MTBPS – November 2023
Closing the negative jaws

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National Treasury delivered the Medium Term Budget Policy Statement (MTBPS) in a very challenging global and domestic economic environment when fiscal space has been eroded. An intensification in geopolitical risks and slower global growth and trade, have amplified a very difficult economic environment at home. The deterioration in fiscal space emanating from the revenue side, with the intensification of the electricity and the logistic crisis and a tighter monetary policy, was not anticipated in the February budget forecasts. The expenditure forecast was incomplete from the start due to the outstanding issue of the public sector wage increase. A less inverted US yield curve, with US 10yr Treasuries rising to 5.0%, more monetary policy tightening from the SARB, and an increase in the fiscal risk premium, have combined to increase the average funding costs from 8.3% in February 2023 to 9.5% in October 2023.

Where were the surprises for F23/24?

- **SAGB and ILB supply is unchanged:** The main budget deficit will rise from 3.9% of GDP to 4.7% of GDP. This is marginally better than ICIB's forecast of 4.9% of GDP but well below the more bearish forecasts of 6.0% of GDP. The shortfall in revenue receipts has been in line with market expectations of R56bn (ICIB R50bn) but the net increase in government spending of R10.4bn (non-interest spending is reduced by R10.4bn countered by an increase in debt servicing costs of R14.0bn to R354.5bn) has been materially lower than even ICIB's more "bullish" estimate of R18.0bn and bearish predictions of ¬R40bn. Bond supply is left unchanged vs market expectations of an increase.
- **Market reaction:** The rand rallied on the headline news from R18.74/$ to R18.61/$ (18h48). A net increase in expenditure of R10.3bn (which was less than market expectations of an R30bn overrun and ICIB's forecast of R18bn) in F23/24, sees a total reduction of R23.2bn over the MTEF to F25/26. SAGB yields closed lower, with the yield on the R2048 declining by 11bps to 12.78%. The absence of support for Transnet has reduced the conviction rate of the bond supply assumption. In this regard, we flag that the redemption amount of the R197 (budget assumption of R106bn), another possible switch auction in November and a rollover bond in December could bolster cash balances.

National Treasury's intervention to avoid a fiscal cliff

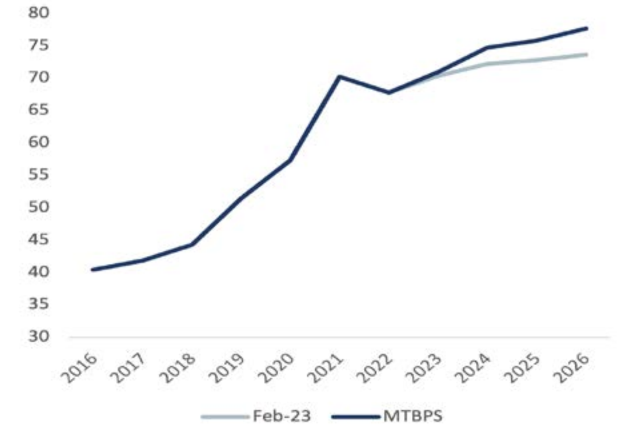
Fiscal sustainability risks are real: Fiscal sustainability remains a concern even as Treasury projects a primary budget surplus of 0.9%, 1.3% and 1.7% of GDP over the MTEF period. The low growth trap, upside risks to expenditure and a rising debt servicing cost bill, warn that there is upside risk to National Treasury's gross debt to GDP forecast of nearly 78% in F26/27.

High-level numbers: National Treasury focused on fiscal consolidation as core spending was revised lower. A rising public sector wage bill (R23bn in F23/24), with carry-through implications of nearly R60bn over the MTEF period, and a fast-growing debt servicing cost bill over the MTEF period (+R65.6bn), have required an offset in non-interest spending which leads to a net reduction in net spending of -R88.7bn. National Treasury has protected layouts in health, education and police. However, financial bailouts to SOEs such as Transnet and other SOEs (the Post Office, SABC and others) have not been included, which continues to dent the credibility of the expenditure outlook. A revenue shortfall of R56bn in revenue receipts in the current fiscal year has lowered the trajectory of the MTEF period by a massive R178.2bn.

Crowding out effect from a rising debt servicing cost bill: The revision in debt servicing costs of R65.6bn in F23/24, F24/25 and F25/26 to R455.9bn by F26/27 is of major concern. The increase can be ascribed to an increase in the main budget deficit, funding costs and the reclassification of Eskom's debt relief package of R254bn as a loan at market rates instead of in one term. Social and infrastructure spending are crowded out and is a key risk to South Africa's sovereign credit rating (S&P's next review is scheduled for 17 November although the outlook is expected to remain unchanged at BB-, stable). The interest rate bill as a share of main revenues is forecast to rise from 18.2% in F22/23 to 22.1% in F26/27, which means that R22 of each R100 spent is absorbed by interest payments.

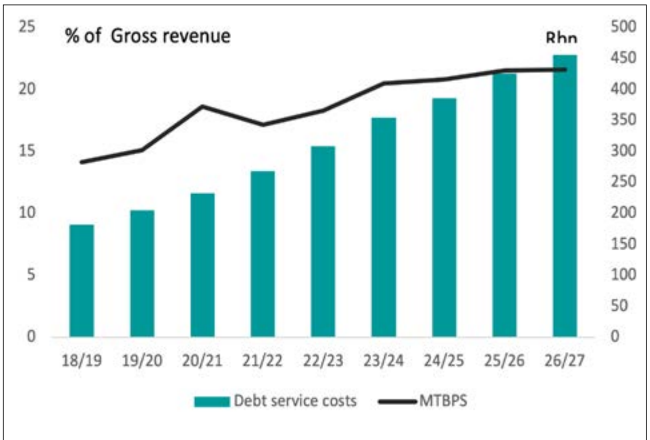
Higher sovereign risk premium: Treasury has increased its sovereign risk premium forecast to 3.9% (3.8%), 4.1% (3.6%), 4.0% (3.6%) and 3.9% from 2023 to 2026. The SARB is also concerned about the increase in the country risk premium, as this impacts the real neutral policy rate, raising the risk of a shallower rate-cutting cycle in 2024 and 2025. The real neutral repo rate has risen to ~2.6% from 2.4% in 2024.

Fig 1: Gross debt to GDP (% of GDP)



Source: National Treasury, ICIB

Fig 2: Rising debt servicing costs are crowding out capital and social spending



Source: National Treasury, ICIB

GDP growth forecast shows little upside from growth reforms

Treasury's real GDP forecast over the MTEF period of 1.0%, 1.6% and 1.8% in 2024, 2025 and 2026 shows the limited manoeuvrability and fiscal space. The growth dynamic remains the key risk to fiscal sustainability, which compels Treasury to reign in core spending and hike taxes when revenue receipts fall short of target.

The revision to the macroeconomic forecast has aligned Treasury's outlook to Bloomberg consensus (1.3%, 1.7% and 1.7%) but is stronger than the SARBs (1.0 and 1.1% in 2024 and 2025). The forecast shows the scepticism of implementing growth reforms to raise growth above 2%. The CPI inflation forecast at 6.0% in 2023 and 4.9%, 4.6% and 4.5% is also in line with expectations.

The tax buoyancy assumption for F24/25 has been revised to 1.01 without the R15bn increase in tax (1.15 with the tax increase).
We think there is upside risk to the revenue forecast in the event of lower load shedding and an improvement in logistics late in 2024.

Tax receipts have pockets of resilience, but revenue trajectory can't escape F23/24s shortfall

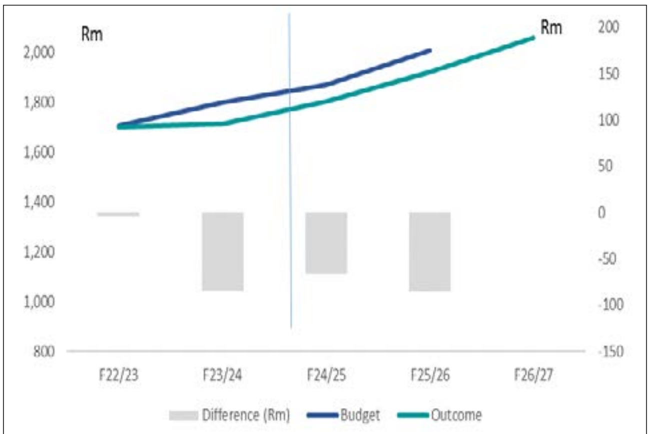
In our MTBPS Preview, we noted that the underperformance in revenue receipts can primarily be ascribed to (1) structural factors manifesting in corporate income performance (CIT) and (2) cyclical factors, which include the decline in global commodity prices, the effect of higher interest rates on household spending and manifested in lower domestic VAT receipts.

National Treasury revised its revenue forecast down by R56.8bn for F23/24. Of this, corporate income tax (CIT) accounted for R35.8bn and dividend payments are estimated to have declined by R3.6bn to R36.2bn. Net VAT receipts are reduced by R25.6bn, mainly because of an increase in VAT refunds as fixed investment in renewable energy, rooftop solar panels, and batteries have increased. PIT continues to do well, and Treasury forecasts an R6.4bn to R646.7bn overrun.

A tax increase coming as early as March 2024: An unexpected development has been Treasury's assumption of an increase in taxes of R15.0bn. Our impression was that a tax increase could only be forthcoming once a decision has been taken on the amount of a permanent increase in the SRD. While premature, we conjecture that the tax increase could consist of a combination of sin taxes, fiscal drag and possibly an increase in direct taxes.

The carry-over effect of the lower revenue base in the next two fiscal years amounts to a total of R178.2bn.

Fig 3: Revenue forecast trajectory vs February 2023 targets



Source: National Treasury, ICIB

Rollover decisions to February 2024

- **SOE bailouts:** Transnet's rail underperformance is estimated to have cost up to 5% of GDP in 2022, with the mining sectors suffering losses of ¬R50bn. The SOE has requested financial support from the government of R108bn, consisting of R47bn cash injection and R61bn debt relief. The Minister of Finance stated there have been preliminary discussions about the turnaround plan, but no support has yet been decided on. This is contingent on three conditions, i.e., sell non-core assets, implement cost containment measures and implement the Roadmap.
- **Mobilisation of private sector finance and technical expertise supporting infrastructure investment.** This involves the amendment of Treasury Regulations and key elements of municipal legislation with the Public-Private Partnerships (PPP) framework review. New regulations will be published in February 2024. A new Infrastructure Finance and Implementation Support Agency will be established that will address the need to crowd-in private sector finance and expertise into the public infrastructure programme. Government will also increase concessional borrowing by creating a new mechanism through which private-sector investors and multilateral institutions can co-invest with government for selected infrastructure projects. (E.g. multilateral institutions could get more involved in social investment in education). This may alleviate some of the problem the private sector has identified and facilitate and alleviate problems for PPPs.
- **Procurement:** The Public Procurement Bill has been tabled, which seeks to create a single regulatory public procurement framework. A relaxation from most SCM Instructions for Schedule 2 SOEs will be announced (soon).
- The reconfiguration of government is a work in progress, and we do not anticipate any hard numbers in the forecasts.
- Support to new-energy vehicles through tax support.

Borrowing requirement – Bond supply unchanged, but material increase could come next year

FIG 4: FINANCING OF NATIONAL GOVERNMENT GROSS BORROWING REQUIREMENT (RBN)

R bn	F22/23	F23/24 Feb 23	MTBPS	F24/25 Feb 23	MTBPS
Main budget balance	**-309,9**	**-275,4**	**-330,1**	**-269,9**	**-321,6**
Redemptions	-90,3	-162,2	-155,5	-168,8	-171,8
Domestic long-term loans	-74,6	-117,9	-106,6	-131,4	-132,3
Foreign loans	-15,8	-44,4	-48,9	-37,4	-39,5
Eskom debt-relief arrangement		-78,0	-78,0	-66,1	-66,2
Total	**-400,3**	**-515,6**	**-563,6**	**-504,8**	**-559,6**
Financing					
Domestic short-term loans (T-Bill + CPD)	-25,6	48,0	48,0	42,0	47,0
Domestic long-term loans	322,4	329,9	375,8	377,7	419,0
SAGBs and ILBS	664,5		253,0		
FRNs	51,2		52,0		
Sukuk			20,0		
Foreign loans	64,5	44,4	45,9	35,0	36,9
Change in cash and other balances (this includes Local and foreign bond issuance)	39,0	93,3	93,9	50,2	56,6
Total	**400,3**	**515,6**	**563,6**	**504,8**	**559,5**

Source: National Treasury, ICIB

Financing strategy for the remainder of R23/24

- The borrowing requirement rises from R515.8bn to R563.3bn. This assumes a redemption amount of R106.6bn for the R197, which, according to our calculations, includes another switch auction of ¬R4bn in November.
- The increase in borrowing requirement will be financed by a rand Sukuk bond and possibly more FRNs, while the weekly bond and ILB auctions will be unchanged.
- Net T-bill issuance is unchanged at R48bn. The R2.3bn increase since July has raised the net gain by R60bn to build up cash balances ahead of the December redemption because of lower revenue receipts. Treasury plans to reduce the quantum of weekly auctions in early 2024 to end up with a net increase of R48bn.
- Domestic long-term consisting of FRNs, SAGBs, ILBs, and a new rand Sukuk bond: The cash forecast has been raised by R43.3bn to R419.1bn. The weekly auctions of nominal and ILBs will be unchanged at R3.9bn and R1.0bn, respectively. The increase should, therefore, be raised from FRNs (YTD increase is R31bn) and a new Sukuk bond of ¬R20b. We conjecture that a larger switch/rollover of the R197 redemption could bolster cash balances.

Borrowing requirement for F24/25

- The borrowing requirement rises to R559.6bn from R504.8bn. The funding strategy remains mostly unchanged with regards to T-bill issuance at R47.0bn (R42.0bn), foreign loans at R36.9bn (R35.0bn) and a rundown in cash balances of R56.6bn (R50.2bn). Domestic long-term loans, however, rises from R377.7bn to R419.0bn. The assumption, however, hinges on several factors, including possible redemptions of the I2025 of ~R132.3bn.