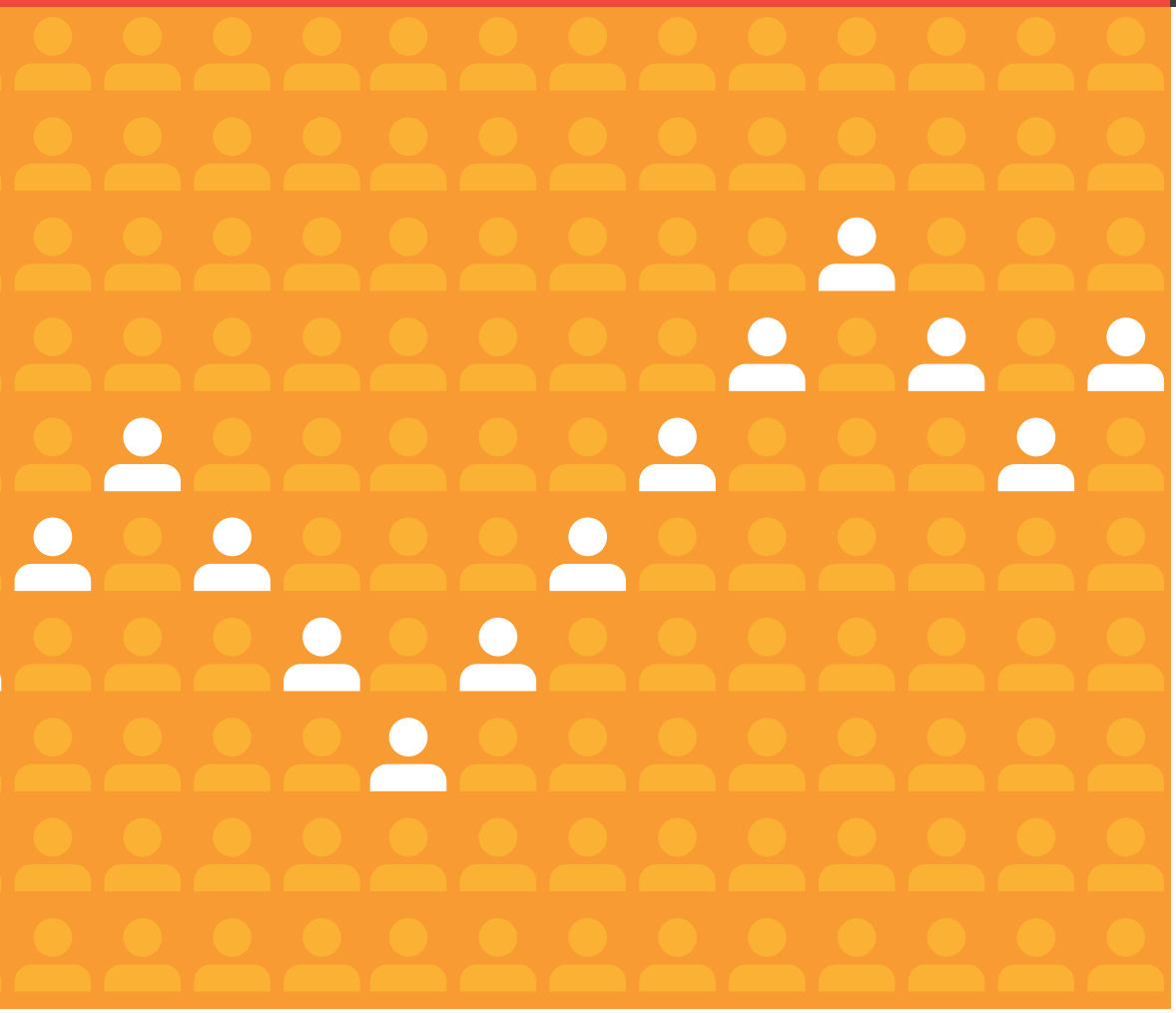
2019 Budget predictions



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Looking ahead at Budget Speech

Minister of Finance Tito Mboweni will deliver the Budget Speech 2019 in Cape Town on 20 February. Expectations are high that he will balance competing expenditure priorities to stimulate economic growth in spite of fiscal consolidation measures. This would help appease credit rating agencies.

However, the former central banker's task is formidable, and his balancing act will need to be performed with the skills of a trapeze artist. PwC has considered some of the most crucial factors that will be addressed in the Budget Speech 2019. Following the State of the Nation Address (SONA) on 7 February, there are great expectations on the shoulders of the Charles Dickens-quoting finance minister.

Improving fiscal sustainability hinges on strong measures for driving economic growth

PwC anticipates the Budget Speech to include details on investment initiatives, including the Infrastructure Fund, an emphasis on stimulating investor confidence, more details on how the reallocation of funds (as part of the stimulus package) will reignite the economy, and a commitment to structural changes on the supply side of the economy

South Africa remains under pressure from slow economic growth, with deteriorating growth levels in recent years contributing to revenue shortfalls and a deterioration in the financial position of state-owned companies.

The National Treasury forecast in October last year that GDP growth would slow to 0.7% in 2018, down from 1.3% in 2017. South Africa's economic performance therefore undershot expectations once again - in February 2018, National Treasury still forecast 1.5% GDP growth for the year.

The disappointing economic growth outcome in 2018, due largely to a fall in mining and agricultural production and a lack of new domestic investment, has put pressure on government tax revenues.

Going forward, National Treasury expects a moderate growth recovery in agriculture and mining, combined with improving business and consumer confidence, which according to the Medium-Term Budget Policy Statement (MTBPS) should lead to an uptick in economic growth to 1.7% in 2019 and 2.1% in 2020. PwC expects slightly lower economic growth of 1.6% and 2.0% in 2019 and 2020, respectively.

Minister Mboweni will be looking to take a practical approach to increasing economic growth. Two proposed solutions that the minister recently shared with media include an agreement where the private sector deploys skilled people to government, as well as arrangements that would facilitate skilled immigration.

The minister will also not have to look far for inspiration to address some of the other challenges. In a series of events bringing together government officials and other experts, the South African government has been considering new policy proposals to raise the level of South Africa's economic growth. These proposals were tested through discussions with economists from the private sector and academia, including world renowned development experts Professors Ricardo Hausmann and Robert Lawrence. PwC would like to see some of the results from these discussions announced in the February budget.

Minister Mboweni is also expected to report back on the successes so far of the stimulus and recovery plan launched in September 2018. The aim of the plan was to reallocate government spending towards activities that will have the greatest impact on economic growth, domestic demand and job creation.

The stimulus package centres on shifting R50 billion in the 2018/19 budget from non-performing projects to areas that can boost the economy and provide jobs and establishing an infrastructure fund to boost labour-intensive investment. This will likely especially benefit people living in townships as well as rural economies, women and the youth.

Business confidence and policy uncertainty has slipped again after initial #Ramaphoria

PwC expects the finance minister to reiterate some of the comments in SONA 2019 on how South Africa is now a much more business-friendly place compared to some 12 months ago. He would do well to provide some anecdotal information on how the National Treasury is experiencing a recovery in investor sentiment and how his ministry is supporting efforts to translate investment pledges into actual financial inflows.

During the World Economic Forum (WEF) 2019 in Davos, President Cyril Ramaphosa stated that government has placed the task of inclusive growth and job creation at the centre of the national agenda. To align with the president's investment initiatives, Minister Mboweni would need to give reassurances of government's emphasis on bringing new investment into the country, both from local and offshore investors.

Business confidence has languished below the neutral level of 50 index points since the first quarter of 2015. This reflects that businesses have been concerned about the prospects for growth in the current economic, political and policy environment, leading to a decline in investment appetite.

To reverse recent investment trends, President Ramaphosa announced last year an investment drive that would generate R1.3 trillion in new investment over the next five years. Pledges worth R290 billion was already announced at the inaugural South African Investment Conference in October 2018. Minister Mboweni is likely to reassure investors during his budget speech that policy consistency and political stability will be at the forefront to build investment initiatives.

On the topic of summits, last year's Job Summit generated over 70 strategies aimed at job creation. These strategies were established in the Presidential Job Summit Framework Agreement, which are expected to create 275 000 jobs annually over five years – should all agreed upon strategies be implemented - over and above government's previous commitment to create 300 000 jobs every year.

However, these strategies will take time to implement and the structures and budgets have not yet been formally confirmed. Ultimately, this brings about the question as to how government will support these strategies, and some further details may emerge in the February budget.

The budget deficit is still growing and government debt requires urgent consolidation

PwC forecasts a fiscal budget deficit of 4.3% of GDP during the current (2018/19) fiscal year. This will be larger than the 4.0% of GDP projected by the MTBPS, largely as a result of a projected R10 billion shortfall in revenue collections than the National Treasury was expecting in October last year. Similarly, we expect a deficit equal to 4.7% of GDP in the coming financial year - if no changes are made on the expenditure side of the budget – compared to a MTBPS forecast of 4.2% of GDP.

Large budget deficits result in more borrowing. Ballooning government debt is increasingly putting South Africa's fiscal consolidation objectives at risk. While in the fiscal year 2008/09, government debt represented 27% of GDP, by 2018/19 this had increased to 56% of GDP.

One third of the total budget of about R1.7 trillion in 2017/18 was spent on South Africa's public sector wage bill. While this amounted to R395-billion in 2014/15, by 2017/18 South Africa's public sector wage bill was approaching R590-billion.

In a Twitter initiative, "Tips for Tito", Minister Mboweni asked South Africans for inputs for his February budget. Many emphasised they are concerned by the ballooning state wage bill. The 2019/20 budget plan will need to address difficult changes needed in the public sector wage bill, as fiscal consolidation remains a key concern for a broad range of stakeholders, including credit rating agencies.

The State's exposure to parastatal debt is on the rise

SONA 2019 announced that Eskom will be restructured into three entities as part of a turnaround plan for the power utility. However, this will bring no immediate relief to Eskom's dire financial situation, and PwC expects the finance minister to comment on the president's pledge that the government will continue to support the state entity's balance sheet.

The worsening financial situation of State-Owned Enterprises (SOEs) over the past decade has emerged as a threat to South Africa's fiscus, as various credit rating agencies have noted. As increasing public resources are dedicated towards ensuring the continued viability of SOEs, resources have been directed away from other opportunities for development and value creation.

The restructuring of SOEs has already brought about many changes at the top level of major entities such as Eskom, Transnet, South African Airways (SAA), the South African Broadcasting Corporation (SABC) and Denel. Minister of Public Enterprises Pravin Gordhan has led this restructuring of the boards at the five parastatals and those boards, in turn, have put in place new leaders and top management structures.

Government's exposure to SOE debt has risen from R160 billion in 2011 to R308 billion in 2017. In 2017, Eskom accounted for 73% of total government exposure to SOE debt. Eskom tariffs have roughly doubled over the past seven years; despite this, Eskom still exposes the state to high levels of debt. Furthermore, the power utility is seeking additional tariff increases of over 15% per year as a way to maintain its going concern.

Credit rating agencies, in particular, have raised that the SOEs remain a risk to the sovereignty of the South African state. Forecasts by S&P Global Ratings see government guarantees for SOEs debt rising to R500 billion by 2020, which will represent around 10% of GDP.

Minister Mboweni will need to indicate the path forward for South Africa's SOEs. Tangible effort will need to be given to a strategy that gives a clear perspective to how government can drive SOEs' developmental mandate while ensuring they remain financially sound. The fate of employees at these public entities is a sensitive issue that must be considered.

Reassurances around the South Africa's Reserve Bank (SARB) mandate

PwC expects Minister Mboweni to once again affirm the independence of the SARB in terms of how the central bank determines its monetary policy. It is important that the finance minister – a key player in the appointment of SARB top management – takes a firm stand on what national government's policy is on the issue. He has already tweeted about this, and needs to reiterate his view in Parliament.

During the African National Congress (ANC) manifesto launch in January 2019, the party again focused on the nationalisation of the SARB. The proposal entails that the central bank should pursue a more flexible monetary policy regime aimed at boosting employment and growth, and should take into consideration fiscal policy. This process would also entail nationalising the SARB, therefore removing all private ownership.

Concerns are widespread that the drive to nationalise the SARB – one of few central bank globally that still has private shareholders - may threaten its independence and interfere with its mandate, which is to achieve and maintain price stability in the interest of balanced and sustainable economic growth. SARB Governor Lesetja Kganyago has emphasised repeatedly he would challenge any attempt to subvert or change the SARB's mandate.

In the upcoming budget speech, Minister Mboweni may find a way to reassure investors and credit rating agencies that the mandate and the independence of the SARB remain protected.

Beyond the budget: what will rating agencies do?

South Africa's sovereign debt has been downgraded to sub-investment grade by S&P and Fitch Ratings due the deterioration in its fiscal position over the past decade. If rating agency Moody's Investors Service were to also downgrade the debt to sub-investment level, South Africa would be removed from the Citi World Government Bond Index. This would prompt asset managers and pension funds to sell billions of rands worth of domestic bonds. This would sharply increase the cost of debt and pressure the exchange rate.

To appease credit rating agencies, Minister Mboweni will need to talk to three specific issues (as discussed in this document) during his budget speech. These are the pace of fiscal consolidation, reforms in SOEs and measures to lift economic growth. By effectively outlining a path forward for South Africa's fiscus, the minister will be able to satisfy credit rating agencies and would steer the economy away from a sub-investment grade.

The fiscal budget for 2019/20 will likely contain difficult prioritisation decisions to ensure that government can meet its fiscal consolidation objectives and appease rating agencies. The public sector wage bill and SOE finances will be top of mind, as National Treasury looks for ways to reign in growing government debt and bring the fiscal deficit down to more manageable levels. In spite of limited fiscal room, the focus of the 2019/20 fiscal budget must also fall on measures to stimulate investor confidence and reignite economic growth. Without prospects of an economic growth recovery, South Africa's fiscal situation will likely remain constrained in coming years.

Tax revenue estimates

2018/19 tax revenues

In the 2018 Medium Term Budget Policy Statement (MTBPS), estimates for 2018/19 tax revenues were revised downwards by R27.4 billion to R1 317 billion. The major contributors to the downward revision were value-added tax (R20 billion) and company tax (R5.9 billion), with personal income tax and dividends tax only contributing slightly to the downward revision (at R1.6 billion and R1.5 billion respectively).

The bad news is that the situation is likely to get worse. Based on revenue collections to end December, we expect tax revenues for 2018/19 to be significantly lower than the MTBPS estimates by an estimated R10 billion. The primary contributors to this forecast shortfall are poor performances in corporate income tax collections, as well as a deterioration in personal income tax collections in recent months. It is possible that the situation could deteriorate further if the slow down in personal income taxes persists for the remainder of the year and VAT collections slow down, a distinct possibility given the recent poor trading updates from retailers.

2019/20 tax revenues

In the 2018 Budget, tax revenues for 2019/20 were estimated at R1 454.8 billion. In the 2018 MTBPS, this estimate was significantly reduced by R24.7 billion to R1 430.1 billion. This downward revision was a result of the downward revisions to estimated revenues in the 2018 fiscal year, slower growth in major tax bases and a reduction in the anticipated buoyancy for domestic VAT from 1.1 to 1.0.

Highlighted in the 2018 MTBPS was the consistent decline, over the past four years, of tax buoyancy to 0.91, despite additional tax policy measures designed to add R28 billion to revenue.

We do not expect that measures will be taken in the 2019 Budget to raise significant amounts of additional revenue. In light of this, we expect tax revenues to grow in line with GDP growth to approximately R1 408 billion, some R22 billion below the MTBPS forecast. We have used a tax buoyancy of 1, although the buoyancy over the last few years has been below this, especially when tax increases are stripped out.

Business

Corporate income tax

Tax rates

No change is expected in the general corporate tax rate of 28%. Any increases would negatively impact on the competitiveness of SA's tax rates (the global trend for corporate tax rates is downwards) and would not be in line with the objective of promoting economic growth. The headline corporate tax rate is already relatively high compared to our main trading partners and other middle income countries. South Africa already has one of the highest CIT tax burdens in the world at 4.5% of GDP.

Any increase in corporate tax rates will likely have a negative impact on economic growth and investment as it is the most economically inefficient of all taxes.

It has become clear that company profits are under pressure, with the result that CIT collections are performing well behind forecasts (CIT collections for 2018/19 are expected to come in some R10 to R12 billion below the MTBPS estimates). An increase in the corporate income tax rate would only exacerbate this situation.

CGT

In 2016, the effective capital gains tax rate for companies was increased from 18.6% to 22.4% (or from 66.6% to 80% of the income tax rate). It is unlikely that this rate can be increased any further (this would effectively result in the taxation of gains arising from inflation) and we therefore don't expect any changes in this regard.

Tax base

Further reforms aimed at broadening the tax base are expected. This could include further limitations on the deduction of interest.

Dividends tax

The dividends tax rate was increased from 15% to 20% in the 2017 Budget (in combination with an increase in the maximum marginal PIT rate to 45%). We don't expect further changes to the dividends tax rate in the 2019 Budget.

Individuals

Personal income tax

Tax rates

In the 2018 Budget, partial relief was given for fiscal drag.

The PIT tax burden is at levels last seen in 1999/2000 at 10% of GDP. Importantly, the PIT tax burden is significantly above the average for OECD countries (8.3% of GDP) and far above the average for developing countries. The PIT base is under severe strain, high levels of PIT have the effect of limiting economic growth and investment, and there has been growing slippage in compliance levels.

A greater portion of this tax burden has also been shifted to higher-income earners. Thus, for example, in 2017, 65.6% of PIT was assessed to individuals with taxable income exceeding R500 000 per annum (a substantial increase from 2014, when only 57.3% of PIT was assessed to individuals with a taxable income exceeding R500 000).

In light of the above factors and the significant increases in PIT in recent years, we do not expect significant tax increases in PIT and it is likely that full relief for fiscal drag will be given, with possibly the exception of the highest tax brackets.

CGT

In 2016, the maximum effective capital gains tax rate for individuals was increased from 13.7% to 16.4% (or from 33.3% to 40% of the income tax rate). No further changes were made to the inclusion rate in 2017 and 2018, although the introduction of the new 45% band in 2017 had the effect of increasing the maximum effective CGT rate to 18%. It is possible, given that CGT is perceived to be a tax on the wealthy as well as pressures on government to increase taxes on the wealthy, that the inclusion rate could be increased to 50% (with the result that the maximum effective CGT rate for individuals would increase to 22.5%). The additional revenue raised as a result of such a measure would not be substantial, and would be unlikely to exceed R2.5 billion.

Medical tax credits

In the 2018 Budget, it was stated that below-inflation increases in medical tax credits over the following three years would help government to fund the rollout of National Health Insurance. It is expected that this policy will be continued and taxpayers can expect to see increases in the medical tax credits significantly less than inflation.

Estate duty and donations tax

In the 2018 Budget, the rate of estate duty on estates with a value above R30 million was increased from 20% to 25% of the value of the estate that exceeds R30 million.

There is a possibility that the rates of estate duty and donations tax could be increased once again. Although such a measure is unlikely to raise substantial additional revenue, it would serve as a counter to calls for a net wealth tax, which is not viewed as ideal from a policy perspective. Such a measure would accord with recommendations made by the Davis Tax Committee.

Indirect taxes

VAT

VAT rates

Given the increase in the VAT rate in the 2018 budget, the significant public outcry over this, as well as the perceived regressivity of VAT, it is certain that there will be no change in the VAT rate. This is despite the fact that SA's VAT rate is still relatively low by international standards and the growing trend to indirect taxes as a source of tax revenue globally.

Luxury VAT rate

We note the suggestion from some quarters that a higher VAT rate be introduced for luxury goods. In this regard, we note warnings from the Davis Tax Committee to the effect that multiple VAT rates add significantly to the complexity of the VAT system and the administrative burden while raising relatively small amounts of additional revenue. We therefore do not expect to see an introduction of higher VAT rates for luxury goods.

Ad valorem duties

As an alternative to a higher VAT rate on luxury goods, rates of ad valorem excise duties, which are applied to some goods that are consumed mainly by wealthier households, were raised in the 2018 Budget.

The benefit of ad valorem duties over VAT is that the tax is collected at the stage of production and the number of participants in the supply chain who are needed to administer the system is limited (as opposed to VAT, which requires participation by all traders in the value chain).

Given that there were increases in ad valorem rates in the 2018 budget, we do not anticipate further increases this year. However, given that the list of goods that are subject to ad valorem duties is fairly narrow, it is possible that the list of goods subject to this tax could be expanded to cover additional luxury goods. We do not, however, anticipate that such a measure will result in significant additional revenues. Goods currently subject to ad valorem duties include such items as perfumes, beauty products, fireworks, furs, air-conditioning, cellular phones, certain electronic equipment, motor vehicles and firearms.

Fuel levies

The general fuel levy has been increased significantly in each of the four previous Budgets as a means of raising additional tax revenues. The general fuel levy is only slightly progressive and was previously seen as being less politically sensitive than VAT. This perception has, however, changed with the increased attention resulting from the VAT increase in 2018. As such, it may no longer be seen as a viable option for government to raise additional revenues. Increases are therefore likely to be limited to inflation. We therefore expect the general fuel levy to be increased by between 15c/l and 20c/l.

In the 2018 MTBPS, it was stated that the liability of the Road Accident Fund (RAF) is expected to grow to R393 billion by 2021/2022 from R206 billion at the time of the MTBPS, and that the RAF would require further large increases to the fuel levy in each of the following three years. We anticipate an increase of at least 30c/l in the RAF levy, in line with the increase in the 2018 Budget.

Transfer duties

In 2015, a new maximum rate of 13% was introduced for properties above R10 million. In 2017 the tax-free threshold was increased from R750 000 to R900 000. Further changes in 2019 are considered unlikely, especially given the current residential property market in which residential property prices are under pressure.

Securities transfer taxes

Securities transfer tax is currently levied at a rate of 0.25% on the transfer of shares. One of the few possibilities still available to government to raise additional significant additional tax revenues would be to increase the securities transfer tax rate. Doubling this rate could raise additional tax revenues of approximately R5.9 billion. Such a tax increase is likely to be perceived as progressive as it is a form of tax on wealth. However, the distortionary implications of any such increase on stock markets would require careful consideration and we expect this to be used as a last resort.

Health Promotion Levy

The Health Promotion Levy (HPL), also known as the sugar tax, is an excise tax that is levied on sugar-sweetened beverages at the rate of 2.1c/g of sugar content that exceeds 4g per 100ml.

In the 2018 Budget, it was estimated that the HPL would raise revenue of approximately R1.68 billion. From the date of its introduction on 1 April 2018, the HPL has raised R2.26 billion to the end of December, far exceeding the forecast. It is anticipated that final revenues from the HPL for 2018/2019 could be as much as R3.4 billion.

Excise duties

Excise duties on tobacco and alcohol have traditionally been a soft target for increased taxes.

Notwithstanding this, we do not anticipate any significant increase in excise duties on tobacco in this year's Budget. This is largely due to concerns relating to illicit trade, which can, to an extent, be facilitated through excessive increases in excise duties on tobacco.

Although illicit trade is also a concern in the context of excise duties on alcohol, the concerns are not as significant and it is anticipated that there will be inflationary increases on excise duties on alcohol.

Carbon tax

Despite the fact that it was expected that the Carbon Tax Bill (which has been introduced in Parliament) would be passed by the end of 2018 so that it could be effective for implementation on 1 January 2019 as announced in the 2018 Budget, the Bill is yet to be enacted. It is expected that the implementation date will therefore (necessarily) be moved to 1 January 2020.

The Carbon Tax will not result in any additional revenue 2019/2020 and is, in any event, intended to be fiscally neutral.

Other environmental taxes

Given substantial increases in the 2018 Budget to the plastic bag levy (50%), the environmental levy on incandescent light bulbs (33%) and the vehicle emissions tax, it is not expected that there will be any significant increases to these taxes in this year's Budget.

The electricity levy is also not expected to be increased due to the already high cost of electricity and the pending introduction of the Carbon Tax.

Contact

Kyle Mandy
Tax Policy Leader, PwC
Office: +27 11 797 4977 | E-mail: kyle.mandy@pwc.com

Lullu Krugel
Chief Economist, PwC
Office: +27 (11) 797 4929 | E-mail: lullu.krugel@pwc.com