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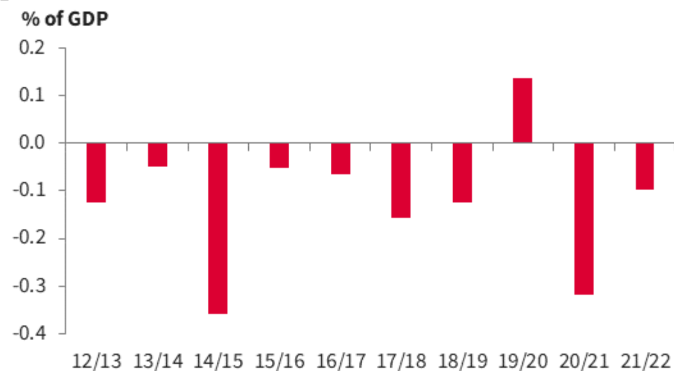
South Africa

Much uncertainty about next week's Budget for FY23/24

Finance Minister Godongwana is due to present the budget for FY23/24 on 22 February. A combination of solid expenditure control and robust tax collections suggest the main budget deficit for FY22/23 could ultimately print at 4.6% of GDP, within the 4.9% target in the MTBPS. For FY23/24, we forecast that a combination of downside revenue pressures and upside spending risks will cause the deficit to widen to 5.1% of GDP. However, we believe the National Treasury (NT) is unlikely to publish a wider budget deficit target for two reasons. First, it will not likely pencil in any public sector wage uplift until a deal has actually been negotiated. Second, the NT will not, at this stage, pencil in anything specific for SOC bailouts or disaster relief – upside spending risks that are uncertain in terms of timing and magnitude. Thus, the budget expenditure envelope for the upcoming fiscal year will need to be scrutinised for realism. Separately, we do not expect a full Eskom debt deal to be unveiled at the budget, and thus see some room for market disappointment.

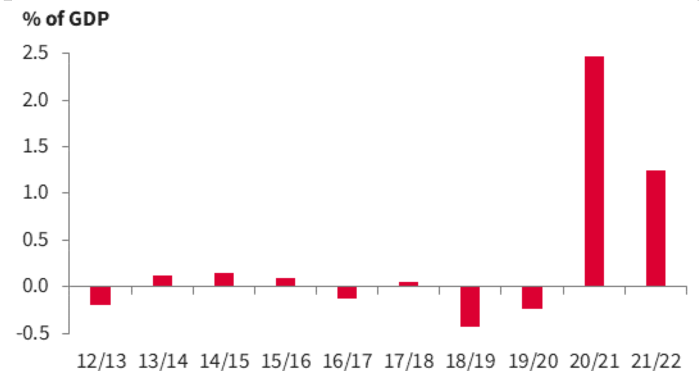
The 2023 Budget, which Finance Minister Godongwana will present on 22 February, will likely confirm a robust fiscal performance in FY22/23. The 2023 Budget document will update the NT's revenue and expenditure targets for the current fiscal year that were published in the Medium Term Budget Policy Statement (MTBPS). So far in FY22/23 (for the period April-December), fiscal progress has been strong, with solid expenditure control and robust revenues. Main budget expenditures in the period were up just 3.8% y/y, while revenues were up 7.6%. However, provisional financing data for January suggest a big cash deficit in January of about R92bn, some R26bn or 39% larger than a year previously. We believe this likely reflects the inclusion of MTBPS special appropriation of almost R24bn for the SANRAL bailout in the January expenditure data. This leaves the MTBPS expenditure target for FY22/23 as a whole looking reasonably realistic. Meanwhile, personal and corporate income tax data for November and December were particularly strong, and we believe this will carry forward into Q1 23. SARS Commissioner Edward Kieswetter said earlier this month that SARS had noticed a big 'compliance dividend' from enhanced scrutiny and enforcement efforts. Additionally, there is usually a small degree of underspending at the end of the fiscal year that flatters the budget outcome relative to the adjusted MTBPS targets (Figure 1). And in the last couple of years, revenues have overshot the MTBPS target as well, as SARS's institutional rehabilitation pays a 'compliance dividend' (Figure 2). With these factors in mind, we forecast a main budget deficit of R310bn or 4.6% of GDP, inside the MTBPS's target of R324bn or 4.9% of GDP. However, the NT will probably not show this in its upcoming budget. Instead, it would only be revealed when the expenditure data for the full FY22/23 are published at the end of April.

Figure 1: Spending typically undershoots the MTBPS targets a little



Source: National Treasury, Absa Research

Figure 2: Revenue overshoots have been big the last two years



Source: National Treasury, Absa Research

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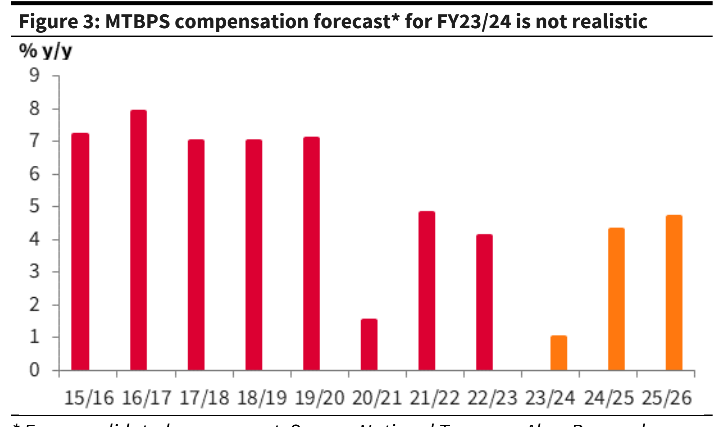
We see downside revenue pressure in FY23/24 compared with the MTBPS targets. The MTBPS pencilled in a main budget deficit of R286bn or 4.1% of GDP for FY23/24. This is unrealistic, in our view. For one thing, it assumes that revenues rise 3.6% with a tax buoyancy assumption of 1.03. However, since the MTBPS, export commodity prices have softened materially (down nearly 9% so far this quarter compared with Q4 22) and the growth outlook has wilted under intensified load shedding. We concur with Kieswetter's observation that intensified load shedding will weigh on tax receipts in the coming fiscal year. Not only will load shedding slow the real rate of growth of the economy in general (thus contributing to a smaller overall tax base), but corporate income tax receipts in particular will suffer as firms' bottom lines are hit by production disruptions and expensive diesel purchases for back-up power generation. Notably, Kieswetter also remarked that SARS and the NT were in agreement that no new taxes are needed at this stage, and he explicitly ruled out a wealth tax, saying instead that they would focus on strengthening compliance further, with quite a bit of low hanging fruit to be gained there. Overall, we pencil in a tax buoyancy assumption of just 0.8 for FY23/24 and thus forecast a R15bn undershoot in tax collections relative to the MTBPS target of R1789bn. Given the big hit to growth from loadshedding, there will be a lot of focus on the realism of the NT's macroeconomic assumptions.

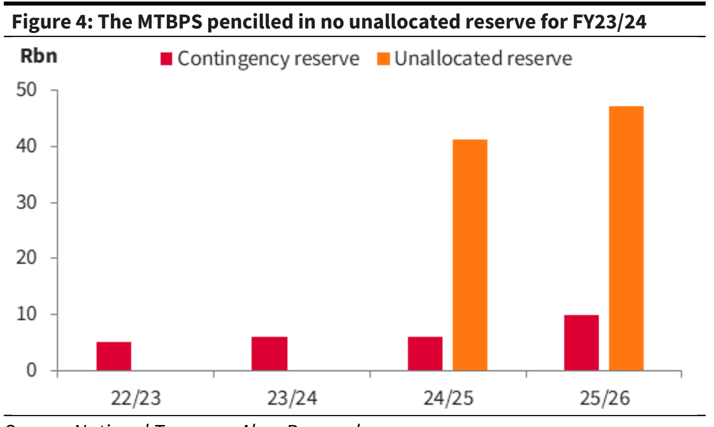
Also, there are various upside spending pressures for FY23/24, which were not written into the MTBPS and are unlikely to be written into the 2023 Budget. Chief amongst these is public sector wages settlement. The MTBPS pencilled in a mere 1% uplift in the envelope for public sector compensation, implying a 0% cost of living adjustment, with the uplift in the overall pay envelope mostly reflecting automatic pay progression (Figure 3). We believe the NT is likely to follow the same approach in the Budget (i.e., pencilling in no wage adjustment) so as to set a low base from which to commence wage negotiations with unions. Ultimately, of course, the government and organised labour are likely to settle higher. (Even last year when negotiations were deadlocked, the government imposed a 3% pay hike on top of the 1.5% automatic pay progression.) For FY23/24, we assume a 5.5% all-in rise in public sector pay as public sector unions push to recover at least some of the real income loss suffered over the past year due to the below-inflation wage adjustment. Each 1pp adjustment in public sector pay is worth about 0.1% of GDP onto expenditure and the deficit, everything else being equal. In the MTBPS framework, there was no unallocated reserve in FY23/24 that could cover a reasonable wage increase, just a R6bn continency reserve (Figure 4).

Figure 3: MTBPS compensation forecast* for FY23/24 is not realistic



** For consolidated government. Source: National Treasury, Absa Research*

Figure 4: The MTBPS pencilled in no unallocated reserve for FY23/24



Source: National Treasury, Absa Research

State-owned companies (SOCs) also pose another big upside spending risk. It is possible that the NT will pencil into the 2023 Budget some further allocations to SOCs but this is not our base case scenario. Instead, we believe that the NT will only make allocations for SOCs when specific bailout demands are received and the NT decides whether or not to extend some fiscal support. This could perhaps lead to mid-year adjustment allocations similar to the 2022 MTBPS for SANRAL, Transnet and Denel, amounting to R30bn in total. With newspaper reports suggesting that Transnet asked for a R40bn bailout at the MTBPS but got just shy of R6bn (News24, 7 February), the transport logistics SOC could come back at some point in the future for further fiscal support, given its deteriorating operational performance and consequent pressure on its revenues against a backdrop of big capital expenditure needs. Other loss-making SOCs could also ask for further support, although Finance Minister Godongwana seems committed to a tough love approach, e.g., with the South African Post Office. Moreover, it is possible that the NT could raise the annual fiscal transfers of R21-23bn already embedded into the fiscal plan, pending a final solution on Eskom's over indebtedness.

We do not expect a full Eskom debt deal to be unveiled and implemented at the Budget next week, because of its complexity and Eskom's apparent lack of progress on the NT's conditions for granting big debt relief.. For example, Eskom seems to have made no headway on lowering its internal cost base and its hands seem to be tied in terms of the NT's demand that it resolves the problem of growing municipal debt arrears. Additionally, it is seemingly proving quite difficult to secure creditor consent for a formal debt exchange. An easier approach would be for the NT to allocate additional funds to Eskom to cover some portion of Eskom's debt servicing obligations, but the amount of relief actually needed is contingent on actions that Eskom is yet to take. President Ramaphosa's comments in the State of the Nation Address (SONA) on 9 February that the 'National Treasury is finalising a solution to Eskom's R400bn debt burden in a manner that is equitable and fair to all stakeholders' seems to confirm that a final solution will not be presented in the Budget. because Finance Minister Godongwana promised at the MTBPS that a solution would be unveiled at the Budget, we believe the government will have to provide some further details on the likely approach to avoid disappointing the market.

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One thing which will be included in the Budget, in our view, is the fiscal support package to households and/or businesses to help them cope with load shedding. However, it is unclear (to us at least) what the modalities and magnitude of the relief will be. Probably the support package will focus on accelerated tax depreciation allowances to encourage the installation of solar PV (and possibly other back-up forms of electricity generation) but it is possible that the budget could go further, perhaps with a rebate for businesses that are buying diesel for generation (because after all, why should they have to pay the road accident fund levy in the diesel price) or perhaps some allocation to Eskom to fund more diesel purchases to run the OCGTs next fiscal year. Furthermore, in the SONA, President Ramaphosa said that the Social Relief of Distress grant would be increased to offset the impact of inflation. If the Minister of Finance grants a full inflation offset on the R350 per month grant since it was implemented in early 2020, it would have to be increased by 15%, which would cost an additional R5bn or so, given the 7.8mn current recipients.

We now forecast a main budget deficit for FY23/24 of 5.1% of GDP. In our modelling of the likely fiscal outcome for FY23/24 – as opposed to what the NT can confidently write into the Budget at this stage – we have pencilled in a modest R15bn above the MTBPS baseline in non-interest, non-wage spending for each year from FY23/24 to account for some combination of disaster relief, load shedding fiscal support and SOC bailouts. Our main budget deficit forecast for FY23/24 stands at 5.1% of GDP, but we may need to rework this forecast when the Budget is published and we can see specific spending items and revenue projections. We stress that this is probably not the deficit target that the NT will pencil in for FY23/24, unless it departs from the parameters of the MTBPS and includes a big unallocated reserve for the next fiscal year.

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