BUDGET SPEECH EDITION

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SMART INVESTOR

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Pulling the proverbial

Rabbit out of a Hat

Touted as the most important budget speech in 20 years, Minister of Finance Tito Mboweni's pro-consumer address to the nation was met with a mixture of surprise and positivity.

On the backdrop of sluggish economic growth, rampant unemployment and a fixation on our SOE resource drainage, this year's budget speech was no easy task for our Minister. Coupled with a Moody's downgrade lurking in the background, economists held their breath as Mboweni layed out his plans for the nation.

The national sigh of relief was acutely evident within two hours of his speech – the Rand rose strongly against the US Dollar and consumer-facing listed companies saw their share prices rallying by as much as 10%.

In this edition of Smart Investor, NMG Benefits will unpack some of the key outcomes of the 2020|2021 budget speech. In particular, we will provide insight into the effect that the announcement will have on the employee benefits environment.

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Pre-budget predictions

How accurate were they?

In the days leading up to the budget speech, the press was in full steam with predictions of the announcements that would be made in Mboweni's address.

Here are some of the top trending predictions – we take a look at how they panned out.

Possible increase in the VAT rate	X
No changes to corporate income tax rate	✓
No changes to estate duty & donations tax	✓
Possible increase in excise duty	✓

Possible increase in fuel and RAF levy	✓
Possible increase in CGT	X
No increase to medical tax credits	X
No changes to transfer duty	X

Budget overview

From an investment perspective, this budget is short-term positive. But we will have to see how the implementation of policies and plans are executed before we see any long-term improvement in what South Africa looks like as an investment destination for foreign investors.

For South Africa in general, this is a positive budget. Small business will benefit from a range of stimulus measures – including reducing data costs, improving connectivity infrastructure, and reducing red tape to encourage small businesses to participate in the formal economy.

Despite the positives, will this budget be enough to provide a stay in execution off what many have seen as the inevitable Moody's downgrade? Will the downgrade be pushed back until later in 2020 or even 2021? Time will tell.

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Tito's plant of choice

The Aloe Ferox

Bringing a plant to the Budget Speech has now been cemented as synonymous for Tito Mboweni. This year his choice of plant was the Aloe Ferox, which he explained as follows:

> *"The Aloe Ferox survives and thrives when times are tough. It actually prefers less water. It wins even when it seems the odds are against it… Our economy has won before, and it will win again."*

THE R160BN QUESTION

Arguably the most contentious segment of the Budget Speech lies in the promise of R160 billion from the wage bill, seen by many as a strong ask considering the union environment in South Africa.

Seen by many as a declaration of war against the unions – with some experts alluding to a "Margaret Thatcher moment" – it is clear that Mboweni will have to convince the unions that the notion is in the best interests of the nation.

The proof of the pudding will be in the eating and although experts believe that some savings is possible, the likelihood of reaching R160 billion could be a stretch.

> ***"There is a clear shift away from government sector spending, effectively tossing the ball to the private sector"***

Budget deep dive

BROAD OVERVIEW

- **General:**
  - GDP growth expected projection for 2020 of 0.9%, with an average 1% over the next three years
  - Budgeted R1.95 trillion spending over 2020/21
  - Expected 29% revenue and 36% expenditure – gives an overall deficit of 6.8% of GDP.
- **Tax:**
  - No major tax increases
  - The annual contribution limit for tax free investments will be increased from R33,000 to R36,000
  - VAT unchanged
  - Some personal income tax relief through restructuring
  - Corporate tax intended to be restructured & rate lowered over the medium term
  - But….sin taxes increasing:
    - beer/cider 340ml up by 8c
    - wine 750ml up by 14c
    - sparkling wine 750ml up by 61c
    - spirits up by R2.89
    - cigarettes up by 74c
    - vaping and e-cigarettes: 75% of the rate of cigarettes
  - Transfer duty threshold for property adjusted to R1 million or less
  - Exemption of foreign remuneration tax of R1.25 million or less.
- **Petrol price to increase by 25c:**
  - 16c fuel levy increase and 9c to Road Accident Fund.
- **Focus on combatting climate change:**
  - Increase in plastic bag levy by 13c to 25c
  - Carbon tax to generate R1.75 billion.
- **Focus on fiscal reductions:**
  - Wage bill reduction of R160 billion over the medium-term by slowdown of hiring
  - Reduction of high government building leases
  - Reduction in cellphone allowance and economy class travel for cabinet
  - Proposed new bill for framework over public entities and SOEs to limit excessive salaries and bonuses.
- **Government Expenditure:**
  - Top 3 areas of expenditure:
    - Learning and Culture – R396 billion
    - Healthcare – R230 billion
    - Social Development – R310 billion
  - Increased expenditure on safety and security – R217 billion
  - Increase in social grants between R20-R80 per month.
- **SOE Expenditure:**
  - Stabilising of electricity supply is critical and a major focus: therefore R230 billion over the next 10 years to restructure the energy sector
  - R16.4 billion will be allocated to SAA to settle guaranteed debt.

Budget deep dive

IN-DEPTH COMMENTARY

Employment

National Treasury observes that job creation and wage growth are not easily achievable in the context of low economic growth. In 2019, just 11.3 million people had formal, non-agricultural jobs. Annual private sector wage growth per worker was just 2.4% in the first nine months of 2019, compared with public-sector wage growth of 7.2%.

Income tax collections from individuals have been affected by "sluggish employment and wage growth".

The Budget Review notes that public service compensation has grown by about 40% in real terms over the past twelve years, thus remuneration growth is increasingly out of line with the rest of the economy. The 2019 Budget announced wage bill measures amounting to R27 billion. These measures included provision for early retirement by certain public servants. National Treasury notes that take-up of the early retirement initiative has been slower than they anticipated, with only one department finalising implementation during 2019/2020. Other departments have submitted proposals which still need to be processed.

Tax-free savings accounts

National Treasury propose increasing the annual contribution limit to tax-free savings accounts by R3,000 – from R33,000 to R36,000 – on 1 March 2020.

Emigration and retirement funds

Persons are currently able to withdraw funds from their pension preservation fund, provident preservation fund and retirement annuity fund upon emigrating for exchange control purposes through the Reserve Bank. As a result of the exchange control announcements in the Budget, the concept of emigration as recognised by the Reserve Bank will be phased out. Thus, Treasury is proposing that the trigger for individuals to withdraw from these funds needs be reviewed. Any resulting amendments will come into effect on 1 March 2021. We will have to wait and see what this proposal entails.

Budget deep dive

IN-DEPTH COMMENTARY

National Health Insurance (NHI)

National Treasury states that *Parliament is considering the NHI Bill and that its enactment is expected to trigger large-scale reforms*.

As can be seen from the Budget, Government appears to be slowing down in the short term on NHI, with a reduction in the overall health budget and allowing for rollout of NHI over a longer period of time.

National Treasury also stated that a team convened by the Presidency has developed a National Quality Health Improvement Plan, which aims to improve the quality of healthcare facilities to ensure that they can be accredited for NHI.

Medical tax credits

Contrary to expectations, and after last years' freeze, there was a small increase of 2.8% in medical tax credits in 2020/2021 announced in the Budget from R310 to R319 per month for the first two beneficiaries and from R209 to R215 per month for the remaining beneficiaries.

Personal Taxes

The main tax proposals include welcome personal income tax relief through above-inflation adjustments in all brackets. The personal income tax brackets and the primary, secondary and tertiary rebates will be increased by 5.2% for 2020/21.

Explaining the rationale for this change, Treasury states that:

"Growth in wages, consumption and business profitability has stagnated in recent years, lowering tax receipts for personal income tax, value-added tax and corporate income tax, which make up more than 80% of total tax revenue. In this context, substantial tax increases are unlikely to be effective. South Africa already has a relatively high tax-to-GDP ratio compared with other countries at a similar level of development. New tax increases at this time could harm the economy's ability to recover. Consequently, government will not raise additional revenue from tax proposals for 2020/21".

In a welcome move for South African residents working offshore, the foreign earnings exemption (which was due to be capped at R1 million from 1 March 2020) will be increased to R1,25 million from 1 March 2020.

Budget deep dive

IN-DEPTH COMMENTARY

Social grants

The 2020 Budget continues with the trend of increasing social grants in line with inflation:

- R80 increase for the old age, disability and care dependency grants to R1,860 per month
- R80 increase in the war veterans grant to R1,880
- R40 increase for the foster care grant to R1,040 per month
- The child support grant will increase by R20 to R445 per month.

Government estimates it will provide access to early childhood development services to almost 700,000 children under the age of four. More than 18 million people receive a social grant in South Africa, which will be increased in the new financial year.

Minister Mboweni stated that *"changing the way we provide social grants has generated about R1 billion per annum in efficiency savings, which will be partly used to raise the daily subsidy per child".*

Lowering the corporate tax rate

In an unexpected move, Treasury exhibited an intention to lower the corporate income tax rate. Treasury points out that, as opposed to other countries, South Africa's corporate income tax rate has remained unchanged at 28% for more than a decade. India, the United States and the United Kingdom have all recently reduced their corporate income tax rates below 28%. Treasury believes that reducing the corporate income tax rate will encourage businesses to invest and expand production, improve the country's competitiveness as an investment destination, and reduce the appeal of base erosion and profit shifting.

Fuel levy

To adjust for inflation, the fuel levy goes up by 25 cents per litre, consisting of 16 cents for the general fuel levy and 9 cents for the Road Accident Fund levy. Despite this increase, the liabilities of the RAF are forecast to exceed R600 billion by 2022/23.

*The information contained in this edition of Smart Investor was compiled by **Megan Bellinger & Wesley Turner-Dauncey** - Associate Consultants | NMG Actuarial & Specialist Consulting*

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