Holding the line

By Marie Antelme, Coronation's chief economist

National Treasury's 2017/18 Budget held the line on its commitment to fiscal consolidation. The 2017 Budget continued the constraint laid out in the Medium-term Budget Policy Statement (MTBPS) in October 2016 by outlining the following key commitments:

1. **Tax amendments**

National Treasury will raise R28 billion in taxes:

- Government has introduced a new tax bracket at 45% for people earning R1.5 million per annum and above – this will raise R4.4 billion in revenue.
- The relief traditionally granted for fiscal drag has been curbed. This is concentrated in the upper income brackets: Lower income earners were granted moderate relief totalling R2.4 billion, while the loss of adjustment for higher income earners should net government an estimated R12.1 billion.
- Together, personal income tax adjustments will net R16.5 billion.
- The dividend tax rate was increased from 15% to 20%. This will add R6.8 billion to revenue.
- The fuel levy was increased by Rc30/l and should provide a revenue boost of about R3.2 billion.
- Excise duties on alcohol and tobacco were increased as is customary, helping to raise about R2.0 billion.
- An added tax on the sugar content of various beverages is still being considered, and the implementation of the proposed carbon tax is being debated.

Applications to the Special Voluntary Disclosure Programme (for tax payers who want to disclose their offshore assets and income) amounted to R3.8 billion, and have yielded R600 million in revenue to date. This has not yet been included in the revenue tally, as the programme runs until August. The Minister also signalled that the VAT exemption on fuel may be repealed in 2018/19, but no general increase was directly mentioned.

2. **Economic context and fiscal consolidation**

National Treasury's economic forecasts were unchanged from the October MTBPS estimates, and seem reasonable in the current context. GDP growth is forecast to accelerate from 0.5% in 2016 to 1.3% in 2017 and to slowly accelerate to 2.2% by 2019. This is broadly in line with consensus. Inflation forecasts were revised moderately to 6.4% (6.1%) in 2017, from 6.4% in 2016 and 5.7% in 2018. GDP inflation – important for tax revenues – is estimated broadly in line with CPI forecasts.

MACROECONOMIC PERFORMANCE AND PROJECTIONS

	2013	2014	2015	2016	2017	2018	2019
Percentage change		Actual		Estimate		Forecast	
Final household consumption	2.0	0.7	1.7	0.9	1.3	2.0	2.3
Final government consumption	3.8	1.8	0.2	1.4	0.9	0.0	0.4
Gross fixed-capital formation	7.0	1.5	2.5	(3.6)	1.5	1.6	2.8
Gross domestic expenditure	2.8	0.5	1.7	(0.3)	1.3	1.8	2.2
Exports	3.6	3.3	4.1	(1.2)	1.9	4.9	5.0
Imports	5.0	(0.5)	5.3	(3.6)	2.0	4.3	4.9
Real GDP growth	**2.3**	**1.6**	**1.3**	**0.5**	**1.3**	**2.0**	**2.2**
GDP inflation	6.6	5.7	4.0	7.2	6.4	5.9	5.8
GDP at current prices (R billion)	**3 549.2**	**3 812.6**	**4 013.6**	**4 322.3**	**4 657.5**	**5 029.9**	**5 440.6**
CPI inflation	5.8	6.1	4.6	6.4	6.4	5.7	5.6
Current account balance (% of GDP)	(5.9)	(5.3)	(4.3)	(4.0)	(3.9)	(3.7)	(3.8)

Sources: National Treasury, South African Reserve Bank

Against this economic performance, the consolidated fiscal deficit for the current year is unchanged from the October estimate at -3.4% of GDP. The deficit is expected to narrow marginally to -3.1% in the coming fiscal year and to -2.6% by the outer year of the fiscal framework in 2019/20. The tax adjustments outlined above are key to Government's consolidation efforts, but managing expenditure is equally as important. Government has stuck to the expenditure ceiling of nominal spending at about 33% of GDP and estimates nominal growth in expenditure of 8.2% year-on-year in the coming fiscal year, from 5.9% in the current year. The allocation to the wage bill was revised slightly higher for the coming fiscal year but lower for 2016/17 and, at an average of 7.1% in the next three years, is well contained. Government's current three-year agreement expires in 2018, and the data provided is an ongoing signal of wage restraint. Interest service costs - still one of the fastest-growing expenditure items - should benefit a little from the slightly stronger exchange rate this fiscal year, but bears watching as a source of pressure in coming periods.

CONSOLIDATED FISCAL FRAMEWORK

R billion/percentage of GDP	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020
		Outcome		Revised estimate		Medium-term estimates	
Revenue	1 008.1	1 098.9	1 222.0	1 297.3	1 414.1	1 535.2	1 668.5
	27.8%	28.4%	29.9%	29.4%	29.8%	29.9%	30.1%
Expenditure	1 143.4	1 233.5	1 364.2	1 445.2	1 563.1	1 677.1	1 814.3
	31.5%	31.9%	33.4%	32.8%	33.0%	32.7%	32.7%
% year on year	-	7.9%	10.6%	5.9%	8.2%	7.3%	8.2%
Non-interest expenditure	1 033.8	1 112.1	1 227.9	1 291.8	1 393.8	1 489.5	1 608.0
	28.5%	28.8%	30.0%	29.3%	29.4%	29.0%	29.0%
Interest payments	109.6	121.4	136.3	153.4	169.3	187.6	206.4
	3.0%	3.1%	3.3%	3.5%	3.6%	3.7%	3.7%
Budget balance	(135.4)	(134.6)	(142.2)	(147.9)	(149.0)	(141.9)	(145.8)
	(3.7%)	(3.5%)	(3.5%)	(3.4%)	(3.1%)	(2.8%)	(2.6%)
Primary balance	(25.8)	(13.2)	(5.9)	5.5	20.3	45.7	60.6
	(0.7%)	(0.3%)	(0.1%)	0.1%	0.4%	0.9%	1.1%

Source: National Treasury

The reduction in the deficit implies some stabilisation in Government's debt accumulation, and its forecast trajectory for its debt holding reflects this improvement. However, the trajectory has again been revised a little higher: Government estimates gross debt of 50.7% (50.5%) of GDP in the current 2016/17 fiscal year, accelerating to 52.3% (51.2%) in 2017/18. The year of stabilisation is still 2018/19 at a marginally higher 52.9% (52.3%), when the primary surplus is targeted to reach 1.1% of GDP.

Contingent liabilities to state owned enterprises remain a major risk to the fiscus. Eskom is the biggest recipient of Government support, with guarantees of R350 billion in place. The utilisation of this guarantee is expected to rise from R174 billion to R218.2 billion in the coming fiscal year, and to about R22 billion annually thereafter. SAA has used R3.5 billion of its R4.7 billion going-concern guarantee, with the remainder expected to be used in the coming fiscal year. South African National Roads Agency Limited and the South African Post Office also have guarantees.

3. Funding the shortfall

The public sector borrowing requirement, needed to fund the deficit for the year – including redemptions, is expected to fall to R220.9 billion from R243.4 billion in the current fiscal year. But the funding mix sees an increase in long-term domestic issuance to R191.5 billion in the coming year (from R173.1 billion), while short-term loans should fall from R41 billion to R21 billion. Over the medium term fiscal framework there will be an increase in long-term borrowing amounting to about R12 billion per annum, offset by lower short-term borrowing of about R4 billion per annum. Net foreign issuance plans are unchanged compared to the MTBPS, and Government expects to fund a rise in its cash balances to facilitate a rising redemption profile in coming years.

4. Structural reform

The Budget highlighted some encouraging progress towards delivering structural reform. Government, labour and business have agreed on a national minimum wage, and the National Economic Development and Labour Council has also agreed on several reforms to provide employers and employees with mechanisms to resolve disputes more effectively and minimise the potential for protracted or violent industrial action. Both of these should go a long way to facilitating more stable labour relations and raising productivity.

5. Policy initiatives

There remains considerable uncertainty about the feasibility and progress of promised Government programmes. The Budget reiterated that Government can only implement programmes that it can afford and clarified that:

- National Health Insurance, which has not been given much attention in recent policy announcements, will be moving to a new phase, funded by a National Health Insurance fund. Discussions and preparation for this will take place this year, and policy proposals could include an adjustment to medical aid tax credits. More details will be published in the MTBPS in October 2017.
- On education, an additional allocation of R5 billion was made over and above the R32 billion allocated in the 2016 MTBPS for financial assistance to students in tertiary education. This will support Government's commitment that no student in tertiary education who comes from a family with combined income of less than R600 000 per annum will have to pay higher fees this year.
- The Finance Minister also announced new guidelines for public procurement, which were Gazetted in January. These will include a 30% contract value for tenders of R30 million or more that must go to black or small enterprises. Various local content regulations are also being implemented.

6. Is this enough to satisfy the ratings agencies?

Growth is the most important ingredient for South Africa's ratings prospects, followed very closely by reinforcing evidence that South Africa's policymakers remain committed to fiscal consolidation. The Budget contains a conservative assessment of growth prospects, and the path of consolidation outlined in the MTBPS is still broadly on track. The issuance profile, which leans heavily on local funding, could put pressure on local ratings in time, but the change in our view is insufficient to be a concern yet given the conservative economic and fiscal context. We therefore think that ratings agencies will maintain their current 'vigilant but unchanged' position at this stage, in the absence of a political shock.