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NEWSLETTER

MAY 2017

Emerging markets stocks and currencies traded near a two-year high, fuelled by investors' appetite for riskier assets. The inflow of capital to emerging markets masked the downgrade of South Africa's (SA) foreign denominated debt, to junk status. The rand remained stable versus the US Dollar and SA bonds recovered in the latter part of the month delivering a return of 1.42%. The JSE All Share Index delivered a return of 3.64% while property closed 0.51% higher for the month. SA bonds and the rand could have been much stronger if it was not for the political instability, and the downgrade by Standard & Poor's and Fitch.

The impact of the downgrade might not be apparent over the short-term — it will, however, have devastating effects over the long-term. SA requires capital, especially from foreigners, to finance projects that will stimulate economic growth. In the past, SA did not find it difficult to raise capital. There are, however, early signs of the adverse impact of a downgrade:

+ The South African National Roads Agency Limited (SANRAL) postponed the selling of bonds after Transnet raised only R20m of the planned R200m. Before the downgrade in March, Transnet managed to raise R300m.
+ MTN and Barloworld also delayed their listed debt auctions.
+ Pioneer Foods withdrew a cautionary announcement made to shareholders on 7 March involving it in a material transaction. It cited the sovereign debt downgrade for the derailing of the plans.

SA's ministry of finance tasked the Davis Tax Committee to investigate the inclusion of wealth tax to reduce inequality in SA. They are considering tax on land, national tax on the value of property (in addition to municipal rates) and an annual wealth tax. Instead of only paying estate duty at death, the wealth tax will be levied once a year.

Thomas Piketty, French economist, introduced the idea of wealth tax. A study done by Chris Evans, professor of taxation at the University of New South Wales, noted that countries of the Organization for Economic Cooperation and Development (OECD) derived less than 1% from their total revenue from wealth tax. The number of countries employing wealth tax decreased from almost 50% in 1990 to only a few countries such as France, Norway and Switzerland. A study done by the Tax Foundation suggests that tax on wealth, as proposed by Piketty, will have a negative impact on economic growth in a country such as the United States (see chart below). It is also difficult to administer this tax. Let's assume a wealth tax of 1% on a property with a value of R2m. It will be difficult for a person with a fixed income, especially a pensioner, to pay an annual tax of R20 000 on the value of that property. It is easier to pay this tax at the point of transfer by using the proceeds of the sale. The deadline for submission to the Davis Tax Committee is the end of this month.