National Budget Review

ECONOMICS | SOUTH AFRICA

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A budget that aims to improve the business environment while keeping the deficit and debt burden under control

- **Macroeconomic environment**: National Treasury revised down their growth forecasts to 4.8% (from 5.1% at MTBPS) in 2021, but upped forecasts for 2022 to 2.1% (from 1.8%). GDP projections were unchanged at 1.6% and 1.7% for 2023 and 2024, respectively. Risks to the growth outlook include further Covid-19 waves, elevated inflation, fiscal risks, power outages and rapid global interest rate hikes.
- **Expected 2021/22 outcome:** Strong revenue performance and lower expenditure relative to the 2021 Medium-Term Budget Policy Statement (MTBPS) estimates reduce the budget deficit to its lowest level since the onset of the pandemic. National Treasury now expects a deficit of 5.7% of GDP, much lower than 7.8% in the MTBPS. Revenue collections are estimated at R67.1 billion more than the MTBPS estimate and R200.9 billion (versus our expected R215.4 billion) above the 2021 Budget figure. Gross tax revenue is R181.9 billion more than the 2021 Budget estimate on the back of the strong performance of corporate income tax (CIT), pay-as-you-earn (PAYE) and value-added tax (VAT).
- **Outlook for 2022/23**: The budget deficit widens to 6% of GDP as expenditure growth exceeds revenue growth in 2022/23. The slowdown in revenue growth is from the high base in 2021/22, while aggregate expenditure is pushed higher by rising debt service costs, which increased by 12.2%, and the larger social grants bill. Other than that, National Treasury aims to keep the growth of the non-interest compensation bill at 1.6% per annum over the MTEF. The main uncertainty on the expenditure is the public sector wage bill, as the government has still not secured a wage agreement with public sector unions.
- **Debt metrics:** The debt-to-GDP trajectory is more moderate on the back of the lower deficits. The ratio peaks at 75.1% in 2024/25 and falls to 70.2% in 2029/30, compared with 78.1% in 2025/26 and 75.2% in 2029/30 projected in the November 2021 MTBPS.
- **Financing:** The public sector borrowing requirement falls as a result of narrower budget deficits. Long-term local currency bonds continue to dominate debt issuance.

Macroeconomic framework

The National Treasury lowered their real GDP growth forecasts for 2021 to 4.8% from 5.1% at the Medium-Term Budget Policy Statement (MTBPS), on the back of the weaker-than-initially anticipated economic activity during the second half of the year. The outlook for 2022 has improved slightly, with the economy forecast to grow by 2.1% (from 1.8%) - reaching pre-pandemic levels. Forecasts for the outer two years have remained unchanged at 1.6% and 1.7%. However, Treasury has highlighted several risks to the growth outlook including, further Covid-19 waves, elevated inflation, fiscal risks, power outages and faster-than-expected global interest rate increases.

TABLE 1: FORECASTS OF KEY MACROECNOMIC VARIABLES

	2018	2019	2020	2021	2022	2023	2024
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	2.4	1.1	-6.5	5.6	2.5	1.8	2.0
Final government consumption	1.0	2.7	1.3	0.3	0.4	-2.0	-0.8
Gross fixed-capital formation	-1.8	-2.4	-14.9	1.2	3.2	3.8	4.1
Gross domestic expenditure	1.6	1.2	-8.0	4.6	2.7	1.9	1.9
Exports	2.8	-3.4	-12.0	9.3	2.9	2.8	2.7
Imports	3.2	0.5	-17.4	8.5	5.4	3.9	3.3
Real GDP growth	1.5	0.1	-6.4	4.8	2.1	1.6	1.7
GDP inflation	**4.0**	**4.5**	**5.3**	**6.7**	**1.5**	**3.3**	**4.4**
GDP at current prices (R billion)	5357.6	5605.0	5521.1	6172.0	6395.4	6712.2	7127.3
CPI inflation	4.6	4.1	3.3	4.5	4.8	4.4	4.5
Current account balance (% of GDP)	-3.0	-2.6	2.0	3.8	0.3	-1.2	-1.5

Source: National Treasury Budget Review 2022

Two alternative growth scenarios were modelled. The **first (upside) scenario** assumes fiscal consolidation combined with successful implementation of economic reforms. This outcome will boost confidence and improve sovereign risk, thereby lowering overall borrowing costs, raising GDP 0.7% over the baseline by 2024. The **second (downside) scenario** assumes lower global growth and persistently high global inflation. This outcome will result in rapid global monetary policy tightening, heightened risk aversion and rising economy-wide borrowing costs. This will erode consumers' spending power and reduce local business investment. Lower global demand will reduce export volumes and prices, reducing average GDP by 0.4% between 2022 and 2024 compared to the baseline.

The fiscal framework

TABLE 2: MAIN BUDGET FRAMEWORK

	2021/22		2022/23		2023/24		2024/25	
	Oct-21	Feb-22	Oct-21	Feb-22	Oct-21	Feb-22	Oct-21	Feb-22
Revenue (Rbn)	1 648.8	1 721.3	1 695.7	1 770.6	1 772.7	1 853.2	1 890.9	1 977.6
% growth	17.3	22.4	2.8	2.9	4.5	4.7	6.7	6.7
% of GDP	26.7	27.5	26.7	27.5	26.5	27.2	26.6	27.3
Expenditure (Rbn)	2 128.5	2 077.0	2 075.0	2 157.3	2 126.3	2 176.8	2 239.8	2 281.8
% growth	8.4	5.8	-2.5	3.9	2.5	0.9	5.3	4.8
% of GDP	34.5	33.2	32.7	33.5	31.7	32.0	31.5	31.5
Consolidated Budget Balance (Rbn)	-479.7	-355.7	-379.3	-386.6	-353.6	-323.6	-348.9	-304.2
% of GDP	-7.8	-5.7	-6.0	-6.0	-5.3	-4.8	-4.9	-4.2
Debt Service Costs (Rbn)	269.2	276.9	303.1	310.8	334.6	343.7	365.8	372.00
% of GDP	4.4	4.4	4.8	4.8	5.1	5.1	5.2	5.1
Primary Balance	-210.5	-78.8	-76.2	-75.8	-19.0	20.1	16.9	67.8
% of GDP	-4.0	-1.3	-1.2	-1.2	-0.3	0.3	0.2	0.9
Gross debt-to-GDP ratio (%)	***69.9***	***69.5***	***74.7***	***72.8***	***76.8***	***74.4***	***77.8***	***75.1***

Source: National Treasury Budget Review 2022, *Oct-21 refers to the MTBPS

The Budget 2022 assumes an economic growth trajectory that is better than at the time of 2021 Budget. As a result, tax collections are higher over the MTEF.

The budget deficit narrows steadily over the Medium-Term Expenditure Framework (2022/23 to 2024/25) and a primary balance is achieved in 2023/24, a year earlier than the 2021 MTBPS estimates.

Steady economic growth during 2021 boosted revenue collections, with the consolidated budget revenue rising by 22.4% in 2021/22. This makes it R200.9 billion more than the 2021 Budget estimate. The revenue windfall reduced the budget deficit for 2021/22, but a portion of it will be directed towards provinces to cover compensation shortfalls in education and health. The much better-than-expected increases in tax collections enabled National Treasury to keep the fuel levy and Road Accident Fund (RAF) levy unchanged. Expenditure plans show a commitment to keeping the growth of non-interest spending under control. National Treasury indicated that the enforcement of the baseline expenditure ceiling, which was adopted in 2013, has been lax and they will assess the adoption of a more robust fiscal anchor over the MTEF.

The budget deficit narrows further in 2021/22 on the back of the strong revenue performance. The ratio rises to 6% of GDP in 2022/23 but falls to 4.8% and 4.2% in 2023/24 and 2024/25, respectively.

Revenue

Gross tax revenue for 2021/22 is expected to exceed the MTBPS and 2021 Budget estimates by R61.7 billion and R181.9 billion, respectively. Most of the windfall will stem from higher corporate income taxes (CIT), particularly from the recovery in the mining, manufacturing, and finance sectors. Personal income taxes (PIT) and value-added taxes (VAT) also remained buoyant on the back of a recovery in earnings and low interest rates. Overall, revenue is forecast to be 23.8% higher (R1.547 trillion) than the previous budget estimates (R1.365 trillion). **Consolidated revenue** will be 22.4% (R1.721 trillion) above the 2021 budget outcome (R1.520 trillion).

Revenue forecasts over the **Medium-Term Expenditure Framework (MTEF)** have been revised upwards from the 2021 MTBPS and 2021 budget estimates. This comes despite the expected easing in commodity prices and weak employment outlook. Given the forecasts for consolidated revenue and fiscal GDP growth of 2.9% and 3% respectively in 2022/23, a **tax buoyancy** of 1.09 is expected. Economic growth and tax collections are expected to normalise in the outer two years.

TABLE 3: BUDGET REVENUE

	2020/21	2021/22	2022/23	2023/24	2024/25	2022/23	2023/24	2024/25
R million	**Outcome**	**Revised**	**Medium-term estimates**			**Y-o-y %**		
Taxes on income and profits	718 180	910 107	894 300	940 469	1 003 972	-1.7	5.2	6.8
Personal income tax	487 011	553 529	587 907	628 220	678 296	6.2	6.9	8.0
Corporate income tax	202 123	318 380	269 931	274 375	286 097	-15.2	1.6	4.3
Skills development levy	12 250	18 933	20 619	22 329	24 099	8.9	8.3	7.9
Taxes on property	15 947	19 693	20 291	21 438	22 787	3.0	5.7	6.3
Domestic taxes	455 867	541 296	600 732	643 211	685 483	11.0	7.1	6.6
VAT	331 197	383 724	439 681	473 092	505 007	14.6	7.6	6.7
International trade	47 455	57 042	62 505	66 812	71 272	9.6	6.9	6.7
Gross tax revenue	**1 249 711**	**1 547 071**	**1 598 447**	**1 694 259**	**1 807 614**	**3.3**	**6.0**	**6.7**
Non-tax revenue	52 053	47 964	33 280	32 505	32 013	-30.6	-2.3	-1.5
Mineral and petroleum royalties	14 228	27 979	18 554	14 899	15 535	-33.7	-19.7	4.3
Less: SACU payments	-63 395	-45 966	-43 683	-66 542	-65 453	-5.0	52.3	-1.6
Main budget revenue	**1 238 369**	**1 549 068**	**1 588 044**	**1 660 223**	**1 774 174**	**2.5**	**4.5**	**6.9**
Provincial and other revenue	167 634	172 235	182 601	192 983	203 457	6.0	5.7	5.4
Consolidated budget revenue	**1 406 003**	**1 721 303**	**1 770 645**	**1 853 206**	**1 977 632**	**2.9**	**4.7**	**6.7**
Tax revenue (% of GDP)	22.5%	24.7%	24.8%	24.9%	25.0%	-	-	-
Main budget revenue (% of GDP)	22.2%	24.8%	24.7%	24.4%	24.5%	-	-	-
GDP (R billion)	5 566.2	6 251.5	6 441.3	6 805.3	7 233.7	3.0	5.7	6.3
Tax buoyancy	3.69	1.93	1.09	1.06	1.06	-43.4	-3.0	0.2

Source: National Treasury Budget Review 2022

Tax proposals for 2022/23 were quite encouraging, providing relief of R5.2 billion for households and the economy. These include:

- 4.5% inflation adjustment to the personal income tax brackets and rebates (-R13.5 billion)
- no change to the fuel levy and Road Accident Fund (RAF) levy (-R3.5 billion)
- 1% reduction in the corporate income tax rate to 27% (-R2.6 billion)
- between 4.5% and 6% increases on alcohol and tobacco excise duties (+R500 million)
- 50% increase in the maximum monthly employment tax incentive to R1500 (year 1) and R750 (year 2) (-R2.2 billion)

Lost tax revenue (-R2.6 billion) from the 1% cut in the CIT rate will be offset by base protection and broadening measures, that is, restricting assessed losses (+R1.1 billion) and additional interest limitation (+R1.5 billion). The new headline tax rate (27%) will be more aligned with the Organisation for Economic Cooperation and Development (OECD) and Group of 20 recommendations on base erosion and profit-shifting. Still, South Africa's company tax rate remains above the OECD's 23% average.

Government also proposes to introduce a new tax on vaping products of at least R2.90 per millilitre from 1 January 2023 and a tax on beer powders from 1 October 2022.

This budget also showed the government's commitments towards addressing climate change. These include:

- increasing the carbon tax rate from R134 to R144, effective 1 January 2022.
- increasing the carbon fuel levy by 1 cent to 9 cents per litre for petrol and 10 cents per litre for diesel, effective 6 April 2022.
- An extension of the first phase of the carbon tax to 31 December 2025
- the carbon tax will progressively increase every year to reach $26 per tonne (in line with COP26 commitments). From 2026, the pace of increase will accelerate to reach $30 per tonne by 2030.

Achieving a just transition will be costly, also brings opportunities, including access to international finance, new business, and employment creation, broadening the tax base further.

Expenditure

The government continues to show a commitment to non-interest expenditure restraint. Consolidated expenditure is projected to increase at an annual rate of 3.2% over the MTEF. Although this is higher than the 1.8% per annum projected in the MTBPS, the increase remains below the inflation rate between 2023/24 and 2024/25. Non-interest spending expands at an annual average of 2.1% over the MTEF. Excluding compensation of employees, non-interest expenditure rises by 1.6% per annum. National Treasury stresses that high debt-service costs, the outstanding public sector wage bill and the poor financial state of large state-owned enterprises pose a risk to expenditure.

Interest payments on public debt remain the fastest-growing expenditure item due to the elevated public debt stock. **Debt service costs** will rise by 12.2% to R310.8 billion in 2022/23 and will absorb 19.4% of gross tax revenue. Over the MTEF, growth in interest payments averages 10.4% per year, which will push debt service costs to 20.6% of gross tax revenue by 2024/25. This translates into 21 cents in every R1 collected in taxes. The high interest bill diverts resources from pressing needs such as infrastructure investment.

Negotiations for a new wage deal with public sector unions will start in March 2022. Therefore, the **public sector wage bill** is a key uncertainty in the expenditure estimates. National Treasury stressed that if an agreement is not reached, the 2021/22 non-pensionable gratuity will be extended for another year. On that basis, the compensation of employees rises by a projected 2.8% in 2022/23, then falls by 1.1% in 2023/24 before rising by 4% in 2024/25, Growth in compensation of employees averages 1.8% per year over the MTEF. National Treasury warned if the wage settlement is higher than needed to contain the overall wage bill, it will occur at the expense of public employment.

S**ocial grants** contract by 0.1% a year over the MTEF. However, the figure is based on the social relief for distress (SRD) grant being terminated in March 2023. The SRD will cost R44.4 billion in 2022/23. We maintain the view that the government will implement some form of a basic income grant once the SRD programme expires, adding about R45 billion a year to aggregate expenditure over the MTEF.

Total **infrastructure spending** increases by 8.5% a year over the MTEF. Strong increases are planned for water resource and bulk infrastructure, which rises by 19.9% a year over the MTEF, while road infrastructure will increase by 13% per year.

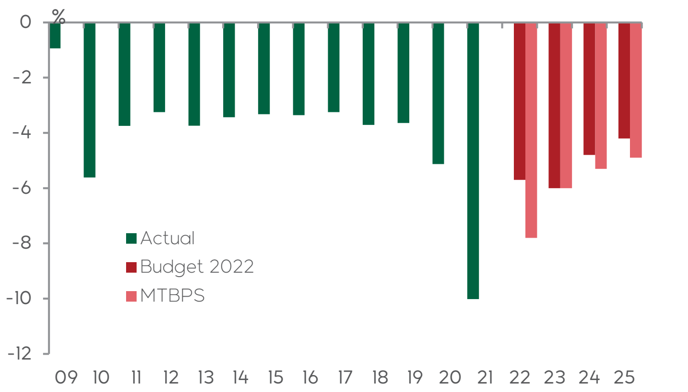
There was no announcement of new allocations to the **state-owned enterprises (SOEs)** in this budget. Eskom has been allocated R88 billion up to 2025/26 for its restructuring programme and liquidity needs.

Budget metrics

Strong revenue collections narrow the budget deficit to 5.7% of GDP in 2021/22, but the shortfall expands marginally to 6% in 2022/23 as revenue growth moderates from the high base in 2021/22 and expenditure growth rebounds. Beyond that, the government will have to ensure that non-interest expenditure growth is contained at the MTEF targets, given that higher interest rates and a weaker currency could worsen debt service payments and result in a larger budget deficit in the years ahead.

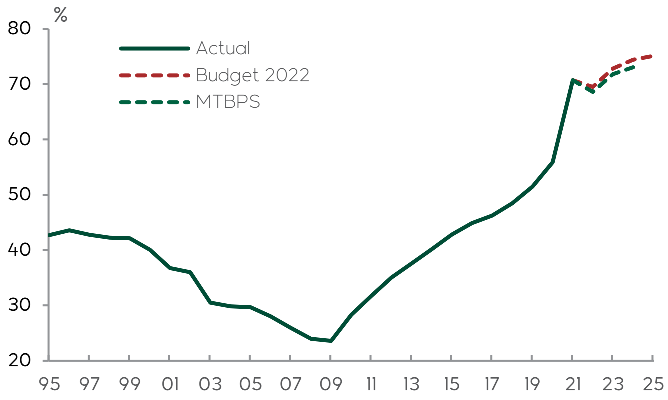
The narrower budget deficit helps reduce the debt-to-GDP ratio further. The ratio falls to 69.5% in 2021/2022, slightly lower than 69.9% estimated in the 2021 MTBPS. Over the MTEF period, the still wide budget deficit pushes the ratio higher, although at a more moderate pace. The ratio is projected to peak at 75.1% in 2024/25 and ease to 70.2% in 2029/30, compared with 78.1% in 2025/26 and 75.2% in 2029/30 projected in the November 2021 MTBPS, respectively. However, the debt burden will remain well above the pre-Covid peak of 63.3% in 2019/20, highlighting the need for fiscal consolidation.

Chart 3: Budget deficit as % of GDP



Source: National Treasury Budget 2022

Chart 4: Gross debt as % of GDP



Source: National Treasury Budget 2022

Financing of the budget deficit

The public sector borrowing requirement declines sharply to R403.5 billion in 2021/22 as a result of the lower budget deficit. It rises to R439.4 billion in 2022/23 but falls thereafter to an average of R384.1 billion per year over the MTEF. According to National Treasury, debt redemptions will average around R150 billion per year over the next five years,

National Treasury will continue to raise the bulk of their financing through local currency bond issuance. National Treasury will lengthen the maturity profile of the overall loan portfolio. External borrowing will remain selective, such as the recent $750 million World Bank loan.

TABLE 4: FINANCING THE BUDGET DEFICIT

	2021/22	2022/23	2023/24	2024/25
R million				
Domestic debt				
Marketable	3 833 993	4 140 317	4 477 884	4 797 554
Government bonds	3 384 828	3 691 152	3 988 719	4 269 389
Treasury bills	449 165	449 165	489 165	528 165
Bridging bonds	-	-	-	-
Non-marketable	18 378	18 378	18 378	18 378
Gross loan debt	3 852 371	4 158 695	4 496 262	4 815 932
Cash balances	- 145 517	- 50 000	- 50 000	- 50 000
Net loan debt	3 706 854	4 108 695	4 446 262	4 765 932
Foreign debt				
Gross loan debt	493 318	533 471	569 331	613 401
Cash balances	- 143 482	- 139 107	- 121 675	- 106 897
Net loan debt	349 836	394 364	447 656	506 504
Gross loan debt	**4 345 689**	**4 692 166**	**5 065 593**	**5 429 333**
Net loan debt	**4 056 690**	**4 503 059**	**4 893 918**	**5 272 436**

Source: National Treasury Budget Review 2022

Conclusion

The Finance Minister continued along the path towards fiscal sustainability, opting to use the windfall gain from the surge in corporate tax revenue due to favourable commodity prices to reduce the budget deficit at a slightly faster pace than presented last year. However, the budget deficit will remain above the sustainable 3%-of-GDP mark over the next three years, which means that the debt burden continues to increase albeit at a slower pace than initially anticipated. The implication is that debt service costs will increasingly crowd out other key economic and social spending priorities.

The most encouraging development is the reduction in the company tax rate and the increase in the employment tax incentive. These decisions suggest that the government realises the urgent need to boost South Africa's appeal as an investment destination following over a decade of power outages and economic stagnation. The budget did not provide any new initiative on structural reforms, largely confirming the progress detailed by the President in his State of Nation (SONA).

Although there are no fireworks in this year's budget, the underlying tone is one of fiscal responsibility, which should offer a sound foundation from which to move towards a more sustainable fiscal future.

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