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2 November 2020

MTBPS 2020: Securing economic recovery beyond COVID -19

The Medium Term Budget Policy Statement (MTBPS) is a key milestone in Parliament's fiscal oversight cycle. It is the first juncture at which Parliament and civil society are able to engage meaningfully with budget proposals, and will culminate in the Budget tabled in February 2021.

This brief provides a snapshot of the emergent outlook with regard to the country's economy, fiscal and expenditure capability for the 2021/22 medium term.

1. The Economic Outlook

- **Global economic outlook and the positioning of South Africa's economic growth**.
  - The COVID-19 pandemic, which necessitated various mitigation measures such as stringent lockdowns, travel restrictions and closure of schools and non-essential business, has negatively affected global economic activity and external demand.
  - Global growth is projected at -4.4 per cent in 2020.[1] A partial recovery from the deep recession can be expected in 2021. The International Monetary Fund (IMF) expects global growth to rebound to 5.2 per cent in 2021.
  - With the exception of China, advanced economies, emerging market and developing economies are projected to experience negative growth in 2020. Advanced economies recover at a slower rate than emerging market and developing economies in 2021.
    - The growth rate of advanced economies is projected to fall by 5.8 per cent in 2020, while emerging markets and developing economies are projected to contract by 3.3 per cent.[2]
    - In 2021, advanced economies and emerging market and developing economies are expected to recover by 3.9 per cent and 6.0 per cent, respectively.[3]
    - China's growth is projected at 1.9 per cent in 2020 and is expected to strengthen to 8.2 per cent in 2021[4] .
  - Despite moderate recovery being projected for 2021, downside risks could serve to deepen the global recession or delay recovery. The main risks to the global outlook are the following:
    - The possibility of a new wave of outbreaks may mean that countries have to re-impose stricter mitigation measures, which could result in a prolonged decline in economic activity.[5]

[1] IMF (2020)
[2] Ibid. (2020)
[3] IMF (2020)
[4] Ibid. (2020).

- Global spill-overs from weaker tourism and lower remittances as well as cross-border spill-overs from weaker external demand can impact negatively on global growth. [6]
- The ongoing trade tensions between the United States of America and China could have negative implications for global economic activity[7].

- **South Africa's economic growth outlook has worsened. This exacerbates existing levels of poverty and inequality.**

    - In contrast to the 2020 Supplementary Budget growth forecast of -7.2 per cent, South Africa's real GDP growth is now projected to contract by 7.8 per cent in 2020.[8] Over the medium term, a moderate recovery is expected. Real economic growth is projected at 3.3 per cent in 2021, 1.7 per cent in 2022 and 1.5 per cent in 2023[9].
    - In the second quarter (Q2) of 2020, the agriculture, forestry and fishing industry was the only positive contributor to GDP growth. The sector's real output increased by 15 per cent, which translates to a contribution of 0.3 percentage points to growth in GDP in Q2 of 2020[10]. This increase is attributable to the increased production of field crops, horticultural and animal products.
    - The manufacturing, trade and transport industries were the largest negative contributors to growth in GDP in Q2 in 2020[11]. The decline in production in these sectors was mainly as a result of the COVID-19 lockdown restrictions:
        - The manufacturing sector contracted by 74.9 per cent, which translates to a contribution of -10.8 percentage points to GDP growth.
        - The trade, catering and accommodation industry saw a decline of 67.6 per cent and contributed -10.5 percentage points to GDP growth.
        - The transport, storage and communication industry contracted by 67.9 percentage and contributed to -6.6 percentage points to GDP growth.

- **COVID-19 has resulted in millions of people losing their jobs. Tax revenues are suppressed and there are increasing demands on the fiscus.**

    - According to Statistics SA, the economy shed about 2.2 million jobs in Q2 of 2020. This was as a result of the hard lockdown, which saw many businesses closing and many prospective job seekers unable to look for work[12].

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[5] IMF (2020)
[6] Ibid. (2020)
[7] Ibid. (2020)
[8] National Treasury (2020)
[9] Ibid. (2020)
[10] StatsSA (2020a)
[11] Ibid. (2020)
[12] StatsSA (2020b)

- Compared to the first quarter (Q1) of 2020, the country's official unemployment rate, which is calculated using the number of persons who are employed and unemployed but excludes economically inactive[13] persons, has fallen to 23.3 per cent in the Q2 of 2020[14].
- The expanded unemployment rate, which considers economically inactive persons, increased from 39.7 per cent in Q1 of 2020 to 42 per cent in Q2.
- With the already high unemployment levels and pervasive poverty, the pandemic has compounded these challenges, which puts more pressure on the State to provide social grants and other relief measures.

- **The inflation outlook**

  - Inflation remains well within the South African Reserve Bank (SARB) target range of 3-6 per cent. The consumer price index (CPI) inflation forecast for 2020 has been revised downwards to 3.2 per cent, from an estimated 4.5 per cent at the time of the 2020 February Budget.[15]
  - According to the South African Reserve Bank (SARB), the overall risks to the inflation outlook are balanced. Oil prices remain low and local food price inflation is expected to remain contained[16]. Furthermore, risks associated with inflation from currency depreciation are expected to remain muted[17].

- **SARB has steadily cut rates so as to mitigate the impact of the pandemic**

  - The repurchase (repo) rate[18] stands at 3.5 per cent. In response to the impact of the COVID-19 pandemic on South Africa's economy, the repo rate has been cut by 300 basis points in 2020.

- **Business and consumer confidence remains depressed**

  - In comparison to the second quarter of 2020, both business and consumer confidence improved in the third quarter but remains depressed[19]. This is largely owing to the effects of the COVID-19 pandemic and the related economic restrictions, which have delayed the full recovery of business and consumer confidence.

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[13] A person is considered to be economically inactive if they were able and available to work in the week prior to the Quarterly Labour Force Survey being administered, but did not work or look for work or start their own business.

[14] Stats SA (2020b)

[15] National Treasury (2020)

[16] SARB (2020)

[17] Ibid. (2020)

[18] The repo rate determines the interest rate at which the central bank lends money to commercial banks — which then affects the amount they lend to their consumers.

[19] BER (2020)

- **Credit downgrades still remain a factor to observe. According to the MTBPS, further downgrades can be anticipated**

  - In the context of subdued economic growth, unsustainable debt levels and continuous cash injections to support debt-laden State-Owned Enterprises (SOEs), further sovereign credit downgrades will exacerbate the impact of the pandemic and it may hamper the implementation of economic reforms that could assist the country's recovery post-COVID-19.
  - Further downgrades will also serve to increase the already rising costs of borrowing and servicing public debt, as well as, lowering investment confidence.

- **Summary of Key Economic Indicators**

  - Table 1 below summarises the aforementioned key economic indicators. It compares the projected growth rates of key indicators prior to the pandemic (at the time of the February 2020 Budget) with the projected growth rates that factor in the pandemic.

Table 1: Key Economic Indicators, pre-pandemic vs current period, 2020

Indicators	2020 Budget (pre-pandemic)	2020 Supplementary Budget (pandemic)	2020 MTBPS (pandemic)
Real GDP Growth	0.9%	-7.2 %	-7.8%
Official Unemployment Rate	29.1 % (Q4 of 2019)	30.1 % (Q1 of 2020)	23.3% (Q2 of 2020)
Expanded Unemployment Rate	38.7%	39.7%	42%
CPI Inflation	4.5%	3.0%	3.2%
Repo Rate	6.25%	3.75%	3.5%

Source: National Treasury (2020b and 2020c); SARB (2020); Stats SA (2020b)

2. The Fiscal Outlook

- Revenue continues to fall sharply worse than the 2019 special adjustment supplementary budget, with a significant decline in most tax categories amplified by weaker wage and economic growth.

- Tax estimate underperformance in the 2020 Adjustment budget was R304 million while the National Treasury estimated a further R8.7 billion decline during the MTBPS bringing the total gross tax revenue to R312.8 billion below the 2020 Budget forecast.

- There are several factors affecting revenue collection in the current financial year: decline in personal income tax due to lockdown, restrictions on tobacco sales and reduced VAT as a result of sharp decline in consumption.

- Over the MTEF, collection in tax revenue will be affected as a result of low economic activity during a crisis. It is expected that revenue shortfalls will affect the tax-GDP ratios only showing signs of recovery in 2027/28.

- South African Customs Union and other non-tax estimates were also revised downwards for the next two years compared to the 2020 Budget.

- In order to maximise tax collection, South African Revenue Service (SARS) must continue to rebuild its capacity following years of mismanagement in order to assist with fiscal consolidation. Some of the objectives identified include focusing on transfer pricing, illicit trade and increasing enforcement to eliminate fraud and tax crimes.

- Specific tax announcements are seldom announced in the MTBPS but in the 2020 Special Adjustment Budget, government adopted the active scenario approach signalling that in the 2021 Budget, there will be tax increases.

- It is unknown which tax instrument is being targeted to obtain the additional R5 billion in 2021/22. Households are already indebted by the pandemic and it will be interesting to see the policy direction the Executive will enforce. Increasing VAT will impact negatively impact consumers especially the poor.

- **The medium term expenditure outlook**

    - The MTBPS proposes a five-year fiscal consolidation pathway that promotes economic growth while bringing debt under control through shifting the composition of government expenditure away from consumption spending towards investment and supporting efforts to lower the cost of capital.
    - Relative to the 2020 main budget, the MTBPS proposes budget cuts of R60 billion in 2021/22, R90 billion in 2022/23 and R150 billion in 2023/24 with constrained spending growth in the following two years. Measures for fiscal consolidation are increasingly becoming limited thus the majority of reductions are effected on compensation.
    - Protracted implementation of fiscal austerity[20] leads to rising unemployment, falling incomes and increased inequality. National Treasury contends that countercyclical measures such as a temporary fiscal expansion in the current period of stagnant growth will not realise the expected increases in GDP.
    - In the medium term, National Treasury will review the assumptions underlying the budget and implement the principles of zero-based budgeting to address the negative impact of waste and unsustainable incremental increases to spending.

- **The budget deficit is likely to increase further, implications thereof (more borrowing)**

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[20] Fiscal austerity policies implemented by the state often include spending cuts, regressive tax increases or a combination of both.

- The revised main budget deficit is projected to be R707.8 billion in 2020/21. The MTBPS targets to narrow the consolidated deficit from 15.7 per cent of GDP in the current year to 7.3 per cent by 2023/24
- Low revenues, high debt-service costs and requests for capital injections from state owned companies pose a significant challenge to addressing the widening budget deficit

- **Debt is increasing rapidly and will likely stabilise at 95.3 per cent of GDP within the next five years**

  - Gross government debt is expected to rise sharply in the current year to R4 trillion – 65.6 per cent of GDP – and reach R5.5 trillion or 81.8 per cent of GDP in 2023/24.
  - The widening budget deficit and steep economic contraction has increased government estimated borrowing requirement from R342 billion to R774.7 billion for the current year. The debt portfolio remains within its strategic benchmarks as an active debt management strategy has served to mitigate risks from elevated market volatility.
  - In response to developing market bond sell-off, Government revised its financing strategy to make use of sterilisation and foreign currency deposits at the Reserve Bank and new loans from international finance institutions to meet its borrowing requirement.
  - Debt service costs are projected to rise to 4.8 per cent of GDP and continue to threaten to displace spending on social protection and realignment of spending towards the requisite investment that would be catalytic for economic growth.
  - High debt - even if stable - constrains the scope for future discretionary policy, retards potential growth, and leaves the economy susceptible to further market shocks.

- **The COVID-19 pandemic and associated economic restrictions exert significant financial pressure on State Owned Entities, increasing the likelihood of government intervention in the form of contingent liabilities and direct requests for state financial support, thus intensifying aggregate fiscal risks**

  - Contingent liabilities are comprised of government guarantees to state-owned companies, public-private partnerships (PPPs), and obligations to the Road Accident Fund and other social security funds; and are projected to exceed R1 trillion by 2022/23.
  - Government’s guarantee portfolio has increased steadily from R680 billion in March 2019 to R693.7 billion in March 2020, representing an increase of 2.01 per cent. In addition, the June 2020 Special Adjustments Budget further extended a R200 billion credit guarantee scheme to support distressed businesses and enable them to withstand the economic pressures of the COVID-19 pandemic.
  - Eskom is overburdened with debt and at R350 billion receives that largest portion of government guarantee portfolio. While Government has committed to providing funding support of R56 billion in 2020/21 and R33 billion in 2021/22, the entity faces heightened liquidity challenges owing to declining revenues, a high cost structure and rise in arrear debt
  - Several SOCs, including South African Airways (SAA) South African National Road Agency (SANRAL) and Denel, are technically insolvent and have insufficient funds to cover operational expenses thus placing additional pressure on public expenditure.

- The sovereign credit rating downgrade has had a knock-on effect on the credit rating of state owned companies thus adversely affecting their ability to access capital market funding and increasing the future cost of borrowing. The deteriorating operating environment is further exacerbated by the COVID-19 pandemic, triggering lenders to call on the guarantees of South African Express and the Land Bank thus increased risk of larger calls on guaranteed debt remain.

3. Measures to enhance inclusive growth

- **Medium Term Spending Priorities: Protecting the Social Wage, Promoting Investment, Economic Recovery and Job Creation**
  - The consolidated spending amounts to R6.2 trillion over the 2021 medium term expenditure framework. The focus is on economic recovery, shifting the composition of spending from consumption to investment, protecting the social wage, and promoting and job creation.
  - In terms of protecting the social wage, the 2020 MTBPS is consistent with previous budgets. The Budget continues to channel significant resources to education, social development, health (as shown in Table 2 below).

Table 2: 2021 Medium Term Consolidated Spending Priorities

	Amount
Learning and Culture	R1.2 trillion
Social Development	R978 billion
Health	R724 billion

- **Promoting Economic Recovery**
  - A significant part of the 2020 MTBPS is about supporting the Economic Recovery and Reconstruction Plan for South Africa.
  - The Plan focuses on investment in infrastructure, expanding electricity generation, allocating digital spectrum, and supporting rapid industrialisation and employment.
  - The primary objective is to stimulate equitable and inclusive growth, and redress broader fiscal weaknesses prompted by the Covid-19 pandemic.
  - The Plan is strategically linked to the key objectives and priorities as set out in the National Development Plan and Vision 2030 for South Africa.
  - The Economic Recovery Plan is set to support a strong rebound in economic activity and subsequently usher in a primary main budget surplus by 2025/2026.
  - The MTBPS centres the success of the Economic Recovery Plan on structural reforms, which will be championed by Operation Vulindlela

- **Infrastructure Investment**

- The 2020 MTBPS emphasise infrastructure investment, which is the focal point of the Economic Recovery Plan.
- The pronouncement of the infrastructure investment build in the 2020 Special Adjustments Budget, unveils a R100 billion infrastructure investment for the next ten (10) year horizon. Of the R100 billion injection into infrastructure projects, R18 billion is targeted for the current medium term period.
- To ensure effective and efficient utilisation of the budget for infrastructure, the MTBPS places emphasis on various mechanisms such as the Investment and Infrastructure Office in The Presidency, the Public Procurement Bill, and the Budget Facility for Infrastructure (BFI).

- **Promotion of Job Creation**

    - The MTBPS presented a total of R12.6 billion to fund various employment initiatives in the 2020/21 financial year. Some of which include:
    - An additional R7 billion to the Provincial Equitable Share to support jobs at fee-paying public schools and government-subsidised independent schools.
    - R600 million to employ early childhood development and social workers
    - R2 billion is allocated to Working for Fire, Working for Water and Working for Forests.
    - The rest of the allocation from the employment initiative is divided between the transport, arts, sports and culture, health and agricultural sectors.

4. The Division of Revenue

- **Given the impact that the COVID-19 pandemic has had on the economy in terms of both output and job losses, large revenue shortfalls will persist over the medium-term. Revenue shortfalls together with increasing debt service costs means that growth in expenditure will be limited to ensure the stabilisation of debt and the achievement of fiscal discipline.**

    - National, Provincial and Local Government will face increasing budgetary pressure over the medium-term as the Government reduces expenditure growth. The Government proposes to rein-in expenditure growth as follows:

        - National Government allocations will decline by 3 per cent on average annually;
        - Provincial transfers will increase by 0.9 per cent; and
        - Local Government transfers will increase by 2.1 per cent.

    - Relative to the 2020 Budget, the Provincial transfers will be reduced as follows:

        - The provincial equitable share will be reduced by R60 billion in 2021/22, R85.6 billion in 2022/23 and R64.1 billion in 2023/24.
        - The reductions to the provincial equitable share include the proposed reductions to the compensation of employees announced in the 2020 Budget.

        - Reductions to conditional grant transfers will amount to R12.1 billion, over the medium-term.

    - Over the 2021 medium-term, Local Government transfers will be reduced by R17.7billion, which is comprised of:

        - R14.5 billion reduction to the Local Government equitable share;
        - R2.7 billion from the general fuel levy; and
        - R569 million reduction to direct municipal conditional grants.

- **Over the medium-term, Provinces and municipalities budgets will also face pressure from the effects of poor economic performance (exacerbated by the Covid-19 pandemic) on revenue and other funding sources.**

    - Rural Provinces and municipalities are more dependent on national transfers than their urban counterparts and are more likely to be affected by the proposed reductions in transfers and reductions in available own revenue sources.

        - It is imperative that all Provinces and Municipalities respond appropriately to the reduced transfers and own revenue by ensuring that expenditure is reprioritised within the available budget and efficiencies are improved and realised.

- **The Government will continue to work together with Provinces and Municipalities to ensure that service delivery is not compromised, because of the proposed expenditure reductions.**

    - The Provincial equitable share formula will be reviewed to include refinements to assist in addressing the costs associated with service delivery in rural and urban locations.
    - The Local Government Fiscal Framework structure will be reviewed to address unfunded budgets, municipal sustainability, and structural and operational challenges that impede the effective functioning of municipalities.

Concluding remarks

- Expenditure growth will be constrained by national revenues shortfalls and the implementation of debt stabilisation measures over the medium-term, which means that transfers to the National, Provincial and Local Government will grow below inflation or contract over the 2021 medium-term.
- Provinces and municipalities budgets, also face additional budgetary pressure as own revenue and other funding sources are further constrained by the effects of poor economic performance exacerbated by the Covid-19 pandemic.
- It is imperative that Provinces and Municipalities respond appropriately to the reduced transfers and own revenue by ensuring that expenditure is reprioritised within the available budget and efficiencies are improved and realised. More than ever, it is important that Municipal Councils ensure that adopted budgets are fully funded, as they cannot rely on national transfers to breach any shortfalls.

- Fiscal risks have increased, namely, SOE government-backed guarantees and the failure of SOEs to fulfil their mandate affects economic growth.
- Mismanagement of public funds needs to be eliminated and be followed by consequence management.

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