Newsletter | February 2024

Capricorn Asset Management
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Taking a deeper look at the 2024 South African Budget

Theme
Fiscal policy comes to the fore. We focus on the RSA and Namibian February Budgets in this note. The **South African (SA)** Budget is largely in line with quite pessimistic market expectations. Hence, the forex and bond markets initially reacted positively, but now, having had time to digest the Budget, combined with a weak macroeconomic outlook, investors have drifted back into a mode of wait and see. The upcoming 29 May elections in SA have now come into view and the result may have a material effect on the fiscal outlook.

Therefore, this year's Budget is characterised, in our view, as a holding pattern exercise awaiting the outcome of the elections. →

Updated Forms and Terms & Conditions

We have updated all the forms for CAM as well as the Investment Platform Terms & Conditions (T&C's). Please ensure you are familiar with these T&C's and periodically check these T&C's for any changes or updates.

The latest version of these documents are easily accessible on our website www.cam.com.na:

- Forms
- T&C's

For queries, please contact our service team at cam.service@capricorn.com.na

Relocation of the Capricorn Asset Management Office

On the 4th of March 2024 our new office will be situated on the 3rd Floor Capricorn Corner, c/o Nelson Mandela and Hofmeyer Street, Klein Windhoek, Windhoek.

We look forward to the relocation and believe this will enable us to serve our clients with more efficiency and ease.

Our contact numbers remains unchanged and our team will be readily available to assist you without any interruptions.

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The markets will hope for continuity, that is for the same Minister of Finance (MoF) as well as the same Director General (DG). The latter has acted as an important counterweight to increasing political demands and has therefore succeeded in preventing this Budget from turning into an election Budget.

An election Budget typically means sharply higher wage settlements and social grants. These have not materialised. However, the highly redistributive nature of fiscal policy is already evident in the high number of civil servants, the large wage bill (R754bn) as well as the large transfers to households in the form of grants (R432bn).

The **Namibia** picture is more positive. Strong nominal GDP growth, combined with rising SACU Revenue, makes for a good story. However, Expenditure is rising simultaneously at a discomforting rate, hence one could be forgiven for suspecting a hint of electioneering in the two budgets of FY24 and FY25, with Expenditure increasing by an average of 15% pa. Furthermore, the Wage Bill is up by 8% in FY25 and various grants and transfers, including SOEs, remain large, taking up 27% of the Budget.

Macro Outlook

In **SA**, the economic outlook remains plagued by a plethora of "own goals", not least of which is a deterioration in the logistics infrastructure. Transnet, with their failing rail and ports, has become the new Eskom, while the old Eskom still hangs like a millstone around the neck of the economy sucking resources out of the Budget – R64bn this year and R110bn next year.

The Budget consists of three years, the Budget year, FY25, which ends in March 2025 and two more years, FY26 and FY27, which make up the Medium Term Expenditure Framework (MTEF). Over these three years, on average the MoF expects nominal GDP growth of 6%. Considering our inflation expectation of 4.5% pa, on average, it means that weak real growth of about 1.5% pa is anticipated, albeit somewhat better than the recessionary conditions that currently prevail.

It certainly looks like the Walvisbay harbour has benefited from the problems at South African ports, not to mention the Suez Canal issues. A more reliable rail network could have amplified these benefits. This is being addressed therein that the MoF makes provision of N$6.6bn for rail betterment over the MTEF. Nevertheless, overall, the Namibian macroeconomic outlook is much more positive than that of SA. Nominal GDP growth is likely to exceed 8% pa, having reached 14% pa over the past two years. This means that the fiscal trajectory is also likely to become increasingly healthier when seen in isolation as well as in comparison to that of SA.

Revenue

A weak macroeconomic climate in **SA** had a sharply negative effect. Total Revenue collected grew by only 1.3% in FY24, the fiscal year now ending. For FY25, 6% growth in Revenue is expected, or rather, hoped for. Nominal GDP growth of 5.7% is foreseen. Therefore, the target might be reached, but there is a risk for another shortfall. The main source of expected growth is from Personal Income Tax, which is set to rise by 14% to R739bn. This represents slightly more than a third of Total Revenue of R2 trillion. Most other sources of income are forecast to achieve very muted growth rates and in some instances to contract. Some tax announcements were as follows:

- The usual, above inflation, hikes in sin taxes (on alcohol, tobacco and vapes) take immediate effect.
- There is no provision made for fiscal drag. The mere inflation adjustments in salary threatens to drag people into higher tax brackets.
- Carbon tax is increased from R159 to R190 per tonne and on petrol and diesel it will be 11c and 14c per litre, respectively.
- No change to the general fuel levy.
- Two-part retirement system. Makes it possible for people to access a portion of retirement capital early.
- Global minimum corporate tax of an effective 15%.
- Rebuilding and modernising SARS. Somehow taxing the illicit gold and tobacco industries has already resulted in big tax takes.
- Apart from these, no new taxes are implemented, or rates adjusted.

For **Namibia**, Total Revenue is estimated to have grown by 26% in FY24, which brought great relief to the fiscal picture. This was largely driven by a jump of 72% in SACU Revenue to N$24bn. However, VAT and Corporate Tax also bounced by 24% and 41% respectively. Personal Income Tax grew by a more moderate 9%. For FY25, the Budget year, Total Revenue is expected to be up by a chunky 12% to N$90.4bn, largely due to an expected further increase in SACU Revenue by 15% to N$28bn, where previously a contraction was expected. In the RSA Budget, the amounts budgeted for payments into the SACU pool remain at record highs, which benefits Namibia greatly. However, from FY26 and onwards, it is likely to drift lower.

The Namibian MoF announced several tax proposals, such as the lowering of the corporate tax rate to 28% by FY27, adjustments to the brackets for fiscal drag, the lifting of the tax threshold to N$100,000, 10% Dividend tax effective January 2023, a 20% tax rate in the new Special Economic Zones (SEZ) regime, as well as for smaller SMEs, also giving relief to the latter as concerns registration for VAT, building deductions, and relief on transfer and stamp duties.

Expenditure

In **SA**, following a 6% increase in FY24, an increase of only 4.4% is foreseen for FY25. The main pressure point is the Interest Bill (R390bn). It has been growing by an average of 14.4% pa over the past five years and will soon gobble up nearly 20% of Total Revenue.

The Wage Bill is budgeted to grow by only 4.6% in FY25, a demanding target. It appears achievable, though, given that the MoF was able to contain the average growth rate in the Wage Bill over the past five years to 4.3% pa. After contracting for three years in a row, Capital Expenditure will be lifted by 8.9% in FY25. However, it will remain too insignificant at 5% of total spending, to move the needle to grow the economy or expand capacity for future growth.

Upward pressure on spending is evident in the following:

- Education (wages) and Health (NHI). The National Health Insurance (NHI) plan gets R1.4bn to get off the ground.
- Elections. Additional funding to the Electoral Commission, the Police and political party funding.
- Resettled farmers. An additional R6bn over the MTEF.
- Increased social grants: old age, war veterans, disability, care dependency and the social relief of distress grant.
- Ad hoc job creation plans, such as that of the President.
- Fighting crime and corruption. Additional 10,000 police recruits.
- Deployment of RSA soldiers in Mozambique and the DRC.
- Implementation of FATF requirements and State Capture Commission recommendations.
- Provinces and Municipalities will absorb 51% of total non-interest expenditure over the MTEF.

For **Namibia**, Total Expenditure is estimated to have grown by 19% in FY24. While the Wage Bill remain contained, big increases were evident in other spending categories – Goods & Services +23%, Interest +29%, Subsidies & Transfers +25% and Capital Investment +63%. These rates of increases must not be allowed to continue, it is not sustainable.

MoF has made provision for an increase in Total Expenditure of 12% in FY25 to N$100.1bn, which entails fairly stiff increases in spending categories across the board as follows: the Wage Bill (+8%), Goods & Services (+7%), the Interest Bill (+9%), Subsidies & Transfers (+11%) and Development oriented spending (+34%). This should give the economy a boost on the aggregate demand side.

However, the MoF had been at pains, again, to emphasise the uncertain revenue outlook, which implies that spending will simply have to remain in check over the next several years until a clearer picture emerges.

Deficit and Debt

This year a marginally positive Primary Balance of about 1% of GDP will be achieved in **SA**, which is quite an important small win. This is the balance between Revenue and Expenditure, excluding Interest. This means that, if there was no interest expense, SA would have a balanced Budget.

In reality, the Deficit amounts to R332bn, or 4.5% of GDP. Considering redemptions, i.e. debt that matures, the gross borrowing requirement amounts to R569bn or 7.6% of GDP, identical to last year. However, this year the gross borrowing requirement will be reduced by the rundown of cash balances to the tune of R53bn and the tapping of GFERCA, the Gold and Foreign Exchange Reserves Contingency Account of Government held at the SARB, to the tune of R100bn.

This means that the funding pressure on the domestic market eases somewhat from R286bn in FY24 to R271bn in FY25.

Total Debt has reached R5.5tn equal to 74% of GDP, of which R4.9tn is domestic and R573bn is foreign. The ratio is expected to peak at 75% of GDP in FY26. This growth rate in debt remains too high and can only be brought down by having smaller deficits in future. Debt servicing costs (see above) are already seriously crowding out other spending. When guarantees, contingencies and provisions are added to debt, the total rises to close to 100% of GDP – the main reason for a non-investment grade rating, in our view.

By way of comparison, the Debt-to-GDP ratio of **Namibia** is expected to decline to 60% this year. Adding guarantees it brings the ratio to 63%. Strong nominal GDP growth is likely to improve this ratio over the next several years. In our view, the Namibian MoF must do more to emphasise the long road back to investment grade.

The deficit is estimated at N$9.7bn in FY25. It equates to 3.5% of GDP. The total funding requirement comes to N$12.4bn, of which the MoF will look to the domestic market to finance N$9.2bn, or 3.3% of GDP. In FY26, though, the situation could prove to be tricky due to the second U$750m Eurobond that matures. The plan is to retire U$500m and roll U$250m. This means that the MoF must be very strict in building up the sinking fund. But regardless, the domestic market will be tapped for a sizeable N$13.5bn to N$14bn in FY26. It is doable but will require good debt management on the part of Treasury and Bank of Namibia (its agent). The total borrowing requirement in FY26 will amount to N$26bn, of which a large portion will have to be covered by cash in the sinking fund.

Policy

The **SA** MoF's speech mentioned several areas of focus. These contained many good-sounding terminologies while being light on details.

- Eskom, electricity and the bane of loadshedding.
- Logistics. Yet another economic plan was made, called the Freight Logistics Roadmap.
- Infrastructure finance and delivery. Amendments to the PPP regulatory framework.
- Mainstreaming climate finance via a multi-layered risk-based approach and raising concessional finance.
- Electric Vehicles White Paper aimed at transitioning the automotive industry.
- The Public Procurement Bill. Provincial legislatures to hold nationwide public hearings.
- SA will host the annual meeting of the New Development Bank, the "BRICS Bank".
- In 2025 SA takes on the presidency of the G20. SA intends to use this platform to emphasise the African developmental agenda, as well as to press for better representation and reforms at multilateral agencies such as the IMF and the World Bank.

As always, plans are made rapidly, with little to no concrete implementation that makes a difference on the ground.

The policy stance by the **Namibian** MoF, takes more concrete form in the tax relief measures announced as well as specific areas of spending focus. This entails, amongst others, spending on the rail network, schools, housing, energy and water. In our view, the MoF needs to take a more hard-nosed approach to governance at SOEs, which is a decades old problem. In all, subsidies and capital transfers to SOEs amount to N$3.2bn in FY25, up from N$1.4bn in FY24. Projections for the next two years are for amounts below N$1bn, but that remains to be seen.

Conclusion

As it stands currently, there seems to be little urgency in SA to right the ship with the intent of regaining an investment grade credit rating. The debt trajectory is too high – the Debt-to-GDP ratio (including contingencies and guarantees) is peaking at close to 100% of GDP. The deficit-to-GDP ratio has not seen 3% now for 14 years, while guarantees to SOEs were issued almost recklessly for several years. These chickens are now coming home to roost.

There continues to exist an immense degree of pressure for fiscal policy to address social ills and needs. For a Government that has at its disposal R2tn annually, we take issue with the statement of the MoF that the message to South Africans is this: "…government is making the most out of very limited resources…"

The South African state is not about to default on its debt, which is made up of 90% domestic and 10% offshore. Nevertheless, the deteriorating fiscal trajectory and the lack of political will to address failing SOEs could result in a high bond yield curve, which, in our view, continues to offer attractive returns, especially in real terms. The latter will improve further as, geopolitics and oil willing, inflation, currently at 5.3%, drifts down to below 4% by year-end, as we anticipate.

Given the increasing daylight between a deteriorating SA fiscal trajectory and an improving Namibian trajectory, it is quite possible for Namibian yields to trade close to, and perhaps below that of SA again in future. Inflation rates in the two countries have been tracking very closely of late. Therefore, with inflation at 5.4% in Namibia and likely on a declining trend, while nominal yields range from 9.3% to 12.5%, the real return on offer remains very attractive.

A noteworthy statement by the MoF, "Introducing a 10% dividend tax effective 1 January 2026 to address the existing disparity in the investment arena where dividends paid to non-resident shareholders is subject to tax", will have a direct impact on a large part of our investors and as such we will explore and discuss this matter in more detail in our March newsletter.

Namibia Grey listing

Namibia was grey listed on Friday, 23 February 2024 by the Financial Action Task Force's (FATF) Plenary and placed under increased monitoring, due to concerns over remaining effective implementation compliance with international Anti-Money laundering (AML), Combating the Financing of Terrorism (CFT), and Combatting Proliferation Financing (CPF) standards.

In 2022, Namibia underwent a second mutual evaluation by the FATF in which shortcomings in both technical (laws) and effectiveness (implementation) compliance were identified. This prompted the FATF to provide the country with a 12-month period for remediation, which concluded in October 2023. The country made significant strides to address all the technical compliance shortcomings through an extensive review of the existing legislation and introduced the new legislation in October 2023. These legislative changes were crucial steps towards aligning Namibia's AML/CFT/CPF regime with international standards, in which standards are revised and updated three times per annum. The FATF found Namibia wanting in AML/CFT/CPF effectiveness in six of the eleven immediate outcomes, assessed around effectiveness compliance.

Consequently, according to the FATF, grey listing publicly announces to the global community that there are deficiencies in a country's ability to effectively counter AML/CTF/CPF. Thus, a FATF Grey listing designation calls for enhanced due diligence and where appropriate, counter-measures from the global community to mitigate AML/CTF/CPF risks posed by a country's financial system.

The implications for Namibia:

- Foreign direct investment, trade and financial transactions could experience delays.
- In a worst case scenario there may be a 6% reduction in the Namibian GDP. In the case of SA, Botswana and Mauritius the impact of their grey listing status was insignificant.
- Entities engaging with Namibia may also be required to conduct enhanced due diligence, leading to increased costs and scrutiny.

The primary implications for local clients could be:

- Increased scrutiny in international transactions: Financial institutions in other countries may conduct more rigorous due diligence before processing transactions to and from Namibia which could cause delays and additional paperwork.
- Namibian citizens living abroad will have to undergo enhanced and additional due diligence. Foreign financial institutions may perceive clients from Namibia as higher risk, leading to more rejections or stringent requirements.

Furthermore, the Financial Intelligence Centre (FIC) may impose stricter regulations to address the deficiencies identified by FATF and the country may implement stricter regulatory measures on financial institutions. The full FIC Media Release can be obtained from their website in the link below:

https://www.fic.na/uploads/Public_Awareness/General_Publications/FIC%20Media%20Release%20-%20NAMIBIAS%20FATF%20GREY%20LISTING.pdf

For further clarification or more information, kindly contact to our Chief Risk Officer, Pearl Ndeipanda at pearl.ndeipanda@capricorn.com.na.