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NEDBANK

# Budget Statement 2021

## Economics | South Africa

### Much better than most expected, but much depends on the ability to contain public wage growth

- **Macroeconomic assumptions:** National Treasury revised its growth forecasts to a less severe contraction of 7.2% for 2020 from the 7.8% anticipated at the time of the October 2020 Medium Term Budget Policy Statement (MTBPS). The economy is forecast to grow by 3.3% in 2021 (unchanged from October) before expanding by 2.2% (up from 1.7%) and 1.6% (up from 1.5%) in 2022 and 2023 respectively.
- The **budget deficit** for 2020/21 is slightly smaller, albeit still exceptionally high, at 14% of GDP compared with the October estimate of 15.7% of GDP. National Treasury also aims to reduce the deficit at a slightly faster pace than indicated in the MTBPS. The budget deficit for 2021/22 is budgeted to narrow to 9% of GDP before moderating to 6.3% of GDP by 2023/24
- **Revenue** for 2020/21 is projected to be 6.7% higher than in the MTBPS. In 2021/22, revenue will jump to R1.6 trillion, supported by the anticipated economic recovery and the low base of the past fiscal year. **Expenditure** for 2020/21 is only slightly higher than the October estimate but fractionally lower as a percentage of GDP at 41.7% compared with 41.9%. The expenditure estimates for 2021/22 to 2023/24 are all modestly higher than projected in October but still reflect considerable expenditure restraint. The outcome still hinges on the government's ability to contain the public sector wage bill's growth.
- **Debt metrics:** The **debt-to-GDP ratio** improves significantly due to the lower deficit projections and the anticipated economic growth trajectory. The gross-government-debt-to-GDP ratio is now projected to rise from 63.3% in 2019/20 to 80.3% in 2020/21, slightly lower than 81.8% anticipated last October. After that, the ratio will climb to 84.9% in 2023/24, much lower than October's estimate of 92.9%. The debt burden is projected to stabilise at 88.9% in 2024/25, also much lower than 95.3% projected in the MTBPS.
- **Financing:** Deficit financing will primarily be via long-term domestic loans, with most issuance on the long-end of the curve.

**Table 1: Consolidated Budget Framework**

| | 2020/21 | | | 2021/22 | | 2022/23 | | 2023/24 | |
|---|---|---|---|---|---|---|---|---|---|
| | Budget 2020 | MTBPS 2020 | Outcome Feb-21 | MTBPS 2020 | Budget 2021 | MTBPS 2020 | Budget 2021 | MTBPS 2020 | Budget 2021 |
| **Revenue (R bn)** | **1 583.9** | **1 276.7** | **1 362.7** | 1 457.6 | **1 520.4** | **1 595.8** | **1 635.4** | **1 705.7** | **1 717.2** |
| *% of GDP* | *29.2* | *26.3* | *27.7* | *27.4* | *28.4* | *28.5* | *28.9* | *29.8* | *28.6* |
| **Expenditure (R bn)** | **1 954.4** | **2 037.8** | **2 052.5** | **1 993.5** | **2 020.4** | **2 005.8** | **2 049.5** | **2 066.0** | **2 095.1** |
| *% of GDP* | *36.0* | *41.9* | *41.7* | *37.5* | *37.7* | *41.4* | *36.2* | *38.8* | *34.9* |
| **Budget Balance (R bn)** | **-370.5** | **-761.1** | **-689.8** | **-535.9** | **-500.0** | **-483.9** | **-414.1** | **-433.4** | **-377.9** |
| ***% of GDP*** | **-6.8** | ***-15.7*** | **-14.0** | **-10.1** | **-9.3** | **-8.6** | **-7.3** | **-7.3** | **-6.3** |
| **Total gross loan debt (R bn)** | 3 561.7 | 3 974.1 | **3 949.7** | 4 551.8 | **4 382.8** | 5 071.3 | **4 819.9** | 5 536.2 | **5 234.5** |
| *% of GDP* | *65.6* | *81.8* | *80.3* | *85.6* | *81.9* | *90.1* | *85.1* | *92.9* | *87.3* |
| **Debt-service costs** | **229.3** | **225.9** | **232.9** | **271.8** | **269.7** | **317.6** | **308.0** | **353.1** | **338.6** |
| *% of GDP* | *4.2* | *4.6* | *4.7* | *5.1* | *5.0* | *5.6* | *5.4* | *5.9* | *5.6* |
| *% of revenue** | *14.5* | *17.7* | *19.4* | *18.6* | *20.0* | *19.9* | *21.2* | *20.7* | *22.2* |
| **GDP (R bn)** | 5 428.2 | 4 858.3 | 4 921.0 | 5 317.0 | 5 352.2 | 5 629.3 | 5 666.3 | 5 961.3 | 5 997.2 |

Source: National Treasury, *Main budget revenue

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## Fiscal Framework:

- The budget figures assume a recovery in economic growth that aligns with our expectations of relatively subdued GDP growth over the MTEF period.
- In addition to their baseline view, the National Treasury modelled **two additional economic scenarios**. Scenario A primarily assumes 'Rapid increases in electricity supply and faster reform implementation to boost growth', which produces GDP growth of 3.6% in 2021, carrying through to the subsequent years. Scenario B assumes 'Additional COVID-19 waves and associated mitigation measures throttle the economy', which translates into a much softer growth rate of 1.6% in 2021, with base effects into 2022.

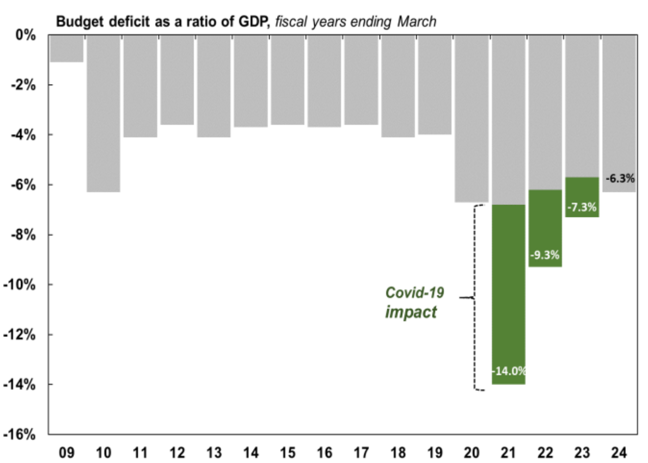
**Table 2: Economic assumptions**

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| | Actual | Revised | Forecast | | |
| **Real GDP** | 0.2 | -7.2 | 3.3 | 2.2 | 1.6 |
| **Real HCE** | 1.0 | -5.9 | 2.9 | 2.4 | 2.0 |
| **Real GFCF** | -0.9 | -18.4 | -2.4 | 3.9 | 3.9 |
| **Current account (% of GDP)** | -3.0 | 1.7 | -0.1 | -1.0 | -1.4 |
| **Consumer inflation (%)** | 4.1 | 3.3 | 3.9 | 4.2 | 4.4 |

Source: National Treasury

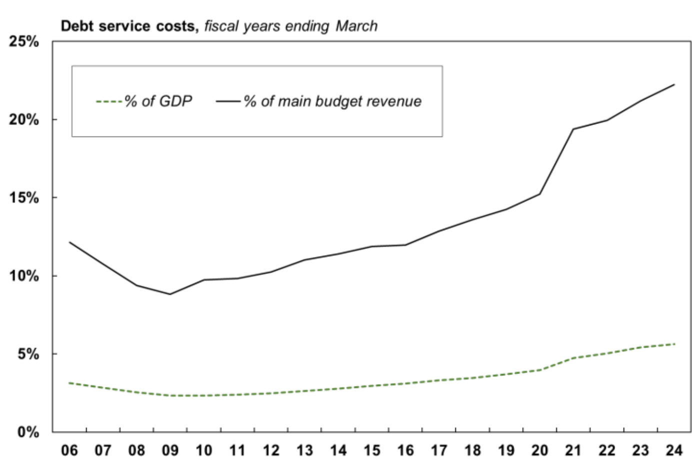
- The Treasury expects the **budget deficit** to narrow at a pace faster than we anticipated, with the reduction premised on more robust revenue growth instead of real expenditure cuts. National Treasury forecasts the deficit at 14% of GDP in 2020/21, lower than the 15.7% projected in the MTBPS. Over the MTEF, the deficit remains above 5% of GDP, narrowing to 6.3% in 2023/24. Our expectation is for the deficit to remain sticky around 8%, as spending reductions are likely to be less than the Treasury's targets.
- The **primary budget balance** remains in deficit over the MTEF, but declines from 7.5% of GDP in 2020/21 to 0.8% in 2023/24. This suggests that a small primary surplus will be recorded at the assumed growth and fiscal consolidation trajectory in 2024/25.
- **Revenue** growth will be boosted by the economic recovery, with its proportion of GDP rebounding to above 28%. No significant new tax measures were announced, with adjustments to personal tax brackets are above-inflation, while increases in the fuel levy and excise duties were lower than in recent years.
- **Main budget non-interest expenditure cuts** are limited, and expenditure allocations remain dominated by social services, primarily health and education. **Consolidated non-interest expenditure** excluding the public sector wage bill increases at an average 0.4% per annum.
- **Debt service costs** are R3.6 billion or 1.6% higher than budgeted in 2020/21, which amounts to a 13.7% rise over the previous fiscal year. This category increases at an annual average of 13.3% per annum over 2020/21 to 2023/24. This will put South Africa in the top 5 of developing economies globally, with only the Dominican Republic, India, Pakistan, Egypt and Sri Lanka spending more of their national revenue on interest payments.

**Chart 1: Still slow reduction of the budget deficit**




Source: National Treasury

**Chart 2: Debt service costs continue to rise steeply**




Source: National Treasury

- An even lower path of the **debt-to-GDP** ratio is anticipated, with the ratio rising to 87.3% in 2023/24 and peaking at 88.9% in 2025/26 before gradually easing to 86% in 2028/29. These figures compare favourably with a peak of 95.3% and 93.3% projected in the MTBPS, respectively but are still slightly higher than the 'active scenario' presented in June 2020.

## Revenue

- The **consolidated budget revenue** for 2020/21 is projected at R1.36 trillion, which is 6.7% (R86 billion) more than the MTBPS estimate, but 19.4% (R221 billion) lower than the 2020 National Budget. **Gross tax revenue** is expected to overshoot the MTBPS estimate by 9% or R99.6 billion, mainly due to the easing of lockdown restrictions, which supported consumption, wages and corporate income tax (particularly the mining sector) collections between October and December 2020.
- In light of the Covid-19 induced job losses and business closures, there will be no new tax increases for the 2021/22 fiscal year. The R40 billion tax increases (over the upcoming three years) announced in the supplementary budget will be withdrawn.
- **Tax proposals** include:

  - above-inflation increase of 5%in personal income tax brackets and rebates (-R2.2 billion)

  - inflation-linked general fuel levy increase of 15c/litre for petrol and diesel and an above-inflation increase of 11c/litre in the Road Accident Fund levy

  - an 8% increase in alcohol and tobacco excise duties (R1.8 billion)

  - the introduction of export tax on scrap metal (R0.4 billion)

**Table 3: Consolidated Budget Revenue**

| | (R bn) | 2021/22 % growth | % of tax | Proposals (R bn) | 2020/21 deviation (R bn) |
|---|---|---|---|---|---|
| **Consolidated revenue** | 1 520.4 | 11.6 | | | -221.2 |
| **Provincial and other revenue** | 168.7 | 4.2 | 11.1 | | -24.0 |
| **National revenue** | 1 351.7 | 12.6 | 88.9 | | -197.2 |
| **Other revenue** | 32.5 | -37.4 | 2.1 | | 16.0 |
| Less SACU | 46.0 | -27.5 | 3.0 | | |
| **Tax revenue** | 1 365.1 | 12.6 | 89.8 | | -213.2 |
| **Income and profits** | 762.0 | 8.8 | 50.1 | | -113.5 |
| Personal income tax | 516.0 | 7.0 | 33.9 | -2.2 | -64.6 |
| Corporate income tax | 213.1 | 12.9 | 14.0 | | -41.4 |
| **Payroll and workforce** | 17.8 | 75.1 | 1.2 | | -9.2 |
| **Property** | 16.8 | 8.8 | 1.1 | | -2.0 |
| **Goods and services** | 514.5 | 16.7 | 33.8 | | -73.4 |
| VAT | 370.2 | | 24.3 | | -36.0 |
| Excise duties | | | | 1.8 | |
| **International trade** | 54.0 | 18.3 | 3.5 | | -15.0 |
| Introduction of export tax on scrap metal | 0.4 | | | 0.4 | |

Source: National Treasury Budget Review 2021

- On the **corporate tax** front, the Minister indicated that the government will reduce tax incentives, expenditure deductions, and assessed loss offsets. While this will increase the tax burden on companies over the short-term, the Minister indicated that the aim is to cut the corporate tax rate over the medium term.
- Fiscal GDP and tax revenue growth are forecasted at 8.8% and 12.6%, respectively, for 2021/22, with resultant **tax buoyancy** of 1.44. Economic growth and tax collections are expected to normalise in the outer two years.

**Table 4: Consolidated Budget Revenue**

| R billion | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/34 |
|---|---|---|---|---|---|
| | Actual | Estimate | | Forecast | |
| **Gross tax revenue** | 1 355.8 | 1 212.2 | 1 365.1 | 1 457.7 | 1 548.5 |
| *Yoy%* | | *-10.6* | *12.6* | *6.8* | *6.2* |
| **Fiscal GDP** | 5 148.9 | 4 921.0 | 5 352.2 | 5 666.3 | 5 997.2 |
| *Yoy%* | | -4.4 | *8.8* | *5.9* | *5.8* |
| **Tax buoyancy** | | **2.39** | **1.44** | **1.15** | **1.07** |

Source: National Treasury Budget Review 2021

## Expenditure

- Reductions to **baseline expenditure** (main budget expenditure less interest cost) are still based on containing the public sector wage bill and lower allocations to some essential functions.
- The non-interest expenditure bill is budgeted to reduce by an annual average of 0.8%, but excluding public sector wages, baseline spending rises by an average of 1.1%.
- The **public sector wage bill** will rise by only 2.1% in 2021/22, including the Covid-19 provisions for temporary workers, and by only 1.2% a year over the MTEF period, marginally higher than the average growth rate of around 0.8% over 2020/21 to 2022/23 envisaged in the MTBPS. Treasury aims to contain the compensation bill by reviewing some fringe benefits, cutting staff numbers and doing away with non-critical posts. Much will depend on the Constitutional Court verdict on the 2020/21 wage freeze and the wage negotiations with labour unions on the upcoming three-year bargaining period. Inflation-linked increases will lift the wage bill by R112.9 billion over the MTEF, while inflation plus 1% adds R132.7 billion.

**Table 5: Consolidated Budget Expenditure**

| R million | 2020/21 Revised estimate | 2021/22 Medium-term estimates | MTEF allocation % of total | Average annual MTEF %∆ |
|---|---|---|---|---|
| **Learning and culture** | **387.2** | **402.9** | **23.5** | **2.4** |
| Basic education | 266.3 | 272.3 | 15.9 | 1.6 |
| Post-school education and training | 111.7 | 119.6 | 7.0 | 3.8 |
| Arts, culture, sport and recreation | 9.2 | 11.0 | 0.6 | 7.6 |
| **Health** | **247.0** | **248.8** | **14.2** | **-0.3** |
| **Social development** | **413.3** | **335.3** | **18.9** | **-7.7** |
| Social protection | 256.8 | 229.4 | 13.6 | -2.1 |
| Social security funds | 156.5 | 105.9 | 5.3 | -18.6 |
| **Community development** | **211.5** | **218.8** | **13.3** | **4.4** |
| **Economic development** | **191.9** | **207.5** | **12.2** | **4.2** |
| Industrialisation and exports | 33.1 | 36.2 | 2.1 | 3.9 |
| Agriculture and rural development | 25.3 | 27.4 | 1.6 | 3.9 |
| Job creation and labour affairs | 31.6 | 33.4 | 1.6 | -8.5 |
| Economic regulation and infrastructure | 86.5 | 93.1 | 5.9 | 8.2 |
| Innovation, science and technology | 15.4 | 17.4 | 1.0 | 5.0 |
| **Peace and security** | **218.6** | **208.6** | **12.1** | **-0.8** |
| Defence and state security | 54.0 | 46.6 | 2.7 | -3.7 |
| Police services | 106.6 | 104.6 | 6.1 | -0.2 |
| Law courts and prisons | 48.3 | 48.5 | 2.8 | 1.1 |
| Home affairs | 9.8 | 8.9 | 0.5 | -1.4 |
| **General public services** | **62.5** | **68.4** | **3.9** | **3.4** |
| Executive and legislative organs | 14.4 | 14.5 | 0.8 | 1.4 |
| Public administration and fiscal affairs | 40.9 | 46.1 | 2.6 | 3.9 |
| External affairs | 7.2 | 7.9 | 0.5 | 5.0 |
| **Payments for financial assets** | **87.6** | **48.2** | | |
| **Allocated by function** | **1 819.6** | **1 738.6** | **1.00** | **-0.01** |
| Debt-service costs | 232.9 | 269.7 | | 0.13 |
| Contingency reserve | – | 12 000 | | |
| **Consolidated expenditure** | **2 052.4** | **2 020.4** | | **0.01** |

Source: National Treasury

- Allocations to **health, social development** and **peace and security** will contract over the period. However, the former two spending categories and **learning and culture** will still receive the largest share of government spending. The Covid-19 vaccine rollout gets R5.2 billion in 2021/22 and R3 billion in 2022/23, while R8 billion has been set aside in 2021/22 to manage the pandemic. Transfers to **higher education institutions** are reduced by R8 billion over the MTEF.
- **Economic development**, which is dominated by infrastructure spending, sees annual allocations rising by an average of 4.2% per year. For which R100 billion has been allocated for the next 10 years, the Infrastructure Fund receives the initial R18 billion over the MTEF.
- **Debt service costs** remain the fastest growing expenditure item due to the rapid rise of the public debt stock. By 2022/23 interest payments will absorb just over 21c of every R1 raised at the national level (chart 2). The interest rate paid by the fiscus, indicated by the sovereign risk premium, has remained relatively contained despite the rating downgrades, but this ratio is likely to increase if further downgrades and tougher financial market conditions are encountered. Restricting the growth of the public debt stock and its eventual reduction will be necessary to contain the interest payments-to-revenue ratio below 20%.
- The balance sheets of the key **state-owned enterprises** deteriorated further over 2020, with most of them recording negative cashflows due to the impact of Covid-19 business disruptions. Additionally, the high volume of maturing SOE loans, of which 60% are guaranteed by the fiscus, clearly point to the need for more bailouts in the coming years. New bailouts over the MTEF period are headlined by **Eskom** and the **Land Bank**. The electricity utility is allocated R31.7 billion in 2021/22 after receiving R56 billion in 2020/21, while the Land Bank is allocated R5 billion in 2021/22 and R1 billion a year in 2022/23 and 2023/24, in addition to R3 billion transferred in 2020/21. **South African Airways** needs a higher R19.3 billion over the MTEF for its business rescue programme, higher than the R16.4 billion set aside in the February 2020 budget statement. The amount includes R14 billion from the fiscus, R10.5 billion of which was transferred in 2020/21, while the remainder will be raised from the expected strategic equity partners. **Therefore, the fiscus will transfer a further R3.5 billion to the airline.** Although no new allocations were announced for **Denel** and the **South African Broadcasting Corporation,** their precarious financial positions point to the need for further financial assistance in the foreseeable future.

## Financing of the deficit

- The **gross borrowing requirement** for 2020/21 amounted to a massive R670.3 billion or 13.6% of GDP, with the bulk of financing raised in the domestic bond market (R518 billion). Domestic monetary institutions and other financial institutions took up substantially more of the bond issuance. In contrast, foreign interest was limited, with foreign investors' share of bond ownership dropping to 29.9% from 37.1% in 2019. There was also a much greater reliance on short-term loans (up to R97.2 billion compared with only R36.1 billion in 2019/20) and foreign loans (up to R107.1 billion compared with R76.1 billion).

**Table 6: Financing of the budget deficit**

| | 2020/21 | | 2021/22 | | 2022/23 | | 2023/24 | |
|---|---|---|---|---|---|---|---|---|
| *R bn* | Budget | Revised | MTBPS 2020 | Budget 2021 | MTBPS 2020 | Budget 2021 | MTBPS 2020 | Budget 2021 |
| **Main budget balance** | **-368.0** | **-603.4** | **537.4** | **-482.6** | **-486.6** | **-417.2** | **-437.5** | **-389.0** |
| **Redemptions** | **-64.7** | **-66.9** | **-65.5** | **-65.3** | **-150.6** | **-144.8** | **-155.7** | **-152.7** |
| Domestic long-term loans | -52.5 | -52.5 | -60.9 | -60.8 | -134.2 | -129.4 | -112.9 | -112.4 |
| Foreign loans | -12.2 | -14.4 | -4.6 | -4.5 | -16.4 | -15.4 | -42.8 | -40.2 |
| **Total** | **-432.7** | **-670.3** | **–** | **-547.9** | **–** | **-562.0** | **–** | **-541.7** |
| **Financing** | | | | | | | | |
| **Domestic short-term loans** | **48.0** | **97.2** | 67.0 | **9.0** | 71.0 | **52.0** | 62.0 | **56.0** |
| **Domestic long-term loans** | **337.7** | **518.5** | 472.2 | **380.0** | 500.8 | **440.8** | 436.8 | **396.9** |
| Market loans | 337.7 | 518.5 | – | 380.0 | – | 440.8 | – | 396.9 |
| Loans issued for switches | – | -0.0 | – | – | – | – | – | – |
| **Foreign loans** | **29.3** | **107.1** | 49.4 | **46.3** | 49.3 | **46.3** | 66.6 | **62.6** |
| **Change in cash and other balances[2]** | **17.7** | **-52.4** | 14.3 | **112.6** | 16.1 | **22.8** | 27.8 | **26.2** |
| **Total** | **433** | **670** | **–** | **548** | **–** | **562** | **–** | **542** |
| *Percentage of GDP* | *8.0%* | *13.6%* | | *10.2%* | | *9.9%* | | *9.0%* |

Source: National Treasury

- In the years ahead, the borrowing requirement is projected to ease, albeit slowly, to R547.9 billion or 10.2% of GDP in 2021/22, before easing to R562 billion or 9.9% of GDP in 2022/23 and ultimately down to R541.7 billion or 9% of GDP in 2023/24. The domestic bond market will remain the primary source of funding, averaging R405 billion over the medium-term. National Treasury will reduce short-term borrowing, with Treasury bill issuance averaging R39 billion or 8.4% of total domestic borrowing from 15.8% in 2020/21. Similarly, the amount government aims to raise from foreign loans will be reduced to around R46 billion in both 2021/22 and 2022/23.
- The public sector debt burden will be lower than projected in the MTBPS. The gross government debt to GDP ratio is now projected to rise from 63.3% in 2019/20 to 80.3% in 2020/21, lower than 81.8% anticipated last October. After that, the ratio will climb to 84.9% in 2023/24, much lower than October's estimate of 92.9%.

## Conclusion

This budget instils some confidence in the Treasury's commitment to stabilise the government's finances against the backdrop of a challenging year on the economic front. The revenue targets are not too demanding, but the risks remain heavily tilted to the downside. A slower growth recovery will subdue revenue growth and shift even more responsibility towards containing spending. The absence of boldness in cutting expenditure is disappointing. The imperative to restructure the bloated non-investment expenditure bill and improve the efficiency of overall government spending has never been clearer. SA is in the top 5 among emerging markets regarding the budget deficit and the share of national revenue absorbed by interest payments on debt. The wage bill is amongst the top 3 in the Organisation of Economic Cooperation and Development countries. The debt ratio is rising to unsustainable levels relative to the size of the economy. The public debt-to-GDP ratio is well above the median of 'BB'-rated sovereigns, which is around 50%. Rating agencies are likely to give this budget a lukewarm assessment but will most probably adopt a 'wait and see' stance. Failure to deliver the expenditure goals will probably result in further downgrades.

## Disclaimer