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Investing with the times

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Budget surprise for investors

The 2018 National Budget treated investors favourably and benefitted Ecsponent's clients, with no increase in dividend withholding tax (DWT) or capital gains tax (CGT).

The Budget's true test, however, will be whether it encourages economic growth. The projected 1.5% real GDP growth is not sufficient to make up of the ground lost during the Zuma era, which The Economist describes as "South Africa's lost decade".

The publication goes on to say, "By most measures the country is worse off now than a decade ago, when Mr Zuma became leader of the ANC before being elected as president in 2009. Economic growth has slowed to a crawl, and briefly dipped into recession last year. Unemployment stands at 36% when people who have abandoned the hunt for jobs are included."

Recovering from this Zuma-era disaster will be no easy task. Confidence is critical to stimulate an economy and the Budget has underpinned it. But it will take time, patience and skilful planning from government.

VAT to the rescue

The decision not to increase DWT and CGT was only possible with the increase of value added tax (VAT). From 1 April it will be 15%. The increase by only one basis point will contribute about R22bn to the budget deficit of R36bn.

For many years now, our VAT rate was below the global average and has remained unchanged at 14% for the past 25 years. The increase will be least damaging to the economy and in an attempt to make the increase more acceptable, Malusi Gigaba, former finance minister, estimated that 35% of wealthy South Africans will carry 85% of the overall VAT increase.

Research has shown that VAT in South Africa is not a "regressive system" which hurts the poor more than the rich. It is the most effective way to collect significant additional revenue for the Treasury and it helps to broaden the tax base. Five million taxpayers cannot subsidise 55 million people indefinitely.

Will South Africa be downgraded?

While the budget deficit has not been reduced significantly, rating agencies will appreciate the VAT increase, because it shows the government is prepared to make unpopular decisions and strives to exercise fiscal discipline. The recent change in leadership and Pres. Ramaphosa's State of The Nation Address will further contribute to allaying the fears of rating agencies.

Our investments may not be directly affected, but we will certainly feel the effects of this Budget in coming months, specifically the proposed increase in the price of fuel by 52c per litre. This increase will have a knock-on economic effect and is expected to result in noticeable price increases.

Amendments affecting investors:

Dividends not taxed further

The government was criticised for the DWT increase from 15 – 20% in 2017. The latter is the rate paid in developed countries such as Canada and Germany, while South Africa is a developing country where taxes should be low enough to attract investors.

DWT can be recovered easily and it was suggested that the government could have increased the DWT to 25%. However, it would discourage savings in South Africa, which means that less capital would flow to local companies, possibly resulting in higher unemployment.

Capital gains tax remains unchanged

There was concern that the Treasury could increase the capital gains tax inclusion rate of individuals from 40% to 50%. Fortunately, it remains at 40%, which means that an investor's tax in Ecsponent's Class B capital growth preference shares will remain the same.

Regulation 28 amended

While no changes were announced with regard to the amounts individuals may contribute to retirement funds, Regulation 28 of the Pension Funds Act was amended. This means that investors and fund managers can now invest 30% (was 25%) of pension funds abroad and an additional 10% elsewhere in Africa. Ironically, the rand has strengthened substantially and fund managers may not make use of the concession at this stage.

No change in interest rate exemption

Investors who earn income from interest, receive an exemption of R23 800 per year, and those older than 65 years receive R34 500. This amount has not been amended since 2014 and hence not keeping up with inflation, penalising investors.

Estate duty and donations tax

In line with the Davis Tax Committee's recommendation relating to wealth taxes, the estate duty on deceased estates valued over R30 million has been increased from 20% to 25%. Similarly, and to prevent the staggering of donations to avoid estate duty, any donations above R30 million in one tax year will also be taxed at 25%.

New era for investors

The election of Cyril Ramaphosa as South Africa's new president puts an end to an era of uncertainty and brings new hope and confidence for citizens, as well as investors locally and abroad.

Investors are looking for a safe investment environment, because no one wants to base their financial future and retirement on uncertainty. Uncertainty creates anxiety and is extremely disruptive to any long-term financial plan.

Pres. Ramaphosa has the potential to rebuild business confidence. Early predictions indicate that the country's economic growth in the 2018/19 financial year could improve by 1.5 - 2%, compared to the forecast by the International Monetary Fund in January this year, of 0,9% growth over the same period.

South Africa will also benefit from strong world growth and low interest rates in Europe, America and Japan. There will be an interest in investing in emerging countries, which means that substantial amounts of investment capital could be flowing to South Africa, setting off a cycle of prosperity.

At the same time there are definite global risks that could affect South Africa and local investors significantly. First, there is the possible overheating of US markets, coupled with rising inflation and interest rates. Then there is uncertainty about China's economic growth, rising international interest rates and also globalisation of markets, which could lead to the beginning of a bear market.

South Africa is faced with a variety of challenges and it could take Pres. Ramaphosa and his new cabinet could take ten years or more to recover state finances, rebuild investor confidence and restore the economy.

- The public service is the country's largest employer. Under Zuma, employment and associated costs increased dramatically and today we have almost a million civil servants. There are 35 ministers and 37 deputy ministers who cost us almost R1 billion annually.
- South Africa has an unemployment rate of 26.7% (36.3% if one includes those who no longer seek employment) and the prospect of large-scale job creation is slim. In addition, about 40% of our population is poor. The challenge is great.
- Commodity markets are lifting internationally, but our local mining sector is being hampered by uncertainties, especially regarding the revision of the Mining Charter. This could limit local investment and slow down long-term production.
- Debt and corruption scandals at Eskom make the utility the biggest risk to South Africa's economy, says Goldman Sachs, the world's third biggest investment bank. With outstanding debt of more than R470 billion, even our ministers have cited the parastatal could force our economy to its knees.
- Pres. Ramaposa's plans to expropriate land without compensation will destroy the agricultural value chain, according to organised agriculture, in South Africa. It is clearly a carrot to attract voters but can become a hot potato as the SA government already owns 4 232 farms taken from white farmers but not yet transferred to black owners.

Investors are seriously exposed. SA missed the bull market in emerging markets, thanks to the Zuma government. Many investors moved their money abroad, even at R16/$ and wanted to profit from the weakening rand, because R20/$ had been predicted. Now the real value of the rand is around R10.70 and those investors are facing huge losses.

More than a quarter of the JSE's index of all shares is made up of Naspers and Richemont. It is especially Naspers' 33% interest in Tencent -- the Chinese Internet giant -- which generates general concern. Devil's advocates warn that China's legislative and regulatory controls could affect Tencent significantly, which will flow through to South African investors.

What should investors do in times of political/economic change?

Pay off debt
Consolidate and pay off debts like credit cards as soon as possible. Do not incur any new debt.

Spend less
Try to live with at least 20% less money and do not buy unnecessary goods, especially if it does not give you an income or return.

Build your emergency fund
Make sure you have at least a three months' emergency fund to provide for those unforeseen monetary expenses.

Remain employed
It will be difficult to find work in the transition phase even if you are well qualified. Convert challenges into opportunities.

Save and invest
Investors need fixed returns that deliver positive outcomes. Look at preference shares which offer stable, predictable returns and are not exposed to the fluctuations of the markets. Focus on investments you can control.

Nobody can be sure what happens tomorrow, next week, month or year. It is therefore important that investors hedge their exposure to retain certainty in an insecure world.