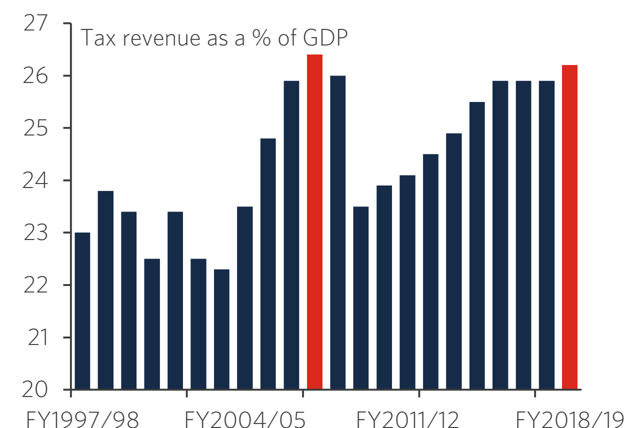
Source: Sars, treasury, Momentum Investments

Tax shortfalls occurred in spite of the implementation of additional tax hikes, including the 1% Vat increase and an increase in taxes for the top tax bracket. Additional tax increases leading to lower tax revenues being generated could partly be due to the disincentives of higher taxes starting to dominate collections, leading to tax evasion and non-compliance.

A slew of corruption allegations in government has likely contributed to the stalling of the tax-revenue-to-GDP ratio (tax burden), see chart 10. The peak in the tax burden tallied 26.4% in FY2007/08, when GDP growth averaged 4.9%. At 26.2%, the tax burden is not far off from its peak, yet growth has stalled at 0.4% in the available past four quarters ending September 2019.

SA's tax burden ranks lower than that of Brazil, Hungary, Poland and Portugal. Still, it is higher than that of China, Indonesia, Turkey and India.

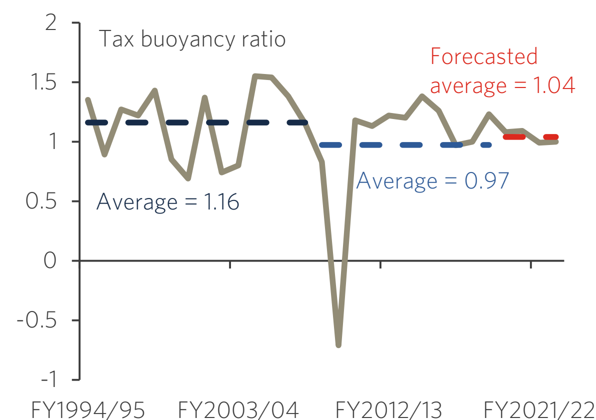
Chart 10: Tax-to-GDP ratio close to peak



Source: Sars, Momentum Investments

Treasury's anticipated improvement in the tax buoyancy ratio to above one between FY2019/20 and FY2022/23 indicates slightly more tax revenue per unit of GDP, unlike the average observed since the global financial crisis (see chart 11). Treasury's February 2019 national budget initially indicated an average buoyancy ratio of 1.2 in the MTEF, but this was lowered to 1.04 in October 2019.

Chart 11: Tax buoyancy ratio set to dip further



Source: Sars, Momentum Investments, forecasts to FY2022/23

Turning around the tax agency

Sars Commissioner, Edward Kieswetter, previously revealed the rebuilding of Sars has begun and would be conducted through a nine-pronged approach. These plans included creating a credible threat for non-compliance, addressing institutional credibility, building an ethical workforce, expanding and improving the use of data, incorporating technology, making it easier for taxpayers to comply, providing greater clarity to taxpayers on their obligations, doing more with less and restoring tax morality by working with the Special Investigative Unit, the National Prosecuting Authority (NPA) and offshore authorities.

In the 2019 budget speech, the Minister of Finance, Tito Mboweni, assigned an examination of the tax gap to the Davis Tax Committee (DTC). The DTC estimated the annual difference between taxes raised and what can be realistically expected to be collected, as R50 billion. The chair of the DTC, Judge Dennis Davis, remarked that this was a conservative estimate, as tax evasion by high-net-worth individuals may push this figure even higher, as evidenced by the leaked Panama Papers. The automatic exchange of information with other tax jurisdictions is expected to help in this regard.

Sars has started to crack down on non-compliance. At the SA Institute of Tax Professional's Tax Indaba in August 2019, Edward Kieswetter, announced Sars seeks to prosecute 1 177 non-compliant taxpayers. Tax collection capacity has been strengthened through the re-establishment of the Large Business Centre and Compliance Unit. In July 2019, the Daily Maverick reported that 60 senior individuals at Sars had been reintegrated after being displaced in the organisation under then Sars Commissioner, Tom Moyane. Sars was also reviewing whether the grounds for 600 disciplinary cases (from 2014) were valid. In the same report, the Daily Maverick noted the Illicit Economy Unit had 54 staff investigating 15 projects, linking 800 cases.

According to Global Financial Integrity, a think tank analysing illicit financial flows, SA has racked up significant revenue losses associated with trade misinvoicing to avoid customs duties or Vat. Losses accrued to US$37 billion between 2010 and 2014. Global Financial Integrity calculated a loss in revenues of around 4% of total tax revenue from trade misinvoicing in SA in 2016.

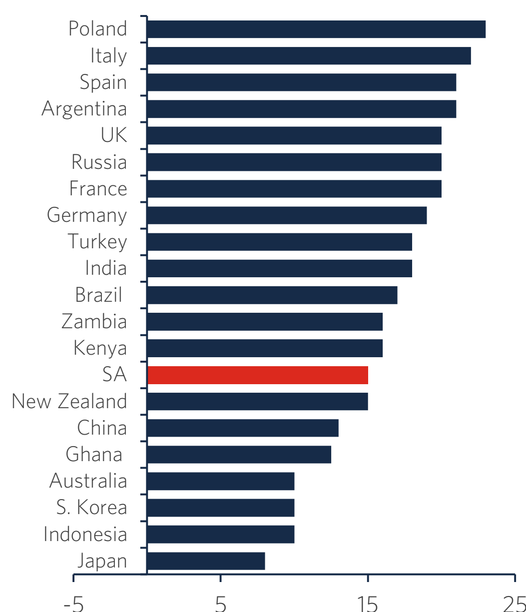
A study by Southern Africa – Towards Inclusive Economic Development (SA-TIED) showed that base erosion and profit shifting cost SA a tax loss of R7 billion per year. The study further showed that firms with a parent registered in a tax haven tended to report 80% less in profits than similar firms without a parent in a tax haven, potentially providing additional evidence of profit shifting. SA-TIED noted that "the top 10% of multinational firms with affiliates in lower tax-rate jurisdictions are responsible for 98% of profit shifting" and the biggest profit shifters by industry included the resource-extractive industry and financial services.

Limited room to raise additional taxes

Tough business and consumer conditions provide a difficult setting to raise additional taxes. SA's relatively high CIT rates (28% in SA compared to a global average of 23.8%) and government's desire to draw foreign direct investment towards the country suggest little scope to raise CIT rates further. The DTC has advised SA to cut its CIT rate to 25% to encourage inward investment but this might prove difficult in the current revenue-constrained environment.

A PIT increase at the current juncture would be difficult to implement in light of persistent consumer headwinds, including higher electricity tariffs, higher fuel prices, slower growth in nominal wages and rising unemployment.

Chart 12: SA has a comparatively low Vat rate (%)



Source: PricewaterhouseCoopers (PwC), Momentum Investments

Similarly, even though SA's Vat rate is comparatively low on a global scale (see chart 12), an increase would come at a time when growth in household spending has fallen below 1% in comparison to the last Vat rise to 15% in April 2018, when consumer spending was growing at 2.8% y/y.

As such, we expect major revenue avenues to include limited compensation for bracket creep (fiscal drag), fuel levies and sin taxes on alcohol and tobacco (see table 1).

Table 1: Potential additional revenue measures and increases in existing taxes

Potential revenue measure	Likelihood of tax increase	Detail
Fiscal drag	High	• Partial relief for fiscal drag is likely to lessen the affect the poor but relief is unlikely to be granted to the higher tax brackets • Between R10 billion and R12 billion can possibly be generated without fully compensating for bracket creep
Sin taxes	High	• Around R1.5 billion could be gained from above-inflation increases to alcohol and tobacco • The 2019 national budget noted government intends to tax electronic cigarettes and tobacco-heating products, but a date has not yet been set
Fuel levies	High	• If fuel levies are raised by 30c/l, government can earn close to an additional R5 billion in revenue • The 2019 medium-term budget indicated that the liability of the Road Accident Fund (RAF) is expected to grow to R605 billion in FY2022/23 from R341 billion in FY2019/20 • Given the delay in the transition to a Road Accident Benefit Scheme, an additional hike in the RAF is likely
Medical tax credits	High (below-inflation increases in short-term)	• The 2018 national budget stated that below-inflation increases in medical tax credits for the following three years would assist government in rolling out the initial stages of the National Health Insurance (NHI) scheme • The new NHI Bill tabled in Parliament on 8 August 2019 suggested taxpayers' medical scheme fee tax credits would be reallocated to the NHI Fund • Using these tax credits as an option to fund NHI is anticipated in the sixth and final phase of implementation, which is expected after 2022 • R1 billion could be collected from not adjusting the medical tax credits
Expat tax	High (in effect from 1 March 2020)	• R1 million limitation exemption for SA expatriates • PwC does not expect a significant inflow of revenue from this tax measure

Potential revenue measure	Likelihood of tax increase	Detail
Luxury goods tax	Medium	• The DTC has warned against the difficulties of a tiered Vat rate and the associated administrative burden • These items (luxury vehicles, art and jewellery) could also be under-reported or undervalued
Wealth tax	Medium	• This could include taxing fixed property under an additional national tax aside from at local government level, but this brings about challenges with the quality of valuation rolls • Financial assets could also be included, but may encourage dissaving • Deloitte has estimated tax on inter-generational wealth could raise between R3 billion and R5 billion a year • PwC estimates an increase in the effective capital gains tax to 22.5% could raise R2.5 billion • Higher transfer duties are less likely given the pressure on the residential housing market
Health promotion levy (sugar tax)	Medium likelihood of an above-inflation increase	• According to Sars data for May 2018 to March 2019, the sugar tax generated R3.2 billion in its first year of implementation, but claims of financial and job losses in the affected industries pose difficulties in lowering the level for the exemption of the sugar tax • The levy should increase in line with inflation
Carbon fuel levy	Designed to be revenue neutral until 2020	• Treasury has forecast revenue of R1.8 billion to be earned from the additional tax on petrol and diesel, which started on 5 June 2019 • According to Deloitte, carbon tax payments on emissions between 1 June 2019 and 31 December 2019 will likely only be due in June 2020 • PwC estimates a gain of R3 billion to be received from carbon taxes
PIT	Medium	• The PIT base is coming under increased strain from higher rates of emigration, higher levels of unemployment and poor economic growth • An attempt to improve compliance levels may help to reduce some of the slippage experienced in recent years • Avior estimates a 1% increase across all brackets could generate between R6 billion and R8 billion in additional revenue • Increasing the highest marginal income tax bracket from 45% to 47% would likely only draw in around R2 billion in additional revenue.
Vat	Medium	• The perceived regressivity of Vat and a broader set of negotiations with labour lower the chance of a Vat hike for now • In the longer term, this source of revenue could be tapped into further, especially since SA's Vat rate is relatively low by international standards • Avior estimates a 1% increase in the Vat rate would generate between R15 billion and R20 billion

Potential revenue measure	Likelihood of tax increase	Detail
CIT	Low	• Comparatively high rate (SA's company tax rate of 28% compares unfavourably to the global average of 23.6%) and the need to draw investment into SA limit the ability to raise CIT • Continued efforts are likely to curb base erosion and profit shifting (multinationals shifting profits to avoid tax)

Source: Treasury, RMB, PwC, Nedbank, Avior, Momentum Investments

The licencing of high demand spectrum is expected to be completed by the end of 2020, while the licencing of the wireless open access network (Woan) is anticipated during 2021. According to Nedbank, treasury has estimated it can raise between R11 billion and R13 billion in additional revenue from the auction.

In the State of the Nation Address (Sona), President Cyril Ramaphosa announced government would formulate policy in 2020 on regulating the medicinal use of hemp and cannabis products to provide opportunities for small-scale farmers, which raises the prospect of an additional source of revenue.

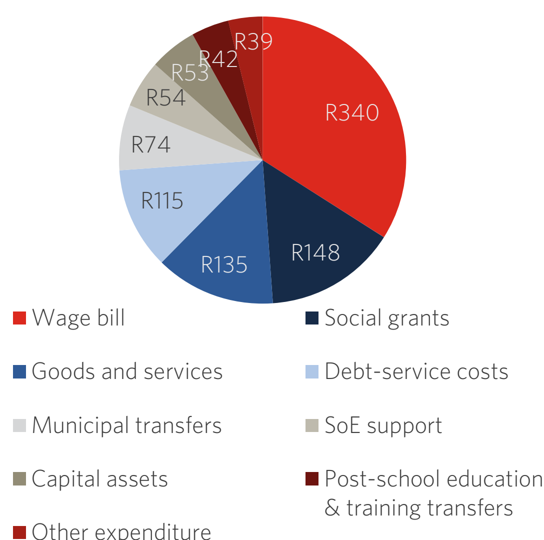
According to the Daily Maverick, the legalisation of cannabis products for medicinal use in Colorado in the United States contributed 2% towards total tax revenue in 2019.

Expenditure cuts have to come from the wage bill

Further cuts to expenditure outside of the wage bill could come at a cost to service delivery.
The government wage bill remains the largest source expenditure. Treasury has stated that out of every R1 000 spent in FY2018/19, R340 went towards the civil servant wage bill (see chart 13).

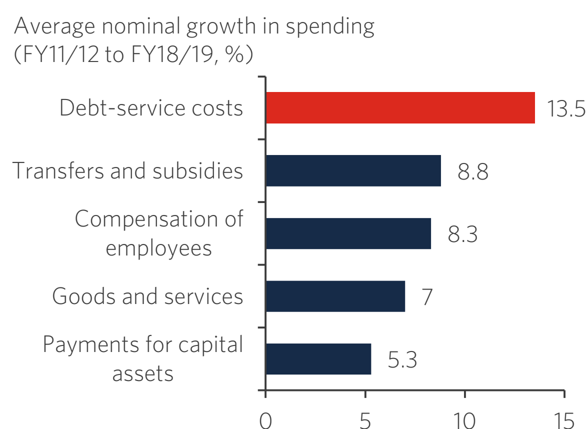
The three-year government wage agreement expires on 1 April 2021. In our view, it will be challenging to achieve a wage freeze across the board. BNP Paribas notes that a targeted wage freeze across certain higher-income earning categories, cuts to bonuses and inflation-linked wage increases for the rest could result in half of government's savings target of R150 billion.

Chart 13: Outsized wage bill (% of consolidated expenditure)



Source: Treasury, Momentum Investments

Chart 14: The interest bill is the fastest-growing area of spending



Source: Treasury, Momentum Investments

Debt-servicing costs remain a sizeable drag on the fiscus. For every R1 spent by government, 11 cents is used to service government's interest bill and, as a result, crowds out more useful forms of expenditure. The rate of growth in the interest bill continues to worryingly outstrip growth in other expenditure items (see chart 14). In October 2019, government warned that without further fiscal measures, spending on debt-service costs will outpace spending in areas such as health and community development by FY2022/23.

Policy uncertainty inhibiting growth and investment

Despite the extent of social and economic challenges facing the country, the latest Citizen Survey (polled in November and December 2019) suggests Ramaphosa's popularity rating remains high at 61%, which is not far off the all-time high of 64%, at the start of his presidency. The survey includes responses from metro, urban, rural and deep rural areas. Ramaphosa's popularity rating remains significantly higher than other senior figures in the ruling party, such as David Mabuza (24%) and Ace Magashule (13%) and higher than the party itself (51%). He has also maintained a significant lead over EFF head, Julius Malema (26%), and Democratic Alliance leader, John Steenhuisen (15%).

Even though the president's favourability rating remains high with SA citizens, strengthened anti-corruption initiatives and action on politically unpopular reforms will likely be faced with resistance from the anti-Ramaphosa factions within the ANC. Nevertheless, the depth of SA's social and economic ills requires urgent and decisive action.

Incremental progress has been made to reform the struggling economy in the past two years (see table of structural reforms in appendix 1). Moreover, positive announcements at the February 2020 Sona around the energy sector, the network industries, measures to improve the ease of doing business and boost tourism have been welcomed by business.

Nevertheless, responses on contentious reforms, including land expropriation without compensation, the NHI and the state of ill-functioning SoEs, have remained vague, as these issues are a function of ideological tensions and are likely to elicit a polarised response from within the ruling party's structures.

Land expropriation without compensation

In the ANC's 8 January 2020 statement, Ramaphosa reiterated "the return of the land will happen and it will be done in a manner that promotes economic growth and sustains food security". He further assured "all legislative efforts to accelerate the return of the land to the people will be done lawfully and in line with the provisions of the Constitution." Recently, The Ad Hoc Committee to Initiate and Introduce Legislation Amending Section 25 of the Constitution extended the deadline for written submissions on the Draft Constitution Eighteenth Amendment Bill to the end of February 2020.

The Land Bank released R3.9 billion to support black commercial farmers, while more than 1 400 30-year leases have been finalised for productive activities. In the Sona, the president noted government released 44 000 hectares of state land to date for the settlement of land restitution claims and, this year, 700 000 hectares of state land would be released for agricultural production. He also confirmed that key recommendations of the Presidential Advisory Panel on Land Reform and Agriculture (including a narrow range of cases in which no compensation would be permitted) would be carried out.

In respect of land reform, the president previously admitted to the need for a clear property rights regime to encourage higher economic growth. While short-term efforts will be concentrated on developing publicly owned land, in the long term ensuring a rollout of land expropriation without compensation, in a way that increases agricultural production and food security, would be viewed as market friendly.

NHI

Very few SA citizens have medical aid, especially among the Black and Coloured race groups. According to Stats SA's 2018 General Household Survey (published in May 2019), 72% of Whites had medical aid coverage, followed by 51% of Indians and Asians. Medical aid coverage was low at 17.1% for Coloureds and 9.8% for Blacks.

The president addressed the NHI in the Sona by announcing that government had registered more than 44 million people at more than 3 000 clinics in the electronic Health Patient Registration System. No indication of funding was outlined and it remains unclear on how the already-strained fiscus will shoulder this financial burden.

In March 2017, the DTC calculated that at an average growth rate of 2%, the NHI scheme would hit a shortfall of R108 billion by 2025, even with financing of R265 billion a year. The DTC proposed a tax rate scenario of a 2% increase in payroll on employers, a 2% surcharge on taxable income and a 2.5% increase in Vat to fund the R108 billion shortfall.

These estimates were, however, based off 2010 pricing. Intellidex notes that, based on updated pricing, funding would have to include a 2.7% increase in payroll on employers, a 2.7% surcharge on taxable income and a 3.5% increase in Vat.

Eskom funding

The Congress of SA Trade Unions' (Cosatu) is proposing to avail R200 billion of government workers' pensions to cut Eskom debt. In his Sona, the president noted that the mobilisation of money needs to happen in a manner that "does not put workers' pensions at risk" and "does not compromise the integrity of the financial system". While a social compact of this nature may lower the risk of additional government injections in the short term, medium-term fiscal risks remain high in our view. A need for additional government guarantees could increase contingent liabilities even further and raise the issue of moral hazard replacing accountability.

Sovereign wealth fund (SWF)

At the Sona, the president further revealed a SWF and a state bank would be set up and details would follow in the budget. In July 2018, the ANC proposed that a SWF must be established to "provide a steady resource for national development objectives". This was followed by then Minister of Resources, Gwede Manatashe, objecting to the proposal to use the mining industry as one of the mechanisms to fund the SWF. With SA running extensive fiscal and current account deficits, no excess cash is generated to fund a SWF. In our view, stringent regulations on the governance of the SWF and stipulations on what it may invest in would be necessary to dispel any concerns over potential mismanagement.

State bank

In early February 2020, treasury warned of the possible negative effects of a state-owned bank on SA's financial system. BusinessTech reported that treasury stated "international experience and SA's own experience suggest that state ownership of banks has (the) potential to undermine prompt corrective action by prudential regulators".

High sovereign ratings risks in 2020

The depth of SA's social and economic ills requires urgent and decisive action. With growth and fiscal outcomes continuing to surprise to the downside, we expect additional downgrades by Moody's and Standard & Poor's Global Ratings (S&P) this year.

Recent comments from Moody's that its 1 November 2019 rating was still "relatively fresh" and that there was "nothing really to flag for the time being" may suggest that, in the absence of a large negative shock in the budget on 26 February 2020, the rating agency may decide to leave its rating unchanged on 27 March 2020 and defer ratings action to 20 November 2020.

In our view, the risk of a Moody's downgrade of SA's sovereign rating from Baa3 (the last rung of investment

grade) to Ba1 remains high in 2020, as the consensus-building nature of the incumbent administration and the incremental pace of structural reform do not indicate that SA is firmly on the path to strong reform efforts to instil significantly higher levels of confidence and credibility to meaningfully kick-start growth.

The SA Reserve Bank (Sarb) estimates an expulsion of SA from the FTSE World Government Bond Index (WGBI) could trigger outflows of between US$5 billion and US$8 billion. However, the net effect could be smaller with purchases of SA government bonds by high-yielding funds given attractive real yields. Discouraging levels of growth and investment, little conviction in a positive change in the fiscal trajectory, a troubling rise in debt levels and mounting contingent liabilities further suggest that, in the absence of strong corrective action by government to place the country on firmer growth and fiscal footing, S&P is also likely to downgrade SA from BB to BB- in May 2020 and the negative outlook might be maintained.

Appendix 1: Reform efforts and shortcomings

Area	Reform	Progress and/or shortcomings
Arresting the deterioration at SA's institutional bodies	• Beginning of Sars restoration including the Large Business Centre, Illicit Economy Unit and Asset Forfeiture Unit • New NPA head • Appointment of a credible finance minister • Appointment of strong political allies in cabinet to vital portfolios • Appointment of 15 judges to various divisions of the High Court	• Credible appointments made at Sars and the NPA • A number of individuals have been removed from Sars or are under investigation for misconduct • The rot is more deeply engraved than initially envisaged and a full restoration of trust in Sars will take time • Hawks finalised 1 800 investigations by July 2019 • Cuts to parliament's compensation and benefits • Ministers due to sign performance agreements • NPA in need of funding • Capacity at treasury is a concern • No clear centre of power and slow decision making in government
Tackling corruption	• Zondo Commission of Inquiry • Nugent Commission of Inquiry	• Investigations are well underway and proof is being sourced from Sars • There is an urgency for prosecutions to be expedited
SoEs	• Governance overhaul • Operational unbundling plan developed for Eskom and timelines have been set (roadmap) • Debt restructuring • SA Airways (SAA) placed under business rescue and routes have been streamlined	• Leadership changes at board or executive leadership level for several SoEs • Some SoE appointments are still outstanding (acting positions) • No clear debt-restructuring plan for Eskom • Plans are on the table to use government workers' pension funds to offset a portion of Eskom debt • Government's stance towards privatisation is softening • Sale of non-strategic assets and a consolidation of smaller SoEs outstanding

Area	Reform	Progress and/or shortcomings
Public finances and fiscal	• Extended powers for the Auditor General • Business-to-business procurement platform • R150 billion worth of fiscal improvements in three years needed to achieve a balanced primary budget • Planned expansion of District Development Model to 23 new districts	• Expanded mandate ensures good governance and clean administration in the public sector • Increased transparency in procurement • Negotiations are ongoing with the unions to make cutbacks in the burgeoning civil servant wage bill but a lack of political capital makes this a challenging task • The District Development Model already successfully piloted in three districts and aims to resolve service delivery issues
Network industries	• Broadband spectrum • Amendment to Gas Act of 2001 to be tabled in Parliament soon • Lowering of port and rail charges • Upgrade of industrial parks	• Licencing of high demand spectrum to be completed by the end of 2020 and licencing of the Woan expected during 2021 • Competition authorities working to secure deep cuts to data prices and free access to educational websites to stimulate education and online businesses • Plans to overhaul the Durban port to reduce costs and delays • Ports Authority of SA lowered tariffs by 6% in late 2018
Energy	• Publication of the 2019 Integrated Resource Plan (IRP) • Supporting gas to power • Licencing requirements for self-generation (commercial and industrial users) • Own-use generation • Municipalities in good standing able to procure their own power from independent power producers (IPPs) • Procurement of emergency power projects to deliver electricity three months to a year after approval	• Renewable energy features strongly in the IRP • Reaffirmation of bid window five for renewable energy IPP procurement (REIPPP) but timeline not forthcoming • Self-generation applications will be processed within 120 days but no announcement of a removal of licencing requirements • No limit to installed capacity above one megawatt for own use

Area	Reform	Progress and/or shortcomings
Mining	• Passing of the third Mining Charter • Withdrawal of the Mineral and Petroleum Resources Development Act (MPRDA) Amendment Bill • Oil and Gas Bill	• Although some residual disagreements exist, the Charter was broadly adopted by the industry following collaborative discussions, largely restoring certainty • However, many junior miners are struggling to meet the requirements and the 30% black ownership requirement for companies that apply for mining rights and stricter procurement rules are seen as deterrents • More certainty for oil and gas exploration
Tourism	• Visa regulations for Chinese and Indian tourists relaxed • More countries granted visa-free access • Quicker processing of scarce-skills visas and development of critical-skills list • Unabridged birth certificates and consent letters are no longer needed • Launch of the e-Visa • More personnel at borders and implementation of e-Gates • Tourism Equity Fund • Increasing policing at tourist sites	• Fewer restrictions on tourism should boost numbers • A more pragmatic approach to attracting critical skills into the country • Speedier processing of trusted frequent visitors • Home Affairs to produce critical skills list in March 2020
Infrastructure	• Investment Conferences (another planned for 2020) • Infrastructure Fund • Budget Facility for Infrastructure • Public-private growth initiative	• R300 billion pledged in 2018 (R238 billion already invested) • R363 billion new investments in 2019 • Significant foreign investor presence at the conferences • Technical entity set up to review complex capital projects and to strengthen state capacity • Participation with the private sector in 19 sectors

Area	Reform	Progress and/or shortcomings
Labour market	• National minimum wage • Secret strike ballot and advisory arbitration panel • Jobs Summit and extension of the employment tax incentive • National Youth Service (50 000 people a year) • Youth Employment Service (Yes) • Early childhood development • Building of nine new technical and vocational education and training (Tvet) colleges in 2020 • Introduction of technical vocational specialisations in 550 schools • Introduction of coding and robotics in 200 schools (full implementation expected by 2022)	• Poverty alleviation • Prevention of prolonged strikes by allowing an intervention by the advisory arbitration panel • Rigid hiring-and-firing regulations render SA's labour market as inflexible • Collective bargaining raises labour costs for small and medium enterprises • Improvement in access to early childhood education to build a better-equipped workforce
Policy clarity	• Land expropriation without compensation • NHI • Sarb nationalisation • Prescribed assets	• The current bill is open for public comment and will be followed by Parliament voting on the proposed amendment • No concrete detail on NHI financing and necessary skills and facilities required • Confirmation of the independence of the Sarb's mandate • Prescription would force capital allocation towards savings that government deems desirable and these assets may not generate returns the market sees as adequate
Ease of doing business	• Biz Portal • One-Stop Shop • Issuance of water licences within 90 days (previously could take up to five years) • Copyright Amendment Bill signed (bill allows for works intended for education to be copied without permission or payment)	• Simplified property registration and taxation • One-stop shop provides centralised support and services to investors • Mixed opinion as the bill does not adequately protect United States intellectual property and could threaten SA's exports to the region

Source: The Presidency, Standard Bank, various news articles, Momentum Investments

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