# Government Finances

ECONOMICS | SOUTH AFRICA

NEDBANK

## Weak corporate taxes and the higher wage bill are rapidly eroding the fiscal position

- Acute power shortages and inefficient logistics networks are seriously impacting government finances as revenue growth falls sharply despite a milder-than-expected global economic slowdown. At the same time, higher public sector wage increases and debt service costs are pushing expenditure higher.
- **Revenue:** Corporate tax collections dropped sharply in the first four months of 2023/24, dragging total tax revenue on income and profits, while subdued VAT growth contained revenue from goods and services.
- **Expenditure:** The higher-than-budget public sector wage settlement has become the major drag on the fiscal position, as it raises total spending significantly above budget, while the higher debt service costs are also adding to the pressure.
- **Budget deficit:** Lower revenue and high expenditure growth point to a much wider budget deficit than projected in the 2023 Budget Statement. Over the first four months of 2023/24, the budget shortfall totalled R191.1 billion, equivalent to 67.4% of the R283.7 billion consolidated budget deficit estimated for the fiscal year.

## Revenue trends

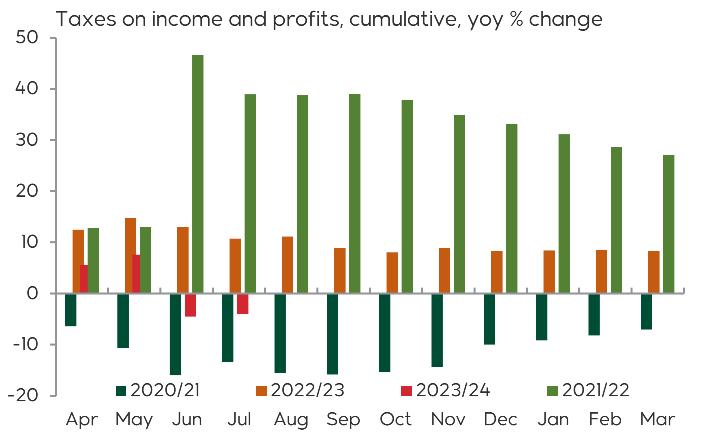
The less favourable global environment and numerous domestic hindrances had a larger-than-anticipated impact on corporate taxes. Global demand has slowed, containing the increase in volumes, while commodity prices have plunged, with prices of South Africa's key mineral exports falling. According to the South African Reserve Bank, the basket price of merchandise exports fell by 2% yoy in the second quarter of 2023. Domestic conditions have also worsened. The higher levels of load-shedding between January and May disrupted operations and inflated input costs as companies relied on expensive generators to keep the lights on, undermining corporate profitability.

Total national revenue was down by 3.2% over the first four months of 2023/24 (April to July) compared with the same period in 2022/23, with the main drag coming from lower taxes on income and profits.

Over the period, taxes on income and profits were down by 4% yoy, pulled lower primarily by a significant drop in company taxes. Personal taxes have held up relatively well, rising by 7.5% yoy compared with 7.6% in 2022/23, boosted by strong non-regular pay (bonuses etc.) (Chart 3). Corporate taxes were 19.8% yoy lower in July after sliding by 20.5% yoy in the three months to June. The rate of decline in corporate taxes almost matched the slump over the first four months of 2020/21 at the height of the Covid lockdown restrictions (Chart 4).

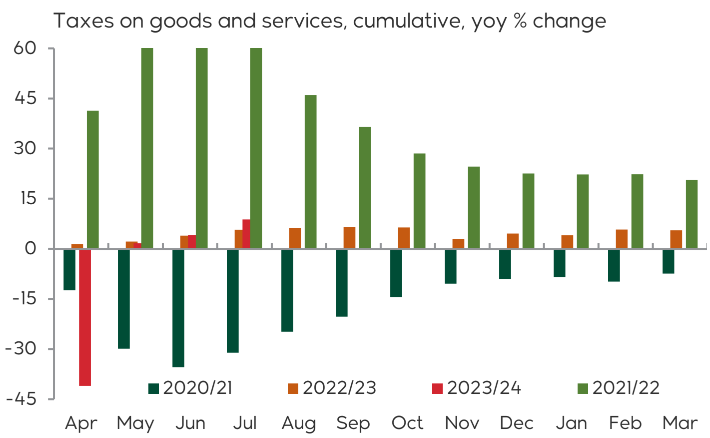
Revenue growth from taxes on goods and services has been undermined by weak gains in value-added tax (VAT), as consumption spending slowed, hurt by elevated inflation and sharply higher interest rates. VAT collections were up by 4.7% yoy over the four months to July, barely matching the inflation rate over the period.

**Chart 1: Taxes on income and profits**



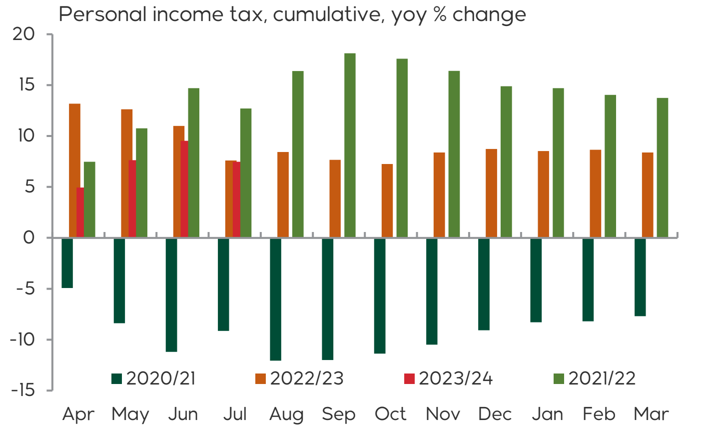

Source: National Treasury and Nedbank calculations

**Chart 2: Taxes on goods and services**



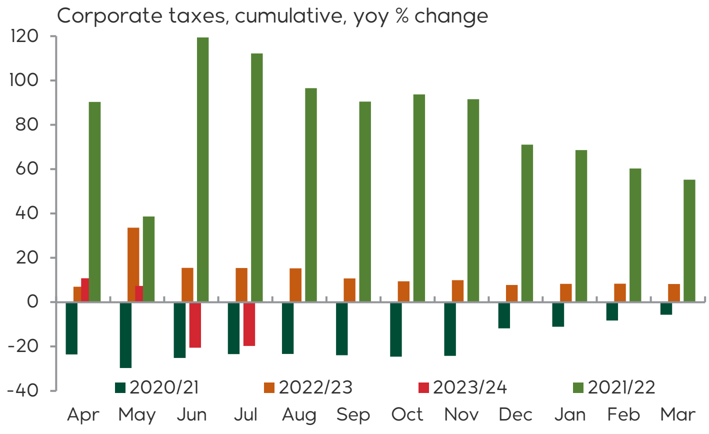

Source: National Treasury and Nedbank calculations

Chart 3: Personal income taxes faring better




Source: National Treasury and Nedbank calculations

Chart 4: Corporate income taxes falling at almost the 2020 pace




Source: National Treasury and Nedbank calculations

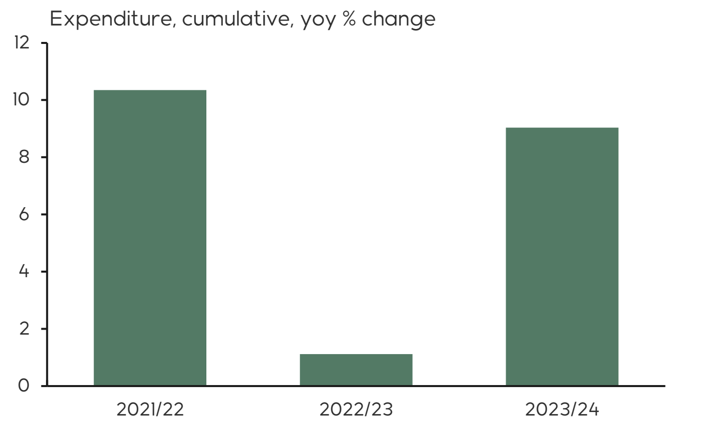
## Expenditure trends

Total national expenditure has risen by 9% yoy over the first four months of 2023/24, well above the targeted 3.4% increase for the fiscal year set in the budget, as public sector wages and debt service costs recorded sharp increases.

The settlement with public sector unions for a 7.5% wage increase for 2023/24, well above the 1.6% increase factored in the budget numbers, costs the fiscus an additional R37.4 billion for the fiscal year. According to the National Treasury, provinces estimate a R24.8 billion overrun on compensation due to the implementation of the wage settlement. National Treasury has directed national departments and provinces to contain staff numbers and meet the additional wage spending from baseline allocations, as there will be no additional transfers from the National Revenue Fund (the wage bill numbers are only provided on an annual basis).

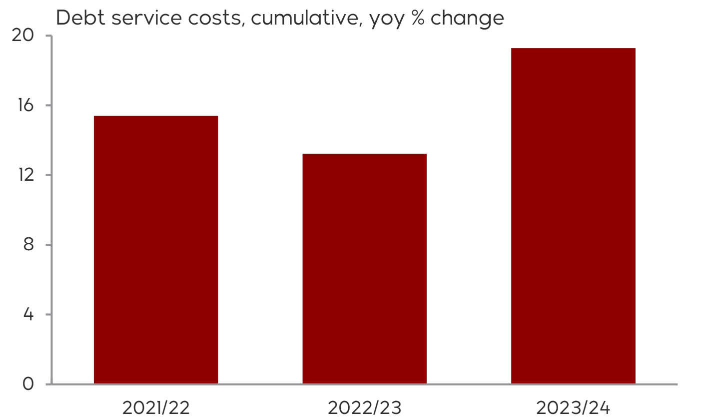
**Debt service costs** are another key contributor to the sharp increase in aggregate expenditure. In the fiscal year to date, interest payments on debt have jumped by 19.3% yoy to R98.2 billion, raised by the higher debt stock and elevated interest rates. Although debt service costs rose in line with the budget estimates, equalling 28.8% of the total annual debt service budget, the rapidly widening budget deficit will result in higher-than-budgeted interest payments unless expenditure growth is restricted during the remainder of the fiscal year.

Chart 5: Wage bill and interest payments pressured total spending




Source: National Treasury and Nedbank calculations

Chart 6: Interest payments rising at a faster rate




Source: National Treasury and Nedbank calculations

## Summary

The first four months of 2023/24 recorded lower revenue and expenditure increases well ahead of budget. The rapid increase in expenditure against the backdrop of underlying poor economic conditions threatens to significantly undermine the fiscal position in 2023/24 and beyond. The myriad economic challenges are clearly hurting tax collections, pointing to the urgent need to contain fiscal spending to restrict the widening of the budget deficit and the consequent increase in public debt and debt service costs.

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