A credible budget that aims to soften the blow

Investors always hold their breath before Government's Annual Budget, in anticipation of bad news. However, the fiscal sinking ship has been steadied in recent years, and this year's Budget continues that trend. SA recorded a primary surplus – revenue greater than expenditure, excluding debt servicing costs – for the first time since 2009. That is another step in the right direction, as are tax incentives for solar and Eskom's debt transfer. Like prior years, the Budget continues to restore Treasury's credibility, and it paints a realistic trajectory for the next few years that has been broadly welcomed by markets

Michael Porter

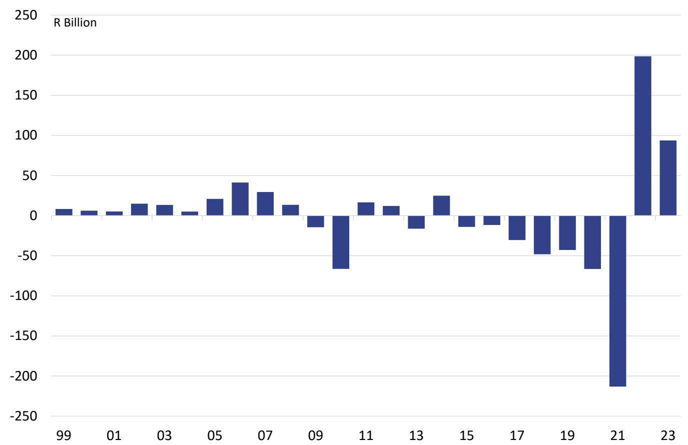
South Africans are rightly sceptical. After all, our leaders are quick to make speeches, but very slow to follow through on the promises made therein. For example, we were promised a Minister of Electricity at SONA but two weeks later there is no sign of him or her. Nor the long-awaited cabinet reshuffle. So you might be forgiven for dismissing the Budget out of hand – just another speech. So what? In fact, this Budget continued the trend set last year – fiscal prudence, predictable tax policy and tackling some of the elephants in the room, notably Eskom.

From a market point of view, the Budget was broadly as expected. Tax revenues were significantly higher than expected, mainly due to higher corporate tax (mining royalties). This meant that the budget deficit narrowed to 4.2% of GDP (from 4.6% last year) and better than the deficit of 5% in the year before Covid. Furthermore, SA recorded a primary budget surplus – defined as revenue less expenditure excluding interest repayments – for the first time since 2009. That is a definite step in the right direction – current expenditure equals current revenue. Maintaining a primary surplus is crucial to stabilizing our fiscal debt over the medium term. However, it's important not to get too carried away. This surplus has been achieved owing to record commodity prices. Those are unlikely to be maintained given a slowing global economy, so we shouldn't expect the same level of tax outperformance next

SPEED READ

- **Apart from small increases to sin taxes, no new taxes were announced.**
- **Expenditure is generally well contained but spending on social grants and debt servicing costs are consuming an ever larger portion of the Budget. Debt servicing costs will grow faster than any other item over the next three years.**
- **Tax incentives for solar – both corporate and residential – are most welcome and demonstrate, for the first time, some urgency to mitigate the electricity crisis, as does the Eskom debt restructuring.**
- **This Budget reinforces our portfolio themes of the supported consumer, reform and infrastructure.**

TAX REVENUE: OVER/UNDER COLLECTION



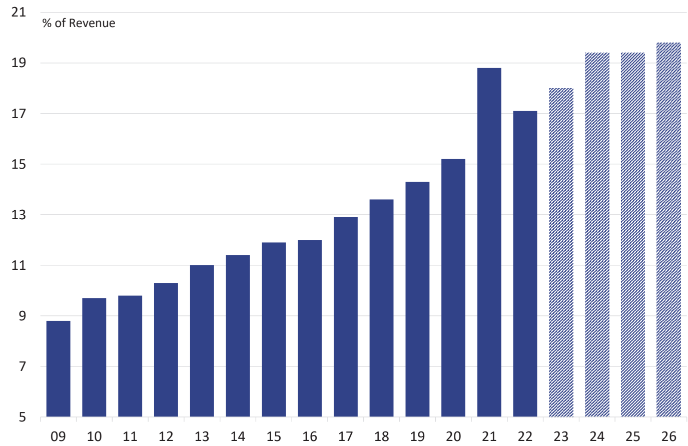
SARS collected almost R94 billion more tax than expected last year, mainly due to higher mining royalties on the back of soaring commodity prices. The last two years have seen a welcome reversal of trend after the Zuma Administration.

year as we have enjoyed over the past two years.

It was reassuring to note Government's continued commitment to prudent spending. There were inflation-related increases to social grants, but no announcement on the basic income grant (BIG) that has been debated so hotly. But the SRD Grant (Covid grant) remains in place. 18.6 million people are receiving social grants in the country, with another 8 million receiving the SRD grant. That will cost R346 billion next year. Small provisions were made for the wage bill but nothing that will scare markets and extra funds were committed to infrastructure through Transnet and SANRAL – essential for longer term growth.

Unfortunately, it's not all good news. The interest bill continues its relentless expansion. Debt-servicing costs will reach 18% of total revenue this year – a staggering R340.5 billion – and this will keep rising to reach almost 20% by March 2026. This is increasingly crowding out private sector borrowing and will ultimately force interest rates higher if unchecked.

DEBT SERVICE COSTS AS % OF REVENUE



Despite an improvement in our overall debt trajectory, the cost of servicing debt continues to rise. We will pay R340 billion in interest payments this year.

The other big news was the long-awaited announcement about the restructuring of Eskom's debt, to the tune of R254 billion over the next three years. Whilst this will raise Government's total debt (and the cost of servicing that debt), we are encouraged that this restructuring comes with four key conditions, namely that 1) Eskom has to prioritise transmission and distribution expenditure; 2) it must improve its energy availability factor (EAF); 3) these loans can only be used to settle debt and interest; and 4) Eskom must implement operation improvements as stipulated by National Treasury. The bailout also came with two pledges for further reform. Firstly, that Eskom, Treasury and DPE will plan to build more transmission with "extensive private sector participation." This is really good news. Some of the delays now creeping into the renewables rollout is the lack of sufficient transmission lines to areas like the Northern and Eastern Cape. Addressing this is crucial to speeding up the building of new generation capacity. Second, Treasury has appointed an international consortium with extensive experience to review the performance of all coal-fired plants and advise on operational improvements. This is expected by mid 2023. Once done, plants will be concessioned. That implies that they will be partly privatized or leased to the private sector which can operate them better. Citizens are rightly sceptical, given that this coincides with effective Stage 7 loadshedding, but if implemented, will be a major step forward to resolving the crisis. Time will tell.

The government is going to restructure Eskom's debt, however it comes with conditions attached, which is positive news.

> "Treasury has appointed an international consortium with extensive experience to review the performance of all coal-fired plants and advise on operational improvements."

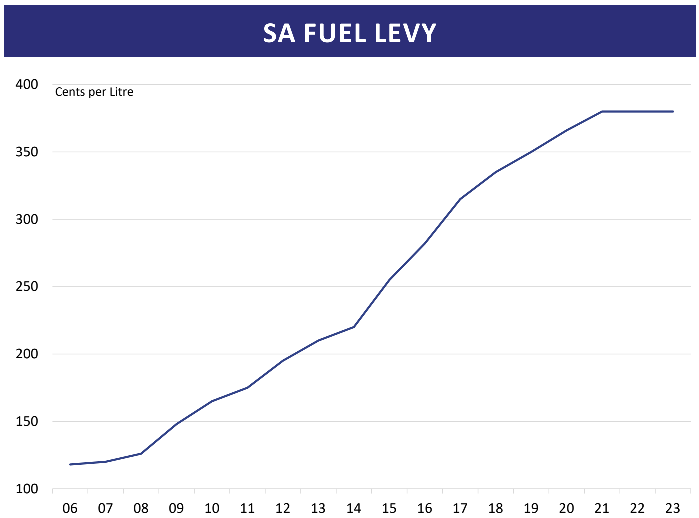
From a personal point of view, the Budget contained no negative surprises. Rather, there was modest good news:

1. Income tax brackets will be adjusted for inflation, providing effective tax relief of over R15 billion.
2. There are solar incentives for residential customers for spending on solar panels only (not inverters and other equipment.) Each individual can claim 25% of the cost of the panels up to a maximum of R15,000 against their 2024 taxable income.
3. For businesses, the allowances are much more generous. They can claim 125% of the value of the investment

against the current year's income, effectively a 34% saving. This should spur businesses to accelerate plans, thereby alleviating pressure on the grid.

4. The fuel levy will not be increased, and food manufacturers will be able to claim back diesel rebates for the next 2 years. This is the second year in a row that the fuel levy has remained unchanged and is positive for inflation, which in turn should moderate further interest rate increases.
5. The threshold for transfer duty on property transactions has been raised to R1.1 million from R1 million previously.
6. The thresholds for withdrawals from retirements funds have been adjusted upwards.

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 and the Budget continues to reinforce our other themes around reform and infrastructure. Like prior years, this Budget reinforces the view that SA has little wiggle room – we are skating close to the edge – but the key trends are improving and are a far cry from the scenarios painted after the end of the Zuma Administration. Yet, as always, the proof of the pudding will be in the eating. The Budget says all the right things. Now government needs to act with urgency to implement its own recommendations.



The Fuel Levy has grown at an annual compound rate of 7.6% over the past 16 years, far outstripping the rate of inflation. It is a small, but welcome, relief that the levy will remain unchanged for the second year in a row.

Hopefully the budget will bring sunnier skies to South Africa if it is implemented properly.

Our next Insight seminar will delve into the mechanics behind markets, why share prices sometimes react the way that they do, and how changing valuations can exaggerate those moves.

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Topic: **The Mechanics of Markets**

Natal Midlands	
Date:	Thursday, 16th of March
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	Tuesday, 14th of March
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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