momentum
investments

SA 2020 national budget (FLASH NOTE)

Favourable budget at face value, but will government deliver on the promised wage bill cuts?

Initial impressions

- Smaller-than-expected budget deficit surprises positively ➔ 0.2% narrower over the medium-term expenditure framework (MTEF) between FY20/21 and FY22/23 on average
- Contractionary budget ➔ real expenditure growth expected to outstrip revenue growth only in the first fiscal year ➔ but reverses in the outer years of the MTEF on extensive expenditure cutbacks
- Relative to the October 2019 medium-term budget, consolidated expenditure was revised downwards by R155.4 billion and revenue was adjusted R131.3 billion lower between FY20/21 and FY22/23
- While government's fiscal consolidation efforts relied heavily on tax increases in the past five years, the 2020 national budget centres its consolidation efforts on reducing the wage bill

Immediate market effect

- Contractionary budget, led by efforts to curb expenditure rather than raise additional taxes, was viewed favourably by SA asset classes ➔ growth-supportive budget underpins shares dependent on local economy

The FTSE/JSE ALSI rose 1.2% on the announcement of no new tax proposals	Industrial (1.1%) and financial (4%) shares led the FTSE/JSE ALSI higher, while a firmer rand dented resource shares	The R2030 government bond rallied on efforts to curb government expenditure	The US dollar/rand strengthened by 0.8%

Bold efforts were insufficient to stabilise debt in the medium term

- Main budget deficit to expand from 6.5% in FY19/20 to 6.8% of gross domestic product (GDP) in FY20/21 (unchanged from previously) before narrowing to 5.9% (previously 6.2%) in FY22/23
- Initial deterioration is due to extra-budgetary pressures from state-owned enterprises (SoEs) and slowing growth ➔ but faster deficit reduction relative to treasury's October 2019 projection is largely related to R155.4 billion worth of cuts in expenditure ➔ largely stemming from the bloated civil servant wage bill
- Gross debt ratio expected to rise to 71.6% in FY22/23 (previously 71.3%) ➔ net debt (including provisions and guarantees) expected to rise to 87.1% by FY22/23
- Primary balance remains in deficit during the MTEF ➔ but closes to 1.1% by FY22/23 (previously 1.4%)
- Debt-service costs absorb 15 cents of every rand government collects and will increase to 18.4 cents by FY22/23 ➔ interest payments to exceed health spending by the end of the MTEF

Poor economic climate limited government's options to increase taxes

- Tax burden (tax-to-GDP ratio) to remain steady at 26.3% throughout MTEF
- R2 billion in tax relief in FY20/21 ➔ all individuals more than compensated for inflation ➔ as a redistributive measure, lower-income to receive a disproportionate amount of relief
- Medical tax credits to rise by a lower-than-inflation increase of 2.8%
- Sin taxes (on alcohol and tobacco-related products) raised between 4.4% and 7.5% ➔ hubbly bubbly will be taxed at 75% of the rate of cigarettes ➔ electronic cigarettes (vapes) will be taxed from 2021
- Fuel levies up 25c/l ➔ 16c/l general fuel levy plus 9c/l Road Accident Fund levy
- No transfer duty liable on property valued below R1 million ➔ to alleviate pressure on fragile housing market
- Annual limits on tax-free savings account lifted by R3 000 to R36 000 from 1 March 2020
- While treasury acknowledges ongoing improvements at the SA Revenue Service (Sars), these gains have not been pre-emptively included in its revenue projections
- Government aims to broaden the corporate tax base and enhance equity by lowering tax rates and repealing inequitable tax incentives in the future

Weak growth has stifled revenue collection efforts

- Corporate tax collections have disappointed while personal income tax has been affected by sluggish employment and wage growth
- Tax buoyancy expected to decline to 0.93 on weak growth and projected reductions in state compensation
- Tax revenue shortfall estimated at R10.7 billion for FY19/20 ➔ estimates lowered by R127.4 billion in MTEF

Consumer effect negative if wage bill promise is upheld

- Redistributive budget ➔ 59% of expenditure goes towards spending on social commitments
- Social grant recipients to grow from 18 million in FY19/20 to 18.9 million by FY22/23
- Grants expected to increase in line with inflation in the MTEF
- Efficiency savings from the change in provision of social grants amounts to R1 billion a year
- Awareness of damaging effect of further tax hikes to economic growth has warded off additional tax proposals
- However, projected wage cuts of R160.2 billion in the MTEF imply lower spending ability particularly for middle-income earners ➔ household spending and growth forecasts could be negatively affected if government successfully negotiates a reduction in the wage bill starting with cuts to the current fiscal year

Tough announcements and lofty promises on the government wage bill

- Non-interest expenditure to contract by 0.4% per year in the MTEF due to reductions in spending and wage bill
- Government aims to slash the wage bill by R160.2 billion for the MTEF relative to February 2019 ➔ taking its share of total non-interest expenditure down to 32.6% in FY22/23 from 34.1% in FY19/20
- Wage increases for civil servants expected to average 3.5% (negative 1% real) in the MTEF
- Options for achieving the required reduction in the wage bill include modifications to cost-of-living adjustments, pay progression and other benefits ➔ clawbacks related to lower inflation to be applied for current fiscal year

Infrastructure efforts remain underway to boost a weak growth environment

- Infrastructure spend in the public sector cut by R65 billion between FY19/20 and FY21/22 ➔ but R272 billion added in outer year of MTEF
- The Infrastructure Fund has a project pipeline of R700 billion for the next ten years ➔ government has committed R100 billion ➔ large-scale investment is being targeted through blended financing ➔ private sector will mostly be responsible for designing, building and operating these assets
- Unclaimed benefits being considered in the mobilisation of funding for infrastructure
- The president's investment initiative has resulted in R664 billion of investment commitments

Long-term spending commitments

- R500 million has been allocated to fast-track the process of restoring land rights
- Spending by the Department of Health reduced by R3.9 billion in the MTEF ➔ delays in phasing in of the National Health Insurance ➔ R25 million reprioritised to improve the quality of healthcare services
- Social protection expected to account for 13.3% of expenditure in the MTEF
- State Bank ➔ banking licences are the prerogative of the Prudential Authority ➔ design of any state bank will protect the fiscus in the event of poor governance, non-performing loans or shortages in capital funding
- Interest bill crowding out other spending priorities ➔ fastest-growing expenditure item at an average of 12.3% (8% real) in the MTEF ➔ accounts for 12.7% of total expenditure and 4.5% of GDP in the MTEF
- Sovereign wealth fund ➔ treasury conducting a feasibility study ➔ considering using the proceeds from the allocation of spectrum, the sale of non-core assets, mineral rights royalties and future fiscal surpluses to capitalise the fund ➔ target capital has been set at R30 billion

No additional allocation to Eskom, but state firms remain a drain on the budget

- Scale of SoE financial challenges apparent with average return on equity for combined SoEs at negative 8.2% in FY18/19 ➔ recapitalisations and bailouts between FY08/09 and the end of the MTEF to total R291.2 billion
- Of this, R112 billion is set aside for Eskom (fiscal support remains unchanged from previously) and R16.4 billion for SA Airways in the MTEF
- Treasury's guarantee portfolio totals R693.3 billion (R555.4 billion already used) ➔ Eskom (54%) and the independent power producers account for more than 80% of the total exposure

Tough fiscal decisions may be enough for Moody's to hold the line in March 2020

- Moody's likely to take a 'wait-and-see' approach to assess whether the ambitious projected wage bill cuts are achievable ➔ this could provide space for an earlier interest rate cut by the SA Reserve Bank of 25 basis points
- Government acknowledges that further deterioration in the financial position of SoEs, unreliable power supper, outcomes of the renegotiation of the existing wage bill and the following round of wage talks, policy inertia and slow implementation of reform remain serious risks to its growth and fiscal forecasts

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