3

Fiscal policy

In brief

- Government remains committed to closing the budget deficit and stabilising the national debt-to-GDP ratio. A combination of expenditure and revenue measures will narrow the main budget deficit from 14.6 per cent of GDP in 2020/21 to 7.3 per cent by 2023/24. Gross national debt is projected to stabilise at 95.3 per cent of GDP by 2025/26.
- Achieving these targets will require large reductions in non-interest spending over the next three years, amounting to R300 billion relative to projections set out in the 2020 *Budget Review*. The majority of these reductions will be applied to the wage bill. Government will aim to protect funding for infrastructure investment.
- To assist with the consolidation, government has projected tax increases of R5 billion in 2021/22.
- The fiscal outlook is highly uncertain. Major risks include the speed of the economic recovery, the legal process associated with public-service compensation and the forthcoming wage negotiations. In the broader public sector, several state-owned companies and municipalities have insufficient funds to cover operational expenses.

Introduction

The 2020 *Medium Term Budget Policy Statement* (MTBPS) proposes steps to reduce the fiscal deficit and stabilise the debt-to-GDP ratio over a five-year period. Large fiscal adjustments and an improving economic outlook will narrow the main budget deficit by 7.3 percentage points of GDP over the medium-term expenditure framework (MTEF) period, and by an additional 1.8 percentage points in the subsequent two years. The aim is to reach a main budget primary surplus by 2025/26. This target is expected to result in debt stabilising at 95.3 per cent of GDP in the same year.

The impact of the COVID-19 economic contraction on South Africa's public finances will be felt for years to come. Although the economy has begun to recover from the hard lockdown, tax revenue in the current year is projected to be R8.7 billion lower than the June estimate. Gross debt is projected to reach 81.8 per cent of GDP in the current year, up from 65.6 per cent projected in February 2020. Additional fiscal pressures from the broader public sector – including state-owned companies, social security funds and municipalities – remain unresolved. The fiscal trajectory is a major source of uncertainty, pushing up borrowing costs for the broader economy.

Returning the public finances to a sustainable position requires large adjustments. Government spending remains too high for the tax base – and this gap has likely increased as a result of the 2020 recession. Recent tax increases have generated less revenue than expected, and evidence suggests that tax increases can have large negative effects on GDP growth. Without a major reduction in public spending, debt will continue to accumulate and interest payments – which already consume 21 cents of every rand of main budget revenue – will crowd out other spending.

Debt stabilisation involves difficult decisions, with short-term costs for the economy and the fiscus. To partially offset the effect of the spending adjustment, government has weighted the largest share of reductions to the wage bill, while supporting capital grants and the Infrastructure Fund.

Figure 3.1 Main budget balance

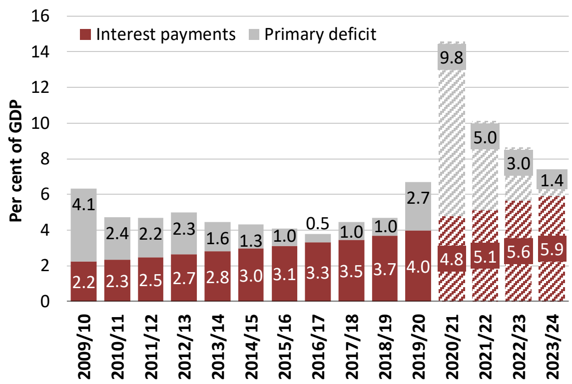


Figure 3.2 Gross debt-to-GDP outlook*

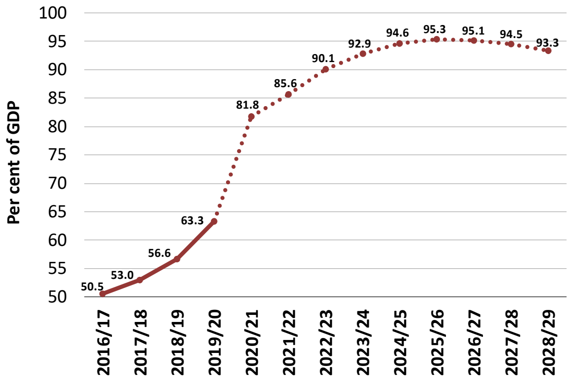


Figure 3.3 Main budget primary balance**

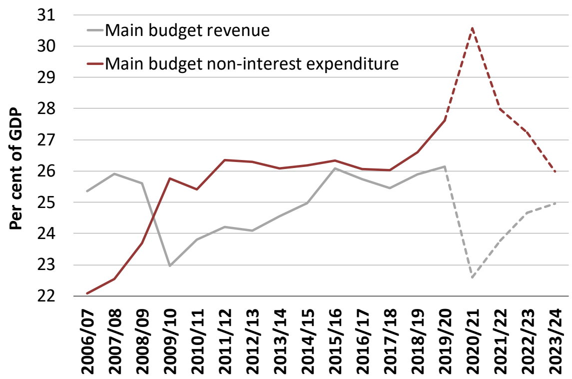
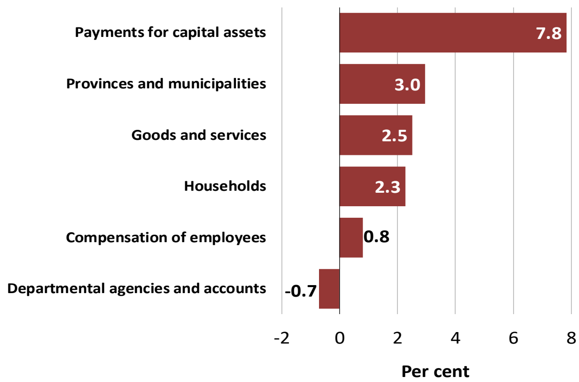


Figure 3.4 Average nominal spending growth, 2020/21 – 2023/24***



**The assumptions underlying the long-term projections appear in Annexure C*

***Excludes Eskom financial support and transactions in financial assets and liabilities*

****Excludes COVID-19 fiscal relief measures in 2020/21*

Source: National Treasury

South Africa's fiscal choices

The deteriorating fiscal position reflects a combination of economic factors and fiscal choices. Between 2007/08 and 2011/12, non-interest spending grew by an annual average of 14 per cent, reflecting an increase in public-service compensation and an expansion of social grants, among other factors. The introduction of the expenditure ceiling in 2012/13 constrained expenditure growth. But despite efforts to slow non-interest spending growth and raise taxes, the structural gap between revenue and expenditure has not been adequately addressed. While deficit spending has provided some support to the economy, real economic growth has declined over the past decade. Downward revisions to nominal GDP have also pushed up the budget deficit and debt-to-GDP ratio.

In comparison with a wide range of other countries (Figure 3.5), South Africa's average primary balance over the last 10 years falls in the middle of the distribution. Figure 3.6, however, shows that South Africa's three-year increase in debt to GDP is the largest among a group of developing countries. The probability of a debt trap – in which rising debt-service costs are increasingly paid from additional borrowing – has increased.

As debt has mounted, these deficits have become a drag on growth. Current expenditure is increasingly funded by debt, and borrowing is becoming more expensive. In June 2020, volatility in bond market auctions triggered the introduction of a bond-purchase programme by the Reserve Bank.

Fiscal distress is mounting in developing countries amid historically high indebtedness. A case in point is Argentina, where a decade of rapid spending growth reversed sharply over the past two years, culminating in a sovereign debt default in March 2020. In this environment of rising fiscal pressures, South Africa is losing ground to its peers, as shown in Figure 3.6.

Figure 3.5 Average primary balance, 2009–2019

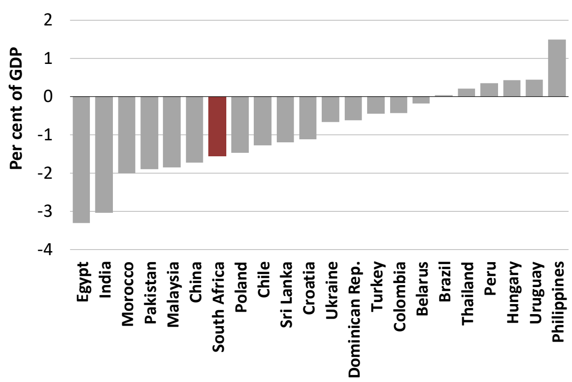
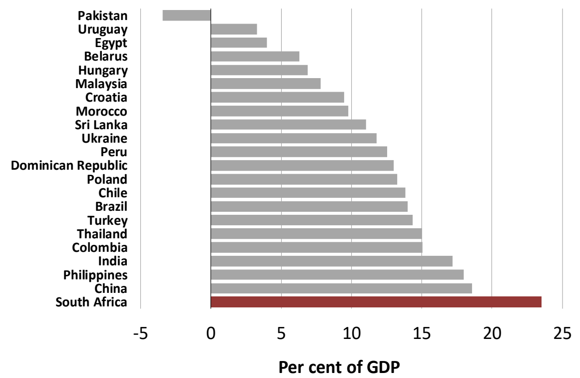


Figure 3.6 Projected three-year increase in debt



Source: IMF Fiscal Monitor, October 2020

Over the past five years, the fiscal environment has been characterised by:

- Interest payments absorbing a growing share of limited public resources, which increasingly crowds out spending on social and economic investment. Debt-service costs are now 4.8 per cent of GDP, up from 3.3 per cent in 2016/17.
- A sharp drop in public infrastructure investment, mostly driven by declines in spending by state-owned companies. Between 2016/17 and 2019/20, total public infrastructure spending fell from R250 billion to R183 billion, or from 5.7 to 4 per cent of GDP.
- A deteriorating government balance sheet, including state-owned companies and municipalities struggling to pay salaries and other operational costs.

Options to stabilise the fiscus are becoming increasingly limited. Implementation of government's economic reform agenda will boost confidence and investment. However, these reforms are only expected to begin yielding results over the next several years, implying continued weakness in revenue collection over the period ahead. Narrowing the deficit and improving the composition of spending requires reductions in the growth of the wage bill, which accounts for about one-third of the consolidated budget. Salaries for civil servants have grown by about 40 per cent in real terms over the past decade.

Update on the public-service wage bill

Government proposes growth in the public-service wage bill of 1.8 per cent in the current year and average annual growth of 0.8 per cent over the 2021 MTEF period.

To achieve these targets, which are essential for fiscal sustainability, government has not implemented the third year of the 2018 wage agreement. Furthermore, the Budget Guidelines propose a wage freeze for the next three years to support fiscal consolidation. Additional options to be explored include harmonising the allowances and benefits available to public servants, reconsidering pay progression rules and reviewing occupation-specific dispensations. The next round of wage negotiations is due to start soon and work is under way to formulate government's position.

In addition, government is coordinating work relating to developing a comprehensive public-sector remuneration strategy for the medium to long term. This will include public office bearers, state-owned companies, public entities and local government. The strategy will seek to better balance competing interests on the basis of fairness, equity and affordability.

The financial position of state-owned companies and public entities was weak before the onset of the pandemic. The current increase in requests for recapitalisation largely reflects the in-year deterioration in their operating environment. Lenders have called the guarantees of South African Express and the Land Bank, with a negligible effect on the fiscal framework. Larger calls on guaranteed debt are expected unless steps are taken to turn around the most indebted state-owned companies.

How much does public spending boost growth? Examining South Africa's fiscal multiplier

There has been considerable debate on South Africa's fiscal strategy. Although there is some agreement that the debt-to-GDP ratio should stabilise over a reasonable time period, there are questions about how much support government can give to the economy in the short term and how much the state can borrow. The fiscal multiplier – a ratio that measures the extent to which national income changes in response to changes in government spending – is one tool for assessing the trade-offs involved in this debate. A multiplier of more than 1 implies that an additional rand of government spending can translate into more than one additional rand of GDP.

In general, a higher fiscal multiplier implies that more government spending will boost economic growth. Recent research in South Africa[1] concluded that spending multipliers are positive, albeit generally smaller than 1. The Reserve Bank estimates that the fiscal multiplier declined from 1.6 to less than zero between 2009 and 2019, as South Africa approached its fiscal limits.[2] In general, infrastructure investment multipliers tend to exceed consumption spending multipliers.

The literature shows large negative multipliers from revenue increases, suggesting that South Africa's growth slowdown over the past five years may be related to rising taxes. The National Treasury's view is that the potential growth rate is low, the country is reaching its fiscal limits, and the fiscal multiplier is low (or possibly negative). This implies that a large fiscal consolidation to narrow the budget deficit and stabilise debt – complemented by implementation of structural reforms – is more likely to support economic growth than continued spending funded by higher borrowing and taxation.

[1]J. H. Kemp. 2020. *Empirical Estimates of Fiscal Multipliers for South Africa.* SA-TIED Working Paper 127
[2]Reserve Bank. 2020. *Monetary Policy Review October 2020*

Expenditure performance and outlook

In-year spending adjustments

Main budget non-interest spending has increased by R36 billion in the current year compared with 2020 Budget estimates. This reflects net additions made for the COVID-19 fiscal relief package, as discussed in the June special adjustments budget. Table 3.1 shows new proposed allocations of R34.3 billion in 2020/21, which are financed through reallocations and baseline reductions.

Table 3.1 Revisions to non-interest expenditure for 2020/21

	R million
Non-interest expenditure (2020 Budget Review)	**1 536 724**
2020 special adjustments budget (SAB) net additions	36 006
Revised non-interest expenditure (2020 SAB)	**1 572 731**
COVID-19 fiscal relief package allocations	**19 431**
Employment creation	12 634
Extension of special COVID-19 social relief of distress grant	6 797
Increases in allocations since 2020 SAB	**14 904**
South African Airways	10 500
Other allocations in AENE[1]	4 404
Resources used to fund adjustments since 2020 SAB	**(33 286)**
Net of provisional allocations for COVID-19 fiscal relief package	(19 575)
Reductions to fund South African Airways allocation	(6 970)
Drawdowns, suspensions and projected underspending[2]	(6 740)
Other adjustments[3]	**(1 050)**
Revised non-interest expenditure (2020 MTBPS)	**1 572 731**
Change in non-interest expenditure from 2020 SAB	–
Change in non-interest expenditure from 2020 Budget	36 006

1. 2020 Adjusted Estimates of National Expenditure
2. Including suspensions, projected underspending and drawdown on the contingency reserve and of provisional allocations announced in 2020 Budget
3. Including an increase of R66 million in NRF payments and R1.1 billion downward adjustment to skills development levy
Source: National Treasury

Medium-term expenditure outlook

Government proposes downward adjustments to main budget spending plans over the next three years. Relative to the 2020 Budget, total main budget non-interest expenditure is projected to decrease by R62.9 billion in 2021/22, R92.9 billion in 2022/23 and R150.9 billion in 2023/24. These downward adjustments reflect:

- Reductions of R60 billion in 2021/22, R90 billion in 2022/23 and R150 billion in 2023/24, mostly falling on compensation. Other non-interest spending items are also reduced, while funding for buildings and other fixed structures, provincial and local capital grants, and the Infrastructure Fund is protected.
- Lower estimated spending by the National Skills Fund and sector education and training authorities of R2.8 billion in 2021/22, R2.7 billion in 2022/23 and R0.9 billion in 2023/24, reflecting the decline in skills development levy projections.

- Early retirement savings anticipated in national departments of R109 million in 2021/22 and R118 million in 2022/23.

Main budget non-interest expenditure is projected to contract in real terms in each year of the MTEF period. As a share of GDP, non-interest expenditure will moderate from a peak of 32.4 per cent in 2020/21 to 26.4 per cent by 2023/24. This includes a contingency reserve of R5 billion per year over the medium term. Due to a wider deficit, weaker currency and higher interest rates, debt-service costs will continue rising over the medium term.

Expenditure ceiling

The main budget expenditure ceiling provides an upper limit within which departments prepare their budgets. The ceiling has anchored fiscal policy since the 2012 Budget. Expenditure exceeded the 2019/20 ceiling mainly due to early payment of social grants. In the current year, expenditure breached the ceiling by R45.2 billion relative to the 2020 *Budget Review* estimates, as a result of the emergency response to COVID-19. Compared with the 2020 Budget, the ceiling is lower by R58.9 billion in 2021/22 and R89 billion in 2022/23.

Eskom financial support, classified as payments for financial assets, is excluded from the expenditure ceiling. Annexure C explains the technical adjustments in calculating the difference between non-interest spending and the expenditure ceiling.

Table 3.2 Main budget expenditure ceiling[1]

R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
2018 MTBPS	1 225 455	1 314 865	1 416 597	1 523 762	1 630 026		
2019 Budget Review		1 310 156	1 407 595	1 502 052	1 607 758		
2019 MTBPS		1 307 235	1 404 675	1 493 029	1 591 287	1 673 601	
2020 Budget Review			1 409 244	1 457 703	1 538 590	1 605 098	
2020 MTBPS			**1 418 408**	**1 502 867**	**1 479 709**	**1 516 052**	**1 529 585**

1. The expenditure ceiling differs from main budget non-interest expenditure
The precise definition and calculation of the expenditure ceiling is contained in Annexure C
Source: National Treasury

Revenue performance and outlook

The gross tax revenue estimate for 2020/21 has been revised down by R8.7 billion compared with the projection in the June special adjustments budget. This deterioration is aligned with revised economic growth projections and the expected performance of the major tax bases.

Gross tax revenue is expected to be 17.9 per cent lower than collections in 2019/20, or R312.8 billion below the 2020 Budget forecast. The tax-to-GDP ratio is expected to decline substantially, dropping from 26.3 per cent to 22.9 per cent. A strong and sustained rebound in economic growth is required for the tax-to-GDP ratio to return to levels seen in 2019/20.

Table 3.3 Gross tax revenue

R billion	2019/20 Budget Review	2019/20 Outcome	2019/20 Deviations	2020/21 Budget Review	2020/21 SAB[1]	2020/21 Revised	2020/21 Deviation from Budget Review	2020/21 Deviation from SAB
Persons and individuals	527.6	527.6	0.0	546.8	455.5	454.2	-92.6	-1.3
Companies	216.7	211.5	-5.2	230.2	154.6	159.6	-70.7	5.0
Value-added tax	344.2	346.7	2.5	360.6	301.3	287.7	-72.9	-13.6
Dividends tax	29.1	27.9	-1.2	31.2	16.7	20.7	-10.5	4.0
Specific excise duties	46.8	46.8	0.1	48.8	36.3	33.8	-15.1	-2.5
Fuel levy	79.3	80.2	0.9	83.4	63.2	68.4	-15.1	5.2
Customs duties	56.3	55.4	-0.9	59.5	45.8	40.3	-19.2	-5.5
Ad valorem excise duties	4.1	4.1	0.0	4.3	3.9	3.2	-1.1	-0.7
Other	54.8	55.4	0.6	60.6	44.1	44.8	-15.8	0.7
Gross tax revenue	**1 358.9**	**1 355.7**	**-3.2**	**1 425.4**	**1 121.3**	**1 112.6**	**-312.8**	**-8.7**

1. 2020 special adjustments budget figures
Source: National Treasury

Tax revenue performance in the initial stage of the pandemic

Tax revenues, which fell sharply during the first several months of the coronavirus pandemic, have begun to recover. However, monthly collections remain well below 2019/20 levels in many tax categories. For example, domestic value-added tax (VAT) collected in the first six months of 2020/21 was 6.7 per cent lower than the same period in 2019/20.

Figure 3.7 Domestic value-added tax

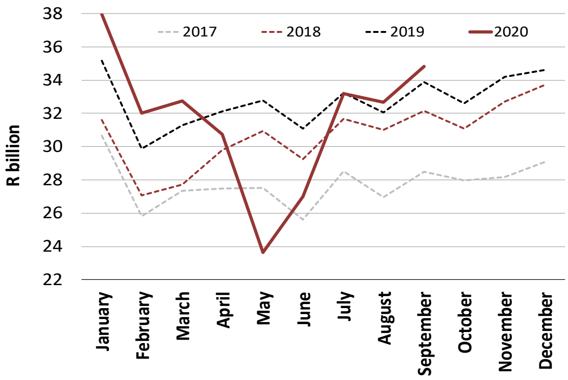
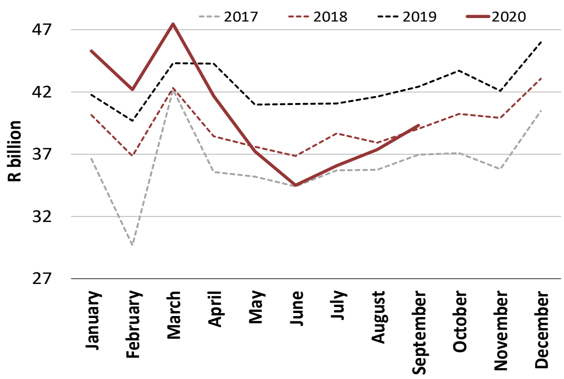


Figure 3.8 Pay-as-you-earn tax



Source: National Treasury and South African Revenue Service

Key factors affecting in-year revenue collection include:

- A significant decline in compensation, and therefore personal income tax, due to the lockdown.
- A weaker import outlook, which has reduced VAT and customs expectations.
- A sharp reduction in consumption, lowering domestic VAT collection.
- Downward adjustments in specific excise duties associated with a longer-than-expected tobacco ban.
- Stronger-than-expected corporate profitability, limiting the anticipated reduction in corporate income tax and dividend tax receipts.

In April 2020, government introduced tax relief measures to provide temporary assistance to businesses and households during the lockdown. These interventions offered a combination of cash-flow relief through tax deferrals, and direct support through increased incentives to retain lower-income employees and reductions in payroll taxes. Details on the take-up and effects of these measures will be provided in the 2021 *Budget Review*.

Improved tax collection and administration continues to be an important element in achieving fiscal consolidation. The South African Revenue Service continues to rebuild its capacity following several years of mismanagement. Near-term objectives include:

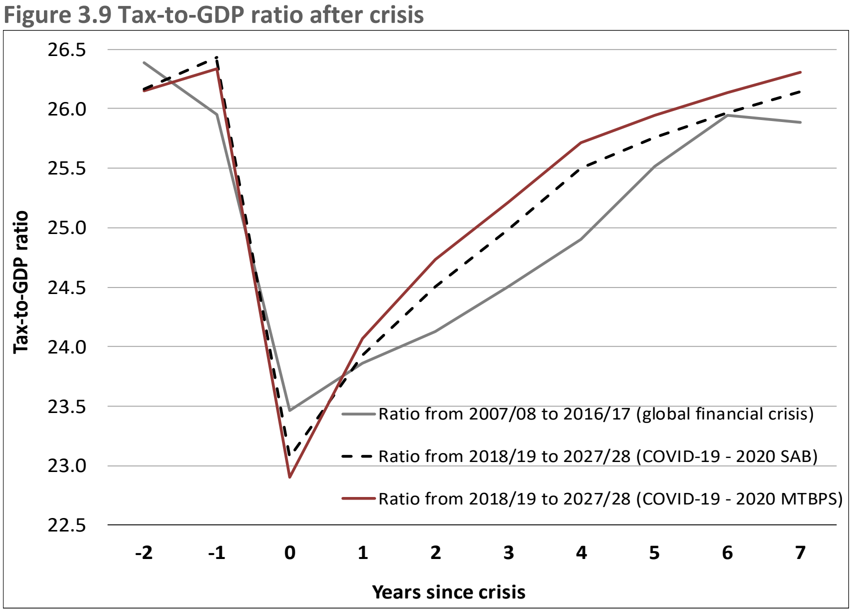
- Finalising the tax gap study in December 2020 to quantify the difference between how much tax should be collected and how much is collected.
- Remaining focused on international taxes, particularly aggressive tax planning using transfer pricing.
- Increasing enforcement to eliminate syndicated fraud and tax crimes.
- Continuing to use third-party data to find non-compliant taxpayers.
- Collecting pay-as-you-earn and VAT debt, and ensuring that outstanding taxpayer returns are filed and liabilities paid.

Medium-term revenue outlook

Tax revenue is expected to increase to R1.5 trillion, or 25.2 per cent of GDP, by the end of the MTEF period.

The extraordinary shock to economic output in 2020/21 translates into large revenue shortfalls that will persist over the medium term. The shortfalls are exacerbated by a reduction in the tax-to-GDP ratio, because the tax system automatically adjusts to reduce the amount of revenue that is collected for a given level of economic activity in the event of a crisis.

Figure 3.9 Tax-to-GDP ratio after crisis



Source: National Treasury and South African Revenue Service

Tax buoyancies can become highly volatile over these periods, as shown in Table 3.4. Although overall buoyancies appear relatively large up until the end of the MTEF period, this reflects a slow improvement in the tax-to-GDP ratio after the large once-off decrease in 2020/21. The ratio is only expected to recover to the 2019/20 level by 2027/28. Additional details appear in Table C.5 of Annexure C.

Table 3.4 Revised revenue projections

R billion	2020/21	2021/22	2022/23	2023/24
2020 Budget	**1 425.4**	**1 512.2**	**1 609.7**	
Buoyancy	*0.93*	*1.00*	*1.01*	
2020 special adjustments budget	**1 121.3**	**1 291.4**	**1 394.0**	**1 508.9**
Buoyancy	*3.23*	*1.58*	*1.46*	*1.33*
Revised estimates	**1 112.6**	**1 279.5**	**1 392.2**	**1 503.2**
Buoyancy	*3.18*	*1.59*	*1.50*	*1.35*
Change since 2020 Budget	**-312.8**	**-232.7**	**-217.5**	
Change since 2020 special adjustments budget	**-8.7**	**-11.9**	**-1.8**	**-5.7**

Source: National Treasury

The improvement in revenue collection over the next four years includes the revenue proposals announced in the June special adjustments budget, including tax increases of R5 billion in 2021/22, R10 billion in 2022/23, R10 billion in 2023/24 and R15 billion in 2024/25. It does not include any additional revenue from more effective collection.

Table 3.5 Medium-term revenue framework

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
R billion		Outcome		Revised		Medium-term estimates	
Gross tax revenue	**1 216.5**	**1 287.7**	**1 355.7**	**1 112.6**	**1 279.5**	**1 392.2**	**1 503.2**
Gross tax revenue growth	6.3%	5.9%	5.3%	-17.9%	15.0%	8.8%	8.0%
Nominal GDP growth	6.3%	4.8%	4.6%	-5.6%	9.4%	5.9%	5.9%
Buoyancy	*1.00*	*1.22*	*1.16*	*3.18*	*1.59*	*1.50*	*1.35*
Non-tax revenue	19.2	23.9	27.6	24.9	22.3	23.3	25.0
Southern African Customs Union[1]	-56.0	-48.3	-50.3	-63.4	-46.0	-31.5	-42.5
National Revenue Fund receipts[2]	16.6	12.0	12.8	23.8	7.9	4.3	1.4
Main budget revenue	**1 196.4**	**1 275.3**	**1 345.9**	**1 097.9**	**1 263.6**	**1 388.3**	**1 487.1**

1. Amount made up of payments and other adjustments
2. Mainly revaluation profits on foreign-currency transactions and premiums on loan transactions
Source: National Treasury

The Southern African Customs Union (SACU) common revenue pool forms part of the National Revenue Fund and main budget calculations. Payments to SACU partners have been revised down sharply over the next two years compared with 2020 Budget estimates. Details appear in Annexure C.

Non-tax revenue estimates for the next two years are lower than the 2020 Budget estimates by an average of R5.8 billion.

Main budget framework

The main budget framework summarises spending financed from the National Revenue Fund. Main budget revenue is expected to fall sharply in the current year to 22.6 per cent of GDP due to the steep economic contraction. It is projected to peak at 37.2 per cent of GDP in 2020/21, relative to the 2020 Budget estimate of 32.5 per cent of GDP. This largely reflects the response to COVID-19 and higher debt-service costs. The main budget deficit is therefore expected to widen significantly to 14.6 per cent of GDP, from 6.8 per cent of GDP as projected in the 2020 Budget.

Main budget revenue will improve as a share of GDP, reaching 24.9 per cent by 2023/24, while non-interest expenditure is expected to decrease as a share of GDP. Debt-service costs will continue rising over the forecast period. The main budget balance and the primary balance will narrow to stabilise debt in 2025/26. Compared with the 2020 *Budget Review* estimates, both metrics have deteriorated. Changes to the main budget framework since February 2020 are presented in Annexure C.

Table 3.6 Main budget framework

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
R billion/percentage of GDP		**Outcome**		**Revised**		**Medium-term estimates**	
Main budget revenue	**1 196.4**	**1 275.3**	**1 345.9**	**1 097.9**	**1 263.6**	**1 388.3**	**1 487.1**
	25.5%	*25.9%*	*26.1%*	*22.6%*	*23.8%*	*24.7%*	*24.9%*
Main budget expenditure	**1 404.9**	**1 506.6**	**1 690.9**	**1 805.8**	**1 801.1**	**1 874.8**	**1 924.6**
	29.9%	*30.6%*	*32.8%*	*37.2%*	*33.9%*	*33.3%*	*32.3%*
Non-interest expenditure	1 242.3	1 324.8	1 486.2	1 572.7	1 529.3	1 557.2	1 571.5
	26.4%	*26.9%*	*28.9%*	*32.4%*	*28.8%*	*27.7%*	*26.4%*
Debt-service costs	162.6	181.8	204.8	233.0	271.8	317.6	353.1
	3.5%	*3.7%*	*4.0%*	*4.8%*	*5.1%*	*5.6%*	*5.9%*
Main budget balance	**-208.6**	**-231.3**	**-345.1**	**-707.8**	**-537.4**	**-486.6**	**-437.5**
	-4.4%	*-4.7%*	*-6.7%*	*-14.6%*	*-10.1%*	*-8.6%*	*-7.3%*
Primary balance	**-45.9**	**-49.5**	**-140.3**	**-474.8**	**-265.7**	**-169.0**	**-84.4**
	-1.0%	*-1.0%*	*-2.7%*	*-9.8%*	*-5.0%*	*-3.0%*	*-1.4%*

Source: National Treasury

Consolidated budget framework

The consolidated budget includes the main budget and spending financed from revenues raised by provinces, social security funds and public entities. In 2020/21, the consolidated budget deficit has been revised from 6.8 per cent of GDP projected in the 2020 Budget to 15.7 per cent of GDP.

Public entities, social security funds and provinces are projected to have a combined cash surplus over the medium term, partially offsetting the main budget deficit. Over the next two years, the consolidated budget deficit is projected, on average, to be 3.4 percentage points of GDP wider than the 2020 Budget estimates.

Table 3.7 Consolidated budget balance

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
R billion		**Outcome**		**Revised**		**Medium-term estimates**	
Main budget	-208.6	-231.3	-345.1	-707.8	-537.4	-486.6	-437.5
Social security funds	9.3	6.8	-3.3	-49.1	-1.0	-2.4	-2.5
Public entities	8.3	26.3	13.4	5.1	2.0	4.2	5.7
Provinces	0.8	1.0	5.0	-9.3	0.6	1.0	0.9
RDP Fund	-0.3	-0.2	-0.6	-0.0	-0.1	-0.1	-0.0
Consolidated budget balance	**-190.5**	**-197.3**	**-330.6**	**-761.1**	**-535.9**	**-483.9**	**-433.4**
Percentage of GDP	*-4.1%*	*-4.0%*	*-6.4%*	*-15.7%*	*-10.1%*	*-8.6%*	*-7.3%*

Source: National Treasury

Financing and debt management strategy

As a result of this year's steep economic contraction, government's gross borrowing requirement – the sum of the budget deficit and maturing loans – has increased by R342 billion to R774.7 billion, relative to the 2020 Budget. This is a marginal decline from the June estimate of R776.9 billion in 2020/21. The debt portfolio, which is structured to manage risk, remains within all its strategic benchmarks.

The coronavirus pandemic triggered a large global selloff of bonds in developing countries, including South Africa. These developments led to Moody's downgrading South Africa's sovereign credit rating to sub-investment grade, which put the domestic capital market under pressure. Higher bond yields – which reflect an elevated perception of risk – and exchange rate depreciation have increased borrowing costs.

In response, government revised its financing strategy, as outlined in the special adjustments budget, to make use of sterilisation and foreign-currency deposits at the Reserve Bank, and new loans from international finance institutions. In addition, government increased its borrowing in the domestic money and bond markets. These actions have ensured that government is able to meet its borrowing requirement.

Table 3.8 National government gross borrowing requirement and financing

	2019/20	2020/21	2021/22	2022/23	2023/24
R billion	**Outcome**	**Revised**		**Medium-term estimates**	
Gross borrowing					
Main budget balance	**-345.1**	**-707.8**	**-537.4**	**-486.6**	**-437.5**
Redemptions	**-70.7**	**-66.9**	**-65.5**	**-150.6**	**-155.7**
Domestic long-term loans	-19.4	-52.5	-60.9	-134.2	-112.9
Foreign loans	-51.2	-14.4	-4.6	-16.4	-42.8
Total	**-415.8**	**-774.7**	**-602.9**	**-637.2**	**-593.2**
Financing					
Domestic short-term loans (net)	36.1	143.0	67.0	71.0	62.0
Domestic long-term loans	305.4	462.5	472.2	500.8	436.8
Foreign loans	76.1	121.4	49.4	49.3	66.6
Change in cash and other balances	-1.8	47.8	14.3	16.1	27.8
Total	**415.8**	**774.7**	**602.9**	**637.2**	**593.2**

Source: National Treasury

In the current year, short-term borrowing has increased by R95 billion to R143 billion, relative to the 2020 Budget estimate. This is marginally lower than the June estimate. Short-term borrowing will average R66.7 billion per year over the next three years. Long-term borrowing in the domestic bond market will be kept at R462.5 billion, unchanged from June 2020, and average R469.9 billion per year over the medium term.

As increased bond market volatility favoured short-dated debt, government issuance initially focused on shorter-term bonds to reduce borrowing costs. Once volatility declined, government renewed issuing bonds over the entire yield curve. Bond auctions were increased in July 2020 to fund the higher borrowing requirement. There was strong support for the bond auctions, especially the non-competitive auctions. As a result, government does not anticipate increasing auction levels in the current year. To manage near-term refinancing risk, government will continue with the bond-switch programme.

In the special adjustments budget, government announced borrowing of US$7 billion from international finance institutions. This has been revised to US$7.3 billion, (R121.4 billion), of which US$5.5 billion has been disbursed, with the remainder expected by 31 March 2021.

Table 3.9 Borrowing from international finance institutions

Institutions	Disbursement date	Interest rate	Terms (years)	Grace period[1] (years)	Amount billions
New Development Bank	20 July 2020	6-month LIBOR[2] plus 1.25%	30	5	US$1.0
International Monetary Fund	29 July 2020	1.066%	5	3	US$4.3
African Development Bank	15 October 2020	3-month JIBAR[3] plus 0.8%	20	5	R5.0[4]

1. A period after the disbursement where no capital repayments are required
2. LIBOR (London Interbank Offered Rate)
3. JIBAR (Johannesburg Interbank Average Rate)
4. The US dollar equivalent is US$0.29 billion
Source: National Treasury

Gross loan debt is expected to increase from R3.97 trillion, or 81.8 per cent of GDP, in 2020/21 to R5.54 trillion, or 92.9 per cent of GDP, in 2023/24. The key drivers of this increase remain the budget balance and fluctuations in the interest, inflation and exchange rates.

Compared with the 2020 Budget estimate, debt-service costs will increase by R3.8 billion to R233 billion in 2020/21. These costs will reach R353.1 billion, or 5.9 per cent of GDP, by 2023/24. As a share of expenditure, debt-service costs will increase from 12.9 per cent in 2020/21 to 18.3 per cent in 2023/24.

Table 3.10 Total national government debt

End of period	2019/20	2020/21	2021/22	2022/23	2023/24
R billion	Outcome	Revised	Medium-term estimates		
Domestic loans[1]	**2 874.1**	**3 497.9**	**4 043.1**	**4 530.7**	**4 964.8**
Short-term	360.7	503.7	570.7	641.7	703.7
Long-term	2 513.4	2 994.2	3 472.4	3 889.0	4 261.1
Fixed-rate	*1 863.2*	*2 227.4*	*2 634.7*	*2 913.9*	*3 264.0*
Inflation-linked	*650.2*	*766.8*	*837.7*	*975.1*	*997.1*
Foreign loans[1]	**387.2**	**476.2**	**508.7**	**540.6**	**571.4**
Gross loan debt	**3 261.3**	**3 974.1**	**4 551.8**	**5 071.3**	**5 536.2**
Less: National Revenue Fund bank balances	-263.6	-204.6	-183.5	-168.1	-147.6
Net loan debt[2]	**2 997.7**	**3 769.5**	**4 368.3**	**4 903.2**	**5 388.6**
As percentage of GDP:					
Gross loan debt	*63.3%*	*81.8%*	*85.6%*	*90.1%*	*92.9%*
Net loan debt	*58.2%*	*77.6%*	*82.2%*	*87.1%*	*90.4%*

1. Estimates include revaluations based on National Treasury's projections of inflation and exchange rates
2. Net loan debt is gross loan debt minus the bank balances of the National Revenue Fund
Source: National Treasury

Risks to the fiscal outlook

This year's global recession has led to extreme economic and fiscal uncertainty, and there are high levels of risk associated with South Africa's outlook.

Without implementation of the proposed fiscal consolidation plans and higher economic growth, the probability of a debt default will increase over time.

The major short- to medium-term risks to the fiscal framework include:

- Uncertainty around the speed of the economic recovery – including the medium-term effects of the lockdown, both domestically and internationally. Globally, several developed economies have returned to strict lockdowns.
- Implementation risks for expenditure reductions, particularly on the wage bill. Both the upcoming decision on the final year of the current wage agreement and the upcoming wage talks pose significant risks to the expenditure ceiling.
- Additional spending pressures from state-owned companies. Several companies, including South African Airways, are insolvent and have insufficient funds to cover operational expenses.

Annexure A contains the fiscal risk statement, which examines medium- to longer-term risks to government's forecasts and the public finances.

Conclusion

Government remains committed to fiscal sustainability. In light of the weak economic outlook and the deteriorating fiscal position, the 2020 MTBPS sets out ambitious consolidation targets to achieve a primary surplus by 2025/26. This requires substantial spending reductions, particularly to the wage bill, to stabilise debt and improve the composition of spending.

Measures to manage and reduce public-sector pressures and risks will be implemented over the medium term. Fiscal policy and the debt management strategy will work to mitigate risks to the outlook.