EFFICIENT GROUP

ECONOMIC COMMENTARY
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WHAT PESSIMISTS MISSED ABOUT SA'S NEW BUDGET

Markets were initially on edge, unsure of what to expect from the budget and at first glance gave it a very poor rating. The rand depreciated to R14.36 against the US Dollar, and the JSE fell by more than a percent. However, after markets had time to work through the data and pick-up on the underlying message, the rand appreciated back to R14-levels, and the JSE ended the day positive by more than a percent.

A couple of things substantiated their initial fears. The budget deficit is expected to be a lot higher, 4.5% during the 2018/19 financial year. Also, debt levels are expected to soar and reach 60% by 2023/24, although we think we'll reach these levels as soon as 2021/22. It's also clear that the government is not able to increase taxes as they please, which is crucial if you want to maintain spending and/or reduce debt levels. The rule of thumb, based on Laffer-curve theories, is that the total taxes incurred by individuals cannot be higher than 50% (some say even 45%), or individuals will simply stop paying certain taxes. This is much like what we are currently experiencing with regards to non-payment of E-tolls in Gauteng. For this reason, then minister of finance, Malusi Gigaba, announced a marked decrease in the taxes individuals paid, shortly after government introduced the new 45% personal income tax (PIT) rate on high earners in SA. This trend has continued because PIT is not the only tax individuals pay. Remember, you pay 15% VAT on most, if not all, the goods and services you purchase. You also pay TV-licenses, car-licensing, fuel-levies (which is now 40% of the petrol price you pay at the pumps), sin-taxes (which is now also a lot higher), toll roads, dividend taxes, capital gains taxes, and the list goes on, and on, and on. So, a lot of households in SA are already paying 50% of their income away in taxes. No wonder the ministers have noted a decrease in the taxes they receive from individuals – the tax burden in SA is simply too high.

Although tax payers are growing weary, the hidden message of the budget continues to point towards a huge supertanker slowly changing course. It started with an investigation into state capture, then Zuma's exit, President Ramaphosa's close victory, the many small but important changes to cabinet, the firing of incompetent ministers and SOE executives, a whistleblower, an attack on the central bank's independence leading to the eventual appointment of an ex-central bank head as finance minister, and even some ministers falling on their swords. Now we have a focused, quite radical budget that highlights the two largest issues (after corruption which they've been working on since Ramaphosa's election): an unproductive and overpaid civil service, and the hopelessness of Eskom. Instead of overpromising with more smokescreens like the Industrial Policy Action Plan or the National Development Plan (that never saw the light), the inner circle is homing in on the direst issues.

The radical undertone therefore, points towards another smart, strategic move from the inner circle towards what we believe will become a successful 10-year turnaround. With radical we mean the government's decision to keep wages unchanged, the discourse about not taking on Eskom's debt, restructuring plans, and the few other subtle mindset changes government continues to make, like being concerned about keeping skills in SA – something that wasn't considered important a decade ago. In the end markets agreed, and the rand strengthened back to below R14.00 and the JSE ended up by a percentage point. One issue with these radical, market-friendly changes is that it places a huge mark on the backs of each member in the inner circle. We can only hope that this was not Minister Tito's last budget.

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