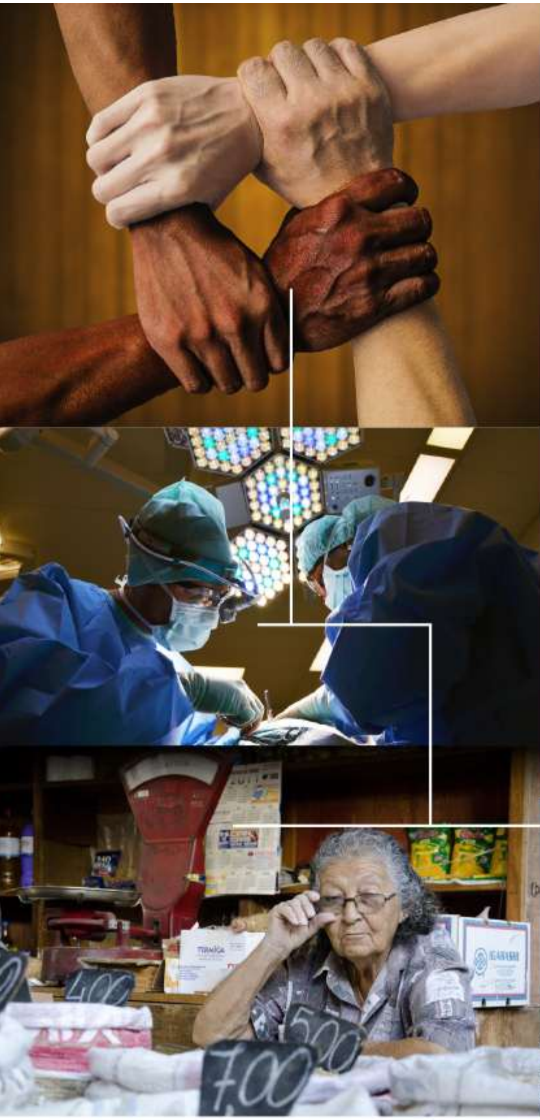

BUDGET 2017

TRANSFORMATION FOR INCLUSIVE GROWTH

February 2017

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National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

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1. Key highlights

South African realities

- Income growth has been uneven - the bottom 20 per cent have benefited from social grants and better access to services, the top 20 per cent have benefited from the rising demand for skills and pay increases. Those in the middle have been left behind.
- Wealth remains highly concentrated – 95 per cent of wealth is in the hands of 10 per cent of the population.
- 35 per cent of the labour force are unemployed or have given up hope of finding work.
- Despite our progress in education, over half of all children in Grade 5 cannot yet read adequately in any language.
- More than half of all school-leavers each year enter the labour market without a senior certificate pass. 75 per cent of these will still be unemployed five years later.
- Our towns and cities remain divided and poverty is concentrated in townships and rural areas.
- Our growth has been too slow – just 1 per cent a year in real per capita terms over the past 25 years, well below that of countries such as Brazil, Turkey, Indonesia, India or China.

Stronger and more inclusive growth is required

- The projected rate of economic growth is insufficient to reduce unemployment, inequality and poverty.
- The budget is highly redistributive, but stronger economic growth is needed to sustain the fiscal position.
- Moving to a path of stronger and more inclusive growth requires:
  - Transforming patterns of asset ownership and production, promoting competition and de-concentrating product markets.
  - Mobilising private and public capital investment in tandem to help modernise and diversify the economy.
  - Providing workers and the poor with access to markets, and social and economic infrastructure.
  - Strengthening transparent government and the rule of law.
  - Investing in research and development, and innovation.
  - Improving the quality of education and training to meet the needs of a modern economy.

2. Macro economic developments

Global growth is projected to accelerate…

IMF growth projections

Region/country Percentage	GDP projections 2015	2016	2017	2018
World	**3.2**	**3.1**	**3.4**	**3.6**
Advanced economies	**2.1**	**1.6**	**1.9**	**2.0**
United States	2.6	1.6	2.3	2.5
Euro area	2.0	1.7	1.6	1.6
United Kingdom	2.2	2.0	1.5	1.4
Japan	1.2	0.9	0.8	0.5
Emerging markets and developing economies	**4.1**	**4.1**	**4.5**	**4.8**
Brazil	-3.8	-3.5	0.2	1.5
Russia	-3.7	-0.6	1.1	1.2
India	7.6	6.6	7.2	7.7
China	6.9	6.7	6.5	6.0
Sub-Saharan Africa	**3.4**	**1.6**	**2.8**	**3.7**

IMF World Economic Outlook Update, January 2017

- The world economy is projected to grow by 3.4 per cent in 2017 and 3.6 per cent in 2018.
- Growth in advanced economies is projected to remain around 2 per cent over the medium term, but this is premised on the introduction and success of a fiscal stimulus in the US.
- Developing economies are expected to remain the main contributors to higher global growth in 2017 and 2018. Growth in India is projected to remain above 7 per cent, and Chinese growth is forecast to decelerate but remain above 6 per cent.
- The outlook for sub-Saharan Africa is expected to improve next year.

South Africa's economic growth will increase moderately

- Economic growth is forecast to improve moderately on the strength of several developments:
  - The real exchange rate has depreciated, boosting competitiveness
  - An uptick in commodity prices is expected to carry through into 2017
  - The severe drought has eased in several farming regions
  - Electricity supply has stabilised
  - Improved labour relations are expected to boost job creation.

Macroeconomic projections

Calendar year	2013	2014	2015	2016	2017	2018	2019
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	2.0	0.7	1.7	0.9	1.3	2.0	2.3
Final government consumption	3.8	1.8	0.2	1.4	0.9	0.0	0.4
Gross fixed-capital formation	7.0	1.5	2.5	-3.6	1.5	1.6	2.8
Gross domestic expenditure	2.8	0.5	1.7	-0.3	1.3	1.8	2.2
Exports	3.6	3.3	4.1	-1.2	1.9	4.9	5.0
Imports	5.0	-0.5	5.3	-3.6	2.0	4.3	4.9
Real GDP growth	**2.3**	**1.6**	**1.3**	**0.5**	**1.3**	**2.0**	**2.2**
GDP inflation	6.6	5.7	4.0	7.2	6.4	5.9	5.8
GDP at current prices (R billion)	**3 549.2**	**3 812.6**	**4 013.6**	**4 322.3**	**4 657.5**	**5 029.9**	**5 440.6**
CPI inflation	5.8	6.1	4.6	6.4	6.4	5.7	5.6
Current account balance (% of GDP)	-5.9	-5.3	-4.3	-4.0	-3.9	-3.7	-3.8

Source: Statistics South Africa

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3. Fiscal Policy

Summary of budget proposals

- Expenditure revised down by R10 billion in 2017/18 and an additional R28 billion will be raised in taxes.
- The budget deficit for 2017/18 will be 3.1 per cent of GDP, in line with government's commitments.
- Government net debt will stabilise at about 50 per cent of GDP over the next three years.
- Main budget non-interest spending ceiling lowered down by R26 billion over the next two years.
- R28 billion in additional tax revenue will be raised in 2017/18, with additional R15 billion planned for 2018/19.
- R30 billion has been reprioritised through the budget process to ensure core social spending is protected.
- Real growth in non-interest spending will average 1.9 per cent over next three years.
- New top marginal income tax bracket for individuals earning from R1.5 million upwards expected to raise additional R4.4 billion.
- Higher dividend withholding tax expected to raise additional R6.8 billion.

Consolidated fiscal framework

- Government is committed to a measured path of fiscal consolidation that contains the budget deficit and stabilises public debt.
- The combination of a lower expenditure ceiling and higher taxes will narrow the consolidated budget deficit from an estimated 3.4 per cent of GDP in 2016/17 to 2.6 per cent by 2019/20.

Consolidated fiscal framework

R billion/percentage of GDP	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
		Outcome		Revised estimate		Medium-term estimates	
Revenue	**1 008.1**	**1 098.9**	**1 222.0**	**1 297.3**	**1 414.1**	**1 535.2**	**1 668.5**
	27.8%	*28.4%*	*29.9%*	*29.4%*	*29.8%*	*29.9%*	*30.1%*
Expenditure	**1 143.4**	**1 233.5**	**1 364.2**	**1 445.2**	**1 563.1**	**1 677.1**	**1 814.3**
	31.5%	*31.9%*	*33.4%*	*32.8%*	*33.0%*	*32.7%*	*32.7%*
Non-interest expenditure	*1 033.8*	*1 112.1*	*1 227.9*	*1 291.8*	*1 393.8*	*1 489.5*	*1 608.0*
	28.5%	*28.8%*	*30.0%*	*29.3%*	*29.4%*	*29.0%*	*29.0%*
Interest payments	109.6	121.4	136.3	153.4	169.3	187.6	206.4
	3.0%	*3.1%*	*3.3%*	*3.5%*	*3.6%*	*3.7%*	*3.7%*
Budget balance	**-135.4**	**-134.6**	**-142.2**	**-147.9**	**-149.0**	**-141.9**	**-145.8**
	-3.7%	*-3.5%*	*-3.5%*	*-3.4%*	*-3.1%*	*-2.8%*	*-2.6%*
Primary balance	**-25.8**	**-13.2**	**-5.9**	**5.5**	**20.3**	**45.7**	**60.6**
	-0.7%	*-0.3%*	*-0.1%*	*0.1%*	*0.4%*	*0.9%*	*1.1%*

Source: National Treasury

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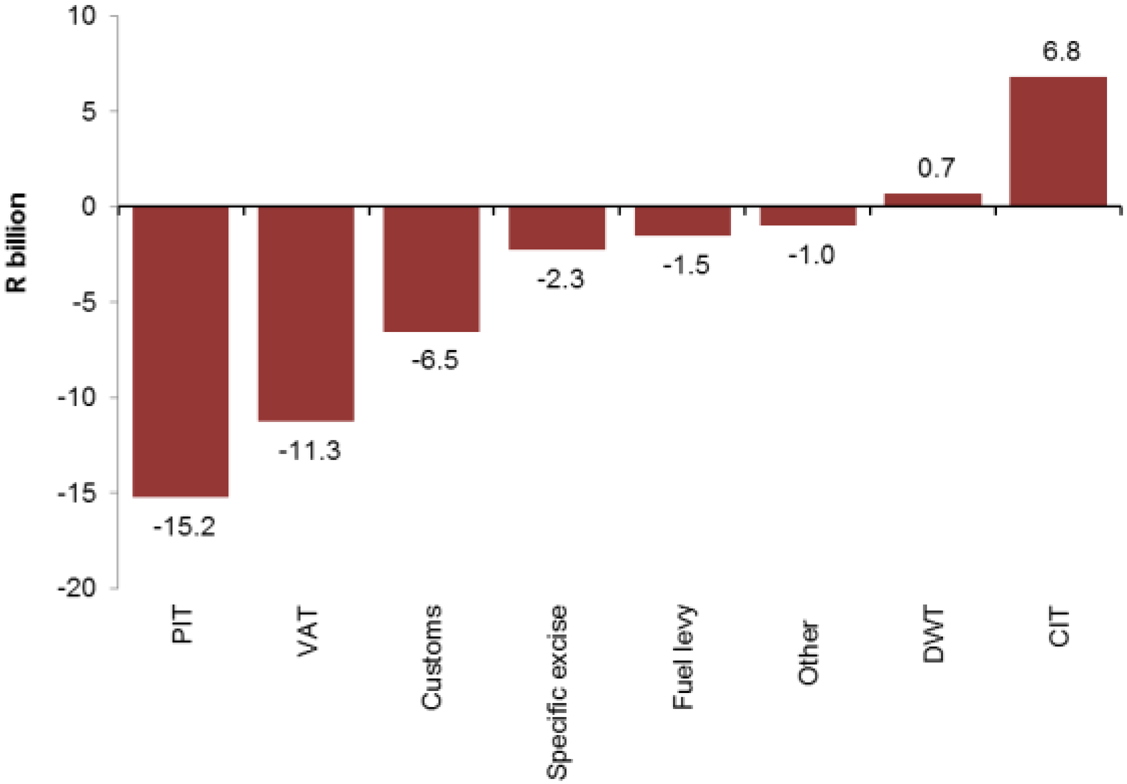
Tax revenue shortfall in 2016/17

Tax performance in 2016/17 relative to Budget 2016 targets



Source: National Treasury

- There is uncertainty regarding the path of revenue collection.
- Risks include weaker-than-expected economic growth, and concerns about tax morality, compliance and administration.

Gross tax revenue for 2016/17 is R30.4 billion lower than the original estimate at the time of 2016 Budget.

- Personal income taxes, customs duties and import VAT are all expected to show large shortfalls, with smaller shortfalls forecast for the fuel levy and specific excise duties.
- Corporate income tax receipts are expected to marginally outperform projections as a result of higher commodity prices and labour stability in the mining sector, along with strong performance in the financial sector.

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Tax proposals to raise additional R28 billion

- A new top personal income tax rate of 45 per cent for those with taxable incomes above R1.5 million.
- An increase in the dividend withholding tax rate from 15 per cent to 20 per cent.
- Limited bracket creep relief, increasing the tax free threshold from R75 000 to R75 750.
- An increase of 30c/litre in the general fuel levy and 9c/litre in the road accident fund levy.
- Increases in the excise duties for alcohol and tobacco, of between 6 per cent and 10 per cent.

Revenue impact of tax proposals

R million	Effect of tax proposals	
Gross tax revenue (before tax proposals)		**1 237 464**
Budget 2017/18 proposals		**28 024**
Taxes on individuals and companies		
Personal income tax	**16 516**	
Revenue from not fully adjusting for inflation	12 148	
Revenue if no adjustment is made	*14 628*	
Bracket creep adjustment	*-2 480*	
New top marginal income tax bracket	4 369	
Dividend withholding tax	**6 822**	
Taxes on property	**-448**	
Indirect taxes	**5 133**	
Gross tax revenue (after tax proposals)		**1 265 488**

Source: National Treasury

NHI fund to be established

- All South Africans should have equitable access to quality, affordable healthcare.
- During 2017/18 government intends to establish a national health insurance fund.
- Its initial focus will be to expand access to a common set of maternal health services and make hearing aids and spectacles available through school health programmes.
- It will offer improved psychiatric care, and services for people with disabilities and the elderly.
- The service package, delivered through public and private medical practitioners, will be progressively expanded.
- The fund will be established through a combination of reorganisation and legislative amendments.
- Government is exploring a small reduction in the tax credit on medical scheme contributions to provide initial resources for the fund.
- During 2017/18, the National Treasury and the Department of Health will work with a wide range of stakeholders to publish the final national health insurance white paper, refine the draft implementation plan and revise cost estimates.

4. Financing of borrowing requirement

Government gross borrowing requirement and financing edging up over the medium-term

Financing of national government borrowing requirement, 2015/16 – 2019/20

R million	2015/16 Outcome	2016/17 Budget	2016/17 Revised	2017/18 Medium-term estimates	2018/19 Medium-term estimates	2019/20 Medium-term estimates
Main budget balance[2]	**-168 389**	**-156 342**	**-170 532**	**-166 798**	**-171 153**	**-180 678**
Redemptions	**-32 023**	**-73 194**	**-72 912**	**-54 078**	**-53 008**	**-103 763**
Domestic long-term loans[3]	-28 144	-57 800	-57 222	-49 514	-50 622	-55 634
Foreign loans[3]	-3 879	-15 394	-15 690	-4 564	-2 386	-48 129
Total	**-200 412**	**-229 536**	**-243 444**	**-220 876**	**-224 161**	**-284 441**
Financing						
Domestic short-term loans	**13 075**	**25 000**	**41 000**	**21 000**	**21 500**	**22 000**
Treasury bills[4]	7 252	25 000	41 000	21 000	21 500	22 000
Corporation for Public Deposits	5 823	–	–	–	–	–
Domestic long-term loans	**174 316**	**174 000**	**173 132**	**191 500**	**195 000**	**197 000**
Market loans	176 795	174 000	174 000	191 500	195 000	197 000
Loans issued for switches	-2 479	–	-868	–	–	–
Foreign loans	**–**	**23 205**	**52 069**	**29 600**	**30 400**	**31 060**
Market loans	–	23 205	50 958	29 600	30 400	31 060
Loans issued for switches	–	–	1 111	–	–	–
Change in cash and other balance	**13 021**	**7 331**	**-22 757**	**-21 224**	**-22 739**	**34 381**
Cash balances	11 698	3 230	-29 179	-25 443	-27 077	30 102
Other balances[6]	1 323	4 101	6 422	4 219	4 338	4 279
Total	**200 412**	**229 536**	**243 444**	**220 876**	**224 161**	**284 441**

1. A longer time series is presented in Table 1 of the statistical annexure at the back of the Budget Review

2. A negative number reflects a deficit

3. Net of loans issued and redeemed in switch transactions

4. Treasury bills are disclosed on a net basis (gross issuance less redemptions)

5. A negative value indicates an increase in cash and other balances. A positive value indicates that cash is used to finance part of the borrowing requirement

6. Net movement in national departments' bank balances due to differences between funds requested and actual cash flows

Source: National Treasury

Portfolio risk benchmarks show that composition of government debt remains sustainable

Benchmark indicators as at 31 January 2017

Benchmark Indicators	Range or limit		
	Benchmark	March 2016	January 2017
Share of short-term debt maturing in 12 months (Treasury bills) as a percentage of total domestic debt (%)	15	11.78	12.98
Share of long-term debt maturing in 5 years as a percentage of fixed rate bonds and inflation linked bonds (%)	25	18.60	12.57
Share of inflation-linked bonds as a percentage of total domestic debt (%)	20-25	22.96	22.20
Share of foreign debt as a percentage of total government debt (%)	15	10.08	9.98
Weighted term-to-maturity (fixed-rate bonds and Treasury bills in years)	10-14	12.60	12.85
Weighted term-to-maturity (inflation-linked bonds in years)	14-17	14.89	15.63
Average term-to-maturity (total government debt in years)		14.20	14.92
Average term-to-maturity (foreign debt in years)		8.37	10.63

Source: National Treasury

- All benchmark risk indicators are still within their ranges/limits
  - Short term debt as a percentage of total domestic debt has increased since March 2016 by 1.2 percentage points, albeit within the benchmark limit.
  - This was due to an increase in net T-bill issuance by R15 billion.
- Combination of further switch auction and maturity of R211 has led to reduction in long-term debt maturing within 5 years.
- Composition of foreign debt has remained very stable due to domestic market being funding vehicle of choice.

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Domestic long-term borrowing on track notwithstanding uncertain funding environment

Domestic long-term borrowing, 2016/17

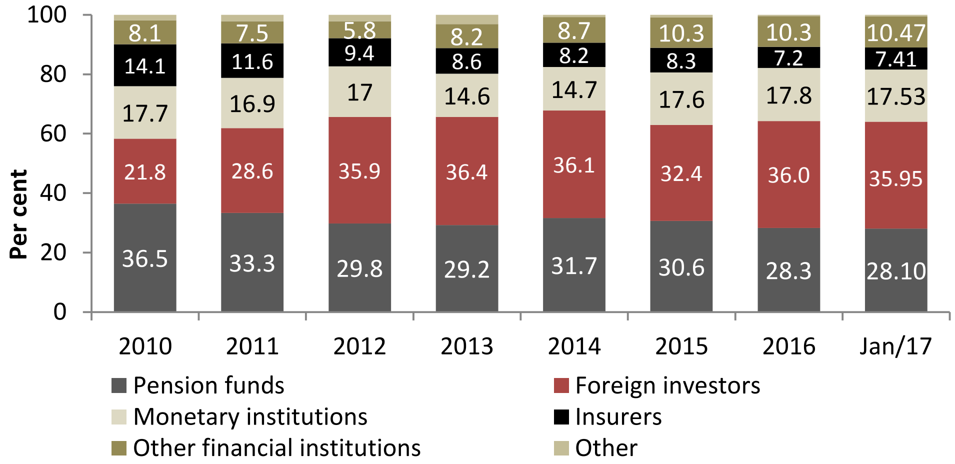
As at 31 January 2017 Bond code (coupon rate; maturity)	Amount (R million)	Average yield (%)	Average bid-to-cover ratio (times)
Fixed-rate bonds	**121 347**	**9.4**	**3.1**
R2023 (7.75%:2023)	3 077	8.7	3.5
R186 (10.5%:2030)	2 926	9.0	4.3
R2030 (8.00%:2026)	4 632	9.5	3.3
R213 (7.00%: 2031)	3 428	9.1	3.3
R2032 (8.25%: 2032)	4 905	9.6	2.9
R2035 (8.875%:2035)	19 316	9.5	2.9
R209 (6.25%:2036)	2 551	9.2	4.4
R2037 (8.50%:2037)	18 130	9.5	3.2
R2040 (9.00%: 2040)	19 100	9.5	2.2
R214 (6.5%:2041)	4 451	9.5	2.3
R2044 (8.75%: 2044)	18 985	9.5	2.7
R2048 (8.75%: 2048)	19 846	9.6	2.9
Inflation-linked bonds	**24 150**	**2.0**	**2.1**
I2025(2.00%:2025)	1 155	2.0	1.9
I2029(1.88%:2029)	5 590	1.9	1.7
I2033(1.88%:2033)	5 935	2.0	2.1
I2046(2.50%:2046)	4 915	1.9	2.7
I2050(2.25%:2050)	6 555	1.9	2.1
Total	**145 497**		

Source: National Treasury

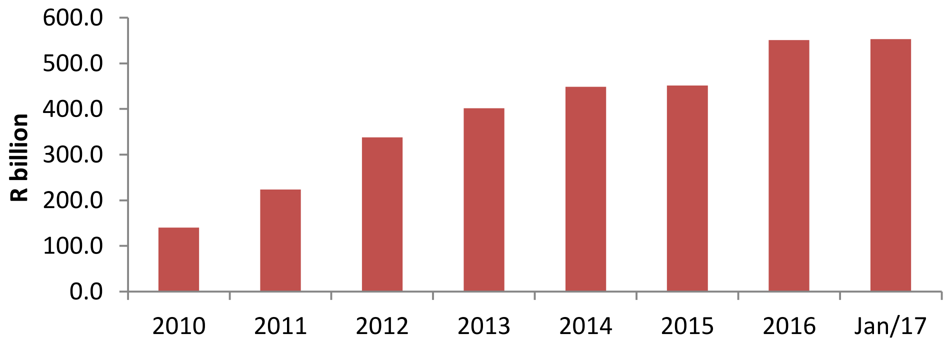
- Total nominal fixed-rate issuance was R121.35 billion
  - This includes 96.78 billion fixed rate primary auctions and R24.57 billion reminder is from non-comps
  - R186 and R2023 bonds were tapped to inject liquidity into these instruments
  - Funding continues to be concentrated in the long end
- Inflation-linked bond issuance achieved notwithstanding uncertainty in auction outcome
  - NT has responded to auction outcome variation by reserving the right to take up more than the indicated R650 million

Strong uptick seen in non-resident holdings as global markets turned ‘risk-on’ in 2016

Holdings of domestic government bonds, 2010 – January 2017



Non-residents domestic government bond holdings, 2010 - 2017



Source: Share Transaction Totally Electronic LTD(Strate)

- Investor flows driven by ‘risk-on’ trades on global political events during the year
  - Outcome from ‘Brexit’ worked in favour of EMs as pound sterling weakened.
  - While US election outcomes reversed some gains.
  - Proportional holdings by non-residents at high of 36 per cent
- Surge in absolute holdings by non-residents closed the year at a high of R550 billion.
  - Risks remain that there could be a reversal of EM flows in 2017.
  - Market will watch US Fed thinking to formulate a view on how to allocate between DMs and Ems.

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5. State-Owned Companies

Improving the performance of state-owned enterprises

- Operational inefficiencies, poor procurement practices, weak corporate governance and failures to abide by fiduciary obligations have plagued several companies that are now in serious financial difficulty.
- Addressing this requires not only stabilisation measures at troubled entities, but a broader restructuring of state-owned companies to ensure they can deliver on their developmental mandates.
- In November 2016, Cabinet:
  - Endorsed a framework to guide collaboration between state-owned companies and the private sector on infrastructure projects.
  - Adopted a guideline for the remuneration and incentive standards for directors of state-owned entities.
  - Approved the broad thrust of a guide for the appointment of boards and executive officers.
  - Recommended further consultation on the first draft of a new government shareholder policy, which will culminate in overarching legislation for state-owned companies.
  - Noted the proposal to determine and cost the developmental mandates of state-owned enterprises.

Guarantee exposure of major state-owned companies

Guarantee exposure to major SOCs and DFIs, 2014/15 – 2016/17

R billion	2014/15		2015/16		2016/17	
Institution	Guarantee	Exposure	Guarantee	Exposure	Guarantee	Exposure
Total	469.6	220.9	469.9	255.8	477.7	308.3
Of which:						
Eskom	350	149.9	350	174.6	350.0	218.2
SANRAL	38.9	27.4	38.9	27.2	38.9	30.1
Denel	1.9	1.9	1.9	1.9	1.9	1.9
Development Bank of Southern Africa	12.9	4.1	13.9	4.4	12.7	4.2
Industrial Development Corporation	1.6	0.3	2.0	0.2	1.9	0.2
Trans-Caledon Tunnel Authority	25.6	20.8	25.8	21.2	25.7	20.7
South African Airways	14.4	8.4	14.4	14.4	19.1	17.9
Transnet	3.5	3.8	3.5	3.8	3.5	3.8
Land and Agricultural Bank of South Africa	6.6	2.1	6.6	5.3	11.1	5.4
South African Post Office	1.9	0.3	4.4	1.3	4.4	3.9
South African Express Airways	1.1	0.5	1.1	0.5	1.1	1.0

Source: National Treasury

- Where funding or guarantees are issued by Government:
  - Public entities must demonstrate sound business plans
  - Public entities will be required to strengthen internal governance and improve operational performance
  - Close monitoring will take place to ensure improved commercial performance

Study on proposed SAA/SAX merger

- Government announced in the 2016 Budget its intention to consider the realignment of its shareholding in the state-owned airlines and the possible introduction of a strategic equity partner
- The consultants will be required to work with and share the recommendations with the airlines, i.e. SAA, SAX, Mango, and Airlink, as well as affected stakeholders
- The purpose of the project is to develop the optimal group corporate structure for the realignment of the state-owned airline assets. The structure to be developed and recommended should:
  - Ensure that the value and impact on the economy from owning and operating the airlines is optimised;
  - Enable improvements in the financial performance and position of the airlines;
  - Optimise the use of capital;
  - Mitigate risks;
  - Provide for sound governance and oversight of the airlines by the state as a shareholder;
  - Facilitate the implementation of a well-coordinated strategy to serve the target markets and customers through realising synergies, efficiencies, and integration of operational activities.

Conclusion

Conclusion

- Broad-based transformation should promote growth, mobilise investment, create jobs and empower citizens. It must create new resources to support social change, including assets and livelihoods for the majority, and strengthen South Africa's constitutional foundations.
- The budget plays a central role in transformation by promoting redistribution and directing scarce resources towards catalytic investments in human and physical capital.
- But the budget depends on the economy to generate the resources to finance these investments, and South Africa has had several years of very low growth.
- The 2017 Budget proposes several difficult trade-offs to safeguard citizens' quality of life, improve the efficiency of spending and ensure that the public finances are sustainable.
- Slow economic growth has placed enormous pressure on the public finances. Government remains committed to a measured, prudent course of fiscal consolidation to narrow the budget deficit and stabilise debt. Doing so will reduce the economy's exposure to global volatility.
- Government, working with business, labour and civil society can act decisively to boost investment and shift the country to a path of transformation for inclusive growth.

Understanding the budget