INTUITION
25 FEBRUARY 2022

Better budgeting

Investors always hold their breath before Government's Annual Budget. In recent years, the news has deteriorated steadily – less revenue, lower growth, higher spending and consequently, higher deficits as well. This trend has brought us to the edge of the abyss, and Covid could well have been the final straw. Instead, some lucky coincidences, coupled with two successive finance ministers worth their salt, have managed to stabilize the ship. We are by no means out of the woods, but at least there is hope for a brighter future.

Harvard House Team

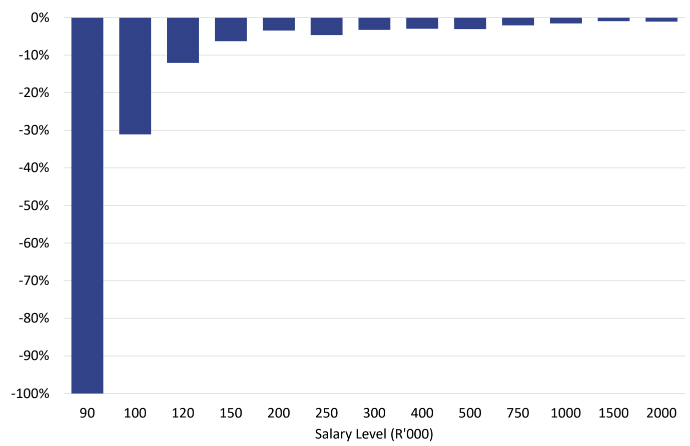
SPEED READ

- **Apart from small increases to sin taxes, no new taxes were announced.**
- **Whilst expenditure ceilings have been raised, the government's net debt position has improved materially over the past 12 months. But interest costs are consuming an ever-rising proportion of the Budget.**
- **This Budget reinforces our portfolio themes of the supported consumer, reform and infrastructure.**

During the Zuma era, investors dreaded the Government's annual budget. Invariably the news was bad and the trends were deteriorating, not improving. It was a constant reminder of the desperate state of the country, and the trajectory that we seemed unable to alter. Consequently, there is room for a resounding cheer that this year's Budget shows some reversal in those awful trends. Whether you are an investor, ordinary citizen or company director, the Budget offers a ray of hope that the future may be better than the past. From that point alone, it's a positive first step.

From a personal perspective, the Budget contained no negative surprises, and in fact, a few positive ones. There were no new tax proposals, apart from an inflationary increase in sin taxes. Rather, tax relief of approximately R13.5 billion was announced, mainly in the form of adjustments to the income tax brackets across the entire income spectrum. The chart below shows the tax saving for different salary bands. As expected, the greatest relief is enjoyed by lower-income earners, but all taxpayers earning less than R500,000 will enjoy relief of about 3%.

PERSONAL TAX RELIEF

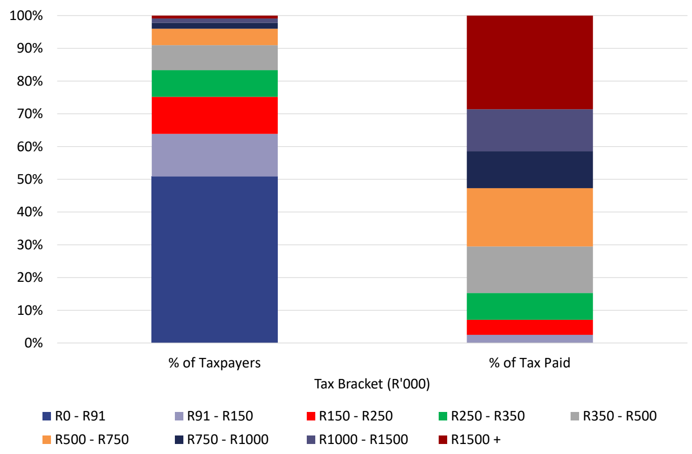


For the second year in a row, Treasury has adjusted income tax brackets to take account of inflation, offering some respite to beleaguered consumers.

The other positive surprise in the Budget was the announcement of no additional fuel or RAF levies. This is the first time in years that fuel levies have remained unchanged. Treasury commented that as a result, tax would remain below 40% of the retail price of fuel – small comfort when the price of a litre of petrol is already above R20 and likely to rise further. But it is better than nothing and does help to contain inflationary pressures, albeit modestly.

There were no changes to any other taxes that impact individuals, ranging from Dividends Withholding Tax through to Estate Duty or Transfer Taxes. From that point of view, this is a welcome change of trend made possible by the huge revenue overruns from higher commodity prices. It is interesting to note that Treasury comment specifically on the success of previous tax changes – notably the 1% increase in VAT in 2018/19 and the 1% increase in rate across all income brackets in 2015/16 – whilst acknowledging that the introduction of a new top marginal rate of 45% in 2017/18 has not yielded any additional tax revenue. In fact, tax collections had gone backwards in that category. They ascribe this to an "adjustment in taxpayer behaviour" – a veiled allusion to tax evasion. In our opinion, emigration is as much to blame as anything else. We have commented before on how the tax base has been hollowed out, and this Budget only reinforces that notion. Currently, there are 15.1 million registered individual taxpayers. 7.7 million of those pay no tax at all. Just 133,230 (or 0.9%) pay 29% of all tax.

TAX BASE VS TAX PAID



Our tax base is getting narrower and narrower. Of the 15.1 million registered taxpayers, almost 10 million of those only contribute 2.5% of total personal income tax paid.

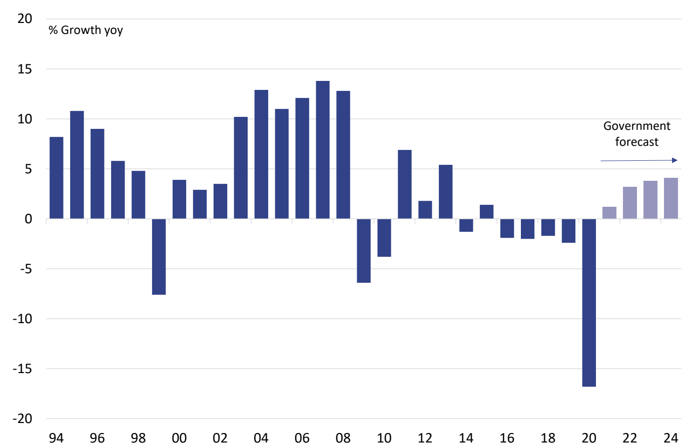
Finally, hidden in the annexures to the Budget were proposed adjustments to Regulation 28 – the legislation that governs how pension and provident funds can be invested. The offshore limit will rise from 30% to 35% (up to 45% if African investments are included) and provision will be made for investment in infrastructure and other asset classes. These changes are expected to be gazetted in March.

Looking at the Budget from an economic point of view, one has to bear in mind the path that we have already travelled. Broadly, the Budget paints a bleak picture of the state of the Nation's finances, but we already knew that. Importantly, this Budget is a step in the right direction, but that does not imply that it is perfect.

Positives include:

1. Thanks to extra revenue of R182 billion (or growth of 23%) the budget deficit has improved dramatically, from 10% last year to a projected 5.7% this year. Furthermore, Treasury projects that it will reach a primary surplus in 2023/24 – a year earlier than previously expected.
2. That in turn has improved the outlook for the ratio of Total Debt to GDP. In the Medium-Term Budget released in October 2020, this ratio was expected to reach 95% by 2025. Now, thanks to revised GDP statistics and better revenue collection, the ratio is expected to peak at 75% in 2025 and decline thereafter. This should appease the rating agencies.
3. The corporate tax rate has been reduced by 1% to 27%, a welcome boost to domestic companies.
4. Infrastructure spending continues to gain momentum, as evidenced by the chart below. Admittedly, this is off a low base, but the rates of growth are the highest in 8 years.
5. Government continues to focus on fiscal consolidation, especially with regard to public sector wages.
6. There were no bailouts for SOEs.

SA GROWTH IN FIXED INVESTMENT



Government is forecasting a welcome uptick in fixed investment, one of the key pillars to a higher sustainable growth rate.

Whilst the Budget did not contain many negative surprises, it does serve as a reminder of the perilous state of our finances and the tough balancing act that Treasury must walk to appease all constituents.

1. One negative was the forecast budget deficit of 6% in 2023/24 – a deterioration from this year. Unfortunately, despite all the good work that has been done, this statistic alone raises a question mark over Government's commitment to fiscal consolidation.
2. 46% of our population now receive some form of social support. Whilst this can be construed as a positive in terms of poverty relief, it highlights the dependency on the State and takes away money that could be used for infrastructure improvements and longer-term job creation opportunities.
3. Interest costs continue to rise. This year, they will

amount to R302 billion (or about 19% of the budget). Interest costs are projected to rise to 21% of the budget by 2024/25.

4. Treasury is forecasting GDP growth of 2.1% this year, which is largely in line with consensus. But their forecasts for 2023 and 2024 are only 1.6% and 1.7% respectively. This is hardly a vote of confidence in the reform process that is supposed to lift our growth rate materially.

In conclusion, this Budget does not alter our outlook for the local economy, nor our focus on portfolio construction. The rise in social grants and tax relief aimed at the lower-income bands strongly supports our "supported consumer" theme that we articulated earlier this year, and the Budget reinforces our other themes around reform and infrastructure. Whilst global developments in Ukraine have taken centre stage and will dictate the direction of markets over the next few weeks, we believe this Budget reinforces the credibility of the Treasury and offers hope for the future, but also reminds us that there is little room for error.

South Africa's finances remain in a parlous state, however, this budget has served to restore some credibility to the Treasury.

Topic:	**Taming Inflation**

Inflation has always been around. Those with long memories will recall periods when our inflation was stuck in the mid-teens year after year. Thanks to globalisation, inflation was tamed. But no longer. Inflation is rearing its head again as the world emerges from the worst of Covid. Our next seminar will focus on inflation and the implications for investors.

Natal Midlands

Date:	17th March 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	15 March 2022 *(Revised Date)*
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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