EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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A REVENUE SHORTFALL AND A TRUCE

South Africa's medium-term budget policy statement (MTBPS), or the mini-budget as it is more commonly known, is due to be released on the 30th of October. This feedback report on government finances is released in October, as October is the halfway mark between the onset of the fiscal year (1 April) and its end (31 March). Current estimates foresee a revenue shortfall between R50 billion and R90 billion.

Like previous years, the main culprit is once again a slower-growing economy. The government's lack of accountable leadership should contribute between R30 billion and R50 billion to the shortfall. A slower-growing economy means:

+ Fewer wage increase and therefore less personal income taxes (PIT).
+ Less sales, and therefore less valued added taxes (VAT).
+ Less profits, and therefore less company income taxes.
+ Less imports and therefore fewer import taxes.

Add to this the excessively high levels of tax in South Africa. A commonly accepted principle is that if taxes are too high, people stop paying; the incentive to find legal ways to avoid taxes becomes too large. The Laffer-curve is a smart theory that explains that at certain tax levels, which have been empirically shown to be around 50%, people start doing all they can to avoid taxes. So, as hard-working South Africans who pay 38% PIT, then a further 15% VAT on all purchases, another form of dividend and capital gains taxes on savings, import taxes and fuel levies, to name but a few, you quickly reach this 50% mark. So South Africans then start making friends with tax-specialists and restructure their income to pay fewer taxes.

In addition to the shortfall driven by a slower-growing economy, the collection inefficiencies at SARS meant that year-to-date collections are 3% behind target. It might not sound like a lot, but 3% on roughly R1.8 trillion is R54 billion. If the shortfall persists, it will have dire implications on the budget deficit and debt levels. This will definitely have an impact on Moody's, the only credit agency that still lists South Africa as investment grade in both our local and foreign currency denominated debt. For this reason, the agency decided to wait until the 1st of November before they will announce their credit decision. We believe markets have already priced in possible bad news, in which case any decision should alleviate some of the pressures of uncertainty and help to appreciate the rand. Although, our base case is to see Moody's downgrade our foreign, and not local debt, in which case there will be significant support for the rand to appreciate.

In international news: The United States (US) Treasury Secretary, Steven Mnuchin, announced Phase 1 of the trade deal. According to the White House, this deal will be signed during November's Asia-Pacific Economic Co-operation (APEC) meeting, held in Chile. Phase 1 will focus on protecting US intellectual property and is only the first-round of truce-negotiations, aimed at opening the door for a common footing and more robust peace offerings. Phase 2 will focus on protecting US companies in China from forced technology transfer and is, therefore, more important for Trump and his election campaign. Overall, this reduces some of the risk associated with uncertainty in global markets and should support emerging markets.