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ECONOMIC COMMENTARY - By Francois Stofberg

2 March 2020

FEBRUARY - A CLEVER BUDGET AMIDST CHILDISH INVESTORS

Despite major tax hikes in recent years, government earned R63 billion less than it budgeted during 2019/20. Because the economy is in such a bad shape individuals and companies are making less and therefore also paying less taxes. Because taxes have increased so dramatically in recent years, clever tax practitioners have introduced extreme measures to avoid them. Nevertheless, this shortfall is greater than the 2009 shortfall we faced after the global financial crisis. As a result, government debt is soaring past its previous record highs, and is now at about 66% of South Africa's GDP. Repayments on this debt remains the fastest growing expenditure item and represents more than 12% of total spending. But, we're not too worried about debt and we don't think Moody's is either. What was lacking until now was a budget that would support a strategy that could lead to sustainable growth. That is, a budget that reduces spending on unproductive items (most notably wages) and increases spending on productive (investments) items. For the first time in a long while, we now have such a budget. In the minister's own words, he explained that wages increased in real terms, at rates that exceeded their increase in productivity. Remember, he doesn't have to fire civil servants, he must simply keep the wage bill at inflation, then we're already winning in real terms. If he can manage to reduce the wage bill, then we're really winning!

To the surprise of all, government plans to reduce their own spending, most notably the wage bill, instead of taking more from consumers through higher taxes. Last year's R27 billion wage bill cut failed because fewer than expected employees were willing to take an early retirement. But then again, who would choose to stop earning an exuberant amount for doing very little. Tito Mboweni, Finance Minister, now has plans to reduce the civil servant wage bill by up to R38 billion in 2020/21, and by R160 billion over the next three years. It will most likely involve cutting benefits, simple things we've already adopted in the private sector, decades ago. Like economy class travel and cost-effective cellphone allowances, to name but a few. But I won't be surprised if we see a wage freeze. Individuals will however pay less income tax this year and companies will pay less in coming years. As an example, a household earning R460 000 a year will see their taxes reduced by nearly R3 400. The net result is that consumers will be paying R2 billion less in taxes, money that can be deployed elsewhere. The expected reduction in corporate income taxes will be offset by various tactics to reach companies that have been using clever accounting to declare "losses", and certain companies (especially multinationals) who were using debt restructuring to move profits offshore. From 2020/21 companies will only be allowed to offset 80% of their assessed losses against taxable income and net interest expense deductions will be limited to 30% of earnings.

Money has also been set aside to fund new universities and unplanned revenues from the sale of oil, gas and mineral rights, or even non-core state assets will be used to fund the R30 billion sovereign wealth fund. Also, as we expected, the VAT rate wasn't increased, although the R0.25 higher fuel levy can be considered a substitute.

So, if the budget was clever, why are markets faltering and the rand stretching towards all-time lows? Unfortunately, as a small open economy (0.6% of global GDP), we're stuck in another perfect storm. Risk-averse, childish investors have piled into safety assets, gold and the USD, pushing the USD to its strongest levels in three years. These risk averse investors are absolutely convinced that the coronavirus will trigger another global recession: a totally scientifically unfounded expectation. Just like they believed the trade war and drone attack in Iran also would. Just like they were wrong then, and the United States markets had another stellar 28% year, they are wrong now. Unfortunately, these childish investors hold the liquidity we need to jump start the rand and local markets. So, for now, we advise investors to stick to their long-term strategy that has the correct exposure to different asset classes and geographies. Our investment team still believe that local markets are heading towards a stellar 12-month period over the next 18 months.

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