ANNEXURES

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A

Fiscal risk statement

Introduction

This statement sets out the medium- and long-term risks to the public finances, with short-term risks outlined in Chapter 3. Some previously anticipated fiscal risks have started to materialise and are worse than anticipated at the time of the 2022 *Budget Review,* although the fiscal position is expected to improve over the medium term.

The major risk categories discussed in this annexure are summarised in Figure A.1.

Figure A.1 Fiscal risk framework

Risk category	Major issues under each category
Macroeconomic risks	▪ Slowdown in economic growth ▪ Higher global interest rates resulting in higher-than-expected debt-service costs ▪ Higher debt trajectory
Expenditure risks	▪ Higher-than-budgeted wage bill expenditure ▪ Large unfunded social expenditures ▪ Subnational government
Contingent and accrued liabilities	▪ Government guarantees ▪ Weak financial position of several state-owned companies

Macroeconomic risks

Gross tax revenue is now estimated to be an average of R92.6 billion higher over the 2022 medium-term expenditure framework (MTEF) period compared to estimates presented in the 2022 Budget. However, there is significant uncertainty associated with this projection. Revenue projections have changed rapidly before, during and after the COVID-19 pandemic. Any significant downward revisions would place the current fiscal strategy under pressure.

If aggressive global monetary policy tightening results in a protracted slowdown in global growth, South Africa's fiscal outlook could deteriorate as revenue collections falter and debt-service costs increase. Furthermore, a failure to address structural economic constraints would result in economic growth decelerating, placing additional pressure on the fiscal position. This could adversely affect public debt dynamics and would require more robust fiscal measures to stabilise the public finances.

As discussed in chapters 2 and 3, government's policy stance is intended to promote faster economic growth through structural reforms, while fiscal policy is well on course to return the public finances to a sustainable position.

Scenarios around the baseline economic forecast

The baseline economic forecast in Chapter 2 underpins the fiscal framework. Deviations from the underlying assumptions can have significant effects on variables such as GDP growth, inflation, interest and exchange rates. To illustrate this, the impact of the two alternative scenarios on the fiscal position has been modelled.

In Scenario A, stronger economic growth results in the primary balance increasing by a total of 0.3 percentage points of GDP over the medium term. As a result, debt-service costs decline to 15.8 per cent as a share of total revenue in 2030/31. Gross loan debt declines at a faster pace, relative to the baseline, and measures 59.4 per cent of GDP in 2030/31.

In Scenario B, debt-service costs increase and economic growth slows due to a more aggressive monetary policy stance, particularly in China, Europe, the United Kingdom and the United States. As a share of total revenue, debt-service costs increase to 17.3 per cent in 2030/31 and stabilisation of gross loan debt is only achieved in 2023/24. Gross loan debt as a share of GDP increases to 65.4 per cent in 2030/31, relative to the baseline.

Figure A.2 Real GDP scenarios

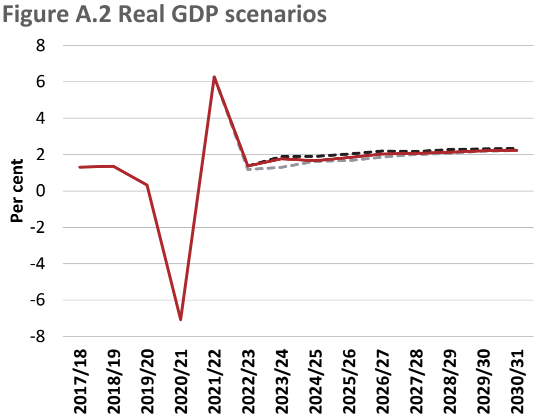
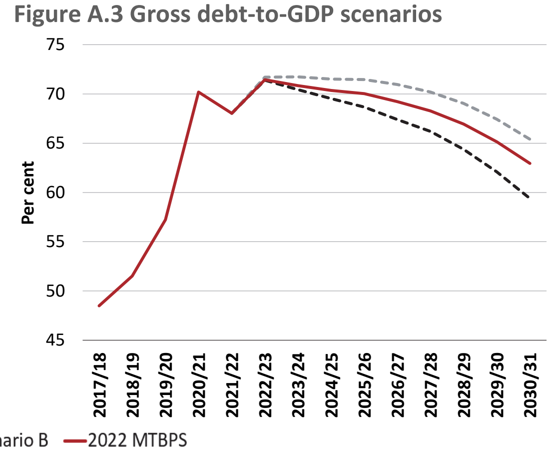


Figure A.3 Gross debt-to-GDP scenarios

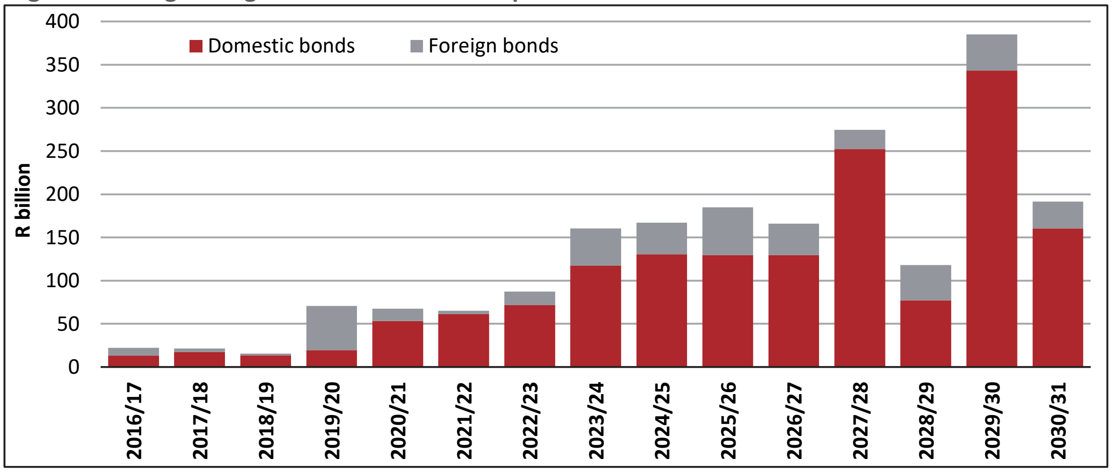


Source: National Treasury

Debt trajectory

From 2016/17 to 2021/22, redemptions on long-term government debt averaged R43.8 billion per year. In comparison, debt redemptions from 2022/23 to 2030/31 will average R192.8 billion per year. A portion of the maturing debt will have to be refinanced, which places significant pressure on capital markets, raising borrowing costs across the economy. Moreover, higher debt redemptions increase the risk that changes in demand for government bonds, a depreciation of the rand exchange rate and/or higher borrowing rates will override the benefits of a lower budget deficit. To reduce these costs and risks, government is prioritising the stabilisation of debt and narrowing the deficit. In addition, government continues to manage debt in a prudent and sustainable manner, by maintaining a diversified portfolio of funding instruments to mitigate debt-service costs and refinancing risks.

Figure A.4 Long-term government debt redemptions



Source: National Treasury

Expenditure risks

Compensation spending

From an economic classification perspective, public-service compensation is the largest spending item. If a wage agreement is reached in 2022/23 that exceeds the available budget, it would pose a significant risk to the in-year and medium-term fiscal projections. Given that higher-than-anticipated wage increases would have cost implications for each year of the 2023 MTEF period, spending on policy priorities might need to be reallocated to compensation budgets. Government departments would also need to ensure that personnel costs, including any hiring, would remain within their budgeted compensation ceilings.

Social spending

A permanent extension of the *COVID-19 social relief of distress grant*, or a similar new grant, needs to be matched by a corresponding permanent increase in revenue, decrease in spending or combination of the two. Assuming the current grant value and take-up rate remain constant and it is extended indefinitely, the cost of the grant could grow at an average of 8.8 per cent per year to reach R64.9 billion in 2030/31. Without a permanent source of funding, this would threaten the sustainability of the public finances.

Subnational government risks

The high level of unpaid bills and accruals in provincial and local government constitutes a significant risk. For provincial government, these are estimated at R24.6 billion in 2021/22, slightly lower than the previous year's R26.5 billion. However, a risk remains that bills and accruals could grow if provincial governments are unable to manage the costs of providing services such as education and health, compensating employees and purchasing goods and services within their budgets.

Provincial health departments continue to face a high level of medico-legal claims. The contingent liability associated with these claims – in other words, the potential loss incurred by the state if all claims are to be paid out – increased from R106.3 billion in 2020/21 to R109 billion in 2021/22, while payment of claims declined from R1.7 billion to R1 billion over the same period. Reforms proposed in the State Liability Amendment Bill would reduce the state's liability for medical claims and create a more sustainable payment model. The National Treasury is reviewing inputs from provincial governments on how the bill will be implemented.

Figure A.5 Provincial bills and accruals

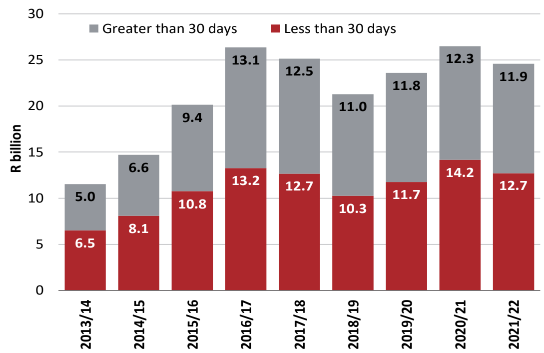
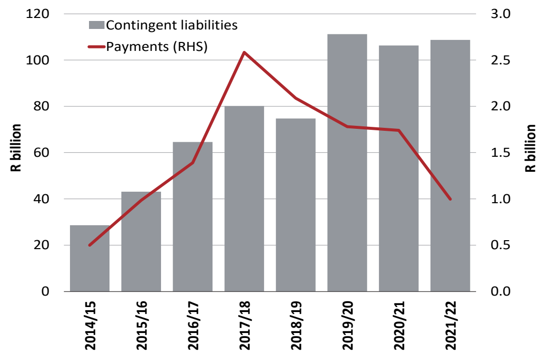


Figure A.6 Provincial medico-legal contingent liabilities and payments



Source: National Treasury

In general, the financial position of South Africa's 257 municipalities remains weak; 98 municipalities adopted unfunded budgets in 2022/23. By 30 June 2022, creditors were owed R89.7 billion, of which 64.9 per cent or R58.2 billion consisted of debts older than 90 days. Monies owed to Eskom, the Department of Water and Sanitation and the water boards also increased by 24.1 per cent, from R51.2 billion in 2021/22 to R63.5 billion in the current year. Uncollected municipal revenue increased from R232.8 billion at end-June 2021 to R255.4 billion at end-June 2022, of which 86 per cent was for debt older than 90 days. The largest share of this debt (71.2 per cent or R181.8 billion) is owed by households, with government accounting for 6.7 per cent, or R17.1 billion of the total outstanding.

In response to municipalities' financial weakness, the National Treasury is working to strengthen its early warning system to improve oversight and timely assistance. An update on the progress will be provided in the 2023 Budget. Municipalities need to ensure that their costs do not exceed the sum of their transfers and revenues collected.

Contingent liabilities

Contingent liabilities represent financial commitments that government may have to fulfil in the future if particular outcomes materialise. Most contingent liability risks originate from the poor financial condition of major state-owned companies. Some of these risks have already materialised, requiring resources from the budget. By 2024/25, contingent liabilities are expected to exceed R1 trillion. At this stage, the fiscal risk statement does yet take into account changes related to planned debt relief, as these are tied to conditions that still need to be finalised between the relevant parties.

Guarantees

Government's guarantee portfolio decreased from R788 billion in March 2021 to R758 billion by March 2022, largely because of a reduction in the guarantees granted to the Trans-Caledon Tunnel Authority and to South African Airways. Guarantee exposure increased from R567 billion in 2020/21 to R594 billion as at 31 March 2022, driven largely by further drawdowns by Eskom, which accounts for 78 per cent of guarantees to state-owned companies. The independent power producer programme guarantee increased from R176.7 billion to R191.2 billion with the signing of additional contracts.

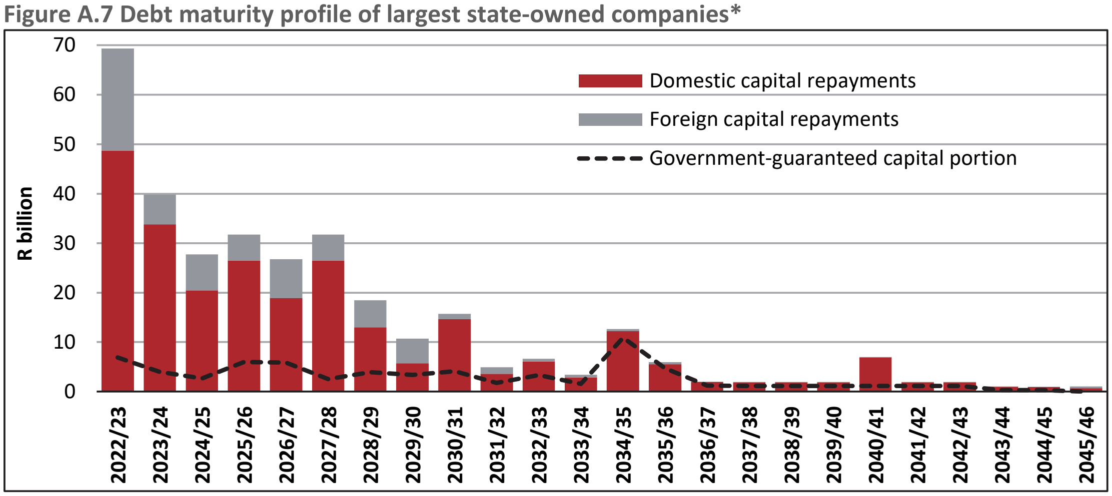
The minimum criteria for the consideration of guarantee requests by the Minister of Finance require state-owned companies to demonstrate their ability to service debt that would be acquired using the guarantee. In 2021/22, no guarantee requests that met the minimum criteria were received, so no new guarantees were issued. As a result, the volume of the exposure declined. However, the quality of the existing exposure is still very poor. Deeper financial, governance and structural reforms are required to sustainably improve performance and operations at major state-owned companies.

Financial condition of state-owned companies

The financial condition of many state-owned companies remains weak, exacerbated in some cases by the effect of the Russia-Ukraine war and the flooding in April 2022. Some state-owned companies had difficulty meeting their funding requirements because of their low credit quality and, for certain development finance institutions, the prolonged Land Bank default position. Overall investment in infrastructure slowed as entities managed their budgets and operations by cutting costs, enhancing revenue and managing capital. Government has maintained the liquidity support extended to Denel and Eskom and continues to closely monitor implementation of turnaround plans.

Total debt redemptions for state-owned companies will average R33.1 billion a year over the medium term, with foreign debt making up 19 per cent of the total. State-owned companies have reduced their participation in the listed debt capital market in recent years, as reflected on their lower gross issuances relative to all other non-government issuers on the Johannesburg Stock Exchange. Between 2018 and 2021, state-owned companies' gross listed issuances declined from 18 per cent to 8 per cent as a share of total listed issuances. Issuances grew marginally in 2022. However, state-owned companies continue to borrow and refinance at high costs, largely because of poor cash generation, weak revenue performance, poor operating performance, and unsustainable balance sheets and financial metrics.

Figure A.7 Debt maturity profile of largest state-owned companies*



**Airports Company South Africa, Denel, Development Bank of Southern Africa, Eskom, Industrial Development Corporation, Land Bank, South African Airways, South African National Roads Agency Limited, Trans-Caledon Tunnel Authority and Transnet*
Source: National Treasury as at 31 March 2022

Denel

Denel remains in financial distress and cannot meet its financial obligations as they fall due. Government allocated R3 billion in 2021/22 to cover capital and interest payments on guaranteed debt. In September 2022, as part of clarifying Denel's future role in the economy, Denel and Armscor signed a memorandum of understanding covering defence equipment and operational requirements. Denel is implementing its turnaround plan and has disposed of some non-core assets, which provided funds to partially finance legacy obligations and immediate working capital requirements. Chapter 3 discusses further allocations for Denel to pay off debt and complete implementation of its turnaround plan.

Eskom

Eskom is the largest long-term risk to the economy, given its high debt levels and unsustainable business model. In 2019, government announced a R230 billion support package for Eskom to remain financially viable. To date, R140 billion of this package has been disbursed. In addition, Eskom had used

R323.9 billion of its R350 billion government guarantee facility as at 30 June 2022. The National Treasury is leading a process to design a debt relief programme that will address the utility's financial challenges, as discussed in Chapter 3. Debt relief will be guided by strict conditions that emphasise progress in significant reforms, such as the unbundling process and financial sustainability.

Road Accident Fund

The Road Accident Fund remains a significant contingent liability despite receiving a growing share of fuel tax revenues. It is estimated that the accumulated deficit will grow by an annual average rate of 7.5 per cent, from R385.5 billion in 2021/22 to R479 billion in 2024/25. A change in disbursement strategy could accommodate a larger share of claims if loss of income support is paid as annuities instead of as lump sum payments. This change in strategy could lead to improved cash flow management, which in turn will help manage short- and long-term liabilities.

South African Airways

In the 2020 *Budget Review*, R16.4 billion was set aside for South African Airways (SAA) over the 2020 MTEF period to settle government-guaranteed debt and interest costs. The final tranche of this debt was repaid in July 2022, eliminating government-guaranteed debt-related exposure to SAA. Government financial support to repay debt and implement the business rescue plan has resulted in a significant improvement of the airline's balance sheet. SAA exited business rescue on 30 April 2021.

South African National Roads Agency Limited

The South African National Roads Agency Limited (SANRAL) remains in limbo given policy uncertainty over government's position on the user-pays principle. As a result, SANRAL cannot collect sufficient cash from its toll portfolio to settle maturing government-guaranteed debt. This balance sheet weakness is affecting SANRAL's ability to maintain the broader road network and as such also presents a medium-term risk to economic growth. Chapter 3 outlines in-year allocations to address this risk.

Transnet

Transnet generated a net profit of R5 billion for 2021/22. The state rail and ports operator suffered severe and widespread damage to assets, installations and operations from the heavy rains and flooding in April 2022, resulting in unexpected repair costs and loss of revenue. While the Port of Durban is now operating, major repairs are still required to fully restore Transnet Freight Rail operations in KwaZulu-Natal. Chapter 3 outlines allocations to Transnet to repair rail infrastructure and to increase locomotive capacity, both of which are expected to support economic growth.

Evaluating the viability of state-owned companies

Government continues to review the value created by state-owned companies as part of evaluating whether they can be run sustainably. The Presidential State-Owned Enterprises Council has developed a draft framework to guide decisions on disposing of and retaining state-owned companies. To complement this work, the National Treasury has begun developing a state-owned companies funding framework, which will be finalised in 2022/23. A discussion of government's contingent liabilities appears in Chapter 7 of the *Budget Review*.

Conclusion

Government faces a range of fiscal risks over the medium to longer term. Significant efforts will be required across the entire public sector to prevent these risks from materialising – and to mitigate those that do. As discussed in Chapter 3, government is setting aside a portion of higher-than-anticipated revenues over the medium term to mitigate certain risks.