momentum investments

Supplementary Budget Review

June 2020

Treasury urges decisive action to stabilise debt by FY23/24

Initial impressions

- In our view, Treasury's growth and inflation forecasts are realistic at an average of negative 0.4% and 3.9%, respectively, for the next four years
- Budget deficit at 15.7% of gross domestic product (GDP) for FY20/21 came out at the higher end of the Bloomberg consensus range of between 10% and 15.9% ➔ fiscal deficit is expected to be 4.2% wider on average in the medium-term expenditure framework (MTEF) between FY20/21 and FY22/23
- Expansionary budget initially as real expenditure growth outstrips revenue growth ➔ government expects cuts in expenditure in the remainder of the MTEF to narrow the deficit to 7.7% by FY22/23
- Relative to the February 2020 national budget, revenue collection was revised lower by R716.7 billion in the MTEF ➔ while expenditure was adjusted lower by a lesser R174.6 billion
- Insufficient detail outlining concrete action on proposed structural reforms to enhance the recovery

Immediate market effect

- Given updated views from treasury on the weekend, markets easily digested the news of a larger fiscal deficit with a sideways movement in the equity, fixed income and currency markets

The FTSE/JSE Alsi moved sideways following the budget announcement	FTSE/JSE Industrials (negative 0.1%) and FTSE/JSE Financials (negative 0.4%) shares led the FTSE/JSE Alsi lower, while a slightly weaker rand lifted FTSE/JSE Resources by 0.4%	The R2030 government bond yield rallied marginally	The US dollar/rand weakened a tad by 0.2%

Government debt expected to stabilise in FY23/24, but adjustments are necessary

- Initial deterioration in SA's government debt ratio is due to a R299 billion revenue shortfall (main budget) and an additional R43.2 billion allocation to expenditure in FY20/21
- Gross debt ratio expected to rise to 86% in FY22/23 (previously 71.6%) ➔ on average the debt ratio is expected to be 14.5% higher over the MTEF
- Primary balance remains in deficit during the MTEF ➔ it is expected to narrow to 2.3% by FY22/23 (previously 1.1%) from 9.7% in FY20/21 (previously 2.6%) ➔ expected to print a surplus in FY23/24
- Debt-service costs absorb 21c of every rand government collects relative to 9c in FY08/09 ➔ interest bill expected to rise from 4.9% of GDP in FY20/21 to 5.4% of GDP in FY22/23 ➔ the allocation to debt-servicing costs is similar in size to what government spends on health and is double the share being spent on capital assets
- Measures to narrow the budget deficit and stabilise debt will be announced in the October 2020 medium-term budget policy statement (MTBPS)

Cost reductions, above efforts to reduce the wage bill, are required

- Treasury has attempted to reopen the final year of the current wage agreement to achieve R37 billion in savings ➔ the proposed savings of R55 billion in FY21/22 and R67 billion in FY22/23 are arguably more crucial
- Treasury claimed that failure to achieve R230 billion worth in savings (beyond the projected cuts to the civil servant wage bill) would result in even larger cuts to the wage bill or a reduction in spend in other areas of the budget
- Little detail was given on the current negotiations between government and the unions ➔ raising concerns over whether government will successfully achieve a reduction in the wage bill of this size

- Conditional grant transfers were scaled back and delayed where possible
- Limited details were shared on the zero-based budgeting approach treasury is expected to adopt ➔ ultimately this process could be time consuming and costly, but it should enhance transparency, enforce accountability and allow for a phasing out of programmes that have little effect on service delivery or economic performance

Income and other support to consumers

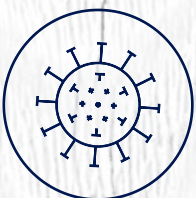
- Government awarded temporary social grant top-ups (67.4% increase in child support grants and 13.4% increases in old age and disability grants) for six months
- These social assistance interventions will apply until October 2020 ➔ continued household vulnerability may pose a challenge to removing the top-up grants in our opinion
- At mid-June 2020, the Unemployment Insurance Fund has disbursed R23 billion to more than 4.7 million employees
- Banks have provided R30 billion of relief to customers
- Awareness of damaging effect of further tax hikes to economic growth has warded off significant tax proposals ➔ tax increases proposed are modest in our view
- However, projected wage cuts of R160.2 billion in the MTEF imply lower spending ability particularly for middle-income earners

State-owned enterprises (SoEs) and municipal finances remain in disarray

- The February 2020 national budget already included a R16 billion allocation to SA Airways ➔ the additional R10 billion may only come through in the October budget, once the business rescue plan has been finalised
- Treasury to inject R3 billion in equity in the Land Bank while restructuring plans are being finalised ➔ the institution plays a critical role in providing 29% of SA's agricultural debt
- Despite lockdown restrictions lowering revenues for Airports Company South Africa, Eskom and the South African National Roads Agency Limited, no other intra-year spending adjustments were proposed for SoEs
- Treasury noted SoE reform included rationalisation and equity partnerships
- No adjustment was made to the R1.1 million taxi industry relief fund despite backlash
- Metropolitan municipalities reported that revenue collected in April fell by 30% on average as a result of higher non-payment by customers ➔ this places local governments deeper in financial stress

Infrastructure at the centre of the recovery plan

- SA's investment-to-GDP ratio tanked to 17.9% in 2019, which is the lowest since 2005
- Treasury reiterated that infrastructure would feature strongly in SA's economic recovery
- Government showcased 280 projects (88 already considered to be bankable) at the Sustainable Infrastructure Development Symposium held on 23 June 2020 which was attended by 681 delegates
- At the symposium, it was announced that government is considering the introduction of green infrastructure bonds
- The New Development Bank has registered a bond sale plan with the Johannesburg Stock Exchange and the first phase is expected to be completed within six to nine months



Financing the COVID-19 stimulus package and the gross borrowing requirement

- Treasury is accessing US$7.0 billion from international finance institutions ➔ this comprises a US$4.2 billion Rapid Financing Instrument from the International Monetary Fund, US$1 billion from the New Development Bank and US$50 million from the World Bank ➔ no detail was given on how the remainder would be funded
- Government revised its borrowing strategy to temporarily issue shorter-dated bonds with a weighted average time to maturity of seven to 10 years, compared to 15 years seen in the previous year ➔ this aims to manage the cost of debt and balances available market demand
- To moderate its domestic borrowing, government will draw down sterilisation deposits by around R43 billion
- The significant ramp up in projected debt and issuance will likely add to pressure for further sovereign rating downgrades

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