Investec

Budget Update: Projected fiscal metrics have deteriorated markedly since February and further ratings downgrades are expected

Thursday 22 October 2020

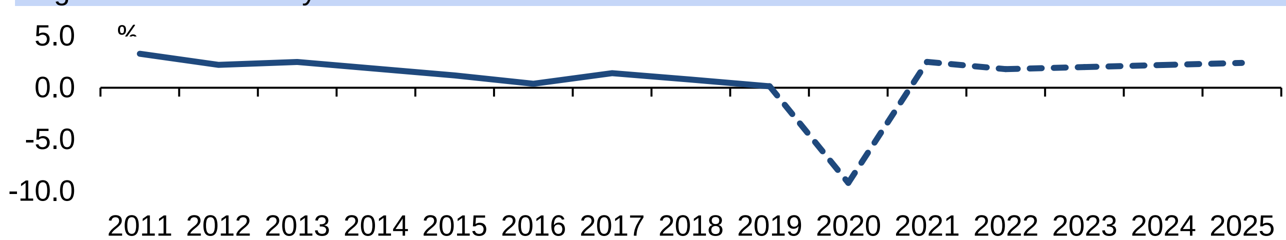
Figure 1: Macroeconomic outlook - summary

	2019	2020	2021	2022	2023
Real percentage growth			Forecast		
Real GDP growth	0.2	-7.2	2.6	1.5	1.5
Investec	0.2	-9.2	2.5	1.8	2.0
GDP at current prices (R billion)	5 077	4 900	5 227	5 536	5 873
Investec	5 077	4 802	5 907	5 450	5 836
Consumer price index (CPI)	4.1	3.0	3.9	4.3	4.5
Investec	4.1	3.3	4.2	4.8	5.0

Source: National Treasury, Investec

- This year's Medium-Term Budget Policy Statement (MTBPS) to be tabled on 28th October 2020 follows on from Treasury's emergency, Supplementary Budget Review (SBR). The SBR, outlined in June, was compiled in response to the rapidly changing economic landscape, as a result of the pandemic, to enable spending on COVID-19 relief.
- The Covid-19 pandemic which wreaked havoc on economies around the globe exacerbated the state of South Africa's already deteriorated fiscal health. Lower real and nominal growth has added to the pressure on significantly stretched public finances with the state failing to effect fiscal consolidation over the past decade.
- This year the state induced collapse in GDP in Q2.20 led to substantial revenue shortfalls, as well as elevating the fiscal ratios, with the consolidated budget deficit estimate rising to 15.7% of GDP in 2020/2021 from the February 2020 Budget projection of 6.8% of GDP in 2020/2021.
- Investec expects GDP to fall by -9.2% y/y this year and projects the consolidated budget deficit to reach 15.6% of GDP, while gross debt to GDP is forecast to climb to 81% in 2020/2021.
- A weaker GDP outturn than expected bolsters debt as a % of GDP projections, raising the starting base.
- The plunge in government revenues, with a shortfall of over R300bn anticipated and limited room for significant tax increases, owing to the dire state of households and businesses, infers that expenditure cuts will be necessary to stabilise public debt and deficit levels. A zero-based budgeting approach will be enforced, allowing for optimal resource allocation.

Figure 2: GDP History and Forecasts



Source: Stats SA

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za •
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Figure 3: Main budget framework

	2019/20	2020/21	
R billion/percentage of GDP	Preliminary	Budget 2020	Revised
Main budget revenue	**1,345.3**	**1,398.0**	**1,099.5**
	26.2%	25.8%	22.6%
Main budget expenditure	**1,690.6**	**1,766.0**	**1,809.2**
	32.9%	32.5%	37.2%
Non-interest expenditure	1,485.8	1,536.7	1,572.7
	28.9%	28.3%	32.4%
Debt-service costs	204.8	229.3	236.4
	4.0%	4.2%	4.9%
Main budget balance	**-345.3**	**-368.0**	**-709.7**
	-6.7%	-6.8%	-14.6%
Primary balance	**-140.5**	**-138.7**	**-473.2**
	-2.7%	-2.6%	-9.7%

Source: Supplementary Budget, National Treasury

Revenue under-collection has been a consistent theme over the past few years as unemployment levels have accelerated and low levels of confidence have dampened tax morality. The pandemic has heightened the situation markedly. Specifically, the impact of the lockdown restrictions in South Africa has had an extremely severe impact on the economy and households, as many businesses were forced to shut their doors or reduce their workforce.

Accordingly, many salaries and wages have been reduced, temporarily suspended or terminated. Statistics SA reports only 81.3% of individuals received pay during the most severe lockdown period (Q2.20), while 2.2million jobs were lost, with the number of employed falling from 16.4million to 14.1million. Personal and corporate income tax receipts which make up over 50.0% of all tax revenue collected fell by -14.0% and -24% between May and August 2020 respectively, on a year-on-year basis. However, the full effect of the pandemic has yet to be felt, with further business closures likely owing to the lack of market demand.

Figure 4: Employment in the non-agriculture formal sector

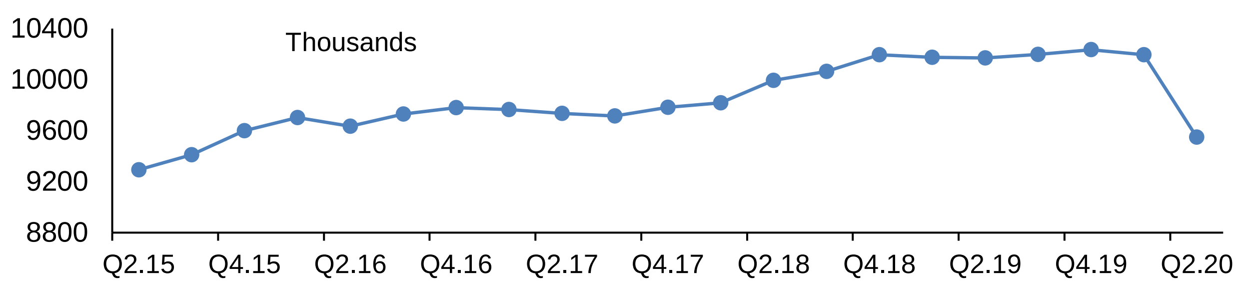

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Figure 5: Covid-19 tax measures

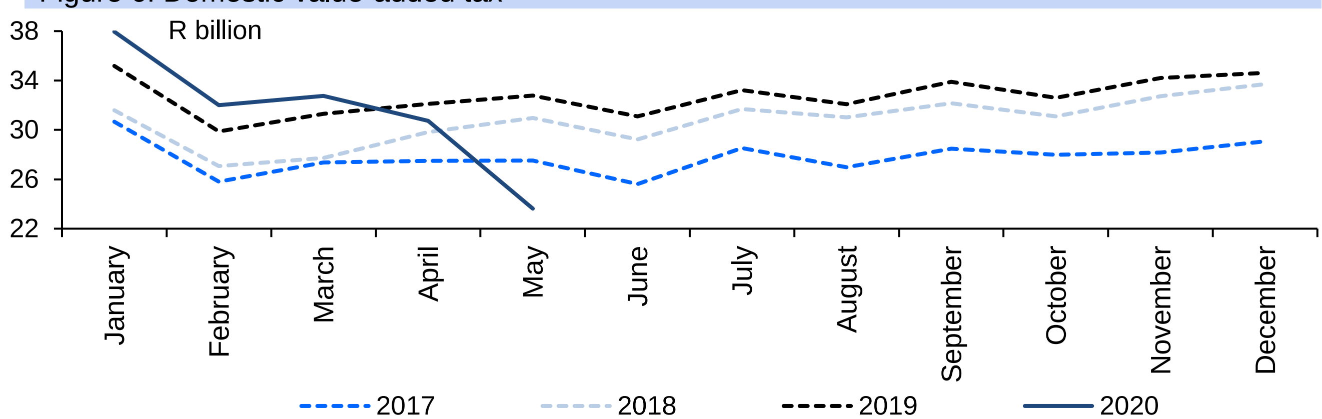
R billion	Liquidity support (delayed revenue)	Revenue Forgone
Expansion of employment tax incentive	-	15
Deferral of 35% of PAYE liability	19	2
Deferral of 35% of provisional tax payments	12	3
Skills development levy holiday for four months	-	6
A 90-day referral for alcohol and tobacco Excise duty due to be paid in May and June	6	-
Two-month deferral for filing and payment date of carbon tax	2	-
Case-by-case application for deferral	5	-
Total	44	26
Grand total		**70**

Source: Stats SA

Excise taxes, a significant form of revenue for government, plummeted by over 65% y/y between April and August, with the prohibition on tobacco sales and for most of the period (levels 5 and 4 and mid-July to 17 August) alcohol trade. This together with the tax relief measures provided as part of the Covid-19 assistance package had a severe impact on Government's coffers. In the June supplementary budget (SBR), Treasury revised their revenue collection target down by R304.1 billion, relative to the 2020 Budget estimate with main budget revenue amended to 22.6% of GDP (from the 25.8% predicted in February). The MTBPS could see Treasury lowering its estimate even further. Indeed, as at 31st August tax receipts were just R415.6bn for the fiscal year-to-date, 32.5% of the anticipated revenue total for the year of R1280bn (Investec's forecast).

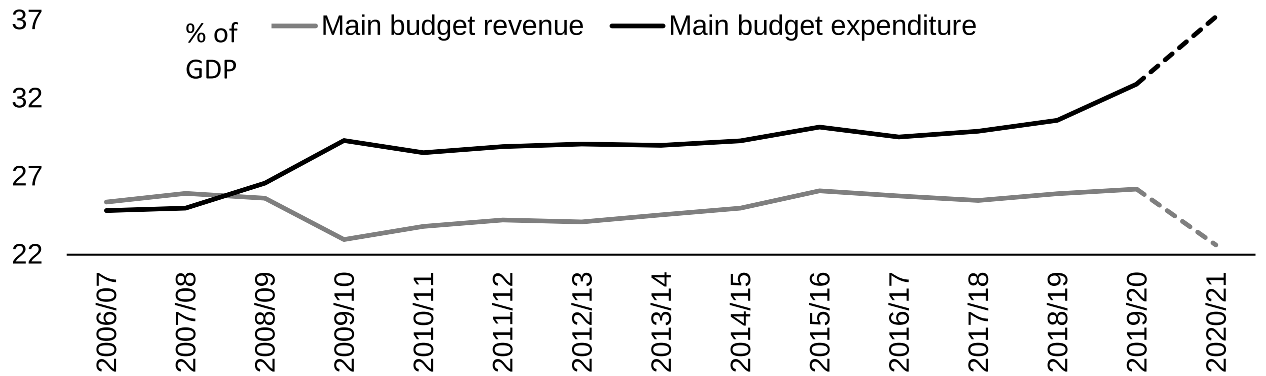
The efficiency of SARS is vital in optimising tax collections. While "SARS is rebuilding its capacity to reverse the decline, improve compliance and recover lost tax revenue," according to government, this is likely to be a protracted process.

Figure 6: Domestic value-added tax



Source: National Treasury

Figure 7: Main budget revenue and expenditure as a % of GDP



Source: National Treasury

The active scenario "(a)ssumes tax increases of R5 billion in 2021/22, R10 billion in 2022/23, R10 billion in 2023/24 and R15 billion in 2024/25." The minister has advised that these projections will be reassessed in the medium term budget policy review and that further tax policy proposals will likely be announced in the February 2021 Budget. The implementation of a temporary solidarity levy on personal income tax as well as escalations in the fuel levy are amongst some of the suggestions proposed, to raise tax revenue.

Expenditure allocations have increased and priorities have shifted as a result of the Covid-19 pandemic. The R500bn fiscal stimulus of which the R200bn loan guarantee scheme is a part, does not require immediate fiscal support in its entirety. Furthermore, additional funding has been secured from international financial institutions and by "(d)rawing down surplus funds from institutions such as the Unemployment Insurance Fund (UIF)".

Figure 8: Main budget non-interest expenditure increases

R million	**2020/21**
Support to vulnerable households for 6 months	40,891
Health	21,544
Support to municipalities	20,034
Other frontline services	13,623
Basic and higher education	12,541
Small and informal business support, and job creation and protection	6,061
Support to public entities	5,964
Other COVID-19 interventions	1,766
Allocated for COVID-19 fiscal relief package	**122,425**
Land Bank equity investment	3,000
Provisional allocations for COVID-19 fiscal relief package	19,575
Total	**145,000**

Source: National Treasury

Figure 9: Major revisions to non-interest spending plans

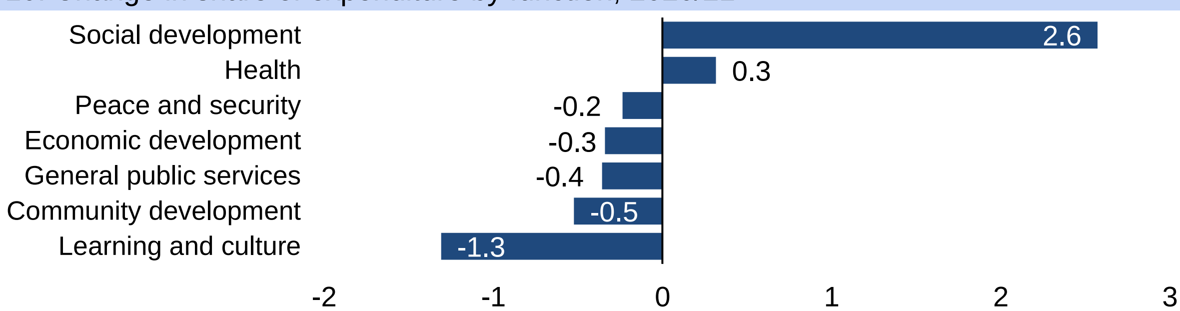
	Budget 2020	Reductions	Allocations	Other adjustments	Revised
General public services[1]	618,840	-24,310	25,055	13	619,599
Economic development	88,381	-12,145	4,649	–	80,886
Learning and culture	151,543	-15,617	10,560	-8,122	138,364
Health	55,516	-2,631	5,544	–	58,430
Peace and security	207,006	-4,185	10,170	–	212,991
Community development	219,727	-26,322	28,430	–	221,835
Social development2	198,497	-15,675	41,016	–	223,837
Provisional allocations: COVID-19 package	–	–	19,575	–	19,575
Provisional allocations not assigned to votes	-7,786	–	–	–	-7,786
Contingency reserve	5,000	–	–	–	5,000
Total	**1,536,724**	**-100,885**	**145,000**	**-8,109**	**1,572,731**

Source: National Treasury

1. Includes the provincial equitable share that funds a range of functions including health and basic education Includes Department of Women, Youth and Persons with Disabilities

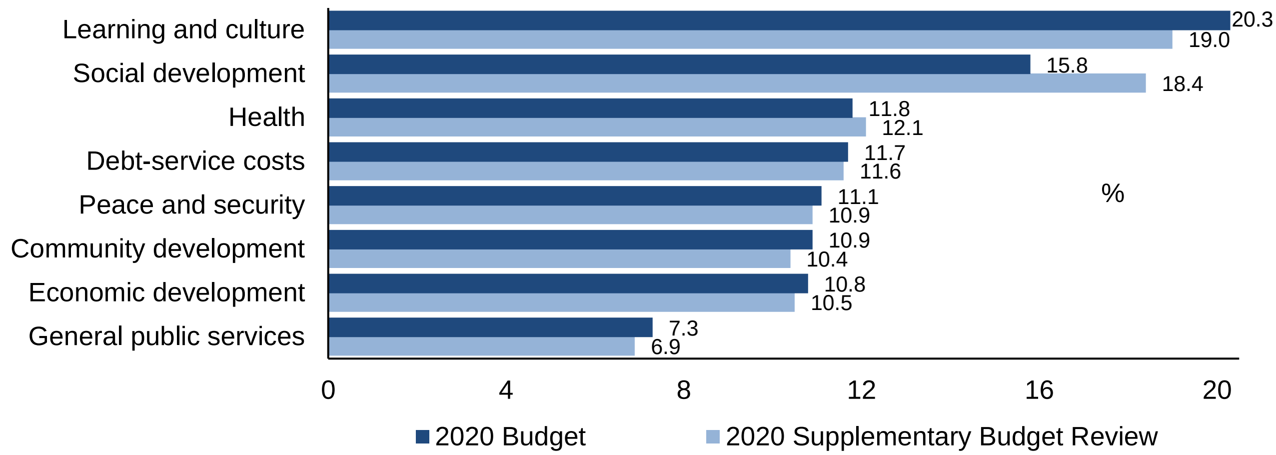
Shifting of resources from current projects was also applied. Specifically, certain spending commitments approved in February's budget can no longer be catered for, while others have been postponed. Spending was adjusted by: "(r)emoving funds underspent due to delays caused by the lockdown from the baselines of affected departments. Suspending allocations for capital and other departmental projects that could be delayed or rescheduled to 2021/22 or later. Suspending allocations to programmes with a history of poor performance and/or slow spending. Redirecting funds towards the COVID-19 response within functions, or towards government's fiscal relief package."

Figure 10: Change in share of expenditure by function, 2020/21*



Source: National Treasury

Figure 11: Share of consolidated expenditure by function, 2020/21

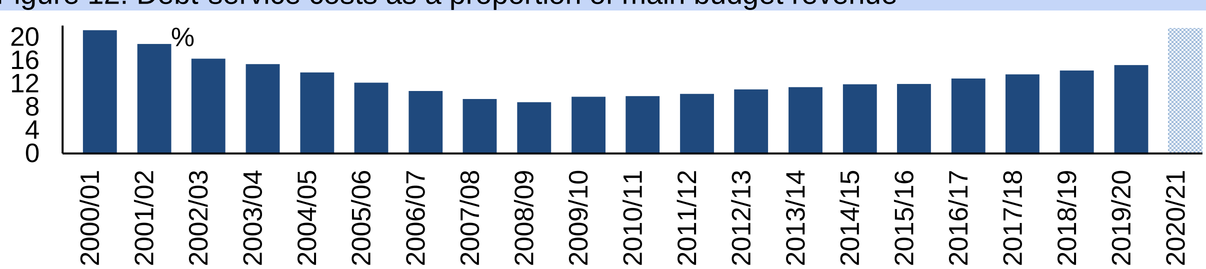


Source: National Treasury

The main budget, non-interest spending was revised up by a net R36 billion for 2020/21 in the June supplementary budget. This consisted of R145 billion "(a)dded to spending for the fiscal response to the pandemic," which was partially offset by R109 billion in proposed downward expenditure adjustments. The expenditure ceiling, (which excludes adjustments to the skills development levy), thus increases by R44.1 billion in 2020/21 compared with February's tabled estimate. According to the active scenario however, over the medium term, main budget non-interest expenditure is projected to decline as a share of GDP.

In order to achieve Treasury's objective, spending reductions totalling approximately R230 billion are needed in 2021/22 and 2022/23, followed by further cutbacks in 2023/24. "These measures are in addition to proposed medium-term reductions of R160.2 billion to the public-service wage bill set out in the 2020 Budget, which are yet to be finalized". A significant reduction of public service wages in planned state expenditure is essential to fiscal consolidation.

Figure 12: Debt-service costs as a proportion of main budget revenue



Source: National Treasury

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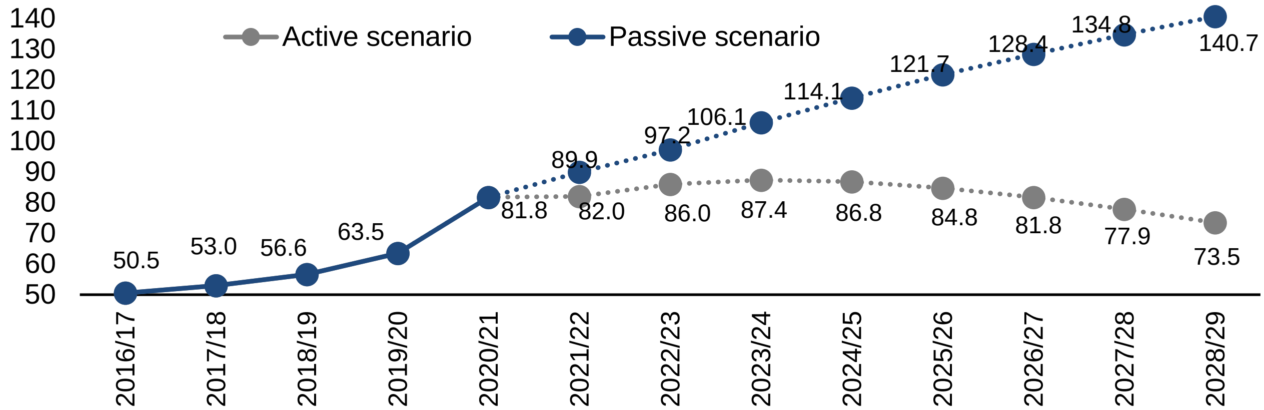
Figure 13: Gross debt- to GDP projections



Source: National Treasury

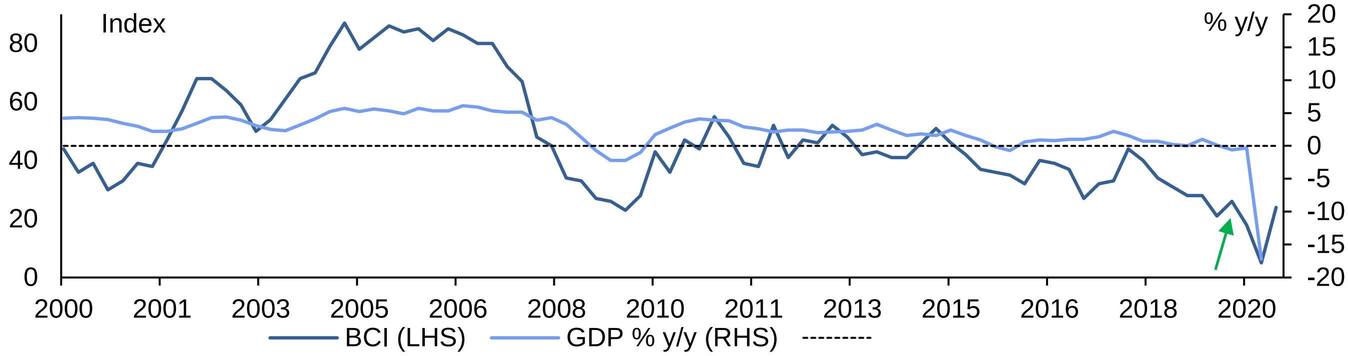
The cost of government borrowing has climbed notably since February's budget and with the probability of further credit rating downgrades post the MTBPS high, debt-service costs would escalate even further. Moody's has stressed that SA is in line to sink deeper into sub-investment grade, from its current equivalent BB+ rating, as government finances continue to deteriorate. Financially constrained state-owned entities, particularly Eskom continue to highlight the urgency of "broad-based reforms at state-owned companies" (which continue to weigh heavily on the fiscus), to improve their efficacy and sustainability. Indeed, gross national government debt is anticipated to rise "(f)rom R3.26 trillion (63.5 per cent of GDP) in 2019/20 to R3.97 trillion (81.8 per cent of GDP) in 2020/21" and by the end of 2022/23 reach R4.83 trillion, or 86% of GDP. Government's proposals to stabilise debt and narrow the deficit in 2024/25, will be clarified in the MTBPS.

Figure 14: Outstanding Govt. debt.

R Billion	Mar 31, 2020	Aug 31, 2020
Domestic debt	**2874**	**3207**
Treasury bills	361	446
Bonds	2513	2761
Fixed-rate	1851	2049
Inflation-linked	650	697
Retail	12	15
Foreign debt	**387**	**437**
% of GDP	7.5%	9.0%
US$ equivalent	22	26
Gross loan debt	3261	3644
% of GDP	63.2%	75.0%
Less: Cash balances	274	300
Net loan debt	2987	3344
% of GDP	57.9%	68.8%

Source: National Treasury

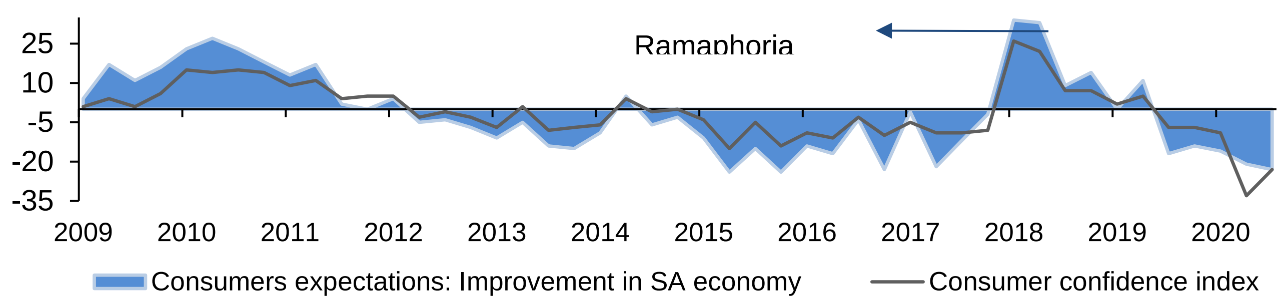
Figure 15: GDP vs. BCI: Business Confidence leads growth



*seasonally adjusted. Source: BER, Stats SA

Suggestions for a more realistic, gradual path towards fiscal consolidation instead of the active scenario outlined in the supplementary budget, have been put forward. However, a debt stabilisation higher than 87.4% of GDP (active scenario) disregards waning foreign investor appetite already occurring. The trajectory proposed by National Treasury needs to be viable, well executed and supported by the hastened implementation of the reforms of the Economic Reconstruction and Recovery Plan, in order to boost confidence and drive sustainable faster economic growth and investment.

Figure 16: Consumer Confidence



Source: BER

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