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Stabilising the public finances to weather the global storm

In brief

- South Africa is restoring the health of its public finances during a global slowdown marked by high levels of economic risk and fiscal distress, particularly for developing countries.
- In 2023/24, a primary budget surplus – revenue exceeding non-interest spending – of 0.7 per cent of GDP is expected. Gross debt is now projected to stabilise at 71.4 per cent of GDP in 2022/23 – more quickly than previously expected.
- Urgent action is required to accelerate growth-enhancing reforms, especially to boost electricity supply. Real GDP growth is forecast to average a moderate 1.6 per cent over the next three years.
- Government will focus on ensuring clear and stable macroeconomic policies, implementing economic reforms and addressing key enablers to growth and state capability.
- Higher-than-anticipated revenues will be used to reduce the gross borrowing requirement, support spending priorities and reduce risks to the fiscal outlook.

Introduction

The strategy outlined in the 2022 *Medium Term Budget Policy Statement* (MTBPS) reduces fiscal risks in the short term, narrows the budget deficit and stabilises debt, while proposing measures to enhance economic growth and restore funding for infrastructure and service delivery programmes.

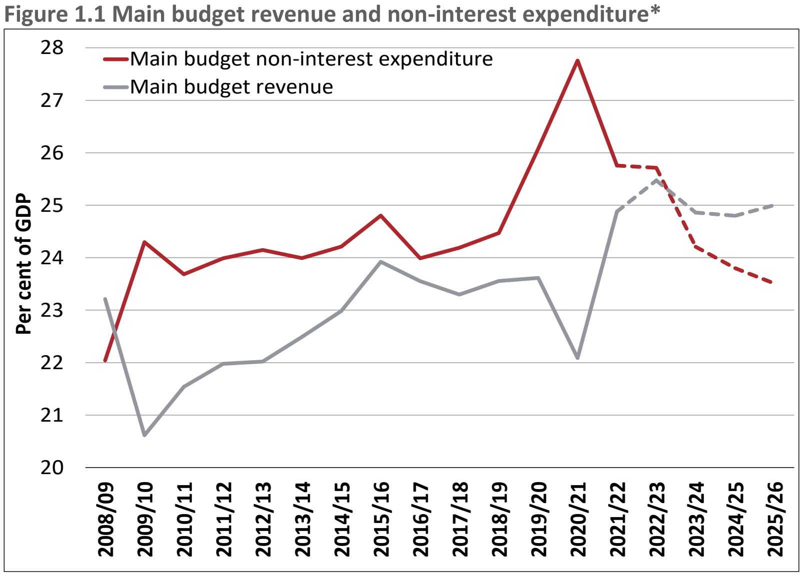
The global economic environment is deteriorating and the risks of distress among developing countries are becoming more acute. In this context, South Africa's fiscal policy is achieving its objective of closing the gap between revenue and non-interest spending. In 2023/24, a primary budget surplus of 0.7 per cent of GDP is projected. Gross loan debt stabilises at 71.4 per cent of GDP in 2022/23 – two years earlier and at a lower level than projected in the 2022 *Budget Review*. Net public debt will stabilise as a percentage of GDP in 2024/25. The improvement in the pace of debt stabilisation is largely a result of higher-than-anticipated inflation and revenue. It will be partly offset by the materialisation of fiscal risks, including a planned takeover of Eskom debt.

Government remains focused on medium- to longer-term economic growth and rebuilding fiscal buffers, which implies prudent restraint in response to short-term spending pressures. A portion of higher-than-anticipated revenue collection will be used to continue reducing the budget deficit.

Stable public finances will underpin economic growth, maintain government's commitment to support vulnerable households and help reduce overall risks to the fiscal outlook. This approach avoids the pitfalls of risky fiscal action that has led to currency depreciation and economic instability in a number of countries.

South Africa's economy is highly dependent on international capital flows and the rand is sensitive to changes in market conditions. High and persistent government debt and deficits can raise lending rates across the economy, make it difficult to attract investors, and raise the cost of machinery and fuel imports. Government's commitment to fiscal stability is reflected in recent credit ratings outlooks that affirmed a stable outlook for South Africa. The fiscal strategy also supports sustainable provision of essential services to low-income households. As the primary balance improves, the real baselines of critical public services can be strengthened.

Figure 1.1 Main budget revenue and non-interest expenditure*



**Excludes Eskom financial support and transactions in financial assets and liabilities*
Source: National Treasury

Over the last several years, the public finances responded to a number of anticipated risks – such as the near-collapse of Eskom – and unanticipated shocks such as the COVID-19 pandemic. These events required urgent reallocations of fiscal resources. The medium-term fiscal strategy will proactively manage critical fiscal and economic risks. Government will increase the size of the contingency reserve and set aside funds from higher-than-expected revenues over the medium term. This year, government is allocating funds to key public entities to address fiscal and economic risks.

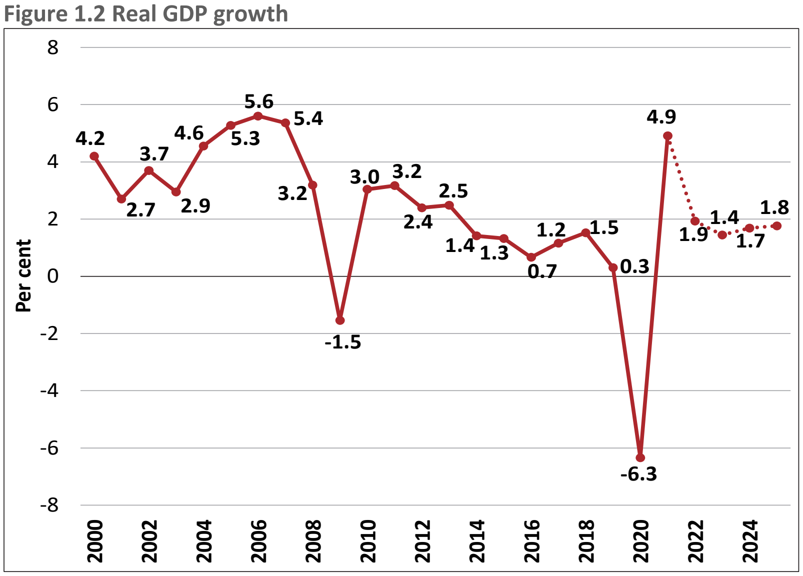
Addressing South Africa's poor economic performance

Over the past two years, South Africa's broad recovery from the COVID-19-induced crisis of 2020 was supported by higher global commodity prices, which improved export and fiscal revenues. Real GDP growth recovered to 4.9 per cent in 2021 from a low base following a contraction of 6.3 per cent in 2020. Yet recovery has been hampered by slow implementation of economic reforms and a series of shocks, including the domestic riots and looting in July 2021, historic flooding in April 2022 and escalating power cuts. The 2022 Budget projected economic growth of 2.1 per cent this year. This has been revised down to 1.9 per cent. GDP growth is expected to average 1.6 per cent over the medium term.

The global outlook is also becoming less favourable, with a broad slowdown marked by higher levels of volatility. Global inflation has risen sharply as a result of supply chain shortages exacerbated by the Russia-Ukraine war. As central banks take necessary action to combat inflation by raising interest rates, developing countries are experiencing tightening financial conditions, constraining investment and household demand. Slower growth in China is having significant consequences for commodity-exporting economies.

South Africa's economic growth levels remain low and insufficient to tackle high poverty and unemployment.

Figure 1.2 Real GDP growth



Source: National Treasury

To sustain the gains from prudent fiscal policies and improve resilience to shocks, the economy needs rapid, job-creating growth. Government's growth strategy focuses on:

- Ensuring clear and stable macroeconomic policies that emphasise price stability and sustainable public finances.

- Implementing growth-enhancing reforms, including by addressing the shortage of electricity and dealing with long-running structural constraints in the economy.
- Enhancing key enablers for growth and state capability, such as fighting crime and corruption and improving municipal services. The fiscal framework prioritises additional funding for safety and security, and infrastructure.

As outlined in Chapter 2, the most urgent problem facing the economy is inadequate electricity supply. Load-shedding has been a feature of South African life since 2007. A decade and a half of this binding energy constraint has discouraged investment and weighed on economic growth and job creation. Increasing the supply and reliability of energy is a key part of economic growth reforms, and new measures to achieve this include greater scope for private-sector generation of electricity.

At the same time, government needs to address infrastructure backlogs, accelerate the reconstruction of damaged structures and installations, fight crime and corruption, and improve the education and health systems.

Disaster relief in response to the April 2022 floods

Due to a substantial La Niña effect, South Africa experienced above-average rainfalls in late 2021 and in 2022. Heavy rainfall in and around eThekwini metro in early April 2022 caused widespread flooding, sinkholes, mudslides and other destruction. More than 400 people died and thousands were left homeless. Electricity and water supplies were disrupted, and billions of rand in infrastructure damage was caused to ports, rail and roads in KwaZulu-Natal and the Eastern Cape. Government declared a state of disaster on 13 April 2022, providing R1 billion through two disaster relief grants for the affected provinces and municipalities. The 2022/23 Adjustments Budget provides additional funding of R6.1 billion to further support rebuilding and humanitarian efforts. Further resources will be considered over the medium-term expenditure framework (MTEF) period.

Allocations for disaster relief, 2022/23

R thousand	2022/23
Eastern Cape	375 509
KwaZulu-Natal	4 508 918
North West	111 100
Western Cape	289 964
SANRAL	454 000
Provincial disaster response grant	96 886
Municipal disaster response grant	247 614
Total	**6 083 991**

Source: National Treasury

While it is difficult to ascribe a particular event to climate change, it is clear that South Africa needs to improve its resilience to extreme weather. Poor infrastructure, urban sprawl and lack of proper planning were major contributors to the devastation in KwaZulu-Natal. Many private dwellings are built with poor materials, and drainage systems in both rural and urban areas need urgent attention to ensure that they can cope with extreme weather patterns.

Climate change

In line with South Africa's global commitments, fiscal policy will continue playing its part to shift economic incentives towards cleaner forms of energy. As announced in the 2022 Budget, the carbon tax rates will be increased significantly from 2023 onwards. A paper on the design options for tax-free allowances under the carbon tax will be published in 2023 for public comment and consultation. Support for climate change mitigation and adaptation measures will increasingly feature in budget policy in the period ahead.

Consolidating the public finances and reducing risk

The medium-term fiscal strategy has three objectives:

- Reduce the budget deficit and stabilise debt as a percentage of GDP.
- Support economic growth by maintaining a prudent fiscal stance and directing resources towards infrastructure and the fight against crime and corruption.
- Reduce fiscal and economic risks, including by using higher-than-anticipated revenues to address contingent liabilities and develop buffers to deal with disaster risks.

Global events since February have had a profound inflationary impact. Gross loan debt is now expected to stabilise at 71.4 per cent of GDP in 2022/23. This is mainly driven by higher nominal GDP projections, resulting from higher inflation, and an improved primary balance given better-than-expected revenue estimates. These factors outweigh the adverse impact of higher interest rates and a weaker exchange rate. Net loan debt – which is gross loan debt less cash balances – will stabilise at 69 per cent of GDP in 2024/25.

The consolidated budget deficit will narrow from 4.9 per cent of GDP in 2022/23 to 3.2 per cent of GDP in 2025/26. This will reduce the need to issue new debt and allow government to better manage the spike in debt redemptions, rein in debt-service costs and gradually restore growth in the baselines of key service delivery and infrastructure programmes. Moreover, slower growth in debt and interest payments will encourage private investment, because high debt and interest payments raise borrowing costs, making it difficult for businesses and households to access finance.

Figure 1.3 Main budget primary balance

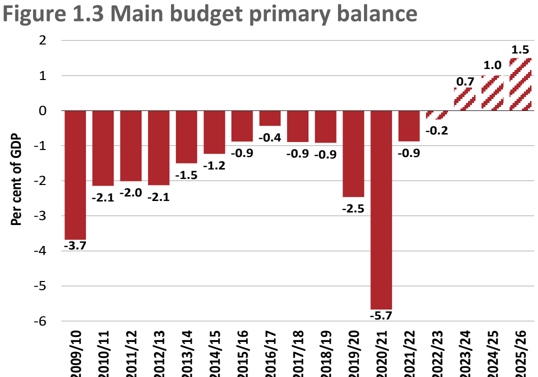
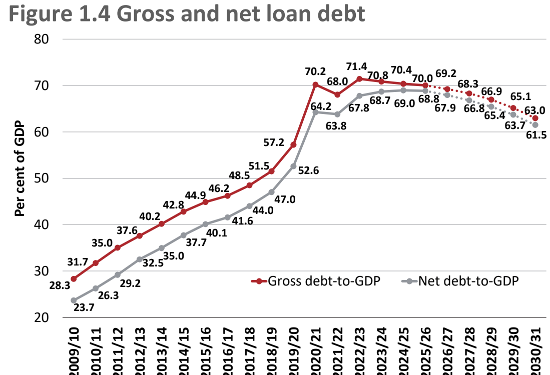


Figure 1.4 Gross and net loan debt



Source: National Treasury

Fiscal policy also supports economic growth through investment in public infrastructure. Over the medium term, government consolidated spending on buildings and fixed structures will increase from R66.7 billion in 2022/23 to R112.5 billion in 2025/26. At the same time, government recognises that the infrastructure challenge is not only a matter of money, but of efficiency and capacity. The 2023 Budget will propose funding to support project preparation.

High levels of crime and corruption undermine public safety, social cohesion, infrastructure investment and economic growth. The 2022 Budget provided additional funding of R8.7 billion for the Department of Police. The 2023 Budget will provide further allocations to support safety and security. To improve the fight against corruption and advance the recommendations of the State Capture Commission, the 2023 Budget will also add to the budgets of the National Prosecuting Authority, the Special Investigating Unit, the Financial Intelligence Centre and the South African Revenue Service. These resources will help the institutions to identify sophisticated financial crimes, prosecute offenders, and recover money and assets that are the proceeds of fraud and corruption.

Maintaining the integrity of South Africa's financial system is critical to long-term growth. Government is addressing deficiencies in the anti-money laundering framework identified by the Financial Action Task Force. These changes are intended to reduce the risk and incidence of financial crime and corruption, and to avoid greylisting. Over the 2023 MTEF period, functions critical to the anti-money laundering regime, particularly in the law enforcement agencies and the Financial Intelligence Centre, will receive additional resources to carry out this work.

Cash position and risk reduction

Higher-than-anticipated revenues have improved government’s short-term cash position, but most of the windfall tax receipts from higher commodity prices are expected to fall away over the next two years. Government will not rely on transitory revenue gains to fund permanent spending increases, but will instead use these funds to reduce some of the risks and contingent liabilities outlined in Annexure A. Two sets of risks have been identified for action in the near to medium term:

- Government will use a portion of the revenue improvement to reduce the annual budget deficit and risks relating to the debt burden.
- As the gross debt burden declines, government will repair the broader public-sector balance sheet by reducing risks posed by public entities.

Government is allocating R30 billion to Denel, the South African National Roads Agency Limited (SANRAL) and Transnet in the current year. All three companies are important enablers of economic growth but face near-term challenges that require immediate injections of funds. Denel is allocated funding to pay off government-guaranteed debt and complete its turnaround plan, making it a viable entity. SANRAL receives funds to pay off government-guaranteed debt, conditional on a solution to phase 1 of the Gauteng Freeway Improvement Project. And Transnet receives funds to repair infrastructure severely damaged by the April 2022 floods and increase locomotive capacity, both of which will support economic growth.

Additional calls for government guarantees or funds will continue to be evaluated against the minimum criteria for consideration of requests outlined in the 2021 Budget.

Government also plans to provide debt relief to Eskom as part of a comprehensive approach to address the utility’s challenges. Eskom does not generate sufficient revenues or control its costs. Nevertheless, a new

Eskom board has been appointed to improve leadership and expertise, and its unbundling into three separate companies is under way. Reducing its debt will ease financial pressure on the utility, enabling it to implement a viable unbundling process and freeing resources for investment in critical electricity supply. Government will apply strict conditions to this debt relief, including the timeous execution of measures to address the sustainability of newly unbundled businesses. Further details will be provided in the 2023 Budget.

Social protection

The *COVID-19 social relief of distress grant* was originally introduced in May 2020 as a temporary measure to support low-income households during the pandemic lockdowns. At present, 7.4 million people receive this grant. In the 2022 Budget, government extended the grant for one year until March 2023. As noted then, the introduction of a new grant in the fiscal framework is a permanent spending increase. To be sustainable, it needs to be financed with permanent increases in revenue, spending reprioritisation, or a combination of the two.

Discussions are still under way to consider options for a replacement for this temporary grant. No final decision has been made about a replacement or how it would be financed. As a result, the temporary grant will be extended for one year until March 2024.

Overview of the 2022 MTBPS

Economic outlook

Chapter 2 provides a review of the near-term economic outlook and medium-term prospects. GDP growth forecasts have declined in 2022 and over the medium term, in part due to slowing global growth and rising inflation.

Table 1.1 Macroeconomic projections

Calendar year	**2021 Actual**	**2022 Estimate**	**2023**	**2024 Forecast**	**2025**
Percentage change unless otherwise indicated					
Household consumption	5.6	2.9	1.6	1.7	1.8
Gross fixed-capital formation	0.2	4.0	1.9	3.6	3.8
Real GDP growth	**4.9**	**1.9**	**1.4**	**1.7**	**1.8**
GDP at current prices (R billion)	**6 192**	**6 572**	**6 956**	**7 406**	**7 884**
CPI inflation	4.5	6.7	5.1	4.6	4.6
Current account balance (% of GDP)	3.7	0.2	-0.9	-1.1	-1.2

Source: Reserve Bank and National Treasury

Fiscal policy

Chapter 3 outlines government's medium-term fiscal policy stance, which focuses on repairing the public finances. The consolidated budget deficit will be reduced to 4.1 per cent of GDP in 2023/24, with the main budget primary balance reaching a surplus of 1.5 per cent of GDP in 2025/26.

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2021/22 Outcome	2022/23 Revised	2023/24	2024/25 Medium-term estimates	2025/26
Revenue	**1 750.4**	**1 882.2**	**1 952.8**	**2 072.2**	**2 218.7**
	27.8%	*28.3%*	*27.7%*	*27.5%*	*27.7%*
Expenditure	**2 047.0**	**2 205.3**	**2 241.7**	**2 364.1**	**2 477.7**
	32.6%	*33.2%*	*31.7%*	*31.4%*	*30.9%*
Budget balance	**-296.7**	**-323.1**	**-288.9**	**-291.9**	**-259.0**
	-4.7%	*-4.9%*	*-4.1%*	*-3.9%*	*-3.2%*
Total gross loan debt	**4 277.5**	**4 752.0**	**5 002.2**	**5 296.1**	**5 607.8**
	68.0%	*71.4%*	*70.8%*	*70.4%*	*70.0%*

Source: National Treasury

Expenditure priorities

Chapter 4 presents government's proposed allocations in broad terms, including adjustments in the current financial year.

Table 1.3 Consolidated government expenditure

R billion	2022/23 Revised	2023/24	2024/25 Medium-term estimates	2025/26	Average annual growth 2022/23 – 2025/26
Learning and culture	447.4	455.6	473.4	496.5	3.5%
Health	258.4	256.1	267.5	279.4	2.6%
Social development	365.6	370.9	350.2	340.3	-2.4%
Community development	236.7	258.7	274.9	291.7	7.2%
Economic development	222.9	237.6	262.4	280.8	8.0%
Peace and security	227.6	226.4	235.4	246.5	2.7%
General public services	71.4	73.1	74.8	78.0	3.0%
Payments for financial assets	62.6	25.2	25.4	26.5	–
Total expenditure by function	**1 892.6**	**1 903.5**	**1 963.9**	**2 039.7**	**2.5%**
Debt-service costs	307.7	332.2	352.9	380.7	7.3%
Unallocated reserve	–	–	41.3	47.3	–
Contingency reserve	5.0	6.0	6.0	10.0	–
Total expenditure	**2 205.3**	**2 241.7**	**2 364.1**	**2 477.7**	**4.0%**

Source: National Treasury

Additional information

The 2022 MTBPS includes several annexures:

- Annexure A contains the fiscal risk statement.
- Annexure B analyses trends in the employment and compensation of public-sector employees.
- Annexure C provides technical information and data.
- Annexure D is the glossary.

The Public Finance Management Act (1999), read together with the Money Bills and Related Matters Act (2009), empowers the Minister of Finance to table an adjustments budget in the National Assembly. An adjustments budget is being tabled with the MTBPS, and it will include funding in response to recent natural disasters.

Conclusion

The 2022 MTBPS presents a strategy to continue stabilising the public finances while supporting economic growth in a highly volatile global economy. Fiscal consolidation is achieving the objectives of the strategy originally outlined in the 2020 MTBPS. Lifted by better-than-expected revenues, the fiscal position is stronger. At the same time, increased funding for safety and security, fighting corruption and delivering infrastructure will support longer-term growth prospects.

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