Budget Preview

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Expect a further deterioration in the country's fiscal metrics.

- **Macroeconomic environment**: The Budget speech is expected to show that economic conditions will remain broadly unsupportive of significant fiscal consolidation, complicating the task of reducing the budget deficit and containing the relentless rise in public debt. Persistent load-shedding, worsening transport bottlenecks, soft global demand and subdued commodity prices will hurt production and exports, while high domestic interest rates and the challenging operating environment will continue to weigh on consumer spending and fixed investment. National Treasury already accounted for the adverse turn in the economy in the Medium Term Budget Policy Statement (MTBPS). As a result, we do not expect significant changes to the GDP and inflation forecasts for the next three years. However, our estimates suggest that National Treasury more than likely underestimated the impact of the weaker economy on tax revenue.
- **Revenue:** Sharply lower company taxes, mainly due to dwindling mining profits on the back of falling commodity prices and elevated operational costs, hit aggregate revenue growth hard in 2023/24. We estimate that gross tax revenue in 2023/24 will be R94.8 billion less than the Budget 2023 estimate and R38 billion lower than the MTBPS 2023 figure. In 2024/25, revenue growth will likely improve as GDP growth recovers. National Treasury's quest to raise an additional R15 billion in 2024/25 is not likely to result in significant hikes in tax rates, with the additional revenue raised from below-inflation adjustments to the personal income brackets.
- **Expenditure:** Aggregate spending for 2023/24 was up by almost 8% yoy, well ahead of the MTBPS and the Budget projections. The pressure came from the higher-than-expected public sector wage settlements and surging debt service costs. In 2024/25, the National Treasury will probably continue to reflect its commitment to expenditure restraint by restricting the increase in expenditure to around the projected inflation rate for the next three years.
- The **consolidated budget deficit** for 2023/24 rises to about 5.4% of GDP, narrowing only slightly to 5.2% in 2024/25, with National Treasury delaying more significant deficit reduction to the outer years of the MTEF period. We project a primary surplus from 2025/26, a year later than estimated in the MTBPS 2023.
- **Other issues**: We expect the public sector borrowing requirement to rise further as the National Treasury borrows more for a Transnet bailout, which we estimate at R50 billion over the next two years.

TABLE 1: CONSOLIDATED BUDGET FRAMEWORK

	2023/24		2024/25		2025/26		2026/27	
	Oct-23	**Feb-24**	**Oct-23**	**Feb-24**	**Oct-23**	**Feb-24**	**Oct-23**	**Feb-24**
Revenue (Rbn)	1 915.5	1 905.8	2 012.6	2 001.1	2 139.3	2 121.2	2 286.5	2 248.4
% growth	0.9	0.4	6.0	5.0	6.3	6.0	6.9	6.0
% of GDP	27.3	27.1	27.0	27.0	27.1	27.0	27.2	26.9
Expenditure (Rbn)	2 262.0	2 284.6	2 352.5	2 387.4	2 473.3	2 494.9	2 588.6	2 619.6
% growth	5.4	6.5	4.0	4.5	5.1	4.5	4.7	5.0
% of GDP	32.3	32.5	31.6	32.2	31.3	31.7	30.8	31.3
Budget Balance (Rbn)	-346.5	-378.8	-339.9	-386.4	-334.0	-373.7	-302.0	-371.2
% of GDP	-4.9	**-5.4**	-4.6	**-5.2**	-4.2	**-4.8**	-3.6	**-4.4**
Debt Service Costs (Rbn)	354.5	367.2	385.9	400.6	425.5	436.2	455.9	462.2
% of GDP	*5.1*	*5.2*	*5.2*	*5.4*	*5.4*	*5.5*	*5.4*	*5.5*
Primary Balance	24.4	-20.1	64.2	-1.9	100.0	42.0	145.2	78.8
% of GDP	*0.3*	*-0.3*	*0.9*	*-0.03*	*1.3*	*0.5*	*1.7*	*0.9*
Gross debt-to-GDP ratio (%)	***74.7***	***75.1***	***75.8***	***77.2***	***77.7***	***79.3***	***77.5***	***78.9***

Source: Oct-23 shows National Treasury MTBPS 2023 figures, Feb-24 refers to Nedbank Budget 2024 forecasts

The economic environment

The Budget 2024 will be presented against a challenging economic environment. Although the world economy held up better than most expected in 2023, growth in SA's main export markets – the Eurozone and China – will likely weaken further before turning the corner later this year. As a result, international commodity prices will probably remain subdued, weighing on earnings in the mining and manufacturing sectors. On top of these factors, local businesses will continue to grapple with persistent load-shedding, crumbling rail services and delays in cargo processing at the country's ports. Consequently, operating costs will remain elevated, which, together with sluggish earnings growth, will contain corporate profits, limiting the upside for company tax revenue. At the same time, consumers will probably trim their spending further in the first half of the year as the squeeze from higher interest rates intensifies. A modest recovery is expected during the year's second half and into 2025. Global and domestic demand should turn the corner as lower inflation boosts real incomes and central banks start to ease monetary policy.

We expect the National Treasury to revise its real GDP growth projections for 2023 lower from the 0.8% estimated in the MTBPS 2023 but to leave their forecast for 2024 unchanged at a modest 1%. The growth forecasts will align with our projections of 0.5% and 1% for 2023 and 2024, respectively. We forecast household spending growth of only 0.5% in 2023 and a further slowdown to 0.2% in 2024. Gross fixed capital formation held up relatively well in 2023, supported by the firm activity in renewable energy projects, but we expect a moderation to 0.5% in 2024 from the high base set over 2022 and 2023, and as some of the construction projects are completed. Overall economic growth will rebound, albeit modestly, over the MTEF, supported by the slight improvement in power supply and firmer global and domestic demand. However, domestic logistical constraints will remain a significant drag on economic growth.

TABLE 2: FORECASTS OF KEY MACROECNOMIC VARIABLES

Indicators (calendar years)	Actuals		Forecasts			
% change	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Final household consumption	5.8	2.5	0.5	0.2	1.8	1.6
Gross fixed-capital formation	0.6	4.8	4.2	0.5	3.9	2.2
Gross domestic expenditure	5.0	3.9	0.7	0.4	2.0	1.5
Exports	9.1	7.4	3.7	1.0	3.1	2.5
Imports	9.6	14.9	3.7	-0.5	4.4	2.0
Real GDP growth	4.7	1.9	0.5	1.0	1.5	1.6
CPI inflation*	4.6	6.9	5.9	5.0	4.6	4.5
Current account balance (% of GDP)	3.6	-0.5	-1.4	-1.8	-2.3	-2.2

Source: Nedbank Group Economic Unit forecasts, *2023 actual figure

Revenue

The less supportive global environment and intense cost pressures in the domestic economy have contained aggregate revenue growth in 2023/24 (Table 3), following two years of higher-than-expected revenue growth. A slump in **corporate taxes** has dampened taxes on income and profits, while personal taxes have been supported by non-regular pay. **Taxes on goods and services** have been underpinned by the higher value-added tax (VAT) collections, which were lifted by still high inflation.

The slump in commodity prices has eroded the mining sector's earnings, hurting corporate earnings significantly. **Company taxes** were down by 11.9% yoy for the first nine months of the fiscal year (April 2023 to December 2023), and we project a decline of 10.5% for the fiscal year. **Personal taxes** will rise by around 8% in 2023/24. We forecast **that gross tax revenue will increase by** 3% in 2023/24, falling R94.8 billion short of the Budget 2023 estimate and R38 billion lower than the MTBPS 2023 estimate.

We estimate **consolidated revenue** in 2023/24 will be R53.1 billion below the February 2023 estimate, more than the National Treasury's projected R43.4 billion shortfall in the MTBPS 2023. For the MTEF period, we forecast aggregate revenue to be R68.4 billion, below the MTBPS 2023 estimates.

We project the **revenue-to-GDP ratio** to hover around 27% of GDP over the MTEF period, with tax buoyancy contained by the underlying economic slack.

TABLE 3: TAX COLLECTIONS IN 2023/24

Tax type (yoy% change)	Jul	Aug	Sep	Oct	Nov	Dec
Taxes on income and profits	-4.0	-0.9	-0.2	1.3	1.7	-0.1
Personal income tax	*7.5*	*8.0*	*7.9*	*8.2*	*8.7*	*8.3*
Taxes on corporate income	*-19.8*	*-13.7*	*-12.2*	*-10.1*	*-11.2*	*-11.9*
Taxes on goods and services	8.8	9.2	8.0	7.6	9.4	7.5
Value-added tax	*4.7*	*5.6*	*4.8*	*4.5*	*7.8*	*6.1*
Gross tax revenue	0.8	2.6	2.4	3.3	4.2	2.4

Source: Nedbank Group Economic Unit forecasts, *2023 actual figure

In the MTBPS 2023, National Treasury announced it will introduce measures to raise an additional R15 billion in tax revenue in 2024/25. We do not expect a wholesale increase in tax rates, as raising tax rates in a weak economy has proven to be counterproductive. Tax increases in 2015, 2017 and 2018 hurt economic activity more than boosting tax collections. The expected additional revenue did not materialise, with the affected taxes shrinking over that period.

Therefore, we expect the additional revenue to be raised from the usual adjustments of tax brackets:

- The **personal income tax brackets** will likely be adjusted by less than the inflation rate, with most of the benefit accruing to the low-income brackets. To help raise the additional R15 billion in taxes, the higher income tax brackets (taxable income of at least R500 000 per annum) will likely be adjusted minimally.
- The **fuel levy** could rise by around 5%, in line with the inflation rate, while the **Road Accident Fund (RAF)** levy will likely remain unchanged for the third successive year.
- **Medical aid tax credits** are likely to be unchanged.
- **Excise duties on tobacco and alcohol products** will be raised by more than inflation as is always the case.
- **Tax breaks for investment in renewable power generation** tabled in February 2023 are not likely to be expanded, although they could be extended for another year.

Expenditure

We expect the National Treasury to signal continued expenditure restraint, compelled by the meagre revenue growth. Expenditure growth in the first nine months of 2023/24 was 7.7% yoy, well ahead of 3.4% and 5.4% projected for the year in the Budget 2023 and MTBPS 2023, respectively. The higher-than-estimated public sector wage settlement and the jump in debt service costs caused the overshoot.

We project **aggregate expenditure** growth of 6.5% in 2023/24 and an average of 5.7% a year between 2024/25 and 2026/27. The main drivers are higher compensation bills and rapid increases in debt service costs. In the MTBPS 2023, National Treasury planned to cut main budget non-interest expenditure by R3.7 billion (0.3%) in 2023/24, R37.3 billion (2.1%) in 2024/25 and R47.7 billion (2.5%) in 2025/26 compared with the 2023 Budget. Although ambitious, we believe these cuts are unlikely to be met.

The **public sector wage bill** increased by R37.4 billion in 2023/24 over Budget 2023 following the two-year wage agreement with labour unions. The 2023/24 wage settlement of 7.5% works out to an effective increase of 3.3%. The National Treasury has directed departments and provinces to meet higher labour costs out of the budget allocations for 2023/24, making it clear that there would be no additional allocations for the wage bill. For 2024/25, the wage settlement has been tied to the National Treasury's CPI forecast, with a minimum of 4.5% and a maximum of 6.5%. In the MTBPS 2023, the public sector wage bill was allocated a further R23.6 billion (equivalent to a 5% increase) for 2023/24 and R33.6 billion (4.6%) for 2024/25. We do not expect additional allocations to be high, as National Treasury intends to limit the compensation bill to close to 30% of consolidated expenditure over the MTEF.

Debt service costs jumped by 17% yoy in the first nine months of 2023/24. The higher debt stock as well as local and global interest rates raised interest payments. In the MTBPS 2023, the debt service costs were revised higher by R14.1 billion in 2023/24, R23 billion in 2024/25 and R28.5 billion in 2025/26. Interest costs will remain the fastest-growing expenditure item and will likely exceed 20% of main budget revenue by 2025/26. The wider budget deficit, the additional borrowing for the Eskom debt package, and now more debt issuance to cover the Transnet bailout package will also add to the tally, which we forecast to average 5.5% of GDP over the MTEF period.

In the MTBPS 2023, National Treasury reaffirmed that the space for additional spending was non-existent, with the postponement of the mooted **Basic Income Grant**, through another extension of the limited Social Relief of Distress grant, confirming the precarious fiscal position. Therefore, social grants will continue to be adjusted below the inflation rate. We expect no new funding for implementing the **National Health Insurance** scheme.

We expect more financial assistance to be announced for **Transnet.** In November 2023, National Treasury advanced a R47 billion bailout package for the transport utility, with R22.8 billion of the facility immediately available for drawdown. The state-owned enterprise (SOE) is reported to need a more substantial capital injection as it fails to generate sufficient operational revenue to service its R130 billion debt pile. We assume further assistance of R25 billion a year in 2024/25 and 2025/26. The package will probably be under the same terms as the Eskom debt deal tabled in February 2023, with the entity required to provide a clear turnaround plan and show progress before more funds are disbursed. Bailouts for the other SOEs will likely be limited and funded from the Contingency Reserve Account.

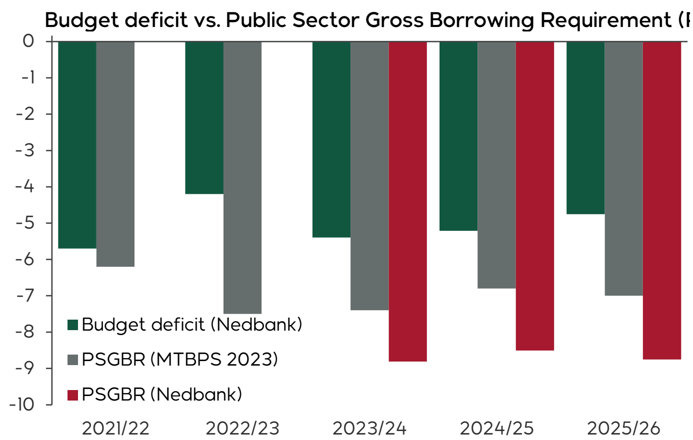
Budget metrics

The **budget deficit** rises to 5.4% in 2023/24, higher than the revised 4.9% in the MTBPS 2023 and well above 4.0% in Budget 2023. Over the MTEF, we expect the deficit to narrow only slowly, dropping to 4.4% in 2026/27.

The figures hidden below the budget deficit are even more concerning. The public sector **gross borrowing requirement (PSBR)**, the total amount required to roll over maturing debt and finance the budget deficit, paints a more dire situation. Added to these usual items are the additional borrowing for the Eskom debt package, broken down into R78 billion in 2023/24, R66.2 billion in 2024/25, and R110.2 billion in 2025/26. Once we add our estimated R50 billion for a Transnet bailout, the PSBR is 8.8% of GDP in 2023/24, 8.5% in 2024/25 and 8.8% in 2025/26, above the 6.8% and 7% projected in the MTBPS 2023, respectively (Chart 1).

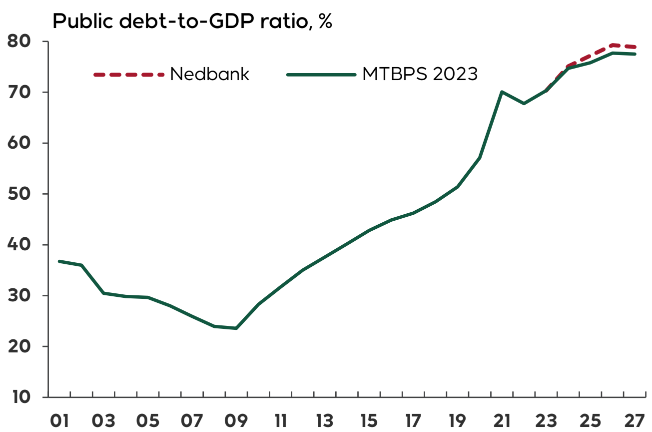
Over the MTEF, we expect the **debt-to-GDP ratio** to peak at 79.3% in 2025/26, easing gradually after from 2026/27 onwards. Our highest point exceeds the 77.7% projected in the MTBPS 2023, partly reflecting our expectations of the Transnet bailout. For 2023/24, the MTBPS 2023 public debt figure for 2023/24 suggested that the National Treasury included most or all of the R22.8 billion immediately available in the assistance package announced after the MTBPS speech.

Chart 1: Budget deficit as % of GDP



Source: National Treasury MTBPS 2023, Nedbank

Chart 2: Gross public debt ratio



Source: National Treasury MTBPS 2022, Nedbank

Conclusion

The challenging economic environment has worsened the budget ratios. However, we expect the National Treasury to signal its commitment to stabilising the fiscal position, but the risk of missing the new targets remains high. The MTEF figures will reflect the lower revenue and higher expenditure bases, but National Treasury will probably strive to bring the budget deficit back to sustainable levels, albeit at a much slower pace than planned in the MTBPS 2023. In our view, this will be a difficult task, and ultimately, the fiscal position is unlikely to improve significantly until economic growth rises to sustainably support corporate profitability, household incomes, and the expansion of the tax base.

On the expenditure side, the government needs to accelerate the measures to consolidate its operations by scaling down programmes and entities that do not significantly contribute to service delivery due to the duplication of functions. The intention to shift towards a more efficient public service was stressed in the MTBPS 2023, and we will watch out for an update on the progress made. Over the MTEF, the many social expenditure demands will have to take a back seat for a while, with the National Treasury prioritising pressing issues that will help to revive economic growth faster, primarily the Eskom debt package and the Transnet bailout.

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