THE REPUBLIC OF SOUTH AFRICA

Investor Presentation

October 2016

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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1. Key highlights

Summary

- South Africa is undergoing a difficult economic transition. This partly reflects global realities. It is also the result of low levels of investor confidence and structural constraints in the domestic economy.
- To grow faster and generate the revenue necessary to fund government policy objectives, the economy needs higher levels of private investment.
- Government remains committed to working with the private sector, labour and civil society to promote inclusive growth and economic transformation.
- Over the medium term, government intends to sustain real spending per capita. However, the public finances face difficult trade-offs in the years ahead.
- The MTBPS proposes a measured fiscal consolidation, reducing the expenditure ceiling by R10 billion next year and adding R13 billion in revenue measures. Combined with the proposals announced in the 2016 Budget, this brings the total tax increase next year to R28 billion.
- Universities and students will receive an additional R17 billion over the medium term. Post-school education and training budgets are the fastest growing, with university subsidies increasing by 10.9 per cent each year on average and NSFAS allocations growing by 18.5 per cent.
- Government continues to prioritise infrastructure investment to ease bottlenecks and raise the economy's potential growth rate. Public-sector infrastructure budgets are estimated at R987.4 billion over the next three years.

2. Macro economic developments

Weakness and uncertainty in the global economy

Global growth projections

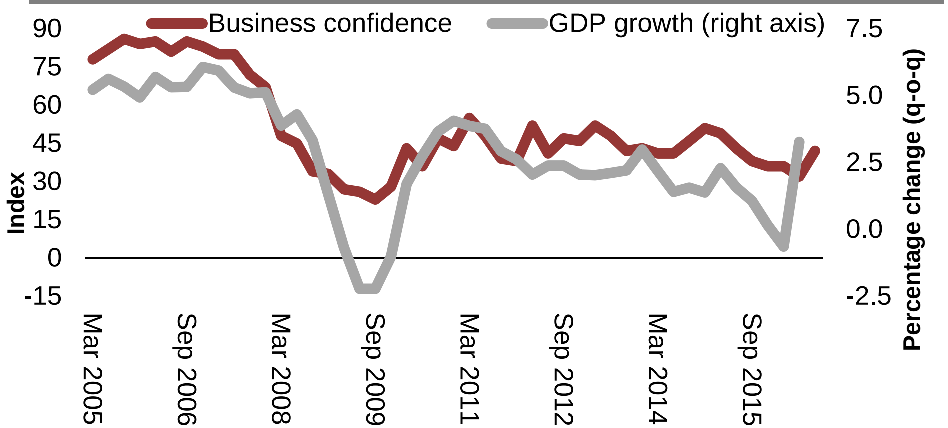
Region / country Percentage	Average 2010 – 2014	GDP growth[1] 2015	2016	2017	Average 2010 – 2014	Average CPI[1] 2015	2016	2017
World	**4.0**	**3.2**	**3.1**	**3.4**	**3.9**	**2.8**	**2.9**	**3.3**
Advanced economies	**1.8**	**2.1**	**1.6**	**1.8**	**1.8**	**0.3**	**0.8**	**1.7**
US	2.1	2.6	1.6	2.2	2.0	0.1	1.2	2.3
Euro area	0.7	2.0	1.7	1.5	1.7	0.0	0.3	1.1
UK	1.9	2.2	1.8	1.1	2.9	0.1	0.7	2.5
Japan	1.5	0.5	0.5	0.6	0.4	0.8	-0.2	0.5
Emerging markets and developing countries	**5.7**	**4.0**	**4.2**	**4.6**	**5.7**	**4.7**	**4.5**	**4.4**
Brazil	3.3	-3.8	-3.3	0.5	5.9	9.0	9.0	5.4
Russia	2.8	-3.7	-0.8	1.1	7.0	15.5	7.2	5.0
India	7.3	7.6	7.6	7.6	8.9	4.9	5.5	5.2
China	8.6	6.9	6.6	6.2	3.2	1.4	2.1	2.3
Sub-Saharan Africa	**5.3**	**3.4**	**1.4**	**2.9**	**7.9**	**7.0**	**11.3**	**10.8**
South Africa[2]	2.5	1.3	0.5	1.3	5.3	4.6	6.4	6.1

Source: IMF, National Treasury

- The recovery from the 2008 crisis remains precarious
- Risks to the global outlook include excessive debt, further deterioration in Chinese growth rates, continued declines in commodity prices and political uncertainty in several major economies
- The outlook for developing economies is mixed: resilience in India and China, a return to moderate growth in Russia and Brazil
- Low interest rates in US, EU and Japan have supported capital inflows to developing economies
- Countries that are highly reliant on foreign savings – including South Africa – will remain vulnerable to global volatility

Low confidence remains the largest obstacle to growth

South Africa: Growth and business confidence



Macroeconomic projections

Calendar year	2013	2014	2015	2016	2017	2018	2019
		Actual		Est		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	2.0	0.7	1.7	0.6	1.3	1.9	2.3
Final government consumption	3.8	1.8	0.2	0.7	0.1	0.0	0.3
Gross fixed capital formation	7.0	1.5	2.5	-2.9	1.1	2.6	3.1
Exports	3.6	3.3	4.1	0.5	3.0	4.7	5.2
Imports	5.0	-0.5	5.3	-2.9	2.7	4.1	4.7
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	6.6	6.0	5.8	5.7
CPI inflation	5.8	6.1	4.6	6.4	6.1	5.9	5.8
Current account balance	-5.9	-5.3	-4.3	-3.9	-3.9	-3.8	-3.8

Source: National Treasury

- South Africa's economic performance reflects low levels of business confidence
- Public investment remains relatively buoyant, but private investment has fallen across all sectors and capital formation is expected to contract in 2016 for the first time since 2010
- Several emerging factors support a recovery:
  - Real exchange has depreciated
  - Moderate rebound in commodity prices
  - Consumer spending improves on lower inflation, wage growth and improving household balance sheets
  - Drought conditions ease
  - Electricity supply improves
  - Investment recovers on low borrowing costs and higher capacity utilisation
  - Public investment sustained

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Key assumptions underlying the forecast

Assumptions underpinning the macroeconomic forecast, 2016- 2019

Percentage change (unless otherwise indicated)	2014	2015	2016	2017	2018	2019
	Outcomes		Projections			
Global growth[1]	4.8	4.1	3.9	4.1	4.3	4.4
Commodity prices[2]						
Brent crude (US$ per barrel)	100	53	43	51	54	56
Gold (US$ per ounce)	1 266	1 160	1 272	1 337	1 352	1 366
Platinum (US$ per ounce)	1 385	1 055	1 015	1 078	1 086	1 093
Iron ore (US$ per ton)	97	55	54	47	42	35
Coal (US$ per ton)	72	57	60	63	62	61
Inflation[3]						
Food inflation	7.6	5.1	10.5	7.5	5.4	5.4
Investment[3]						
Real public corporation investment	0.7	3.5	0.4	0.5	2.1	2.3
Real government investment	8.5	14.6	4.6	5.3	4.2	5.0

Further details of the Fiscal Framework can be found in the technical annexure
Including special appropriations

Source: National Treasury

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3. Fiscal Policy

Two fiscal dilemmas

- **Medium term | Avoiding a low growth trap**
  - Further deterioration of the economy could lead South Africa into a low-growth trap.
  - In this scenario, weak GDP growth produces less tax revenue. Fiscal consolidation that is too aggressive may bolster confidence, but further may also undermine the economy.
  - Taking no action could result in ratings downgrades, capital flight, rapid exchange rate depreciation and a spike in interest rates, resulting in even lower growth outcomes.
  - To avoid this trap, government proposes a balanced consolidation. This needs to be supported by action to rebuild confidence for investment.

- **Long term | Realising the aspirations of the constitution within available resources**
  - The Constitution requires government to pursue a progressive expansion of access to public services within its available resources.
  - To realise these aspirations, South Africa needs to accelerate the pace of economic growth.
  - Proposals have been tabled for a substantial expansion of spending commitments. But if implemented simultaneously, the costs would be incompatible with fiscal sustainability.
  - The limited space available to increase taxation cannot accommodate all of these aims. For now, however, long-term policy aspirations far exceed available resources.
  - Difficult trade-offs are needed to resume the expansion of public resources available for social and economic development.

In-year revenue revised down

Total tax and consolidated budget revenue, 2015/16- 2017/18

R billion	2015/16 Outcome	2016/17 Budget	2016/17 Revised	2016/17 Deviations	2017/18 Estimates
Persons and individuals	388.1	441.0	428.5	-12.5	471.7
Companies	191.2	198.3	200.8	2.5	211.9
Value-added tax	281.1	301.3	293.3	-7.9	315.2
Dividend withholding tax[1]	24.2	25.3	26.1	0.8	27.5
Specific excise duties	35.1	38.0	36.7	-1.3	38.9
Fuel levy	55.6	64.5	64.2	-0.3	68.0
Customs duties	46.3	54.0	51.9	-2.1	57.2
Other	48.5	52.4	50.5	-1.9	54.7
Revenue measures in 2017 Budget	–	–	–	–	28.0
Gross tax revenue	**1 070.0**	**1 174.8**	**1 152.0**	**-22.8**	**1 273.3**
Non-tax revenue	56.3	26.7	31.1	4.5	31.7
of which:					
Mineral royalties	*3.7*	*4.4*	*4.8*	*0.4*	*5.2*
Receipts from financial transactions[2]	*14.4*	*12.2*	*14.7*	*2.5*	*14.6*
Estimate of SACU payments[3]	-51.0	-39.4	-39.4	–	-56.0
Provinces, social security funds and selected public entities	145.7	162.3	157.3	-5.1	167.8
Consolidated budget revenue	**1 220.9**	**1 324.3**	**1 301.0**	**-23.3**	**1 416.9**

1. Includes interest withholding tax from 2015/16 onward

2. Consists mainly of premiums and revaluation profits on debt transactions

3. Southern African Customs Union agreement

Source: National Treasury

- Composition of aggregate demand affecting revenue outcomes (net exports vs domestic demand)
- PIT revisions lower outcomes for the last fiscal year, slower growth in wages and higher outlays on the ETI
- Fall in imports negatively affecting customs duties
- CIT has benefited from higher profitability of export-intensive sectors

Revenue outlook

Tax revenue outcomes, projections and assumptions, 2013/14 – 2019/20

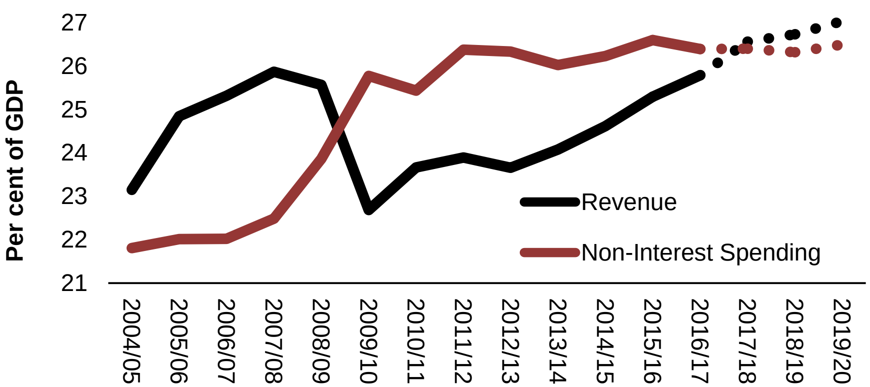
R billion	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
		Outcome		Estimate		Projections	
Personal Income tax	**310**	**353**	**388**	**429**	**472**	**522**	**577**
Wage bill[1]	1 654	1 786	1 931	2 070	2 230	2 411	2 616
Buoyancy	*1.23*	*1.74*	*1.23*	*1.45*	*1.30*	*1.30*	*1.25*
Corporate income tax	**177**	**185**	**191**	**201**	**212**	**225**	**243**
Net operating surplus	1 053	1 072	1 067	1 119	1 181	1 255	1 354
Buoyancy	*1.83*	*2.35*	*-6.89*	*1.03*	*1.00*	*1.00*	*1.00*
Value-added tax	**238**	**261**	**281**	**293**	**315**	**340**	**367**
Final household expenditure	2 179	2 313	2 457	2 608	2 785	2 980	3 197
Buoyancy	*1.36*	*1.62*	*1.22*	*0.71*	*1.10*	*1.10*	*1.10*
Gross tax revenue	**900**	**986**	**1 070**	**1 152**	**1 273**	**1 397**	**1 522**
Nominal GDP	3 624	3 863	4 087	4 381	4 702	5 078	5 490
Buoyancy	*1.17*	*1.46*	*1.47*	*1.07*	*1.43*	*1.22*	*1.10*

1.Remuneration in the formal non- agriculture sector, private and public
Source: National Treasury

- Over the medium term, tax buoyancies of the major taxes (PIT, CIT, VAT) are in line with long-term averages
- The high buoyancy of gross tax revenue in 2017/18 and 2018/19 includes new tax measures

A measured fiscal consolidation

Main budget revenue and non- interest spending



Announced consolidation measures

R billion	2015/16	2016/17	2017/18	2018/19
2015 Budget Review				
Expenditure reductions	10	15	–	–
Revenue increases	17	–	–	–
2016 Budget Review				
Expenditure reductions	–	–	10	15
Revenue increases	–	18	15	15
2016 MTBPS				
Expenditure reductions	–	–	10	16
Revenue increases	–	–	13	–
Total				
Expenditure reductions	10	15	20	31
Revenue increases	17	18	28	15
Total	**27**	**33**	**48**	**46**

Source: National Treasury

- To create the conditions for more rapid growth, fiscal policy aims to deliver a measured consolidation that avoids a sharp contraction in expenditure, continues to prioritise capital investment and stabilises national debt as a share of GDP.
- Government proposes:
  - Reductions to the expenditure ceiling of R10 billion in 2017/18 and R16 billion in 2018/19.
  - Tax measures to raise an additional R13 billion in 2017/18.
  - Combined with the proposals announced in the 2016 Budget, this brings the total tax increase next year to R28 billion.
  - Government will also propose measures to raise additional revenue of R15 billion in 2018/19.
- Consolidated budget deficit expected to narrow from 3.4 per cent to 2.5 per cent of GDP in outer year

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Key risks to fiscal sustainability

Risk category	Major issues considered under each subtopic
Macroeconomic risks	▪ Impact of slower-than-expected nominal GDP and revenue growth ▪ Debt sustainability under different economic scenarios ▪ Effect of macroeconomic outlook on expenditure and debt-servicing costs
Policy and budget execution	▪ Unplanned or emergency spending requests leading to pressures on the expenditure ceiling ▪ Implementation risks around proposed in-year expenditure estimates
Contingent and accrued liabilities	▪ Quality of guarantee exposures, particularly to state-owned companies ▪ Funding status of the social security funds and the GEPF
Long-term spending commitments	▪ Impact of long-run growth, demographic changes, and new policy proposals ▪ Infrastructure and maintenance backlogs

4. Financing of borrowing requirement

Financing the borrowing requirement

Financing of national government borrowing requirement, 2016/17 – 2019/20

R million	2016/17 Revised	2017/18	2018/19	2019/20
		Medium-term estimates		
Main budget balance[1]	**-165 024**	**-160 956**	**-162 298**	**-169 556**
Financing				
Domestic short-term loans (net)	**40 000**	**25 000**	**25 000**	**26 000**
Market loans (gross)	435 064	481 944	507 899	541 594
Redemptions	-395 064	-456 944	-482 899	-515 594
Domestic long-term loans (net)	**116 266**	**131 503**	**130 130**	**129 372**
Market loans (gross)	174 000	181 000	180 500	185 500
Loans issued for switches[2]	-718	–	–	–
Redemptions	-57 016	-49 497	-50 370	-56 128
Foreign loans (net)	**36 264**	**25 744**	**28 379**	**-17 238**
Market loans (gross)	50 958	30 540	30 860	31 320
Loans issued for switches[2]	1 111	–	–	–
Redemptions (including revaluation of loans)	-15 805	-4 796	-2 481	-48 558
Change in cash and other balances[3]	**-27 506**	**-21 291**	**-21 211**	**31 422**
Total	**165 024**	**160 956**	**162 298**	**169 556**

1. A negative number reflects a deficit

2. Net of loans issued and redeemed in switch transactions

3. A negative change indicates an increase in cash balances

Source: National Treasury

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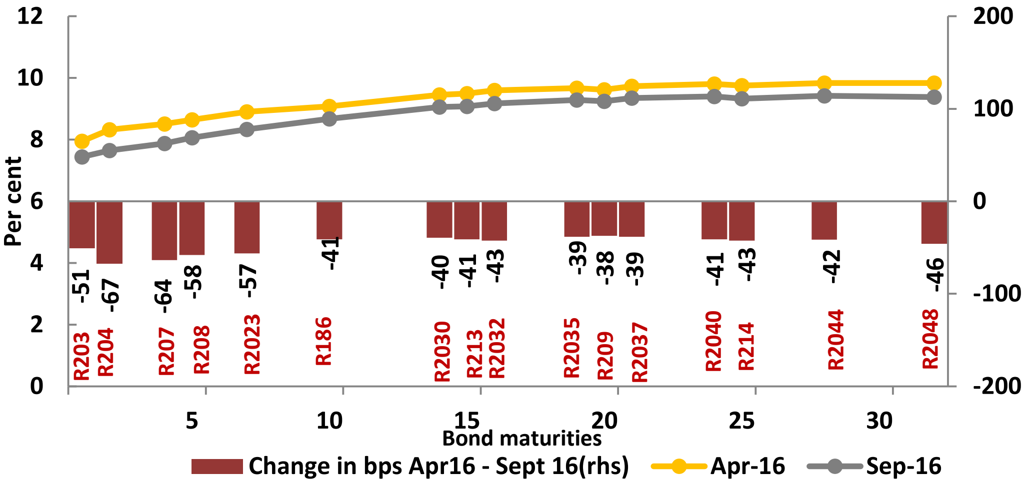
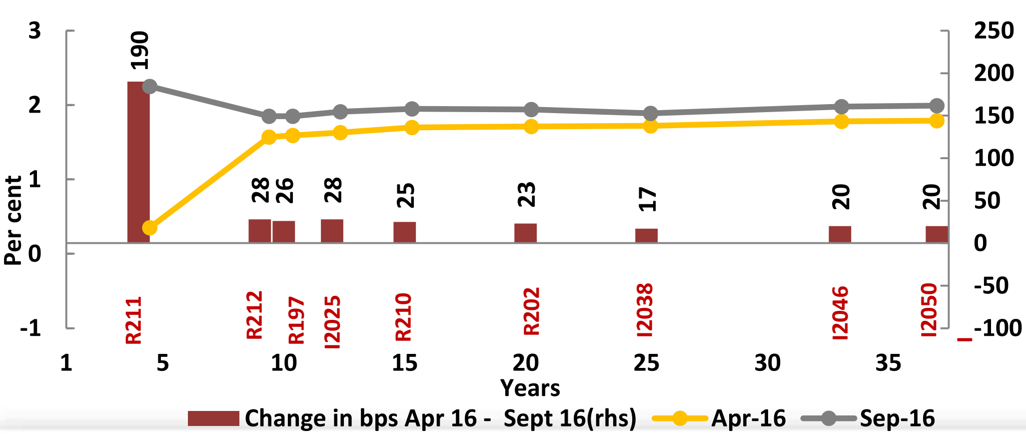
Borrowing costs have declined indicating increased investor interest

Fixed-rate bond yield curve movement



Inflation-linked bond yield curve movement



- Government borrowing costs decreased by an average of 47 basis points since April 2016
  - Reflective of improved investor interest in EM and SA
  - Uncertain economic growth in the US driving rand strength and capital flows into SA bond market
  - Post Brexit, risk-on sentiment continued due to optimism that the US Fed will keep rates lower for longer
- Inflation curve edged up by an average of 23.4 basis points, excluding the R211 bond
  - Inflation-linked bonds slightly overvalued due to their stickiness

Source: National Treasury

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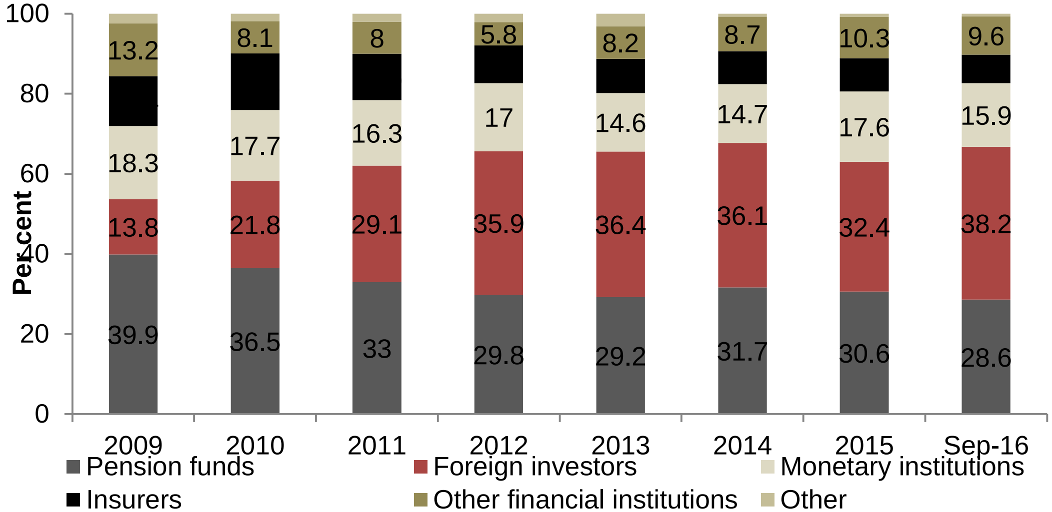
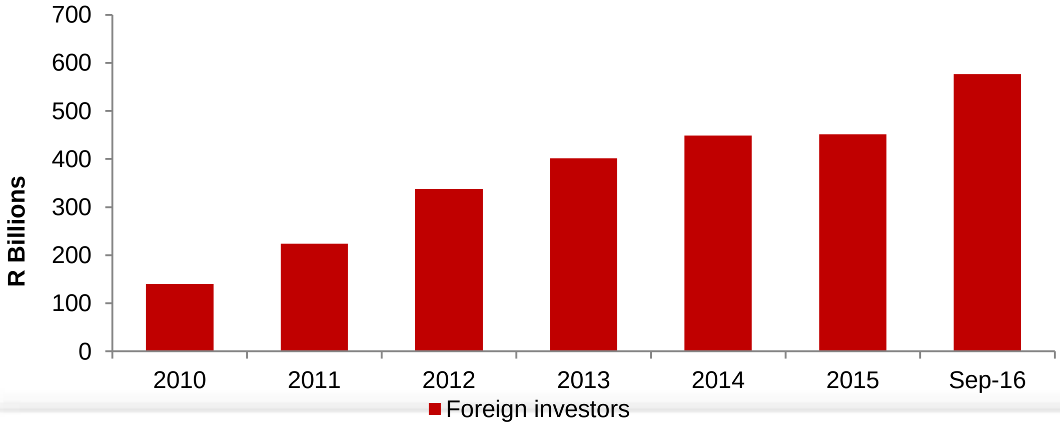
Deep capital markets enable funding of borrowing requirement

Holdings of domestic government bonds, 2009– Sep 2016



Non-residents domestic government bond holdings, 2010 - 2016



- Foreign investor holdings have increased significantly since December 2015
  - Aggressive buying of R126 billion since Dec 2015
  - In absolute terms foreign investor holdings increased from R451 billion (Dec 2015) to R577 billion (Sep 2016)

Source: Share Transaction Totally Electronic LTD(Strate)

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5. SOCs borrowing requirement and guarantees

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Government is taking actions to improve SOE performance

- Government is taking steps to rationalise several housing development finance institutions, as well as entities in the telecommunications sector.
- Advisors will be appointed to provide technical assistance as government considers the possible realignment of its airline shareholdings.
- The inter-ministerial committee responsible for overseeing the implementation of the reforms has approved the principles that will guide collaboration between state-owned companies and the private sector to accelerate the delivery of new infrastructure projects.
- The newly-established Presidential State-Owned Companies Coordinating Council will play a monitoring and coordinating role. The statutory responsibilities of company boards and executive authorities as set out in the Companies Act (2008) and Public Finance Management Act (1999) remain unchanged.
- Over the medium term, any requests for fiscal support will be informed by the principles set out in the 2015 *Budget Review*
- Government is closely monitoring South African Airways (SAA), the South African Post Office (SAPO), SANRAL and Eskom, with the aim of stabilising these entities and mitigating any risks that may materialise.

6. Strategic Initiatives to unlock long-term growth

South Africa's strengths and challenges

Great strengths to draw on:

- Strong institutions and robust framework
- Well-developed and deep capital markets
- Share of infrastructure spending to GDP exceeds that of most other economies
- Good environment for business compared to many of our peers
- Renewed vigour from government, business and civil society for economic reforms
- Strong resource base
- Established macroeconomic policy credibility

Challenges to address:

- Volatile and uncertain global environment limits external stimulus
- Domestic business confidence and investor sentiments is low
- Lower commodity prices undermine performance of primary sector
- Room for fiscal and monetary stimulus has narrowed
- Increasing external imbalances
- Rising global populism
- Migration and trade protectionism

The 9-Point plan: immediate priorities for jobs and growth

- Resolving the energy challenge
- Revitalizing agriculture and agro-processing value chain
- Advancing beneficiation of South Africa’s mineral wealth
- Implementing a high-impact Industrial Policy Action Plan
- Encouraging private sector investment
- Moderating workplace conflict
- Unlocking the potential of SMMEs township and rural enterprises
- Boosting the role of state-owned companies and strengthening ICT, water, sanitation and transport infrastructure
- Operation Phakisa: growing the ocean economy and other sectors

Restoring investor confidence and reducing policy uncertainty

- The parliamentary portfolio committee consulted on the Mineral and Petroleum Resource Development Act amendment bill
- Negotiations on the new Mining Charter, which has been identified as a key obstacle to certainty and growth , continue
- One application system for mining is being negotiated and implemented which will be used as blueprint for other sectors
- The newly-appointed Immigration Advisory Board is implementing the recommendations of the Inter Ministerial Committee on Tourism
- Broadband War Room established to co-ordinate spectrum allocation and the rationalisation of state owned companies in this area.

Country’s achievement: ensuring electricity supply becomes less binding on growth

- Energy availability has improved from 70% in the second quarter of 2015 to 81 per cent in June 2016
- All six units of Medupi and Kusile expected to be completed by May 2020 and September 2022, respectively
- In September 2016, Unit 5 of Medupi was synchronised, well ahead of the scheduled date of March 2017
- The Renewable Energy Independent Power Producer (REIPP) Programme has procured 6 376MW to date, with 2 220MW connected to the grid (44 projects)
- Increased cost competitiveness of renewable technologies: a 75 per cent decrease in the price trend of solar photovoltaic and 50 per cent decrease in the price trend of onshore wind
- R194bn investment has been attracted for energy infrastructure through REIPP programme with R30bn local content spend achieved by March 2016
- Between 2019-2025, the Gas-to-Power Programme will procure 3 726MW
- The coal baseload IPP Programme aims to procure 2 500MW

Steps to achieve more supportive business environment

- Incentives leverage substantial private sector investments:
  - R15,4bn from leading automotive assemblers in the last three months demonstrate the measure of confidence global manufacturers have in South Africa; resulting in projected employment creation of 4 675
  - Clothing and Textiles Competitiveness Programme has been relatively successful in stabilising the clothing and textile sector through grant funding, clustering initiatives, and intensive work to match retailers expectations and manufacturers capabilities. The actual spending for the previous financial years were R723.4m and R855.6m, respectively. And the budget for the 2016/17 financial year is R601m.
  - Manufacturing Enhancement Competitiveness Programme has a current budget of R7.2bn for the 2012/13 to 2017/18 periods, averaging a little above R1bn per year. As at December 2015, the MCEP had approved 1 153 projects with a projected investment value of R28bn; sustaining over 200 000 jobs since its inception in agro-processing, metals, chemicals, plastic, electro technical, printing, pharmaceuticals and wood.

Regulatory framework continues to be improved

- The Ports regulator continues with its 10 year strategy to reform tariffs
  - All cargo dues will increase by 0 per cent, except marine services and related tariffs for the 2016/17 financial year
  - Full container export dues will decrease by 10 per cent for the 2016/17 financial year
- A Presidential Proclamation brings into effect certain sections of the Competition Amendment Act, which makes it a criminal offence for directors or managers of a firm to collude with their competitors to fix prices, divide markets among themselves, or collude in tenders
- Innovative approaches to competition means that of two large mergers and acquisitions, R1.8bn will be set aside to promote economic activity up and down the value chain for smaller players.

Efforts to introduce reforms to the labour market continue

- Discussions at Nedlac are in progress focusing on
  - the introduction of codes of good practice
  - secret ballots
  - compulsory advisory arbitration
  - the introduction of a national minimum wage
- An independent panel to consider work on the minimum wage has been established and is reviewing inputs into the debate.
- A review of the Employment Tax Incentive is suggesting an extension of the initiative. Draft legislation will be released after consultations through Nedlac.

Conclusion

- A protracted period of low growth will set back the country's ability to realise the constitutional vision to "improve the quality of life of all citizens and free the potential of each person"

- Government's economic reform programme is guided by the NDP and, over the short term, the 9-point plan announced in February 2015. These efforts aim to create a more just society and ensure that the benefits of transformation are shared as broadly as possible.

- Implementation of reforms must be accompanied by efforts to tackle corruption. The benefits of empowerment should be accessible on equal basis, not limited to connected insiders.

- The fiscal framework maintains real expenditure per capita and supports macrostability. The sustainability of the fiscal framework depends on the recovery of economic activity.

Thank you