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2023 BUDGET: FISCAL CONSOLIDATION REMAINS A PRIORITY

Author: Rhandzo Mukansi, Portfolio Manager
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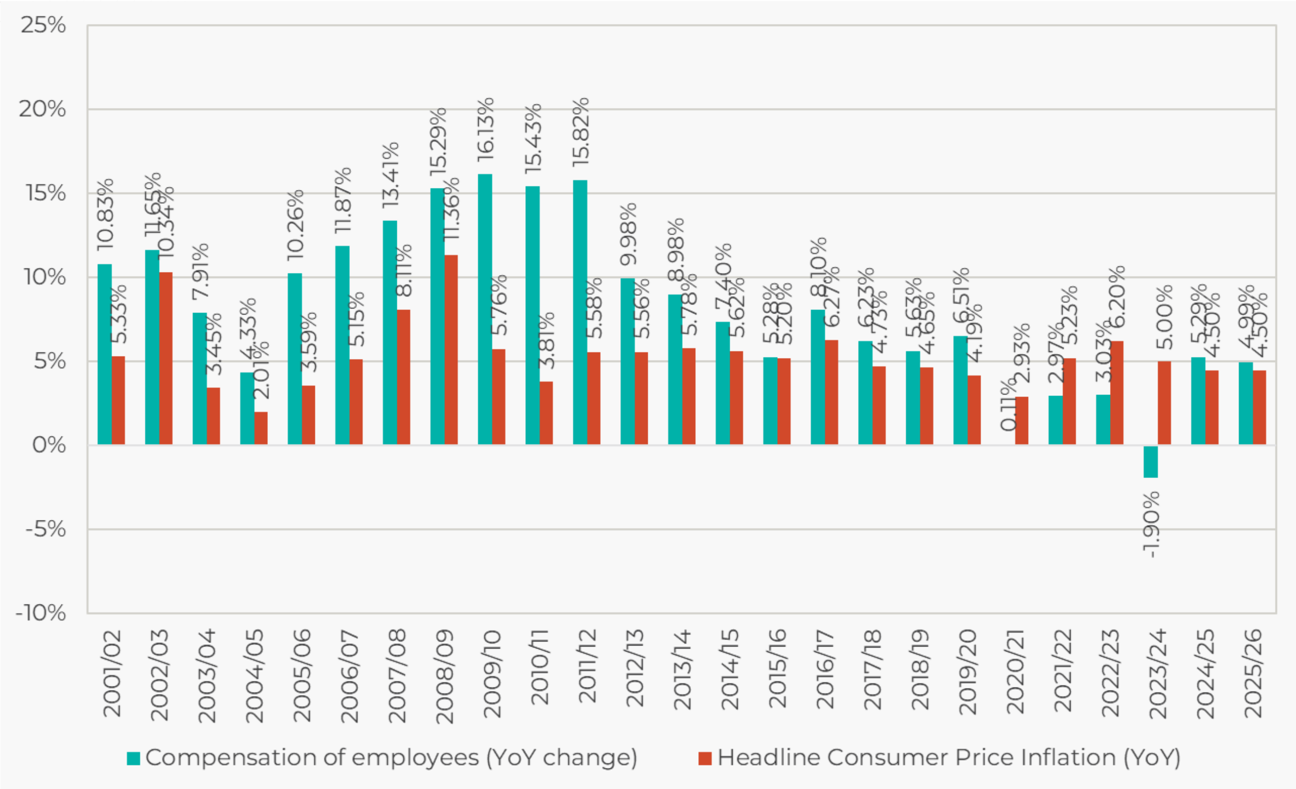
Fiscal consolidation remains a priority against a tenuous domestic economic backdrop, but significant execution risk remains.

With South Africa firmly in the throes of crippling electricity blackouts, the 2023 Budget was always going to be judged on its ability to table a comprehensive solution to Eskom's debt overhang while still credibly committing to fiscal probity. In our assessment, the Minister of Finance suitably delivered on these imperatives, freeing Eskom of an estimated 50% of its debt and interest payment obligations over the Medium-term Expenditure Framework (MTEF), but importantly, still committing to a primary budget surplus over this period.

The budgeting of a primary surplus amid a constrained economic growth backdrop and lingering expenditure pressure reads as a clear signal of intent from National Treasury to return government finances to a sustainable path. While commendably staving off elevated and persistent expenditure risk in this budget, lending renewed credibility to the hitherto porous "expenditure ceiling", we continue to highlight that expenditure risk will eventually come to bear on the fiscus if the economy doesn't sustainably unlock higher levels of inclusive economic growth.

The impasse between organised labour and the Ministry of Public Service and Administration remains the immediate litmus test for government's resolve to withstand expenditure pressure. While a R15bn per annum provision has been made for an extension of the non-pensionable cash gratuity to public-sector employees, which certainly goes some way to cushioning the overall fiscal threat, the gulf between the average 3% offered to public sector employees over the MTEF relative to the +10% demand will continue to pose upside expenditure risk. In addition to this immediate threat, expenditure risks in the medium-term include financial support to State Owned Enterprises (SOEs), securing the social welfare net with the provision of a Basic Income Grant (BIG) in some form or another, National Health Insurance (NHI), and combating the collapse of infrastructure and service delivery across many provinces and municipalities.

Figure 1: Public-sector wage inflation relative to consumer price inflation



Source: National Treasury, Futuregrowth

As announced in the tabling of the 2022 Medium-Term Budget Policy Statement (MTBPS), the Social Relief of Distress (SRD) grant has again been budgeted for the forthcoming fiscal year but not beyond that, given the provision that a permanent allocation in the MTEF will need to be accompanied by permanent revenue measures. However, we account for this as a permanent disbursement in our fiscal modeling, with it likely to eventually form the foundation of a BIG. The SRD grant, budgeted at c. R35bn per annum, alongside the other expenditure needs, will continue to stalk the fiscus in the coming years. A cumulative R95bn unallocated/contingency reserve has been provisioned in the medium-term, which will serve to cushion some, but not all, of the inevitable expenditure risk.

From a tax revenue perspective, as the fortuitous commodity super-cycle fades, and with it the buoyant corporate income tax receipts that propelled main budget tax revenue to a historic peak of 25.82% of GDP in the 2022/23 fiscal year, the improved efficiency of the South African Revenue Service (SARS) will be severely tested given the budgeted levitation of tax revenue relative to GDP over the MTEF. National Treasury's reasonable tax revenue buoyancy estimates have seemingly accounted for an easing growth rate in tax revenue intake relative to nominal GDP growth, but in a twist of fate relative to the post-covid period, tax revenue intake clearly bears downside bias in the medium-term.

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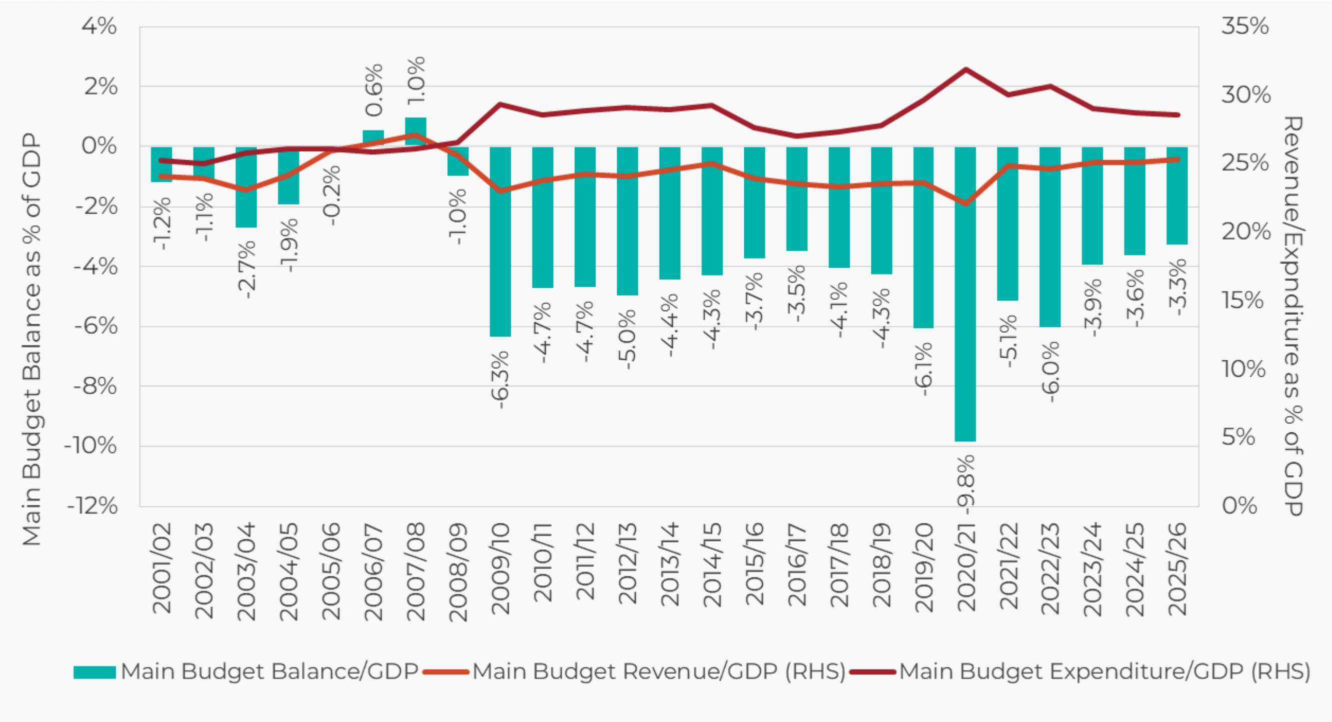
Figure 2: Main Budget Balance & Revenue/Expenditure Trends



Source: National Treasury, Futuregrowth

Against a decidedly tenuous domestic backdrop, the budget provides the necessary reassurance of National Treasury's fiscal consolidation effort. Commendably, the corporate income tax revenue windfall from the super-commodity cycle has significantly contributed to the first primary surplus since 2008/09. With the revenue windfall now a thing of the past, and while still stalked by persistent expenditure pressure, National Treasury's resolve for fiscal probity will be sorely tested in the coming years.

The substantial debt relief provided to Eskom needs to serve as a bridge to stabilising the national electricity grid by relieving the entity of the extreme pressure on its balance sheet, and ultimately freeing it to invest in the critical maintenance of its generation fleet, distribution network and transmission grid. The Eskom debt relief package will increase National Treasury's debt obligations, resulting in an increased borrowing requirement and debt-servicing costs – risks that may ultimately be cushioned by the positive economic growth impact of a functional electricity sector. For our collective good, we dare not miss the opportunity.