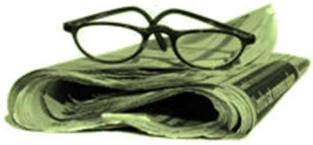


# Legal Update
# V2018.1

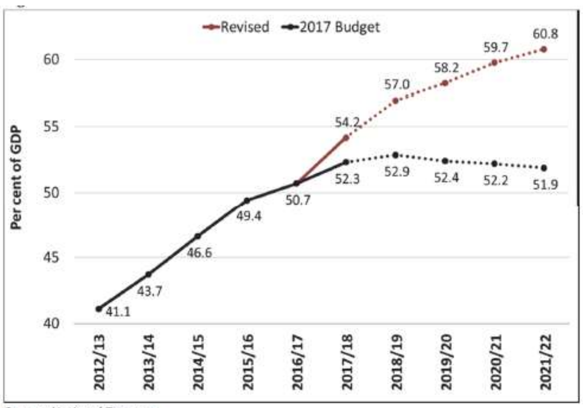
## 2018 National Budget

### Background

When we reported on the 2017 National Budget 12 months ago, we suggested that the 2017 budget … *was prepared amidst the most uncertain political climate in South Africa since 1994 …”*

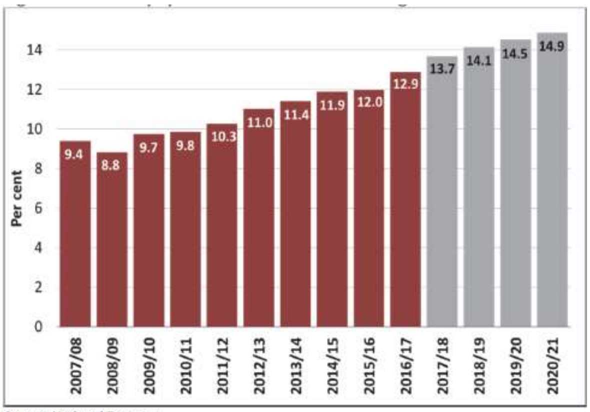
Little did we know at the time just how much that uncertainty would increase before the change of sentiment that emanated from the election of Cyril Ramaphosa as leader of the ANC and more recently, him replacing Jacob Zuma as president of the Republic before the end of the former’s scheduled term of office.

The *Medium-Term Budget Policy Statement* issued by Finance Minister, Malusi Gigaba in October 2017 reflected a bleak picture of fiscal projections. Of particular concern was the revised projected Debt vs GDP projections that suggested a ratio of 60.8% was likely unless additional fiscal measured were implemented to curb the increasing debt accumulation.




*Source: National Treasury*

The impact of the increase in Debt vs GDP was most obvious when considering the rapid increase in the percentage of the overall budget needed to service interest payments on the debt. The credit rating downgrades and resultant increase in interest payable on new debt would have a secondary knock-on effect on this number.




*Source: National Treasury*

Whilst the international economy had shown widespread positive signs of new growth, South Africa’s economic growth remained sluggish, largely because of low business confidence, which has caused corporate South Africa to retain R1.3 trn on their balance sheets as opposed to investing it in growth-orientated projects.

Business Confidence in South Africa decreased to 34 in the fourth quarter of 2017 from 35 in the third quarter of 2017. Business Confidence in South Africa averaged 44.64 from 1975 until 2017, reaching an all-time high of 91 in the third quarter of 1980 and a record low of 10.20 in the third quarter of 1985.



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All indications are that this is likely to turn around following the removal of Jacob Zuma and the election of Cyril Ramaphosa as president of the Republic.

The absence of economic growth has contributed to the lower than budgeted tax collection in the 2017/18 tax year.

Some of the key challenges that we believe Minister Gigaba had to address in the 2018 National Budget were:

- Build on the positive sentiment generated by President Ramaphosa's State of the Nation Address.
- Address 2017/18 revenue collection shortfall.
- Address fiscal deficit reduction.
- Reduce Government expenditure.
- Address calls for economic reform to unlock economic growth.
- Provide policy clarity to boost business and investor confidence.
- Address the turmoil in State Owned Enterprises.
- Address the issue of free tertiary education promised by Jacob Zuma.

Having regard for all of these challenges, we expected a 2018 National Budget that the South African consumer and tax payer would find hard to swallow, but would yield the required result.

## 2018 National Budget

The key components of the 2018 National Budget can be summarised as follows:

| R billion/percentage of GDP | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|
| | Revised estimate | Medium-term estimates | | |
| **Revenue** | 1 353.6 | 1 490.7 | 1 609.7 | 1 736.9 |
| *Percentage of GDP* | 28.8% | 29.7% | 29.9% | 29.9% |
| **Expenditure** | 1 558.0 | 1 671.2 | 1 803.0 | 1 941.9 |
| *Percentage of GDP* | 33.2% | 33.3% | 33.4% | 33.4% |
| **Budget balance** | -204.3 | -180.5 | -193.3 | -205.0 |
| *Percentage of GDP* | -4.3% | -3.6% | -3.6% | -3.5% |
| *Gross domestic product* | 4 699.4 | 5 025.4 | 5 390.1 | 5 808.3 |

### Economic Growth Forecasts Increased

The economic outlook has improved since October and Treasury is now projecting GDP growth of 1% for 2017, 1.5% in 2018, 1.8% in 2019 and 2.1% in 2020.

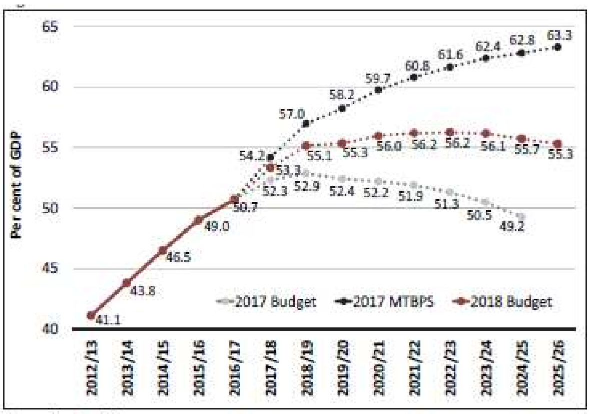
This compares with the October 2017 forecasts of 0.7%, 1.1%, 1.5% and 1.9% respectively.

### Budget Deficit & Government Debt

The 2017/18 budget deficit increased to 4.3% of GDP, compared to the budget of 3.1%, largely due to a R48.2 bn shortfall in revenue collections

The 2018/19 budget deficit is expected to be 3.6% and to reduce to 3.5% in 2020/21.

Government Debt as a percentage of GDP continues to rise, but not at the levels estimated in October 2017. It is expected to stabilise at 53.2% of GDP in 2023/24.



*Source: National Treasury*

### Government Expenditure

Despite plans to reduce expenditure on certain infrastructure projects by R85.7 bn over the next 3 years, overall government expenditure will increase from R1.56 trn to R1.67 trn in the year ahead.

It is projected to rise at a real rate of 2.1% over the next three years.

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Some of the key allocations are:

- **<u>Free tertiary education</u>** has been allocated R57 bn over the next three years. It will be phased in, starting this year with free tertiary education for first year students from households that earn less than R350,000 per annum (75% of taxpayers).

- The **<u>Education Budget</u>** will receive R32 bn over the next 3 years to build and upgrade schools; R22 bn to feed 9 m learners at 19 800 schools; and R3.8 bn to provide water and sanitation for 325 and 286 schools respectively.

- The **<u>National Health Insurance</u>** project will receive an additional R4.2 bn funded through a reduction in tax benefits on medical expenses.

- **<u>Old Age Grants</u>** will increase by R90 to R1,690 in April and to R1,700 in October. The child support grant rises to by R20 to R400 in April and to R410 in October.

The medium-term expenditure allocation estimates are as follows:

| | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|
| **R billion** | **Revised estimate** | **Medium-term estimates** | | |
| Learning and culture | 323.1 | 351.1 | 385.4 | 413.1 |
| Health | 191.7 | 205.4 | 222.0 | 240.3 |
| Social development | 234.9 | 259.4 | 281.8 | 305.8 |
| Community development | 183.5 | 196.3 | 210.5 | 227.1 |
| Economic Development | 183.5 | 200.1 | 211.9 | 227.1 |
| Peace and security | 195.7 | 200.8 | 213.6 | 227.7 |
| General public services | 62.1 | 64.0 | 65.9 | 70.5 |
| Payments for financial assets | 20.4 | 6.0 | 6.2 | 6.6 |
| **Allocated expenditure** | **1 394.8** | **1 483.1** | **1 597.3** | **1 718.1** |
| Debt-service costs | 163.2 | 180.1 | 197.7 | 213.9 |
| Contingency reserve | – | 8.0 | 8.0 | 10.0 |
| **Consolidated expenditure** | **1 558.0** | **1 671.2** | **1 803.0** | **1 941.9** |

## Tax Proposals will raise an additional R36 bn in 2018/19

The increase in VAT, the fuel levy and sin taxes will affect the poor negatively, despite the increase in social grants and the fiscal drag relief for lower earners. Whilst no specific "wealth tax" was introduced, the absence of fiscal drag relief for higher earners, the increase in excise duties on luxury goods and the increase in estate duty for estates above R30 mn will increase the tax burden on the wealthy.

- VAT will increase from 14% to 15% on 1 April 2018. Minister Gigaba conceded that personal and corporate tax rates were high by international comparison, whereas VAT was not. This is the first VAT increase since 1993.

- Only the bottom three income levels (earning less than R410,000 per year) will enjoy fiscal drag relief. The Income Tax rates for 2017/18 will be as follows:

| TAXABLE INCOME (R) | 2018/19 RATES OF TAX |
|---|---|
| 0 - 195 850 | 18% of taxable income |
| 195 851 - 305 850 | 35 253 + 26% of taxable income above 195 850 |
| 305 851 - 423 300 | 63 853 + 31% of taxable income above 305 850 |
| 423 301 - 555 600 | 100 263 + 36% of taxable income above 423 300 |
| 555 601 - 708 310 | 147 891 + 39% of taxable income above 555 600 |
| 708 311 - 1 500 000 | 207 448 + 41% of taxable income above 708 310 |
| 1 500 001 and above | 532 041 + 45% of taxable income above 1 500 000 |
| REBATES | |
| Primary | R 14 067 |
| Secondary | R 7 713 |
| Tertiary | R 2 574 |
| TAX THRESHOLD | |
| Below age 65 | R 78 150 |
| Age 65 and over | R 121 000 |
| Age 75 and over | R 135 300 |

- The total levy on fuel will increase by 52 cents per litre on 4 April 2018. The total levy on fuel will now be R3.62 per litre.

- "Sin taxes" on alcohol products will increase by between 6% and 10% and 8.5% on tobacco products.

- Estate duty for estates above R30 mn will increase from 20% to 25%.

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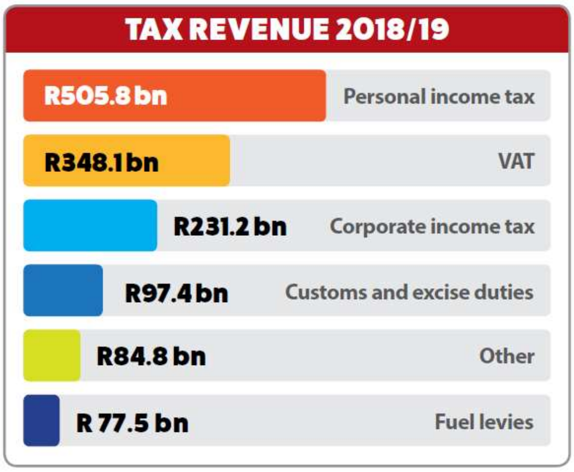
- The excise duty on luxury goods is raised from 7% to 9%.

Tax revenue sources for 2018/19 can be summarised as follows:




### State Owned Enterprises

President Ramaphosa outlined his administration's tough stance on the ongoing lack of accountability within and mismanagement at State Owned Enterprises (SOE's) in his State of the Nation address.

As expected, Minister Gigaba re-emphasised this position and announced that Government plans to introduce a reform programme for SOE's with the aim of refocussing their role in economic development.

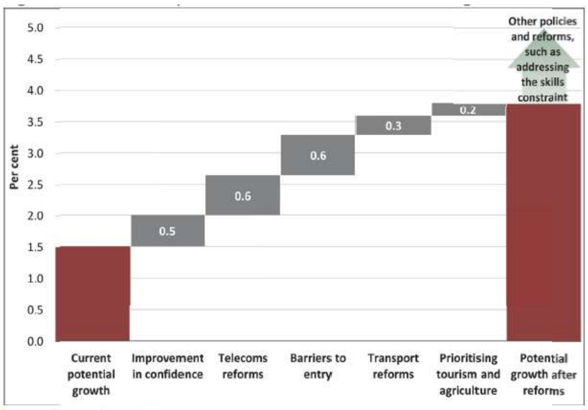
Gigaba indicated that some SOE's will require restructuring with equity investment. Whilst he also acknowledged that government may be required to provide financial support to several SOE's during the year, it will be done in a budget-neutral manner through a combination of disposing of non-core assets, strategic equity partners, or direct capital injections.

### Economic Reform

The growth of the South African economy has been sluggish compared to our peers and the rest of the world. Over the past decade South Africa's GDP growth has declined from 3% to the latest projection of 1% for 2017. This has been a significant contributor to government's budget woes.

Much of the budget woes could be remedied if sustainable economic growth of 3% - 4% is achieved.

National Treasury has, for the first time in 24 years identified five economic reforms and quantified the commensurate likely contribution, to lift GDP growth.




*Source: National Treasury*

### Offshore Investment Allowances

Offshore limit for institutional funds is increased by 5% for all categories, including the African allowance. This implies that the African allowance increases from 5% to 10% and the Rest of World increases from 25% to 30%, increasing the total foreign exposure allowance to 40%.

## Conclusion

In light of the political turmoil of the past six months, we are delighted with the depth and foresight of the 2018 National Budget Review Framework. In the midst of state capture allegations, it is pleasing to note the quality of skills and level of commitment of staff within National Treasury.

As expected, it is, as Minister Gigaba stated at the start of his budget speech, "a *tough but hopeful budget*".

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Even though the fiscal deficit will remain for some time, the measures that have been taken demonstrate the resolve and willingness of the Ramaphosa administration to reverse the decade of economic decay that preceded his election.

All the ingredients to achieve the long-overdue return to sustainable economic growth whilst also addressing the socio-economic demands of the largely populist mandate that got President Ramaphosa elected, has been included.

It is a budget that should settle some of the concerns of the credit rating agencies. This, together with the change in leadership is likely to restore confidence in South Africa as an investment destination for both foreign and local investors.

The challenge will now be for Government, business and labour to find common ground to work together towards achieving the same goals.

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**Prepared by:**
**Ensimini Financial Services (Pty) Ltd**
**22 February 2018**

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