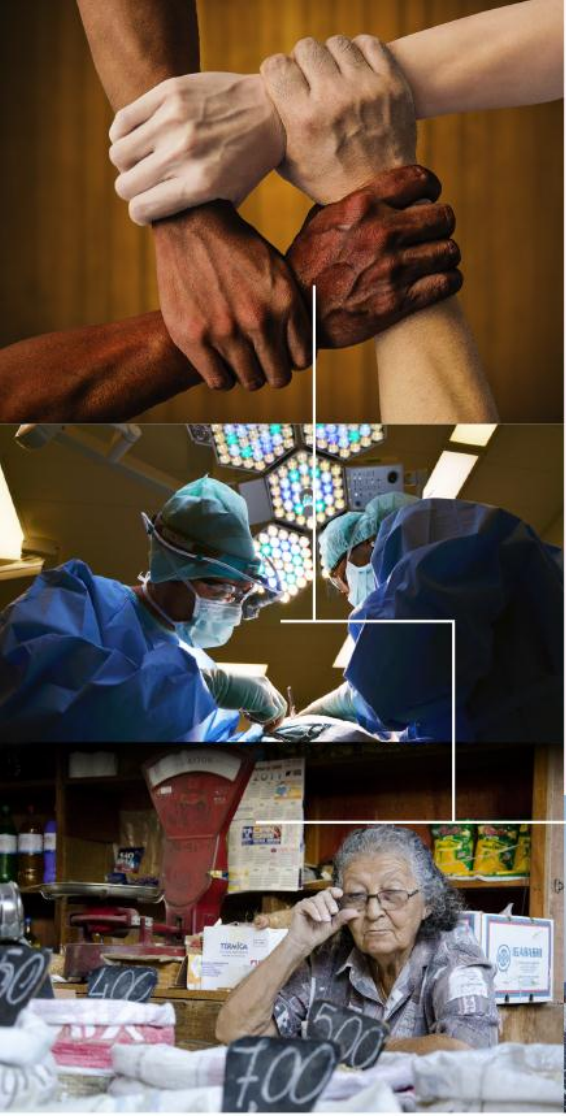
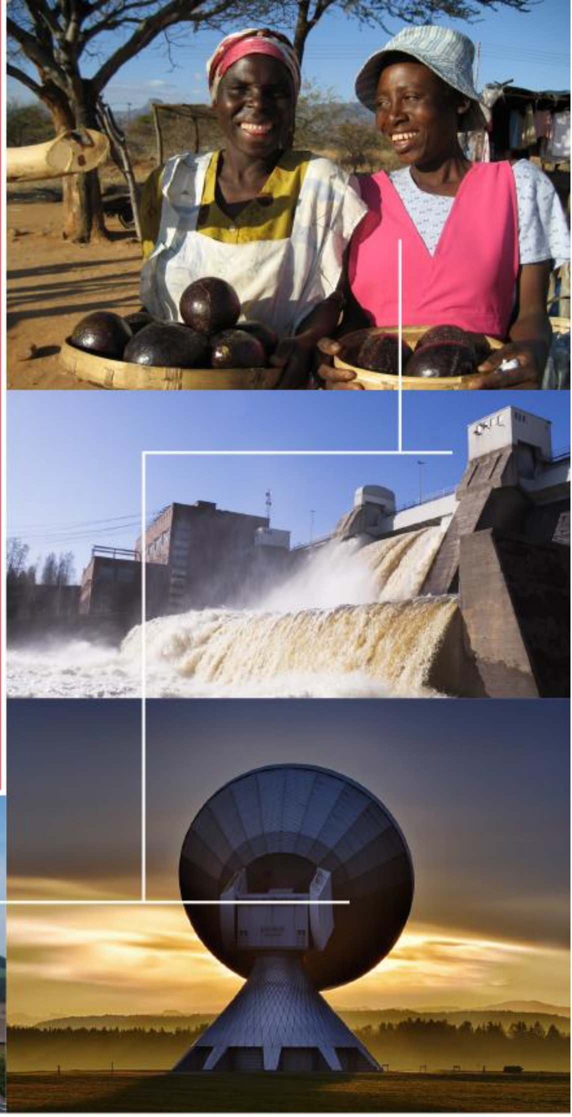


BUDGET 2017

TRANSFORMATION FOR INCLUSIVE GROWTH

22 February 2017



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2030 NDP

South African realities

- Income growth has been uneven - the bottom 20 per cent have benefited from social grants and better access to services, the top 20 per cent have benefited from the rising demand for skills and pay increases. Those in the middle have been left behind.
- Wealth remains highly concentrated – 95 per cent of wealth is in the hands of 10 per cent of the population.
- 35 per cent of the labour force are unemployed or have given up hope of finding work.
- Despite our progress in education, over half of all children in Grade 5 cannot yet read adequately in any language.
- More than half of all school-leavers each year enter the labour market without a senior certificate pass. 75 per cent of these will still be unemployed five years later.
- Our towns and cities remain divided and poverty is concentrated in townships and rural areas.
- Our growth has been too slow – just 1 per cent a year in real per capita terms over the past 25 years, well below that of countries such as Brazil, Turkey, Indonesia, India or China.

Transformation for inclusive growth

- To realise the vision of the Constitution, South Africa needs transformation that opens a path to inclusive economic growth and development.
- Growth without transformation would only reinforce the inequitable patterns of wealth inherited from the past. Transformation without economic growth would be narrow and unsustainable.
- Broad-based transformation should promote growth, mobilise investment, create jobs and empower citizens. It must create new resources to support social change, including assets and livelihoods for the majority, and strengthen South Africa's constitutional foundations.
- The budget plays a central role in transformation by promoting redistribution and directing scarce resources towards catalytic investments in human and physical capital.
- The 2017 Budget proposes several difficult trade-offs to safeguard citizens' quality of life, improve the efficiency of spending and ensure that the public finances are sustainable.

Stronger and more inclusive growth is required

- The projected rate of economic growth is insufficient to reduce unemployment, inequality and poverty.
- The budget is highly redistributive, but stronger economic growth is needed to sustain the fiscal position.
- Moving to a path of stronger and more inclusive growth requires:
  - Transforming patterns of asset ownership and production, promoting competition and de-concentrating product markets.
  - Mobilising private and public capital investment in tandem to help modernise and diversify the economy.
  - Providing workers and the poor with access to markets, and social and economic infrastructure.
  - Strengthening transparent government and the rule of law.
  - Investing in research and development, and innovation.
  - Improving the quality of education and training to meet the needs of a modern economy.

Global growth is projected to accelerate…

- The world economy is projected to grow by 3.4 per cent in 2017 and 3.6 per cent in 2018.
- Growth in advanced economies is projected to remain around 2 per cent over the medium term, but this is premised on the introduction and success of a fiscal stimulus in the US.
- Developing economies are expected to remain the main contributors to higher global growth in 2017 and 2018. Growth in India is projected to remain above 7 per cent, and Chinese growth is forecast to decelerate but remain above 6 per cent.
- The outlook for sub-Saharan Africa is expected to improve next year.

IMF growth projections

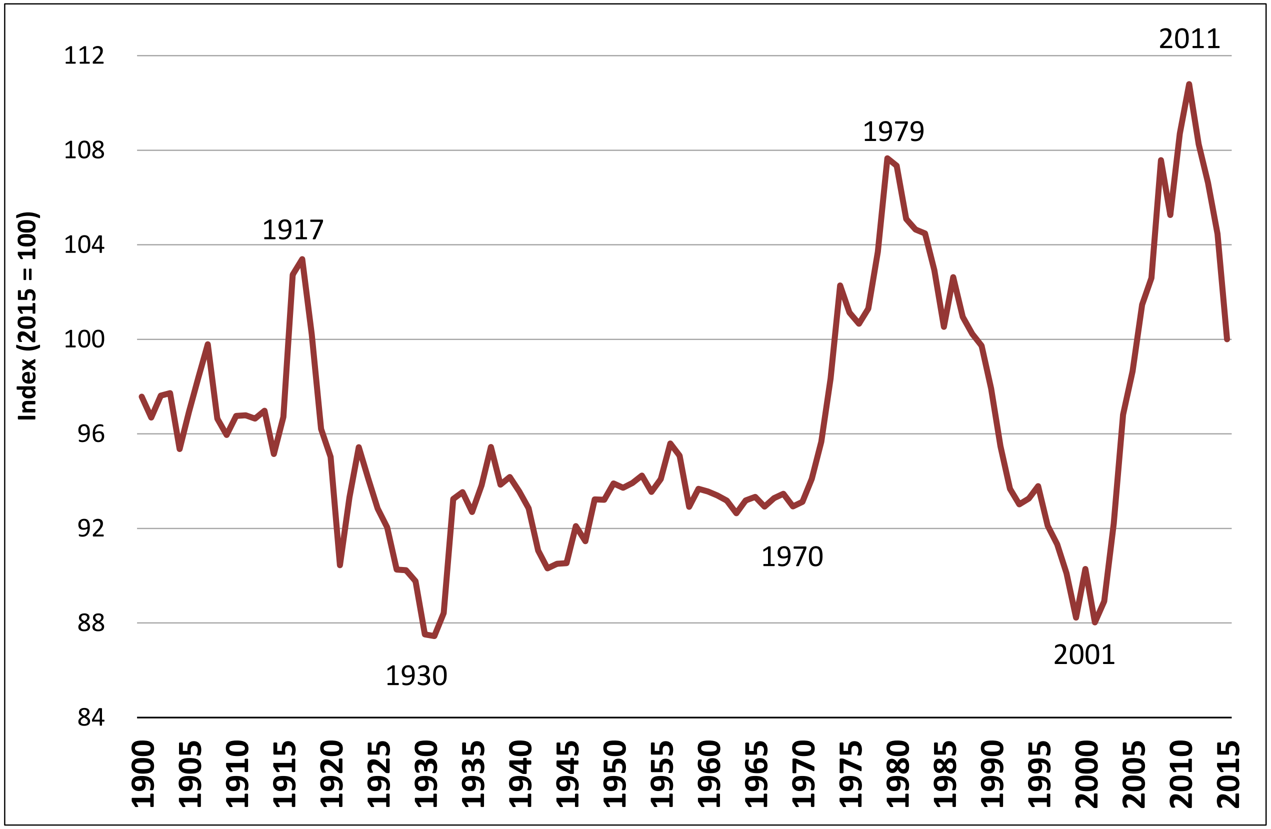
Region/country	GDP projections			
Percentage	2015	2016	2017	2018
World	**3.2**	**3.1**	**3.4**	**3.6**
Advanced economies	**2.1**	**1.6**	**1.9**	**2.0**
United States	2.6	1.6	2.3	2.5
Euro area	2.0	1.7	1.6	1.6
United Kingdom	2.2	2.0	1.5	1.4
Japan	1.2	0.9	0.8	0.5
Emerging markets and developing economies	**4.1**	**4.1**	**4.5**	**4.8**
Brazil	-3.8	-3.5	0.2	1.5
Russia	-3.7	-0.6	1.1	1.2
India	7.6	6.6	7.2	7.7
China	6.9	6.7	6.5	6.0
Sub-Saharan Africa	**3.4**	**1.6**	**2.8**	**3.7**

IMF World Economic Outlook Update, January 2017

…but global uncertainty is rising

- Between 2000 and 2008 South Africa's economic fortunes rose on the strength of a commodity boom and robust domestic investment.
- But by 2011 the decade-long upswing in commodity prices had begun to turn signalling deeper shifts in the global economy.
- Over the past year, a series of political changes in the US and Europe signalled more global uncertainty in the years ahead.
- Growth on the African continent has also fallen sharply.
- South Africa's development rests on a fair, rules-based global trading and financial system.
- Political uncertainty about the future of this system is the single biggest risk to global economic recovery, with potentially serious consequences for South Africa.

Index of South African commodity export prices (real US$)



Source: Budget Review 2017

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South Africa’s economic growth will increase moderately

- Economic growth is forecast to improve moderately on the strength of several developments:
  - The real exchange rate has depreciated, boosting competitiveness
  - An uptick in commodity prices is expected to carry through into 2017
  - The severe drought has eased in several farming regions
  - Electricity supply has stabilised
  - Improved labour relations are expected to boost job creation.

Macroeconomic projections

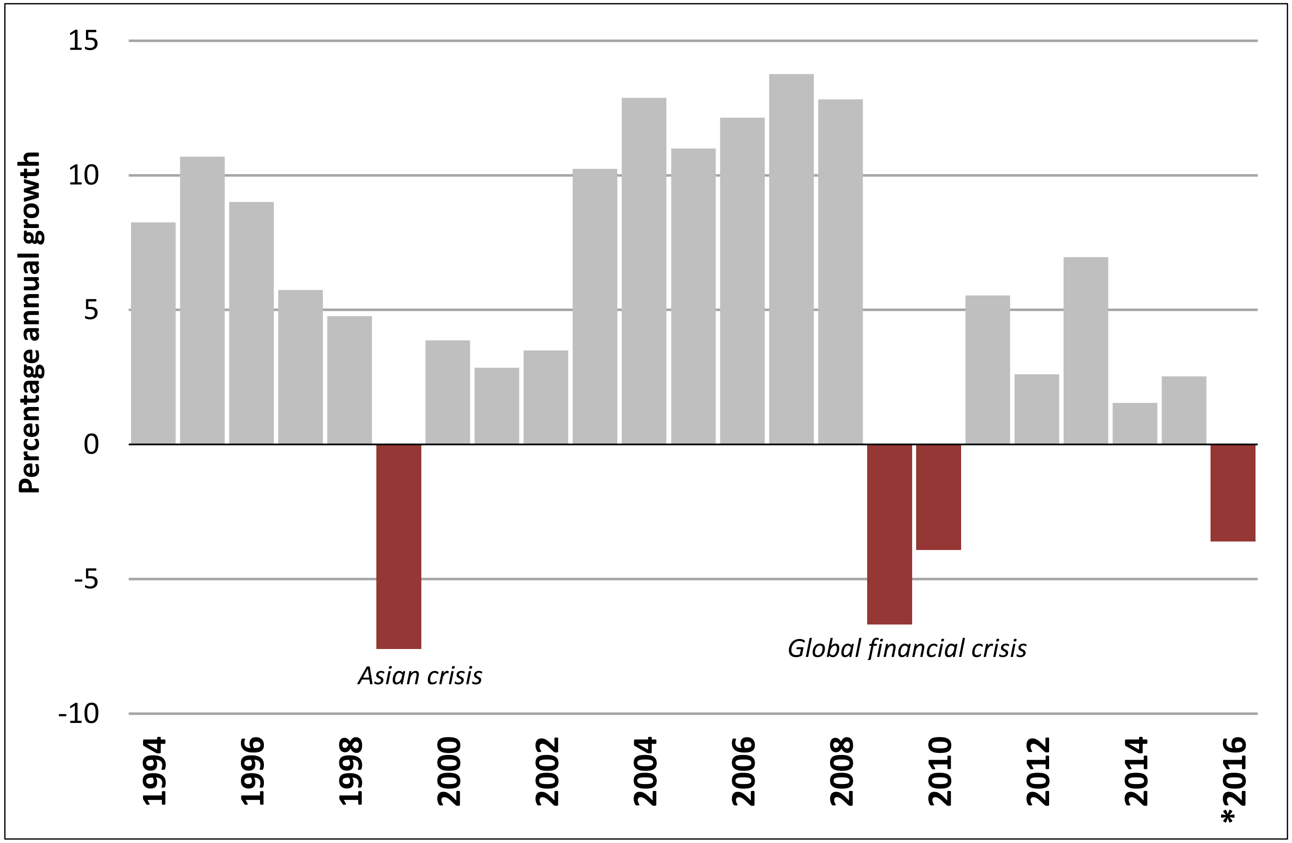
	2013	2014	2015	2016	2017	2018	2019
Percentage change		Actual		Estimate		Forecast	
Final household consumption	2.0	0.7	1.7	0.9	1.3	2.0	2.3
Final government consumption	3.8	1.8	0.2	1.4	0.9	0.0	0.4
Gross fixed-capital formation	7.0	1.5	2.5	-3.6	1.5	1.6	2.8
Gross domestic expenditure	2.8	0.5	1.7	-0.3	1.3	1.8	2.2
Exports	3.6	3.3	4.1	-1.2	1.9	4.9	5.0
Imports	5.0	-0.5	5.3	-3.6	2.0	4.3	4.9
Real GDP growth	**2.3**	**1.6**	**1.3**	**0.5**	**1.3**	**2.0**	**2.2**
GDP inflation	6.6	5.7	4.0	7.2	6.4	5.9	5.8
CPI inflation	5.8	6.1	4.6	6.4	6.4	5.7	5.6
Current account balance	-5.9	-5.3	-4.3	-4.0	-3.9	-3.7	-3.8

Source: National Treasury and South African Reserve Bank

Reviving investment critical to faster growth

- During the first three quarters of 2016, investment in fixed capital fell by 3.9 per cent – the first decline since 2010.
- The main driver was investment by private business, which fell by 5.9 per cent.
- Reversing this contraction requires renewed efforts to strengthen business and consumer confidence.

Real growth in fixed investment



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Service sectors increasingly important in growth and job creation

- Unemployment recorded its highest level since 2003 in the third quarter of 2016, but recovered marginally in the fourth quarter.
- Taken together, mining and manufacturing employment declined by 80 thousand jobs in 2016. The services sector created 119 thousand jobs over the same period
- During 2016:
  - Real value added in the mining sector contracted by 4.1 per cent due to safety stoppages, lower commodity prices and rising operating costs.
  - Real value added in the agriculture, forestry and fishing sector contracted by 7 per cent in the year to September 2016 due to drought conditions.
- Finance, insurance, real estate and business services sector remain the largest contributor to growth

Sector growth trends

Percentage	2011	2012	2013	2014	2015	2016[1]
Agriculture, forestry and fishing	2.0	1.8	3.6	6.9	-5.9	-7.0
Mining and quarrying	-0.7	-2.9	4.0	-1.4	3.2	-4.1
Manufacturing	3.0	2.1	0.8	0.1	-0.3	0.7
Electricity and water	1.5	-0.4	-0.6	-1.3	-1.0	-2.9
Construction	0.4	2.6	4.6	3.6	2.0	1.4
Wholesale and retail trade	4.1	4.0	1.9	1.4	1.4	1.1
Transport and communication	3.5	2.4	2.8	3.1	1.4	-0.1
Finance, real estate and business services	4.3	3.0	2.5	2.4	2.8	2.1
Personal services	2.5	2.1	2.2	1.7	1.1	1.1
General government	4.7	3.0	2.9	2.7	0.7	1.7
GDP	**3.3**	**2.2**	**2.3**	**1.6**	**1.3**	**0.4**

1. Up to September 2016

Source: Statistics South Africa

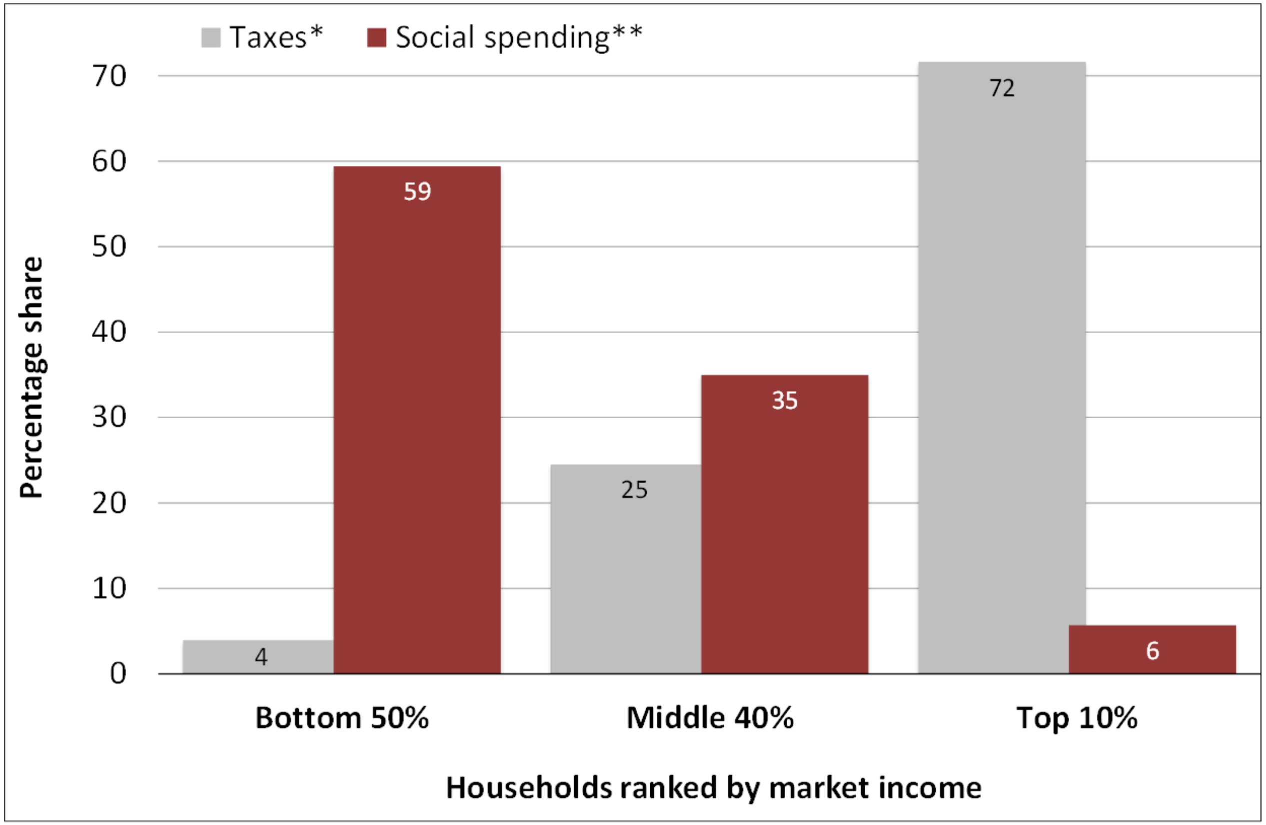
Summary of budget proposals

- Expenditure revised down by R10 billion in 2017/18 and an additional R28 billion will be raised in taxes.
- The budget deficit for 2017/18 will be 3.1 per cent of GDP, in line with government's commitments.
- Government net debt will stabilise at about 50 per cent of GDP over the next three years.
- Redistribution in support of education, health services and municipal functions in rural areas remains the central thrust of our spending programmes.
- Government's wage bill has stabilised. Procurement reforms continue to improve the effectiveness of public spending and opening opportunities for small business participation.
- Our state-owned companies and finance institutions play a substantial role in infrastructure investment and financing development. Restructuring of governance and improved financial performance is necessary to ensure they can deliver on their developmental mandates.

The budget redistributes income to poor and working families

- The budget plays a central role in transformation by promoting redistribution and directing scarce resources towards catalytic investments in human and physical capital.
- But the budget depends on the economy to generate the resources to finance these investments, and South Africa has had several years of very low growth.

Distribution of taxes and spending by household income



Based on Statistics South Africa's income and expenditure survey, 2010/11
**Includes personal income tax, value-added tax, fuel levies and excise* ***Includes social grants, free basic electricity and water, health and education budgets, Source: Inchauste et al. (2015), Distributional Impact of Fiscal Policy in South Africa, World Bank*

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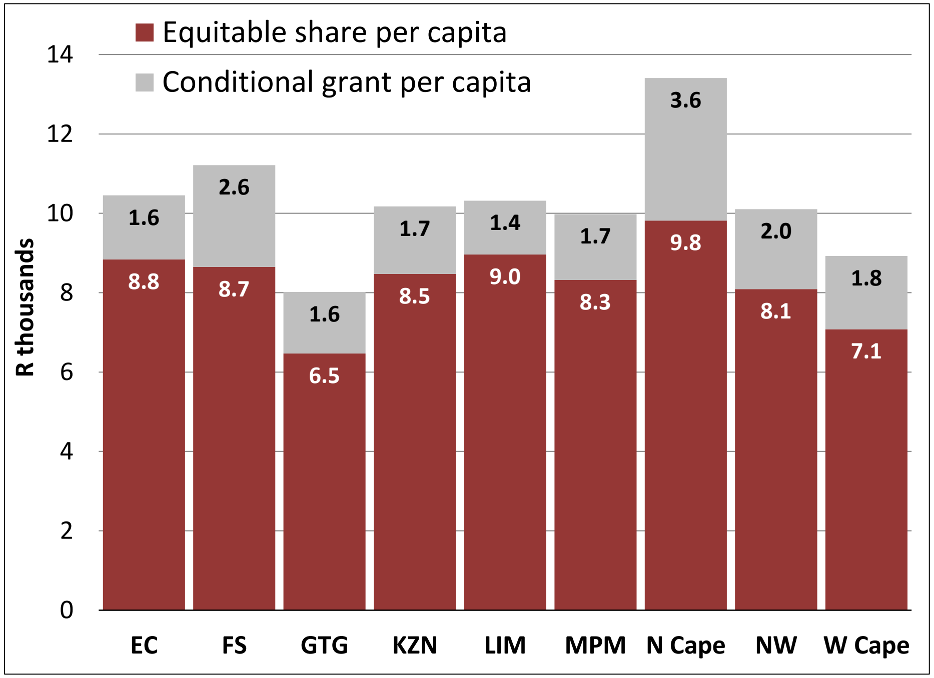
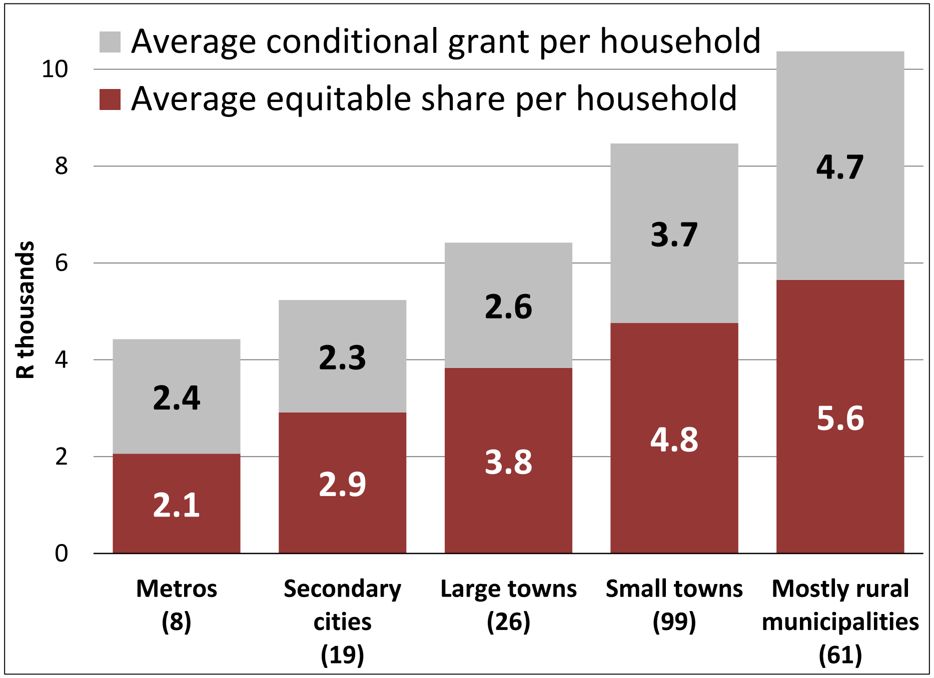
The budget redistributes resources to the rural poor

- The division of revenue redistributes substantial resources from the urban economy to fund services in rural areas.
- It also subsidises services to millions of poor households in towns and cities through considerable allocations to urban municipalities and provinces.
- Metropolitan municipalities account for 70 per cent of personal income tax revenue, but receive only 31 per cent of local government transfers.
- The 61 mostly rural local municipalities also receive 31 per cent of transfers to local government, but account for only 5 per cent of personal income tax revenues.

Per capita allocations to provinces



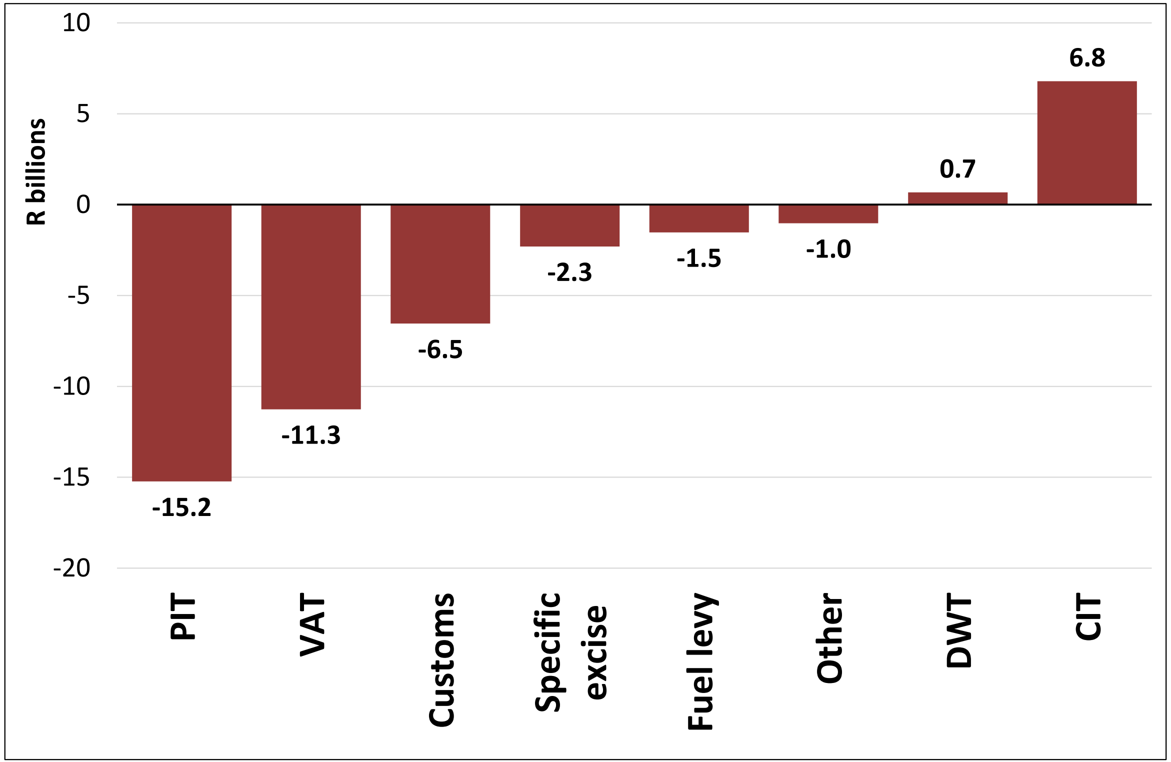
Per household allocations to municipalities



Tax revenue shortfall in 2016/17

- Gross tax revenue for 2016/17 is R30.4 billion lower than the original estimate at the time of 2016 Budget.
- Personal income taxes, customs duties and import VAT are all expected to show large shortfalls, with smaller shortfalls forecast for the fuel levy and specific excise duties.
- Corporate income tax receipts are expected to marginally outperform projections as a result of higher commodity prices and labour stability in the mining sector, along with strong performance in the financial sector.
- There is uncertainty regarding the path of revenue collection.
- Risks include weaker-than-expected economic growth, and concerns about tax morality, compliance and administration.

Tax performance in 2016/17 relative to Budget 2016 targets



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Consolidated fiscal framework

- Government is committed to a measured path of fiscal consolidation that contains the budget deficit and stabilises public debt.
- The combination of a lower expenditure ceiling and higher taxes will narrow the consolidated budget deficit from an estimated 3.4 per cent of GDP in 2016/17 to 2.6 per cent by 2019/20.

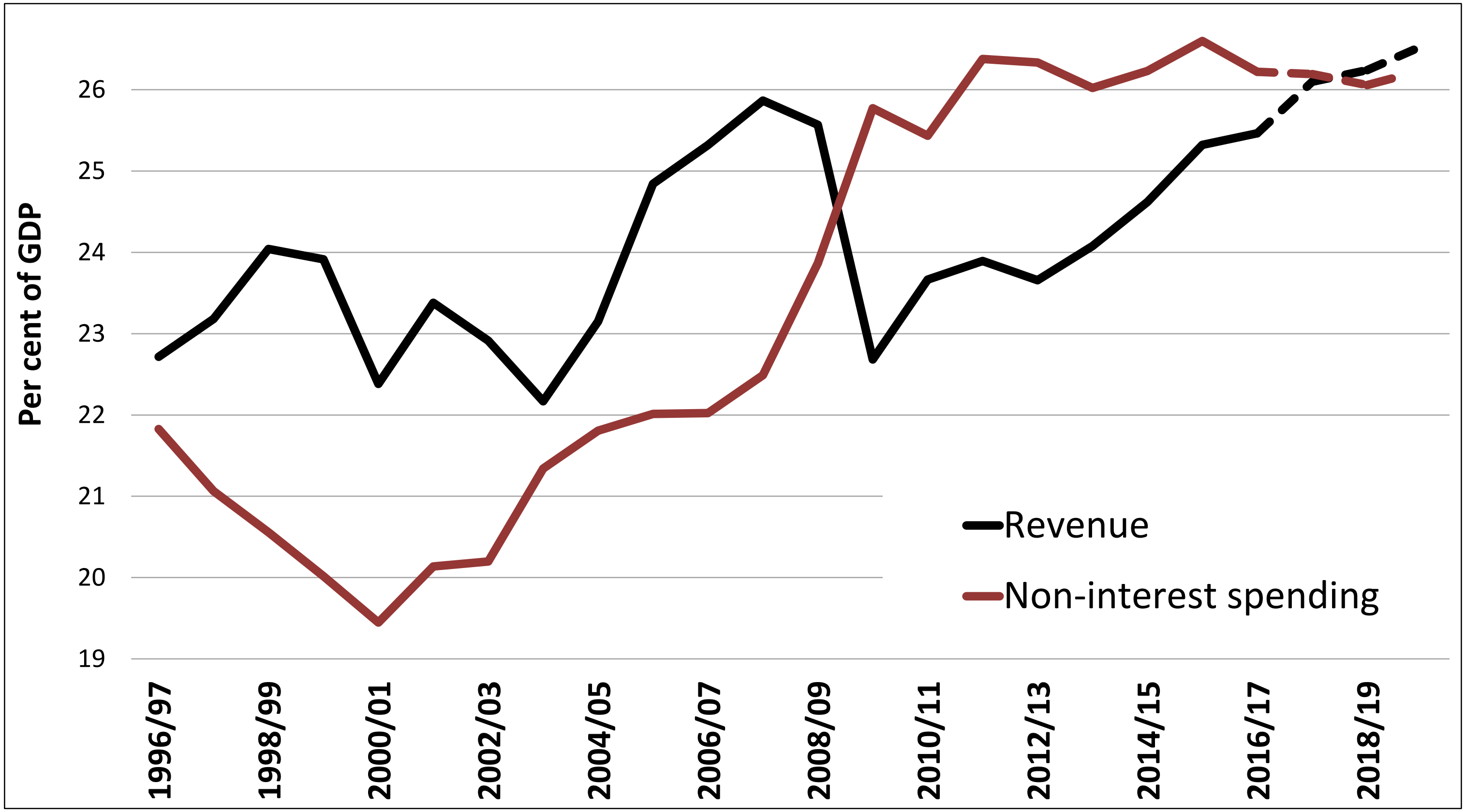
Consolidated fiscal framework

R billion/percentage of GDP	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
		Outcome		Revised estimate		Medium-term estimates	
Revenue	**1 008.1**	**1 098.9**	**1 222.0**	**1 297.3**	**1 414.1**	**1 535.2**	**1 668.5**
	27.8%	*28.4%*	*29.9%*	*29.4%*	*29.8%*	*29.9%*	*30.1%*
Expenditure	**1 143.4**	**1 233.5**	**1 364.2**	**1 445.2**	**1 563.1**	**1 677.1**	**1 814.3**
	31.5%	*31.9%*	*33.4%*	*32.8%*	*33.0%*	*32.7%*	*32.7%*
Non-interest expenditure	*1 033.8*	*1 112.1*	*1 227.9*	*1 291.8*	*1 393.8*	*1 489.5*	*1 608.0*
	28.5%	*28.8%*	*30.0%*	*29.3%*	*29.4%*	*29.0%*	*29.0%*
Interest payments	109.6	121.4	136.3	153.4	169.3	187.6	206.4
	3.0%	*3.1%*	*3.3%*	*3.5%*	*3.6%*	*3.7%*	*3.7%*
Budget balance	**-135.4**	**-134.6**	**-142.2**	**-147.9**	**-149.0**	**-141.9**	**-145.8**
	-3.7%	*-3.5%*	*-3.5%*	*-3.4%*	*-3.1%*	*-2.8%*	*-2.6%*
Primary balance	**-25.8**	**-13.2**	**-5.9**	**5.5**	**20.3**	**45.7**	**60.6**
	-0.7%	*-0.3%*	*-0.1%*	*0.1%*	*0.4%*	*0.9%*	*1.1%*

Main budget primary deficit continues to narrow

- Despite revenue underperformance, the main budget primary deficit will halve from 1 per cent of GDP in 2015/16 to 0.5 per cent of GDP by the end of 2016/17.
- Main budget non-interest spending has stabilised at around 26 per cent of GDP
- Tax increases and buoyancy over the last five years have supported a substantial improvement in revenue

Main budget revenue and non-interest spending



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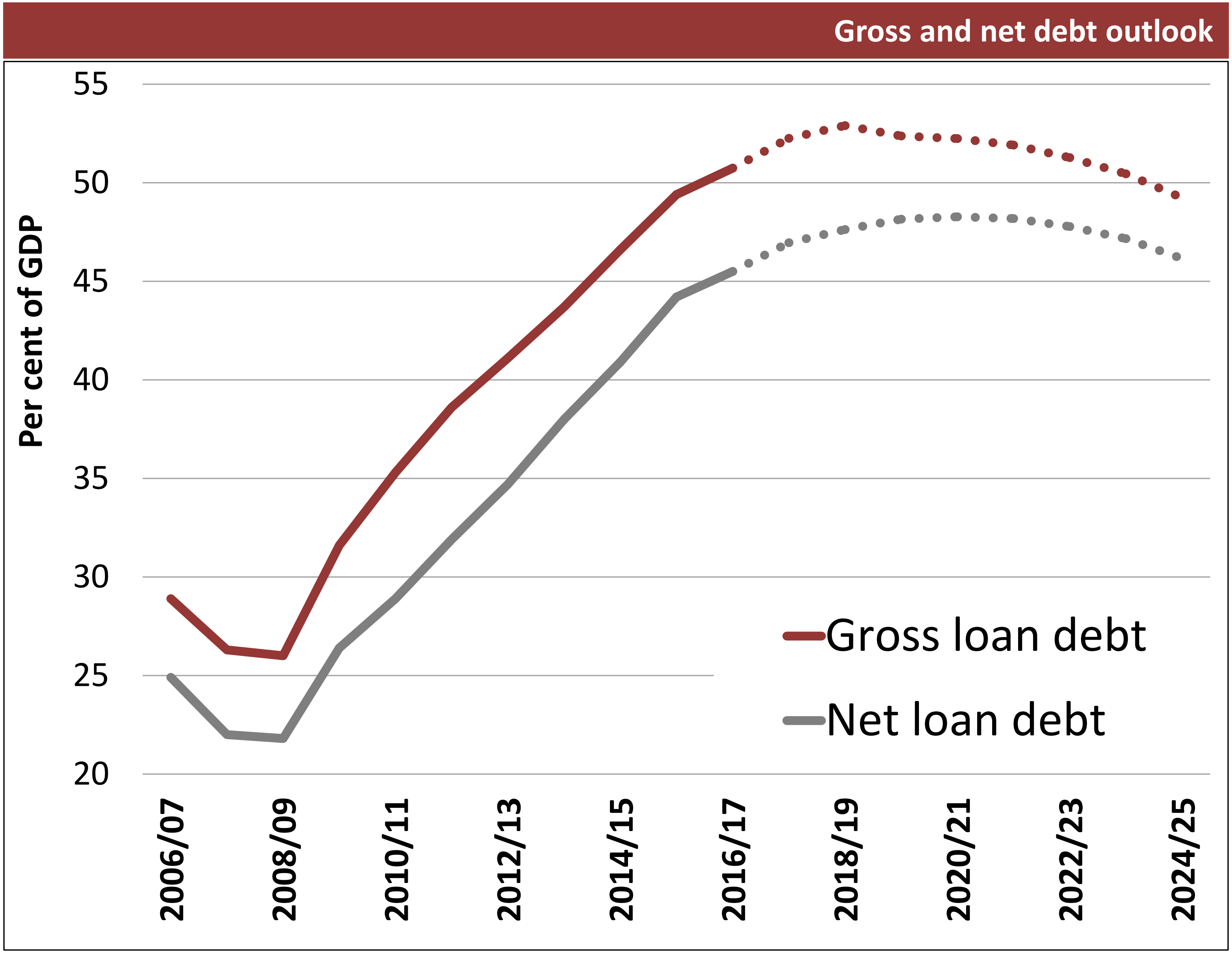
Net debt stabilising below 50 per cent of GDP



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Tax proposals

- The tax proposals this year will raise an additional R28 billion.
- A new top personal income tax rate of 45 per cent for those with taxable incomes above R1.5 million.
- An increase in the dividend withholding tax rate from 15 per cent to 20 per cent.
- Limited bracket creep relief, increasing the tax free threshold from R75 000 to R75 750.
- An increase of 30c/litre in the general fuel levy and 9c/litre in the road accident fund levy.
- Increases in the excise duties for alcohol and tobacco, of between 6 per cent and 10 per cent.
- An increase in the transfer duty threshold from R750 000 to R900 00 will provide relief to the affordable housing market.

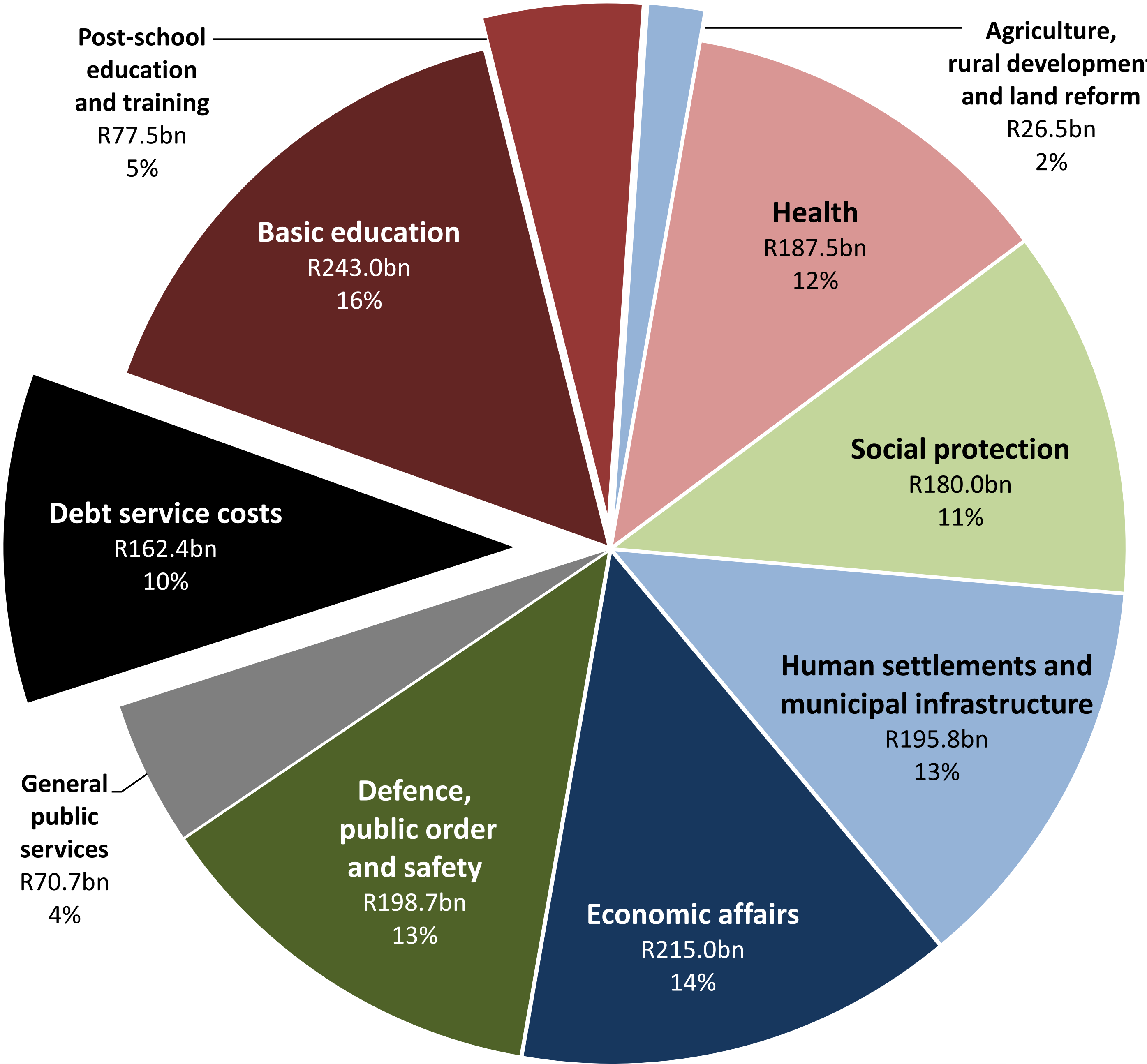
Revenue impact of tax proposals

R million	
Taxes on individuals and companies	
Personal income tax	**16 516**
Revenue from not fully adjusting for inflation	12 148
Revenue if no adjustment is made	*14 628*
Bracket creep adjustment	*-2 480*
New top marginal income tax bracket	4 369
Dividend withholding tax	**6 822**
Taxes on property	**-448**
Indirect taxes	**5 133**
Increase in general fuel levy	3 197
Increase in excise duties on tobacco products	656
Increase in excise duties on alcoholic beverages	1 280

Consolidated spending in 2017/18

The national budget is strongly aligned with constitutional imperatives.

About two-thirds of the 2017 Budget is allocated to functions dedicated to realising constitutionally mandated social rights – including education, healthcare, social security and housing.



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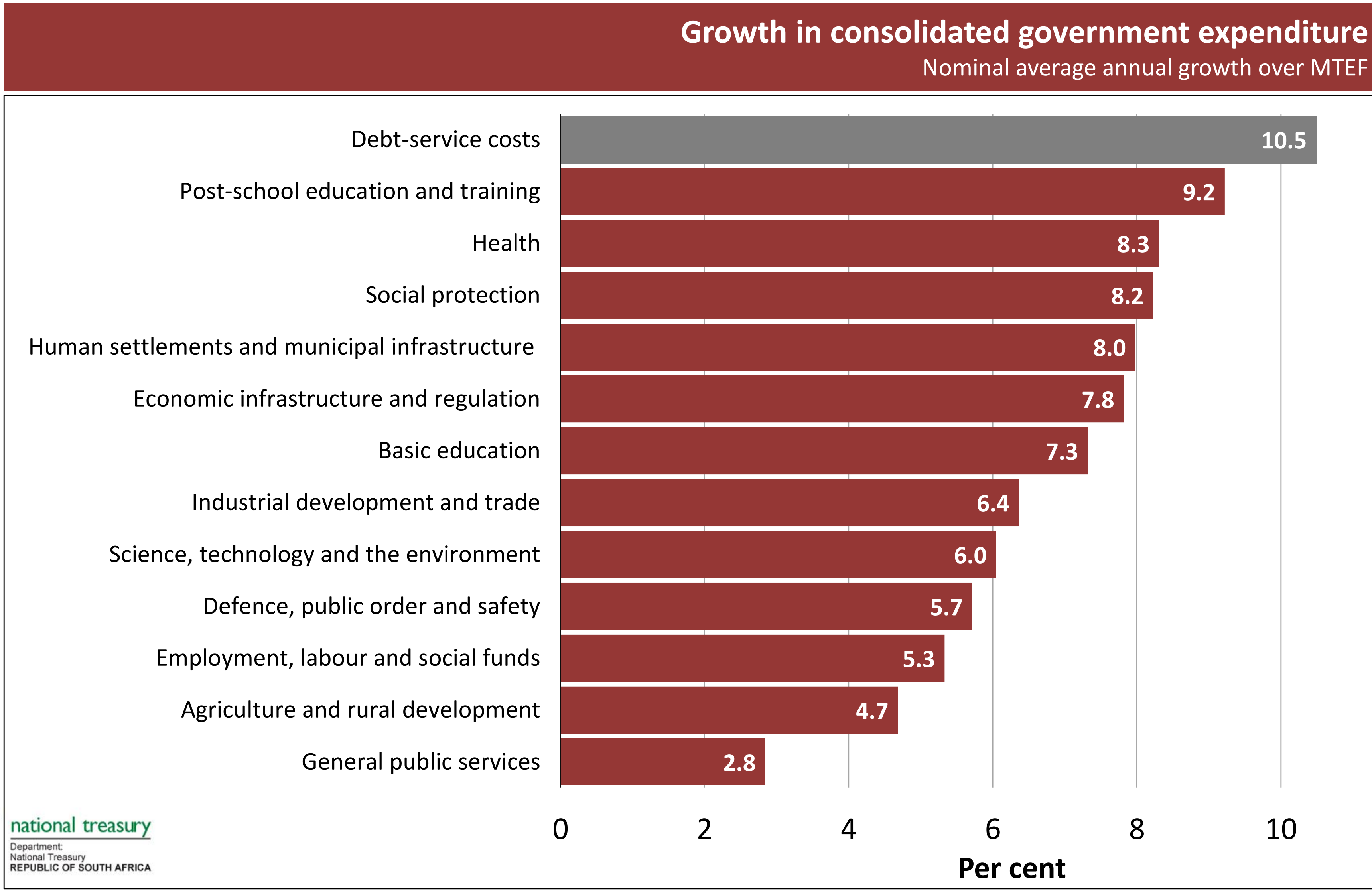
Debt-service costs and post-school education grow fastest



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Budget allocations support economic growth and development

- R3.9 billion for small, medium and micro enterprises and cooperatives.
- R4.2 billion for industrial infrastructure in special economic zones and industrial parks.
- R1.9 billion for broadband implementation.
- R3.9 billion for the Council for Scientific and Industrial Research.
- An additional R494 million for tourism promotion.
- An additional R266m to support the aquaculture sector and realise the goals of the Oceans Economy Phakisa Operation.
- Spending on agriculture, rural development and land reform amounting to nearly R30 billion by 2019/20.

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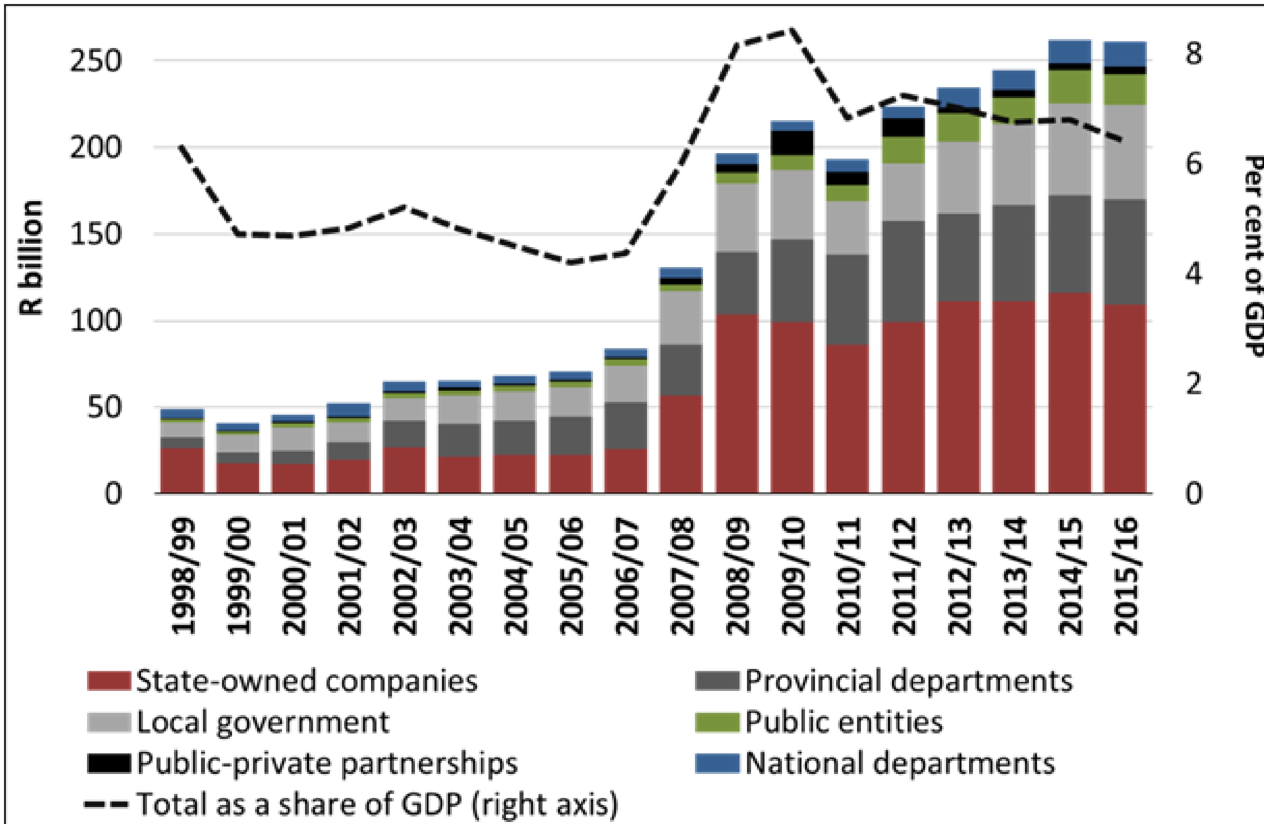
Public investment supports growth and transformation

- Public-sector infrastructure spending estimated to total R947.2 billion over MTEF
- Economic infrastructure spending, mainly by state-owned companies, accounts for 77 per cent of total public-sector infrastructure spending.
- A new infrastructure facility is to be launched this year. The facility would address many problems in the existing infrastructure budgeting process.

Public sector infrastructure spending



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Improving procurement for transformation

- Chief Procurement Officer aims to **save R25 billion** over the medium term by renegotiating contracts with government's top 100 suppliers, consolidating spending on common goods, using technology to reduce duplication and cutting red tape.
- Revised preferential procurement policy regulations take effect on 1 April 2017 and provide expanded opportunities for black firms to benefit from government procurement.
- Where large firms are awarded tenders of R30 million or more, 30 per cent of the contract value must go to small firms, where feasible.
- South African suppliers will enjoy preference in respect of goods with significant local content and employment benefits.
- To increase market access and competition, the National Treasury will give private companies access to its supplier database and allow them to publish their own tenders on the eTender portal.

Local content requirements

	Product
Textile, clothing, leather and footw ear	100%
Pow er pylons, substations, related hardw are	100%
School furniture	100%
Working vessels/boats and components	10% -100%
Conveyance pipes	80% - 100%
Components and conversion activities	50% - 100%
Tw o-w ay radio terminals components	20% - 100%
Wheelie bins	100%
Fire trucks (crew cabin, super structure & assembly)	100%
Steel construction materials	100%

1. Excludes products below 100 per cent local content requirements

Source: Department of Trade and Industry

NHI fund to be established

- All South Africans should have equitable access to quality, affordable healthcare.
- During 2017/18 government intends to establish a national health insurance fund.
- Its initial focus will be to expand access to a common set of maternal health services and make hearing aids and spectacles available through school health programmes.
- It will offer improved psychiatric care, and services for people with disabilities and the elderly.
- The service package, delivered through public and private medical practitioners, will be progressively expanded.
- The fund will be established through a combination of reorganisation and legislative amendments.
- Government is exploring a small reduction in the tax credit on medical scheme contributions to provide initial resources for the fund.
- During 2017/18, the National Treasury and the Department of Health will work with a wide range of stakeholders to publish the final national health insurance white paper, refine the draft implementation plan and revise cost estimates.

New budgeting facility for infrastructure projects

- Government is proposing a new financing facility for large infrastructure projects that require funding or other state support, such as sovereign guarantees.
- It will address shortcomings in the planning and execution of infrastructure projects, particularly as they relate to life-cycle budgeting, operations and maintenance costs.
- The facility will help government build a pipeline of projects that have undergone rigorous technical analysis.
- A technical unit will develop government-wide project design and evaluation guidelines that will be issued as a regulation by the National Treasury. Projects will be rigorously appraised from inception until financial closure.
- Large infrastructure projects typically take more than three years to complete. The reform will ensure that full life-cycle, multi-year budgeting takes place in a transparent manner.
- This will be done by introducing legislation that will govern funding, implementation and reporting requirements for very large projects.
- The first phase of the facility is expected to begin operating in 2017 with the establishment of a technical unit and governing board.

Public-sector institutions

- Public-sector institutions play a central role in achieving South Africa’s development goals. To deliver on their mandates, they need to be financially sound.
- The public-sector borrowing requirement will be R254.4 billion, or 5.8 per cent of GDP, in 2016/17, revised up by R32.8 billion since the 2016 Budget.
- State-owned companies project total capital spending of R432.8 billion over the medium term, with borrowing reaching R307.1 billion.
- Over the next two years, the aggregate loan portfolio of development finance institutions is projected to increase by 20.5 per cent to R195.9 billion, with support targeting farmers, industrial development and municipal infrastructure.
- The deteriorating financial position of the social security funds is a serious risk, owing to growing liabilities at the Road Accident Fund and the Compensation Fund.

Improving the performance of state owned enterprises

- Operational inefficiencies, poor procurement practices, weak corporate governance and failures to abide by fiduciary obligations have plagued several companies that are now in serious financial difficulty.
- Addressing this requires not only stabilisation measures at troubled entities, but a broader restructuring of state-owned companies to ensure they can deliver on their developmental mandates.
- In November 2016, Cabinet:
  - Endorsed a framework to guide collaboration between state-owned companies and the private sector on infrastructure projects.
  - Adopted a guideline for the remuneration and incentive standards for directors of state-owned entities.
  - Approved the broad thrust of a guide for the appointment of boards and executive officers.
  - Recommended further consultation on the first draft of a new government shareholder policy, which will culminate in overarching legislation for state-owned companies.
  - Noted the proposal to determine and cost the developmental mandates of state-owned enterprises.

Conclusion

- Broad-based transformation should promote growth, mobilise investment, create jobs and empower citizens. It must create new resources to support social change, including assets and livelihoods for the majority, and strengthen South Africa's constitutional foundations.
- The budget plays a central role in transformation by promoting redistribution and directing scarce resources towards catalytic investments in human and physical capital.
- But the budget depends on the economy to generate the resources to finance these investments, and South Africa has had several years of very low growth.
- The 2017 Budget proposes several difficult trade-offs to safeguard citizens' quality of life, improve the efficiency of spending and ensure that the public finances are sustainable.
- Slow economic growth has placed enormous pressure on the public finances. Government remains committed to a measured, prudent course of fiscal consolidation to narrow the budget deficit and stabilise debt. Doing so will reduce the economy's exposure to global volatility.
- Government, working with business, labour and civil society can act decisively to boost investment and shift the country to a path of transformation for inclusive growth.

Understanding the budget