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NOVEMBER 2021

A review of South Africa's Medium Term Budget Policy Statement (MTBPS)

South Africa's finance minister, Enoch Godongwana, tabled his debut Medium-Term Budget Policy Statement (MTBPS) on 11 November 2021. The budget was well received by the market as it was largely in line with, or even better than, market expectations. The theme of this MTBPS centered around economic recovery, stabilization, and reforms.

ECONOMIC OUTLOOK

Following a deep contraction of -6.4% in 2020, real GDP for 2021 is now expected to accelerate to 5.1% in 2021 (an upward revision of 1.8% since the February budget review). This uptick in growth is mainly due to base effects. GDP in South Africa is expected to increase at a slower pace thereafter, 1.8%, 1.6% and 1.7% in 2022, 2023 and 2024 respectively.

STRUCTURAL REFORM

Credit rating agencies have been clear and consistent in the economic reforms they would like to see in South Africa to improve its credit rating. Encouragingly, the MTBPS emphasised the importance of reforms to create economic growth. The key reforms that are being implemented include the following:

- Changes in the Electricity Regulation Act (2006) to relax some restrictions on generation and procurement of extra capacity. This should have the effect of reducing pressure on the struggling national grid and minimise the risks of power cuts.
- Transnet will allow third parties to access the freight rail network, this will improve the system volume and is expected to be implemented by the end of 2022.
- The eVisa system, will be rolled out in 2022 to 15 countries, this will support the tourism sector by reducing the number of administrative requirements for tourists to enter South Africa.
- In telecommunications, work is underway to standardise and improve process applications to use property to roll out towers and fibre to improve digital communication infrastructure. This is also expected to be finalised before the end of 2022.
- Infrastructure spending including private-public

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Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 31/10/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STeFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%

partnerships. The regulations were completed in May 2021 and will be implemented early in 2022.

- The Department of Water and Sanitation is also improving its application process to ensure that the 90-day target for issuing single-use water licences will be implemented by March 2022 to improve the ease of doing business.

TAX REVENUE AND TEMPORARY OVERSHOOT

Revenue collection was revised upward as all the major tax categories are performing better than the National Treasury's projections in the February budget. A surge in commodity prices has generated a better-than-expected revenue outlook, although this may be a temporary reprieve.

The tax-to-GDP ratio has increased to 24.1% in the current year after dipping to 22.5% last year but this will not be sustainable in the medium term. Gross tax revenue has been revised up by R120.3bn in 2021/22. This was largely due to the strong income tax collections from corporates followed by persons and individuals which were revised up by R75.5bn and R26.1bn respectively. The only category with a downward revision is excise duties.

Gross tax revenue growth comes off a low base of -7.8% for 2020/21 and is now at 18.9% for 2021/22. The medium-term revenue estimates are also better than anticipated and have been revised up by R69.7bn and R59.5bn in 2022/23 and 2023/24 respectively. The medium-term numbers reflect the conservative approach taken by the National Treasury in expecting commodity prices to decline and terms of trade to deteriorate in the outer years of the forecast.

EXPENDITURE

Government spending from the consolidated budget is expected to increase at an annual growth rate of 1.7% from the current fiscal year through to 2024/25. There were no spending reductions proposed in the MTBPS and this is mainly because of the upward revisions of revenue.

Non-interest spending for the current year was revised up by 59.4bn to 77.3bn. This is on the back of the unbudgeted reinstatement of the special COVID-19 social relief of distress grant (SRD) through the second special appropriation bill, costs associated with the public violence outbreak in July along with the implementation of the public service wage bill.

According to the National Treasury, 9.5 million people are benefiting from the SRD grant which is expected to end in March 2022. It was also highlighted that, currently, 27.8 million South Africans (~46% of the population) are receiving some form of social grant.

Government spending on grants is exceptionally high considering South Africa is a developing country, rather than spending more on growth generating line items than social services. Nevertheless, the treasury has indicated that if there is a need for additional funding for special relief it will only be funded through improved revenue collections or reprioritising of existing expenditure, meaning no additional expenditure.

The public sector wage agreement provides for a pensionable increase for all employees of 1.5%, as well as a once-off non-pensionable cash gratuity of R1 000 after tax per person per month, which was not budgeted for.

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This is expected to cost R20.5 billion in the current year, with a possibility of carrying through to 2022/23 if no new agreement is reached. The national treasury has stated that should this agreement continue it may be required to shift funds from the infrastructure fund, taking away an opportunity to prioritise growth generating spending.

There were no additional allocations to state-owned enterprise (SOE) bailouts, however, the treasury has noted that the financial conditions as well as the operational performance of several SOE's remain a significant contingent risk. SOE's are facing difficulties with access to capital becoming difficult due to their poor performance, unsound governance, and the general high interest rate environment for debt funding.

The government has also been successful recently in enforcing minimum requirements before guaranteeing debt issued by state-owned enterprises and as a result the guaranteed requests have declined. Nonetheless, poor governance and inefficiencies in these corporates remain an issue.

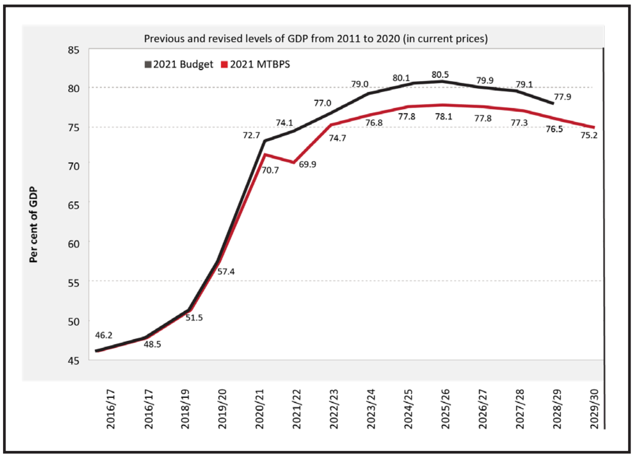
DEBT AND DEBT SERVICING COSTS

There were superficial improvements in debt-to-GDP ratios following the rebasing of GDP numbers (Chart 1:). In the current year, debt-to-GDP is expected to be 69.9%, revised down from 74.1% in the February budget. Over the medium term, debt-to-GDP is expected to rise and stabilise at 78.1% in 2025/26 (down from 88.9% in February). The ratios are better than that expected by the market, although there are still significant risks which can arise from the expenditure side.

It is important to note that the decline in the debt ratios is mainly on the back of upward GDP revisions by Stats SA and not necessarily reduced borrowings. Government's gross borrowing requirement remains elevated and debt servicing costs (interest expenditure) continue to rise. The government has therefore resorted to using some of the sterilisation deposits held with the South African Reserve Bank to reduce the impact on debt servicing costs and debt levels.

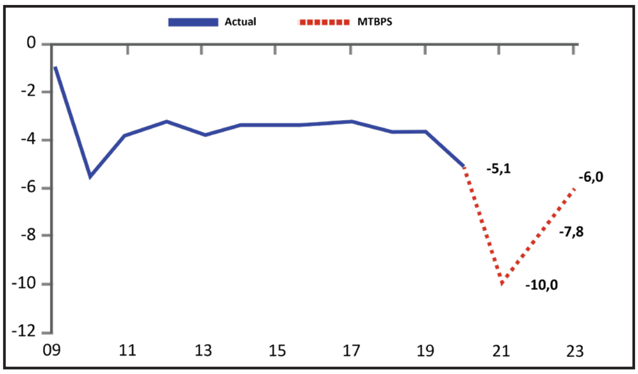
Debt service costs continue to consume a large share of the revenue which crowds out spending on programmes necessary to bolster economic growth as well as providing essential services to improve the livelihood of South African citizens. Currently, 21 cents of every rand collected in revenue over the forecast period will be spent on servicing debt. This is the clearest indicator that greater efforts are needed to stabilise public finances (Chart 2&3).

Chart 1: Gross debt-to-GDP



Source: National Treasury

Chart 2: Budget deficit as % of GDP



Source: Nedbank

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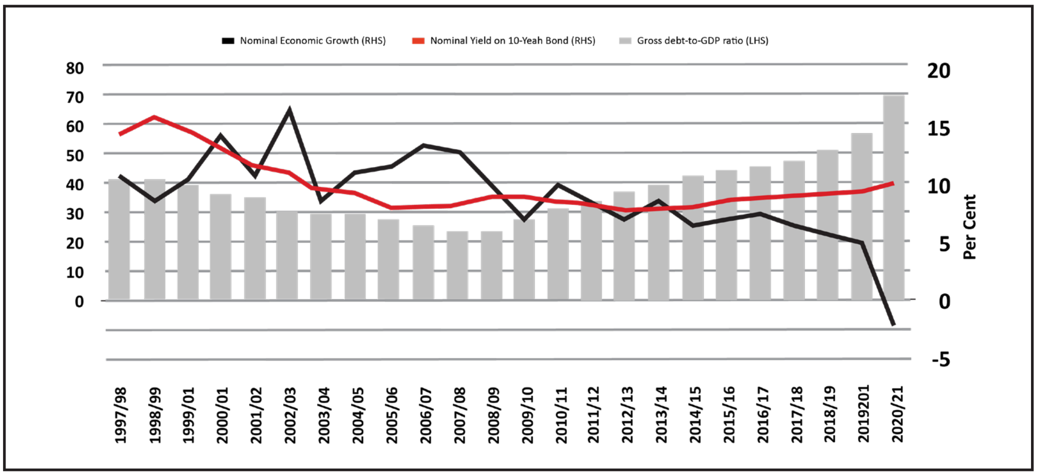
Chart 3: Debt Dynamics



Source: National Treasury

FISCAL DEFICIT

The consolidated budget balance is now expected to be -10% (2020/21), -7.8% (2021/22) and to decline in the outer years reaching -4.9% (2024/25). This all depends on the Government's commitment to cut wasteful spending and not expanding expenses further. If implemented, these revisions will assist South Africa avoiding further rating downgrades.

While the national treasury continues to demonstrate its commitment to provide stability in public finances and the MTBPS was well received by the market, this was short lived, as the SARB announced a 25bpts rate hike on November 18th.

There are grounds to take a positive view of the MTBPS is statement considering the risks of the ongoing wage negotiations, risks from various struggling SOEs, poor economic growth, the rising debt trajectory, and the sustainability of social expenditure. To restore the health of public finances in South Africa, government needs to make more efforts in reducing spending over and above the national income.

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