SOUTH AFRICA AT A CROSSROADS

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Overview

- South Africa finds itself at a crossroads. This MTBPS highlights the difficult economic and fiscal choices confronting government over the next several years
- Economic growth has been revised down from 1.5 per cent to 0.7 per cent in the current year, and the global environment remains challenging for emerging market economies
- Government remains committed to fiscal sustainability, but there has been slippage since the 2018 Budget
  - Tax revenues have been revised down, partly due to higher value-added tax refunds
  - Despite spending pressures, expenditure ceiling remains intact as the anchor of fiscal policy
  - Gross debt is now projected to stabilise at 59.6 per cent of GDP in 2023/24
- Consolidated expenditure grows by 7.8 per cent a year on average, from R1.8 trillion in 2019/20 to R2.1 trillion in 2021/22, prioritising education, social welfare, and health
- The President's economic stimulus and recovery plan aims to address low economic growth and high unemployment. Elements include an infrastructure fund to be developed in partnership with the private sector, growth and governance-enhancing reforms, and support for urgent education and health needs
- State institutions are being repaired and renewed, but serious governance challenges exist across the public sector

Global outlook less supportive of domestic economy

2018 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- Global growth is expected to stay stable at 3.7 per cent, while growth in global trade is projected to slow
- Risk appetite is weighed against emerging markets – since the 2018 Budget, government bond yields have risen by around 120 basis points, while the rand has weakened by 19 per cent against the US dollar

Mounting trade disputes, tighter financial conditions and volatility in commodity prices present risks to global growth and investment

Economic growth in selected countries

Region/country	2000-2008	2010-2016	2017	2018	2019
Percentage	Pre-crisis	Post-crisis	Actual	Average GDP	
World	**4.3**	**3.9**	**3.7**	**3.7**	**3.7**
Advanced economies	**2.4**	**1.9**	**2.3**	**2.4**	**2.1**
United States	2.4	2.2	2.2	2.9	2.5
Euro area	2.0	1.1	2.4	2.0	1.9
United Kingdom	2.5	2.0	1.7	1.4	1.5
Japan	1.2	1.5	1.7	1.1	0.9
Developing countries	**6.5**	**5.4**	**4.7**	**4.7**	**4.7**
China	10.4	8.1	6.9	6.6	6.2
India	6.8	7.3	6.7	7.3	7.4
Brazil	3.8	1.4	1.0	1.4	2.4
Russia	7.0	1.9	1.5	1.7	1.8
Sub-Saharan Africa	**5.8**	**4.5**	**2.7**	**3.1**	**3.8**
South Africa[1]	4.2	2.1	1.3	0.7	1.7

1. National Treasury forecast

Source: IMF World Economic Outlook, October 2018, and IMF World Economic Outlook Database

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Growth outlook is revised down in the current year

- 2018 GDP growth has been revised down from 1.5 per cent at the time of the Budget, to 0.7 per cent – reflecting the impact of recession
- Over the medium term, growth is expected to recover to 2.3 per cent by 2021, on the back of gradually rising confidence and investment
- Despite lower inflation in 2018, the weaker exchange rate, along with rising fuel and energy prices, are placing upward pressure on consumer prices

Macroeconomic performance and projections

Calendar year	2017 Actual	2018 Estimate	2019	2020 Forecast	2021
Percentage change unless otherwise indicated					
Household consumption	2.2	1.6	1.9	2.3	2.6
Gross fixed-capital formation	0.4	0.9	1.5	2.1	2.9
Real GDP growth	**1.3**	**0.7**	**1.7**	**2.1**	**2.3**
GDP at current prices (R billion)	**4 651.8**	**4 949.1**	**5 317.2**	**5 724.1**	**6 167.2**
CPI inflation	5.3	4.9	5.6	5.4	5.4
Current account balance (% of GDP)	-2.4	-3.2	-3.2	-3.7	-3.9

Source: Reserve Bank and National Treasury

Progress on economic stimulus and recovery plan

- **Implementation of growth enhancing economic reforms**
  - Draft policy direction for licensing high-demand spectrum has been issued
  - Work under way on restructuring options for electricity sector
  - Mining Charter has been approved by Cabinet
  - Visa regulations are being amended to boost tourism

- **Reprioritisation of public spending to support growth and job creation**
  - R32.4 billion over the next three years of which:
    - R15.9 billion goes towards faster-spending infrastructure programmes, clothing and textile incentives, and the Expanded Public Works Programme.
    - R16.5 billion allocated to various programmes and entities, including funding for the South African Revenue Service (SARS), a minimum wage for community health workers, critical posts in health, and management of the justice system.
  - Changes to grant structures amounting to R14.7 billion will promote upgrading of informal settlements in partnership with communities. Housing subsidies amounting to R1 billion will be centralised to better support middle- and lower-income home buyers.
  - In the current year: R1.7 billion added to infrastructure spending (including funding for school building programmes), and R3.4 billion allocated to drought relief, mostly for water infrastructure

Progress on economic stimulus and recovery plan (2)

- **Infrastructure fund**
  - Government is working with development finance institutions (DFIs) and private-sector partners on an infrastructure project preparation facility
  - To strengthen accountability and transparency, government will publish online expenditure reports of current infrastructure projects
  - Government is negotiating access to funding from DFIs, multilateral development banks and private banks. These institutions have committed technical resources to help plan, approve, manage and implement projects
  - Work is under way to design a fund that supports “blended” finance, combining capital from the public and private sectors, and DFIs

- **Investing in municipal social infrastructure improvement**
  - Consideration is being given to increased infrastructure financing from municipal borrowing and own-revenue, including development charges
  - Government aims to improve the use of existing municipal infrastructure grants, through incentives and stronger national support and oversight

Revenue outlook has deteriorated

- Total revenue shortfall for 2018/19 will amount to R27.4 billion, reflecting:
  - R9 billion in upward revisions to the VAT refunds estimate
  - R7.4 billion shortfall in corporate and personal income tax
  - R11 billion to reduce the backlog of VAT refunds. The refunds payment is a once-off
- Revenue is projected to fall short of budgeted estimates by R24.7 billion in 2019/20 and R33 billion in 2020/21. Tax buoyancies have been revised down over the medium term

Revised revenue projections

R billion	2018/19	2019/20	2020/21	2021/22
2018 Budget	**1 345.0**	**1 454.8**	**1 581.9**	
Buoyancy	*1.51*	*1.13*	*1.13*	
Revised estimates	**1 317.6**	**1 430.1**	**1 548.9**	**1 674.8**
Buoyancy	*1.21*	*1.17*	*1.07*	*1.04*
Change since 2018 Budget	**-27.4**	**-24.7**	**-33.0**	

Source: National Treasury

- Earlier this year, a panel of experts was commissioned to investigate mitigating the effect of the VAT rate increase on low-income households. Government proposes zero-rating of white bread flour, cake flour and sanitary pads from 1 April 2019

Fiscal framework

2018 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- Maintain the main budget expenditure ceiling
- Avoid increases in the major tax instruments, unless the economic environment requires it
- Retain national departments' compensation ceilings which implies continued restrictions on personnel budgets and public employment

Consolidated government fiscal framework

	2017/18	2018/19	2019/20	2020/21	2021/22
R billion/percentage of GDP	**Outcome**	**Revised**	**Medium-term estimates**		
Revenue	**1 360.0**	**1 467.2**	**1 582.0**	**1 705.1**	**1 840.0**
	28.8%	*29.1%*	*29.2%*	*29.2%*	*29.3%*
Expenditure	**1 549.5**	**1 669.2**	**1 808.4**	**1 950.9**	**2 091.1**
	32.8%	*33.1%*	*33.4%*	*33.4%*	*33.2%*
Budget balance	**-189.6**	**-202.0**	**-226.4**	**-245.8**	**-251.1**
	-4.0%	*-4.0%*	*-4.2%*	*-4.2%*	*-4.0%*
Total gross loan debt	**2 489.7**	**2 817.7**	**3 038.4**	**3 349.6**	**3 679.9**
	52.7%	*55.8%*	*56.1%*	*57.4%*	*58.5%*

Source: National Treasury

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In-year expenditure ceiling is also maintained

- In-year adjustments of R17.4 billion are offset by the use of the contingency reserve, provisional allocations, projected underspending and declared unspent funds.

Revisions to the 2018/19 expenditure ceiling

	R million
Expenditure ceiling: 2018 Budget Review	**1 315 002**
Upward expenditure adjustments	**17 392**
Budget Facility for Infrastructure projects and project preparation	870
Schools infrastructure backlogs grant	800
Drought relief	3 412
Financial support to state-owned companies:	
Special Appropriation Bill: South African Airways	5 000
South African Express Airways	1 249
South African Post Office	2 947
Commissions of inquiry into tax administration and state capture	409
Self-financing[1]	1 777
Roll-overs and unforeseeable and unavoidable expenditure	927
Downward expenditure adjustments	**(17 529)**
Declared unspent funds	(329)
Contingency reserve	(8 000)
Provisional allocation for contingencies not assigned to votes	(6 000)
National government projected underspending	(2 700)
Local government repayment to the National Revenue Fund	(500)
Revised expenditure ceiling	**1 314 865**

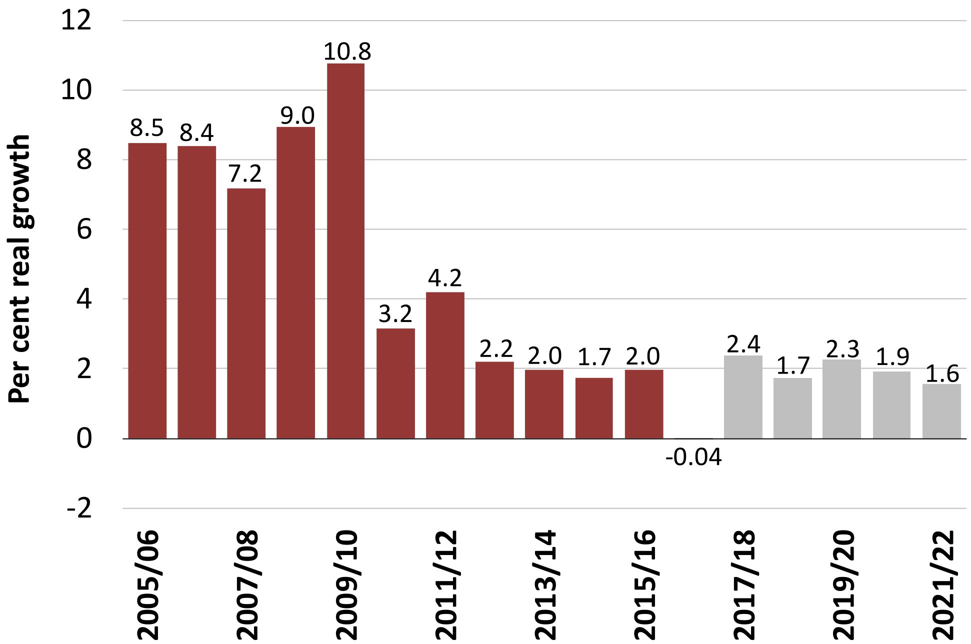
1. Spending financed from revenue derived from departments' specific activities

Source: National Treasury

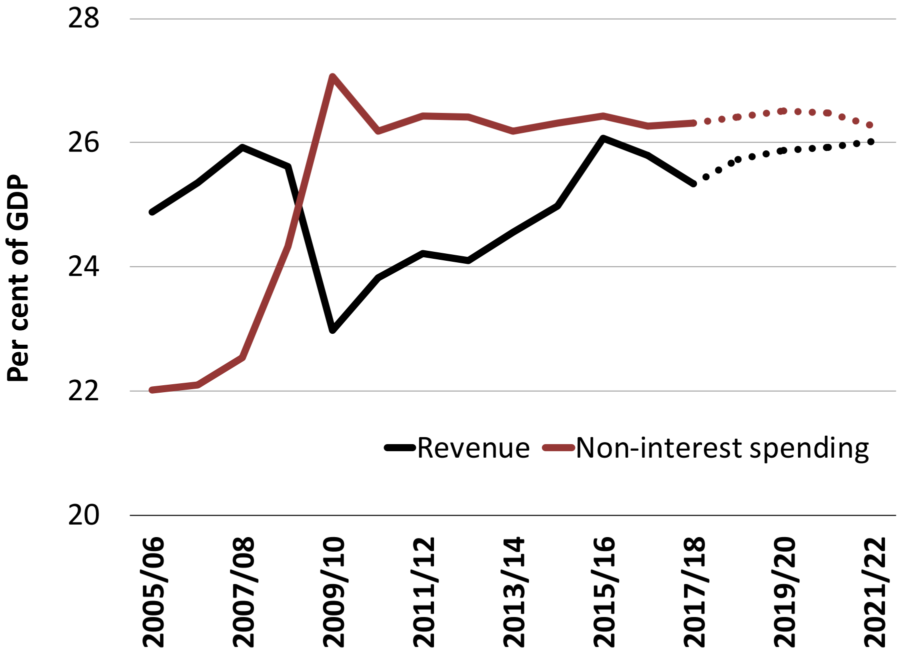
Main budget primary deficit narrows over medium term

- Main budget non-interest spending grows by an average 1.9 per cent per year
- Primary deficit narrows over time, reaching 0.2 per cent of GDP in 2021/22

Real main budget non-interest spending growth



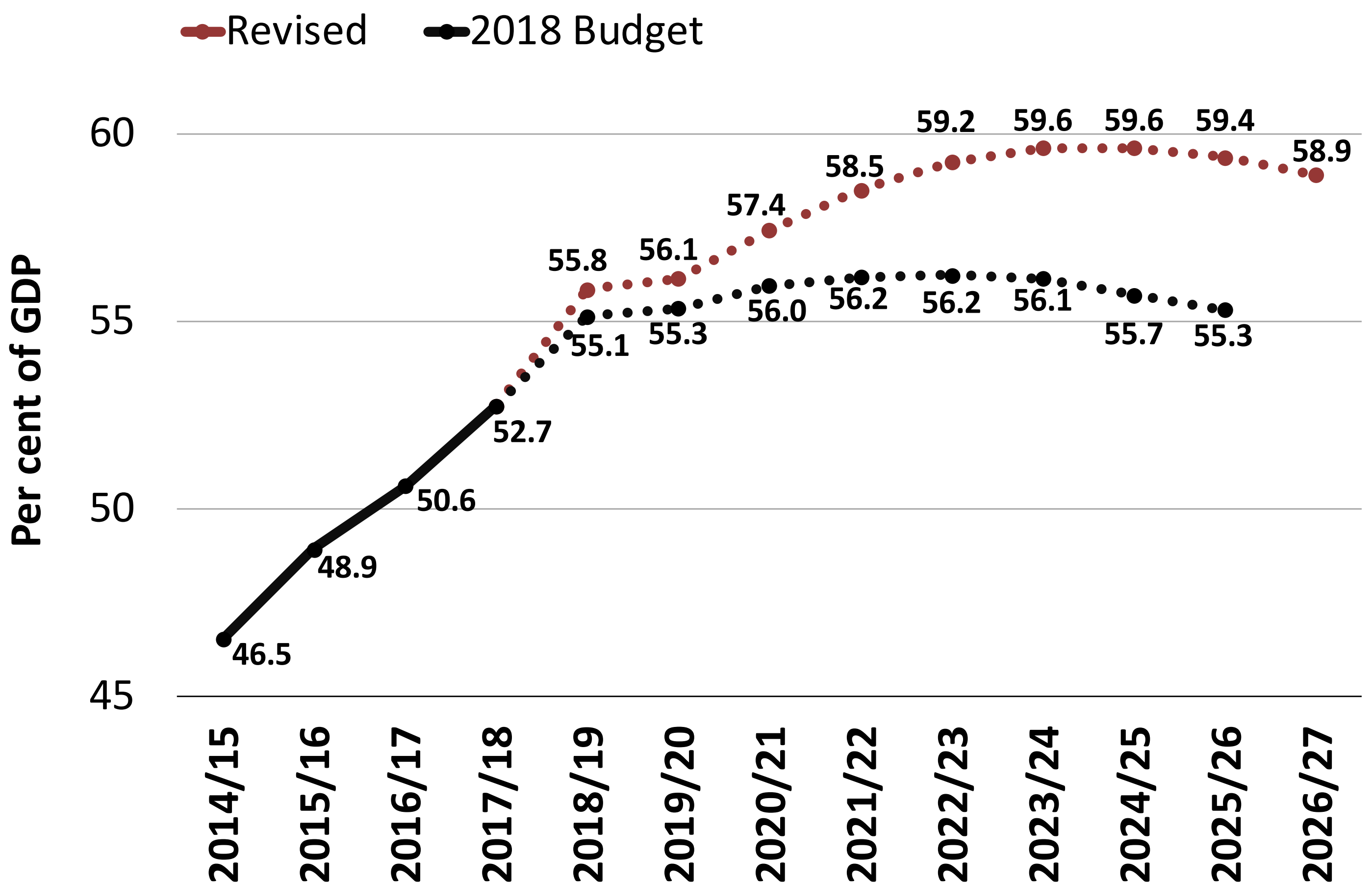
Main budget revenue and non-interest spending



Debt outlook

- Debt is expected to stabilise at 59.6 per cent of GDP in 2023/24
- In the current year, upward revisions to gross loan debt reflect the wider deficit and weaker exchange rate

Gross debt-to-GDP outlook



Compensation is a major driver of spending

- Compensation has grown from 32.8 per cent of total spending in 2006/07 to 35.2 per cent in 2017/18, putting pressure on goods and services and capital investment
- The 2018 public-service wage agreement exceeds budgeted baselines by about R30.2 billion through 2020/21. National and provincial departments are expected to absorb these costs within their R1.8 trillion compensation baselines over the same period
- Government is working on options to manage these pressures over the medium term

Table B.1 Consolidated spending

R million	2006/07	2017/18	Annual growth	% of 2006/07 spending	% of 2017/18 spending
	Outcome				
Current payments	**317 280**	**939 735**	**10.4%**	**61.2%**	**60.6%**
Compensation of employees	170 288	546 194	11.2%	32.8%	35.2%
Goods and services	91 506	223 521	8.5%	17.7%	14.4%
Interest and rent on land	55 486	170 020	10.7%	10.7%	11.0%
Transfers and subsidies	**171 241**	**507 740**	**10.4%**	**33.0%**	**32.8%**
Payments for capital assets	**28 491**	**81 746**	**10.1%**	**5.5%**	**5.3%**
Payments for financial assets	**1 435**	**20 318**	**27.2%**	**0.3%**	**1.3%**
Total	**518 447**	**1 549 538**	**10.5%**		
GDP	1 911 150	4 720 955	8.6%		

Source: National Treasury (budget data)

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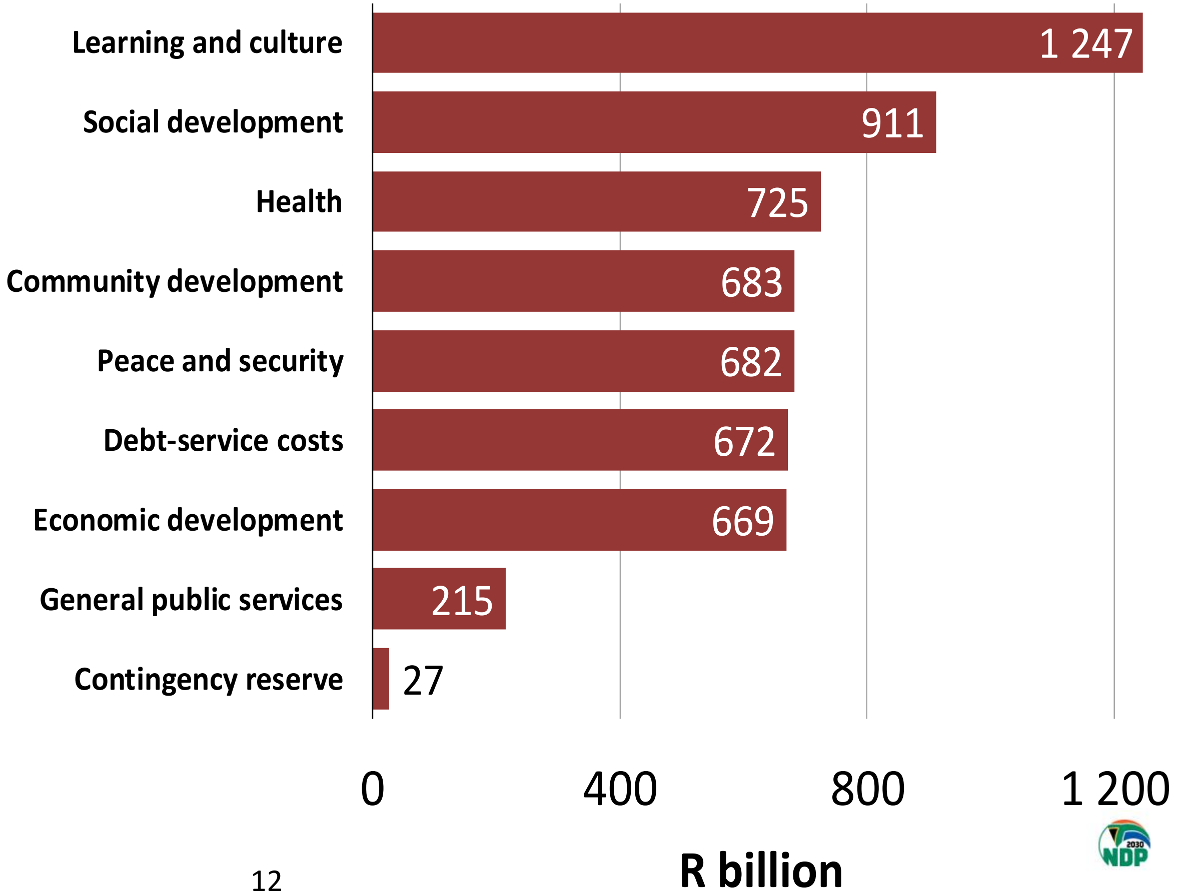
Expenditure priorities

- The budget continues to prioritise social spending including education, health, the provision of water and electricity services, and social grants
- These commitments support economic and social development, and ensure sustainable support to millions of South Africans who live in poverty

- Of the R1.7 trillion allocated to consolidated expenditure in 2018/19:
  - 15 per cent goes to basic education
  - 12 per cent goes to public health
  - 12 per cent goes to social protection
- R3.3 trillion, or 56.2 per cent of total consolidated spending over the next three years, will be allocated to social spending

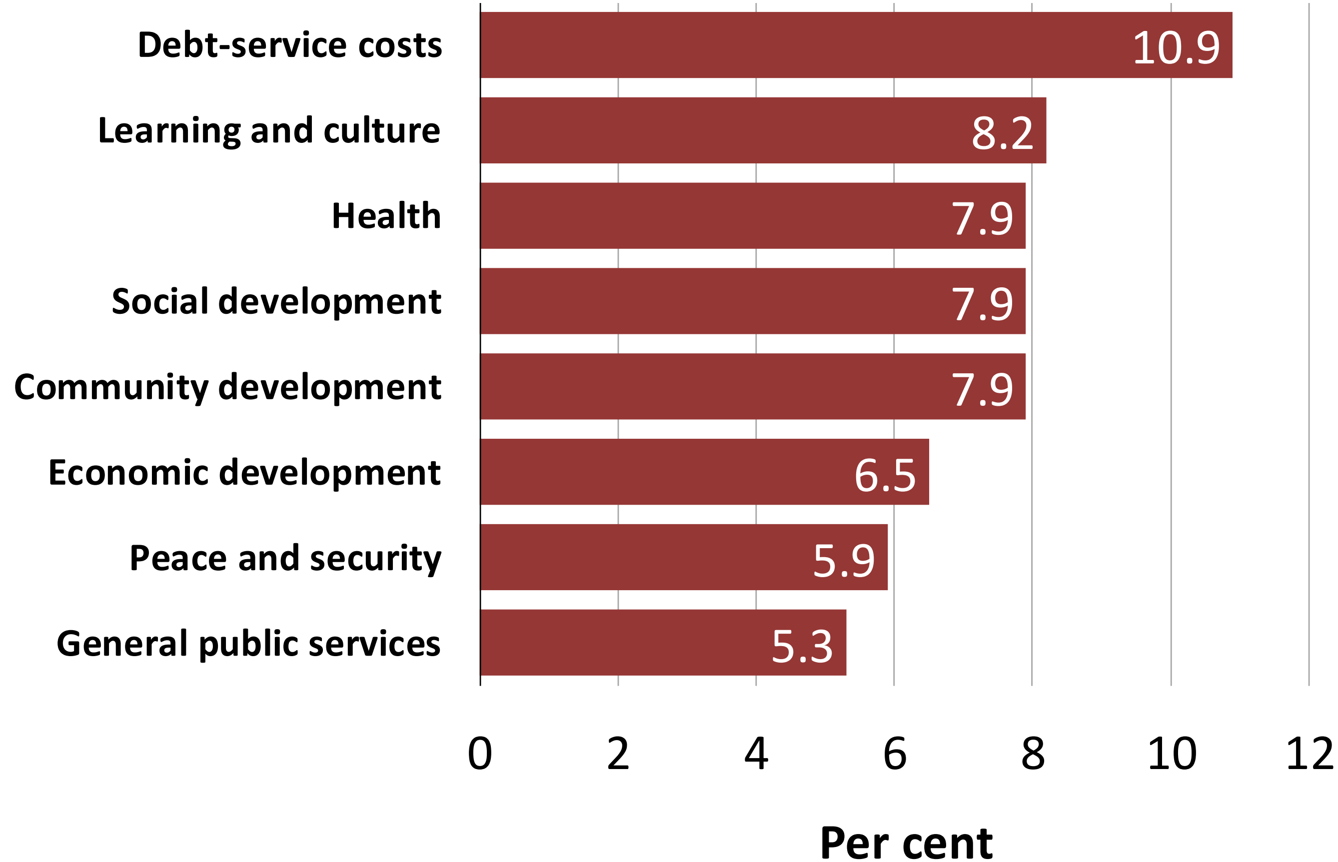
Consolidated government expenditure by function, 2019/20 – 21/22



Debt-service costs are the fastest growing area of spending

- Rising debt-service costs reflect the widening of the budget deficit and projected increases in debt
- The second fastest-growing category is learning and culture, followed by health
- High growth in learning and culture reflects the bursary scheme for poor and working-class students

Average nominal growth in spending, 2019/20 – 21/22



Division of revenue

2018 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- The proposed division of revenue continues to prioritise large social spending programmes that support basic education, health, social welfare services, water, sanitation and electricity services
- Over the medium term, government proposes to allocate national departments 48.1 per cent of available non-interest expenditure, provinces 42.9 per cent and local government 9 per cent
- On average, national government resources grow by 7 per cent, provincial resources by 7.2 per cent and local government resources by 7.2 per cent per annum

Division of revenue framework

R billion	2015/16	2016/17 Outcome	2017/18	2018/19 Revised	2019/20	2020/21 Medium-term estimates	2021/22
Division of available funds							
National departments	**546.1**	**555.7**	**592.7**	**641.5**	**688.1**	**739.4**	**786.4**
Provinces	**471.4**	**500.4**	**538.6**	**572.2**	**613.0**	**658.6**	**704.0**
Equitable share	386.5	410.7	441.3	470.3	505.5	543.0	578.7
Conditional grants	84.9	89.7	97.2	101.9	107.4	115.6	125.3
Local government	**98.3**	**102.9**	**111.1**	**121.8**	**127.3**	**138.2**	**149.9**
Equitable share	49.4	50.7	55.6	62.7	69.0	75.7	82.2
General fuel levy sharing	10.7	11.2	11.8	12.5	13.2	14.0	15.2
Conditional grants	38.3	40.9	43.7	46.6	45.1	48.5	52.6
Total	**1 115.8**	**1 159.0**	**1 242.3**	**1 335.5**	**1 428.4**	**1 536.2**	**1 640.3**
Percentage shares							
National departments	48.9%	48.0%	47.7%	48.0%	48.2%	48.1%	47.9%
Provinces	42.2%	43.2%	43.3%	42.8%	42.9%	42.9%	42.9%
Local government	8.8%	8.9%	8.9%	9.1%	8.9%	9.0%	9.1%

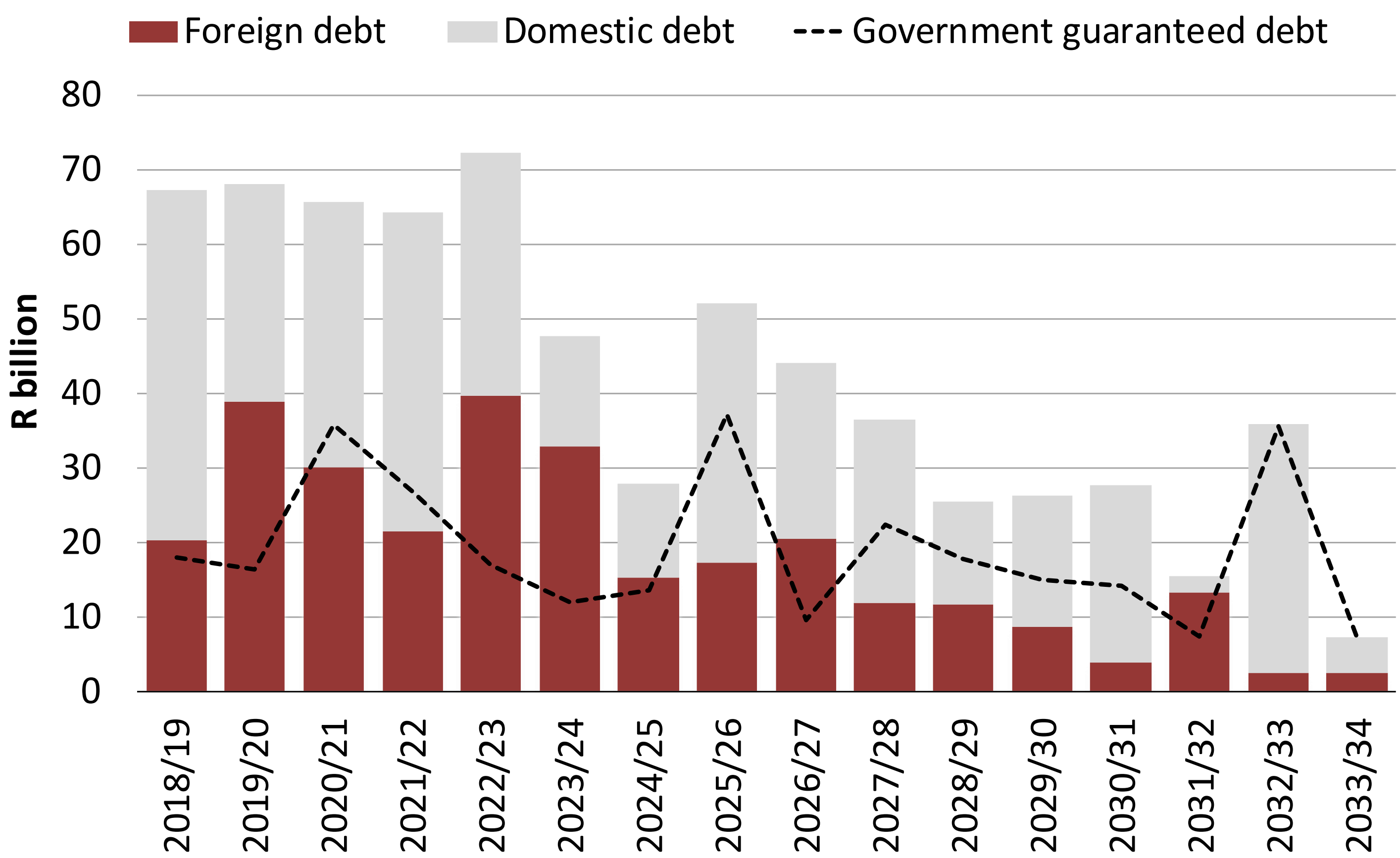
Source: National Treasury

State-owned companies are a major risk to public finances

2018 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- SOC debt redemptions over the medium term are expected to average R66 billion per year
- Several SOCs are not making sufficient profits to be able to service debt obligations falling due

SOC debt redemptions



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Initial steps to reform state-owned companies

- Over the past year, new boards and executives have been appointed at Denel, Transnet, South African Express Airways and the Passenger Rail Agency of South Africa
- SAA has found R400 million in procurement savings, begun turning profits on most domestic and regional routes, and removed several senior officials linked to malfeasance.
- The Auditor-General is working with private firms to audit several state-owned companies. To date, previously unreported irregular expenditure amounting to R27 billion has come to light
- The boards of state-owned companies have initiated forensic investigations into allegations of corruption
- The Eskom board is preparing a long-term turnaround strategy to be presented to government in November 2018, and several other entities have recently updated their turnaround strategies

Rebuilding state institutions

- Some national, provincial and municipal departments are in financial disarray. Latest Auditor-General findings show increasing levels of irregular spending
- Government has begun the process of rebuilding important state institutions
  - Judicial Commission of Inquiry into Allegations of State Capture
  - Commission of Inquiry into Tax Administration and Governance by the South African Revenue Service
- National Treasury's efforts to strengthen financial management include:
  - Assisting SARS to regularise VAT refund payments and rebuild capacity
  - Working with the Auditor-General and law enforcement agencies to reduce irregular expenditure in government, while improving transparency to reduce corruption
  - Enhancing capacity-building in local government by deploying skilled professionals to manage and recover revenue
  - Introducing a strategic framework to support more efficient, cost-effective and transparent procurement efforts, particularly in the health sector
  - Developing a framework that will include financial recovery plans to address non-performing departments

Conclusion

- Public resources cannot be substantially expanded without faster economic growth and job creation. Over the period ahead, government is focusing on reforms that support growth, stabilise state institutions, and improve service delivery
- In-year growth outlook has been revised down sharply, and revenue shortfalls for 2018/19 — 2020/21 remain significant
- Despite spending pressures materialising, the expenditure ceiling remains intact as the anchor of fiscal policy. Real non-interest spending grows by 1.9 per cent per annum prioritising education, social welfare, and health
- The weaker growth outlook, medium-term revenue shortfalls, and weaker rand result in debt stabilising at 59.6 per cent of GDP in 2023/24
- Key fiscal risks in the period ahead include weak economic growth, uncertainty in the revenue outlook and the poor financial position of state-owned companies