INTUITION

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The Annual Budget

As far back as I can remember, the narrative going into the Budget has been one of doom and gloom. Commentators would focus on the precarious fiscal position and the unsustainable path on which the country finds itself. Those commentators are not wrong. Our national finances leave much to be desired. Over the past 15 years, our finances have deteriorated significantly, due to wasteful and fruitless expenditure, and weak growth that has failed to generate sufficient tax revenue. Our backs are against the wall, so to speak. But as has become the norm, the Budget delivered sensible proposals without much of the sensationalist hype. This issue highlights the key points.

Michael Porter

The full Budget document stretches to an overwhelming 277 pages, so it can take a few hours to wade through it. However, if you want a "sneak peek" at the tone of the document, all you need to do is watch the movement of the Rand as the Minister starts his speech. Before the announcement, the Rand was trading at R18.95 per US Dollar. 15 minutes later, the Rand had strengthened to R18.75 per US Dollar. In a nutshell, that tells you all you need to know. Similar to past years, markets were pricing in a doomsday scenario that did not materialize.

That is not to say that SA does not have its challenges. Total debt has continued to grow – our government debt now sits at a whopping R5.2 trillion – and its forecast to rise to R6.3 trillion over the next three years. It is therefore no surprise that the cost of servicing that debt has skyrocketed as well. Interest on that debt will be R356 billion this year and will rise to R440 billion by April 2027. That is a big number - enough to give anyone indigestion. This brings us to the most controversial aspect of this Budget – government's decision to tap the GFECRA Account at the Reserve Bank for R150 billion to reduce debt. Whilst this can clearly be interpreted as "raiding the cookie jar", new legislation is being introduced to ensure that these funds are only used to reduce debt, not for day-to-day expenses such as salaries. That is a sensible compromise given the situation in which we find ourselves. Furthermore, government is on track to record its first primary surplus (defined as revenue less expenditure before interest costs) since 2009. Whilst small at R16 billion, this primary surplus is forecast to grow over the next three years, thereby reigning in total debt. Consequently, net debt to GDP is now expected to peak at 75.3% in 2026 rather than the 77.7% forecast in November last year. There will still be short term pain - debt servicing costs measured as a percentage of annual expenditure will rise to 20.8% this year and peak at 21.3% in 2026, before hopefully starting to fall. But reducing debt and sticking to the principle of a primary surplus will start the journey to reverse that slippery trajectory of the past ten years.

SPEED READ

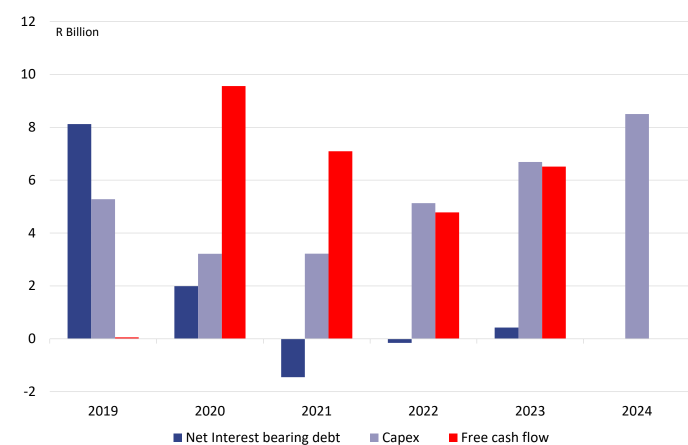
- **Government will access R150 billion from the GFECRA Account held at the Reserve Bank to reduce national debt. This will reduce interest costs.**
- **National debt is forecast to peak at 75.5% of GDP over the next 3 years, down from the previous forecast of 77.7%.**
- **Treasury forecasts GDP growth of 1.3% this year, rising to 1.6% and 1.8% in 2025 and 2026 respectively.**
- **Personal income tax will rise by R18 billion, thanks to no adjustment to the brackets to take account of inflation nor to medical tax credits will also remain unchanged. There are no other major tax increases, a positive surprise.**
- **To offset the impact, there will be no increase in the fuel levy, a tax saving of R4 billion. This is the third year in a row of no increase.**

Treasury also articulated the impact on selected variables on our national debt and interest costs. A 1% increase in inflation and interest rates, together with a R1 depreciation of the Rand against the Dollar, results in a R50.7 billion increase in gross debt and a R8 billion increase in debt-servicing

costs. That is sobering to say the least. It shows why other reforms are so important, not least to instill confidence in the currency, which in turn would drive down inflation and therefore interest rates.

Treasury included a fascinating chart in their document, which sums up the debt problem rather succinctly. This chart compares the amount of money we spend on servicing debt relative to an average of 74 other non-oil producing emerging markets. The gap is sobering and goes a long way to explaining why our growth rate is so poor. We spend far too much money on interest and not enough on infrastructure and other services.

DEBT SERVICING COST TRENDS: SA VS EM



SA spends 21% of its revenue on servicing debt, versus less than 10% across 74 other emerging markets. It is one of the key reasons for our low growth rate and lack of competitiveness.

Apart from the discussion around debt, the Budget contained few surprises. The main points include:

1. Growth forecasts appear realistic, and point to a mild acceleration, but still well below the 2% level.
2. Importantly, fixed investment is forecast to grow at a faster rate – about 4% per annum over the next 3 years – which speaks to continued investment into infrastructure. The Minister referred several times to the crucial role that the private sector would play.
3. The Minister flagged in the Medium-Term Budget that taxes would have to rise. This was achieved by not adjusting the personal income tax brackets for inflation, nor making any changes to medical tax credits. To offset the impact, there was no adjustment in the fuel levy – the third year in a row. That is positive for inflation.
4. Government collected R56.1 billion less tax than it anticipated this past year. This was largely due to weaker VAT collections (and larger refunds) and weaker corporate tax. Within the corporate sector, mining was the main culprit, generating almost R40 billion less tax than anticipated. Some of the blame is on weaker commodity prices, but failures at Transnet have certainly contributed to this. This alone should be sufficient motivation for government to undertake the necessary reforms within the logistics sector.
5. As in past years, spending is directed heavily towards the "social wage" – which now accounts for 60% of total non-interest spending. Treasury has allocated more funding (R251 billion over three years) for salaries for teachers, doctors, nurses and police. Social grants have risen as well, and the Covid grant has been extended again by another 12 months. Total spending on social grants this past year amounted to R251 billion – 13% of non-interest expenditure. Excluding those receiving the Covid SRD grant, 19.1 million now receive social grants in SA.

ALCOHOL TAXES RISE AGAIN

As is common at budget time, "sin taxes" affecting alcohol have risen but not so much that that a drink becomes unaffordable. The tax on a can of beer or cider was increased by 14c

In conclusion, the Budget, as has become the norm, held few surprises, and the doomsday scenarios discussed in the media failed to materialize. Using the GFECRA Account at the Reserve Bank is controversial – but if used properly and responsibly, can make a once-off impact that can help to stabilize the ship. But that will mean nothing if government doesn't push hard for further reform. Ultimately, the only way to solve our fiscal challenges is to boost investment and growth. Thereby fueling tax revenue and allowing for quicker deleveraging. So, whilst the Budget was a reflection of a steady hand at the wheel, and the Minister avoided the trap of populist policies ahead of a make-or-break election, our fiscal challenges remain.

Our next Insight seminar will be held in March, and will focus on why our investment philosophy places so much importance on income.

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Topic: **Why the obsession with income?**

Natal Midlands	
Date:	14th March 2024
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	12th March 2024
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	N/a
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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