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Fixed Income
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February 2022 Budget Review: Thanks to "windfall" revenues, debt ship has not quite sailed

Key takeaways

The Minister of Finance divided the windfall revenue receipts of F21/22 between deficit reduction and spending priorities. This meets our criteria of our Budget Preview titled "Spending the windfall wisely".

Key issues we were watching were mostly in line with our expectations:

- Macro economic forecasts over the MTEF period remains lacklustre, with 2.1%, 1.6% and 1.7% projected for 2022, 2023 and 2024.
- The size of the revenue overrun in FY21/22 relative to the November 2022 MTBPS is projected to be R66bn (ICIB forecast: R45bn). Base effects and a higher tax buoyancy forecast raise F22/23s revenue forecast by R70bn (ICIB forecast: R50bn).
- Expenditure is forecast to increase by R78bn in FY22/23 (ICIBs forecast: R40bn). The FY21/22 main budget deficit has been revised down to 5.5% of GDP (in line with ICIBs forecast) compared to the MTBPS forecast of 6.6% of GDP. The forecast for F22/23 is unchanged at 6.6% of GDP, in line with our expectations.
- Fiscal consolidation over the MTEF period is helped by a moderation in bond supply, a drawdown of sterilisation deposit and an increase in the nominal GDP growth rate. Of interest is that a primary budget surplus is expected as soon as F24/25. We this as ambitious given the risks to revenue and expenditure forecasts.
- Bond supply in F22/23 is forecast to rise from R285bn to R330bn. Issuance will consist of SAGBs, ILBs, rand-denominated Sukuk bonds and a new FRN. We expect the quantum of the weekly bond auctions to remain unchanged while awaiting more details on the FRN in coming months. Switch auctions of the R2023 of R5bn will continue. Net T-bill issuance is expected to be flat in F22/23 following a net decline of R6.8bn in F21/22. A drawdown of the sterilisation deposit of R41bn is a contributory factor. The extent to which bond supply could be raised is a function of a FRN issuance, which the Budget Review has not elaborated on.
- No additional assistance has been provided to SOE's.

Risks to the MTEF forecast:

- A slower growth recovery as National Treasury's GDP forecasts factors in firmer commodity prices and Chinese growth, which supports its tax buoyancy and revenue projection.
- Limited progress has been made on SOE reforms although SONA noted that some of the SOE's could be disposed of.
- The public sector wage bill with the gratuity bonus of R20.4bn carried over into F22/23 with wage negotiations starting in March 2022. In our view, the latter should form part of President Ramaphosa's 100 day target to reach a comprehensive social compact, focused on strengthening the ERRP which requires trade offs between stakeholders in the economy.

Bond market outlook: We view the Budget Review 2022 as neutral for the country risk premium and the rand.

Tertia Jacobs
+27 11 286 8659
tertia.jacobs@investec.co.za

Main points

Debt stabilisation

A key focus of the February 2022 Budget Review has been the allocation of the revenue overrun in stabilising the rising debt trajectory. Positive progress has been made and a debt trap, which featured prominently in 2020, has been avoided. The allocation of the revenue windfall to reduce debt issuance, has been amplified by two important developments in 2020: (1) an 11% increase in the size of the economy and (2) a wage freeze, which lowered spending by R37bn. The ruling by the Constitutional Court on the latter remains an outstanding and is viewed as a risk to the forecast.

Progress is made in reducing the primary balance deficit from 1.35% of GDP in FY21/22 to zero by FY23/24. A surplus is envisaged as early as FY24/25, which we deem as ambitious, considering the risks to the forecast. Additionally, the debt servicing forecast in absolute terms, have not been adjusted from the MTBPS projection to reflect the lower gross debt forecast. National Treasury expects the debt to GDP ratio to peak at 75.1% of GDP in F24/25 (MTBPS forecast: 77.8% of GDP). However, risks to the expenditure forecast remains elevated and the credibility attached to the debt to GDP forecast, remains low.

The macro economic assumptions factored into the fiscal forecasts are reasonable but more optimistic than ICIB's forecast. Real GDP growth in 2022 is expected at 2.1% (ICIB at 1.8%) and CPI inflation has been revised to 4.8% from 4.2% (ICIB F: 5.4%). The nominal GDP growth forecasts are revised up to 12.3% (10.3%), 3.0% (2.9%) and 5.7% (5.5%) for F21/22, F22/23 and F23/24, which assumes a stronger terms of trade in 2022. This supports an upward revision to revenue receipts of 2.5% (previously 4.2%). The real GDP forecast factors in a modest acceleration in fixed investment but not sufficient to provide a lift to the growth forecast of 1.6% and 1.7% in 2023 and 2024. The incremental nature of the economic reform process and a slow rollout of infrastructure projects remains a major constraint to accelerating growth momentum in the context of the potential GDP growth rate at ~1%, owing to the electricity constraint. Shovel-ready projects are few, with the development of a pipeline of projects held back by capacity and coordination constraints in all spheres of government. President Ramaphosa announced a number of initiatives to overcome obstacles to growth in the February 2022 SONA.

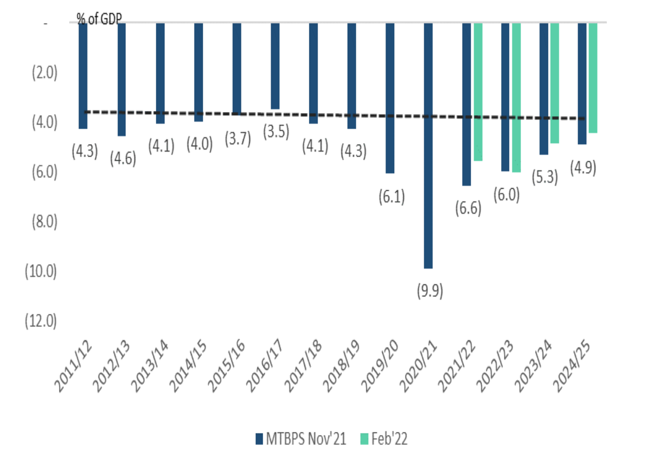
Alleviating the tax burden on households and corporates

The overrun in revenue receipts allows for some support to disposable incomes. Allowance has been made for bracket creep of R13.2bn (compared to R2bn in F21/22) based on an inflation increase of 4.5%, by raising tax brackets. The fuel and RAF levies have been left unchanged, while another steep increase in the fuel price of ~R1.30/l is expected in March. Excise duties on alcohol will be raised by between 4.5% to 6.5% and tobacco by 5.5% to 6.5%. The carbon levy will be increased by 1c to 9c/l for petrol and 10c/l for diesel.

The focus in the SONA of enabling the private sector by an improvement in infrastructure, has been enhanced by a reduction in the corporate income tax rate from 28% to 27% for companies with financial year ending in F22/23. However, the effect on the fiscus is expected to be neutral as the tax base is set to be widened by measures such as restricting assessed losses and additional interest limitations.

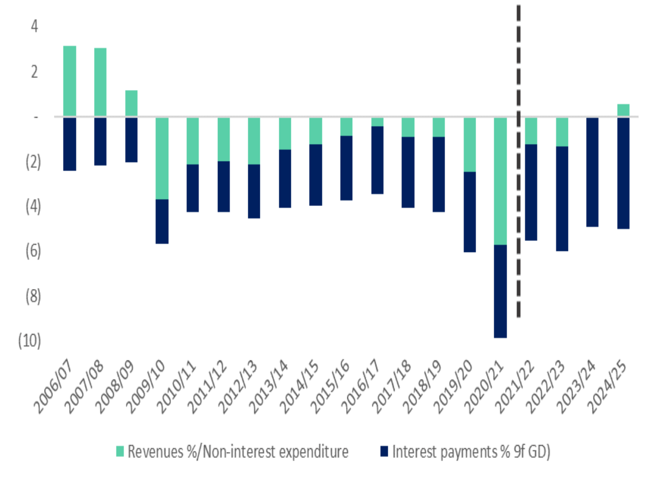
SARS remains critical to widening the tax base in South Africa and close a tax gap, estimated at R200bn. We note that 490 new personnel has been appointed in the the past year.

Figure 1: Main budget deficit as % of GDP – Improvement but MTEF risks remain



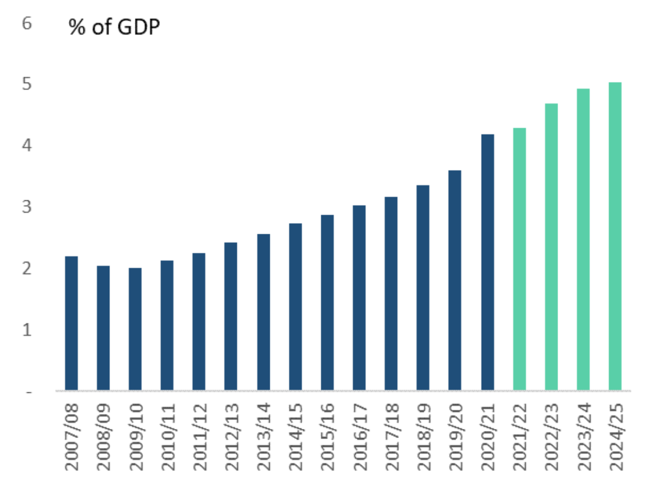
Source: National Treasury, CIB

Figure 2: Breakdown of the main budget deficit: Primary balance and interest payments (% of GDP)



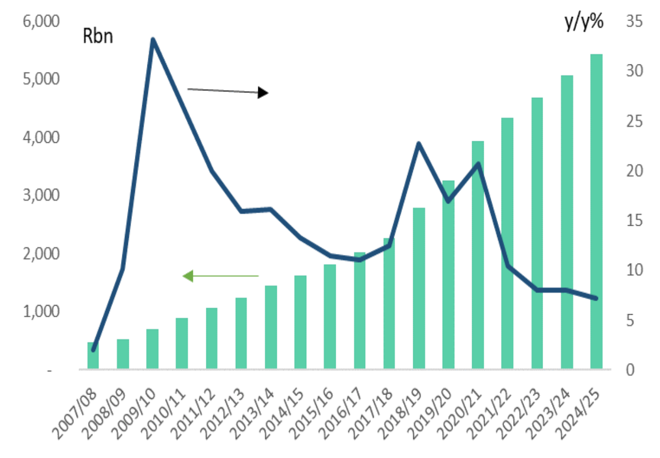
Source: National Treasury, ,ICIB

Figure 3: Debt servicing costs as % of GDP remains high



Source: National Treasury, ICIB

Figure 4: Moderation in gross debt to GDP trajectory



Source: National Treasury, ICIB

"Wise" allocation of expenditure

Additional allocations of R78bn have been made for F22/23. This consisted of the SDR grant (R45bn), Sasria (R7.5bn) and the President Employment initiative of R20.4bn. While the Minister of Finance stated that the increase in the SDR is temporary, the MTEF period maintains an unallocated reserve of R25bn and R30bn in F23/24 and F24/25. This covers downside risk to revenue receipts and/or an increase in a permanent income transfer, which is widely anticipated. National Treasury against stressed a permanent increase needs to be financed from a permanent income. In this respect, R50bn can be generated by a 2ppt increase in the VAT rate or a 2pp increase in all marginal personal income tax rates.

The increase in the compensation bill in F22/22 consist of a carryover of the gratuity bonus of R20.4bn, as presented in the November 2022 MTBPS. Wage negotiations start in March 2022.

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Risks to the forecast over the MTEF period remains unforeseen liquidity injections to SOEs, the growth recovery and the revenue forecast.

SOEs support remains unresolved with elevated risks

Contingent liabilities have increased in F21/22. Exposure to SOEs increased from R384.7bn to R416.8bn, consisting mainly to more guarantees issued to Eskom (rising from R298.3bn to R327.9bn) and Sanral (from R37.4bn to R49.1bn). Guarantees to SAA declined from R6.7bn to R2.9bn and TCTA from R13.2bn to R9.5bn. The President stated in the SONA that government will adopt a centralised shareholder model for its key commercial state-owned companies. The Presidential SOE Council is preparing recommendations on SOEs to be retained, consolidated or disposable of. With limited progress and reforms in 2021, this remains a crucial area of uncertainty for the fiscus and the government's contingent liabilities.

Figure 5: Gross borrowing requirement and funding

R billion	2021/22 MTBPS	2021/22 ICIB F	2022/23 Feb 22	2022/23 ICIB	2024/25 Feb 22	2024/25 Feb 22
Gross borrowing						
Main budget balance	**--346.9**	**-349.9**	**-387.2**	**-380.4**	**-331.2**	**-322.4**
Redemptions	**-65-6**	**-65.2**	**-97.2**	**-90.7**	**-155.8**	**-156.9**
Domestic long-term loans	-61.3	-61.3	-81.3	-75.0	-113.1	-121.2
Foreign loans	-3.9	-3.9	-16.0	-15.7	-42.0	-35.8
Total	**-412.0**	**-415.1**	**-484.5**	**-471.1**	**-4887.6**	**-479.3**
Financing						
Domestic short-term loans (net)	-6.8	0	0	45.0	40.0	39.0
Domestic long-term loans	285.3	280.0	330.0	300.0	360.0	353.2
Foreign loans	80.6	77.6	47.9	47.0	65.3	66.8
Change in cash and other balances	52.9	57.5	106.2*	79.0	22.0	20.3
Total	**412.0**	**415.1**	**493.3**	**471.0**	**487.6**	**479.3**

*Rundown in sterilisation deposit of R41bn
National Treasury, ICIB

Financing strategy

- The main budget deficit in FY21/22 has been reduced from R482.6bn to R346.9bn. The MTBPS projected a zero increase in net T-bill issuance but lower demand for T-bills is expected to lead to a net decline of R6.8bn. Cash raised from long-term loans is unchanged at R285bn while a rundown in cash balances reduces the cash balance from R112.6bn to R52.9bn. The budget includes $3bn to be raised on the international capital markets by 31 March 2022.
- In F22/23, the gross borrowing requirement is estimated to amount to R484.7bn. This consists of a main budget deficit of R387.2bn and bond redemptions of R97.2bn. The outstanding amount of R2023s of R81.3bn is expected to be reduced as switch auctions will continue in 2022.
- The funding mix consists of the following:
  - Net T-bill issuance is expected to be zero, with an increase replaced by a drawdown of the sterilisation deposit of R41bn.
  - Long term bond issuance is forecast to be raised from R285bn in FY21/22 to R330bn in FY22/23. The funding instruments will consist of SAGBs and ILBs, in addition to a new FRN and a rand-denominated Sukuk bond. The current funding pace of SAGBs and ILBs amounts to ~R280bn, with the swing factor the take up of weekly non-competitive auctions. For the quantum of bond auctions to remain unchanged, a FRN of ~R50bn is required. This in turn will depend on the size of a

rand-Sukuk issue. More details of a FRN and quantum of weekly bond auctions are expected in the coming months.

- The funding strategy over the MTEF includes a total of $11bn of funds to be raised in the international capital market and from DFIs.

Contact details

Institutional Sales and Structuring, Investec Specialist Bank

InstitutionalSales&Structuring@investec.co.za

Distribution and Syndication		Institutional Sales and Structuring		Money Market	
Leanne Large	+27 21 416 3303	Laurence Adams	+27 21 416 3351	Jeanine Polley	+27 11 286 4824
Keshiv Nayagar	+27 11 286 8715	Freda Hamersma	+27 21 809 0717	Lettie Matthews	+27 11 286 4825
Long Term and Structuring				Ruanita de Kock	+27 11 286 9815
Firdaus Aziz	+27 11 263 5144				

Insto Sales

insto.sales@investec.co.za

Fixed Income Economist / Strategist		Interest Rate Derivatives		FX Trading	
Tertia Jacobs	+27 11 286 8659	Denvin Naidoo	+27 11 286 4671	Thulane Kunene	+27 11 286 4810
Bond Trading					
Steven Arnold	+27 11 286 4720				

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