Economic Insights | 24 October 2024

MTBPS preview

ECONOMICS | South Africa

NEDBANK

A narrower deficit in FY2024/25 but the wage bill is a significant drag in FY2025/26

- Macroeconomic assumptions: The 2024 Medium-Term Budget Statement (MTBPS) will be presented against the backdrop of an improved macroeconomic environment. Business sentiment is rebounding as political and policy uncertainty ease. Electricity supply has improved, although the transport system constraints remain a drag on economic activity. Lower inflation will facilitate more interest rate reductions. Our real GDP growth forecasts are 1% in 2024 and 1.6% and 1.7% in 2025 and 2026, respectively. The figures are marginally lower than the National Treasury's (NT's) estimate for 2024 but aligned for the next two years.
- Revenue: We project slightly higher aggregate revenue growth in FY2024/25 as gross tax revenue is lifted by a robust increase in personal taxes and a marginal gain in corporate taxes. However, relatively subdued spending will contain value-added tax collections, with a slight shortfall likely for the FY. Overall, we estimate gross tax revenue to be R2 billion higher than the NT's February 2024 estimate, lifting aggregate revenue growth to 6.1%.
- Expenditure: The public sector wage bill will re-emerge as a significant drag on spending as the government and public unions are in talks for FY2025/26 wage settlements. The unions have tabled a double-digit figure, well above the 4.6% rise in the February 2024 budget numbers. Debt service costs will likely rise at a slightly higher rate than the NT's forecasts. Overall, we expect expenditure growth at 4.2% in FY2024/25 vs. the NT's projected 4.4%.
- Budget balance: We project the consolidated budget deficit at 4.4% of GDP in 2024/25, slightly lower than the 4.5% projected in the 2024 National Budget. However, over the MTEF period, the deficit will be wider than estimated in February, mainly due to the higher wage bill in FY2025/26. Encouragingly, the primary surplus will increase over the period.
- Debt metrics: The public debt ratio is likely to be higher than February 2024, primarily as a result of lower nominal GDP.
- Policy announcements: The Treasury could announce changes to the inflation targeting framework by lowering the midpoint of the inflation target band to 3% from the current 4.5%.

Table 1: Consolidated Budget framework

	2023/24	2024/25		2025/26		2026/27		2027/28
	Feb-24	Feb-24	Oct-24	Feb-24	Oct-24	Feb-24	Oct-24	Oct-24
Revenue (Rbn)	1 921.4	2 036.6	2 038.6	2 176.4	2 185.4	2 323.6	2 327.4	2 467.1
% growth	1.3	6.0	6.1	6.9	7.2	6.8	6.5	6.0
% of GDP	27.1	27.4	27.5	27.8	27.9	27.9	27.9	28.0
Expenditure (R bn)	2 268.9	2 369.0	2 364.2	2 471.4	2 506.0	2 597.8	2 626.3	2 744.5
% growth	6.0	4.4	4.2	4.3	6.0	5.1	4.8	4.5
% of GDP	32.0	31.9	31.9	31.6	32.0	31.2	31.5	31.2
Consolidated Budget Balance (R bn)	-347.4	-332.4	-325.6	-295.0	-320.7	-274.2	-298.9	-277.4
% of GDP	-4.9	-4.5	-4.4	-3.7	-4.1	-3.3	-3.6	-3.2
Debt Service Costs (R bn)	356.1	382.2	379.3	414.7	393.6	440.2	423.8	446.7
% of GDP	5.1	5.1	5.1	5.2	5.0	5.2	5.1	5.1
Primary Balance	24.8	61.2	53.7	106.5	72.9	153.0	124.9	169.3
% of GDP	0.4	0.8	0.7	1.3	0.9	1.8	1.5	1.9
Gross debt-to-GDP ratio (%)*	*73.9*	*74.1*	*75.2*	*75.3*	*76.2*	*74.7*	*75.9*	*75.7*

Source: Budget 2024 and Nedbank Group Economic Unit. Feb-24 shows Budget 2024, Oct-24 is our MTBPS forecasts

The macroeconomic backdrop

The MTBPS will be presented against the backdrop of an improved macroeconomic environment. Business sentiment has turned since the formation of the government of national unity, which has helped to dampen political risks. The government's focus is firmly on service delivery, with the crowding-in of the private sector in the large infrastructure projects prioritised. The power grid is more stable, with load-shedding not being implemented for over 200 days as Eskom operates more efficiently and more renewable energy generation is commissioned. Although there are green shoots of the constraints in the logistics chain being addressed, the inefficient transport system will remain a drag on economic activity for the foreseeable future. Business investment will be supported by the improving economic growth expectations. Consumer spending has been supported by increased real disposable income, which has benefitted from higher wage settlements and lower inflation in the first half of 2024. Falling interest rates will reduce debt service costs, while withdrawals from the two-pot system will decrease indebtedness for consumers who utilise the funds to pay off loans. These factors will support consumer confidence and sustain spending in the remainder of this year and into 2025. Global conditions have also improved somewhat as monetary policy in the major economies eases, which will drive a modest recovery in commodity prices and boost export earnings.

We project the local economy to expand by 1% in 2024 and 1.6% and 1.7% in 2025 and 2026, respectively. The NT is likely to revise its 2024 GDP growth forecast marginally lower from the 1.3% projected in the February 2024 Budget after growth disappointed in H1 2024. The forecasts for 2025 and 2026 will probably be maintained at 1.6% and 1.8%, respectively.

Table 2: Forecasts of key macroeconomic variables

Indicators (calendar years)	Actuals		Forecasts		
% change	2022	2023	2024	2025	2026
Final household consumption	2.5	0.7	1.4	2.3	1.5
Gross fixed-capital formation	4.8	3.9	-3.5	1.8	2.4
Gross domestic expenditure	3.9	0.8	0.2	2.0	1.5
Exports	6.8	3.7	-1.4	3.5	4.0
Imports	15.0	3.9	-3.6	5.1	3.2
Real GDP growth	1.9	0.7	1.0	1.6	1.7
CPI inflation	6.9	5.9	4.6	4.2	4.5
Current account balance (% of GDP)	-0.5	-1.6	-1.2	-1.8	-1.9

Source: Nedbank Group Economic Unit

The fiscal framework

The marginally faster real GDP growth in 2024 compared with 2023 and once-off factors, primarily the tax intake from the two-pot system withdrawals, boost tax collections. Meanwhile, expenditure growth has been broadly contained at the start of FY2024/25.

We expect a marginally lower budget deficit in the current FY, at 4.4% of GDP vs. the NT's February 2024 estimate of 4.5%. Over the remainder of the Medium-Term Expenditure Framework (MTEF) period, we estimate a wider deficit due to the higher-than-budgeted wage settlements in FY2025/26. However, we expect the downward trend to resume, reaching 3.2% in FY2027/28. Encouragingly, the primary surplus will expand over the period, helping to limit new borrowing.

Lower nominal GDP, due to the lower inflation rate, pushes the public debt ratio to a peak of 76.2% in FY2025/26, with the debt ratio easing at a slow pace in the subsequent FYs.

Revenue

The improved macroeconomic environment supports a rebound in tax collections. Gross tax collections were up by 3.7% yoy fiscal year to date (FYTD) (April—August 2024), well below the NT's February 2024 estimate of 7.6% for FY2024/25 as a whole. We expect a rebound in personal income taxes (PAYE), boosted by firmer consumer spending and a small windfall from the two-pot retirement system withdrawals, to lift PAYE growth to 14.9% in FY2024/25, vs. the NT's 13.7% projection. The South African Revenue Service (SARS) announced on 11 October that the two-pot withdrawals had reached R21.4 billion since the system became effective on 1 September. The table below shows the tax collections with total withdrawals of between R35 billion and R50 billion and average tax rates ranging from 18% to 28%. We assume collections at the low end of that range, totalling R8 billion but higher than the NT's February 2024 estimate of R5 billion.

Table 3: FY2024/25 two-pot retirement system PAYE tax collections (R billion).

Total withdrawals	18%	20%	25%	26%	28%
R35 billion	6.3	7.0	8.8	9.1	9.8
R40 billion	7.2	8.0	10.0	10.4	11.2
R50 billion	9.0	10.0	12.5	13.0	14.0

Source: Nedbank calculations

Value-added tax (VAT) collections are also lagging behind the NT's FY2024/25 estimates, with FYTD collections totalling only 35.1% of the NT's February 2024 estimate for the FY. Although we expect higher intakes from the festive season shopping to close the gap significantly, VAT is likely to fall short by around R5 billion for the FY.

Corporate taxes will benefit from a rebound in corporate profitability as local operational cost pressures ease, reversing some of the R34.8 billion underperformance of FY2023/24. In FY2024/25, collections were 1.2% yoy lower in the FYTD, but we anticipate a pickup in the second half to lift collections by a marginal 0.1% for the FY, vs. the NT's 0.4% projection, which totals a R997 million shortfall.

Overall, we estimate gross tax collections to be around R2 billion more than the NT's February 2024 projection of R1.86 billion, which boosts consolidated revenue growth to 6.1% (vs. NT's 6%) in FY2024/25.

No major revenue measures will be announced in the MTBPS.

Expenditure

We expect FY2024/25 expenditure growth to be slightly lower than NT forecasts. Lower inflation and below-budget spending in some areas, although modest, will help to keep the increase in spending below 4.5% in this FY. However, we expect higher growth in the subsequent two FYs, with the wage bill being a critical concern.

The public sector wage bill will re-emerge as a significant risk to expenditure restraint from FY2025/26. The two-year wage settlement concluded in March 2023 was 7.5% for FY2023/24 and a capped CPI-linked increase between 4.5% and 6.5% for FY2024/25. CPI averaged 4.3% in the 12 months to March 2024, pointing to a 4.5% wage increase in April 2024. Wage negotiations have commenced as the current agreement ends in March 2025. The government has tabled a 3% offer, while unions have demanded 12%. Therefore, the settlement will likely exceed the NT's 4.5% a year incorporated in the February 2024 Budget. We assume a public sector wage settlement of 6.5% for FY2025/26. After that, NT will strive to restrict the annual increase to 4.5% in the subsequent two FYs. Although the NT has historically provided for wage bill overshoots, we project a marginal lift to aggregate spending over the MTEF period.

Debt service costs rose by 8% yoy in the first five months of FY2024/25, which compares favourably with 14.7% over the same period in FY2023/24, but is slightly ahead of the NT's 7.3% estimate for the FY. We estimate that rising public debt and the still high interest rates will raise the interest payments bill by around 7.8% in FY2024/25. Therefore, the interest payments to revenue ratio will remain around 20% over the MTEF, with every 20c collected in revenue going towards servicing interest costs.

No large bailouts for the large state-owned enterprises will be announced as the NT sticks to its policy of no blanket financial aid packages. However, some assistance for the troubled SA Post Office could be announced. Transnet received a R47 billion guarantee facility in November 2023, and we do not expect a package similar to Eskom's R252 billion debt aid to be announced for the transport utility in the MTBPS. Such a major announcement would be made in the main budget speech in February.

Budget metrics

For FY2024/25, we expect a slightly lower budget deficit than the NT's 4.5% in FY2024/25 on the back of slightly higher revenue and expenditure restraint. However, the deficit will widen in FY2025/26, with the magnitude of the increase dependent on the public sector wage settlement. In addition to the wage bill, debt service costs could also widen the deficit if interest rates drop slower than we currently expect.

The gross debt-to-GDP ratio is higher primarily due to the effect of lower inflation on nominal GDP. We project the debt ratio at 75.2% in FY2024/25, peaking at 76.2% in FY2025/26 and easing slowly thereafter. A faster rise in real GDP as local consumption and investment expand could provide a positive surprise to the debt ratio.

We still expect steady demand for government bonds, with the proportion of foreign investors willing to hold South African public debt stable at around 25% since Q1 2023.

Financing the budget deficit

Global financing conditions are more favourable than in 2023. Still, we do not anticipate the NT to expand its foreign currency bond issuance in FY2024/25 as it has already indicated higher foreign issuance over the remaining years of the MTEF period. In the February 2024 Budget, foreign-currency bond issuance was planned at R36.7 billion, totalling 8% of the FY2024/25 public sector gross borrowing requirement (PSGBR). In FY2025/26 and FY2026/27, new foreign bonds are planned at 14.2% and 21.5% of the PSGBR, respectively.

We do not expect an expansion of the utilisation of the Gold and Foreign Exchange Contingency Reserves (GFECRA) account over the MTEF period.

Conclusion

The MTBPS will be presented in a better macroeconomic environment than the February 2024 Budget speech. Although economic growth was disappointing in H1 2024, preliminary data point to a stronger momentum in Q3, which will spill over into Q4. Lower inflation and interest rates, a more stable power grid, and rebounding consumption will lift the overall growth rate. However, we expect slightly lower growth than the NT's 1.3% in 2024. Overall, the improving growth momentum will help to improve the budget metrics in FY2024/25. After FY2025/26, NT will ensure that the impact of the likely high wage settlement is contained.

Over the MTEF, the Treasury continues to face the challenge of ensuring that the higher public sector wage bill and debt service costs do not significantly widen the budget deficit and push the public debt stock even higher. To achieve this, the government must contain spending growth in most areas and cut spending in non-essential areas. The Treasury has committed to shielding social programmes and infrastructure investment from expenditure cuts. However, it is tough to see the government achieving notable reductions in non-wage expenditure without spending restrictions on some critical functions.

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