South Africa Medium-Term Budget Policy Statement Preview: October 2022

Details:

Finance Minister to table MTBPS at 2pm local time (1300BST / 0700ET), Wednesday 26th October 2022

MNI Point of View

- **Public finances expected on a better track, with deficit seen stabilizing at 4.5 – 5.0% of GDP**
- **Better growth outlook and commodity price seen pressuring debt-to-GDP ratio below 73%**
- **Market to focus on Eskom debt re-structuring plans and any basic income grant announcement**

Godongwana should present a flattering set of metrics for the MTBPS, with deficits seen smaller and debt pile seen improving further. Nonetheless, the government are likely to double-down on their conservative, consolidative approach as the global economy deteriorates. Outside of the usual fiscal health check, headline policy announcements will likely include the government's plans for Eskom debt, a focus on environmental measures, a possible basic income grant as well as a possible deferral of a public sector wage agreement.

Tackling South Africa's biggest economic issues will be top-of-mind for the government, with Ramaphosa privately conceding that Eskom is "killing us" ahead of December's ANC elective conference. Similarly, Godongwana has stated that the economy is underperforming by as much as 40% due to rolling blackouts and load-shedding. As such, a longer-term plan for Eskom debt will be carefully watched, with the Treasury expected to shoulder a significant portion of outstanding debt to free up funds.

The finance minister is expected to address load-shedding and power cut issues next year by announcing the shouldering of a significant portion of Eskom's debt pile. The total debt pile amounts to ZAR 400bln, and the Treasury could adopt half – or even more – of this load, thereby freeing funds for the utility to invest in infrastructure and tap funds for diesel-fuelled power generation – a bill that's nearing $1bln per year. On top of the debt restructuring, fresh funding for the utility could be announced to meet the requests of the board of directors, who outlined an 18-24 month turnaround plan.

Figure 1: 5y CDS prices remain elevated, although off the year's highs

Source: MNI/BBG

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Adopting ZAR 200bln of Eskom debt will widen debt-to-GDP ratios by as much as 2.5 percentage points, but the boon from higher international commodity prices has provided a windfall for the Treasury this year that's improved public finances as well as the GDP path ahead of expectations for 2022. The source of this windfall is largely via corporation, VAT and personal taxes, and may put tax revenues as much as ZAR 130bln or 8% ahead of expectations. Nonetheless, the cabinet will likely treat this as a one-off fiscal event, and not a new normal for the government balance.

This leaves expectations that the government will report a narrower budget deficit, which should be trimmed further still out to 2026. As such, the fiscal deficit is expected to stabilize at around 4.5 – 5.0% of GDP, down from the 5.3% of GDP estimated for 2021/22. Markets expect this to moderate further across the projection horizon, down to 4.35% of GDP for the 2024/25 fiscal year.

The improved growth outlook is seen denting gross debt-to-GDP measures, which are now seen dropping to a median of 72.6% for 2024/25, down from 77.1% seen previously.

Sell-side Views

Barclays: Sees three main risks ahead

- For the year as a whole, we look for a ZAR65bn outperformance in the corporate income tax handle due high international commodity prices in the wake of the Russia-Ukraine war and a weaker-than-expected currency. Similarly, International trade taxes have also outperformed their budgeted targets significantly (up a cumulative 43% y/y so far vs a budgeted target of 9.6% y/y), as have personal income taxes.
- Elsewhere, at a decline of 25% y/y, the fuel tax take has thus far slipped behind its budgeted growth rate of 0.9% y/y, given that it was frozen/cut for a few months to help place a lid on domestic fuel prices. Incoming VAT receipts have also printed marginally below their budgeted estimates, thanks to the weaker economy and rising unemployment. Even so, for the year as a whole, we now expect the gross tax take to exceed budgeted estimates by ZAR70bn (1.0% of GDP).
- With regards to government spending, we see three main risks ahead. First, is the wage bill. As we have argued in the past, we believe the government's assumption of wage increases is too conservative. We expect the final settlement to come in at around 10%. This would push the government wage bill towards our estimate of ZAR695bn or 10% of GDP, the second largest single item on the budget.
- Secondly, the ruling party has been mulling the idea of introducing a basic income grant to help deal with the country's highly skewed income distribution. We continue to see risk that a Basic Income Grant (BIG) is introduced to either replace or complement the current Social Relief of Distress Grant (SRDG) of ZAR350/month.
- Thirdly, the government has indicated that it hopes to put forward a plan to put to rest concerns about Eskom's debt sustainability prospects. Such a plan would also form the template for its application for the USD8.5bn of funding that it was promised at the COP26 meetings for sustainable energy infrastructure.
- Migrating the entire debt to the sovereign balance sheet would lift the country's debt-to-GDP ratio by some 6pp. If it were to migrate only the guaranteed component (ZAR350bn), it would raise the debt burden by 5pp. Moving over only the 'active' guarantees reduces the load further – to approximately ZAR310bn, or 4.6pp.
- Alternatively it might want to shift only half of the Eskom debt, as this would cut the latter's ZAR30bn of service costs in half, freeing up the balance sheet in the process. Such a decision would lift the country's debt-GDP ratio by some 3pp (ie, from 70% of GDP to 73% of GDP in 2022).

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Goldman Sachs: Sees narrower deficit forecast and lower pubic debt path

- We anticipate that the Treasury will present updated fiscal projections with narrower deficits (a main budget deficit of 5.3% of GDP or 0.5% of GDP in primary terms) and a revision lower to the projected path for public debt. That said, on our more optimistic projections for fiscal revenues, we forecast that the actual deficit outturn will be 4.5-5% of GDP and around balanced in primary terms.
- We do not expect any major change in the fiscal strategy with regard to either spending or revenue policies, or significant adjustments to macroeconomic forecasts (beyond a mark-to-market for current-year GDP and inflation forecasts).
- Additionally, in line with guidance from National Treasury, the announcement of a transfer of a significant portion of Eskom's debt (around 2.5-3.5% of GDP) onto the sovereign balance sheet is likely, reducing sovereign guarantees extended to Eskom by a commensurate amount and therefore having a neutral effect on total public and publicly guaranteed debt.
- A combination of narrower deficits and strong nominal GDP growth (our estimate for 2022 nominal GDP stands at ZAR 6.6tn, as compared to the budget assumption of ZAR 6.4tn) implies an improved outlook for public debt. On our estimates, gross public debt is likely to fall slightly from 69% of GDP in FY21/22 (all-else equal) and, with our expectation for continued primary fiscal surpluses, is likely to decline gradually further thereafter. Thus, as we argued recently, we think that the fiscal adjustment and revenue outperformance in the past two years has already achieved a stabilization in public debt ratios, with the likely peak in debt having been at 70% of GDP in FY20/21.
- However, we do not anticipate that National Treasury will show a projection for the debt path that is quite as favourable, for two reasons. First, fiscal revenue projections are likely to remain conservative, assuming that the windfall commodity revenue of the past 2.5 years proves to be temporary. Second, we anticipate that National Treasury will build in a transfer of some 2.5-3.5% of GDP of Eskom's debt (ZAR 150-200bn, or up to half of Eskom's total debt) onto the public balance sheet, thereby increasing public debt.

Investec: Expected to see a further improvement in finances, with focus still on consolidation

- The current fiscal year of 2022/23 has seen a marked lift in inflation, which will boost nominal GDP against which the fiscal ratios are calculated, and so ease both fiscal debt and deficit projections as a % of GDP. Indeed, National Treasury forecast a CPI inflation outcome of 4.8% y/y for the current fiscal year, while 6.9% y/y is now more likely.
- We expect gross loan debt to be projected near 70% of GDP (2022 Budget prediction was 72.8%), as nominal GDP rises on the year by up to 9.6% y/y. The following three medium-term years of 2023/24 to 2025/26 are also improved by the inflationary effect, to close to 70% of GDP as well, versus the original National Treasury projections of 74.4%, 75.1% and 75.0% of GDP.
- We now expect -5.6% on upwards revisions to nominal growth, with 2023/24 at -4.4% and 2024/25 at -3.9% (previously -4.8% and -4.2%).

JP Morgan: Expects deficit marked smaller, but inflection point nearing

- This year's fiscal deficit is likely marked around 1%pts smaller to -4.9% (Treasury: -6%), but FY23/24 deficit may be marginally wider as fiscal dynamics near an inflection point. The small revisions for next year understate the large uncertainties on revenue as well as expenditure.
- Budget expected to further mark up revenue projections, yet we believe fiscal dynamics are nearing an inflection point. We expect the FY22/23 deficit to be marked around 1%pt smaller to -4.9% of GDP, from -6% in the February Budget, but the fiscal gap is either unchanged or a touch wider at -5.1% for FY23/24 if wage bill estimates are refreshed.
- Thanks to higher nominal GDP growth and the seeming revenue beat so far this year, the near-term debt-to-GDP ratio is probably lowered to 69.9% (Treasury: 71.8%) in FY22/23 and 71.5% (Treasury: 73.4%) in FY23/24. Yet, we don't believe the debt ratio will peak already by FY24/25 (Treasury: 75.1% peak in FY24/25).
- Investor focus will be on gauging how credible and committed authorities are in dealing with SOE reforms, particularly in the energy sector. Most pressing are reforms in the network industries as electricity cuts, strikes at ports and poor rail network performance have severely weighed on 2Q and 3Q economic activity,

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and are expected to continue to do so. We have penciled in additional SOE support (affecting the sovereign's fiscal deficit) of R15bn this year and R25bn-R40bn next year (and similar amounts for subsequent years).

- We expect FY22/23 domestic long-term loan issuance to reach R310bn, with the weekly pace to be unchanged through the remainder of the fiscal year.
- We expect no change in the weekly pace of domestic fixed rate issuance in FY22/23. We expect authorities will take a more prudent approach and keep the weekly pace of fixed rate local issuance unchanged for the remainder of FY22/23.

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