Economic Update | February 2020

Capricorn Asset Management
a member of Capricorn Group

South Africa Budget 2020

"...and the second verse is Dumela..."

Finance Minister (MoF) Tito Mboweni delivered what is arguably the most important Budget Speech in South Africa's recent history. We said exactly the same thing last year. Hence the second verse quote, meaning that the same song is being sung. Last year we expressed the hope that the A-Team that took the reins would be able to implement fundamental improvements. However, hope springs eternal, but was disappointed in this instance.

The context in which the Budget was delivered is extremely challenging. Recession-like macroeconomic conditions persist. This means that revenue will continue to grow slowly. In the past year it slowed to 5.5% (9.2% was expected) and is budgeted to grow by 4% this fiscal year. The outlook of the Minister that it will grow by 6% plus going forward might be too optimistic. We expected some tax hikes, but in the end some relief was given on the personal income tax side, albeit marginal.

Spending was projected to grow by 9.7%, but actually expanded by 12.2%. This damages the credibility of fiscal policy. The budgeted increases are 6.0%, 4.4% and 4.9% for the next three years. To achieve this degree of control requires that growth in the wage bill be contained to 1.5%, a herculean task. Then it has to grow by only 4.5% and 4.4% over the next two years – basically in line with inflation. The MoF promised savings of R261bn on the wage bill and program spending. The wage bill constitutes about a third of total spending.

SOE's remain a threat to creditworthiness. Contingent liabilities and guarantees at R1.3tn now amount to 25% of GDP. Eskom (R296bn) is by no means alone in this. The effort to enable alternative sources of electricity resulted in guarantees on behalf of independent power producers of R163bn, whilst the Road Accident Fund contingent liability is on its way to R500bn. Total debt plus contingent liabilities now amounts to 90% of GDP.

The deficit this year will be the largest on record – a gargantuan R370bn. The deficit-to-GDP ratio will pop out to 6.8% - the highest its been since the birth of the Rainbow Nation. In 1993/94 it was 10% plus, but in the following decade it actually turned into a surplus. However, the healthy 3% rule-of-thumb level has not been seen since 2010.

Against this background, the RSA is already being rated as "BB" by the markets, that is non-investment grade, also known as junk status. This is evident from the levels of the bond yields and credit default swaps when compared to similarly rated counties. Furthermore, the currency has fallen by more than 50% since 2010. We would say that constitutes a de-rating. Moody's now merely has to play catch-up and publish its report-card. Indications are that they will do so by November 2020.

One thing in SA's favour is its low level of foreign debt. It constitutes 10% of total debt and 6% of GDP. This means that debt is largely denominated in local currency. Therefore, despite the litany of issues, problems and unhealthy ratios, we do not foresee a debt default by the South African state. Deteriorating creditworthiness means that the interest rate charged by lenders (bond investors) will remain high. This provides an attractive yield in a yield-scarce world – compare 8.7% in SA to the USA at 1.3%, Japan at 0% and Germany at -0.5%, all 10-year bond yields.

Fiscal policy cannot provide much by way of stimulation to the economy. Therefore, we are of the view that interest rates will be lowered further by the SARB. The economy is in a predicament and inflation ought not to be a problem. This means that the prime rate in Namibia will also be lowered – it could be as low as 9.25% by the end of 2021. A snippet of positive news for Namibia from the SA Budget is that the payment to the SACU pool is estimated to increase substantially. This will provide welcome breathing room in our fiscal space.