29 October 2021

Medium Term Budget Policy Statement Preview.

Commodity boom drives modest revenue overrun

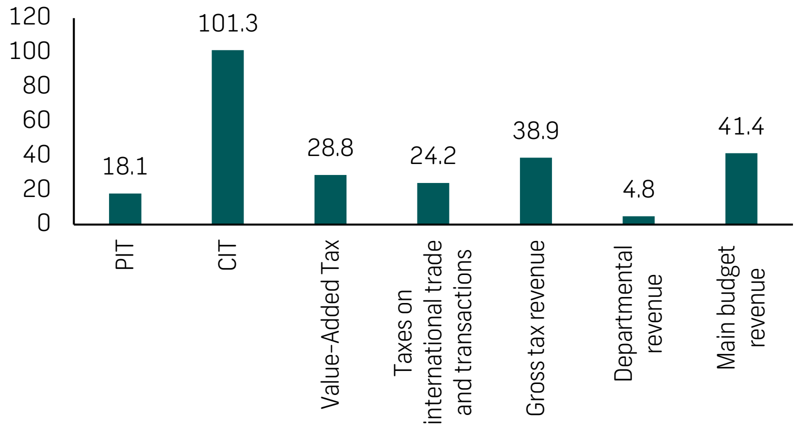
On 11 November Finance Minister Enoch Godongwana will present the Medium Term Budget Policy Statement (MTBPS) in parliament. We don't expect this budget to signal any deviation from the current fiscal consolidation path. Instead, the budget could highlight progress on critical policy considerations such as the Public Procurement Bill and implementation of the Zero-Based Budgeting framework. In addition, we expect the budget to highlight progress on various options that Treasury is considering to address the widening poverty gap, which includes:

- the Basic Income Grant (BIG);
- an extension of the R350 Social Relief of Distressed (SRD) grant; and
- the extension of the Presidential Employment Stimulus[1] and Job Seekers allowance.

On the SRD grant, we will not be surprised by a possible temporary extension beyond March 2022, given government's commitment to address the widening poverty gap. However, such an extension may be fiscally challenging given the structurally reduced revenue base due to reduced capacity utilisation, weaknesses in the labour market, and the generally deteriorated fiscal position. In July, Treasury indicated that the reinstatement of the SRD grant was made possible by the temporary revenue performance from elevated commodity prices. In his recent remarks Godongwana reiterated that the country could only effectively address poverty, unemployment and inequality through higher levels of inclusive growth. Thus, we expect the budget to signal continued consolidation and highlight progress on implementing growth-enhancing reforms, mainly related to the Economic Recovery and Reconstruction Plan (ERRP).

Despite the impaired revenue base over the years, the current fiscal year's revenue performance is primarily underpinned by elevated commodity prices and pent-up demand created by last year's lockdown restrictions. We unpack the YTD (April to September) revenue performance below and provide our estimate for the revenue overrun.

Figure 1: Year-on-year YTD revenue growth performance



Source: Treasury, SARS, FNB Economics

[1] Phase 1 of the Presidential Employment Stimulus benefited more than 500 000 people, and the government has recently launched Phase 2.

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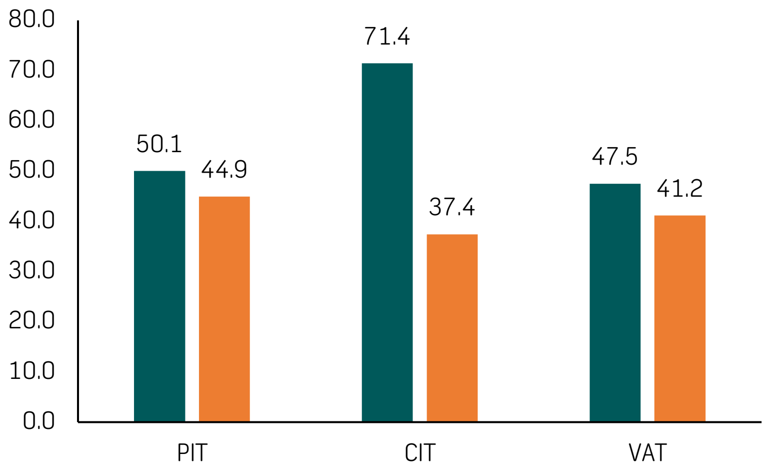
Modest cyclical revenue overrun of +/-R110 billion: boosted by higher terms of trade

According to our (average and ARIMA-based) estimates and accounting for growth dynamics, the YTD performance of monthly tax revenue signals a modest revenue outperformance of around R110 billion for the current fiscal year, primarily assisted by corporate income tax revenue, which has benefited from elevated commodity prices and terms of trade. Consequently, the budget deficit should be around R373 billion (6.1% of GDP) for 2021/22. YTD gross tax revenue is up by 38.9% y/y relative to the full-year 2021 Budget projection of 12.6% y/y. Specifically, major tax revenue categories have performed as follows (Figure 1):

- Personal income tax (PIT; 38% of gross tax revenue) revenue is up by 18.1% YTD compared to the corresponding period in 2020 and by 3.9% compared to 2019, pre-pandemic. At 18.1% y/y, PIT revenue is ahead of the 2021 Budget review projection of 7.0% for the current 2021/22 fiscal year. YTD 50.1% of PIT revenue has been collected compared to 45% in the corresponding period last year. The recovery in compensation of employees to slightly above pre-pandemic levels should boost PIT revenue in the current fiscal year despite persisting labour market weaknesses.
- Corporate income tax (CIT; 17.2% of gross tax revenue) revenue has largely benefited from elevated commodity prices and is up significantly by 101.3% YTD compared to the corresponding period last year and up by 50.3% compared to the corresponding period in 2019. The 2021 Budget review projected CIT revenue growth of 12.9%. About 71.4% of CIT revenue has been collected compared to 37.4% in last year's corresponding period.
- Value-added Tax (VAT; 26.6% of gross tax revenue) revenue is up by 28.8% YTD compared to the same period last year and by 9.5% compared to the corresponding period in 2019. VAT revenue growth of 14.1% for the current fiscal year had been projected at the 2021 Budget review. YTD 47.5% of VAT revenue has been collected compared to 41.2% in the corresponding period last year.

Figure 2: YTD percentage of tax revenue collected versus target



Source: Treasury, SARS, FNB Economics

Overall, the modest revenue cyclical growth performance is underpinned by the combination of a pandemic-induced low base of 2020, a boost from elevated commodity prices and higher export earnings, and the general economic recovery from further easing of lockdown restrictions. The long-existing narrowing of the revenue base, which the pandemic has now worsened, means that the cyclical revenue performance will be short-lived in the absence of accelerated growth-enhancing reforms and when commodity prices moderate from the current elevated levels. SARB Governor Lesetja Kganyago also cautioned at the BIS-SARB Centenary Conference that, like in the previous cycles, the current commodity price boom, which has boosted corporate income tax revenue, would not be long-lived.

On the expenditure side, the 2021 Budget review had expected the main budget expenditure to grow by 1.7% in the current fiscal year. However, preliminary outcomes show that expenditure is likely to grow by 2.6% due to lower expenditure in the previous fiscal year than initially assumed. YTD main budget expenditure is up by 7.6% y/y, reflecting YTD growth of 10.8% y/y of expenditure (appropriation by vote) and 14.0% y/y growth of debt-service cost. Year to date 42.7% of the budgeted total main expenditure of R1 834 billion has been spent compared to 40.7% in the corresponding period last year.

Treasury 2021 Budget projections and the latest benchmarking cycle

For the fiscal year 2020/21, Treasury expected a main budget deficit of R603 billion (12.3% of GDP). Preliminary data indicates that the deficit now looks to have been narrower at around R553 billion (9.9% of GDP) amid better-than-expected revenue and GDP outcomes and the recent national accounts benchmarking cycle, which showed that the size of nominal GDP (the denominator) is now larger compared to the previous benchmarking cycle. This improved starting point means that projections for the subsequent fiscal years may look better than those at the 2021 Budget review. The higher GDP size would also reflect a reduced gross government debt ratio that Treasury had predicted, at the 2021 Budget review, to peak at 88.9% of GDP in 2025/26. From a sovereign ratings and financial markets perspective, it will be critical for Treasury to credibly demonstrate that it is still able to have the government gross debt ratio peaking over the forecast horizon. Worryingly, the IMF's latest World Economic Outlook shows that SA's gross debt ratio will not stabilise until 2026, highlighting fiscal credibility and implementation risks amid pressing social issues and wage bill disputes.

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