National budget speech

21 February 2019

The 2019 National Budget Speech delivered by Finance Minister Tito Mboweni had the market somewhat flustered initially, the rand sold-off close to R13.40 to the US dollar. Yields spiked alongside this move, but as Minister Mboweni continued, both settled down somewhat.

The government presented a deteriorated set of fiscal figures since the Medium-Term Budget Policy Statement (October 2018) as a result of tax revenue misses and the significant requirement for Eskom support. Eskom is scheduled to receive R23 billion per year for the next three years in an attempt to support the urgent operational changes planned.

We also saw a set of spending adjustments to save R50 billion over the next three years. More than half of this will come from a reduction in the government wage bill through natural attrition alongside active measures to reduce compensation and encourage early retirement.

In general, the budget was bold on taking a new approach, but I am sceptical on the ability of government to execute on some of its promises most notably Eskom staff reductions and lowering of government wage bill.

The initial reaction of the bond markets was negative due to wider deficits and higher debt/gross domestic product ratios. South African Government Bonds issuance will increase roughly 550m/week from April onwards which is not currently well reflected in yields in my opinion.

The recovery from initial bond sell-off is largely due to consensus thinking that action announced on Eskom will be deemed as credit neutral by Moody's and that Eskom sustainability task team will be credible and take action that addresses a lot of Eskom's financial and operational concerns and to make headway in restructuring Eskom by mid-2019.

The three main things we wish to highlight that stood out to us:

1. The government has been prepared to go the partial privatisation route by announcing intention to seek strategic equity partnerships for Eskom transmission unit. This is likely ratings/credit positive if executed well.
2. We expect to hear some comments from ratings agencies in next 24 hours. Moody's being the most important at this stage as they are the only remaining agency rating us at investment grade. We believe the budget tabled meets the bar to keep Moody's at bay from lowering their credit outlook on South Africa's debt rating when they announce on 29 March.
3. On the downside, Minister Mboweni said that tax brackets will not be adjusted for inflation and hence there will be substantial bracket creep in the next fiscal year meaning most personal income tax payers will be paying more income tax to help meet their revenue goals.