

ECONOMIC AND FISCAL CONSIDERATIONS FOR THE 2020 MTBPS

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



KEY POINTS

- High levels of uncertainty, unprecedented growth shock, and unsustainable fiscal position make this the most difficult budget in the democratic era.
- Since the global financial crisis, South African macroeconomic policy has been firmly expansionary. Fiscal deficits have been large and public debt has roughly tripled. While there have been spending constraints in some areas to try to manage the size of fiscal deficits, policy has not been austere.
- Recent calls for fiscal stimulus are not new and precede the current crisis. The arguments hinge on assumptions about fiscal multipliers which have not been borne out in recent history.
- A debt/GDP ratio above 90 percent is consistent with double-digit fiscal deficits for the foreseeable future.
- The looming fiscal crisis is about 3 things:
 - A Growth-extracting rise in sovereign risk premia;
 - High and unaffordable cost of borrowing;
 - Risk of financial sector crisis as government deficits overwhelm the domestic savings market
- Active measures are necessary to address the structural gap between spending and revenue
- Measures in other parts of the system (addressing maladministration and corruption at the department level, addressing SOC failures, economic reforms for growth) would help improve the picture.

THE ECONOMIC OUTLOOK HAS DETERIORATED SINCE THE 2020 BUDGET, NEVERTHELESS SIGNIFICANT BASE EFFECTS WILL SEE SOME RECOVERY IN 2021

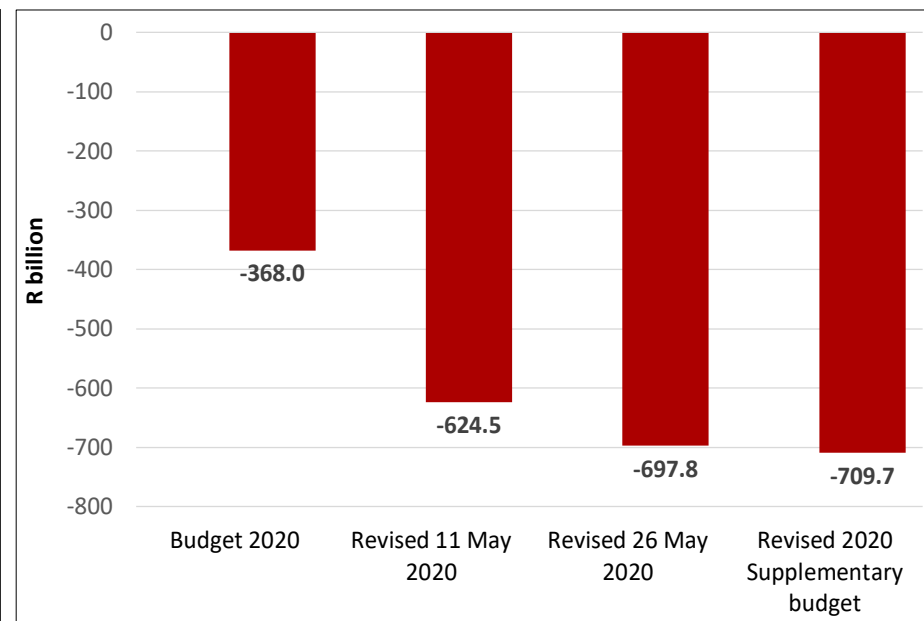
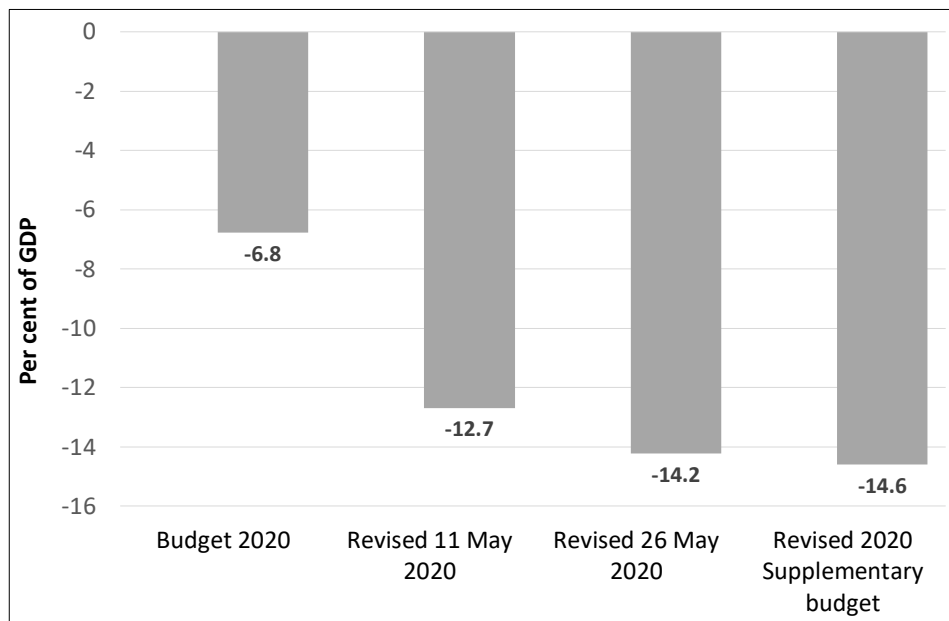
Latest economic outlook

GDP growth forecast (Per cent)				
Institution	Last update	2020	2021	2022
National Treasury	SAB 2020	-7.2	2.6	1.5
IMF*	Jun-20	-8.0	3.5	-
SARB	Jul-20	-7.3	3.7	2.8
BER	Jul-20	-8.7	2.6	1.5
Reuters	Jul-20	-8.0	3.5	1.6
Bloomberg	Jul-20	-7.6	3.1	1.8
HSBC	Jul-20	-7.9	2.9	-
Average (excl NT)		-7.9	3.2	1.3

- The 2020 Budget Review forecast growth of 0.9 per cent for 2020. That forecast proved optimistic given the unexpected contraction in Q4 of 2019, which emerged after the Budget was tabled in Parliament but before the onset of COVID-19.
- South Africa's economic growth is forecast to fall by 7.2 per cent in 2020 as a result of the crisis, the March and April 2020 credit rating downgrades, and the compounding effects of weak investor confidence. The economic outlook is highly uncertain.
- South Africa's economic outlook is heavily influenced by global trends. However, it is primarily domestic fiscal policy measures and implementation of economic reforms over the next six to 12 months that will determine the growth trajectory over the next several years. These will be outlined in the 2020 MTBPS

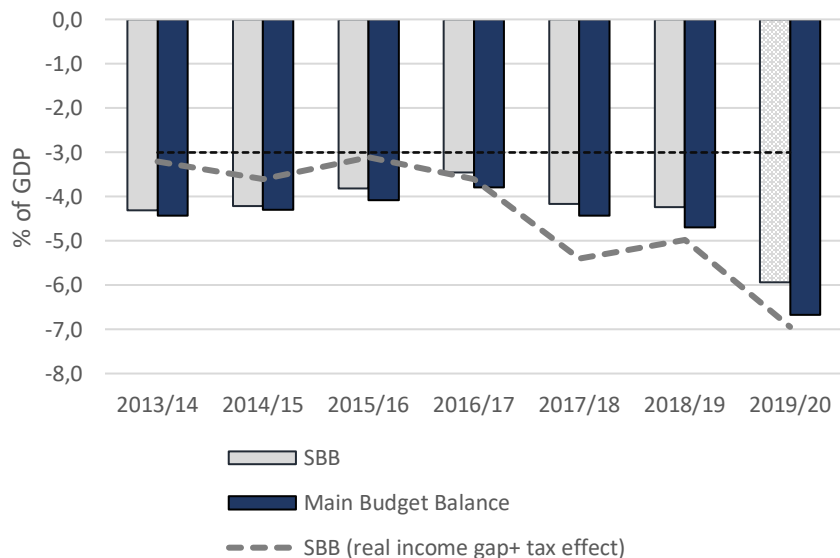
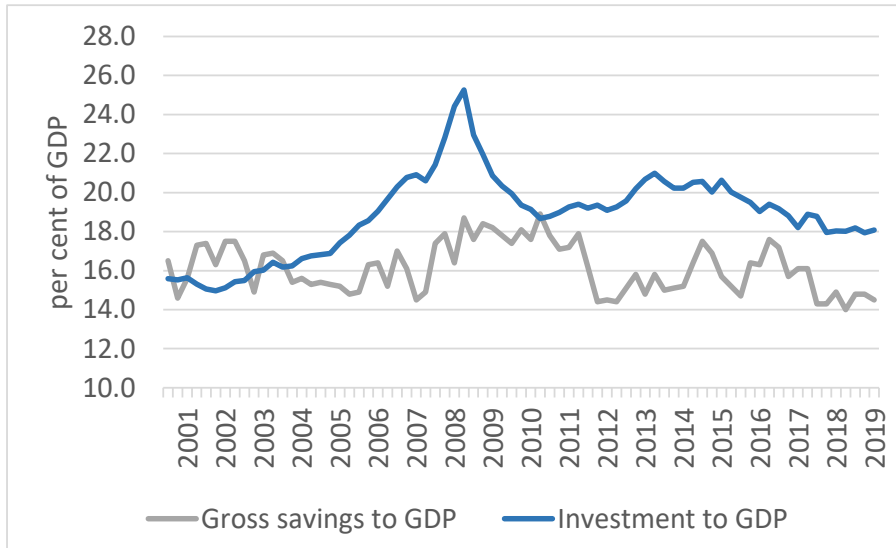
THE FISCAL SITUATION CHANGED SIGNIFICANTLY AND QUICKLY

Main budget deficit (percent of GDP), 2020/21 **Main budget deficit (R billion), 2020/21**



- Consolidated fiscal deficit is 15.7 percent of GDP
- Estimated gross domestic savings in 2020 – 14.6%
- We consider that if active measures are not taken, a debt crisis – either in the form of a debt distress episode or a permanent squeeze of the investment channel – will ensure.

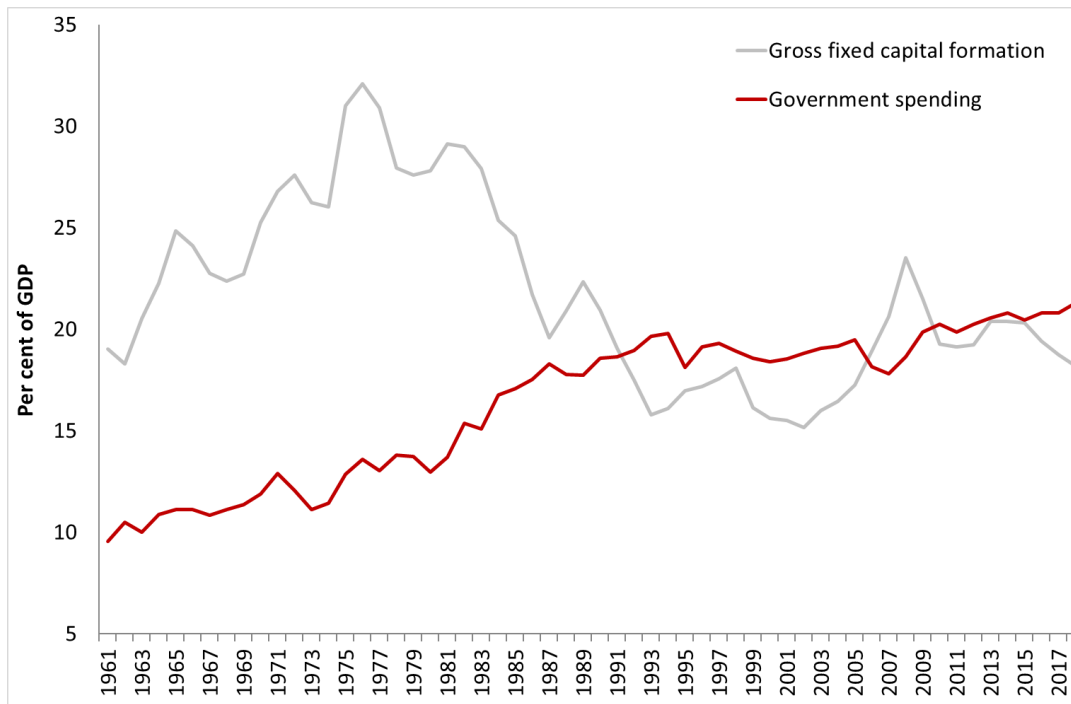
SA'S FISCAL HISTORY - FISCAL EXPANSION WITH LOW SAVINGS RATE



- The accumulation of deficits has been rising faster than the accumulation of savings.
- The resulting savings-investment gap, as illustrated in the persistent current account deficit, has become structural, together with the fiscal deficit.
- The typical implications of this phenomenon have been hidden by the flow of cheap capital due to loose monetary policy in the AEs
- SA is even more unprepared for a policy reversal in AEs than at any time after the 2008 GFC
- The only solution to avoid a second-round crisis is a more sustainable fiscal policy.

THE RELATIONSHIP BETWEEN GOVERNMENT SPENDING AND INVESTMENT IS NOT ALWAYS POSITIVE

Spending as % GDP

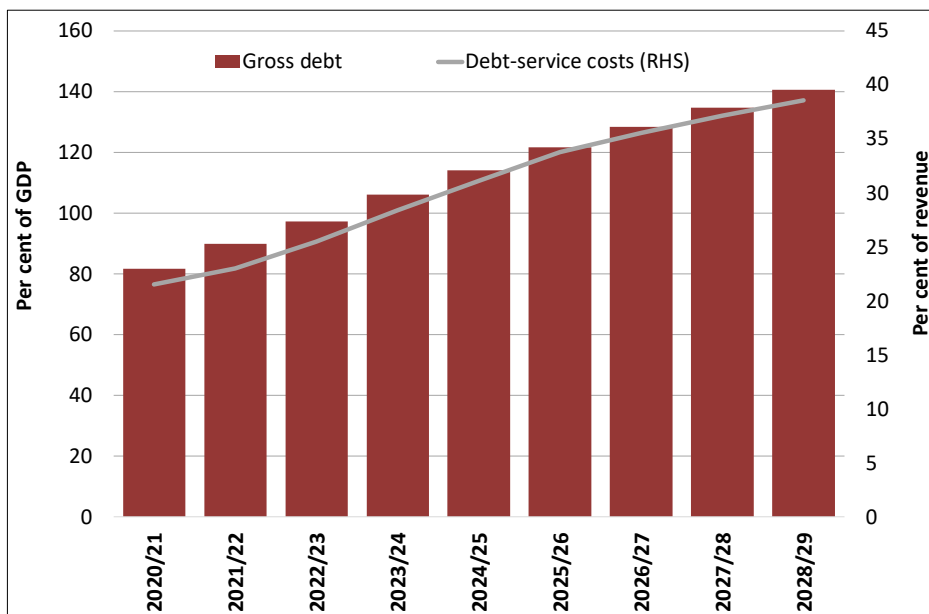


Source: SARB Quarterly Bulletin; National Treasury

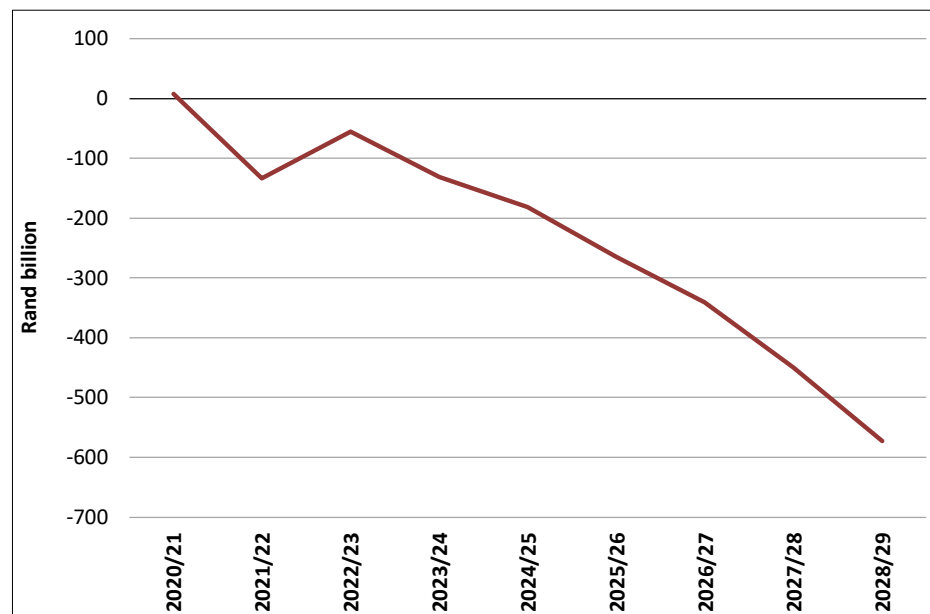
- A negative correlation between govt spending and the overall investment began to appear around 2014, for the first time since the GFC.
- **Government spending has overtaken investment** as a share of nominal GDP
- **Investment has begun to decline as an overall share** following a resurgence in the 2000s
- This has **negative implications for future potential growth**
- It does matter what the money is spent on and how efficiently
- Overall, data for SA indicates that fiscal multipliers are zero or negative.

A DEBT CRISIS CAN HAVE LONG RUN IMPLICATIONS – CONSERVATIVE ANALYSIS

Debt dynamics



Loss of nominal GDP



- Failure to arrest the debt trajectory will see debt-service costs consume around 31% of main budget revenue by 2024/25
- The stock of debt crosses the 100% mark in 2023/24, reaching 140% in 2028/29
- Deficits remain elevated at around 12% of GDP for a long-time, severely constraining domestic saving and investment
- A fiscal crisis could deduct more than R2 trillion from GDP over the next decade

AN ACTIVE, INTEGRATED APPROACH TO ECONOMY AND FISCUS IS NEEDED

Active scenario outlook

	2010-2018 ¹	2019	2020	2021	2022	2023
Percentage change						
Real GDP growth	1.9	0.2	-7.2	2.6	1.5	1.5
GDP inflation	5.7	4.0	4.0	3.9	4.4	4.6
GDP at current prices (R billion)	3 811.9	5 077.6	4 900.2	5 227.9	5 536.1	5 873.4
CPI inflation	5.3	4.1	3.0	3.9	4.3	4.5

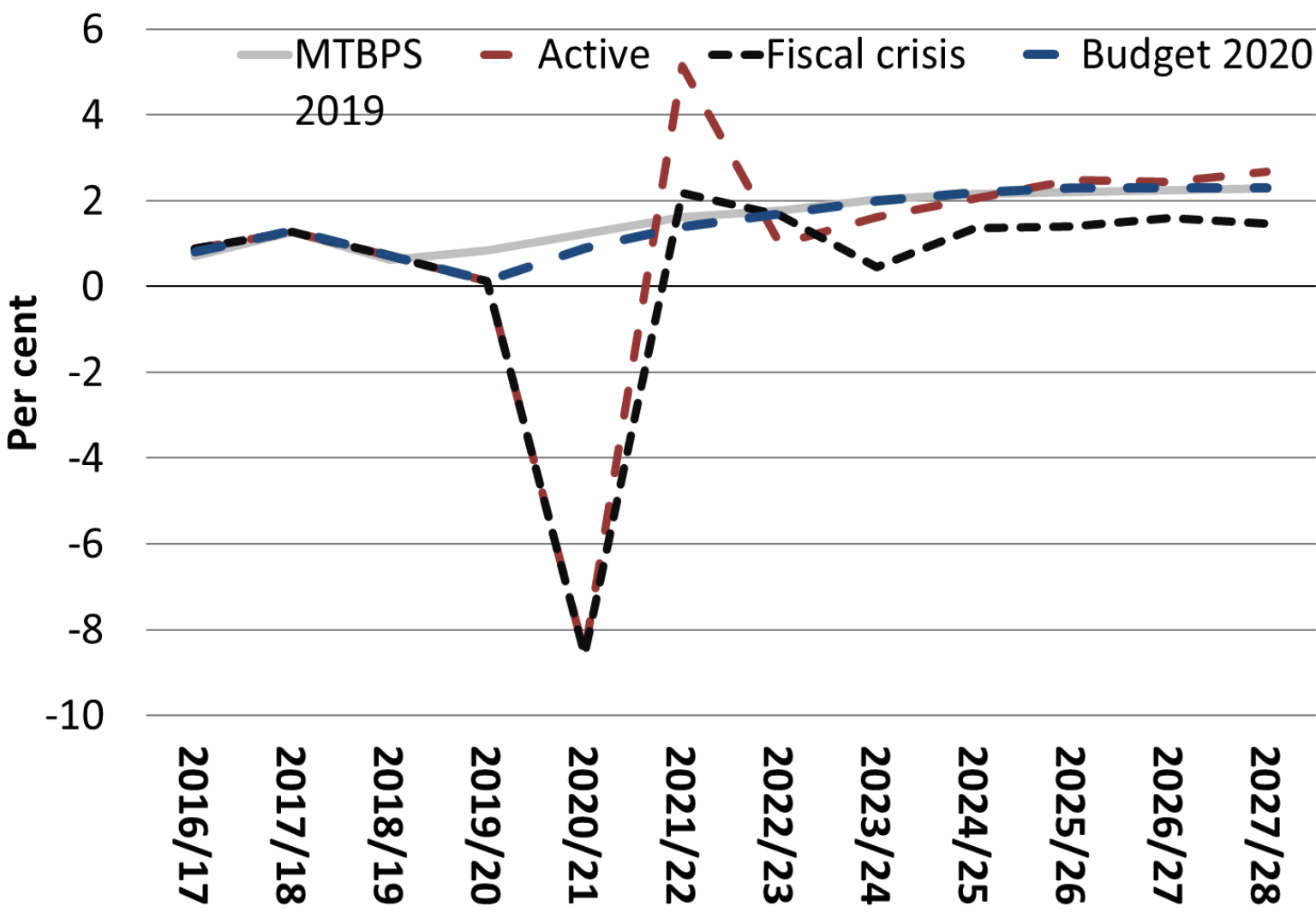
1. Average growth rates

Sources: National Treasury, Reserve Bank and Statistics South Africa

- **Need active set of fiscal and economic reforms to raise confidence and growth**
 - Fiscal restraint mitigates borrowing cost increases, raises confidence
 - SOC reform allows network industry reform, raises competition and lowers cost of living and doing business
 - Economic reforms need to support investment and employment, raise productivity and competitiveness, and lower cost of living and doing business
- **Economic reforms take time to impact on growth outlook – hence the need to implement now**
 - Government envisages reforms to finalise electricity determinations, unbundling Eskom and other steps to open up energy markets, modernise ports and rail infrastructure, and license spectrum
 - Reforms captured in Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa also included supporting labour intensive sectors, regional trade, SME finance
- **Additional reforms to support increased savings, investment and employment will be required to help speed the recovery from the COVID shock**

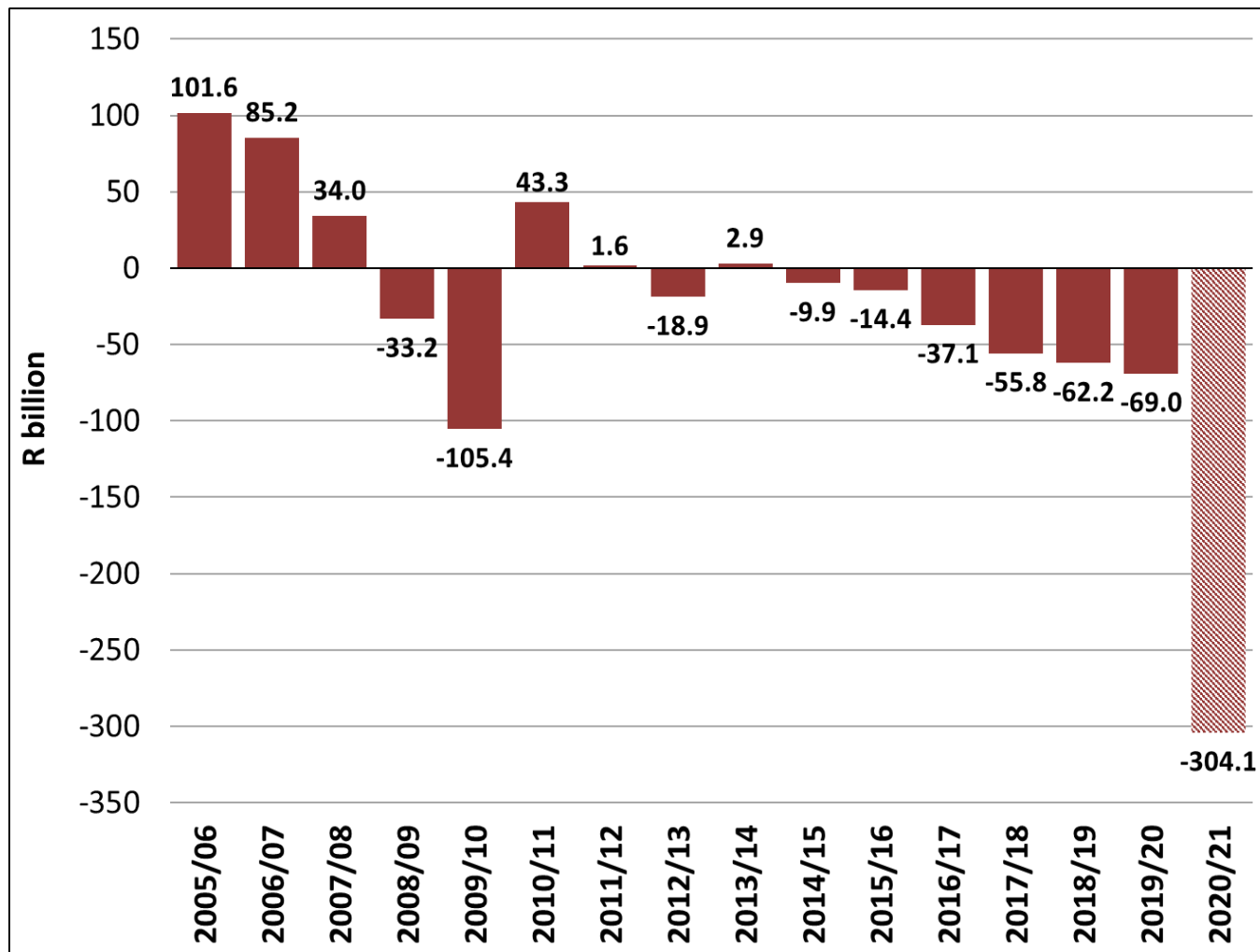
LONG-RUN ECONOMIC GROWTH IS BELOW 2 PER CENT IF ACTIVE MEASURES ARE NOT IMPLEMENTED

Real GDP growth, per cent



HUGE TAX REVENUE SHORTFALL IS PROJECTED IN 2020/21

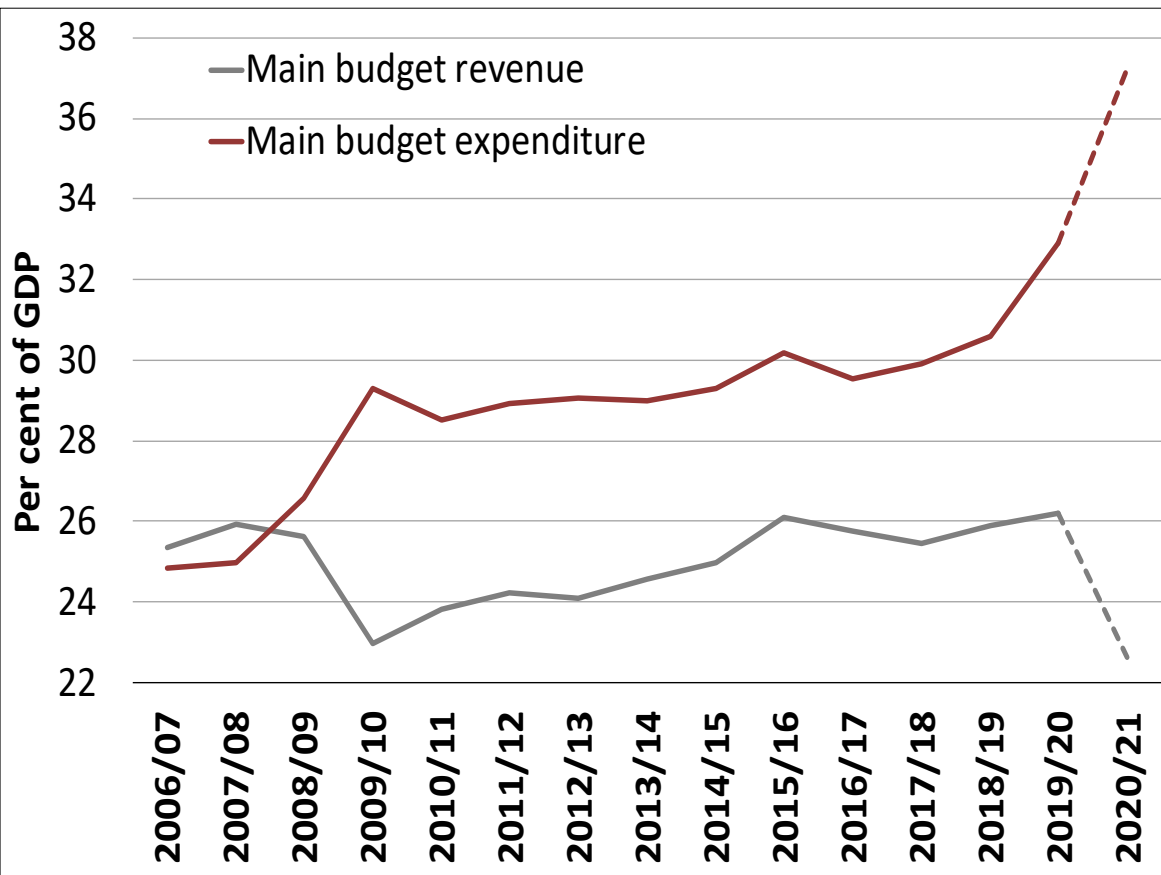
In-year revenue compared with Budget forecasts (2020/21 prices)



- COVID-19 fallout leads to unprecedented drop in in-year revenue estimates compared to prior Budget
- Expect temporary shrinkage in tax base as businesses close and jobs are lost
- Revenue shortfalls include tax relief measures amounting to R26 billion in foregone revenue
- Improved tax collection and administration will be key to achieving fiscal stabilisation

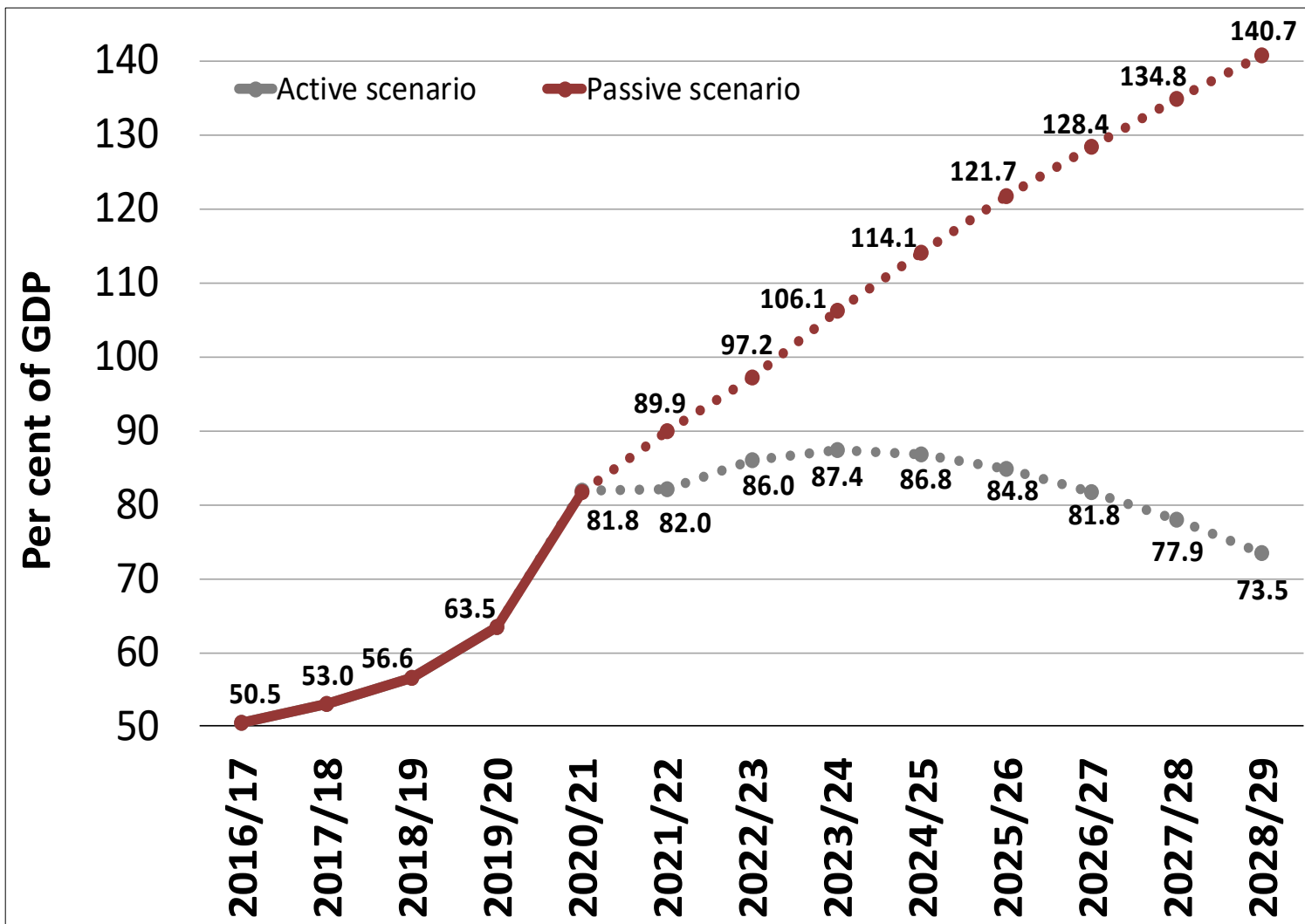
THE GAP BETWEEN REVENUE AND EXPENDITURE IS EXPECTED TO WIDEN

Main budget revenue and expenditure



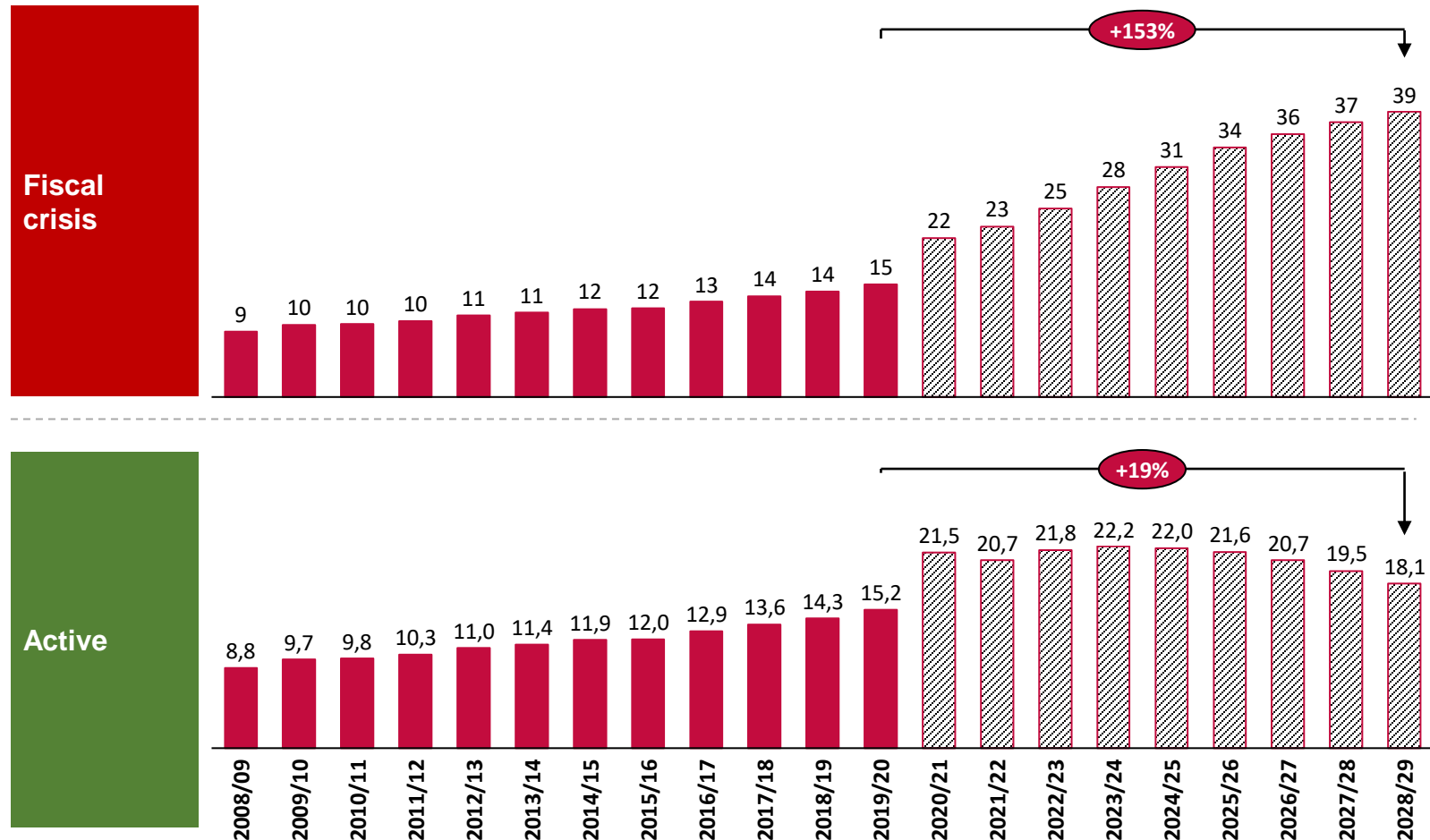
- The COVID-19 pandemic erupted when South Africa was already in a weak fiscal position
- In recent months, fiscal deterioration has accelerated
- In 2020/21, significant tax revenue underperformance is expected, and expenditure will increase as government reprioritises and allocates funds to contain COVID-19.
- The main budget deficit and gross borrowing requirement will increase sharply

DEBT OUTLOOK SCENARIOS



UNDER A FISCAL CRISIS SCENARIO INTEREST ON DEBT WILL CONSUME 39 PER CENT OF MAIN BUDGET REVENUE

Debt-service costs as a share of main budget revenue, %



MEDIUM-TERM FISCAL POSITION

- Beyond 2020/21, government considered two scenarios:
 - A passive approach, in which South Africa continues on its current trajectory and debt spirals out of control; and
 - An active scenario, in which major reforms and fiscal consolidation are implemented rapidly to stabilise debt in 2023/24.
- Cabinet has adopted the active approach. It has endorsed the target of a primary surplus by 2023/24, meaning revenue will exceed non-interest expenditure.
- This will require spending reductions and revenue adjustments amounting to approximately R250 billion over the next two years. Specifically, the active scenario assumes:
 - Tax increases of R5 billion in 2021/22, R10 billion in 2022/23, R10 billion in 2023/24 and R15 billion in 2024/25.
 - Spending reductions amounting to about R230 billion are required in 2021/22 and 2022/23. At a minimum a baseline freeze in 2023/24 will be necessary
 - These measures require difficult choices that will affect the distribution of public resources. The 2020 MTBPS will set out these proposals in detail.
- These measures are in addition to proposed medium-term reductions of R160.2 billion to the public-service wage bill set out in the 2020 Budget, which are yet to be finalised.

ACTIVE SCENARIO FISCAL POSITION

Table 4.1 Active scenario medium-term budget balances

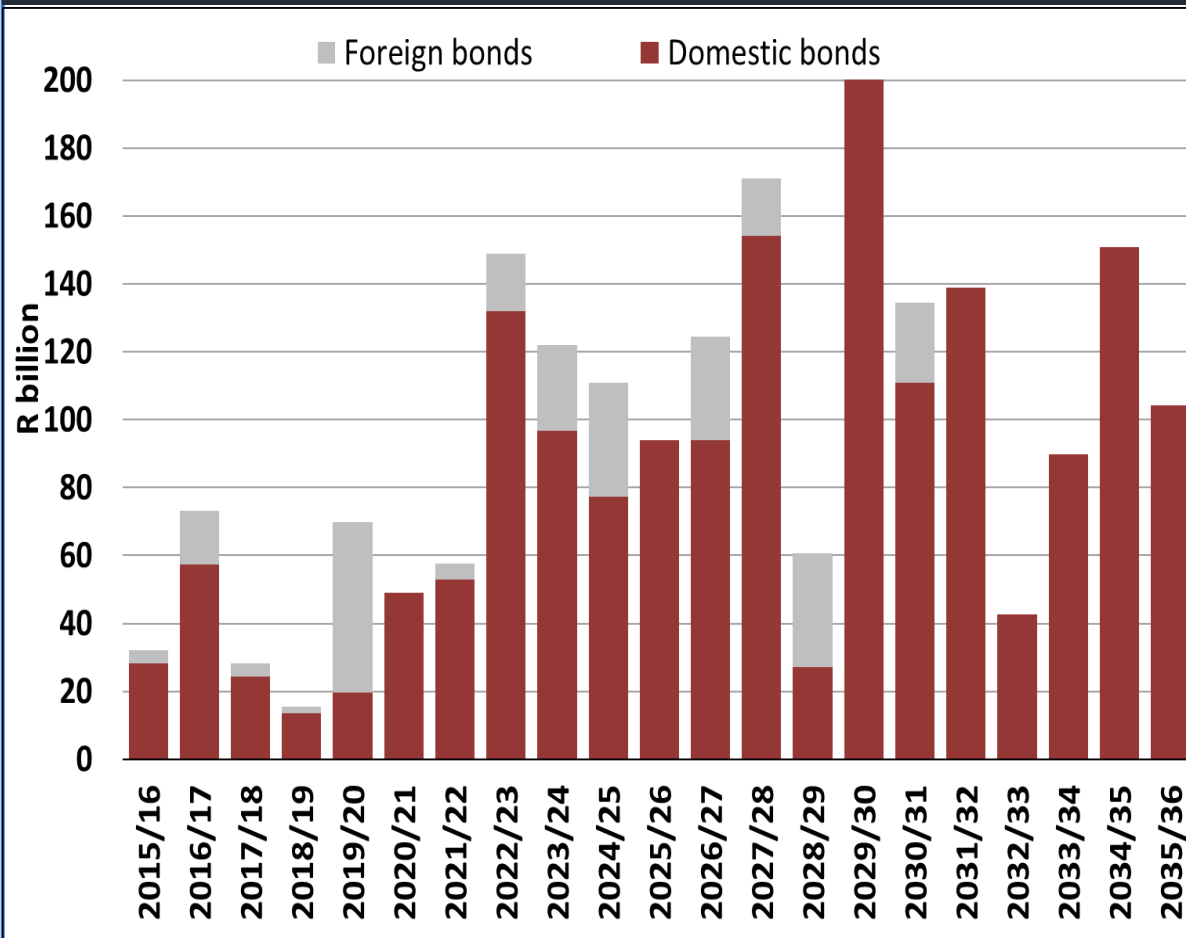
	2020/21	2021/22	2022/23
R billion/percentage of GDP	Revised	Medium-term estimates	
Main budget revenue	1 099.5	1 268.2	1 378.8
	22.6%	23.8%	24.5%
Main budget expenditure	1 809.2	1 763.8	1 809.3
	37.2%	33.1%	32.2%
Non-interest expenditure	1 572.7	1 500.6	1 508.2
	32.4%	28.2%	26.8%
Debt-service costs	236.4	263.1	301.1
	4.9%	4.9%	5.4%
Main budget balance	-709.7	-495.6	-430.5
	-14.6%	-9.3%	-7.7%
Primary balance	-473.2	-232.4	-129.5
	-9.7%	-4.4%	-2.3%

Source: National Treasury

- The main budget balance and the primary balance will narrow over the medium term in order to stabilise debt in 2023/24

AVERAGE DEBT REDEMPTIONS WILL INCREASE TO R127 BILLION FROM 2022/23 ONWARDS

Debt redemptions



- Average debt redemptions will increase to R127 billion from 2022/23 onwards compared partly as a consequence of new debt issuances due to revenue shortfalls
- This analysis does not assume any new debt issuances from 2020 onwards. Borrowing to finance the deficit will worsen this outlook

KEY CONSIDERATIONS AND PRINCIPLES FOR 2021 MTEF

- Implementing active reforms as outlined in the Supplementary Budget Review is critical. Failure to implement places further pressure on long-run fiscal sustainability
- Small primary surplus is targeted for 2023/24. Debt stabilization target will be missed if the spending adjustments and revenue measures are not implemented.
- Principles for the 2021 MTEF (as per budgeting guidelines):
 - The aim of the 2021 MTEF Budget is fiscal consolidation for the purpose of stabilising public debt. The total non-interest expenditure baseline for 2021/22 and 2022/23 has been revised downward compared to 2020 Budget baselines. There will also be no nominal baseline increase in 2023/24.
 - NO additional resources available for the 2021 MTEF. This means that any additional allocations to a programme will need to be funded from reductions in another programme, either within the department's budget, or from another department's budget.
 - Reductions to fund additional allocations should seek to preserve the actual provision of constitutionally mandated programmes.
 - Nevertheless, this does not preclude measures that would improve the efficiency of those programs and the implementation of reforms that would reduce the resource requirements for a given output.
 - Compensation budgets are not exempted from proposed spending adjustments and will be targeted in this regard
 - Shifting the composition of expenditure away from consumption remains a key objective

OTHER POINTS

- Additional tax measures will be announced in February
 - Improvements in collections by SARS will greatly assist
 - Research and analysis being undertaken on wealth taxes
- Work underway on the principles of zero-based budgeting and how these can be implemented. Cabinet approval of a concept will be sought
- Wage bill a key area for meeting fiscal targets
- Procurement reforms critical:
 - Emergency procurement measures being withdrawn;
 - Medium-term focus is on passing the public procurement bill and implementing greater automation of procurement processes
- Details of Vulindlela initiative being released shortly

THANK YOU