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Budget Preview: SA is unlikely to show much decline in debt projections in the near term, as any revenue overrun will be tiny in comparison, but must work down longer-term projections

Tuesday 16 February 2021

Figure 1: Macroeconomic outlook - summary

	2019	2020	2021	2022	2023
	Actual		Forecast		
Real GDP growth	0.2	-7.8	3.3	1.7	1.5
Investec	0.2	-7.3	2.9	1.0	2.2
GDP at current prices (R billion)	5 078	4 885	5 240	5 553	5 877
Investec	5 078	4 904	5 251	5 552	5 930
Consumer price index (CPI)	4.1	3.2	4.1	4.4	4.5
Investec	4.1	3.3	4.0	4.8	5.0

Source: National Treasury, Investec

- The Budget Review to be tabled on the 24th February will expand on key fiscal reforms outlined in October's Medium Term Budget Policy Statement (MTBPS). Lower real and nominal growth coupled with expenditure side overshoot, exacerbated by necessary COVID-19 relief funding, continues to undermine Treasury's efforts to adhere to fiscal consolidation.
- The effects of the pandemic have further served to highlight the fragility of South Africa's economic predicament, which continues to be weighed down by structural inefficiencies, contentious policy decisions and a history of corruption.
- By the end of December 2020 (latest government finance figures published), South Africa's cumulative budget deficit for the first three quarters of the 2020/2021 fiscal year had reached -R432.97billion.
- Main budget revenue was projected to reach R1.1trillion in 2020/2021, but there is now the possibility of a modest overrun, with revenue receipts already at R869bn or 79.1% of the projected total for the year. Last year, during the comparable period revenue receipts were 71.9% of the total for the year.
- Expenditure at 1.3trillion, is sitting at 72% of the estimated total for the fiscal year of R1.8trillion, a similar position to last year.
- We expect expenditure to be essentially in line with Treasury's MTBPS estimate and thus coupled with our slightly stronger GDP forecast, we anticipate a deficit of around -15.0% of GDP in 2020/21. This is narrower than the MTBPS estimate of -15.7%, but substantially weaker than February 2020's pre-pandemic budget estimate of -6.8%.
- While some fiscal consolidation is planned by closing the budget deficit to -7.3% of GDP by 2023/24 and stabilising the debt to GDP ratio by 2025/26 at 95.3% of GDP, this will likely not be enough for credit rating agencies as Fitch's current negative outlook warns of further downgrades for SA (Fitch and S&P have SA at BB-, Moody's at ba2, the BB equivalent).
- The 2021 State of the Nation Address (SONA) detailed the progress that has been made thus far with regards to the implementation of key reforms stipulated in the reconstruction and recovery plan. Evidence of implementation is necessary to boost investor confidence and accordingly drive growth.

Figure 2: Budget Balance and Gross Loan Debt Forecasts

% of GDP	2020/21	2021/22	2022/23	2023/24
		Medium-term estimates		
Budget balance	-15.0%	-10.0%	-8.5%	-7.0%
Total gross loan debt	81.8%	84.5%	88.5%	90.5%

Source: Investec

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Figure 3: Consolidated government fiscal framework

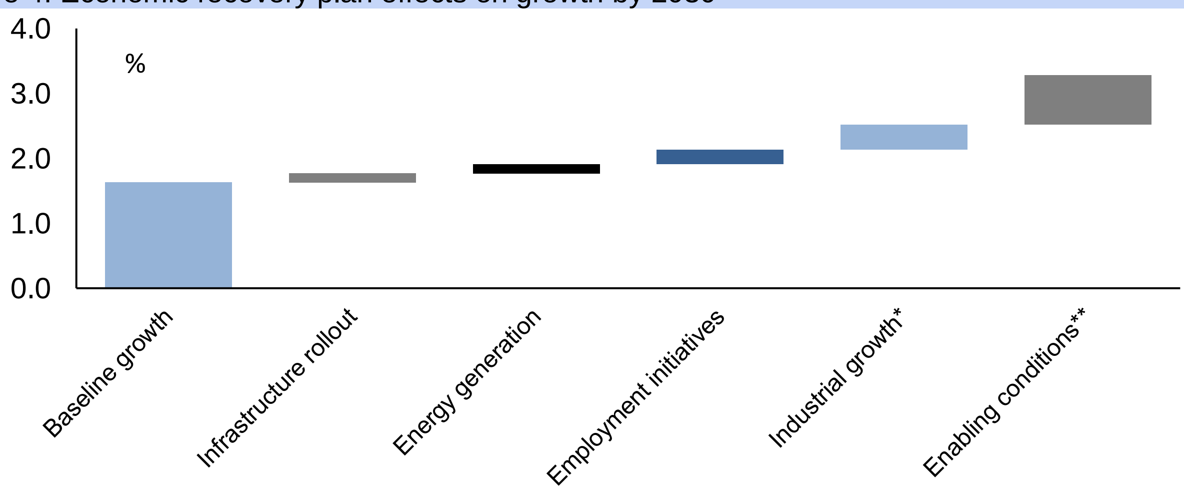
R billion/% of GDP	2019/20	2020/21	2021/22	2022/23	2023/24
	Outcome	Revised	Medium-term estimates		
Revenue	1 518.1	1 276.7	1 457.6	1 595.8	1 705.7
	29.5%	*26.3%*	*27.4%*	*28.3%*	*28.6%*
Expenditure	1 847.7	2 037.8	1 993.5	2 079.6	2 139.2
	35.9%	*41.9%*	*37.5%*	*36.9%*	*35.9%*
Budget balance	-330.6	-761.1	-535.9	-483.9	-433.4
	-6.4%	*-15.7%*	*-10.1%*	*-8.6%*	*-7.3%*
Total gross loan debt	3 261.3	3 974.1	4 551.8	5 071.3	5 536.2
	63.3%	*81.8%*	*85.6%*	*90.1%*	*92.9%*

Source: National Treasury MTBPS 2020

The economy entered a recession in Q4.19 which was exacerbated by the collapse in GDP in Q2.20 of -51.0% on a quarter on quarter seasonally adjusted annualised basis (qqsaa), all of which exacerbate the debt to GDP ratios. Growth rebounded in Q3.20 to 66.1% qqsaa, supported by the easing of domestic lockdown restrictions during the third quarter, coupled with a sharp recovery in global trade, and the uptick in commodity prices. We anticipate a lift in Q4.20's GDP reading of around 2.5% qqsaa, which would culminate in a -7.3% y/y decline in 2020's GDP outcome, a slightly stronger result than Treasury's estimate of -7.8% (MTBPS), but still dire.

Going forward, depending on the effectiveness of the vaccination rollout and the speed of recovery of global economies, we are projecting real GDP to increase by 2.9% y/y this year and thereafter moderate to 1.0% y/y in 2022. Indeed, a return to pre-pandemic actual levels of activity is likely to be protracted.

Figure 4: Economic recovery plan effects on growth by 2030



Source: National Treasury

*Agriculture and industrial initiatives
**Reducing barriers to entry, easing the skills constraint and implementing tourism initiatives

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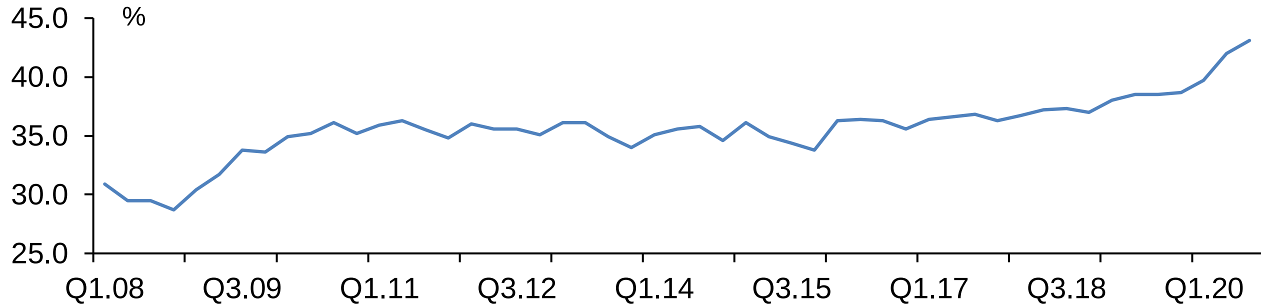
Figure 5: Expanded Unemployment Rate Trend



Source: Stats SA

Revenue under-collection has been a consistent theme over the past few years as unemployment has spiked. Specifically, the official unemployment rate reached 30.8% in Q3.20, while the labour absorption rate remains staggeringly low by international standards at around 37.5%. Furthermore, subdued levels of confidence have dampened tax morality.

The most recent government finance figures, however, show that from 1st April to 31st December of the current (2020/21) fiscal year, government revenue receipts at R869bn are already at 79.1% of the planned collection of R1.1trillion (MTBPS forecast). If this persists there could be a revenue overrun. During the comparative period last year, revenue collection was only 71.9% of the outcome for the full 2019/20 fiscal year of R1.3trillion. But while we could see a moderate revenue overrun this fiscal year, total tax receipts will still be down in rand terms when compared to 2019/2020. This, coupled with the substantial increase in expenditure demands as a result of the Covid-19 pandemic, will necessitate a further reduction in expenditure and the continued reprioritization of spending away from less urgent areas.

Figure 6: Revised revenue projections

R billion	2020/21	2021/22	2022/23	2023/24
2020 Budget	**1,425.4**	**1,512.2**	**1,609.7**	
Buoyancy	0.93	1.00	1.01	
2020 special adjustments budget	**1,121.3**	**1,291.4**	**1,394.0**	**1,508.9**
Buoyancy	3.23	1.58	1.46	1.33
Revised estimates	**1,112.6**	**1,279.5**	**1,392.2**	**1,503.2**
Buoyancy	3.18	1.59	1.50	1.35
Change since 2020 Budget	**-312.8**	**-232.7**	**-217.5**	
Change since 2020 special adjustments budget	**-8.7**	**-11.9**	**-1.8**	**-5.7**

Source: MTBPS, National Treasury

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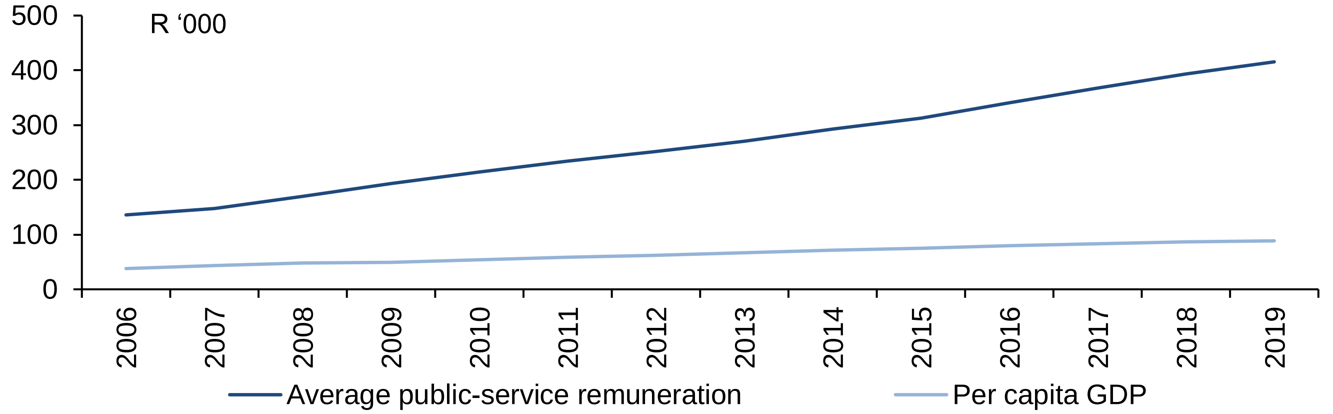
Figure 7: Public-service remuneration and per capita GDP



Source: National Treasury

The better than anticipated collection rate largely came about by underestimation of revenue collection this year and was supported by increased efficiencies at SARS. A cumulative revenue surplus of around R100bn could occur which would fund the vaccination rollout, remove the need for tax hikes and have some monies over to reduce borrowings. Indeed, we anticipate that Treasury is likely to be lenient on the tax front, with little to no income tax increase and even potentially allowing for fiscal drag. Additionally, no corporate tax increases are anticipated as government prioritises economic recovery.

There is the possibility the fuel levy and other indirect taxes could rise. VAT is unlikely to be adjusted however, as the impact of the stringent lockdown restrictions in South Africa has had an extremely severe impact on households, whom even prior to the pandemic were already financially constrained. Indeed, many businesses have been forced to shut their doors or reduce their workforce. Specifically, the number of business liquidation cases increased in Q4.20, according to Stats SA and on a trend basis, the 12-month moving average continues to signal an uptick in the actual number of liquidations. Reducing the public sector wage bill remains a priority. Indeed, "since 2008, the real cost of the public-service wage bill has risen by around 40% in real terms over the past decade," according to Treasury.

Figure 8: Reductions to compensation of employees

R million	**2020/21**	**2021/22**	**2022/23**	**2023/24**
Function				
Community development	-632	-1,636	-2,294	-1,545
Economic development	-1,676	-4,469	-6,084	-4,112
General public services	-1,268	-4,064	-5,444	-3,765
Health	-8,987	-19,147	-27,388	-17,202
Learning and culture	-14,007	-30,038	-42,948	-27,207
Peace and security	-9,185	-21,644	-28,848	-18,863
Social development	-760	-2,190	-3,065	-2,116
Total	**-36,515**	**-83,187**	**-116,071**	**-74,811**

Source: National Treasury

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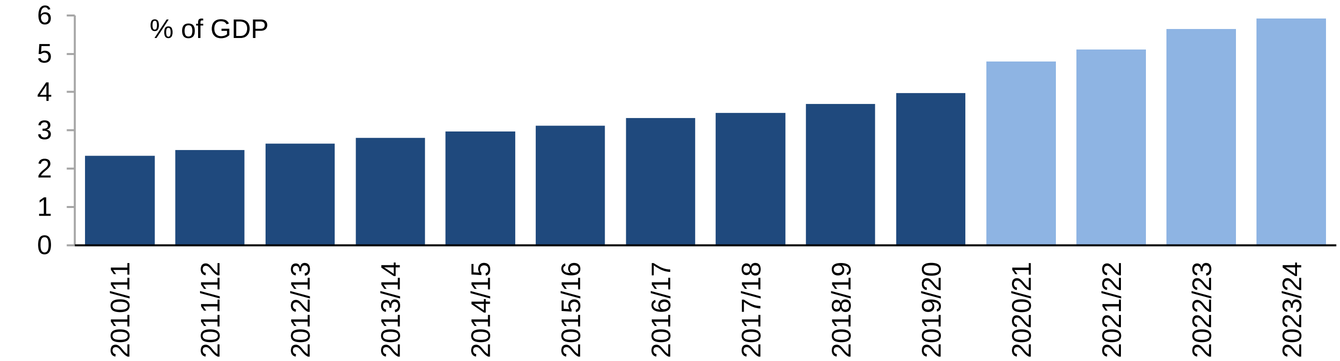
Figure 9: Debt-service costs as a % of GDP

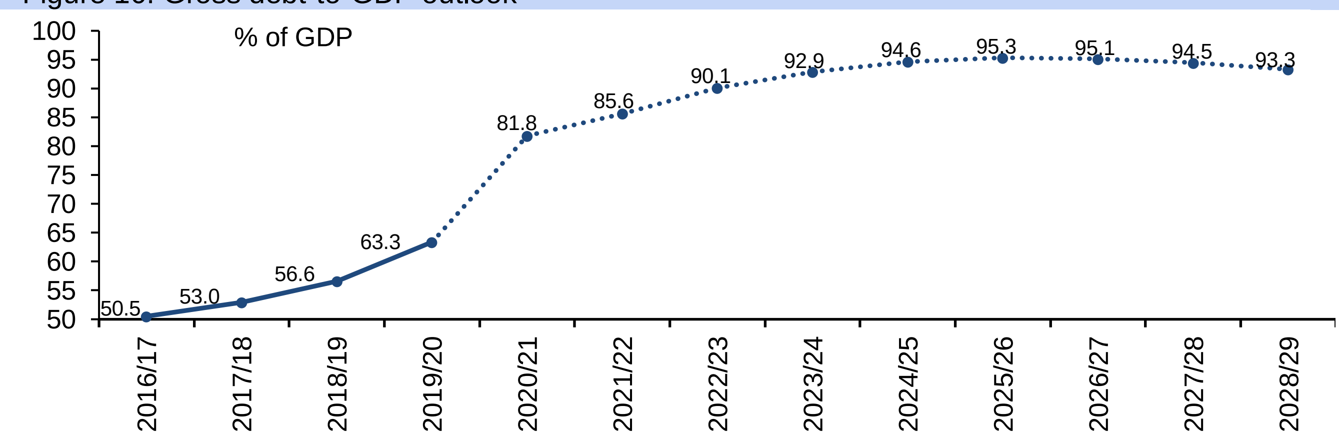


Source: National Treasury

Decreasing borrowing costs in the face of negative outlooks from the rating agencies is also a key objective. Interest payments continue to absorb a "(g)rowing share of limited public resources, which increasingly crowds out spending on social and economic investment," according to Treasury. Debt-service costs make up a marked 4.8% of GDP, this is up from 3.3% just a few years ago. Indeed, "the probability of a debt trap – in which rising debt-service costs are increasingly paid from additional borrowing – has increased," according to Treasury.

Projected borrowings are forecast to reach 81.8% of GDP in 2020/2021 and peak at 95.3% of GDP in 2025/26, according to the 2020 MTBPS, however a lower reading, closer to 90% could likely be achieved, if wastages, inefficacies and corruption are eliminated, and SARS efficiencies quicken.

Figure 10: Gross debt-to-GDP outlook



Source: National Treasury

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Figure 11: Main budget expenditure ceiling[1]

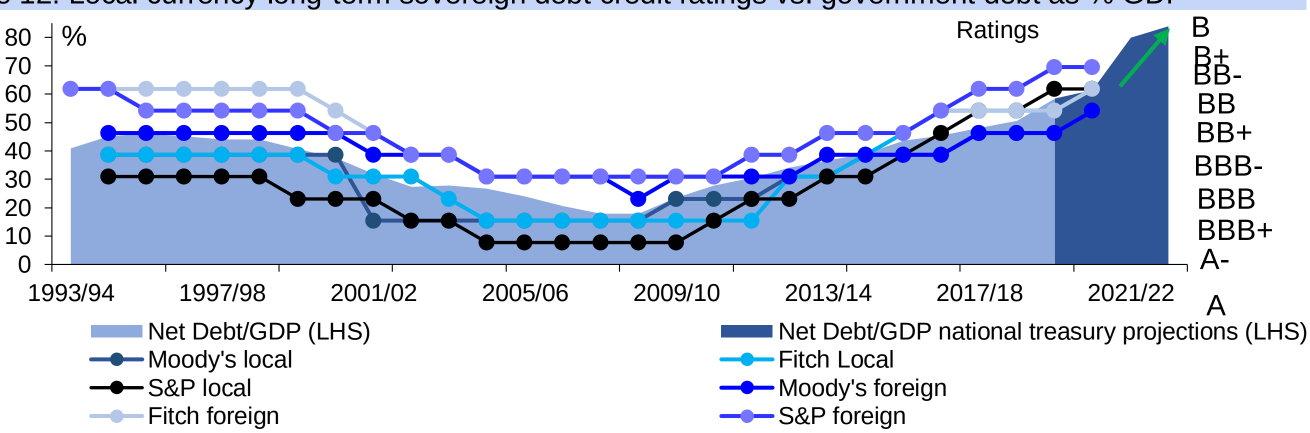
R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
2018 MTBPS	1,225,455	1,314,865	1,416,597	1,523,762	1,630,026		
2019 Budget Review		1,310,156	1,407,595	1,502,052	1,607,758		
2019 MTBPS		1,307,235	1,404,675	1,493,029	1,591,287	1,673,601	
2020 Budget Review			1,409,244	1,457,703	1,538,590	1,605,098	
2020 MTBPS			**1,418,408**	**1,502,867**	**1,479,709**	**1,516,052**	**1,529,585**

Source: National Treasury

1. The expenditure ceiling differs from main budget non-interest expenditure. The precise definition and calculation of the expenditure ceiling is contained in Annexure C

In the MTBPS Treasury stressed that "over the medium term, government will phase in the principles of zero-based budgeting," allowing for optimal resource allocation. The expenditure ceilings for 2021/2022 and 2022/2023 are in turn, R58.9 billion and R89 billion lower than February's estimates. The implementation of "broad-based reforms at state-owned companies" (which continue to weigh heavily on the fiscus), to improve their efficacy and sustainability is paramount. Indeed, by 2022/23, contingent liabilities are projected to surpass R1 trillion. Specifically, Government's guarantee portfolio lifted "(f)rom R680 billion in March 2019 to R693.7 billion in March 2020, of which the largest facility," was conceded to Eskom. Further information of funding to SOE's will be detailed in February's budget. Indeed, the contentious issue of additional financing to cash-strapped state entities continues to weigh on sentiment and is a key concern for rating agencies.

Figure 12: Local currency long-term sovereign debt credit ratings vs. government debt as % GDP



Source: Credit rating agencies, National treasury, Bloomberg

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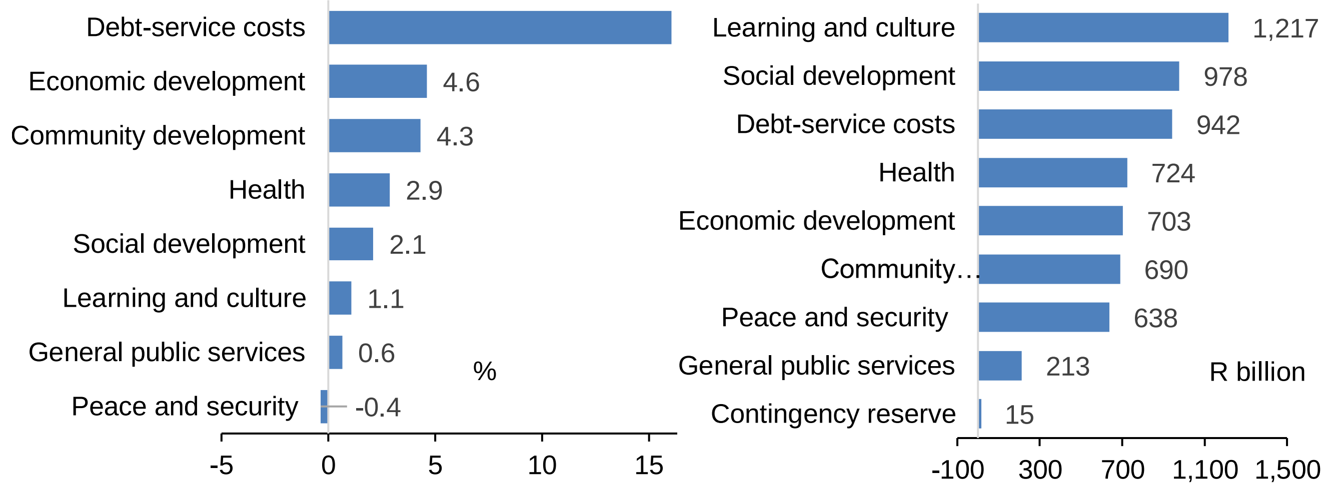
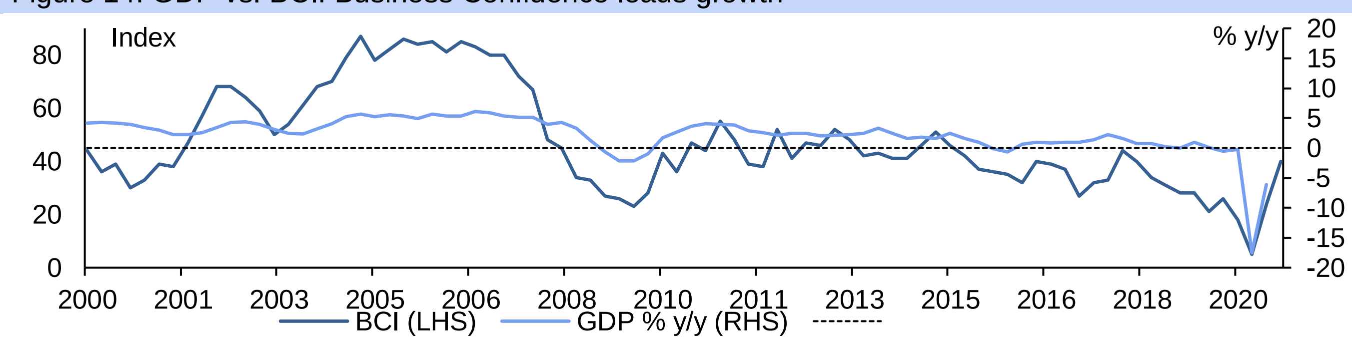
Figure 13: Average nominal growth in spending and Consolidated government expenditure by function, 2020/21-2023/24



Source: National Treasury

Government's commitment to its key policy goals over the MTEF of returning the public finances to a sustainable position (achieving a budget surplus by 2025/2026) and positioning the "(e)conomy for faster, broad-based economic growth," is vital to boost confidence, increase South's Africa's competitiveness and drive investment. Critical interventions laid out in its reconstruction and recovery plan have been slow to implement. Indeed, Covid-19 related matters have hindered the roll-out to an extent, however the hastened implementation of these key reforms is essential. Until the successful rollout of a broad-based vaccination program is achieved however, further waves of infections, followed by renewed restrictions remains a real risk to growth and accordingly government's objectives.

Figure 14: GDP vs. BCI: Business Confidence leads growth



*seasonally adjusted. Source: BER, Stats SA

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