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in the moment

Budget 2021/22 preview: Smaller deficits than expected in October

Highlights

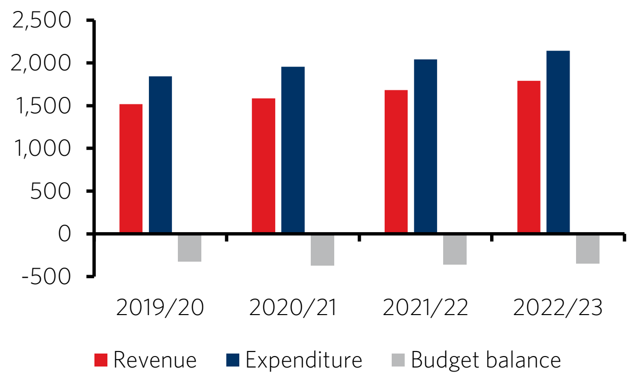
- Revenue for Budget 2020/21 can be about R216 billion less than national treasury's estimate in February 2020.
- However, it could be R100 billion more compared to the Medium-Term Budget Policy Statement (MTBPS).
- This revenue overrun is broad based and points to a strong economic recovery during the second half of 2020.
- The budget deficit for 2020/21 will likely be much lower than the 15,7% of gross domestic product (GDP) announced in the MTBPS.
- The budget for 2021/22 and subsequent years will focus on the priorities set out by President Cyril Ramaphosa in the State of the Nation Address (Sona).
- Personal Income Tax rates are expected to remain unchanged in 2021/22.

Looking back at Budget 2020/21, delivered on 26 February 2020

When the minister of finance delivered Budget 2020/21 on 26 February 2020, COVID-19 was mostly contained to China (with other countries registering few cases). The budget therefore made virtually no provision for what was to become one of the largest health and economic meltdowns in the past 90 years. As such, except for the growing fiscal deficit, the main and consolidated budgets[1] contained no earth-shattering announcements.

The main budget's fiscal deficit was estimated to increase by 9% in 2020/21 to R368 billion and that of the consolidated budget by 13,5% to R370,5 billion (see figure 1). These deficits equated to respectively 7,1% and 7,2% of GDP. Faster revenue growth and slower expenditure increases in subsequent years were estimated to stabilise and reduce the fiscal deficit.

Figure 1: Consolidated budget revenue, expenditure and balance (R' billion) announced in February 2020



Sources: National Treasury, Momentum Investments

Key:

1. The largest difference between the main and consolidated budgets is the latter includes the social security funds, certain public entities and some other sources of income.

Looking back at the MTBPS, tabled on 28 October2020

When level 5 lockdown was instituted on 26 March 2020, it was evident that economic activity and the fiscal stance would be affected on a large scale. Government introduced several emergency measures, which led to the minister of finance delivering a supplementary budget on 24 June 2020. These measures included increasing some social grant amounts and introducing payments from the Unemployment Insurance Fund to workers and firms in distress. The supplementary budget estimates were again adjusted in the MTBPS, which was tabled on 28 October 2020 (see tables 1 and 2). The lockdown, especially levels 5 and 4, had a negative effect on revenue collection, while putting upward pressure on expenditure and the fiscal deficit.

Table 1: Main budget revenue, expenditure and balance estimated in MTBPS (October 2020)

R' billion	Gross revenue	Percentage change	Net revenue	Percentage change	Expenditure	Percentage change	Budget balance	Percentage change	Budget balance as % of GDP
2019/20	1 355,7		1 345,9		1 690,9		-345,0		6,7
2020/21	1 112,6	-17,9	1.097,9	-18,4	1 805,8	6,8	-707,9	105,2	14,6
2021/22	1 279,5	15,0	1 263,1	15,0	1 801,1	-0,3	-538,0	-24,0	10,1
2022/23	1 392,2	8,8	1 388,3	9,9	1 874,8	4,1	-486,5	-9,6	8,6
2023/24	1 503,2	8,0	1 487,1	7,1	1 924,6	2,7	-437,5	-10,1	7,3

Sources: National Treasury, Momentum Investments

Table 2: Consolidated budget revenue, expenditure and balance estimated in MTBPS (October 2020)

R' billion	Revenue	Expenditure	Budget balance	Budget balance as % of GDP	Estimated Nominal GDP	Percentage change
2019/20	1 518,1	1 848,7	-330,6	6,4	5 148,3	
2020/21	1 267,7	2 037,8	-761,1	15,7	4 858,3	-5,6
2021/22	1 457,6	1 993,5	-535,9	10,1	5 317,0	9,4
2022/23	1 595,8	2 079,6	-483,9	8,6	5 629,3	5,9
2023/24	1 705,7	2 139,2	-433,4	7,3	5 961,3	5,9

Sources: National Treasury, Momentum Investments

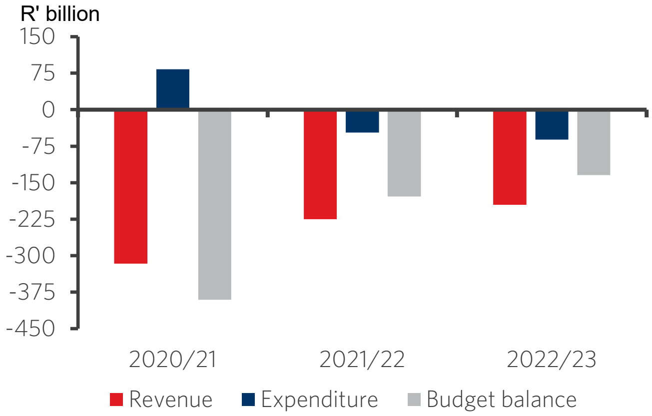
Differences between the 2020/21 budget in February and MTBPS in October

The October adjustments to the 2020/21 budget were extreme (see figure 2). The largest change was in revenue estimates. The national treasury in October 2020 estimated that its February estimate of consolidated budget revenue for 2020/21 could be R316,2 billion lower. For the outer years, the decreases were estimated to be less pronounced, but still substantial (R225,2 billion in 2021/22 and R195,5 billion in 2022/23).

The expenditure overrun for 2020/21 was estimated at R83,4 billion, but that of 2021/22 and 2022/23 were adjusted downward by respectively R46,8 billion and R61,4 billion.

These changes contributed to large increases in the budget deficit. The consolidated budget deficit for 2020/21 was projected to be R390,6 billion higher than estimated in February declining to R178,4 billion in 2021/22 and R134,2 billion in 2022/23.

Figure 2: Difference between consolidated budget in February and in MTBPS



Sources: National Treasury, Momentum Investments

As nominal GDP was adjusted lower and the budget deficit higher, the combined effect was an estimated budget deficit increase of 7,6 percentage points of GDP (it more than doubled from 7,2% of GDP to 15,7% of GDP).

Budget revenue, expenditure and balance for April 2020 to December 2020

Although the consolidated budget is the one that matters from a macroeconomic perspective (as it contains the total expenditure and borrowing requirement), it is necessary to monitor the main budget, as the national treasury provides relatively detailed monthly updates on the main budget's income, expenditure and the budget balance (refer to footnote 1 for an explanation of the difference between the main and consolidated budgets). The main budget represents around 88% of the consolidated budget's revenue and 90% of expenditure (see table 3), so it provides a good indication of what can be expected in the consolidated budget.

Table 3: Main budget as a percentage of consolidated budget

	Revenue	Expenditure	Budget balance
2019/20	88,6	91,3	103,4
2020/21	88,3	90,4	99,3
2021/22	88,2	90,7	102,5
2022/23	88,3	90,6	102,7

Sources: National Treasury, Momentum Investments

Analysis of the revenue collections for the first nine months of the financial year (75% of the financial year) revealed that a revenue overrun (compared to the MTBPS estimates) can be expected. Table 4 shows that most of the large revenue sources are either on track to achieve, or likely to exceed, the MTBPS projections. For instance, personal income tax (PIT) collected in the first nine months amounted to R340,5 billion, which is equal to 75% of the MTBPS estimated amount of R454,2 billion.

Company income tax (CIT) collections up to December 2020 amounted to 90,7% of the full-year estimate. These collections benefitted from high metal prices that profited especially mining companies and their up- and downstream partners. Value-added tax (VAT) and fuel levy collections are beyond 80% of the estimated amount. It is only excise duties that, at this stage, seem to be below target. This is mainly due to the ban on the sale of alcohol and subsequent restrictions on the sale of alcohol.

Table 4: Selected items comprising 93,3% of MTBPS gross revenue in 2020/21

R' billion	MTBPS revenue (full year)	Proportion of MTBPS revenue (%)	First nine months revenue	First nine months as a percentage of MTBPS
PIT	454,2	40,8	340,5	75,0
CIT	159,6	14,3	144,7	90,7
VAT	287,7	25,9	233,3	81,1
Excise duties	33,8	3,0	19,5	57,6
Fuel levy	68,4	6,1	55,1	80,5
Customs duties	36,5	3,3	28,4	77,6

Sources: National Treasury, Momentum Investments

Main budget expenditure was just below target for the first nine months (72% of the MTBPS budget). Table 5 shows that 65,6% of the budgeted 'current payments' (mainly compensation of employees and consumption of goods and services) were spent in the first nine months of the fiscal year. However, 'transfers and subsidies' (payments to provinces, local governments, households, non-profit institutions and public corporations), which is the largest spending category, ran a bit ahead at 77,2% of the MTBPS main budget expenditure. Expenditure on the two smaller categories, namely payments for 'capital assets' (purchases of new assets, upgrades, additions, rehabilitation and refurbishment of existing assets) and 'for financial assets' (lending to public corporations or making equity investments in them) were running far below target.

Table 5: MTBPS main budget expenditure 2020/21 for April 2020 to December 2020

R' billion	MTBPS expenditure (full year)	Proportion of MTBPS expenditure (%)	First nine months expenditure	First nine months as a percentage of MTBPS
Current payments	491,4	27,2	322,3	65,6
Transfers and subsidies	1 213,6	67,1	937,1	77,2
Capital assets	14,8	0,8	6,4	43,3
Financial assets	88,0	4,9	36,2	41,1
Total	1 807,9	100,0	1 301,9	72,0

Sources: National Treasury, Momentum Investments

The budget deficit for the nine months to December 2020 amounted to R433 billion (see table 6). Due mostly to the revenue overrun, the deficit comprised only 61,2% of the amount budgeted in the MTBPS. Such an overrun increased the cash balances, which, in turn, contributed to less borrowing. If this trend continues, it will affect the amounts to be borrowed from domestic (short- and long-term) and foreign sources. However, as almost the full amount budgeted for domestic long-term borrowing had been taken up in the first nine months, it suggests that a change will mostly occur in domestic short-term and foreign borrowing.

Table 6: MTBPS main budget balance and borrowing: April to December 2020

R' billion	MTBPS full year	First nine months	First nine months as percentage of MTBPS
Revenue	1 097,9	869,0	79,1
Expenditure [1]	1 805,8	1 301,9	72,1
Balance	-707,8	-433,0	61,2
Domestic short-term loans (net)	143,0	85,3	59,6
Domestic long-term loans (net)	410,0	400,6	97,7
Foreign loans (net)	107,0	77,5	72,5
Change in cash and other balances	47,8	-130,5	-272,7
Total financing (net)	707,8	433,0	61,2

Sources: National Treasury, Momentum Investments

Key: 1. Includes national government underspending of R2,1 billion

To estimate whether the borrowing requirement will be lower or not, it is necessary to perform a trend analysis of revenue sources.

Analysing the revenue trends with year-on-year comparisons

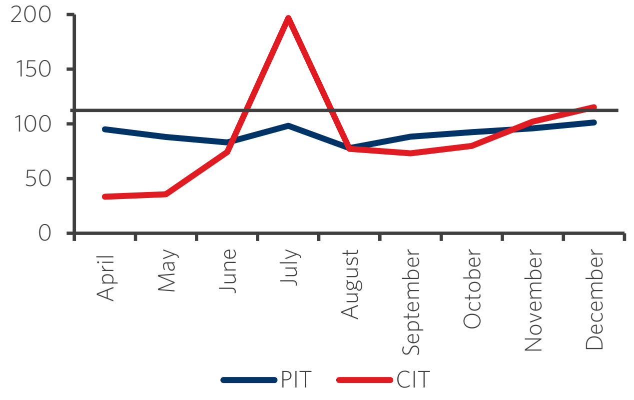
During times of a pandemic characterised by frequently changing levels of lockdown, the use of models to estimate budget revenue becomes less useful. It is therefore understandable if the national treasury's estimation of revenue is off the mark. In fact, it would have been a miracle if the estimates were on target.

To assist with the analysis of estimating budget revenue for the full year, a trend analysis is helpful. One way of doing this is to express the monthly revenue collections per revenue category (for example PIT, CIT, VAT, etc.) in the first nine months of 2020/21 as a percentage of such collections in 2019/20. A percentage above 100 means more revenue was collected in a particular month in 2020/21 compared to the same month in 2019/20, and vice versa. This is shown in figures 3, 4 and 5.

This analysis is also an indicator of underlying economic strength, as taxes are mostly levied on income, spending and valuations. So, higher tax income could mean that the underlying economy is actually stronger than estimated in the MTBPS.

Figure 3 shows that PIT first trended downward and then upward compared to 2019/20. Under levels 5, 4 and 3 of lockdown, PIT collections lagged that of 2019/20. Since levels 2 and 1 were introduced on respectively 17 August 2020 and 21 September 2020, the trend was upward and even exceeded the collections of 2019/20 in December 2020. However, lockdown was changed to an adjusted level 3 on 29 December 2020 and more restrictions were instituted on 11 January 2021. This may have affected the upward trend. But, on 1 February 2021, some restrictions were lifted to a re-adjusted level 3, which actually is closer to the previous level 2. This meant more companies were open for business and should support PIT collections in at least February. CIT was to a large degree affected by the same factors (lockdown levels) that impacted PIT. In addition, high metal prices benefitted the earnings of mining companies.

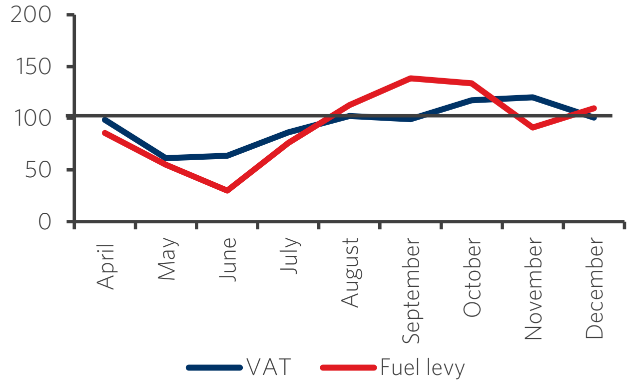
Figure 3: Personal and company income tax collections as a percentage of 2019/20 collections



Sources: National Treasury, Momentum Investments

The opening of the economy and subsequent increases in spending as well as driving supported collections of VAT and the fuel levy. Traffic decreased in November 2020 according to Tracker/Lightstone measurements and it showed up in fuel levy collections. Collections would probably have been affected in January 2021, as more restrictions were placed on border crossings on 11 January 2020. VAT collections were affected by domestic and foreign trade, which in turn was affected by lockdown levels.

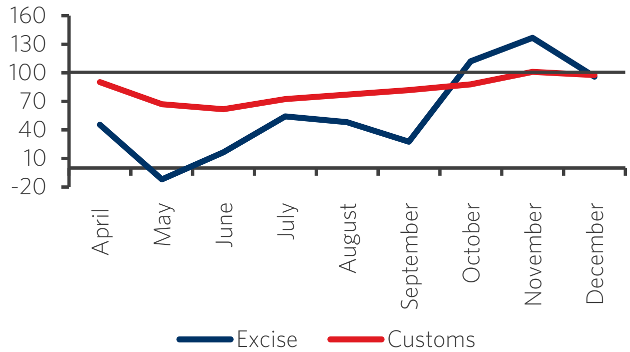
Figure 4: VAT and fuel levy collections as a percentage of 2019/20 collections



Sources: National Treasury, Momentum Investments

Customs and excise duty collections were heavily affected by the lockdown. The early ban on tobacco and liquor sales and subsequent bans/restrictions on liquor sales severely affected excise duty collections. Research from the National Income Dynamics Study Wave 3 estimated the loss in excise levies from the tobacco ban around R5,8 billion.

Figure 5: Customs and excise duty collections as a percentage of 2019/20 collections



Sources: National Treasury, Momentum Investments

Overall, revenue collections for the first nine months of 2020/21 were around 90% of that collected in the first nine months of 2019/20. This and other methodologies can be used to provide a rough estimate of expected revenue collection in 2020/21.

Estimated budget revenue and the budget balance for 2020/21

Forecasting of revenue collection became a challenging exercise due to the uncertainties caused by different restrictions on the economy (changes in lockdown levels). Different approaches can be applied to estimate revenue, ranging from simple to more sophisticated exercises. The following provides an indication of what can be expected under different scenarios:

- Approaching the exercise from the borrowing requirement, assuming expenditure will be contained to the MTBPS estimate, indicates a revenue overrun of about *R98 billion* if borrowing continues at the point level registered after nine months.
- If the comparison with 2019/20 is used as a base and it is assumed that revenue will continue to be around 90% of the revenue collected in 2019/20, then *R113 billion* may be collected in addition to the MTBPS estimate.
- A like-for-like exercise (using the revenue collected under levels 3 and 2 as departure point) per tax category (PIT, CIT, VAT, etc.) extrapolated forward reveals a revenue overrun of around *R101 billion* (bearing in mind some lags in collection). This analysis also signalled a stronger recovery in the economy during the second half of 2020 than anticipated by the national treasury.
- Even an implosion in revenue collections in the last three months of the financial year may still yield an overrun of around *R52 billion* on the main budget.

There might be expenditure overruns due to, among others, the continuation of the decision to extend the special COVID-19 grant of R350 for another three months. However, lower interest rates should have assisted in limiting the effect on debt service costs on expenditure.

A revenue overrun of around R100 billion might seem excessive, but other research points to a strong recovery in the jobs market. The Momentum-Unisa Consumer Financial Vulnerability Index (CFVI) revealed that consumers' income vulnerability declined gradually and returned to the same level before the pandemic in the fourth quarter of 2020.

Against this background, and using a revenue overrun of around R100 billion as estimate, it is likely that the consolidated budget deficit may be around R90 billion smaller than estimated in the MTBPS. Using the national treasury's nominal GDP as base, this points to a budget deficit of 13,8% of GDP, which is substantially smaller than the MTBPS estimate of 15,7% (refer to table 2).

Outlook for Budget 2021/22

The budget for 2021/22 will, as usual, take its cue from President Cyril Ramaphosa's State of the Nation Address. The president listed four priority areas, which will receive a lot of attention in Budget 2021/22 and in the planned budgets for subsequent years. These priorities were:

- Defeat the COVID-19 pandemic
- Accelerate the economic recovery
- Reform the economy to drive job creation and economic growth
- Fight corruption

Ten issues to look out for

Given the above, we expect the minister of finance, Mr Tito Mboweni, to at least focus on the following ten issues in his budget speech:

- An improving macroeconomic situation and measures to support higher sustainable economic growth
- The fiscal squeeze, given the large revenue shortfall compared to the February budget and efforts to control government debt
- Funding of procurement and distribution of vaccines
- Setting money aside for investment in infrastructure development (for example the infrastructure fund)
- Public-private partnerships and increasing local production of goods
- Strengthening local governments, health and education to improve service delivery
- Allocations directed at poverty alleviation, job creation and combatting corruption
- Reforms and transfers to state-owned enterprises
- Remuneration of government employees
- Steep increases in excise duties on alcohol and tobacco products, while the fuel levy will also increase.

Revenue overrun in 2020/21 and salary increases for government officials

Another issue that will attract attention is the revenue overrun in 2020/21. Although positive from a debt reduction point of view, it might create another risk for the minister and the national treasury's efforts to scale down government expenditure. Labour unions representing civil servants might use it as rationale for salary increases going forward. In this respect, it is relevant to note that the budget did not provide for salary increases. Salary increases, if granted, may therefore widen the fiscal deficit. However, using the revenue overrun compared to the MTPBS as rationale for salary increases is the wrong comparison. It is important to note that even with a R100 billion revenue overrun compared to the MTBPS, revenue is still expected to be around R216 billion lower than the revenue estimate of February 2020/21.

Can the recovery in revenue continue in 2021/22?

The main difference between the above analysis on the revenue overrun and the revenue expectations contained in the MTBPS is that the recovery in tax collections occurred earlier than estimated by the national treasury. As table 1 shows, the national treasury estimated relatively strong growth of 15% in revenue to occur in the next financial year (2021/22). It is therefore possible that, given the revenue overrun in 2020/21, the growth in revenue for 2021/22 may be adjusted downward. However, if the economy and jobs market continue on their current recovery paths, revenue collections may continue. The budget deficit for 2021/22 may therefore still be smaller than the MTBPS estimate of 10,1% of GDP. The likelihood is also strong for the primary budget deficit to decline to below 10% of GDP, a bit earlier than anticipated by the national treasury.

Will there by changes in personal income tax rates?

Although the possibility always remains, we are of the opinion that it will send the wrong signal in the current economic climate. President Ramaphosa hinted at measures to reduce inequality but doing it in a recovery climate will work against the priorities of reconstruction and job creation. Furthermore, the PIT-base contracted during the initial stages of lockdown, while the number of high personal-income-tax-paying individuals (earning a taxable income exceeding R1 million) likely decreased from the about 307 912 people estimated by national treasury in February 2020.

Will a wealth tax be implemented?

This is possible, but unlikely. There is not sufficient data on distributional household wealth levels and research on the topic is scarce. Furthermore, there is no clarity on what wealth to tax, if it is to be taxed at all.

Household wealth comprises assets less liabilities, but some assets are already taxed. Assets consist of financial assets and non-financial assets such as residential property. Households already pay property tax to local governments, property transfer duties and capital gains tax. They also pay estate duties. So, a tax on residential assets may be interpreted as double taxation.

Financial assets comprise deposits, retirement funds, investments and other assets such as life insurance. The problems with taxing the values of, for instance, retirement funds and investments are that these values change from day to day and sometimes are very volatile. For instance, South African household wealth declined by almost R1 trillion in March 2020, when the largest part of the world went into lockdown. However, by the end of the year, their wealth not only regained the R1 trillion, but added almost another R1 trillion.

A number of other questions remain. Is it fair to tax life insurance? And, if so, what will happen to the life insurance industry? Will a tax on retirement savings negatively affect savings behaviour? How will it affect the savings industry in its entirety?

Distributional wealth research done by Momentum Insights (a research division of Momentum) in conjunction with Unisa also revealed that the highest income earners are not necessarily the wealthiest households.

Like in most countries, wealth inequality is high in South Africa. The research show that although the 2% wealthiest households own almost 50% of the wealth, the 2% include a number of middle-income households. They decided to save and invest opposed to spend and borrow. Should they be taxed for doing the right thing? Contrastingly, a number of the high-income households had a negative wealth position, as their debt exceeded their asset values. So, a wealth tax will not be applicable to them if net wealth is to be taxed.

Introducing a tax on wealth is not an easy exercise and deserves thorough research and economic impact studies before a decision should be made.