Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 36th year of service to the investing public of South Africa

Volume: 36 - Issue: 32

11 August 2023

I hate having become a prophet of doom lately but by the calculations of South Africa's Energy Minister Kgosientsho Ramokgopa, with a series of observers concurring, load-shedding has cost the SA economy an estimated R1.6-trillion in the lost production of goods and services and the result could be a R77-billion loss to the fiscus. It is a crisis that likely warns of big tax increases ahead!

Add to that a July report from RMB Morgan Stanley, based on data collected from 15 SA mining companies, that given this year's severely reduced spot metal prices the tax take from SA's mining companies is likely to fall from last year's R110-billion to around R50bn, and it is clear that Finance Minister Enoch Godongwana is going to struggle to balance the nation's books next year.

Ramokgopa's office has also calculated that persistent electricity cuts could also add around 860,000 to our already massive 32.9 percent unemployment rate in 2023. That is, if I read the numbers correctly, an additional to the 7 933 000 already walking our streets and the 3 900 000 who have given up looking: a current total of 11.5 million compared with 15.6-million who still have jobs....so rising social tensions likely explain the current Cape taxi riots.

This is the moribund economy ANC economic thinking has bequeathed our country in its quest for a "Better life for all." And one cannot exclude this as a major factor in the rioting in Cape Town sparked last week by a clamp-down on taxi illegality.....just as one cannot exclude joblessness and economic hardship from the KwaZulu Natal riots recently. We have to find a way to fix the economy before it is too late and centuries of development go up in smoke!

Meanwhile, the ANC is rushing through its devastatingly costly National Health plan which the Socio-Economic Impact Assessment Unit (SEIAU) in the presidency estimated four years ago would cost R265-billion. That, as I understand it, is in addition to the R259.2-billion already being spent on health!

Putting those numbers together suggests that the current 4.2 percent hole in Mr Godongwana's budget, an amount of + - R195-billion, could grow by an incredible R402-billion. That is a completely un-fundable 13 percent of GDP.

Currently, income taxes raised by the government represent 27.3 percent of South Africa's GDP and so if personal taxes were to be the source of this money, a roughly 50 percent tax increase is implied, a burden which even South Africa's tax chief Edward Kieswetter believes is impossible. How that tax burden is spread is neatly explained in the table on the right:

Taxable bracket	2021/22 Registered individuals		2021/22 Income tax payable before relief		2022/23 Registered individuals		2022/23 Income tax payable before relief	
R thousand	Number	%	R billion	%	Number	%	R billion	%
R0 - R80[1]	7 183 913	–	–	–	7 700 135	–		
R80 - R150	1 855 292	26.7	15.7	3.0	1 973 185	26.5	15.8	2.6
R150 - R250	1 691 889	24.3	29.5	5.6	1 717 760	23.1	28.4	4.7
R250 - R350	1 283 954	18.4	54.5	10.3	1 231 672	16.5	50.2	8.3
R350 - R500	981 993	14.1	76.6	14.5	1 158 117	15.6	86.4	14.4
R500 - R750	612 177	8.8	88.4	16.7	756 629	10.2	107.4	17.9
R750 - R1 000	262 643	3.8	65.1	12.3	274 963	3.7	67.6	11.2
R1 000 - R1 500	159 127	2.3	61.9	11.7	199 837	2.7	76.3	12.7
R1 500 +	113 192	1.6	137.7	26.0	133 230	1.8	169.4	28.2
Total	**6 960 267**	**100.0**	**529.4**	**100.0**	**7 445 393**	**100.0**	**601.4**	**100.0**
Grand total	**14 144 180**		**529.4**		**15 145 528**		**601.4**	

Speaking at a PSG on-line conference earlier this year Kieswetter said that the revenue service was NOT pushing for higher taxes – on the contrary, he said that the tax burden on South African taxpayers should be lighter. “SARS is of the view that the compliance dividend means that there is no need to raise taxes,” he said.

Given the incredibly small tax base of only 333 000 registered taxpayers collectively shouldering 41 percent of the tax burden and who currently hold the world’s record emigration rate, Mr Godongwana cannot afford to try and place a further burden on them. The next table on the right puts their current income into perspective:

	Income per year
Top 1%	**R2 584 000**
Top 10%	R783 750
Middle 40%	R82 650
Bottom 50%	R12 350

If my numbers are correct – and for once I hope I am wrong – in order to balance his books Mr Godongwana would need to **ADD an average of R1.2-million to each of them**. Since the average income of the top two groups is R1.68 million, such an increase would be beyond comprehension.

That leaves only increased borrowing and VAT as a possible source. But foreign lenders are increasingly unwilling lenders because, at 75 percent of GDP we are considered a high-risk country. Nedbank CEO Mike Brown this week flagged SA’s high public debt as one of the factors driving up the country’s risk premium and increasing borrowing costs across the economy, with the government having to borrow an average of R2bn a day while the foreign appetite for SA bonds has fallen.

Demand for government long bonds by foreign investors has materially reduced, he said, with net outflows of R116bn from the bond market for the year to date. Furthermore, **the** JSE has recorded outflows of R65bn so far this year, up from R42bn in 2022’s matching period.

“When you’ve got more sellers than buyers the price goes up, and when the price of bonds goes up the cost of capital goes up. That in turn is negative for investment because investments have to meet a higher hurdle rate. That is a huge concern,” Brown said.

So that leaves only VAT as a possible source. Currently, after refunds, South Africa raises R298-billion from VAT and so to raise an additional R402-billion implies that VAT would have to increase from 15 percent to 35 percent.

It is equally impossible. So if losing your access to private medicine is currently keeping you awake, my suggestion is that you stop worrying. The fact is that the country simply cannot afford the NHI at present.

But there **IS** another way: Fix the railways so we can get more minerals to our harbours and fix the economy so that we can achieve a bigger tax base. I think that means we would have to change a government which, in 30 years of trying to achieve our economic potential, has completely failed! Time to learn from the Western Cape where jobs ARE being created and the economy IS growing!

The month ahead:

New York's SP500: I correctly predicted a retreat which I still expect it to last until early September within an overall long-term recovery.

Nasdaq: I correctly warned of declines with a recovery likely to begin late this week. Now I see an almost unrelenting recovery well into the New Year.

London's Footsie: I correctly predicted an extremely volatile but declining period until the end of August followed by sporadic gains until mid October within an overall longer term declining trend.

France's Cac 40: I correctly warned that a down-turn is under way again and is likely to last well into the New Year.

Hong Kong's Hangsen: I correctly predicted the start of a recovery until late November ahead of a seasonal decline to late January.

Japan's Nikkei: I correctly warned of considerable volatility within a modestly rising medium-term trend which essentially goes nowhere to the end of the year when a longer-term decline seems likely.

Australia's All Ordinaries: I correctly warned of weakness which I still expect to last until late-September. A long-term recovery is likely to begin then, lasting far into the New Year.

JSE Top 40 Index: I correctly warned of a declining trend until the end of October....amid much volatility.

ShareFinder JSE Blue Chip Index: I correctly predicted a volatile slightly-declining trend but now I see gains until mid-November ahead of a two-month correction and then further gains well into the New Year.

Rand/Dollar: I correctly predicted gains likely to the end of the year.

Rand/Euro: I correctly predicted a recovery. However things have radically changed now and I expect weakness until March.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.96 percent. For the past 12 months it has been 91.49 percent.

Keep dumping assets

BL PREMIUM KABELO KHUMALO

The JSE has recorded foreign outflows of R65bn so far this year, up from R42bn over last year's matching period as poor investor sentiment and the relaxing of retirement funds' offshore allocations weigh on the asset management industry.

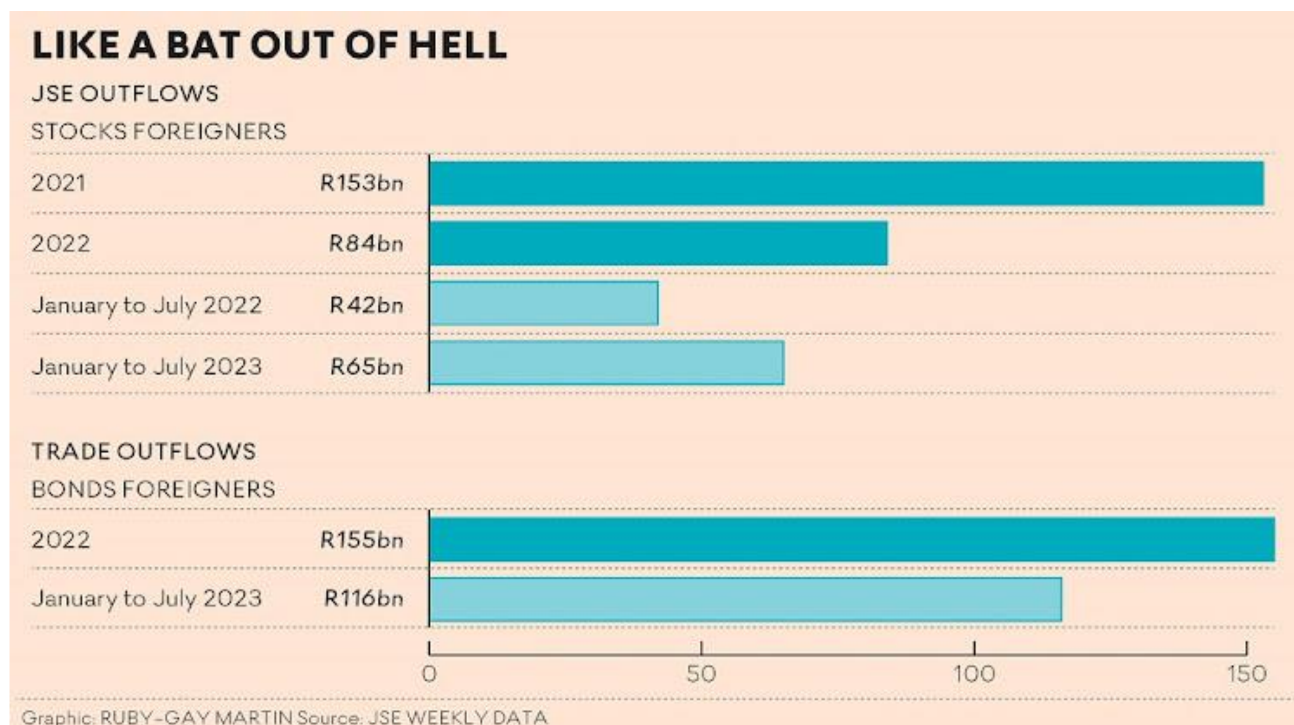
Glenn Silverman, a strategist at investment consultant firm RisCura, said one of the headwinds facing the industry is that recent legislative changes increased outflows.

"From a flow point of view, the recent decision by National Treasury to increase the pension fund offshore allowance from 35% to 45%, has resulted in net outflows from the SA savings industry as pension funds have shifted assets to be managed offshore," said Silverman.

"As far as markets are concerned, most local managers believe that local assets — equities, bonds and property — are currently undervalued, as a consequence of poor investor sentiment, leading to foreign sales of local assets. Emerging markets have struggled generally, with SA assets even more affected by the likes of load-shedding," he said.

Revenues of asset management companies are driven largely by movements in asset values, which rely mostly on the performance of markets, but also by the flow of assets in and out of the SA savings industry.

One of the biggest pools is pension funds, but it had systematic outflows as their overall growth depends on market returns.



Ninety One, SA's largest asset manager, said in its year to end-March earnings statement that relaxing exchange controls on retirement assets came while SA "is not attracting offsetting flows of the same quality" [as before].

That puts puts more pressure on the industry and ultimately on asset prices as there is less money buying assets, said Ninety One.

Net sellers

Silverman said one way to reignite the industry is to stem the foreign sell-off of SA assets.

“Foreign investors have been substantial net sellers on the JSE for several years, and any reversal of this trend could add further momentum to the market. Any improvements in the news flow, whether economic, political, global growth or relating to electricity supply — that is, reduced load-shedding — could serve as a further catalyst for a market advance,” he said.

Stanlib, with assets of more than R600bn under its custodianship, warned the industry faces more headwinds than tailwinds in the next two years for reasons such as high net-worth individuals continuing to emigrate and taking their money with them.

Silverman said policymakers have several options to stem emigration of wealthy individuals, including implementing better policies aimed at boosting consumer, business and investor confidence.

Silverman said such policies would help achieve positive outcomes such as attracting and retaining skilled people, fostering economic growth and reducing unemployment.

“Asset managers typically charge higher fees and earn higher margins when managing money on behalf of individuals as opposed to institutions such as pension funds,” he said.

“Emigration, to the extent that it leads to included disinvestment from SA assets (or lower margins), would thus negatively affect the industry. Emigration is not only a concern for the local industry (which would have fewer funds to manage), but also for the country as it results in, inter alia, a loss of skills and potentially lower future tax revenues for the country.”

Highly regarded

With margins squeezed at home, some asset managers, including Ninety One, have looked to the Middle East, particularly Saudi Arabia, to deploy some of the trillions of rand under their management for growth.

Faisal Rafi, investment researcher at RisCura, said Saudi Arabia is a highly regarded stock market for investors in emerging markets for several compelling reasons.

“It serves as a safe haven for emerging markets during periods when most of them struggle due to high oil prices. Given that the Saudi economy is heavily reliant on oil, it tends to perform well when oil prices are elevated,” said Rafi.

“The country is undergoing a rapid transformation under the leadership of Crown Prince Mohammed bin Salman. His vision includes diversifying the economy away from oil, resulting in the opening up of what was once a closed, conservative nation where women weren’t allowed to drive, and cinemas were banned.”

Foreign investors also continue to sell SA bonds, with outflows amounting to R116bn so far this year, according to JSE data. At the present rate that would exceed 2022’s outflows of R155bn.

khumalok@businesslive.co.za