Government finances – were they saved by a few "once-off's"?

The economy is widely believed to have contracted in the third quarter (and possibly in Q4 as well), in large part because of the eruption of social unrest in July that rocked Gauteng and KZN. Furthermore, load shedding has returned with a vengeance, metals prices have been cooling off, and who knows what renewed lockdown restrictions lie ahead to ruin the festive season. Hence it was with great anticipation that we waited for the "midyear" update from the new Minister of Finance to tell us how the Government is doing given both constraints and windfalls. Fortunately, Mr Godongwana delivered a muted yet market-friendly update: we (Government) are going to spend less, earn more and pay off debt (or reduce the deficit as % of GDP as it's more commonly referred to). A few windfalls saved the day - higher corporate taxes especially from the mining industry and upwardly revised GDP statistics for South Africa. Will expenditure be reduced, and will there be no more bailouts? Following the municipal elections, there appears to be a mood swing in SA. Hopefully this positive mood will last and words turn into action.

Willie Pelser

A lot has been written about the impact of Covid-19, the riots, load shedding, sentiment indicators, the local municipal elections and other factors such as the state of the global economy. Twice a year we wait for National Government to give us an update on how they have accounted for these factors in the State's coffers and their future forecasts. This time was no different. However, we can probably say that the key variables were different this time as it came "all at once", or at least that is how it felt for most of us.

After a Cabinet reshuffle when Mr Mboweni indicated that we want to farm and prep more meals in Magoebaskloof, Mr Enoch Godongwana was appointed the new Minister of Finance. His first mini-budget was delivered last week after having been postponed to make space for the local elections. Godongwana is no stranger when it comes to government data. He is the longest-serving economic policy intern to become finance minister given his role as head of the economic transformation committee of the ANC for more than a decade.

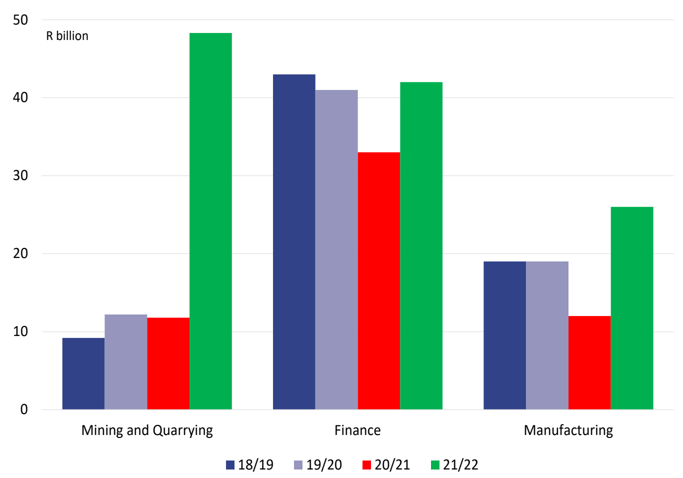
The country's eyes were firmly focused on him given numerous COVID-19 induced challenges and the issues around fiscal sustainability. Continuity of policy, structural reforms and the ability to hold the line, particularly regarding the government's commitment to containing civil servant wage increases, remain front and centre for all. The new minister was fortunate to take over the reins during a period of windfall gains on the revenue front. This has consequently improved the debt metrics considerably since the February budget speech projections, but it is widely recognized as being transitory. The Minister appears committed to fiscal consolidation and to have a similar inclination to his predecessor.

SPEED READ

- **The New Minister of Finance gave his first update on the state of government finances. It was well received by the financial markets.**
- **Budget numbers were "saved" by surplus corporate tax income after a commodity price boom.**
- **Containing expenditure remains the number one priority for South Africa given a large "Social Wage" packet.**

Early estimates indicate that Government will have a R128 billion tax overshoot relative to the 2021/22 Budget estimates. The reason behind this is an economy that has rebounded faster and stronger than anyone expected. However, the rebound is not internally driven (i.e. not relating to local consumption or infrastructure spending) but rather of an external nature. Global growth and specifically commodity prices ballooned, resulting in a buoyant local mining sector. The chart shows the big lift to corporate tax revenue from the mining and quarrying subsector of the economy relative to other sectors.

GOVERNMENT REVENUE OVERRUN



The commodity boom resulted in South African mining companies paying a much bigger tax bill.

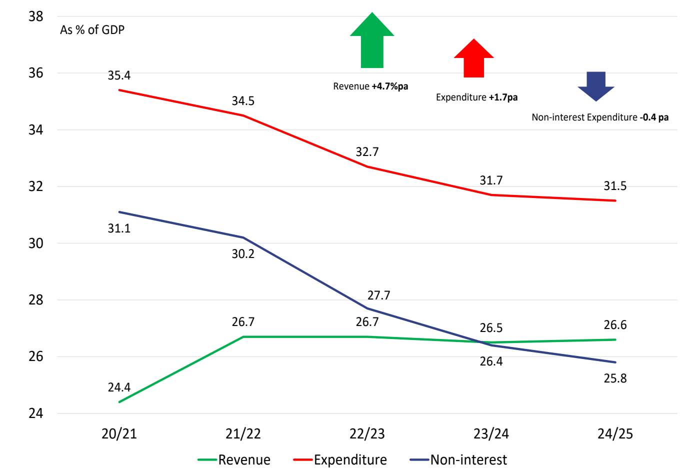
A standout in the Budget was that the Minister has not fallen into the trap of spending this surplus income. He was quite outspoken that South Africa cannot continue to distribute money for nothing. He indicated that government would opt to stay on the straight and narrow. Therefore, a more prudent narrowing of the budget deficit from 9.3% of GDP currently to 4.9% in 2025 financial year was tabled.

Let us assume that because National Treasury's future GDP forecasts are much more realistic (on average 1.7% for the next 3 years) their revenue estimates are achievable – illustrated by the green line in the chart below. Echoing this assumption was the Minister's comment that Government will not commit to new long-term spending in response to temporary revenue windfalls. As part of the assumption, it then all comes back to expenditure that needs to toe the line.

The chart below is based on Treasury's latest published numbers. The red line in the chart indicates that expenditure will slow down relative to revenue (or put another way - expenditure will be cut).

Our concern is the trajectory of the blue line in the chart. The biggest issue that South Africa faces is declining non-interest expenditure growth - spending on the things that make the average citizen's life better. The big bold arrows reflect this concern. Over the next three-year forecast period, revenue will on average grow by 4.7% p.a, expenditure by 1.7% p.a. - thereby reducing the deficit as indicated earlier - but spending on non-interest areas will actually contract by 0.4% per annum.

KEY FISCAL TRENDS IN SA

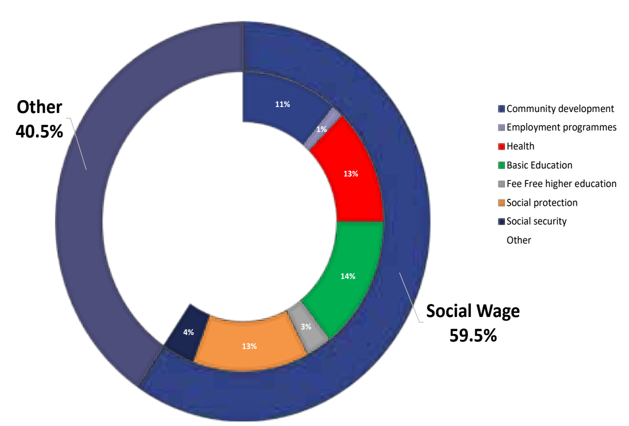


Reducing the budget deficit comes at a cost. Whilst it is important to see total expenditure falling, the cuts will come in the non-interest items, which is exactly where expenditure needs to be increased to improve lives and productivity.

What is the reason behind the decline in non-interest expenditure? It is simply because we have too much debt. The rebasing of our GDP numbers made the Debt / GDP metrics more manageable. However, the total amount of outstanding debt did not shrink just because we suddenly have a bigger economy. We still need to pay interest on this debt, which is crowding-out necessary productive expenditure that could be used to improve our productivity. Debt servicing costs alone comprise more than 20% of the revenue line and is expected to grow at more than 10% per annum.

The most interesting chart I discovered in a presentation released after the interim budget showed a breakdown of

SA: NON-INTEREST EXPENDITURE



Spending towards Social Health accounts for the majority of non-interest government expenditure. Adding spending on wages leaves precious little for investment and productivity improvements.

South Africa's Social Wage - not to be confused as social grants. The "physically paid" grants are included in the social protection portion of the chart. South Africa spends a higher percentage of GDP on cash grants than the vast majority of developing countries and I think the reason the Minister highlighted this was to get "government" to see that SA is already spending a lot on social responsibility.

More alarming from an economic perspective is that 59.5% of non-interest spending goes to the "Social Wage", which leaves the remaining 40% to sort out the salary bill (which is forecast to decline from a whopping 36% of total expenditure to 31%) and items that can make the economy perform better – for example, capital projects, spectrum (bandwidth), efficiency gains etc.

The minister made two interesting remarks (and he was quite verbal during his speech on these points) which I sincerely hope government will honour. The first was that the temporary Covid-related grant will end in March 2022. The second referred to bailouts; "No additional funding is provided to state-owned companies over the medium-term, but the poor financial conditions and operating performance of several of these companies remains a large contingent risk". Hopefully the minster is aware of "Table C.2 - Expenditure Ceiling Calculations" which formed part of the Budget release. The table reflects an expenditure line-item that reads: Eskom funding provisions for the financial years '23, '24 and '25 of R21.8 billion, R21 billion and R22 billion respectively.

Despite the comments and concerns highlighted here, the financial markets gave Mr Godongwana a "Facebook" thumbs up. We are all in agreement that a well thought through budget is achievable as long as we hold all accountable to stick to the proposals and measures. If that can be achieved, then the Budget story can have a happy ending.

We all know the story of Red Riding Hood and the Wolf with its happy ending. Roald Dahl wrote a lovely collection of poems (called "Revolting Rhymes") which have rather different outcomes to the traditional fairytales. Let us hope that Treasury continues to toe the line – otherwise our own wolf (the debt burden) might have the final laugh!

> He (Wolf) sat there watching her and smiled
> He thought, I am going to eat this child.
> Compared with her old Grandmamma
> She's going to taste like caviar.
> Then Little Red Riding Hood said, "But Grandma
> what a lovely great big furry coat you have on"
>
> "That's wrong! Cried Wolf. "Have you forgot
> To tell me what BIG TEETH I've got?
> Ah well, no matter what you say,
> I'm going to eat you anyway."
> The small girl smiles. One eyelid flickers.
> She whips a pistol from her knickers.
> She aims it at the creature's head
> And bang bang bang, she shorts him dead.
> A few weeks later, in the woods,
> I came across Miss Riding Hood
> But what a change! No cloak in red,
> No silly hood upon her head
> She said, "Hello, and do please note
> My lovely furry wolfskin coat."

South African Finance Minister, Enoch Godongwana, is treading a very fine line trying to persuade government to understand that social expenditure and state bailouts cannot continue at the current level.

Now that we have moved back to Level 1, we are delighted to once again be able to host clients at our Insight Seminars. We will hold our next seminar in December, which will focus on the outlook for 2022 amd the key themes that we expect to unfold. For those based in the Midlands, please note the change of venue. The presentation will be followed by drinks and snacks. Seating is limited and subject to regulation, so please ensure that you book.

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Topic: **2022: a brighter year?**

Natal Midlands	
Date:	2nd of December
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	13th January 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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