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CADIZ ASSET MANAGEMENT INVESTMENT UPDATE

JULY 2020

Special Budget June 2020

At the end of June 2020, the minister of Finance delivered a Special Adjustment or Emergency budget to parliament, which sought to make adjustments to the 2020/21 budget and to enable spending on the COVID-19 pandemic. The revision of the budget was prompted after President Ramaphosa declared a state emergency on 15 of March and then again announced a R500 billion support package to combat the effects of the pandemic. The minister also delivered a very sobering analysis of the country's economic position even before we entered the COVID -19 crisis. An economy hampered by low growth, high unemployment, ailing state-owned enterprises and a weakening fiscal situation.

The adjustments were substantial and largely know no precedent. The economy is now forecast to contract by 7.2% for 2020/21 compared with a meagre but positive 0.9% growth announced in February's budget speech. The consolidated budget deficit is expected to ramp up to 15.7% of GDP versus the original tabled figure of 6.8%. The tax collection shortfall is expected to be at least R300bn for the 2020/21 tax year. The main budget expenditure is expected to rise by only 2.5% to R1 809bn from R1 766bn. The underlying assumptions being CPI inflation of 3% versus previous 4.4% and GDP inflation of 4%. Gross loan debt is now projected to be 81.8%, rising to 86% in 3 years' time. The minister sketched two scenarios where debt is concerned - a passive approach where debt spirals out of control and an active approach in which reforms and fiscal consolidation are implemented rapidly to stabilise debt in 2023/24.

Treasury expects a significant portion of the extra required funding to come from foreign loans (mainly from multinational institutions including the IMF, World Bank and the New Development Bank), the utilisation of sterilisation deposits and higher short-term borrowing. A further sizeable increase in weekly bond issuance is on the cards concentrated in the 7-10yr area of the yield curve.

Government also envisions a package of economic reforms that will improve productivity, lower costs and reduce demands of state-owned companies on the public purse. These measures include finalising electricity determinations, unbundling Eskom and taking other steps to open energy markets, modernising ports and rail infrastructure, and licensing spectrum.

The issue of zero-based budgeting was touched on briefly with the process to start in July. Hopefully, this concept will lead to significant enough savings and less corrupt activity. The devil is always in the detail and no doubt the implementation of such a system will come with its own challenges.

Good news in the form of R3bn support for the Landbank provided some uplift to a rather dreary outlook.

The budget, in many ways, was as expected but came with a stern warning that "we must do something now". One could say that it was a "bridging budget" to the Medium Term Budget Policy Statement (MTBPS) expected in October.

All that remains is the political will to follow through, especially when it comes to containment of expenditure, and the intellectual wisdom to make the best possible decisions as we traverse the uncharted waters of the COVID-10 pandemic. •

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