momentum
investments

Medium-term Budget Review
October 2020

Hard choices and reform implementation key to achieving five-year stabilisation plan

Initial impressions

- We are slightly more bearish on average on real growth relative to Treasury's estimate of 2.7% for the next three years, while our average inflation estimates are broadly in line at 4.4%
- Consolidated budget deficit at 15.7% of gross domestic product (GDP) for FY20/21 bettered the Bloomberg consensus of 15.9% ➔ main fiscal deficit is expected to be 0.6% wider on average between FY20/21 and FY22/23
- Contractionary budget ➔government expects deep cuts in expenditure in the remainder of the medium-term expenditure framework (MTEF) to narrow the main budget deficit to 8.6% by FY22/23 in comparison to the Bloomberg consensus of 9.0%
- Relative to the February 2020 national budget, revenue collection was revised higher by R583.6 billion between FY20/21 and FY22/23 and expenditure lifted by R728.6 billion
- Fiscal consolidation and debt stabilisation in the next five years rely on significant expenditure cuts and the earnest implementation of structural reforms

Immediate market effect

- Although government's fiscal projections are more favourable than the market consensus, financial markets dipped on a slower-than-previously indicated pace of consolidation and significant implementation risk attached to forecasted civil servant wage bill cuts

The FTSE/JSE Alsi moved 2.2% lower relative to the previous close following the budget announcement	FTSE/JSE Resources (down 2.9%) and FTSE/JSE Financials (down 3.5%) shares led the FTSE/JSE Alsi lower relative to the previous close	The R2030 government bond yield sold off only marginally relative to the previous close on a broadly unchanged government borrowing requirement	The US dollar/ rand weakened by 1.8% relative to the previous close

Five-year path to fiscal consolidation depends on extensive expenditure cuts

- Government aims to phase in zero-based budgeting in the 2022 MTEF to justify departmental spending ➔ this should enhance transparency, enforce accountability and allow for the phasing out of programmes that have little effect on service delivery or economic performance
- Gross debt ratio expected to rise from 81.8% in FY22/23 (in line with June 2020 estimate) to 90.4% in FY23/24 ➔ on average the debt ratio is expected to be 1% lower between FY20/23 – FY22/23 relative to June 2020's estimate ➔ this is nevertheless the largest expected three-year rise from SA's peer group
- Primary balance remains in deficit during the MTEF ➔ it is expected to narrow to 3.0% by FY22/23 (previously 2.3% in June 2020) from 9.8% in FY20/21 (previously 9.7%) ➔ expected to print a surplus in FY25/26 with debt stabilising at 95.3% of GDP in the same year
- Debt-service costs absorb 21c of every rand government collects relative to 9c in FY08/09 ➔ interest bill expected to rise from 4.8% of GDP in FY20/21 to 5.9% of GDP in FY23/24 ➔ fastest growing expenditure item at nominal growth of 16.1% (11.7% real) in the next three fiscal years

A lot hinges on reducing the wage bill

- Treasury proposed a wage freeze for the next three fiscal years and suggested further avenues of consideration (harmonising allowances and benefits, reconsidering pay progression rules and reviewing occupation-specific dispensations) ➔ legal battle ensuing between public-sector workers and government on the third year of the 2018 wage agreement ➔ will be heard by the Labour Appeal Court on 2 December 2020
- Treasury is developing a public sector remuneration strategy for the longer term which will apply to public office bearers, state-owned enterprises (SoEs) and local government
- The civil servant wage bill's share of consolidated expenditure averages 31.3% in the next three years compared to 33.6% in the previous three years

Income and other support to consumers

- The special COVID-19 social relief of distress grant will be extended until 31 January 2021 ➔ partly redirected from the public employment programme ➔ more than 12 million new recipients have received income protection ➔ continued household vulnerability and a poor outlook for jobs may pose a challenge to removing the top-up grants ➔ no detail was raised on the potential for a basic income grant ➔ temporary increases in other grants ceases
- By the end of September 2020, the Unemployment Insurance Fund had disbursed R47.4 billion to 10.6 million beneficiaries through the temporary employee relief scheme
- The loan guarantee scheme extended R16 billion since May 2020 launch (R200 billion set aside originally) ➔ work is underway with the SA Reserve Bank and Banking Association to improve the take-up
- Treasury noted evidence suggests tax increases can have large negative effects on growth ➔ no further tax increases were proposed relative to the June 2020 Supplementary Budget ➔ Treasury aims to lower the tax burden from 26.3% to 22.9%
- However, projected wage cuts of R300 billion in the next three years relative to the February 2020 national budget imply lower spending ability particularly for middle-income earners

SoEs and municipal finances remain in disarray

- R10.5 billion allocation to SA Airways based on a reprioritisation of funds (contingency reserve, lower Skills Development Levy and projected underspending)
- Treasury assumes no further recapitalisations of SoEs in the medium term
- Uncollected revenues in local government grew to R171.9 billion in June 2020, which is up 16.3% from a year earlier ➔ this is a consequence of weak financial management at municipalities

Realigning composition of spending away from consumption and towards investment

- Treasury expects fixed investment to contract for a fourth consecutive year in 2021 ➔ SA's investment-to-GDP ratio has averaged 17% year to date, which is the lowest since 2005
- R18 billion of government's R100 billion infrastructure commitment is allocated in the medium term
- Government wage bill to grow at an average nominal rate of 0.8% (negative 2% real) for the next three years ➔ while capital assets expected to increase at a nominal rate of 7.8% (5.2% real) in the same period

Feasibility of longer-term demands on the fiscus

- Government highlighted that a growth rate of 3.3% and the generation of one million jobs could be achieved within a 10-year timeframe if structural reforms, such as industrialisation, lowering barriers to entry, boosting tourism initiatives, securing electricity generation and boosting infrastructure, were executed ➔ however, Treasury expects growth levels to only recover to pre-pandemic levels by 2024 and growth beyond the medium term is expected to average 2%
- Sub-national government and accrued liability risks, including the poor condition of municipalities and the financial position of the Road Accident Fund, pose threats in the longer term
- The importance of the National Health Insurance (NHI) was highlighted again despite the health budget growing at a negative real rate of 1.2% in the medium term and despite a delay to capacity building within the health department ➔ the NHI Bill is being processed by government and newly costed spending estimates will be revealed next year in Treasury's updated long-term fiscal model
- Though additional taxes are difficult to implement in the current income-constrained environment, increasing support for a basic income grant highlights pressure on government to adopt a formal stance

No immediate pressure but bias to lower sovereign ratings

- The risks to a further downgrade remain high in 2021 as the consensus-building nature of the incumbent administration and the incremental pace of structural reform do not indicate that SA is firmly on the path to strong reform efforts to instil significantly higher levels of confidence and credibility to meaningfully kick-start growth

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