Investec

Budget: Fiscal adjustments and higher GDP growth to reduce fiscal deficit aimed at stabilising government debt

22 February 2018

Figure 1: Consolidated government fiscal framework, 2015/16 - 2020/21

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
R billion/Percentage of GDP	Outcome		Revised	Medium-term estimates		
Revenue	**1 215.3**	**1 285.7**	**1 353.6**	**1 490.7**	**1 609.7**	**1 736.9**
	29.5%	*29.2%*	*28.8%*	*29.7%*	*29.9%*	*29.9%*
Expenditure	**1 366.3**	**1 441.8**	**1 558.0**	**1 671.2**	**1 803.0**	**1 941.9**
	33.1%	*32.7%*	*33.2%*	*33.3%*	*33.4%*	*33.4%*
Budget balance	**-151.0**	**-156.1**	**-204.3**	**-180.5**	**-193.3**	**-205.0**
	-3.7%	*-3.5%*	*-4.3%*	*-3.6%*	*-3.6%*	*-3.5%*
Primary Balance	**-13.2**	**-5.9**	**5.5**	**20.3**	**45.7**	**60.6**
	-0.3%	*-0.1%*	*0.1%*	*0.4%*	*0.9%*	*1.1%*

Source: National Treasury

- The 2018 Budget proposes that necessary fiscal measures, alongside higher GDP growth outcomes, will reduce the deficit and stabilise gross government debt over the medium term. Specifically, the consolidated budget deficit is projected to decline from 4.3% of GDP in 2017/18 to 3.6% of GDP in 2018/19 and 2019/20 and to 3.5% in 2020/21.

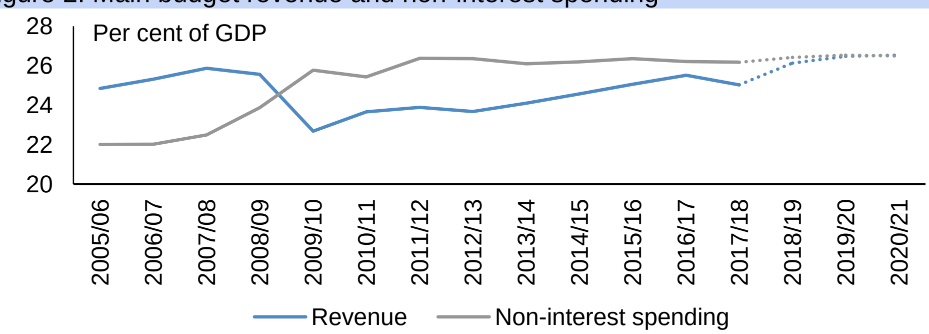
- According to the Treasury, the "narrower deficit, stronger rand and lower borrowing costs" will result in gross government debt stabilising at 56.2% in 2022/23 and receding thereafter, with net debt peaking at 53.2% in 2023/24.

- The fiscal measures outlined in the 2018 Budget showed that most of the burden of adjustment was concentrated on the revenue side, via further tax policy adjustments. The extent of expenditure side adjustment was restricted by the provision for fee-free higher education. Ideally, fiscal consolidation that ensures long-term fiscal sustainability, and creates the space to absorb any future economic shocks and the funding of new policy priorities, should be biased towards expenditure cuts.

- The efforts of the moderate fiscal consolidation outlined in the 2018 Budget are likely to be deemed as sufficient to avert a Moody's downgrade.

- However, averting further credit rating downgrades over the longer-term will require a sustained economic growth recovery to 3.0% and beyond. In a persistently weak growth environment, accomplishing fiscal consolidation will be difficult. Effective policy implementation and the enhancement of policy certainty are required to restore business confidence and enhance the investment climate which would ultimately lift potential GDP growth.

Figure 2: Main budget revenue and non-interest spending



Source: National Treasury

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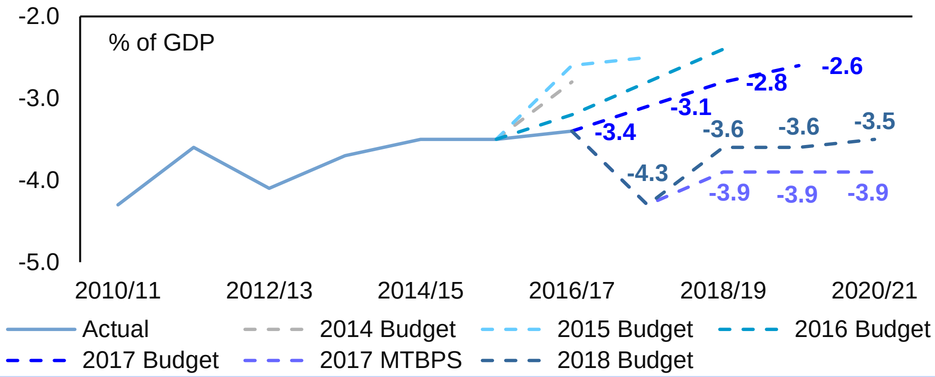
Figure 3: Consolidated budget deficit: actuals and forecasts



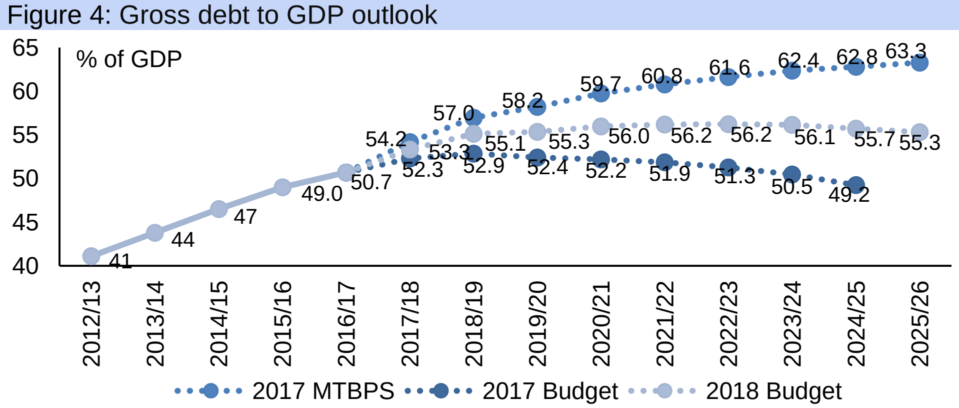
Source: National Treasury

The 2018 Budget proposes that necessary fiscal measures, alongside higher GDP growth outcomes, will reduce the deficit and stabilise gross government debt over the medium term. Specifically, the consolidated budget deficit is projected to decline from 4.3% of GDP in 2017/18 to 3.6% of GDP in 2018/19 and 2019/20 and to 3.5% in 2020/21 (see figure 1). Although the deficit projections are an improvement on what was outlined in the 2017 Medium Term Budget Policy Statement (MTBPS) the timeframe for consolidation has been pushed back from 2017's Budget whereby the deficit narrowed to 2.6% by 2019/20, well within the internationally accepted and fiscally sustainable benchmark of 3.0% of GDP (see figure 3).

The relatively moderate pace of fiscal adjustment over the medium-term fiscal framework period suggests a cautious approach to fiscal tightening to avoid denting the nascent economic recovery. National Treasury linked its projected improvement in GDP growth prospects to the expected strengthening in domestic consumer and business sentiment, underpinned by enhanced policy and political certainty, and the derived benefits of an increasingly synchronised global economic upturn (see figure 5).

According to the Treasury, the "narrower deficit, stronger rand and lower borrowing costs" will result in gross government debt stabilising at 56.2% in 2022/23 and receding thereafter, with net debt peaking at 53.2% in 2023/24. The 2017 MTBPS, which was devoid of a fiscal adjustment package, projected an increase to 63.3% of GDP in gross debt over the medium term (see figure 4).

Figure 4: Gross debt to GDP outlook



Source: National Treasury

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Figure 5: Macroeconomic outlook - summary

	2017	2018	2019	2020
Real percentage growth	Estimate		Forecast	
Household consumption	1.3	1.7	1.9	2.3
Gross fixed-capital formation	0.3	1.9	3.3	3.7
Exports	1.5	3.8	3.4	3.5
Imports	2.7	4.4	4.6	4.5
Real GDP growth	**1.0**	**1.5**	**1.8**	**2.1**

Source: National Treasury

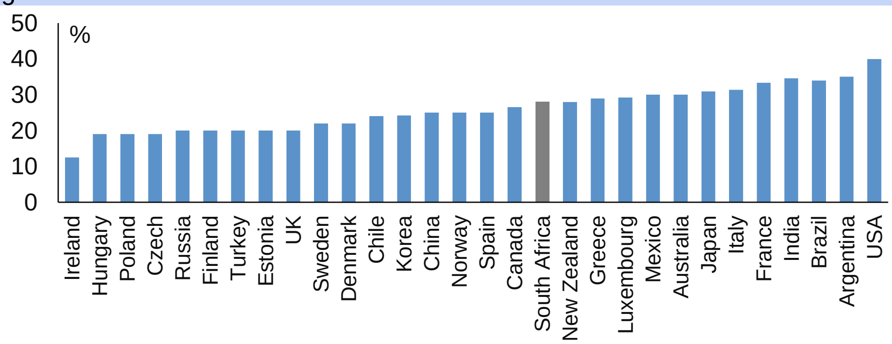
The fiscal measures outlined in the 2018 Budget showed that most of the burden of adjustment was concentrated on the revenue side, via further tax policy adjustments. The extent of expenditure side adjustment was restricted by the provision for fee-free higher education. Ideally, fiscal consolidation that ensures long-term fiscal sustainability, and creates the space to absorb any future economic shocks and the funding of new policy priorities, should be biased towards expenditure cuts. Typically government spending restraint, especially with respect to consumption expenditure, is a better enabler of fiscal consolidation than tax increases.

The tax adjustments outlined in 2018 Budget propose to raise an additional R36bn in 2018/19 – over and above the baseline forecasts. The highest proportion of the additional amount is to be raised through indirect taxes as the scope to raise personal and corporate taxes is limited. The tax adjustments were also aimed at enhancing the progressiveness of the tax system.

Specifically, the 2017 MTBPS cautioned that “(g)iven that per capita income is falling, the economic impact of further… tax hikes could be counter-productive”. Personal income tax collections have been suppressed by high unemployment and slower growth in employee compensation. Another contributing factor to the lower collections relates to “(c)ompliance concerns [that] are mounting in the context of tax administration challenges and weakening tax morality” according to the 2017 MTBPS. In this regard, there is to be a commission of inquiry into the “functioning and governance of SARS” in a bid to strengthen the “social contract between taxpayers and the state.”

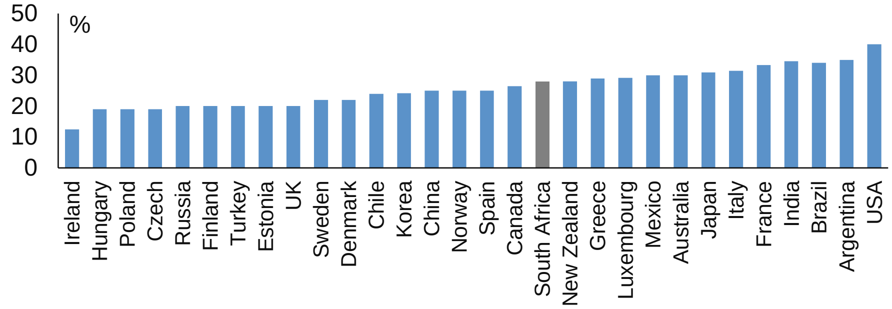
With both the personal and corporate tax burdens rising over the last few years and being considered as already relatively high, corporate tax rates also remained unchanged (see figure 6 and 7). Given the relatively modest economic growth climate, raising corporate taxes at this juncture would weaken the prospects for a recovery in private sector employment levels and fixed investment rates. On the corporate tax front, the 2018 Budget outlines intentions to approve six special economic zones to benefit from tax incentives that are estimated to reduce gross tax revenue by R0.35bn.

Figure 6: Personal tax rates



Source: KPMG

Figure 7: Corporate tax rates



Source: KPMG

In view of these considerations the main tax adjustments comprised:

- **R6.8bn from restricted fiscal drag relief**

Personal income tax brackets and thresholds were increased well below expected inflation which translated to limited fiscal drag relief for lower income earners and no fiscal drag relief for higher income earners. Specifically, the bottom three personal income tax brackets and the primary, secondary and tertiary rebates were increased by 3.1% whilst the top four brackets were unchanged (see figure 8).

Figure 8: Personal income tax rates and bracket adjustments

2017/18		2018/19	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R189 880	18% of each R1	R0 - R195 850	18% of each R1
R189 881 - R296 540	R34 178 + 26% of the amount above R189 880	R195 851 - R305 850	R35 253 + 26% of the amount above R195 850
R296 541 - R410 460	R61 910 + 31% of the amount above R296 540	R305 851 - R423 300	R63 853 + 31% of the amount above R305 850
R410 461 - R555 600	R97 225 + 36% of the amount above R410 460	R423 301 - R555 600	R100 263 + 36% of the amount above R423 300
R555 601 - R708 310	R149 475 + 39% of the amount above R555 600	R555 601 - R708 310	R147 891 + 39% of the amount above R555 600
R708 311 - R1 500 000	R209 032 + 41% of the amount above R708 310	R708 311 - R1 500 000	R207 448 + 41% of the amount above R708 310
R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000	R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary	R13 635	Primary	R14 067
Secondary	R7 479	Secondary	R7 713
Tertiary	R2 493	Tertiary	R2 574
Tax threshold		**Tax threshold**	
Below age 65	R75 750	Below age 65	R78 150
Age 65 and over	R117 300	Age 65 and over	R121 000
Age 75 and over	R131 150	Age 75 and over	R135 300

Source: National Treasury

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Figure 9: Estimates of individual tax payers and taxable income, 2018/19

Taxable bracket	Registered individuals		Taxable income		Income tax payable before relief		**Income tax relief**		**Income tax from medical**		**Income tax payable after proposals**	
	Number	%	R bn	%	R bn	%	Rbn	%	R bn	%	R bn	%
0 – R70 000[1]	6 557 245	–	170.2	–	–	–	–	–	–	–	–	–
R70 001 – R150 000	2 502 678	33.4	262.0	10.8	11.1	2.2	-0.9	12.5	0.04	5.0	10.2	2.0
R150 001 – R250 000	1 790 280	23.9	351.8	14.5	34.3	6.7	-1.3	17.3	0.16	23.1	33.2	6.6
R250 001 – R350 000	1 178 901	15.7	349.8	14.4	51.6	10.1	-1.3	18.4	0.15	22.1	50.5	10.0
R350 001 – R500 000	934 615	12.5	386.8	15.9	74.2	14.5	-1.6	21.5	0.15	21.9	72.7	14.4
R500 001 – R750 000	576 469	7.7	348.4	14.3	85.6	16.7	-1.2	16.1	0.10	14.3	84.5	16.7
R750 001 – R1 000 000	233 652	3.1	200.7	8.3	58.4	11.4	-0.5	6.5	0.04	6.1	58.0	11.5
R1 000 001 – R1 500 000	161 014	2.2	192.3	7.9	62.4	12.2	-0.3	4.5	0.03	4.4	62.1	12.3
R1 500 001+	109 783	1.5	339.4	14.0	134.8	26.3	-0.2	3.1	0.02	3.2	134.6	26.6
Total	**7 487 392**	**100**	**2 431**	**100**	**512.5**	**100**	**-7.3**	**100**	**0.70**	**100**	**505.8**	**100**
Grand total	**14 044 637**		**2 601**		**512.5**		**-7.3**		**0.70**		**505.8**	

Source: National Treasury

- **R0.7bn from medical tax credit adjustment**

Over the medium-term fiscal framework there will be below inflation increases in medical tax credits. The 2017 MTBPS maintained that structural increases in expenditure, such as the funding of the national health insurance (NHI), must be matched by a permanent source of revenue. The medical tax credit is being earmarked as a funding source for the NHI.

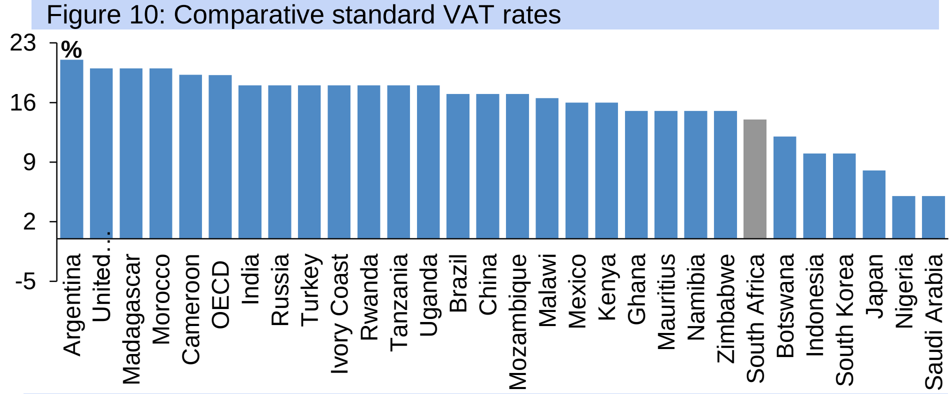
- **R0.15bn from an estate duty increase**

Changes to the estate duty rate were effected. The DTC has previously recommended increasing the rate from 20% to 25% of the dutiable value of an estate exceeding R30 million. Moreover, donations exceeding R30mn will be taxed at 25%.

- **R22.9bn from a 1% increase in value-added tax to 15%**

The 2016 Budget already evaluated a possible future increase in the VAT rate by citing that "(t)he current tax mix suggests that there may be greater room to increase indirect taxes, such as VAT." The 2017 Budget noted that given the limited scope to continue raising the personal income tax burden "it may be necessary

Figure 10: Comparative standard VAT rates



Source: National Treasury

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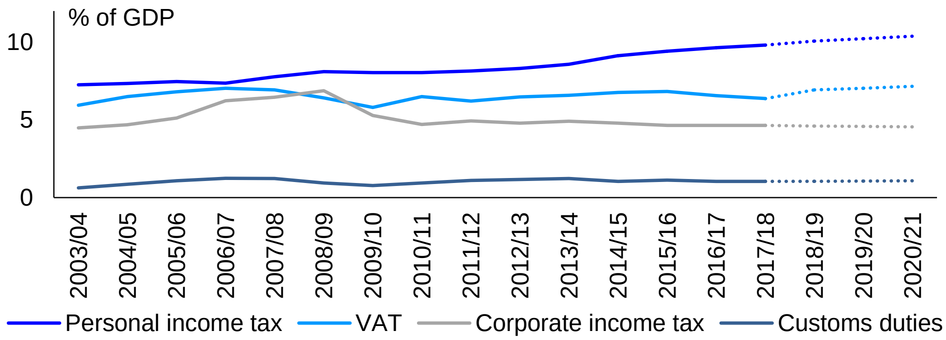
Figure 11: Tax revenue performance and projections



Source: National Treasury

to adjust consumption taxes."

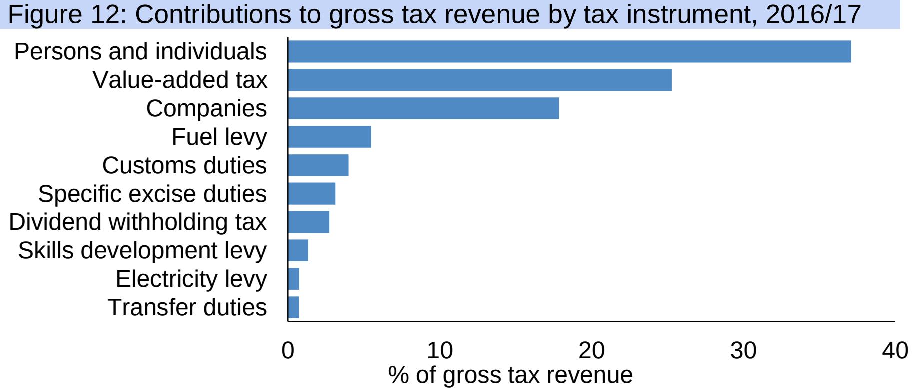
This tax policy adjustment will have been informed by the Davis Tax Committee (DTC). Specifically, the DTC assessed that although an increase in the VAT rate would have negative implications for inflation and possibly for economic growth in the short-term, over the longer-term it is less damaging compared to increases in personal or corporate income taxes.

Moreover, the impact on low-income households will be mitigated by increased social grants and already, most necessities purchased by low income households are exempt from VAT. The DTC found that increased social grants was preferable to increasing the number of VAT exemptions for specific products. VAT exemptions typically benefit richer households more than the poorer households owing to higher rate of consumption.

- **R1.0bn from luxury ad valorem excise duties**

Higher taxes on luxury goods will be applied. Ad valorem duties for motor vehicles will be increased to 25% from 30%. Ad valorem excise duty rates on cellular telephones will be increased to 7% and 9% from 5% and 7%.

Figure 12: Contributions to gross tax revenue by tax instrument, 2016/17



Source: National Treasury

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Figure 13: Impact of tax proposals on 2018/19 revenue

R million		
Gross tax revenue (before tax proposals)		**1 308 965**
Budget 2018/19 proposals		**36 000**
Direct taxes		**7 310**
Taxes on individuals and companies		
Personal income tax	**7 510**	
Revenue from not fully adjusting for inflation	6 810	
Revenue if no adjustment is made	*14 155*	
Partial bracket creep for personal income tax	*-7 345*	
Medical tax credit adjustment	700	
Corporate income tax	**-350**	
Special economic zones	*-350*	
Taxes on property	**150**	
Estate duty increase	150	
Indirect taxes		**28 690**
Increase in value-added tax	22 900	
Increase in general fuel levy	1 220	
Increase in excise duties on tobacco products	420	
Increase in excise duties on alcoholic beverages	910	
Increase in ad valorem excise duties	1 030	
Increase in environmental taxes	280	
Introduction of health promotion levy	1 930	
Gross tax revenue (after tax proposals)		**1 344 965**

Source: National Treasury

- **R1.2bn from fuel levy increases**

In terms of the general fuel levy, it will be increased by 22c/litre, effective 4 April 2018. The magnitude can be considered somewhat smaller than the prior three years of increases amounting to 30c/litre or more. In previous fiscal years the increases were in the region of 12 - 15c/litre. The Road Accident Fund levy will be increased by a substantial 30c/litre.

- **R0.28bn from environmental taxes**

Increases were implemented in the environmental tax spectrum that includes levies on incandescent globes, plastic bags and vehicle emissions.

- **R1.3bn from sin tax increases**

Excise taxes on alcohol and tobacco will continue increasing at an above inflation rate, as has been the case since 2002. Excise duties on alcoholic beverages will be increased by 6% - 10% and on tobacco products by 8.5%.

- **R1.9bn from the health promotion levy**

The tax on sugar-sweetened beverages will be implemented on 1 April 2018.

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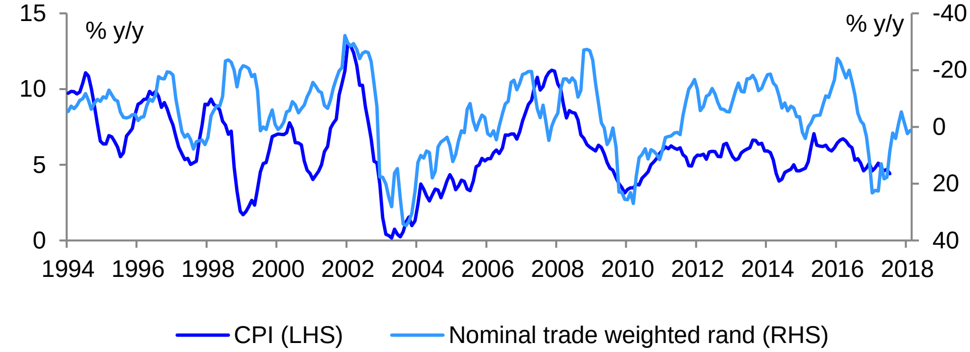
Figure 14: CPI inflation versus nominal trade weighted rand



Source: Stats SA, IRESS, Investec

The Treasury estimates that these tax proposals will add 0.6% to headline inflation. We had previously forecast CPI inflation at sub 5.0% y/y in 2018 on the assumption that the rand will remain resilient and demand led inflationary pressures muted as only a relatively mild pick-up in economic growth is forecast. Moreover, the electricity tariff increase, of 5.23% granted by NERSA was well below the 19.9% requested by Eskom. Based on the Treasury's estimate, CPI inflation is likely to come out around 5.0% y/y this year.

This does not necessarily argue for interest rate hikes as the bulk of the effect of the tax increases will come through this year whilst the SARB forecast horizon is mainly over the twelve to 24 month horizon. The SARB's current inflation forecast is closer to 5.5% over the twelve to 24 month forecast horizon, which constrains the room to cut interest rates. However, should the rand strengthen notably further on a sustained basis, the SARB may consider an interest rate cut on expected lower inflation.

The expenditure adjustments outlined in the 2018 Budget reflect "major expenditure commitments, and corresponding expenditure reductions and reprioritisation in line with new policy initiatives." Departmental baselines will be reduced by R26.4bn in 2018/19, R28.8bn in 2019/20 and R30.5bn in 2020/21 (see figure 15).

Figure 15: Baseline reductions by sphere of government, before funding fee-free

R million	2018/19	2019/20	2020/21	MTEF total	% of baseline
National government	**-18 048**	**-17 221**	**-18 177**	**-53 446**	**-2.1%**
Goods and services	-5 165	-5 525	-5 834	-16 523	-7.6%
Transfers to public entities	-10 402	-9 393	-9 917	-29 712	-7.7%
Other national spending items[1]	-2 481	-2 304	-2 427	-7 211	-1.1%
Provincial government	**-5 182**	**-6 387**	**-6 797**	**-18 366**	**-1.0%**
Provincial equitable share	-1 437	-1 584	-1 684	-4 705	-0.3%
Provincial conditional grants	-3 745	-4 803	-5 113	-13 661	-0.9%
Local government	**-3 152**	**-5 212**	**-5 499**	**-13 863**	**-3.5%**
Local government conditional grants	-3 152	-5 212	-5 499	-13 863	-9.3%
Total baseline reductions	**-26 382**	**-28 820**	**-30 473**	**-85 676**	**-1.8%**

Source: National Treasury

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Figure 16: Social grants

	2017/18 Revised estimate	2018/19	2019/20	2020/21	Percentage of total MTEF	Average annual MTEF growth
		Medium-term estimates				
Social grants as percentage of GDP	*3.2%*	*3.2%*	*3.3%*	*3.3%*		
Social grant beneficiary numbers by grant type (Thousands)						
Child support	12 239	12 402	12 631	12 815	70.7%	1.5%
Old age[1]	3 392	3 513	3 627	3 741	20.3%	3.3%
Disability	1 057	1 050	1 041	1 034	5.8%	-0.7%
Foster care	400	398	394	391	2.2%	-0.8%
Care dependency	149	154	160	165	0.9%	3.5%
Total	**17 237**	**17 517**	**17 853**	**18 146**	**100.0%**	**1.7%**

Source: National Treasury

Additions to 2018/19 government spending include:

- **R12.4bn for fee-free higher education**

Treasury has allocated a total of R57bn to fee free education; R12.4bn in 2018/19, R20.3bn in 2019/20 and R24.3mn in 2020/21.

- **R4.2bn for the national health insurance**

The medical tax credit has been earmarked for the funding of the NHI.

- **R2.6bn for social grants**

Social grants will increase by more than inflation to compensate low-income households for the effects of the VAT increase.

- **R6.0bn for drought relief**

Assistance will be extended to several provinces, to the water sector and public investment projects.

- **R8bn for the contingency reserve**

Treasury will allocate a total of R26bn over the medium term to the contingency reserve which has been depleted in prior years to fund above inflation increases in government employee compensation and increased university subsidies. Historically, SA's contingency reserve was used for natural disasters and global economic shocks.

Table 17: Expenditure ceiling

R million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
2016 Budget Review	1 076 705	1 152 833	1 240 086	1 339 422		
2016 MTBPS	1 074 992	1 144 353	1 229 742	1 323 465	1 435 314	
2017 Budget Review	1 074 970	1 144 225	1 229 823	1 323 553	1 435 408	
2017 MTBPS	1 074 970	1 141 978	1 233 722	1 316 553	1 420 408	1 524 222
2018 Budget Review	1 074 970	1 141 978	1 232 678	1 315 002	1 416 597	1 523 762

Source: National Treasury

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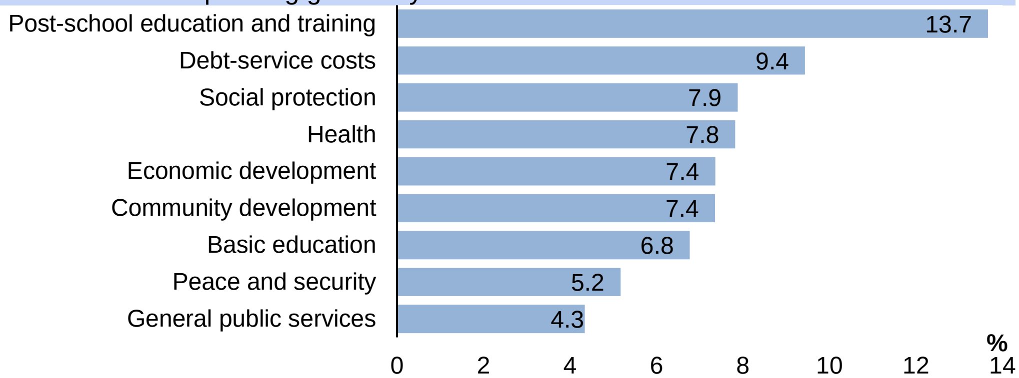
Figure 18: Nominal spending growth by function over MTEF



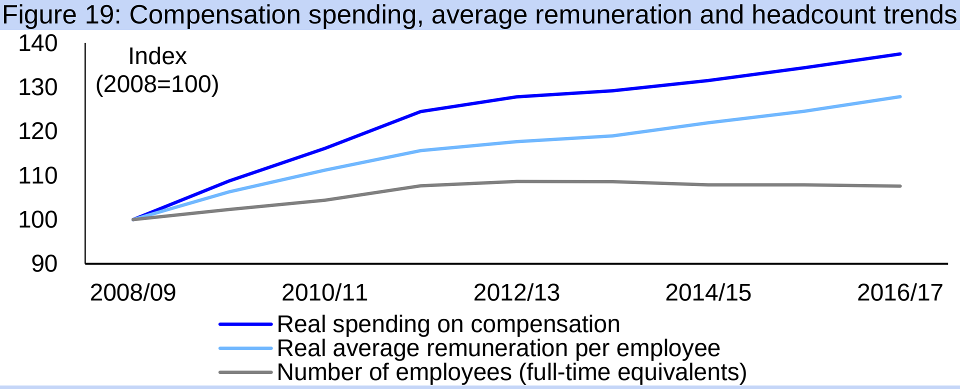
Source: National Treasury

Taking into account the expenditure reductions and the spending allocations yields a reduction in the expenditure ceiling, which places a limit on main budget non-interest spending, by R5.8bn over the medium term (see figure **17**). However, the 2017/18 expenditure ceiling will be breached by R2.9bn owing to government bailouts of South African Airways (SAA) and the South African Post Office (SAPO). The combined allocation to SAA and SAPO totaled R13.7bn. However, this amount was partially offset by a projected underspending and a drawdown of the contingency reserve which adjusts the effect of the bailouts on expenditure to R2.9bn

Consolidated expenditure is expected to grow at 7.6% over the medium term period. Following the fee-free allocations, growth in expenditure on tertiary education has surpassed debt-service costs as the fastest growing expenditure item, at 13.7% (see figure **18**). Debt servicing costs continue to absorb a large proportion, of 11.0%, of overall expenditure.

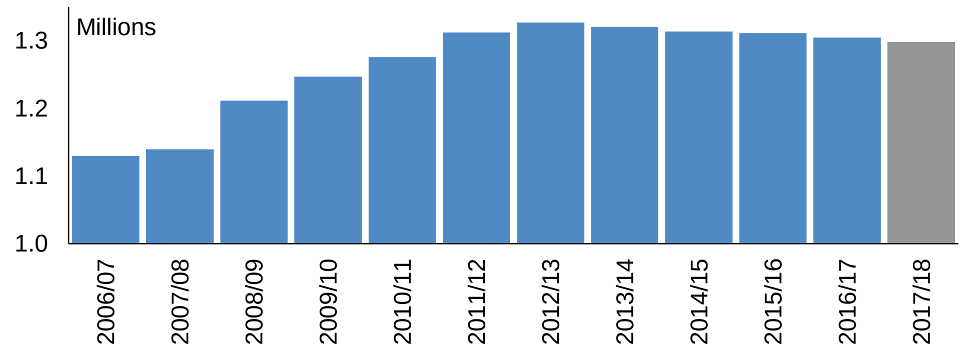
Spending on social protection is envisaged to rise by 7.9% over the medium term framework. Social grants account for 13.0% of total government spending over the medium term period. The social protection budget has been increased by R46.0bn over the medium term framework to account for above-inflation adjustments and the expected increase in the number of beneficiaries. The number of beneficiaries is expected to increase from the current 16.97 million to 18.1 million by 2019/20 (see figure **16**).

Figure 19: Compensation spending, average remuneration and headcount trends



Source: 2017 MTBPS National Treasury

Figure 20: Total public-service employment



Source: 2017 MTBPS National Treasury

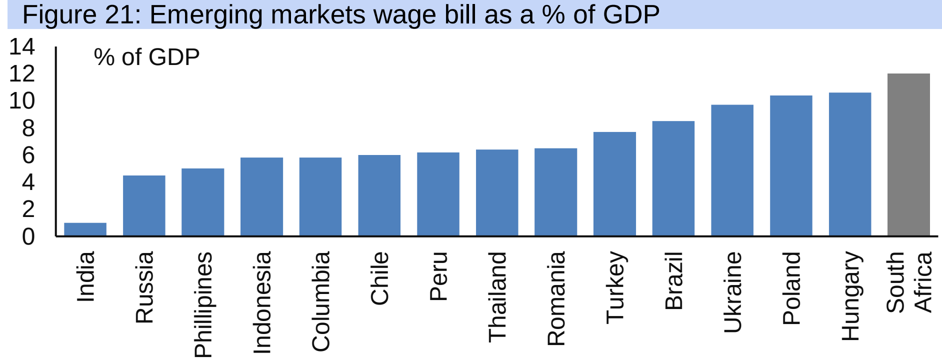
The wage bill comprises the largest share of current expenditure, at an expected 35.2% over the medium term, on account of both an expansion of civil servant headcounts and high average wages (see figure 19). The 2018 Budget assumes the wage bill to increase at a nominal annual average of 7.3% over the medium-term framework. This assumption could be subject to change depending on the outcome of the wage negotiations when the prevailing wage agreement expires on March 2018. Should the wage settlement again exceed inflation it is likely that the composition of expenditure will be altered so as not to affect overall expenditure.

Treasury noted that the public-service wage bill has crowded out spending in other areas, particularly in capital investment. The 2018 Budget acknowledged the need to enhance the efficiency of spending by shifting “spending away from consumption towards capital investment”.

In 2016/17, the government’s borrowing requirement (main budget deficit and redemptions) will amount to R224.2bn and is expected to increase to R282.3bn by 2020/21. The borrowing requirement will continue to be financed mainly through the issuance of domestic short and long term loans. The bulk of the issuance will be concentrated in bonds with longer maturities of an estimated R191bn in 2018/19.

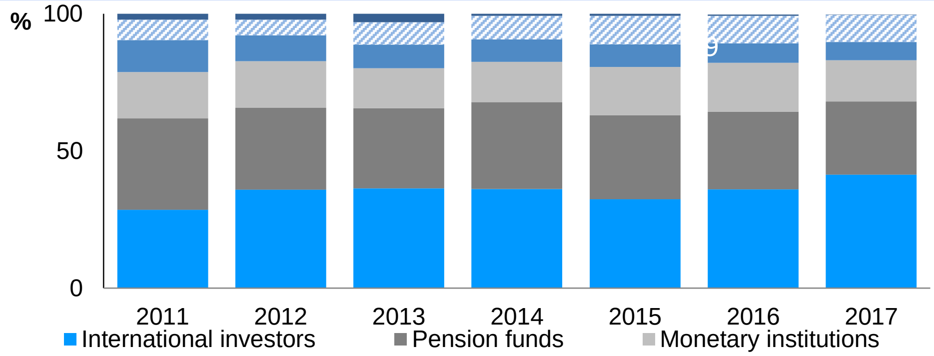
Issuance in global capital markets is forecast to be in the order of US$3bn per year over the medium term, compared to US$2bn per year in the 2017 Budget. Treasury noted that “(p)reviously, government had borrowed in the domestic market to buy foreign currency, as well as borrowing directly in foreign capital markets. Over the period ahead, government will not borrow in the domestic market to fund such commitments.”

Figure 21: Emerging markets wage bill as a % of GDP



Source: IMF

Figure 22: Ownership of domestic government bonds



Source: National Treasury

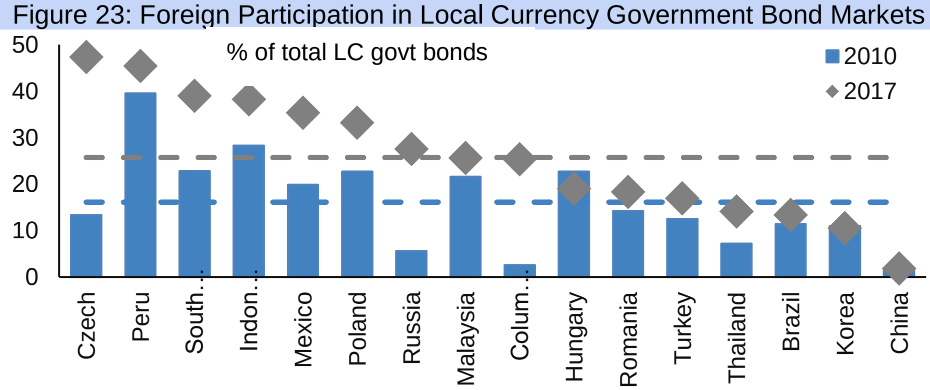
The government's exposure to foreign currency denominated debt remains relatively limited in the region of 10% of total gross debt. In terms of the holdings of government debt instruments, foreign investors hold a relatively large portion of SA government debt. Foreign investor holdings have risen from 21.8% in 2010 to 41.4% in 2017 (see figure 22).

Across the emerging market spectrum, foreign participation in local currency bond markets has risen substantially, supported by risk appetite and the positive momentum in global growth and trade (see figure 23). The increase in foreign participation does however render emerging markets more vulnerable to sudden shifts in investor sentiment.

The 2018 Budget identifies the main risks to the fiscal position as "uncertainty in the growth forecast, contingent liabilities of state-owned companies and the public-service compensation budget".

Government contingent liabilities have risen since 2008/09, reflecting the deterioration in the balance sheet position of several SOEs and the absence of structural reform in governance and management of SOEs. In the 2018 State of the Nation Address, President Rampahosa pledged to "intervene decisively to stabilise and revitalise state owned enterprises." It is encouraging that new boards have been installed at Eskom and SAA and that government is looking to render the guarantee framework more stringent. However, the concerns surrounding rising SOE debt still need to be addressed.

Figure 23: Foreign Participation in Local Currency Government Bond Markets



Source: IIF

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http://www.investec.co.za/research-and-insights/economy/economic-research-v1.html •

Table 24: Government guarantee exposure

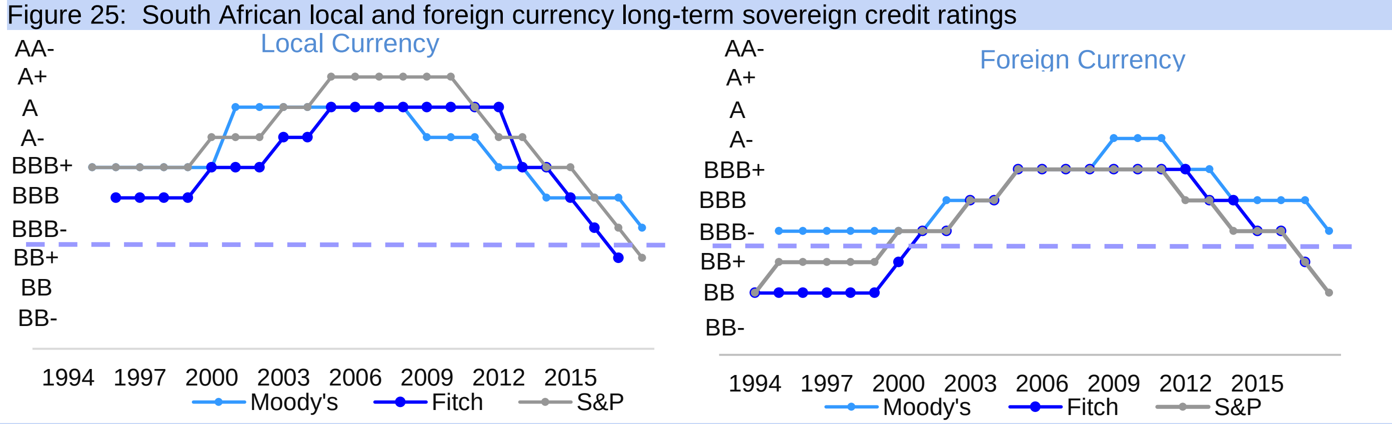
	2015/16		2016/17		2017/18	
R billion	**Guarantee**	**Exposure**	**Guarantee**	**Exposure[2]**	**Guarantee**	**Exposure**
Public institutions	**469.9**	**255.8**	**475.7**	**290.4**	**466.0**	**300.4**
of which:						
Eskom	350.0	174.6	350.0	202.8	350.0	220.8
SANRAL	38.9	27.2	38.9	29.4	38.9	30.1
Trans-Caledon Tunnel Authority	25.8	21.2	25.6	20.9	25.7	18.7
South African Airways	14.4	14.4	19.1	17.8	19.1	11.8
Land and Agricultural Bank of South Africa	6.6	5.3	11.1	3.8	9.6	6.6
Development Bank of Southern Africa	13.9	4.4	12.5	4.1	12.3	4.2
South African Post Office	4.4	1.3	4.4	4.0	0.4	0.4
Transnet	3.5	3.8	3.5	3.8	3.5	3.8
Denel	1.9	1.9	1.9	1.9	2.4	2.3
South African Express	1.1	0.5	1.1	0.8	0.8	0.8
Industrial Development Corporation	2.0	0.2	0.4	0.2	0.5	0.1
South African Reserve Bank	3.0	–	3.0	–	–	–
Independent power producers	**200.2**	**114.0**	**200.2**	**125.8**	**200.2**	**122.2**
Public-private partnerships	**10.3**	**10.3**	**10.0**	**10.0**	**9.6**	**9.6**

Source: National Treasury

The total guarantees to SOEs amount to R466.0bn in 2017/18 (see figure **24**). Of this the government's guarantee exposure (portion of the guarantees that SOEs have borrowed against) amounts to R300.4bn. The largest guarantee exposure of R220.8bn is to Eskom. In the event of default by an SOE, the government may be called upon to fund the portion of the guarantees it has exposure to. Treasury noted that "(g)overnemnt is committed to reducing guarantees as part of its efforts to maintain prudent levels of liabilities".

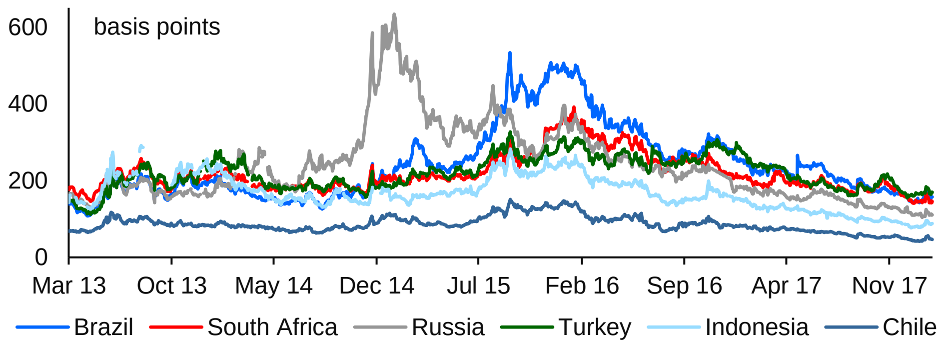
The perceived policy inaction in prior years, subdued economic growth and weakening fiscal metrics led to a steady deterioration in SA's credit fundamentals. Presently, SA's local and foreign currency credit ratings with Fitch and S&P are non-investment grade whilst its rating with Moody's is one notch above non-investment grade but on review for a downgrade (see figure **25**). Moody's noted that this review would assess the "size and the composition of the 2018 budget."

Figure 25: South African local and foreign currency long-term sovereign credit ratings



Sources: Rating Agencies

Figure 26: 5yr CDS spread

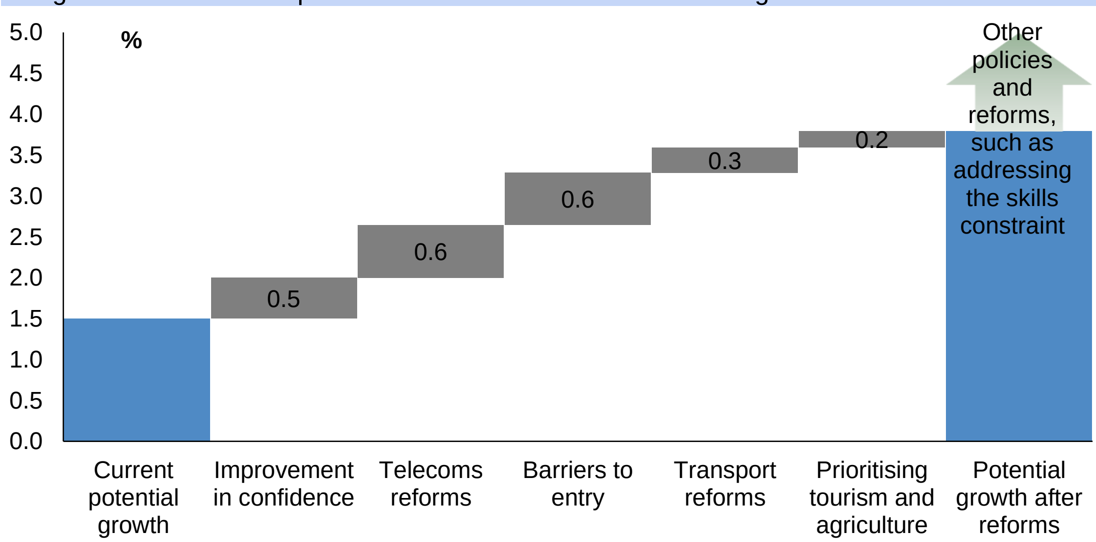


Source: Bloomberg

The efforts of the moderate fiscal consolidation outlined in the 2018 Budget are likely to be deemed as sufficient to avert a Moody's downgrade. Indeed, market perceptions are of a lower possibility of a Moody's downgrade and therefore likely avoidance of the consequent exclusion from the World Government Bond Index (WGBI), which could result in outflows of as much as R200bn. Specifically, the market risk measure of the 5 year credit default swap (CDS) spread has narrowed to 142bp presently compared to levels closer to 200bp prior to the ANC December elective conference. SA's CDS spread has also moved away from the spreads of emerging market peers, such as Turkey, which are already rated non-investment grade (see figure 26).

However, averting further credit rating downgrades over the longer-term will require a sustained economic growth recovery to 3.0% and beyond. In a persistently weak growth environment, accomplishing fiscal consolidation will be difficult. Effective policy implementation and the enhancement of policy certainty are required to restore business confidence and enhance the investment climate which would ultimately lift potential GDP growth. The 2018 Budget estimates that effective implementation of structural reforms could increase potential growth from 1.5% presently to nearly 4.0% (see figure 27).

Figure 27: Potential impact of selected NDP reforms on GDP growth



Source: National Treasury

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