momentum investments

Budget 2021

24 February 2021

Marrying near-term pandemic and economic support with expenditure restraint to effect fiscal sustainability

Overall impressions

- The national treasury's expected economic growth rate of 3,3% for 2021 is realistic and in accordance with our expectation of 3,2%. Our expected headline consumer price inflation rate of 3,9% for 2021 is shared by treasury. Medium-term estimates also seem fair.
- Government expenditure is reduced to such an extent that its contribution to economic growth will be contractionary over the forecasting period up to 2023. However, the spending balance is changed towards "economic growth enabling" as the reduction is in operating expenses, while capital outlays are due to increase by an average 10,5% over the next three years.
- Enough money was set aside to vaccinate 67% of the population against COVID-19 in the next 12 months. Some R19,3 billion is available for vaccination in 2020, 2021 and 2022.
- A consolidated budget revenue overrun of R95 billion compared to the MediumTerm Budget Policy Statement (MTBPS) for 2020/21 assisted to reduce the budget deficit to 14% of gross domestic product (GDP) compared to the estimate of the MTBPS of 15,7%. This had a knock-on effect, reducing the expected deficit over the forecast period up to 2023/24 (see table below).
- If treasury's forecasts prove to be correct and government can stick to treasury's plans, it will reduce the government's debt burden significantly. The MTBPS estimate was for gross debt to GDP to reach a peak at 95,3% in 2025/26. The new estimate is 88,9% in 2025/26. The lower budget deficits and debt burden could avoid further ratings downgrades.
- Household consumption expenditure will be boosted by bracket creep relief, contributing to lower personal income taxes. On the other hand, social grants will be raised by less than inflation.

Effect on markets in the short- to medium term

- A contractionary budget amid fiscal consolidation favours fixed income assets over SA Inc equities. Government extracts more from the economy through taxes than it injects back through spending in the FY21/22-FY23/24 period. This is evident from a declining budget deficit in absolute terms (R311,9 billion smaller by FY23/24) and as a percentage of GDP (7,7 percentage points smaller). This is effected through a 3,5% reduction in real expenditure growth versus a 3,8% increase in real revenue in the period.
- Another positive for the government debt market is the R128,6 billion reduction in the borrowing requirement and hence debt issuance in the medium term, partly also by using the higher accumulated cash balances due to the revenue overruns relative to the October MTBPS expectations for this.
- Tax relief to corporates and individuals. A one percentage point reduction in the corporate tax rate (to 27%) from 1 April 2022 should provide some reprieve to company profits. Above-inflation adjustments to personal income tax brackets are estimated to provide R2,2 billion relief to individuals with some potential positive spending impact.

Fiscal consolidation depends on expenditure cuts and reforms to increase economic growth

- The fiscal strategy aims to narrow the budget deficit and stabilise the debt-to-GDP ratio by constraining non-interest expenditure growth; supporting the economy and public health services in the short term, without adding to long-term spending pressures; and improving the composition of spending by reducing growth in remuneration, while protecting capital investment.
- Tax increases are to a large degree limited to an 8% increase in excise duties on alcohol and tobacco and an increase of 26c/l in the fuel price (fuel levy of 15c/l and 11c/l in the Road Accident Fund).
- Notwithstanding the slower growth in expenditure, the focus is still on social services as 56,8% of total expenditure is allocated to health, education and social development.

  Although expenditure growth is contained via a proposed lower remuneration bill, debt service costs is not under control as it is increasing faster than revenue growth (and economic growth).

Consolidated budget				
R' billion	2020/21	2021/22	2022/23	2023/24
Revenue	1 362,7	1 520,4	1 635,4	1 717,2
Expenditure	2 052,5	2 020,4	2 049,5	2 095,1
Remuneration costs	636,9	650,4	656,0	659,3
Debt service costs	232,9	269,7	308,0	338,6
Balance	689,8	500,0	414,1	377,9
Balance as % of GDP	14,0	9,3	7,3	6,3
Net outstanding debt as % of GDP	74,3	78,5	82,2	84,9
Remuneration as % of revenue	46,7	42,8	40,1	38,4
Debt service costs as % of revenue	17,1	17,7	18,8	19,7

Risks to the debt stabilisation target

- Treasury's strategy (to reduce expenditure and stabilise debt) to a very large degree depends on an estimate of faster economic growth (and therefore tax collections), decreasing employee remuneration costs and less state-owned enterprises (SOEs) dependence on government.
- The backbone of this strategy, though, is decreasing the remuneration bill. Should this not happen, debt stabilisation will not occur.
- But, even if remuneration containment is successful, it is not sufficient to stabilise debt and create space for more productive spending. Debt service costs are forecast to continue increasing as proportion of revenue (from 17,1% of revenue in 2020/21 to 19,7% in 2023/24). It also continues to increase as percentage of GDP, namely from 4,7% in 2020/21 to 5,6% in 2023/24. Moreover, debt service cost is now the third largest expense item on the budget (13,4% of total expenditure). It is more than the health budget (12,3% of total expenditure) and only smaller than the budgets for social development (16,6%) and basic education (13,5%).
- For these risks to subside, it is also necessary for revenue to grow at a faster rate. In turn, this requires faster economic growth (and not higher taxes). However, treasury does not expect economic growth to accelerate from proposed economic reforms as the growth forecast decreases from 3,3% in 2021 to respectively 2,2% and 1,6% in 2022 and 2023. This suggests that even more pro-growth reforms will be necessary to reduce the risk of non-debt stabilisation.
- Treasury notes that if financial management of SOEs and disputes on the user pay principle is not resolved, government will have to increase its expenditure to assist the SOEs and this will also increase the risk of non-stabilisation of debt.
- Another risk is weak local government financial management. If it does not improve, local governments will continue foregoing revenue, not paying SOEs for services and wasting money on unproductive expenses.

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