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Medium Term Budget Policy Statement 2020

Economics | South Africa

No big surprises, but a much higher debt trajectory adds to an already dismal fiscal picture

- **Macroeconomic assumptions:** As expected, National Treasury expects a deeper contraction in 2020, but the revision was marginal. Its expected -7.8% in 2020 is moderate compared with our projection of -9.2%. The economic recovery will be contained by long-standing structural constraints and weak productivity gains. National Treasury forecasts aggregate economic output to reach pre-Covid levels only in 2024, which is similar to our expectations.
- **The main budget deficit** is still estimated at 14.6% of GDP in 2020/21, and it is projected to halve by 2023/24 on the back of improving revenue and expenditure reduction measures.
- **Revenue** forecasts for 2020/21 were revised down, mainly reflecting the deeper than previously anticipated recession, which has decimated tax collections. **Expenditure** reduction measures are anchored by plans to contain the growth of the public sector wage bill, while spending reviews will be undertaken as part of the shift towards 'zero-based budgeting'.
- **Debt metrics:** The revised public debt trajectory is much worse than the 'active scenario' presented in the June 2020 Supplementary Budget, but still not quite as dire as the 'passive scenario'. The **debt-to-GDP ratio** peaks at 95.3% in 2025/26 (versus 87.4% in 2023/24 in June) and then eases only marginally to 93.9% in 2028/29 (compared with 73.5% previously). According to National Treasury, the increase in the debt-to-GDP ratio will be among the highest within the emerging market universe and SA is losing ground against its peers.
- **Financing:** The **gross borrowing requirement** jumps to R774.7 billion in 2020/21, from R415.8 billion in 2019/20, before easing to just below R600 billion in 2023/24. Financing remains primarily via domestic long-term loans, which will total R462.5 billion in the current fiscal year. Domestic short-term loans will raise R143.0 billion, up from R36.1 billion in 2019/20, while foreign loans are budgeted at R121.4 billion in 2020/21. According to National Treasury, the increase in bond market volatility led to issuances mainly on the shorter end, but government has since started issuing bonds along the entire curve. The financing strategy seems to be to marginally increase foreign loans over the medium-term, while remaining reliant on local currency long-term loans for the bulk of the financing.
- **Market implications:** The MTBPS has not been well received in the markets despite offering no surprises and few new insights. The country's debt trajectory is, however, substantially worse than reflected in the Supplementary Budget. The MTBPS reiterates the need to make difficult choices to stabilise debt, stressing that failing to do so will lead to a fiscal crisis. The fiscal policy path presented today will be a further drag on SA's recovery, with higher taxes and spending constraints likely to weigh on incomes, earnings and growth.

Table 1: Forecasts of key macroeconomic variables

	2020		2021		2022		2023	
	Previous	Oct-20	Previous	Oct-20	Previous	Oct-20	Previous	Oct-20
Household spending*	1.1	-7.9	1.3	4.7	1.6	2.2		1.9
Government spending*	1.6	1.0	-0.6	-2.5	1.2	-2.4		-3.6
Gross Fixed Capital Formation*	0.2	-19.6	1.3	-1.4	1.9	3.9		3.9
Gross domestic expenditure*	0.7	-8.5	1.3	2.9	1.6	1.6		1.3
Exports*	2.3	-12.8	2.6	5.9	2.8	3.0		2.7
Imports*	1.8	-14.7	2.5	4.7	2.8	2.8		2.2
GDP growth	**-7.2**	**-7.8**	**2.6**	**3.3**	**1.5**	**1.7**	**1.5**	**1.5**
GDP inflation	4.0	4.3	3.9	3.9	4.4	4.2	4.6	4.3
Headline CPI	3.0	3.2	3.9	4.1	4.3	4.4	4.5	4.5
Current account balance (% of GDP)*	-3.4	-0.8	-3.5	-1.6	-3.7	-2.0		-2.7

Source: National Treasury, *previous forecasts in the February 2020 Budget statement, otherwise June 2020 Supplementary Budget forecasts

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- **Key fiscal metrics:** The **main budget deficit** is the same 14.6% of GDP as in the Supplementary Budget and narrows to 7.3% in 2023/24. The **primary budget deficit** (which excludes debt service costs) also falls gradually, with a primary surplus targeted for 2025/26. At a **consolidated level** (including revenue and expenditure of provinces, public entities and social security), the shortfall widens to 15.7% in 2020/21 – unchanged from the Supplementary Budget estimate but sharply higher than the 6.8% reported in the February Budget. A trajectory similar to the reduction of the main budget deficit is projected, with the consolidated deficit also falling to 7.3% in 2023/24.

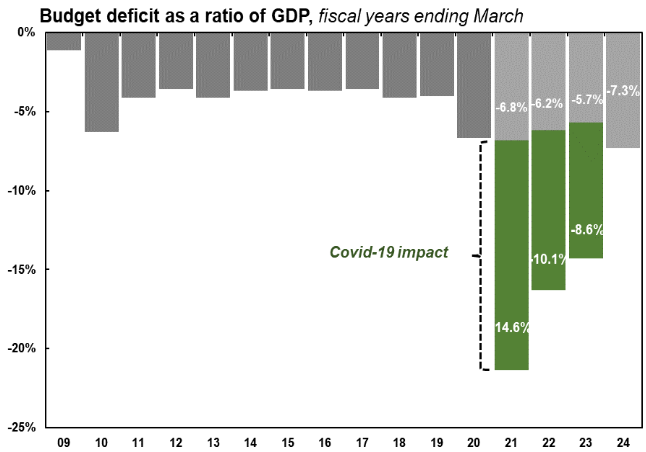
Table 2: Main Budget Framework

	2020/21			2021/22		2022/23	
	Feb-20	**Jun-20**	**Oct-20**	**Jun-20**	**Oct-20**	**Jun-20**	**Oct-20**
Revenue (Rbn)	**1398.0**	**1099.5**	**1097.9**	**1268.2**	**1263.7**	**1378.8**	**1388.3**
% of GDP	*25.8*	*22.6*	*22.6*	*23.8*	*23.8*	*24.5*	*24.7*
Expenditure (Rbn)	**1766**	**1809.2**	**1805.8**	**1763.8**	**1801.1**	**1809.3**	**1874.8**
% of GDP	*32.5*	*37.2*	*37.2*	*33.1*	*33.9*	*32.2*	*33.3*
Main Budget Balance (Rbn)	**-368.0**	**-709.7**	**707.8**	**-495.6**	**-537.4**	**-430.5**	**-486.6**
% of GDP	*-6.8*	*-14.6*	*-14.6*	*-9.3*	*-10.1*	*-7.7*	*-8.6*
Primary Balance	**-138.7**	**-473.2**	**-474.8**	**-232.4**	**-265.7**	**-129.5**	**-169.0**
% of GDP	*-2.6*	*-9.7*	*-9.8*	*-4.4*	*-5.0*	*-2.3*	*-3.0*

Source: National Treasury

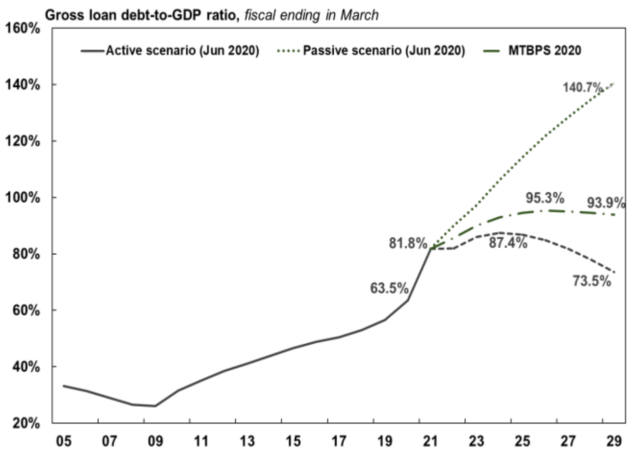
- Government borrowing continues to rise at a rapid rate as the budget deficit remains wide. The trajectory of the public debt stock is now expected to be much higher than the 'active scenario' envisaged in the Supplementary Budget, but well below the 'passive scenario'.
- **Gross loan debt** will rise from R3.97 trillion in 2020/21 to R5.54 trillion in 2023/24.
- The peak of the **debt-to-GDP ratio** is higher at 95.3% in 2025/26, but the ratio is projected to remain below 100% over the forecast period.

Chart 1: Budget deficit as a % of GDP



Source: National Treasury South Africa

Chart 2: Still ahigher public debt trajectory



Source: National Treasury South Africa

Fiscal Framework:

- The fiscal position is envisaged to stabilise, with revenue boosting measures and significant cuts to the public sector wage bill planned.

Revenue

- **Main budget revenue** is drawn down by lower collections across all tax categories, but a 21% downward revision of direct taxes accounts for most of the decline. Gross tax revenue has been reduced by another R8.7 billion from the projection in the Supplementary Budget. This takes the expected revenue for 2020/21 to R312.8 billion below that projected in the February 2020 Budget, R236.2 billion (75.5%) of which is on the back of lower personal tax (-R92.6 billion), value-added tax (-

R72.9 billion) and corporate tax (-R70.7 billion) collections. The secondary effects of the anti-Covid lockdown measures slash the fuel levy and specific excise duties by R15.1 billion each, while customs duties will be down by R19.2 billion. A sharp fall in dividend payments reduces these taxes by R10.5 billion below the February 2020 projections.

- The **revenue-to-GDP ratio** falls to 22.6%, lower than even the 27.2% recorded in 2009/10 in the aftermath of the global financial crisis.
- Revenue boosting measures, which do not include more effective tax collections, are targeted to raise revenue by R5 billion in 2021/22, R10 billion per annum in 2022/23 and 2023/24, and R15 billion in 2024/25. These measures (the details of which will be announced in the February Budget statements of the respective years) combined with the anticipated economic recovery will help to raise the revenue-to-GDP ratio to 24.9% by 2023/24.

Expenditure

- Key expenditure measures aim to stabilise the public debt stock while supporting the economic recovery. Growth of **consolidated expenditure** will be restricted to 1.6% per annum, rising from R2.04 trillion in 2020/21 to R2.14 trillion in 2023/24, while **non-interest expenditure** will be reduced to 26.4% of GDP by 2023/24 from 32.4% in 2020/21.
- **Interest payments** will remain the fastest growing expenditure item as the public debt stock continues to expand. The interest bill is predicted to reach 5.9% of GDP in 2023/24 (from 4.8% in 2020/21) as it grows at an annual average of 16.1% over 2020/21 to 2023/24. The burden placed on the fiscus by the high debt stock is accentuated by the elevated debt service burden: interest costs account for 12.9% of total expenditure in 2020/21 and will increase to 18.3% in 2023/24, while they currently absorb a significant 21% of revenue.
- The 2020/21 **expenditure ceiling** set in the February 2020 Budget is breached by R45.2 billion, but limits for 2021/22 and 2022/23 are reduced by an aggregate of R147.9 billion. These figures, however, exclude the envisaged financial support for electricity utility Eskom (in addition to the R23 billion set aside in the 2020/21 budget).
- **Non-interest spending** rises by R34.3 billion in 2020/21 due to emergency measures announced in the Supplementary Budget, and this is achieved through reallocations and baseline reductions. Thereafter it falls by R300 billion over 2021/22 to 2023/24, with R150 billion of the reduction implemented in 2023/24.
- These **expenditure caps** are premised on large reductions in the rise of the public sector wage bill. Growth of the wage bill will be restricted to 1.8% in 2020/21 and an annual average of 0.8% over 2020/21 to 2022/23 – well below the 7% per year recorded in recent years. The government intends to achieve this by not implementing any increases in the current fiscal year − the final year of the 2018 wage agreement with public sector unions − while increases in the subsequent years will be kept close to 0% (an average of 0.35% a year for 2021/22 and 2022/23).
- **Bailouts** for the large state-owned enterprises will continue. The Minister announced that South African Airways is allocated R10.5 billion in 2020/21 for its business rescue plan, while the Land Bank's restructuring will require R7 billion over 2021/22 to 2023/24.
- National Treasury stressed that dialogue to achieve further expenditure savings should, among others, focus on: the approaches to tertiary student funding, subsidies for urban transport systems, consolidating the number of and functions across government departments at national and provincial levels as well as the numerous public entities across these spheres.

Financing of the deficit

- The **gross borrowing requirement** rises to R774.7 billion, up by R342 billion in 2020/21 compared to the figure in the February Budget, and slightly more than R776.9 billion expected in the Supplementary Budget. The medium-term estimates show the requirement easing to R593.2 billion in 2023/24.
- Most of the new borrowing will still be in the domestic bond market; this figure remains R462.5 billion in 2020/21 (unchanged from June 2020) and rises to R500.8 billion in 2022/23 to average R469.9 billion a year over 2020/21 to 2022/23.
- In the current fiscal year short-term borrowing rises by R95 billion to R143 billion − marginally lower than the June 2020 figure of R146 billion − averaging R66.7 billion per year over 2020/21 to 2022/23.
- Loans from international financial institutions will total US$7.3 billion (R121.4 billion) in 2020/21 − slightly higher than the US$7 billion planned at the time of the Supplementary Budget; US$5.5 trillion has already been received, with the remainder due by 31 March 2021.

Table 3: Gross borrowing requirement

		2020/21		2021/22		2022/23	
	Feb-20	**Jun-20**	Oct-20	**Jun-20**	Oct-20	**Jun-20**	Oct-20
Domestic short-term loans	**48.0**	**146.0**	**143.0**	**56.0**	**67.0**	**64.0**	**71.0**
Domestic long-term loans	**285.2**	**410.0**	**462.5**	**327.9**	**472.2**	**317.2**	**500.8**
Foreign loans	**17.0**	**110.5**	**121.4**	**27.5**	**49.4**	**47.4**	**49.3**
∆ in cash & other balances	17.7	43.2	47.8	84.2	14.3	1.9	27.8
Total	**368.0**	**709.7**	**774.7**	**425.4**	**602.9**	**430.5**	**637.2**

Source: National Treasury

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