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Budget preview: 2022's credit neural Budget expected to stay the course of the MTBPS

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With mild fiscal consolidation set to continue, this year's budget has the potential to be very "boring" a feature quite liked by markets and credit rating agencies.

Under the stable hands of Minister Godongwana, markets do not expect that this year's Budget, on the 23 February, will reveal any need for the credit rating agencies to change SA's ratings.

Key will be the debt projections, and the assessment of debt sustainability, and both the financial market and the credit rating agencies will be looking closely to see if the fiscal consolidation trend in both the projected metrics and in recently improved fiscal metrics seeing the momentums maintained.

Any significant increase in the borrowing requirement would most likely be negative for bond markets on SA's already heady supply of state debt. SA's borrowing costs are still elevated compared to before the pandemic and so are borrowings themselves, with the sovereign far removed from any rating upgrades on its very high debt quantum and servicing costs.

Ending the years of fiscal slippage

The unexpected revenue overruns stemming from the commodity boom has been a key support, and the past fiscal year is likely to see gross loan debt come out at 69.8% of GDP (2021's MTBPS projected 69.9%). Key will be the following three medium-term years of 2022/23 to 2024/25, we forecast at 74.5%, 76.2% and 77.1% of GDP, similar to the MTBPS projections of 74.7%, 76.8% and 77.8% of GDP.

There have been concerns of potential increases in spending pressures, but the Finance Minsiter has been careful to highlight the risk to fiscal consolidation if this occurs, given especially that revenue overruns cannot be relied on continuously to finance extraordinary, or other, additional, spending pressures, including a large Basic Income Grant (BIG).

This year's budget deficit (2022/23) projection, at -5.9% very close to the MTBPS's -6.0% of GDP, and 2023/24 and 2024/25 deficits revised to -5.1% and -4.8% of GDP respectively (from the MTBPS projections of -5.3% and -4.9% of GDP). The deficits outcome for the past fiscal year (2021/22) however should see a much more substantial revision towards -6.0% of GDP (MTBPS -7.8%) on revenue overruns.

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Fiscal consolidation without a dependable higher state revenue stream requires a move away from accelerating current expenditure, with the Minister highlighting the economy is too weak for higher taxes, and indeed we expect no tax hikes in this year's budget.

Investec's stronger economic growth assumptions are in contrast to those held by National Treasury

We instead anticipate accelerating GDP growth to close to 3.0% y/y by 2026, and already nearing 2.5% y/y by 2024. Our higher economic growth outlooks are built on a quickening in reform implementation post 2022 and so suggests revenue collection will be higher, which has aided our reduction of the likely deficits, but we have also built in an expectation of a form of basic income grant.

Our slightly lower deficit and debt projections are also aided by the quicker economic growth and so somewhat higher revenue collections aiding underlying debt sustainability and so servicing costs. No large revisions to the debt and deficit projections are likely as these already occurred in November on Stats SA's upwards revision to the size of the economy.

The IMF and the World Bank predict South Africa's economy will see growth remain below 2.0% y/y, and indeed slow to 1.7% y/y by 2024, and the IMF and World bank also have a similar dip down.

On the revenue side no major tax changes are likely

We do not anticipate any changes in personal income tax, VAT or corporate tax in the Budget and believe overall it will not be growth-negative from a tax perspective. Indeed, in a similar vein to the 2021/22 fiscal year, we'll likely see larger-than-expected revenue collections negating the need for tax increases the following year.

The tax base is still tiny compared to South Africa's 60 million-strong population, although the South African Revenue Service (SARS) has shown some progress in increasing its reach. For example, although the pandemic took a heavy toll on revenue collection in 2020, the number of assessments increased in 2020 versus the decline seen in earlier years.

No change to inflation targets likely

The SARB has been wishing for a lowering of the inflation target, and so mid-point from 4.5% y/y to 4.0% y/y, with benefits of less rand depreciation on a longer-term purchasing power basis, as well as lower real interest rates, although there is a risk of higher interest rates in the short-term to achieve this. However, major changes are unlikely in an ANC elective conference year,

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particularly with President Ramaphosa's consensus leadership style, and so also are unlikely to suddenly appear in a Budget speech.

The Budget cannot drive strong economic growth in SA, but can help avoid credit rating downgrades

Markets do not expect that the Budget will reveal any need for the credit rating agencies to change SA's ratings, but risks remain. South Africa is in the run up to the ANC elective conference in December, and financial markets and rating agencies would react negatively to substantial, unexpected pressure on government expenditure.

Concerns also centers around the lack of sufficient reforms to date to substantially strengthen economic growth, reduce the onerous regulatory burden and expand the size of the private business sector in order to boost tax revenues, employment and business confidence. Key however will be the debt projections, and the assessment of debt sustainability. We do not think there will be deterioration and so the budget should be credit neutral.

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