MTBPS Preview – October 2022

A glimpse into major policy decisions ahead and allocation of revenue overrun

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The Medium Term Budget Policy Statement (MTBPS), tabled by the Minister of Finance on October 26, is delivered in the context of a complex economic and political international backdrop and a domestic energy and logistics crisis, which is limiting growth over the next 12 to 18 months, and the ANC's elective conference in December 2022. South Africa's fiscal position remains relatively sound, having avoided a fiscal cliff in 2021, as commodity prices surged. However, a high country-risk premium embedded in SAGBs, compared with other emerging markets, reflects continued uncertainty about the growth/expenditure dynamics over the MTEF (Medium Term Economic Framework) period.

The MTBPS is expected to address several key long-term outstanding issues. But the baseline MTEF forecast is likely to provide concrete numbers only when the Budget Review is presented in February 2023.

- More SOCs to receive cash injections
- Policy decisions on e-tolls and permanent income transfer
- Revenue overrun of R110bn expected
- Reduction in ILB/FIX/FRN auction sizes expected but opening cash balance for FY23/24 could be higher
- Eskom debt transfer plan in principle
- Larger primary surplus expected in FY23/24
- The gross debt-to-GDP ratio could temporarily decline below 70% of GDP in FY22/23 but stabilise at 75% of GDP over the MTEF period (including guaranteed Eskom debt to the value of R200bn (2.9% of GDP).

Key focus points

Expenditure allocations and policy intentions

ICIB forecasts a revenue overrun of R110.0bn (1.7% of nominal GDP). Whereas a large portion of the revenue windfall of R182bn in F21/22 had been directed towards social protection, the National Student Financial Aid Scheme, the Presidential Job Creation Programme and debt reduction, the October 2022 MTBPS could see State Owned Corporations (SOCs) and infrastructure spending featuring more prominently in allocations.
FY22/23: ICIB forecasts an increase in main expenditure of R40bn

More financial assistance to SOCs

The weak financial position of SOCs is likely to see an increased allocation to several SOCs. In an attempt to support growth, Transnet could receive a liquidity injection as the logistics crisis at its port, rail and pipeline infrastructure has become a major constraint on growth. The Minister of Finance is requesting more financial support for Denel to the tune of R3.7bn. The Post Office is facing liquidity challenges and has requested an R1.6bn cash injection.
Expenditure allocation: R13bn National Treasury

Policy decisions on e-tolls and permanent income transfer

E-tolls: The user-pay principle could be addressed as the lack of e-toll payments for Sanral's GFIP (Gauteng Freeway Project) has led to the Auditor-General sounding a warning on the public entity's ability to continue as a going concern. There are three possibilities: Scrap e-tolls (but this is complicated by the debt raised to finance GFIP) or a hybrid model that could include a combination of reducing e-toll tariffs and a road tax, or just a road tax financed from the fuel levy.

Financial impact: Implications for Department of Transport expenditure budget/non-toll revenues/fuel price (inflation)

Permanent income transfer: In addition to the Presidential Employment Programme (which is allocating R9bn p.a. to youth job creation in F22/23 and F23/24), the Social Relief of Distress (SRD) is widely expected to be replaced by a permanent income transfer to 10m unemployed people. The Social Relief of Distress (SRD) grant of R44bn p.a. has been extended since first announced in 2022 to the end of F22/23. The social wage has increased from 58.2% to 59.5% of consolidated non-interest spending over this period.

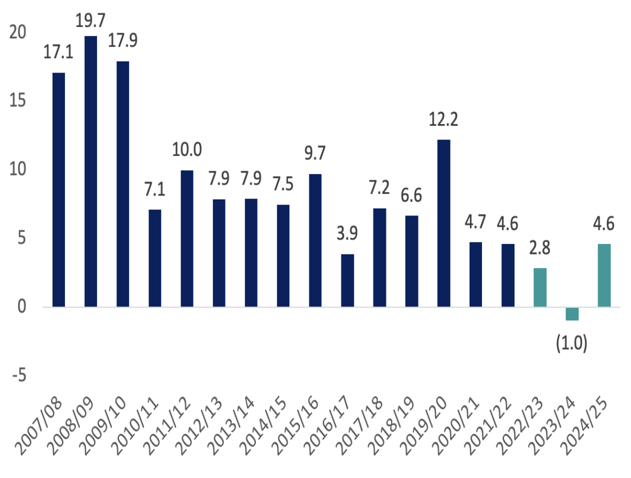
Fiscal implications: To be included in the February 2023 MTEF baseline forecast. There could be a structural increase of R25bn, depending on the size of the grant (currently at R350 per person), financed by the possible reprioritisation of spending of ~R20bn and permanent tax increases (PIT or VAT). National Treasury is likely to provide a scenario analysis in its risk assessment of fiscal risks.

Public sector wage bill: At the time of writing, government has offered a cost-of-living increase of 3.0%, which amounts to ~R21bn. This is over and above the R20.5bn cash gratuity which has been carried over into the current fiscal year and an increase of 1.5% pay progression. The Public Servants' Association (PSA), consisting of 235 000 members, has rejected the government's 3% wage increases, and could go on strike in the week ahead. The wage offer has been accepted by SADTU, the teachers' union.

With a contingency reserve of R10bn, the net increase could be at least R10bn. It is unclear whether there will be a firm outcome by 26.10.

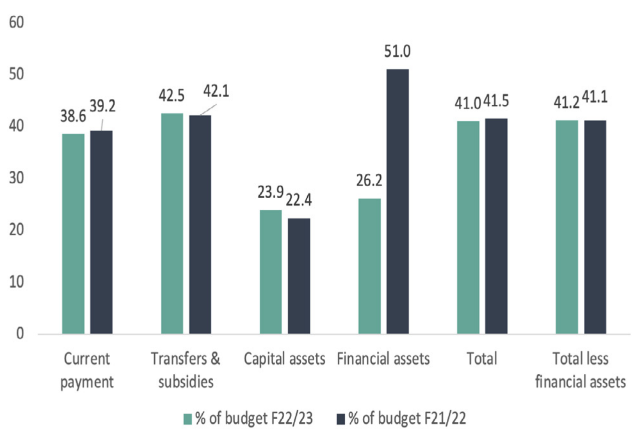
Other potential increases: An increase in transfers to the justice cluster and inflation adjustment to social protection.

Figure 1: Monitoring revisions to non-interest spending



Source: National Treasury

Figure 2: Spending behind target owing to current spending and transfers to Eskom



Source: National Treasury

Macroeconomic outlook

Macroeconomic headwinds have increased since the February 2022 Budget Review. However, National Treasury presented a very conservative nominal GDP forecast, which is expected to be marked higher (2022: 3.0% to ICIB's 8.0%; 2023: 5.7% to 7.0%). Real GDP growth of 2.1% in 2022 is slightly ahead of market expectations but the 1.6% forecast will be revised lower. Bloomberg consensus forecasts are at 1.8% and 1.4%, the IMF at 2.1% and 1.1% and the SARB at 2.0% and 1.3% respectively.

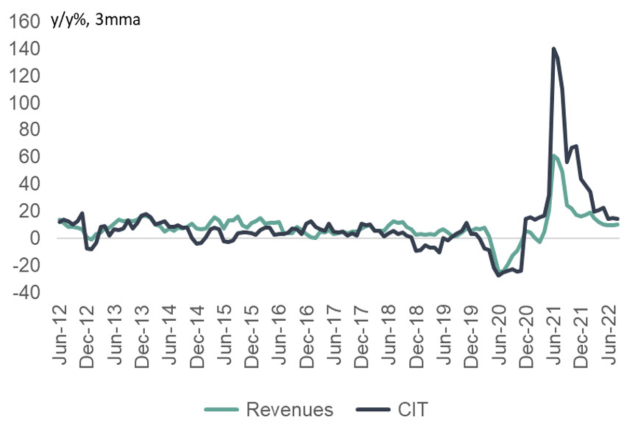
Tax buoyancy assumptions and revenue projections too conservative

Revenue receipts are expected to exceed the budget target for a second consecutive year. It is encouraging that tax buoyancy has been maintained at 1.09 times as the economic recovery has broadened. The better revenue performance can be ascribed to a combination of factors such as higher inflation, better earnings growth from some of the mining companies and a broadening of the economic recovery into the services sector. We estimate an overrun of R110bn (8.8% vs a target of 2.5%) and main revenue receipts could rise to 25.0% of GDP (F24.7%) vs 24.8% in the previous fiscal year. An improvement in efficiencies at SARS and an increase in compliance are likely to have added more tax receipts to the baseline. Our analysis suggests the overrun has been driven mostly by corporate income tax (CIT), followed by VAT paid on imports and personal income tax (PIT).

- **CIT of R40bn and withholding tax of R6bn:** A better than expected performance of mining taxes has again been an important contributor to the overrun in revenue receipts.The acceleration in commodity prices, such as coal, chemicals and oil, have bolstered earnings growth for some of the mining companies. Withholding tax has been bolstered by an increase in dividend payments. Earnings growth of the manufacturing sector has improved. The end of Covid-19 mobility restrictions has supported the services sector, leading to an increase in tax payments from the financial services industry.
- **PIT of R15bn:** While the recovery in formal employment has been modest, an increase in employment in the public sector, combined with higher inflation related salary and bonus payments, have made a positive contribution.
- **VAT of R35bn:** Higher inflation has supported nominal spending on goods and services. However, import VAT has received a fillip from an increase in the volume of imports, enhanced by the depreciation of the rand. We estimate taxes on international trade to be R20bn ahead of target.
- **Fuel levy to fall short by at least R5.0bn:** The DMRE (Department of Minerals and Energy) has not yet paid an amount of ~R10bn to National Treasury arising from the temporary reduction in the fuel levy, which was to be funded from the proceeds of the sale of strategic oil reserves.

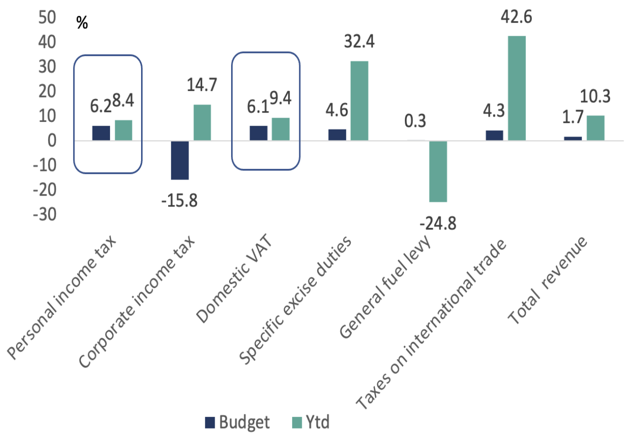
Forecast: Revenue overrun estimate: FY22/23: R110bn (8.8% of 1.6% of GDP). The baseline forecast for F23/24 is lifted by ~R100bn (3.7%y/y on our revised forecast).

Figure 3: CIT vs revenue receipts will determine tax buoyancy ahead



Source: National Treasury, ICIB

Figure 4: F22/23 revenue performance vs budget target



Source: National Treasury, ICIB

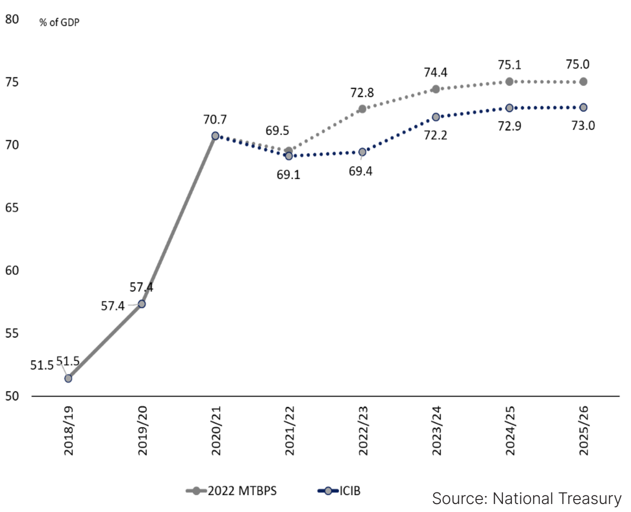
Fiscal risk remains contained

The main budget deficit for FY21/22 and FY22/23 is expected to show an improvement relative to the February 2022 forecast to 5.2% (F5.5%) and 4.8% (P: 6.0%) of GDP. The MTEF period will be extended to FY26/27 and the baseline forecast in the MTEF remains fluid. It is likely that the MTEF forecast could show a primary surplus by F23/24 but this will not be adequate to stabilise the increase in debt servicing costs, which will continue to increase as a share of GDP.

Gross debt-to-GDP trajectory is likely to stabilise over the MTEF period. The combination of the increase in nominal GDP and a reduction in local sovereign bond supply and lower foreign bond issuance, relative to the February 2021 forecast, could result in reduction in the gross debt-to-GDP level in the current fiscal year to below 7.0% of GDP from 70.8% in the previous fiscal year. However, a debt transfer of R200.0bn from Eskom could add ~2.9% of GDP to gross debt but reduce the government's exposure to the public sector 3.2% (using ICIB's 2023 nominal GDP forecast). Eskom holds ~R274bn in guaranteed debt and utilised R328.0bn of the government's R350.0bn guarantee at end March 2022. We are also waiting for guidance as to whether the current annual transfer of R23bn, which is part of expenditure, could continue or be reduced, whereas interest payments could rise by ~R15bn. The implication is that government's debt servicing costs will continue to grow over the MTEF period.

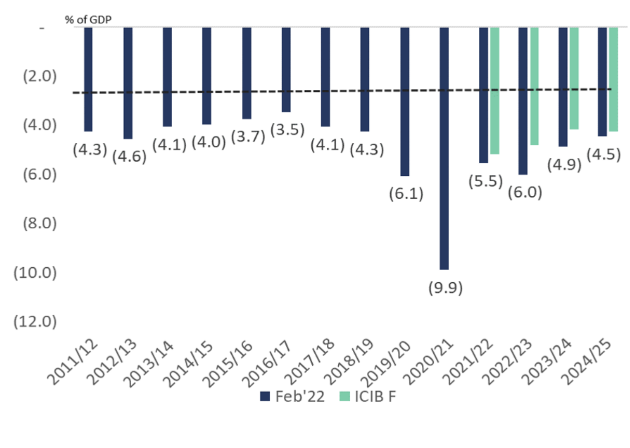
Fiscal impact: February 2023

Figure 5: Gross debt to GDP trajectory including R200bn of Eskom's guaranteed debt



Source: National Treasury

Figure 6: Main budget deficit has improved



Source: National Treasury

Could bond supply be reduced?

Current F22/23: The government's cash balances are ahead of target, bolstered by several factors consisting of a higher opening cash balance (+R24.4bn), a lower main budget balance (an improvement estimated at R60.0bn) and a smaller R2023 redemption (R69.5bn vs R97.3bn). We think that the sterilisation deposit of R41.0bn may not have been drawn down. These dynamics suggest there is room for National Treasury to reduce the amount of cash raised from FIX, ILB and FRN auctions from a target of R330.0bn to R300.0bn. However, a key issue in the mix of funding is if the FRN could become a permanent source of funding. The current pace of FIX/ILB raises approximately R285bn in cash. The funds raised from non-competitive bond auctions have declined (R22.4bn ytd compared to R28.7bn over the same period in 2021) whereas cash raised from the FRN issue has reached R45.4bn.

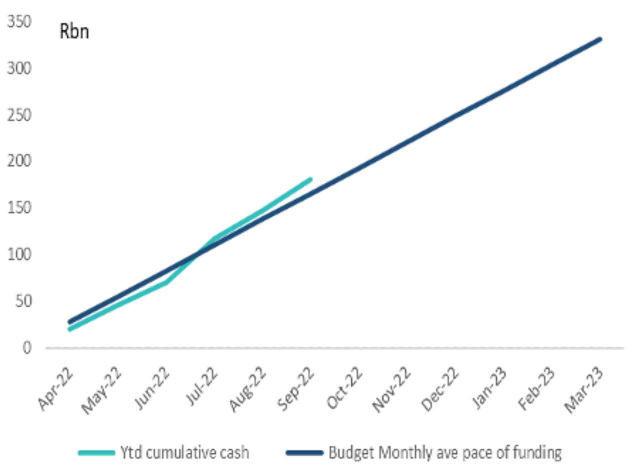
F23/24 dynamics to monitor: National Treasury's mix of funding in the domestic bond market will be closely monitored. Although it is likely that the value of market loans could decline, compared to the February 22 forecast, we doubt if it could fall meaningfully below the current funding pace of R330.0bn in F22/23.

Figure 7: Financing of the main borrowing requirement

	F21/22		F22/23		F23/24	
	Feb '22	ICIB F	Feb'22	ICIB	Feb'22	ICIB
Main budget deficit	**-5.5**	**-5.2**	**-6.0**	**-4.8**	**-4.9**	**-4.2**
Total financing	-6.6	-6.3	-7,5	-5.8	-7.2	-6.3
Main budget deficit (Rbn)						
Revenue	1 549,1	1 561,1	1 588,0	1 698,0	1 660,2	1 761,2
Expenditure	1 896,0	1 886,9	1 975,3	2 025,3	1 992,0	2 064,0
Budget balance	**(346,9)**	**(325,7)**	**(387,2)**	**(327,3)**	**(331,8)**	**(302,8)**
Redemptions	(65,1)	(67,6)	(97,3)	(69,5)	(155,8)	(157,0)
Domestic loans	(61,2)	(53,2)	(81,3)	(65,6)	(113,9)	(115,0)
Foreign loans	(3,9)	(14,4)	(16,0)	(3,9)	(42,0)	(42,0)
Total financing	**(412,0)**	**(393,3)**	**(484,5)**	**(396,8)**	**(487,6)**	**(459,8)**
Financing						
T-bills (net)	(6,8)	(7,8)	–	(15,0)	40,0	30,0
Bonds and FRN	285,3	289,6	330,4	300,0	360,3	320,0
Foreign loans	80,6	27,4	47,9	53,4	65,3	65,3
Change in cash balances	52,9	77,3	106,2	58,4	22,0	55,0
Total	**412,0**	**386,5**	**484,5**	**396,8**	**487,6**	**460,3**

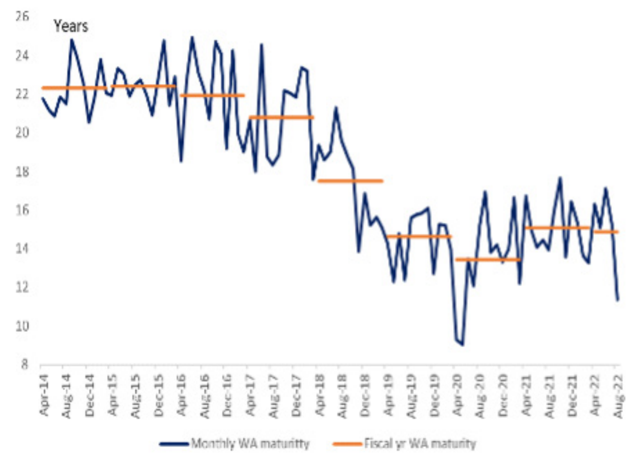
Source: National Treasury, ICIB

Figure 8: Funding pace of FIX/ILB/FRNs



Source: National Treasury, ICIB

Figure 9: Maturity of financing bonds has been shorter



Source: National Treasury, ICIB